STRATEGIC PLANS AND BUDGET OF THE INTERNAL REVENUE SERVICE, 1999

JOINT REVIEW

BEFORE THE

COMMITTEE ON WAYS AND MEANS
COMMITTEE ON APPROPRIATIONS
COMMITTEE ON GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

AND THE

COMMITTEE ON FINANCE
COMMITTEE ON APPROPRIATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
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CONTENTS

JOINT REVIEW OF THE STRATEGIC PLANS AND BUDGET OF THE INTERNAL REVENUE SERVICE, 1999

TUESDAY, MAY 25, 1999

The joint review met, pursuant to notice, at 11 a.m., in room 1100 Longworth House Office Building, Hon. Bill Archer, Chairman of the Joint Committee on Taxation, presiding.

[The press release announcing the hearing follows:]

JOINT COMMITTEE ON TAXATION
PRESS RELEASE

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For Immediate Release: May 19, 1999
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The Internal Revenue Service Restructuring and Reform Act of 1998 (the "IRS Reform Act") requires the chair of the Joint Committee on Taxation to convene a joint review of the strategic plans and budget of the IRS. The joint review is to be held by June 1 of each year after 1998 and before 2004. The joint review is to include two Members of the majority and one Member of the minority from each of the House Committees on Ways and Means, Appropriations, and Government Reform and the Senate Committees on Finance, Appropriations, and Governmental Affairs.

Pursuant to the IRS Reform Act, Congressman Bill Archer, Chairman, Joint Committee on Taxation, has scheduled a joint review of the IRS strategic plans and fiscal year 2000 budget for **Tuesday, May 25th at 11:00 a.m. in room 1100 of the Longworth House Office Building**. Charles O. Rossotti, Commissioner of Internal Revenue, will be the only witness. The joint review will be open to the public.

The requirement of a joint review stems from concerns raised by the National Commission on Restructuring the IRS, which found that the Congressional Committees responsible for IRS oversight "focus on different issues from year to year. While these issues are important, there is a lack of coordinated focus on high level and strategic matters. Because the IRS tries to satisfy requests from Congress, this nonintegrated approach to oversight further blurs the ability to set strategic direction and focus on priorities."

In announcing the joint review, Chairman Archer stated: "Passing the IRS Restructuring and Reform Act was the first step towards making the IRS more responsive to taxpayers. The next major step is continued oversight of the IRS to ensure that the law is being implemented the way Congress intended."

Senator William V. Roth, Jr., Vice Chairman of the Joint Committee on Taxation, commented: "It is helpful in our ongoing oversight of the IRS for these Committees to get together to review the agency's progress on reform."

JOINT REVIEW OF THE STRATEGIC PLANS AND BUDGET OF THE INTERNAL REVENUE SERVICE, AS REQUIRED BY THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998

TUESDAY, MAY 25, 1999

HOUSE OF REPRESENTATIVES,
JOINT COMMITTEE ON TAXATION,
Washington, DC.

The joint review met, pursuant to call, at 11 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer, Chairman of the Joint Committee on Taxation presiding.

Representatives present: Archer, Portman, Kolbe, Forbes, Horn, Coyne, Hoyer, and Kucinich.

Senators present: Stevens, Grassley, and Kerrey.

Chairman ARCHER. The Committee will come to order.

Today, we continue the important work that was begun by the Congress in the IRS Restructuring and Reform Act of 1998, which we passed last July.

This Act was, I believe, a major victory for America's taxpayers. It was the first major reform of the IRS since 1952, and it was long overdue. In passing the Act, we made it clear that the IRS is to put taxpayers first. We included in the Act an arsenal of almost 100 new taxpayer rights and protections including a shift in the burden of proof and protections for innocent spouses, who usually are women.

The IRS Restructuring and Reform Act also provided for improved oversight of the IRS and held IRS employees accountable for their actions. The Act struck an appropriate balance between protecting taxpayers and providing the necessary tools to fund the government.

I am proud to be a part of the Congress that put America's taxpayers first and protected America's taxpayers from IRS abuses.

While the IRS Restructuring and Reform Act is landmark legislation, it is only a first step. Ultimately, I believe that the true answer is to provide America with a new tax system—one that is fairer, simpler, less intrusive, less costly, and that creates more economic growth.

Until that day comes, we must do all we can to ensure that America's taxpayers are treated fairly. We must ensure that the spirit, as well as the letter, of the IRS Restructuring and Reform Act is fulfilled.

I am disappointed that the White House has not fulfilled its obligations under the Act. The Act called for the President to nominate members of the new independent IRS Oversight Board within 6 months after the date of enactment, and that was January 22 of this year. It is now over 10 months after the date of enactment, and no nominations have been made.

While American taxpayers work hard each year to pay their taxes on time, the White House is 4 months late in setting up the independent IRS Oversight Board as Congress required. That's just not fair and sets exactly the wrong example. I urge the President to fulfill his obligations and nominate members of the IRS Oversight Board right away.

We, the Congress, must also fulfill our obligations under the Act and continue the diligent oversight that ultimately led to its passage. The requirement for the joint review that we are having today stems from the concerns of the National Commission on Restructuring the IRS that the several Congressional committees with jurisdiction over the IRS will pull the IRS in different directions.

This joint review provides an opportunity for all the committees of jurisdiction to receive the same information regarding the long-range goals of the IRS and to provide a coordinated review of the IRS's goals and its progress in achieving them.

I support Commissioner Rossotti's efforts to implement the provisions of the IRS Restructuring and Reform Act and to modernize the IRS so that it can deal more effectively and appropriately with taxpayers. I recognize the task of modernizing the IRS is not an easy one and it may take some time. Until broad tax reform can be achieved, I believe that implementing the IRS Restructuring and Reform Act will further the goals of increasing voluntary compliance with the tax laws and ensuring that America's taxpayers are treated with the dignity and respect they deserve.

Commissioner Rosotti, I look forward to hearing your views on what has been done and what needs to be done to achieve those goals.

I now recognize Senator Grassley for any comments that he might like to make.

Senator GRASSLEY. First of all, I want to agree with others that you, Commissioner Rossotti, are doing an excellent job, particularly considering the systemic problems that existed within the bowels of the IRS bureaucracy, and you are probably tired of hearing that because you wonder whether those compliments are sincere, but I have heard that they are sincere and they are not in fear of having an IRS audit on the person. So I hope you will take those as sincere comments from all of us.

We have come a long way in the last year, but of course we have much further to go. Chairman Archer, you should be commended for making sure that this mandatory hearing before the statutory deadline was actually held. Thank you.

It is also too bad that the Administration can't seem to meet the required deadlines, at least in regards to the appointing of the extremely important Oversight Board.

Given the inherent problems within the IRS, I do have a number of concerns about how the restructuring law is or is not being implemented. Of course, the number one concern is getting the Oversight Board up and running. The Administration has really dropped the ball here. They not only have not gotten us the nominees, but a couple of the ones that were leaked are serious disappointments that I might have trouble supporting.

Then we see these neatly placed press stories about how the new law allegedly has negatively affected enforcement collections. The insinuation is that IRS agents are so afraid of violating provisions of the new law that they have held back on enforcement.

First of all, these articles failed to mention that many of these enforcement figures were down before the law was enacted. Also, we concluded that many of the methods used in these enforcement actions should, in fact, be illegal; and so we hope that a certain percentage of these enforcement actions would go down.

Secondly, some of the taxpayer protection provisions, now apparently dubbed by some as 10 deadly sins, are a very important part of this restructuring bill. Some are saying Congress went too far in passing them. Well, all of them required some kind of willful misconduct or assault and battery, retaliation or threats.

Now if an employee engages in any of that conduct, there should be firings as the law prescribed. We are not going to start watering down these protections just because there is an effort by some who never supported the law in the first place to undermine its effectiveness.

I hope you share my views on this, Commissioner, and I look forward to your testimony. If I have learned anything in the last 16 or 17 years that I have been involved with the protecting of taxpayers' rights, we have to be ever vigilant, otherwise we are going to be outlasted and outdone by the permanent bureaucracy. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I want to commend you for your leadership in holding this bicameral IRS joint review and doing so ahead of schedule. I wish the White House was taking these statutory deadlines set out in the IRS Act as seriously as you are, especially with regard to the Oversight Board, which are crucial to the long-term reforms we all seek.

I had the honor to serve as co-chairman with Senator Bob Kerrey, who is here, of the National Commission on Restructuring the IRS in 1996 and 1997. Senator Grassley and Congressman Coyne to my right were also invaluable members of that panel.

In the Commission report, called *A Vision for a New IRS,* and in the subsequent Restructuring Act based on the Commission's recommendations, a very clear vision was laid out to transform the IRS to better serve taxpayers in the new century.

Among those key changes enacted just last year were to first make taxpayer service the top priority of the IRS; second, to reorganize the IRS along customer service lines; third, to level the playing field between taxpayers and the IRS—the Chairman has talked about that, the over-50 new taxpayer rights—and, finally, to provide incentives to reach up to 80 percent of electronic filing over the next 10 years.

There are many other recommendations, but those were some of the key strategic ones that I wanted to touch on in the context of this review today to ensure that those reforms took place and that they were sustained over time. We also created a more accountable management structure at the IRS, the Oversight Board providing expertise, continuity and accountability at the top, and finally a more effective oversight structure on Capitol Hill.

I believe this joint review today is one of the key aspects of the Restructuring Commission, a key aspect to improved oversight of the IRS by Congress.

During the Restructuring Commission's work, we found that there was inadequate coordination between the seven Congressional committees that shared IRS oversight responsibility, all of which are represented here today; and too often in the past we found those committees have had to focus on putting out the small brush fires which occur within their jurisdiction without looking at the overall forest fire that had developed over the years at the Internal Revenue Service.

I believe that is already changing. I believe we saw it firsthand in the way that the committees worked together in the development of the Act, but this IRS joint review provides us with a specific statutory mechanism year in and year out to ensure that Congress will focus on the big-picture issues that affect the IRS and that we will, as much as possible, speak with one voice to you, Commissioner, and to your people on the overall direction and progress of the agency.

So our purpose today is not so much to get into the details of the individual issues, but rather the objective today should be to focus on the big picture, focus on some of the longer-term issues such as the IRS budget, the implementation of the Reform Act provisions which Senator Grassley just talked about, the reorganization plan which the Commissioner is beginning to put in place, and to do so in a coordinated and focused way.

Again, Mr. Chairman, I am delighted we are here at this unprecedented gathering, the first joint review. I look forward to hearing Commissioner Rossotti's testimony, and I look forward to the input and expertise from my colleagues who serve on the various committees represented here today. Thank you, Mr. Chairman.

[The statement of Congressman Portman follows:]

Rob Portman

Congressman
2nd District, Ohio

Press Release

May 25, 1999
FOR IMMEDIATE RELEASE

CONTACT: Brian Besanceney
202-225-3164

PORTMAN COMMENTS ON IRS JOINT REVIEW MEETING

WASHINGTON, DC -- Congressman Rob Portman (R-Ohio-2) issued the following statement on today's first meeting of the IRS Joint Review panel. Portman served as co-chairman of the National Commission on Restructuring the IRS from 1996 to 1997, and the Commission's recommendations served as the basis for the IRS Restructuring and Reform Act of 1998.

*I commend Chairman Archer for his leadership in holding this unprecedented IRS joint review and for doing so **ahead** of the statutory deadline. I only wish the White House took the statutory deadlines set out in the IRS Restructuring and Reform Act as seriously as Chairman Archer.*

I am very interested in hearing from the Commissioner today and from my colleagues on their views on the strategic direction of the IRS. I had the honor to serve as co-chairman, with Senator Bob Kerrey, of the National Commission on Restructuring the IRS in 1996 and 1997. In our Commission report -- "A Vision for a New IRS" -- and in the subsequent IRS Restructuring and Reform Act based on the Commission's recommendations, we laid out a clear vision to transform the IRS to better serve taxpayers in the new century.

Among the key changes enacted last year were: to

- ***Make taxpayer service the top priority of the IRS** and actually **reward** IRS employees based on the quality of service they provide, not the amount of revenue they collect;*
- ***Reorganize the IRS along customer service lines** and give the IRS Commissioner new powers to make change at the agency;*
- ***Level the playing field between taxpayers and the IRS with more than 50 new taxpayer rights**; and*
- ***Provide incentives to reach 80% electronic filing over the next ten years***

*To ensure that these and other reforms take place and are sustained over time, we created: (1) a more accountable and effective management structure at the IRS; (2) a very important IRS Oversight Board I mentioned earlier to provide expertise, continuity and accountability at the top; **and** (3) a more effective oversight structure on Capitol Hill.*

I believe this Joint Review – one of the key recommendations of the Restructuring Commission -- is crucial to improved oversight by Congress.

During the Restructuring Commission's work, we found that there was inadequate coordination between the seven Congressional committees that share IRS oversight responsibilities. Too often in the past, Committees have had to focus on putting out the small brush fires at the agency within their jurisdiction, while failing to look at the overall forest fire that had developed over the years at the IRS.

*I believe that's already changing -- I saw it firsthand with the way these committees worked well together during development of the IRS Restructuring and Reform Act. But this IRS Joint Review provides us with a specific statutory mechanism to **ensure** that Congress will focus on the "big picture" issues affecting the IRS, and that Capitol Hill will, as much as possible, speak with one voice on the overall direction and progress of the agency.*

So our purpose today is not so much to get into the details of the individual issues that will come up in the course of our ongoing oversight of the IRS. Rather, our objective should be to focus on the big picture and longer-term issues – the IRS budget; the implementation of the reform law; the reorganization plan – in a coordinated and focused way.

Again, Mr. Chairman, I am delighted we are here. I look forward to the Commissioner's testimony and the input and expertise of my colleagues who serve on different committees.

Chairman ARCHER. Thank you, Mr. Portman. The Chair observes that Senator Roth was unable to be here with us today because he is occupied with an amendment on the Senate floor and a Finance Committee hearing. Without objection, the record will be held open for any statement that he would like to make and for any statement of any other Member that unavoidably could not attend today's hearing.

The Chair now recognizes Senator Kerrey.

Senator KERREY. Thank you. I would simply say that I look forward to the testimony of Commissioner Rossotti, and I regret that the Oversight Board has not only not been appointed, but had they been appointed, that Oversight Board would be present at this hearing today.

Under the law, the Oversight Board has the authority to review budget and strategic plan, and it would have made this hearing a lot more constructive. I know that the Administration has started to get them vetted and that creates some time lags, but I do look forward someday to seeing Mr. Rossotti before this committee, but also with all of the other members of the Oversight Board.

Chairman ARCHER. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. I would like to take this time to welcome Commissioner Rossotti and look forward to hearing his testimony. In the interest of hearing from the Commissioner, I would like to submit my statement for the record.

Chairman ARCHER. Without objection the entire written statement by any Member will be included in the record.

[The statement of Mr. Coyne follows:]

OPENING STATEMENT OF HON. WILLIAM J. COYNE

Today's session is the first annual hearing on the Internal Revenue Service held jointly by the House and Senate committees having jurisdiction over aspects of the Internal Revenue Service. As we begin our bipartisan review, I look forward to discussing with the IRS Commissioner recent improvements in administration of our tax laws and his vision for the future. The IRS restructuring and reform legislation enacted last year has already had a positive effect on the taxpaying public. Much, however, still remains to be done.

Taxpayers already are benefitting from a new IRS management team and a modernized tax system. The 1999 filing season is proof that improved taxpayer services will make a difference. IRS telephone lines and walk-in return preparation assistance now are available 24 hours a day, seven days a week. Taxpayers nationwide already are seeing the impact of reformed innocent spouse rules, improved taxpayer notification of audit issues, and clearer IRS forms and instructions. Soon funding will be provided by the IRS to taxpayer clinics—through schools and tax-exempt organizations—to provide legal assistance to those needing help to resolve their tax cases.

With each of our Committees and Subcommittees conducting oversight of the IRS, our messages to the IRS Commissioner and employees often are conflicting or raise different priorities. The authors of the joint hearing mandate hoped that this proceeding would clarify the voice of Congress and provide the IRS with clearer directions.

With this goal in mind, I look forward to our discussion of the IRS's strategic plans and proposed budget for fiscal year 2000. Specifically, I must emphasize that Commissioner Rossotti strongly urged the Ways and Means Oversight Subcommittee to support full-funding of the IRS's fiscal year 2000 budget, as requested by the President. I am convinced that the IRS must have the tools and resources to do its job well, and that proper funding is a critical step to a successful restructuring and reform of the IRS.

I hope that we all can agree that it's time to evaluate where we are and give the IRS a chance to perform. The agency is in the midst of a major reorganization. Congress' clear and consistent message to the IRS should be one of active support, guided by a long-term commitment to excellence.

Chairman ARCHER. Senator Stevens.

Senator STEVENS. Thank you very much, Mr. Chairman. I appreciate the opportunity to be with you also, and I would like my statement to appear in the record as though read. I do want to congratulate you, particularly, for holding the hearing on time.

I have just left the Library of Congress where we have made more progress on the digital program there, and I am amazed at the speed with which the IRS is adopting the digital mode and electronic filing.

And as Chairman of Appropriations, I am very interested in the fact that I am told if a taxpayer files a return which has a refund coming electronically, that will be back to the taxpayer in 6 to 8 days, rather than 6 to 8 weeks and that the cost is less than one-tenth of handling the return if filed in the normal way on paper.

I think we are coming a long way towards making some savings. You, Senator Grassley, Senator Roth and others, should be congratulated for the basic Act. This Reform and Restructuring Act is working. It follows to a great extent the progress that we made in terms of the bill that came out of the Governmental Affairs Committee and in terms of the basic concepts of restructuring the whole Federal Government.

I am delighted to know that as we are proceeding here that we are going to have more and more input from all of the committees that are affected, and I look forward to working with you. I do thank you for the opportunity to be with you today.

Chairman Archer. Thank you, Senator.

[The statement of Senator Stevens follows:]

STATEMENT OF SENATOR TED STEVENS

I want to thank Chairman Archer for scheduling this hearing and for the opportunity to discuss the changes taking place within the IRS with Commissioner Rossotti. Part of those changes are as a result of the IRS Restructuring and Reform Act of 1998, while other improvements are the result of advances in technology and data gathering. These changes are important to the overall goal of improving IRS customer service for the American people.

With the new improvements in technology we are seeing more returns filed electronically. According to Commissioner Rossotti's printed statement, the amount of returns filed on-line in 1998 increased by 161 percent compared to 1997. This should mean more efficient processing and review of returns.

We are all used to waiting six to eight weeks to receive our refund checks, if we are entitled to a refund. Now I am told that a taxpayer who files electronically and has his refund direct-deposited into a bank account can get his money in as little as eight days—not eight weeks. That is a real improvement and it is very cost effective—costing the IRS only 3.9 cents to direct-deposit a refund into an individual's bank account versus 45 cents to issue a traditional check.

The IRS has also made improvements in reducing the cost of collecting revenue. According to the IRS, the cost of collecting $100 dollars in 1997 was 44 cents. This was the lowest cost since 1982. As Chairman of the Senate Appropriations Committee I am interested in seeing this type of agency efficiency. As former Chairman of the Governmental Affairs Committee I am interested in seeing IRS strive for concrete goals in customer service. This is what we envisioned by the Government Performance Results Act developed in that committee.

I represent a State where many of the people still do not have running water or a centralized delivery system for electricity, much less access to the Internet for electronic filing. Universal availability of these on-line services should include all of Alaska and the rest of rural America. This is something we are working on and I urge my colleagues and the IRS to keep that in mind when we talk about improvements in service and technology.

Lastly, we should understand that the best reform possible is the simplification of the U.S. Tax Code.

Chairman ARCHER. Mr. Kolbe.

Mr. KOLBE. Thank you, Mr. Chairman. I don't have an opening statement, but would just like to thank you for having this hearing and would like to say that in my responsibility as Chairman of the subcommittee that funds the IRS, I am pleased we can say that our subcommittee, in a bipartisan way, has met the needs of the IRS.

We fund their requests, the Administration's requests, in order to carry out the mandates of the Reform Act, and certainly we will continue to do so to meet these needs. I look forward to hearing the testimony of Commissioner Rossotti and the comments of my colleagues. Thank you.

Chairman ARCHER. Mr. Forbes.

Mr. FORBES. Mr. Chairman, I will also submit my opening statement for the record. I just would look forward to hearing from Mr. Rossotti on a couple of key issues, particularly eliminating the confusion that I think exists, particularly now under reorganization, but in all fairness has existed upwards of half a dozen years in some of the regional service centers as to what their exact mission is.

I think there is still some confusion about what those missions are, whether it is customer service or processing. I look forward to hearing from you on retraining, particularly sensitivity training and how that would be delivered; and finally on a growing and continued concern by Members of Congress on taxpayer privacy. Thank you for being here.

[The statement of Mr. Forbes follows:]

OPENING STATEMENT OF REPRESENTATIVE MICHAEL P. FORBES

Commissioner Rossotti, thank you for being here this morning. In 1997, Congress held a series of hearings where the American people saw the Internal Revenue Service almost literally on trial. They saw a parade of witness come before Congress to testify about the naked abuse of power over at the Internal Revenue Service.

We saw current and former IRS agents who had to testify in secret because they feared for their lives. We saw ordinary citizens, taxpayers, who talked about how an audit turned their entire lives upside down, with some of them suffering great financial loss that will never be recovered. We saw a government agency totally out of control, lacking accountability, an agency where one is guilty until proven innocent.

We saw and heard all this and we acted to put a stop to it. We enacted sweeping reforms of the IRS to make it more efficient and taxpayer friendly, and we provided critical new protections for the American taxpayer to make the IRS more accountable.

In a sense, the Internal Revenue Service Restructuring and Reform Act put the IRS on probation. Today, we see in part if they are behaving themselves.

The IRS has a work force of around 100,000 people, this compares to the 50 largest business organizations in America. The IRS is projected to process during the 1998–1999 tax filing season that is just winding down over 228 million tax returns, including over 126 million individual returns, and it expects to have issued over 93 million individual refunds, while collection $1.7 trillion.

The IRS has offices in every State in the Nation, and the National Treasury Employees Union is one of the largest labor unions in the country. The IRS deals with over 12,000 financial institutions and 12 Federal Reserve banks in some 600 locations.

Turning such a massive troubled ship around is not easy and it cannot be done quickly.

But, from what I have seen and heard from talking to Commissioner Rossotti at Appropriations hearings, IRS employees in my Long Island district and ordinary taxpayers, Charles Rossotti is doing an excellent job of doing what Congress asked him to do, make the IRS, more efficient and more accountable.

Charles Rossotti is the first nontax lawyer to head the IRS since World War Two and it is his outsider's viewpoint and experience that have made his efforts to date so successful. In the private sector Charles Rossotti knew his organization would not be successful without putting customer service No. 1 on his priority list.

The IRS's previous mission statement read in part: "The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue * * *"

Today, under Commissioner Rossotti, that mission statement reads: to "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".

Thanks to the reform enacted by Congress and the leadership of Commissioner Rossotti we are starting to reinstall the attitude of customer service at the IRS, putting the word service back into the Internal Revenue Service.

Certainly mistakes will be made, but we can correct those mistakes. Uncovering and correcting those mistakes is in fact the very reason we are here this morning.

I look forward to Commissioner Rossotti's testimony and continuing to work with him to "Provide America's taxpayers with top quality service." They deserve and expect nothing less.

Chairman ARCHER. Mr. Hoyer.

Mr. HOYER. I too want to congratulate you on having this joint review, which I think is historic, in having this many Members of both the Senate and the House convene to oversee the implementation of a very significant change in how the IRS is managed and how it operates.

I want to congratulate Mr. Portman and Mr. Kerrey on their leadership, as well, on this issue. I was not always the most enthusiastic supporter of their efforts, although I think there have been very positive results from the passage of the bill and in fact, I voted for the conference report, although I did not support it initially. I want to state at this hearing at the outset, that as a Member of the Treasury Postal Committee since 1983, I have seen the IRS develop and develop its problems and frankly not come to grips with some of the problems that it had.

And I had a discussion with Secretary Rubin about 4 years ago with reference to the management of IRS and suggested, as I know others on this panel suggested, that what IRS needed was a manager, not a tax lawyer, not somebody who was interested in policy, but somebody who was interested in how to serve the taxpayer best and manage a very large enterprise that was complex, but critically important to the operations of government.

I want to use my time to congratulate Secretary Rubin and Deputy Secretary Summers. Mr. Chairman, I know that you have been involved longer than I, but I don't know of any Secretary of the Treasury since I have been in the Congress who has paid more attention to management issues than Secretary Rubin.

All have paid attention to policy issues, but Secretary Rubin, in fact, paid very close attention to management issues. And prior to the adoption of the Act made substantial changes, the most significant of which was to ask Commissioner Rossotti to take a 5-year contract, not just an 18-month or 2-year, which we saw a cycle of Commissioners which really wasn't long enough to get a handle on what they needed to do and do it.

Mr. Rossotti, I want to congratulate you for your positive involvement in making sure that the Reform and Restructuring Act works and making sure the IRS functions in a business manner—businesslike manner and a customer-friendly manner.

I think this hearing will be positive because you have a positive report to give us, and I look forward to hearing that. And I am very appreciative, Mr. Chairman, that we have this collegial environment—where we have split responsibility but joint responsibility in making sure that the taxpayers get the best possible service, the most honest and fair service that they can get. Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Mr. Hoyer. Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman. I commend you for bringing us all together and focusing on this very important matter. I want to thank Members of my committee on both the Democratic and Republican side.

We started on this in 1993–1994 when Mr. Condit chaired the Management Subcommittee of then House Government Operations; and we all saw what was happening, and we weren't too happy with that. So out of this, as you know, came the chief financial officer, the strategic plan, the balance, the fiscal sheet and so forth.

When we took over in 1995 on a bipartisan basis, we wrote the President and said, Mr. President, there is an opening here and we hope you will find a chief executive—previous Administrations under whether Republican or Democratic auspices either put a tax accountant, as fine as they are, or a tax attorney in that position, and it was very clear the IRS needed better management than that.

We found their debt collection was really nonexistent. We passed a law that affected everybody but the IRS, and we hope the relevant authorization committees will include the IRS under that law. It is absolutely wrong to have over a hundred billion dollars in uncollected debts and another pile we were shown by Mr. Rossotti's predecessor there was a $60 billion group, and they had no real organization to deal with that.

And I am delighted to also praise Secretary Rubin because after we wrote the President to get a chief executive-type in there, not more tax accountants and tax lawyers, he went out and talked to some of the major industrialists in America as to who he could bring in as a Commissioner.

I think Commissioner Rossotti was a splendid choice. When he testified before us a year ago, he said he would shift the entire focus of the agency from one which focuses solely on conducting our own internal operations to one which puts far more emphasis on trying to see things from the point of view of the taxpayers and emphasizing service and fairness to taxpayers.

A few months after that testimony, July 22, 1998, the IRS Restructuring Act was signed into law, and I commend Mr. Portman and the others who were very deeply involved in it. The initiatives presented by the Commissioner last year go hand in hand with the broad array of provisions in the IRS Reform and Restructuring Act, and we held an annual meeting with the Commissioner, which just happened to be on April 15, and he told us the first steps that he has implemented toward restructuring and refocusing the agency.

In addition, we have held very candid discussions on the challenge that lies ahead—and there are many—and I wish the Commissioner well. And I hope that it isn't just 5 years—I hope it is

10 years because when you turn around a corporate culture, you have got to do it.

There are many fine people in the IRS, and he has the responsibility, since he cannot put any political appointees in there, to promote from the bureaucracy the people that share his vision, and that will be a tough assignment that is essential to the success of his goals and strategic plan. Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Mr. Horn. Mr. Kucinich.

Mr. KUCINICH. Thank you, Mr. Chairman. It is an honor to join with you and the members of the panel. I am also pleased to be here with my good friend, Mr. Horn, with whom I worked very closely on these issues relating to IRS reform and particularly with respect to the matter of collection of debts.

Good morning, Commissioner Rossotti. I want to thank you for being here with us this morning to tell us about some of the changes that you made to make the IRS more taxpayer friendly. Without taxes, our government could not provide the protections, benefits, and services Americans depend upon. Thus, it is imperative that the IRS successfully fulfill its mission to collect taxes.

I appreciate the difficulty of completing this monumental task; however, it is important that taxpayers are treated with respect and are given information that they need to meet their responsibilities. Furthermore, we need to ensure that our resources are appropriately directed at ensuring that everyone, including large foreign-controlled corporations doing business in the United States, pay their fair share. I look forward to your testimony, Mr. Rossotti. Thank you.

Chairman ARCHER. Thank you, Mr. Kucinich. Commissioner Rossotti, you have heard comments by Members which preface your presentation. We do have your complete statement which will, without objection, be included in the record. I understand that you have requested 15 minutes for your oral presentation and we are happy to grant you that.

I join with my colleagues in complimenting you on the job that you have done and the personal sacrifices that you have made to be able to take on this very, very difficult job. We are happy to have you before us and we will be pleased to hear any comments that you would like to make to us.

STATEMENT OF MR. ROSSOTTI

Mr. ROSSOTTI. Thank you very much, Mr. Chairman, and all of the Members for your gracious comments. I will try not to take all of the 15 minutes and follow your lead in being ahead of schedule. I am certainly pleased to be here at this first joint hearing on the Internal Revenue Service.

Since the beginning of 1999, I have testified on eight occasions before most of the committees represented here, and we have covered a wide range of topics, such as the budget request, the 1999 filing season, and implementation of the restructuring law. So, I think at today's joint hearing, we have an excellent opportunity to discuss broadly how all of these pieces fit together.

I believe that, although each of the provisions of the restructuring law individually is very, very important, the bill as a whole says something even more important; I think what it said was that the IRS must change direction. We must not only collect taxes, but we must think of our job as serving the people who are paying the taxes, America's taxpayers.

I have been in office 18 months, and I have become more convinced, as a matter of fact, that we can succeed in this mandate that the Congress gave us. I do not believe that this mandate implies or requires less effective tax collection. I really believe that we can have a tax agency that simply does a better job on all aspects of our mission.

So, today, what I would like to do is discuss how we are interpreting and implementing the mandate that we believe we have and how it relates to the resources that we will require. I would also like to thank the Joint Committee staff for preparing this analysis which provides good commentary on many of the details of our program.

Let me start with a few of the intangible, but nevertheless some of the critically important, changes that we are making. As required by the RRA, we have restated our mission to clarify the purpose of the agency.

And, equally, to make this mission a reality, we have also reformulated our goals, which are the standards by which we will measure our own performance in achieving our mission. And there is a chart over here which lays out the new mission and the three goals.

[Chart 1 follows:]

The IRS Mission Statement

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

GOALS

Service to Each Taxpayer

- Make filing and paying easier
- Provide top quality service to each taxpayer needing help
- Provide prompt, professional, helpful treatment in cases where additional taxes may be due
- Ensure taxpayer rights are observed

Service to All Taxpayers

- Increase fairness of compliance
- Increase overall compliance

Productivity Through a Quality Work Environment

- Increase employee job satisfaction
- Hold agency employment stable while economy grows and service improves

IRS

Department of the Treasury
Internal Revenue Service

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Mr. ROSSOTTI. As stated on there, there are three goals, and the first two are directly derived from the mission statement. They describe the two ways that we serve the taxpayers.

Individually, we must provide each taxpayer the service that he or she expects and the rights that the taxpayer deserves. But, collectively, we must also serve all taxpayers by administering the law fairly, ensuring that those who do not comply are not allowed to unfairly burden the rest.

Finally, we have a third goal, which is to conduct our mission with the fewest possible resources, which we believe we will achieve by providing a high quality and productive work environment for our employees.

We will not achieve our mission unless we achieve all three goals. And if we do achieve all three goals, we will, by definition, collect taxes efficiently as well as fairly. Clearly, this is a difficult task which requires balancing multiple objectives; but it is not impossible, nor is it one that is fundamentally different from the task that almost every large business organization faces.

In my previous company, we helped large clients design and build computer systems. We had to make each of our clients satisfied so they would give us repeat business and good references so we could stay in business. But we were also a publicly owned company and we had to be profitable so we could keep our shareholders satisfied.

What this meant was that we had to charge our customers adequate prices for our services, and we had to collect our bills on time. And not uncommonly, this meant that we sometimes had to ask our customers to pay more than they might have liked or pay faster than they might have liked.

Further, we depended on retaining good employees and making them productive so we could serve our clients. In other words, to succeed in our business, we had to achieve and reconcile multiple objectives, just as we do here at the IRS.

So, one of the most important steps we have already taken is to clarify our mission and goals and make it clear to everyone that we do have to achieve multiple objectives, all three goals.

Now, one of the most powerful means of communicating this to each and every employee is through a new system of balanced performance measurements which we are beginning to implement throughout the agency this year. This system translates our mission and goals into very operational terms in regard to customer service, collections, examination, and other functions.

We are currently conducting extensive training for every executive and manager in the IRS in the system, and we are also revising our job descriptions and appraisal systems for almost all of our employees so they will be aligned with our mission and those three goals.

Now, it is important—it is very important to do that, to articulate our mission and our goals and our measurements; but we will also not succeed unless we actually revamp the way that we go about doing our business.

Within the IRS and in other private and public organizations, there are innumerable successful examples of how we can improve our way of doing business. These improvements hold out the prospect of advancing all three of our goals and not to a minor extent, to a major extent.

Over here there is a chart entitled “Improved Business Practices Advance All Three Strategic Goals,” and it lists some of the areas for improvement in IRS business practices.

[Chart 2 follows:]

Improved Business Practices Advance All Three Strategic Goals

- Increase electronic information exchange.
- Educate and assist taxpayers to avoid common errors.
- Leverage IRS resources with partnerships.
- Increase use of technology to identify and correct taxpayer errors.
- Provide IRS employees with accurate, up-to-date information on taxpayer accounts and applicable tax laws.
- Increase knowledge and understanding of taxpayer's business by IRS employees and managers.
- Develop voluntary agreements with taxpayers to address specialized issues.
- Make greater and faster use of knowledge gained in taxpayer cases to clarify tax law interpretation and requirements.
- Identify and resolve collection risks much faster.
- Carefully target enforcement actions to cases where risk of non-compliance is greatest.
- Develop integrated strategies for areas of high non-compliance.

Each one of these broad areas actually implies hundreds of more specific changes in the way business is done. We have, at the present time, a process in place to set priorities for these improvements, to focus on those that can be done in the next 12 to 18 months.

In that time frame, we settled on 161 near-term actions, and those include many of the taxpayer rights provisions. That is only a small beginning of what we can achieve longer term as we get into our new modernized structure and technology.

Let me illustrate with a few examples how these kinds of improvements can advance all three goals. As Congress noted in the Restructuring and Reform Act, and Senator Stevens noted in his opening statement, increased electronic filing of returns holds great promise for improvement in speed, accuracy, and cost of filing.

However, the opportunities for electronic exchange of information are not limited to the filing of returns. Linking practitioners and eventually taxpayers to the IRS in a secure way over the Internet will allow many account issues to be solved faster and more efficiently.

And internally improved electronic exchange of information will provide our employees with the information and the expertise that they need to resolve taxpayers' problems more quickly and more accurately. These kinds of improvements advance all three goals, reducing time spent by taxpayers dealing with the IRS, reducing the number of phone calls, and freeing up our compliance employees to focus on compliance issues, rather than just retrieving or correcting information.

A second example, one of the most efficient actions the IRS can take, is to head off taxpayer errors before they occur. As an example of how to accomplish this, we are working with the Small Business Administration to develop specialized services for small businesses, especially start-up businesses, to help the entrepreneurs obtain everything they need to meet filing and paying requirements. Right now, this comes in the form of a CD–ROM as well as an Internet site. It also includes staffing SBA business information centers with people to answer tax questions.

Now, since it is very costly for both the taxpayer and the IRS to resolve an issue after a small business taxpayer has filed incorrectly, every such problem prevented not only increases compliance directly, but it frees up IRS resources to deal with more serious compliance issues.

A third example is that most of the tax issues with large businesses where many dollars are at stake revolve around interpretation of the tax law when applied to a specific set of business circumstances.

The rapid increase in international business, for example, increases the importance of such issues as how income is apportioned among many corporate entities in many countries. Determining the accuracy of such accounting in audits that may take place many years after the business transactions have occurred is extremely difficult and inefficient for both taxpayers and the IRS.

By addressing such issues before the fact, for example with advanced pricing agreements, or by examining more contemporaneous analysis presented by the taxpayers, as is now required by regulation, the likelihood of correct interpretation can be increased and the cost of compliance for the taxpayer and the IRS can be reduced.

Finally, my last example, collecting. All businesses must collect money due from customers. There is a vast amount of experience and technology that has been developed to make this process efficient and effective.

The essential elements of these proven practices are to identify collection risks as quickly as possible and to intervene either through phone calls or visits or by mail to resolve the issues as early as possible in a way that is suited to the financial circumstances of the customer.

These are proven and widely known ways of improving collections. And in applying them, the customer not only benefits, in the IRS case in reduced interest charges and penalties, but also the likelihood of the IRS receiving payment is much greater.

This method of collection offers major opportunities for improvement for the IRS and taxpayers, especially given that today's methods are very slow and relatively inefficient.

Many of these improvements will produce additional revenue, although they will not show up under the statistic that is commonly known as enforcement revenue, which has traditionally been given undue importance because of the lack of measurement of overall compliance.

A 2 percent increase in compliance as a result of these kinds of business improvements will equal 100 percent of the revenues that we get from case-oriented enforcement actions. I would note that the Joint Committee staff report has an excellent discussion of these issues.

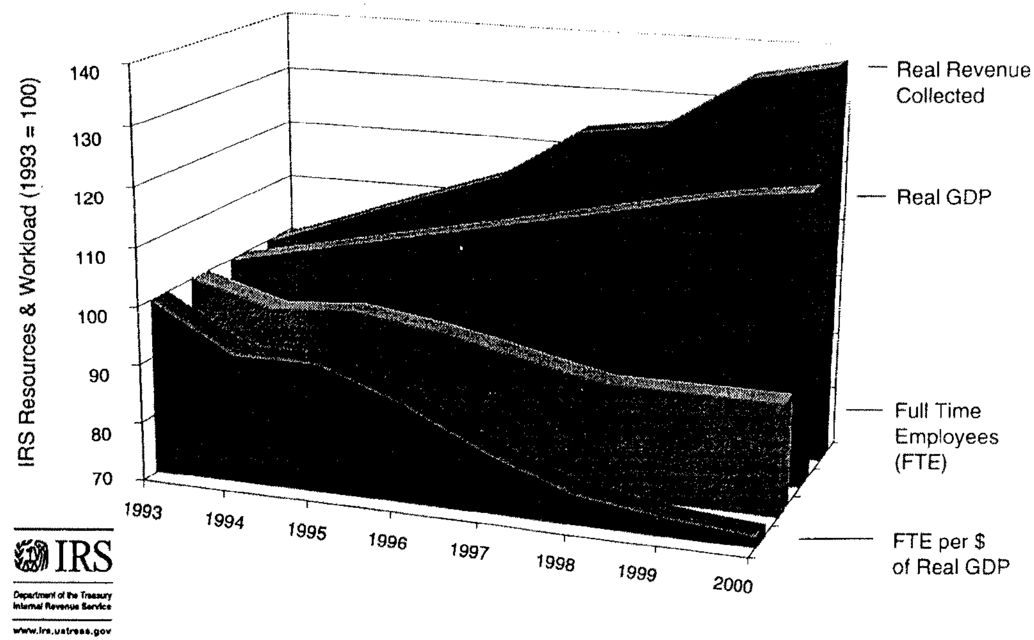
These kinds of improvements do, however, require investments to fund changes in organization, training, and, especially, technology. This process of continuous change and improvement to enhance performance, which is what our whole modernization program is all about, is actually no different from what practically every business in America must do to remain competitive. The major difference at the IRS is that we have more catching up to do.

Now, at many of the hearings so far, I have been asked what are the resources needed to accomplish the mandate. At this hearing, I would like to step back from the details of our current budget request and consider the relationship between the IRS mission, programs, and resources over the next few years.

Looking at the chart, which is entitled "IRS Resources & Workload," we can see, in the last 5 years, the IRS has been shrinking in size relative to the economy and this trend will continue through fiscal year 2000.

[Chart 3 follows:]

IRS SHRINKS AS A FRACTION OF THE ECONOMY



The economy has grown in real terms by 20 percent, while the number of full-time employees has been reduced by about 13 percent. The IRS has shrunk by about 30 percent, and it is important to note that 70 percent of IRS employees deal directly with taxpayers in providing information or in working on specific cases.

Thus, for the most part, this shrinkage has resulted in less activity, especially in the most expensive case-oriented activities such as examinations, criminal investigations, and collections.

For example, the number of individual returns with over $100,000 of income has increased by 56 percent over the last 5 years while the number of such returns examined has decreased by 21 percent. The recent press publicity about the decline in examination coverage simply reflects this basic arithmetic.

Clearly, the path the IRS had been on cannot continue. To simply continue doing business the same way while the economy grows and resources decline will eventually undermine the whole tax system.

Fortunately, as I have discussed briefly here today, and in more detail in the document submitted for the record, I believe there is a better way, and that is to take advantage of improved management and business practices and new technology to improve the way that we accomplish our mission and goals.

In terms of resources, I believe this approach is captured in our third goal on the chart, which is to improve productivity through a quality work environment. Translated, what this simply means is that we can do the job with a limited workforce at approximately the current level even while the economy grows and while we improve service, if we make the necessary improvements and investments.

This would continue to allow the IRS to shrink in terms of full-time employment relative to the size of the economy. And in budget terms, this is also important since the cost of the workforce for pay and benefits is about 70 pecent of the budget. This approach, however, does depend critically on obtaining assured investment funds every year for improvement of our organization business practices and technology; and in our budgets for the coming years, we will request funds for these investments.

I appreciate the support that we have received from the committees that oversee the IRS, all of the committees, and look forward to working with all of the committees on the task ahead. Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Commissioner, and thank you for synopsizing your full statement, which we will definitely review.

[The statement of Mr. Rossotti follows:]

**PREPARED TESTIMONY OF
COMMISSIONER OF INTERNAL REVENUE
CHARLES O. ROSSOTTI
BEFORE THE
ANNUAL RRA '98 JOINT HEARING ON IRS PROGRESS
CONVENED BY THE
JOINT COMMITTEE ON TAXATION
MAY 25, 1999**

INTRODUCTION

Mr. Chairman, I am pleased to testify at the first annual joint hearing on the Internal Revenue Service as set forth by the IRS Restructuring and Reform Act of 1998 (RRA '98).

Since the beginning of 1999, I have testified on eight occasions and before most of the committees represented here today. Together, we have discussed a wide range of issues, including our FY 2000 budget request, the Y2K conversion progress, technology investments, the 1999 filing season, customer service initiatives, implementation of RRA '98, our modernization program and taxpayer burden, to name a few.

Today's joint hearing presents an excellent opportunity to discuss broadly how all the pieces fit together.

As important as the individual provisions of the RRA '98 are, the bill as a whole said something even more important. It told the IRS we must fundamentally change direction. We must not only collect taxes, but we must think of our job as serving the people who are paying the taxes, America's taxpayers.

In the 18 months that I have been in office, I have become even more convinced that we can succeed in the mandate Congress gave us. I do not believe this mandate implies or requires less effective tax collection. I firmly believe we can have a tax agency that does a far better job across the board on all aspects of our mission.

Today I would like to discuss how we are interpreting and implementing the mandate we believe we have, and how it relates to the resources we will require. I am also submitting for the hearing record a document entitled "Modernizing America's Tax Agency," (MATA) which describes our overall change program.

I believe we know quite clearly the fundamental changes we must make. While some of these changes are intangible; many are quite tangible. Collectively, these changes affect the skills, attitudes, tools and processes which constitute the way taxpayers are served and the law is administered.

No one change will fulfill our mandate. There is no quick fix and there is no silver bullet. Nor is there a low-risk plan, since such major and fundamental change necessarily carries with it risk.

Mission, Goals and Measurements

Let me first discuss some of the more intangible, but nevertheless critically important, changes we are making.

As required by RRA '98, we have restated our mission to clarify the purpose of the agency. To make this mission a reality we have reformulated our strategic goals — the standards by which we will measure our own performance in achieving our mission.

As shown on the chart entitled "IRS Mission and Goals," we have three strategic goals. The first two are derived directly from our mission statement which describes the two ways we serve taxpayers: individually, we must provide each taxpayer the service he or she expects and protects the rights he or she deserves. Collectively, we must serve all taxpayers by administering the law fairly, ensuring that those who do not comply are not allowed to unfairly burden those who do. Finally we have the third strategic goal, which is to conduct our mission with the fewest possible resources, which we will achieve by providing a high-quality, productive work environment.

We will not achieve our mission unless we achieve all three of these strategic goals. And I think it is evident that if we achieve all three goals we will by definition collect taxes efficiently, as well as fairly. Clearly, this is a difficult task that requires balancing multiple objectives, but it is not an impossible one nor is it fundamentally different from the task faced by almost every business organization.

In my previous company, we helped large clients design and build computer systems. To succeed over time, we had to try to make each client satisfied so they would give us repeat business and good references. But we also were a public company and we had to be profitable to keep our shareholders satisfied. This meant that we had to charge our customers adequate prices for our services and collect our bills on time. Not uncommonly this meant asking our customers to pay more and faster than they would have liked. In addition, we totally depended on retaining good employees and making them productive, so they could serve clients. In other words, to succeed we had to achieve and reconcile multiple objectives, just as we must do here at the IRS.

So one of the most important steps we have taken is to clarify our mission and goals and make it clear that we do have to achieve multiple objectives. One of the most powerful methods of communicating this to every employee is through the new system of balanced performance measurements we are beginning to implement this year.

This system translates our mission and goals into operational terms in customer service, collections, examination and other functions. In this fiscal year, we are conducting extensive training for every executive and nearly every manager on this balanced measurement system. We are also revising our job descriptions and appraisal system for most employees, aligning it with the mission and goals. These are major tasks that require significant changes in the way people at the IRS deal with each taxpayer and with all taxpayers.

Business Practices

As important as the changes in mission, goals and measurements are, we will not succeed in achieving all three strategic goals without revamping the way we actually go about doing business to take advantage of modern and well-established business practices and strategies. Within the IRS itself and in other private and public sector organizations, there are innumerable successful examples of how we can improve our way of doing business. These improvements hold out the prospect of advancing all three of our strategic goals to a great degree. However, these kinds of advancements often depend on making investments in organization, training and technology.

The chart entitled "Improved Business Practices Advance All Three Strategic Goals" lists some of the areas for improvement in IRS business practices. This is not a complete list; yet, each one of these broad areas implies hundreds or even thousands of more specific changes in the way business is done at the IRS. We have a process in place to set priorities for improvements to be made over the next 12-18 months and have settled on 161 near-term actions. These are but a small beginning on what we can do over the longer term.

Let me illustrate with just a few examples how these kinds of improvements can advance all three strategic goals.

As Congress noted in RRA '98, increased electronic filing of returns indeed holds promise for improving tax administration by speeding refunds to taxpayers, providing positive acknowledgment that a return has been received and reducing the need to correct errors. However, the opportunities for electronic exchange of information are not limited to filing of returns. Linking practitioners and eventually taxpayers to the IRS in a secure way over the Internet will allow account issues to be resolved faster and more efficiently. And improved electronic exchange of information within the IRS will provide employees with information and expertise they need to resolve taxpayers' problems. These kinds of improvements advance all three strategic goals: reducing time spent by taxpayers dealing with the IRS, reducing the number of phone calls we have to answer, and freeing up our compliance employees to focus on real compliance issues, rather than just retrieving or correcting information.

One of the most efficient actions the IRS can take is to head off taxpayer errors before they occur. As an example of how to accomplish this, we are working with the Small Business Administration to develop specialized service for small businesses, especially start-up businesses, to help entrepreneurs obtain everything they need to meet filing requirements. This comes in the form of a CD-ROM or an Internet site, and also staffing the SBA business information centers with people to answer tax questions. Since it is very costly for both the taxpayer and the IRS to resolve an issue after a small business taxpayer has filed incorrectly, every such problem prevented not only increases compliance directly but frees up resources to deal with more serious compliance issues. This also illustrates how we can leverage our limited IRS resources by working with partners such as other government agencies, practitioners and industry groups.

Most of the tax issues with large businesses, where many dollars are at stake, revolve around interpretation of the tax law when applied to a specific set of business circumstances. The rapid increase in international business, for example, increases the importance of ensuring that income is accurately reported among many corporate entities in many countries. Determining the accuracy of such accounting in audits that take place many years after the business transactions have occurred is extremely difficult and inefficient for both taxpayers and the IRS.

By addressing such issues before the fact through such programs as advanced pricing agreements, or by examining existing analyses presented by the taxpayers as is now required by regulation, the likelihood of correct interpretation can be increased and the cost of compliance to the taxpayer and the IRS can be reduced. Similarly, by organizing and training our employees to familiarize them with the specialized business circumstances of industries such as financial services, technology, natural resources and many others, we increase their effectiveness and reduce time to resolve issues.

All businesses must collect money due from customers. A vast amount of experience and technology has been developed in business and government to make this process efficient and effective. The essential elements of all these proven practices are to identify collection risks as quickly as possible and to intervene, through phone calls or visits, to resolve the issues as early as possible in a way that is suited to the financial circumstances of the customer. In applying these essential elements, the customer not only benefits in reduced interest charges and penalties, but also the likelihood of payment is much greater. Also, less time is spent on taxpayers who do not really pose a risk of non-payment. This method of collection offers major opportunities for improvement for the IRS and for taxpayers, since today's methods are extremely slow and do not take advantage of available technology which can tailor collection activities more effectively.

These are but a small sampling of the many improvements that our modernization program will support in order to make progress on all three strategic goals. Furthermore, this is a continuous, not a one-time, process. As we implement changes, we find even more opportunities. For example, we are only beginning to discover the potential of the Internet to transact business, and there are many opportunities to improve the targeting of our enforcement activities, as Judge William Webster indicated in his report on our Criminal

Investigation Division. These kinds of improvements do, however, require investments to fund changes in organization, training, and especially technology. This process of continuous change and investment to improve performance is no different from that which every business in America must do to remain competitive. The major difference at the IRS is that we have more catching up to do.

Resources

At many of my hearings so far this year, I have been asked what resources are needed to accomplish the mandate we have been given. I do not believe I am different from most other heads of organizations in the philosophy that we can do more if we are given more resources. And given the enormous job we have at the IRS, more resources can most definitely be put to good use to benefit taxpayers. At this hearing, however, I think it would be most useful to step back from the details of our current budget request and consider the relationship between the IRS and our mission and goals and resources over the next few years.

Looking at the chart titled "IRS Shrinks as a Fraction of the Economy," we can see that the IRS has been shrinking in size relative to the economy, and this trend will continue through FY 2000. Over this period, the economy is projected has grown in real terms by 20.1 percent, and the number of full-time equivalent employees has shrunk by 13.7 percent. Thus, in relative terms the IRS has shrunk by 28.7 percent. It is also important to note that about 70 percent of IRS employees deal directly with taxpayers, either in providing information or assistance or in working on specific cases.

While some of the shrinkage in staff has been offset by real productivity improvements, for the most part this shrinkage has simply resulted in less activity, especially in the most expensive, case-oriented activities such as examinations, criminal investigations and collections. For example, the number of individual returns with over $100,000 income has increased by 56 percent over the last 5 years, while the number of such returns examined has decreased by 21 percent. The recent press publicity about the decline in examination coverage simply reflects this basic arithmetic. Furthermore, as it has become evident that service to taxpayers is inadequate and a backlog of problem cases has built up, and with the passage of the many new taxpayer rights provisions of RRA '98, even fewer resources are available for initiating new cases.

Clearly, the path that the IRS has taken cannot continue. Doing business the same way while the economy grows and resources decline will eventually undermine the whole tax system of the U.S. Fortunately, as I have discussed briefly here today and in more detail in the document submitted for the record, I believe there is a better way. That is to take advantage of improved management and business practices and new technology to improve the way we accomplish our mission and goals.

In terms of resources, I believe this approach is well captured in our third strategic goal: improve productivity through a quality work environment. This means that we can do the job with a limited work force, even while the economy grows, if we make the necessary investments. As measured by full-time employment, the IRS will continue to shrink in relation to the economy. In budget terms, this is also important, since the cost of the workforce for pay, benefits and direct support represents about 88 percent of the budget. However, this approach also critically depends on obtaining assured investment funds every year for improvement of organization, training, business practices, and technology. In our budgets for the coming years, we will request funds for these investments.

TAXPAYER RIGHTS AND EMPLOYEE TRAINING

The 1999 filing season brought a major expansion in taxpayer rights due to the landmark IRS Restructuring and Reform Act of 1998. From new rules ranging from protecting innocent spouses to burden of proof to greater power for the National Taxpayer Advocate, taxpayers are finding an array of new options available to assist them.

Delivering on the new law and the hundreds of specific changes to both the tax code and our organization is an enormous task. We are in the process of: (1) implementing 161 near-term initiatives to improve service and treatment of taxpayers, of which 82 are mandated by the Restructuring Act; (2) implementing 1,260 tax code changes from the Taxpayer Relief Act of 1997 and the Restructuring Act, many of which require significant and complex interpretations to guide taxpayers and employees; and (3) providing essential training related to these many changes to nearly every one of our over 100,000 employees.

The IRS is fully committed to implementing these laws and changes on behalf of America's taxpayers. However, as in any cases where there is such a multitude of change, problems and mistakes may occur and timetables may need to be adjusted.

A detailed description of our activities regarding taxpayer rights and training can be found in Appendix A.

FILING SEASON AND CUSTOMER SERVICE

The Restructuring Act directed the IRS to place a greater emphasis on serving the public and meeting taxpayer needs. While providing service on a level with the best financial services institutions may take years, we have put some serious management muscle behind near-term service improvements. Our goal is to provide service when and where our taxpayers need it.

The IRS had a very successful filing season this year, especially given the enormous challenges and risks we faced when nearly all of our mission critical systems were made Y2K compliant and placed back into production for the 1999 filing season. [Please see Appendix B for a complete discussion of the Y2K conversion effort.] The massive amount of change made to our systems in the last year, coupled with the extremely heavy volume of processing that occurs during the filing season, posed major risks as we began the season.

However, I am pleased to report that by managing this massive risk and change in an orderly and integrated fashion, the 1999 tax filing season that is winding down was nearly error free. Projected net collections for FY 1999 are $1.7 trillion. During FY 1999, we also project to receive 228 million returns, including over 126 million individual returns, and expect to issue over 93 million individual refunds. As of May 7, 1999, refunds are up almost seven percent over last year, and the average refund is $1,521.

Following the RRA's mandates, we have a vigorous electronic tax administration program and strategy. On-line filing is running 161 percent ahead of last year's pace and has already exceeded last year's total volume of 942,000. The successful completion of the filing season is one major milestone on the road to solving the Y2K problem.

Our toll-free telephone lines are now open 24 hours-a-day/7 days a week. This filing season, more than 250 IRS offices across the nation offered Saturday service. We are making it easier for taxpayers to get forms and information whether it is from our website (www.irs.ustreas.gov), fax machine or CD-ROMs. In addition, we hope to be able to add even more services in the future as we bring new technology online, and just as importantly, measure taxpayer satisfaction with our services.

A detailed description of filing season activities, including electronic tax administration and customer service initiatives can be found in Appendix C.

MODERNIZATION AND FY 2000 BUDGET REQUEST

As I have previously testified, fiscal years 1999 and 2000 represent a crucial turning point for the IRS. In this period we are aggressively addressing the problems described by Congress and the American people over the past few years. As mandated in the Restructuring and Reform Act, the IRS is expected to do a far better job of serving the public based on a much better understanding of the taxpayer's point of view. Delivering on this mandate is our top priority in the FY 2000 budget and will continue to be through FY 2001 and 2002.

The problems that led up to the passage of the Restructuring Act can be solved but they will require fundamental change in order to modernize almost all aspects of the IRS. This process also carries with it considerable cost and risk. Our plans may need to be revised and operational problems may occur. However, there is no low risk plan for the massive job we must do at the IRS that I described at the beginning of my testimony.

We will complete the plan for our new organizational structure this year and have already begun implementing parts of it. Much more implementation will occur in FY 2000 and Fy 2001. Using the authority granted by Congress, we also have put in place a new top management team and are actively recruiting to fill leadership positions in our new operating divisions.

Updating our business practices for dealing with taxpayers requires almost a complete replacement of IRS information technology systems, which are built on a 30-year old fundamentally deficient foundation that cannot provide accurate up-to-date information about taxpayer accounts. (For a detailed description see *MATA*)

And GAO has repeatedly reported IRS cannot provide reliable taxpayer account and financial information to manage the Agency. On December 9, 1998, the IRS awarded a Prime Systems Integration Services Contract (PRIME) to Computer Sciences Corporation (CSC) and their partners. We are currently working with CSC to update our strategic systems plan and to implement near-term projects which will focus on improved phone service and electronic filing options.

Despite these many challenges, in preparing the budget request for FY 2000, we were well aware of funding constraints and have therefore requested the bare minimum. While the size of the IRS in terms of employment, and hence most operating costs, should be relatively stable in absolute terms and declining in relation to the economy, the agency will nevertheless require investments over the next several years in order to implement the modernization program. The greatest part of this investment will be for replacement of technology, but some will also be required to redesign the organization and business practices, training, and facilities replacement. Without this funding, the entire reform and restructuring program demanded by Congress and the public could stall and the risks increase.

The FY 2000 resource request of $8.105 billion will enable steady progress on the many changes needed to deliver on the reform and restructuring program and the Year 2000 Conversion. This request in total is essentially level with resources provided in FY 1999.

These numbers present a management challenge — effecting major changes requiring investment within the confines of a flat budget. This combination is only possible in FY 2000 for three reasons: first, because of the stringent fiscal constraints we are carrying out many of the changes by diverting resources from on-going programs such as compliance; second, the Congress advance funded our ITIA to a level that will sustain us through FY 2000; and third, our current estimates of specifically identified and known year 2000 costs are less than the costs for FY 1999.

These three factors enable us to include in our budget request some absolutely essential items for implementing the required changes. These include $17 million to train our employees in the tax laws that Congress passed; $40 million for implementing the Restructuring Act's customer service and ETA initiatives; and $140 million for implementing the modernization plan required by the RRA '98 which will increase accountability for service to specific groups of taxpayers. The money for implementing the modernization plan will be used to reorganize and provide new skills for the IRS workforce.

I want to particularly stress that increased training of our employees is essential for delivering on the mandates that Congress gave us and the service that the public expects. It is also the linchpin in our budget request. To succeed in the long term, we must invest carefully now.

About 70 percent of IRS employees deal directly with taxpayers. Taxpayers have every right to expect that in every such encounter with an IRS employee, whether it's a phone call asking a question about how to fill out a return, or a meeting with a revenue agent in an audit, the IRS employee should understand the current tax law and have the skills to understand the facts and circumstances of that taxpayer. A year ago, when I took office, it was abundantly clear that there was already a serious deficit in this area. Since then, Congress has given us the responsibility of implementing 1,260 changes to the Tax Code and a mandate to restructure the whole way we do business with taxpayers. The money in the budget request, including that part included within the modernization program, is essential to our effort and will only begin to rectify our training deficit.

Overall, this budget will continue the trend of the last six years in which the IRS workforce has been shrinking in relation to the size of the economy. In FY 2000, while the workload grows as a result of the growth in the economy and the additional demands of the Restructuring Act, the total workforce size will remain approximately constant. This trend will only be possible if we make the investments in organization, training and technology that are needed.

THE IRS — BEYOND FY 2000

Information Systems

We must also look beyond the FY 2000 budget. Building bridges between the "legacy" and modernized systems requires sustaining the old while planning and implementing the new.

Training funds will be necessary for technical courses for new recruits and to retrain current associates. The funding will also be used for courses to deliver expertise required during the expanded issuance of work to contractors, training for IS programmers responsible for maintaining systems developed by the contractors for modernization, and training for the entire workforce on new end user software to be implemented over the next few years.

Resources are also essential to support the Integrated Submission and Remittance Processing System (ISRP), which was implemented as part of the Service's Y2K efforts. ISRP is a new system combining and improving the processing of submissions and remittances. These resources will support the ISRP projects in the areas of project management, testing, and software development and will be used to address telecommunications, performance, and security issues. Resources are critical to the Mainframe Consolidation project for contractor services, project management, and related support. They will provide for hardware and software including disaster recovery hardware and software, telecommunications requirements, hardware and software maintenance, and software monthly licensing charges.

Legacy bridge systems will require developmental staffing to support Electronic Tax Administration, the Payment Information Database, the Integrated Personnel System, and the Financial Reporting Release. These resources will also provide development staffing to support the Modernization Blueprint/PRIME and will continue the Service's commitment to ensure adequate product assurance testing of its tax systems. Additionally, these resources will enable the Service to perform capacity and performance reviews of both modernization and near term initiatives in support of PRIME.

Operation and maintenance of the newly compliant systems also require support to maximize the technology improvements gained through Y2K compliance and conversion efforts.

Systemic realignments and information technology changes resulting from the rapidly evolving organizational modernization effort need resources as well. These requirements include applications changes to align taxpayer segments and employees with the new business units; and modifications in payroll, financial management, personnel, accounting, reporting, MIS, and workload management. Changes to accommodate the systems for the new operating divisions, such as Wage and Investment, requires significant support. Finally, determining changes required and reworking infrastructure based on capacity, performance, and telecommunications assessments call for a major effort.

Electronic Tax Administration

As required by RRA '98, the IRS issued its first-ever *Strategic Plan for Electronic Tax Administration* for public comment on December 3, 1998. The Strategic Plan is designed to eliminate barriers, provide incentives, and use competitive market forces to make significant progress toward the congressionally mandated goal of 80 percent of all tax and information returns being filed electronically by 2007.

As also required by the Act, the IRS established the Electronic Tax Administration Advisory Committee (ETAAC) to provide an organized public forum for the discussion of ETA issues in support of paperless filing.

The ETAAC, which is comprised of representatives from various groups including tax practitioners and preparers, transmitters of electronic returns, tax software developers, small and large businesses, employers and payroll service providers, individual taxpayers, state governments, and financial industry members, provides continuing input into the development and implementation of the *Strategic Plan for Electronic Tax Administration*.

In order to implement this strategic plan, ETA will engage in marketing and implementing the final phase of the Field-Based Account Management contract as well as the Distribution Channel Management contract for the Extranet.

Proposed Capital Investments for Technology Modernization Initiative

Implementing new technology based on revamped business practices is critical to properly support our modernization concept and fully comply with the mandates of RRA '98. Technology modernization will help build an up-to-date infrastructure in a way that clearly supports business goals.

Technology Modernization supports the agency's goals to replace the IRS' archaic Information Technology systems in conjunction with redesigned business practices, while continuing to provide service to taxpayers and responding to ongoing tax law and other changes. It will be supported by a modern infrastructure and managed through disciplined processes to execute Technology Modernization effectively.

If properly funded, we expect the Technology Modernization initiative to realize the following benefits. In the short-term, there will be: improved access to IRS customer service representatives; improved service to internal and other Federal customers; the start-up of electronic communication with taxpayers and timely, accurate information for personnel systems.

Mid-term benefits include: improved financial management; expanded electronic filing and payment options and expanded electronic interaction with taxpayers. And the long-term benefits are: more accurate and timely information for increased customer service; more customer friendly collection capabilities; faster refund processing; and secure and auditable access to all taxpayer account information through a single terminal.

As previously discussed, our accomplishments to date include the selection of and contract award to the PRIME contractor. CSC and its partners which were selected as the PRIME contractor will provide the IRS the capacity and skills required to undertake a project of the size and complexity of the Technology Modernization. In cooperation with the PRIME Alliance, we are developing work plans for the projects to be undertaken in FY 2000 and have established a Governance process to direct Technology Modernization and oversee critical program management activities.

By the close of FY 1999, we will have developed a process for creating, submitting, and managing expenditure plans. In the next few weeks, we will submit an initial expenditure plan for the portion of the ITIA account needed for the balance of FY 1999. This plan will provide details on our needs and planned accomplishments for this fiscal year. By the close of the fiscal year, we intend to submit an expenditure plan for the next increment to begin system development in FY 2000.

The development and submission of expenditure plans fulfills the requirements mandated in the FY 1998 and FY 1999 Appropriations Acts which list the criteria to be met before the approval to proceed is granted. We will also have completed the following critical tasks to lay the foundation for successful Technology Modernization:

- Re-sequencing and implementation of the IT Modernization Blueprint to include identifying critical technology and business process change investments in support of the overall strategic plan, developing plans for accelerating development of new corporate databases, and developing plans for the technical infrastructure to support modernization.
- Providing tools and training to enable the execution of new processes; documenting, implementing, and enforcing processes to enable consistent, high-quality outcomes; and installing a long-term process improvement structure.
- Meeting the OMB investment guidelines for developing a process for making sound investment decisions; updating existing business cases to comply with new Federal investment guidelines; developing business cases that comply with Federal investment guidelines for new initiatives; and implementing acquisition plans, processes, and procedures in accordance with Federal acquisition rules.

CONCLUSION

Mr. Chairman, I believe that the IRS is fundamentally changing in the direction mandated by RRA '98. And it is changing in virtually every aspect — in mission, goals and principles, practices and procedures, management and organization, training, performance measures and technology. Through these changes, we can succeed in producing an IRS that better serves America's taxpayers — individually and collectively — but we must realize that there are no quick fixes, magic bullets or low risk plans.

Without adequate funding, the entire reform and restructuring program demanded by Congress and the public could stall and the risks increase. Overall, the IRS budget will continue the trend of the last six years in which the IRS workforce has been shrinking in relation to the size of the economy. While the workload grows as a result of the growth in the economy, the total workforce size will remain relatively constant. We must maintain current services for labor and non-labor costs and promotions to support improved business processes, organizational modernization implementation, Electronic Tax Administration marketing services, information systems life cycle management, and information technology investments.

What we need most of all, given the current situation at the IRS, is the sustained support of Congress and the public while we make these fundamental changes and while we administer a huge and complex tax system. And I have been very, very pleased at the support we have received to date from all quarters.

However, we will also need your understanding of the enormity of our challenge. One forecast I made at my confirmation hearing before this committee was that it would take the better part of a decade to reach our goals for the IRS. Having now been in office for 17 months, this is one forecast that I stand by. But I believe that the destination is worth the long and difficult journey we have begun.

APPENDIX A – TAXPAYER RIGHTS

Delivering on the Restructuring Act and the hundreds of specific changes to both the tax code and our organization is an enormous task. We are in the process of: (1) implementing 157 near-term initiatives to improve service and treatment of taxpayers, of which 82 are mandated by RRA '98; (2) implementing 1,260 tax code changes from the Taxpayer Relief Act of 1997 and RRA '98, many of which require significant and complex interpretations to guide taxpayers and employees; and (3) providing essential training related to these many changes to nearly every one of our over 100,000 employees.

Let me highlight some of the progress to date in implementing RRA '98: a massive training effort is underway: two new forms are being developed (706C/706D on estate taxes); 153 forms have been revised; 39 publications have been revised; 33 items from Chief Counsel were published (14 regulations, 8 revenue procedures, and 11 notices/ announcements); more than 75 guidance memoranda have been issued; and 1,300 implementing actions have been identified.

I want to particularly stress that increased training of our employees is essential for delivering on the mandates that Congress gave us and the service that the public expects. About 70 percent of IRS employees deal directly with taxpayers. And taxpayers have every right to expect that in every such encounter with an IRS employee, whether it's a phone call asking a question about how to fill out a return, or a meeting with a revenue agent in an audit, the IRS employee should understand the current tax law and have the skills to understand the facts and circumstances of that taxpayer.

A year ago, when I took office, it was abundantly clear that there was already a serious deficit in this area. Since then, Congress has given us the responsibility of implementing the 1260 changes to the Tax Code and a mandate to restructure the whole way we do business with taxpayers. And this will require extremely complex training for our employees. The money in our FY 2000 budget request, including that part included within modernization program, is essential and will only begin to rectify our training deficit.

There are three phases to our RRA '98 training, and even prior to enactment of RRA '98, we began to take action. In July of 1998, the IRS' Chief Operations Officer established a National Resource Center to coordinate policy and program questions so that consistent messages were sent to stakeholders. As of March 15, 1999, more than 1,100 inquiries have been submitted. Also in July, approximately 185 RRA '98 field coordinators in each IRS district, region and service center were identified and trained to be local points of contact for coordination and questions. I held my first RRA video conference on July 17, five days before the President signed the legislation into public law.

RRA '98 Phase I training took place from July 1998 to January 1999. Some of the actions we took included: (1) providing 60,000 front-line employees with basic implementation training on new statutory requirements and key procedures; (2) developing individual training plans for each IRS function; (3) implementing a course completion certification process; (4) establishing weekly conference calls with over 180 RRA '98 Coordinators and Education Branch Chiefs; and (5) posting information on School of Taxation Web Site and links to the National Resource Center.

We are now in the midst of RRA '98 Phase II training. Our overarching goal is to provide formal training with clear learning objectives, testing and evaluation. We are developing courses on: Due Process, Installment Agreements, Offers in Compromise, Seizures, Relief from Joint and Several Liability, Third Party Contact and Interest netting. The goals for RRA Phase III Technical Training for FY 2000 are to: (1) embed specific provisions of RRA '98 and the newly revised Internal Revenue Manual into the IRS day-to-day operations; (2) supplement Phase I and Phase II training as needed; (3) deliver Phase II of Customer Service Training; and (4) continue to evaluate, monitor and update training as necessary.

One of our critical training needs has been Section 1203 in which all 100,000 employees must be trained. The initial mandatory training that all employees have now received was certainly an important first step, but we must do more. All employees have received with their pay stub a brochure written especially for them on Section 1203. It includes a plain language summary of all the provisions, how potential violations are reported, employee appeal rights and other important reminders. We are also encouraging our employees to take advantage of the IRS Labor and Employee Relations Resource Center that can help answer many of their Section 1203 questions.

We will then build on this information with better training and guidance. Beginning later this month, all employees will be provided detailed instruction on the procedures to be used in handling Section 1203 cases. This instruction, including a training video, will be based on a new Section 1203 Procedural Guide that is currently under development. It will emphasize good customer service and case management practices. In addition, we are ensuring that all training courses on RRA '98 consider the impact of Section 1203 on how employees carry out their duties and we will then begin the process of integrating Section 1203 into course material already existence.

In addition to training, I would like to highlight some of the significant changes called for by RRA '98. In January, the IRS issued new versions of its form and publication for innocent spouse relief, each revised to incorporate the changes made by RRA '98. This is the latest of several steps we have taken in our ongoing effort to help innocent spouses. We hope that our materials will effectively explain the new law to taxpayers and assist them in taking full advantage of their rights. We also appreciate the comments we received on the draft form last fall and welcome suggestions on how we might further improve these items. In addition, the IRS plans to incorporate additional feedback from taxpayers and practitioners — as well as our own experience in processing these requests — and provide even better products.

In the area of due process, taxpayers now have the right to request a hearing before an impartial appeals officer after a notice of lien has been filed or a notice of intent to levy has been sent. In addition, the IRS must provide the taxpayer with a written notification of this appeals right. If the taxpayer requests a hearing during this period, the proposed levy may not take place until after the appeals officer makes a finding. The taxpayer also has 30 days to challenge the appeals finding in U.S. Tax Court or U.S. District Court, during which period the IRS may not levy. During the appeals process the taxpayer can also request the IRS to consider establishing collection alternatives, such as an installment agreement, to pay off the tax bill. Under the new law, the IRS must consider all other payment possibilities before seizing the assets of a business.

With the publication in March 1999 of revised tax Form 656, and an array of internal changes, the IRS is also fundamentally changing the Offer in Compromise program to make it easier for taxpayers to apply for help and allow the IRS to be more flexible when considering taxpayer offers to settle tax bills. For taxpayers facing dire financial circumstances and unable to pay the entire tax bill, the Offer in Compromise program allows the IRS to negotiate a settlement. We expect to have the new OIC program in operation by the end of the year.

In the end, this helps all taxpayers. Instead of collecting nothing from people with an unpaid tax bill, we are able to collect something. We will also work with taxpayers facing severe hardship to help find a way to satisfy their tax obligations.

In addition, under the changes being made at the IRS, the Offer in Compromise program will feature more straightforward rules, increased flexibility by key agency employees and fewer rejections of compromise offers.

Even more changes will unfold in the weeks and months ahead. We want to work with taxpayers to make it simpler for them to apply for an Offer in Compromise. The process will be streamlined to make more people eligible. The program will feature new flexibility in evaluating taxpayer expenses. In the past, the program frequently relied on local and national standards for evaluating cost-of-living expenses — a key element in determining how much a taxpayer can afford to pay through the compromise offer. But the new guidelines allow IRS employees more freedom to assess an individual's particular financial circumstances beyond the standard cost-of-living formulas. The move will help guarantee that a taxpayer can still afford basic living expenses while paying his or her tax bill.

APPENDIX B -- Y2K CONVERSION

The IRS made significant progress in preparing for the Year 2000. As of last month, approximately 93 percent of our mission critical systems were made Y2K compliant and successfully placed back into production for the 1999 filing season. Any problems that we encountered had a minimal impact on a small number of taxpayers and were generally fixed within 24 hours of being identified.

Since April, most of our efforts will be applied to wrapping up remediation activities on some smaller systems, infrastructure components and most importantly, completing the full-scale End-to-End Testing. While this picture is generally positive, I want to emphasize that there is still risk and a great deal of work to be done.

Ensuring Our Success

There are a number of factors and efforts that I believe will contribute significantly to a successful Y2K effort: management commitment, independent assessment and managing priorities.

Y2K is an IRS top priority, as well as one of my own this year. In support of our Y2K repair project, I chair a monthly Executive Steering Committee and I meet regularly with the IRS' Chief Information Officer and other key executives to obtain individual project status updates, monitor key risks, and ensure that all necessary actions are being taken.

We continue to receive independent assessments of our work from Booz•Allen & Hamilton, Inc. and Northrop Grumman, Inc. Booz•Allen is performing risk identification and assessment on all Century Date Change (CDC) Program activities, while Grumman is performing a 100 percent review of our code renovation. They have reviewed over 89 percent of our code and have found only one in every 33,000 lines of code that requires reprogramming.

We also prioritized our schedule so that systems involved in the filing season were either converted, tested, and implemented in January or held off until after the filing season. If we do not continue to manage risks and schedules in this flexible fashion, we may increase the likelihood of failure and end up delaying, rather than accelerating, actual progress.

Current Priorities

As we move into the spring of 1999, we will focus our Y2K conversion efforts in a few key areas.

Improved Tracking Mechanism

Based on a GAO recommendation, we recently developed a matrix that relates all of our applications to their respective infrastructure systems. In the past, we tracked infrastructure separately. The new matrix approach allows both IRS and outside organizations to better track our progress toward becoming Y2K compliant.

End-to-End Testing

Like many other organizations, we are conducting integrated tests to ensure that our Y2K remediated systems will actually function *together* once we reach January 2000. We have been conducting End-to-End Testing since last July and have been successful to date. As we move towards the summer of 1999, we will begin incorporating more and more of our mission critical systems into the End-to-End tests. These activities leading up to the Fall of 1999 will prepare us for the final phase of End-to-End Testing which begins in October. During this last phase, we plan to run the test in an environment that is as close as possible to what we will actually face in the Year 2000.

End Game Planning

We are also devising an "end game" strategy that will guide our activities during the critical "rollover" weekend of December 31, 1999 through January 2, 2000. End game plans will be developed for all of our organizations that are critical to tax processing activities.

Taxpayer Impact

We want to be sure that taxpayers who attempt to file in good faith or pay on a timely basis are not harmed because of a Y2K computer problem beyond their control. At the present time, the IRS has discretion to abate penalties for reasonable cause, but has only limited discretion to abate interest. We are now working with the Treasury Department to develop abatement policies and recommendations to address this issue. We will certainly keep you aware of our progress and advise you of any legislative changes that may be needed.

Contingency Planning

The IRS is also developing contingency plans that outline the necessary procedures to follow in the event that any of the IRS' mission critical tax processing systems suffer a major failure. These plans concentrate on those areas that have the greatest impact on tax processing activities in addition to the areas we know to be particularly affected by the Y2K problem. We do not think we will encounter such a failure, but it is better to have plans ready in case they are needed.

APPENDIX C — 1999 FILING SEASON

The IRS is having a very successful filing season, especially given the enormous challenges and risks we faced when nearly all of our mission critical systems were made Y2K compliant and placed back into production for the 1999 filing season. The massive amount of change made to our systems in the last year, coupled with the extremely heavy volume of processing that occurs during the filing season, posed major risks as we began the season.

However, I am pleased to report that by managing this massive risk and change in an orderly and integrated fashion, the 1999 tax filing season has been relatively error free to date. As previously stated, projected net collections for FY 1999 are $1.7 trillion. During FY 1999, we also project to receive 228 million returns, including over 126 million individual returns, and expect to issue over 93 million individual refunds. As of May 7, 1999, refunds are up over seven percent over last year, and the average refund is $1,521. On-line filing is running 161 percent ahead of last year's pace and has already exceeded last year's total volume of 942,000. And of course, the successful completion of the filing season is a major milestone on the road to solving the Y2K problem.

Electronic Tax Administration

As the financial world moved toward electronic transactions, the IRS did the same. The opportunity for growth in electronic tax administration is clear. More than 30 percent of American homes now have computers and more than half of those also have modems. An estimated 50 million individuals used some form of Internet application in 1997. Most Americans routinely use credit and debit cards for recurring financial transactions, as well as for major expenditures. In addition, a growing number of state and local governments accept credit or debit cards for payment of taxes and fees.

Industry watchers also predict that an increasing number of U.S. households will do their banking on-line — whether through a dial-up direct connection or through the Internet. An estimated 4.5 million households were banking on-line in 1997. By the year 2000, that figure could swell to 10 to 16 million households.

PC services are also becoming less expensive, or even free. Last year, certain tax software companies offered free electronic filing for the first time and more did so this year. Many financial institutions also distribute free software to account holders who want to do their banking by personal computer.

The challenge for the IRS, in conjunction with the private sector, is to develop products and services that are so simple, inexpensive and trusted that taxpayers will prefer them to the traditional methods of calling and mailing.

I want to highlight our progress in several critical areas this filing season including: electronic tax return filing; electronic payments, and direct deposit.

Individual Taxpayers

Twenty-five million individual taxpayers took advantage of IRS' *e-file* options last year. They learned that filing through an authorized practitioner, over the telephone, or on-line is fast, safe and virtually error-proof.

The 1999 filing season is turning out to be another growth year for Electronic Tax Administration as more taxpayers than ever before are enjoying the benefits of filing taxes electronically. Through May 7, 1999, nearly 29 million individual taxpayers filed using one of three convenient *e-file* options; a 19 percent increase over the same period last year.

- Nearly 21 million taxpayers *e-filed* their tax returns electronically through an IRS-authorized Electronic Return Originator (ERO); a 19.8 percent increase over the same period last year.
- Approximately 2.4 million taxpayers filed their tax returns on-line via their home computer through a third party transmitter. On-line filing is running 161 percent ahead of last year's pace and has already exceeded last year's total volume of 942 thousand.
- Almost 5.7 million taxpayers filed their returns over the telephone using the award winning TeleFile system. For the first time, taxpayers in Indiana and Kentucky can file both their federal and state returns in a single telephone call during the pilot of the first Federal/State TeleFile option.
- Overall, 8.3 million taxpayers have chosen to file both their federal and state tax returns simultaneously in a single electronic transmission. This year, 35 states and the District of Columbia are participating in the program.

In addition, this filing season the IRS is conducting two pilots which provide a paperless filing experience for thousands of taxpayers. These pilots involve the use of Personal Identification Numbers (PIN) as the taxpayer's signature, thus eliminating the need to file the paper signature *jurat*.

- Nearly 650,000 taxpayers have participated in the On-Line Signature Pilot where the IRS distributed *e-file* Customer Numbers to taxpayers who prepare their own returns using tax preparation software to file from their home computers.
- Another 493,000 taxpayers have participated in the Practitioner Signature Pilot where taxpayers choose a PIN when filing through 8,100 participating practitioners.

Also new this year, taxpayers filing balance due returns have several options for not only filing electronically, but paying electronically as well.

- Over 73,000 taxpayers filing balance due returns paid using an Automated Clearing House (ACH) debit as part of their electronic return. Taxpayers can file early and have the debit occur as late as April 15th.

- Another 53,000 taxpayers used credit cards to pay the taxes due as part of two credit card pilots that the IRS is conducting this year. Under the first pilot, US Audiotex is processing credit card payments over the telephone. After *e-filing* by computer -- either from home or through a tax preparer -- or by TeleFile, a taxpayer can charge the balance due with a toll-free phone call. US Audiotex is accepting MasterCard, Discover or the American Express card. In the second pilot, individuals using Intuit's TurboTax or MacInTax software to *e-file* from their computers are able to use a credit card to pay the balance owed to the IRS. Taxpayers can charge their balance due to a Discover card.

Business Taxpayers

Business taxpayers are also benefitting from the wide range of electronic filing and payment options that are available to them.

- On February 16, 1999, the IRS announced that taxpayers have made more than \$2 trillion in tax deposits electronically since the government established the Electronic Federal Tax Deposit System (EFTPS) in November 1996. This year alone, through May 8th, \$817 billion has been deposited electronically. Over two million businesses are now enrolled in the Hammer Award-winning EFTPS system which allows taxpayers to make their federal tax deposits over the telephone or by using a personal computer, eliminating the need for paper deposit coupons, checks, or trips to the bank. During FY 1998, taxpayers made \$1.2 trillion in tax deposits through EFTPS which accounts for over 80 percent of all federal tax deposits.

- During Fiscal Year 1998, 750,000 quarterly employment tax returns were filed over the telephone by small businesses, in addition to the nearly 582,000 Forms 941 that were filed electronically by payroll service providers. In FY 1999, the IRS expects over 2.3 million Forms 941 to be either filed electronically or over the telephone.

- Under the Simplified Tax and Wage Reporting System (STAWRS), the IRS is working with other federal agencies and states to reduce employer burden by conducting single point filing projects in the states of Iowa and Montana, establishing a Harmonized Wage Code database, and improving customer service.

Planning for the Future

In addition to successfully managing the current filing season, the IRS is also planning for the future. As required by the IRS Restructuring and Reform Act of 1998, the IRS issued its first-ever Strategic Plan for Electronic Tax Administration for public comment on December 3, 1998. The Strategic Plan describes the steps the IRS will take to eliminate barriers, provide incentives and use competitive market forces to make significant progress toward the congressionally mandated goal of 80 percent of all tax and information returns being filed electronically by 2007.

As also required by the Act, the IRS established last year the Electronic Tax Administration Advisory Committee (ETAAC) to provide an organized public forum for the discussion of ETA issues in support of the objective that paperless filing should be the preferred and most convenient method of filing tax and information returns. The ETAAC, which is comprised of representatives from various groups including tax practitioners and preparers, transmitters of electronic returns, tax software developers, small and large businesses, employers and payroll service providers, individual taxpayers, state governments, and financial industry members, provides continuing input into the development and implementation of the Strategic Plan for Electronic Tax Administration.

Providing Information and Service to Taxpayers

From web-based technology to 24 hour-a-day/7-days-a-week phone service to sitting down one-on-one with a taxpayer with a problem, the Internal Revenue Service is working to provide the easiest and most efficient ways for taxpayers to get the information and assistance they need not only during filing season, but throughout the year.

Web Site

An increasing number of taxpayers are discovering that the IRS home page on the World Wide Web (www.irs.ustreas.gov) is an excellent and convenient source for tax forms and tax information. And they can get them around-the-clock, 365-days-a-year and from anywhere in the world. Since coming on line in January 1998, taxpayers have downloaded over 69 million forms, publications and products. For the first three months of the filing season there have been over 39 million downloads as compared to 17.4 million for the same period in 1998 — an increase of almost 130 percent.

Anyone with Internet access can receive: tax forms, instructions, and publications; the latest tax information and tax law changes; tax tables and rate schedules; and hypertext versions of Publication 17, "Your Federal Income Tax"; all TeleTax topics; answers to the most frequently asked tax questions; a library of tax regulations; the weekly Internal Revenue Bulletin, which contains all the latest revenue rulings, revenue procedures, notices, announcements, proposed regulations and final regulations.

Web Site Alerts

This filing season, the IRS also created a new page found on its web site to alert taxpayers and practitioners about problems that could affect them. Similar to a product recall notice, the "Special Taxpayer Alert," describes the problem, its scope — such as the number of people likely to be affected, where they are located — and most importantly, what the IRS is doing to fix the problem, and what, if anything the taxpayer needs to do about it. In most cases, taxpayers do not have to take any action. However, if they want more information, taxpayers can call our toll- free, 24 hour-a-day/7-day- a week phone number 1-800-829-1040.

Thankfully, there were few problems to report on the "Special Taxpayer Alerts Page." The alerts we posted included: a report that some employees received W-2 forms from their employers that had an "X" in or near an incorrect checkbox, a printing error in Form 4562 (*Depreciation and Amortization*) and a production delay for Package 1040-ES/V (*Estimated Tax for Individuals*) due to ice and snowstorms.

Web Site Small Business Corner

The Small Business Corner located on the IRS web site was inaugurated in January 1999 to benefit the over 23 million small business taxpayers and the 800,000 start-up businesses begun each year. It is intended to provide these taxpayers with easy-to-access and understand information. This type of convenient "one-stop shopping" for assistance could provide most, if not all of the immediate products and services that a small business needs. It also offers the potential for Web-based Q&As which can help the IRS identify and address trends and systemic problems. Improved electronic access to information should also result in decreased demand for telephone and walk-in assistance.

Expanded Web Site Tax Professional Corner

The Tax Professional's Corner of the IRS' web site was developed to provide a quick listing of the information resources most needed by Tax Professionals. It provides news items, early release of items to be issued in the Internal Revenue Bulletins, drafts of revised forms, *e-file* resources and links to the most technical items on our site. The twelve categories of information will continue to be expanded.

Web-based Customer Service

This filing season, the IRS continues to provide interactive *e-mail* customer service to taxpayers on the web site. This capability is very limited and was conducted as a test of the capability, and is not necessarily a permanent addition to our customer service offerings.

We are also offering interactive help in navigating our web site, assistance with certain Employment Tax Issues, and help for certain priority programs like the Banks, Post Offices and Libraries Program and the Corporate Partnership Program. Users in these areas on our web site will be able to e-mail their questions without leaving the site. The web site will use intelligent routing to get the question to an available assistor, who then researches and responds through a hot link URL, providing the answer to the user. If this pilot is successful, we will expand it to cover other functions responsible for customer service. We are currently exploring future possibilities for this application with our internal customers.

CD-ROM

The Federal Tax Forms CD-ROM contains more than 600 tax forms and instructions, and some 3,000 pages of topic-oriented tax information. Users can electronically search, view-on-screen, or print-out any of the items contained on the CD. Available through the Government Printing Office's Superintendent of Documents, the three-issue subscription is $25. As of March 22, 1999, almost 65,000 subscriptions were sold.

In conjunction with the Small Business Administration, the IRS also recently produced the joint small business CD-ROM, "Small Business Resource Guide: What You Need to Know About Taxes and Other Topics." It is an interactive multi-agency product utilizing the latest technology to provide the small business taxpayer with easy-to-access and understand information. A total of 17,000 copies will be available to distribution; half of which will go to SBA Small Business Information Centers.

Similar to the web-based "Small Business Corner", the information is organized by stages of the business life cycle and provides guidance on preparing a business, financing a business, record keeping, selecting a business structure, employment tax information and other important topics. All of the business tax forms and publications are available, most in fill-in-the-blank and/or searchable format. For those users with Internet access, there are also direct links to the web sites of most federal regulatory and state tax agencies. The CD-ROM will be tested at strategic locations, such as the SBA's Business Information Centers.

TAXI On-line Learning Lab

In July of 1998, the Internet application TAXI went live. This is an on-line learning lab for first-time taxpayers, students aged 13-18, who learn about taxes in school. It covers the reasons we pay taxes and how the students can meet their tax obligations. Particularly important is the availability of electronic filing options and teaching early on the benefits of electronic filing. First time taxpayers will learn electronic filing methods rather than paper-based filing and how to interact electronically with the IRS. This was a successful collaborative effort between IRS and the American Bar Association's Section of Taxation. Additional modules are planned as follow-ons to the existing four units.

IRS Local News Net

IRS Local News Net is a list server which supplements the web site's Digital Dispatch (there are over 40,000 Digital Dispatch subscribers) by providing localized, targeted and immediate information for tax professionals. It is a system capable of reliable and efficient delivery of information to tax professional communities across the nation.

The system is designed to provide a vehicle for disseminating information that has particular significance to taxpayers and practitioners in various localities, e,g, a change in office location, hour of service, etc.. Any District Office, Service Center or Computing Center that needs to communicate with the public or with tax professionals on a regular basis can request a list server.

TELEPHONE ASSISTANCE

24/7 Phone Service and Access

One of the hallmarks of the IRS' new commitment to providing top quality service to taxpayers is 24 hours-a-day/7 days-a-week toll-fee telephone service (1-800-829-1040) which we began on a trial basis at the end of the 1998 filing season. So-called "24/7" phone service became a permanent IRS service feature on January 4, 1999. As of May 8, 1999, more than 40 million taxpayers have been served.

As the subcommittee is aware, the expansion of hours of service to 24 hours/7 days a week, combined with increased training demands to implement the new tax law and preceding requirements, did cause the effective level of service to decline, especially during the beginning of the filing season. For the season as a whole so far, our level of access is 68 percent in 1999 compared to our target range of 80-90 percent.

One of the very important steps we are taking to improve telephone service is to change the way we measure service and quality to better reflect the real world way that taxpayers receive it. These are more stringent, but also more useful ways, of measuring.

Concerning access, we have begun to measure the percentage of calls in which the taxpayer receives actual service, in relation to the percentage of time the taxpayer simply gains access to our system. In terms of call quality, we are now rating the quality of a sample of actual taxpayer calls and rating those who receive complete and accurate service, as well as technical tax law or account accuracy.

In order to deliver truly high quality communication to taxpayers, we need to improve the management, organization, technology and training that support these operations. This is a major objective of our overall modernization program.

Forms By Fax

Taxpayers can receive about 100 different tax forms 7 days-a-week, 24-hours-a-day from IRS TaxFax. In addition to forms and instructions, taxpayers can receive faxed copies of TeleTax topics and small business newsletters. Taxpayers use the voice unit of their fax machine to dial the service at 703-487-4160. The only cost to the taxpayer is the cost of the call.

Recorded Tax Information

TeleTax has 148 topics available 24 hours a day using a Touch-tone phone. Taxpayers can call (toll-free) 1-800-829-4477 to hear recorded information on tax subjects such as earned income credit, child care/elderly credit, dependents or other topics such as electronic filing, which form to use, or what to do if you cannot pay your taxes. Nearly nine million taxpayers used TeleTax last year for recorded tax information; as of May 8, 1999, over 9.5 million have taken advantage of the service.

Automated Refund Information

Last year more than 52 million taxpayers used the Automated Refund Information system on TeleTax to check on the issuance of their refund checks. As of May 8, 1999, the number stands at nearly 30.1 million. Taxpayers may call 1-800-829-4477 to check on their refund status Monday through Friday from 7 a.m. to 11:00 p.m. if using a Touch-Tone phone, or 7:30 a.m.— 5:30 p.m. for rotary or pulse service.

WALK-IN ASSISTANCE

Saturday Service

Delivering on its promise to supply even more reliable and helpful taxpayer assistance, the Internal Revenue Service provided Saturday walk-in service during the 1999 filing season on 13 Saturdays at nearly 262 locations nationwide, compared to six Saturdays in 178 locations in FY 1998. As of April 10, 1999, we served over 140,000 taxpayers on weekends. So far this filing season, we have served over 6 million taxpayers at all of our walk-in sites.

The Saturday Service sites were selected based on their weekend accessibility, year-round operational status, and high traffic volume, including 32 non-traditional locations, such as shopping malls, community centers and post offices.

On each of the Saturday Service Days, IRS employees provided taxpayers with the following services: (1) distribution of forms and publications; (2) answers to account and tax law inquiries; (3) verification of Individual Taxpayer Identification Number documentation; and (4) processing of alien clearances.

The first six Saturday sessions focused on assisting low-income taxpayers who may be eligible for the earned income tax credit (EITC). We assisted over 16,000 EITC taxpayers through April 10. 1999 compared with about 4,000 during the last filing season.

Problem Solving Days

Problem Solving Days continue to be a great success story on the problem resolution front. Begun in November 1997, over 50,000 taxpayers have taken advantage of this innovative program. Monthly Problem Solving Days are held at IRS District Offices and taxpayers can make an appointment to meet with IRS personnel to resolve special tax problems they have. In addition, many taxpayers who called to set up an appointment for a Problem Solving Day had their problems resolved over the phone, and never had to come in person.

Taxpayers comment that they like the opportunity for face-to-face contact and that they appreciate that someone is listening to them and trying to resolve their problem. Employees also respond favorably to Problem Solving Days. They especially like the multi-functional approach to problem solving which ensures that the taxpayer's problem can be heard by someone with the right set of skills to help resolve the issue.

Both taxpayers and employees recognize that not all of the issues coming in during PSD will be resolved in favor of the taxpayer. Audits must still be conducted, and IRS is not offering amnesty. Taxpayers do, however, appreciate the opportunity to sit down with someone to discuss the issue at hand and get a complete explanation of what needs to be done even if the result may be different from their expectations.

As I testified earlier this year at the Ways and Means Oversight subcommittee's hearing on the Taxpayer Advocate's Annual Report to Congress, the taxpayer advocates have built a lot of equity into Problem Solving Days and I want to see them continue, but more importantly, I want to build these practices into our everyday treatment of taxpayers. The taxpayer advocates can also help us solve the recurring, systemic and practical problems that plague the IRS. From their many meetings with taxpayers, including Problem Solving Days, they see trends and patterns emerging. If they help us diagnose these overarching taxpayer problems, the National Taxpayer Advocate and I will do our best to get the right prescription to cure them.

Volunteer Programs

During FY 1998, over 3.5 million taxpayers were assisted by more than 39,000 IRS Volunteer Income Tax Assistance volunteers and more than 32,000 Tax Counseling for the Elderly volunteers at a combined 16,500 sites. Last year, 2,400 VITA and TCE sites also provided *e-file* to over 400,000 taxpayers.

We also opened up VITA and TCE offices that were in locations close to our walk-in offices observing EITC awareness day. Our volunteer programs are set up in shopping centers, libraries, churches and community centers, This provided an additional avenue of support to taxpayers visiting an IRS office for EITC assistance.

In addition to this type of volunteer assistance, our outreach program targeted EITC education and assistance. We identified EITC coordinators in our offices who are responsible for the full complement of our EITC outreach activities. Through April 10, this program has reached nearly 141,000 EITC taxpayers through social workers, community organizations, homeless shelters and similar organizations.

The IRS Corporate Partnership Program

The IRS Corporate Partnership Program expanded dramatically; far beyond the initial goal of 500 companies and 600,000 employees. There are now more than 2,100 companies with more than 13 million potential employees in the program who can get forms through the corporation's Internet site or local LAN. The program has also grown by 210 members as a result of a sidebar 'link' on the IRS web site.

Forms Simplification Research

For the 1999 filing season, 11 new forms were developed and 177 forms and instructions and 39 publications were revised.

In 1998, the IRS conducted focus groups to obtain taxpayers' feedback on the new form and worksheets developed for the child tax credit. For the first time, we provided access to draft 1998 tax forms on the web site to obtain comments from practitioners and others about new and revised forms. In prior years, only paper copies of draft forms were published and distributed for comment. We have also added worksheets from publications to the web site. These worksheets supplement existing forms when an extra calculation is needed to compute a credit, exclusion, or a deduction.

During 1999, our tax forms and publications personnel are working with an outside contractor to redesign the earned income credit and child tax credit forms and instructions. As part of the project, focus groups were conducted using the current IRS products. After redesign, focus groups will be conducted to test taxpayers' reactions.

Also in development is a forms simplification research plan that will provide strategies for moving taxpayers to the simpler tax forms and for targeting where revisions are needed.

Tax Package Innovations

The 1998 Form 1040 tax packages were revised to provide more white space and increase the print size of the text for improved readability. Throughout Form 1040 packages, and on the covers, tax law changes for 1998 are highlighted, including the new child tax credit (generally $400 per child), the education credits, and the deduction for student loan interest. To protect taxpayers' privacy, their Social Security numbers are no longer preprinted on the peel-off label sent with the tax package. This change is highlighted on the covers, in the "What's new for 1998" section of the packages and on the front of the tax return by reminding taxpayers to enter their social security numbers on the return. We also moved information about other sources of assistance, such as Forms by Fax, near the front of the tax booklet.

For better customer service, other changes were made to the 1998 individual tax forms and packages. In case the IRS needs to contact the taxpayer while the return is being processed, there is an optional space for the taxpayer to enter a daytime telephone number. The tax packages also included more information about the Problem Resolution Program.

Newspaper Supplement Program

The Newspaper Supplement Program promotes distribution of IRS forms in selected areas that do not currently have sufficient outlets for tax products. There are currently 13 newspapers enrolled in the program with a circulation of 1.57 million readers. Each newspaper distributes six pre-selected tax items (Forms 1040, 1040EZ, 4868, Schedules EIC, A&B, and Publication 2053, Quick and Easy Access to IRS Tax Help and Forms) in one of their Sunday editions. The IRS will supply the newspapers with enough forms to satisfy one Sunday circulation. All participating newspapers distribute in one or more of the counties identified as needing additional tax form outlets.

Improved Business Practices Advance All Three Strategic Goals

- Increase electronic information exchange.
- Educate and assist taxpayers to avoid common errors.
- Leverage IRS resources with partnerships.
- Increase use of technology to identify and correct taxpayer errors.
- Provide IRS employees with accurate, up-to-date information on taxpayer accounts and applicable tax laws.
- Increase knowledge and understanding of taxpayer's business by IRS employees and managers.
- Develop voluntary agreements with taxpayers to address specialized issues.
- Make greater and faster use of knowledge gained in taxpayer cases to clarify tax law interpretation and requirements.
- Identify and resolve collection risks much faster.
- Carefully target enforcement actions to cases where risk of non-compliance is greatest.
- Develop integrated strategies for areas of high non-compliance.

(Joint Hearing ppt)

The IRS Mission Statement

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

GOALS

Service to Each Taxpayer

- Make filing and paying easier
- Provide top quality service to each taxpayer needing help
- Provide prompt, professional, helpful treatment in cases where additional taxes may be due
- Ensure taxpayer rights are observed

Service to All Taxpayers

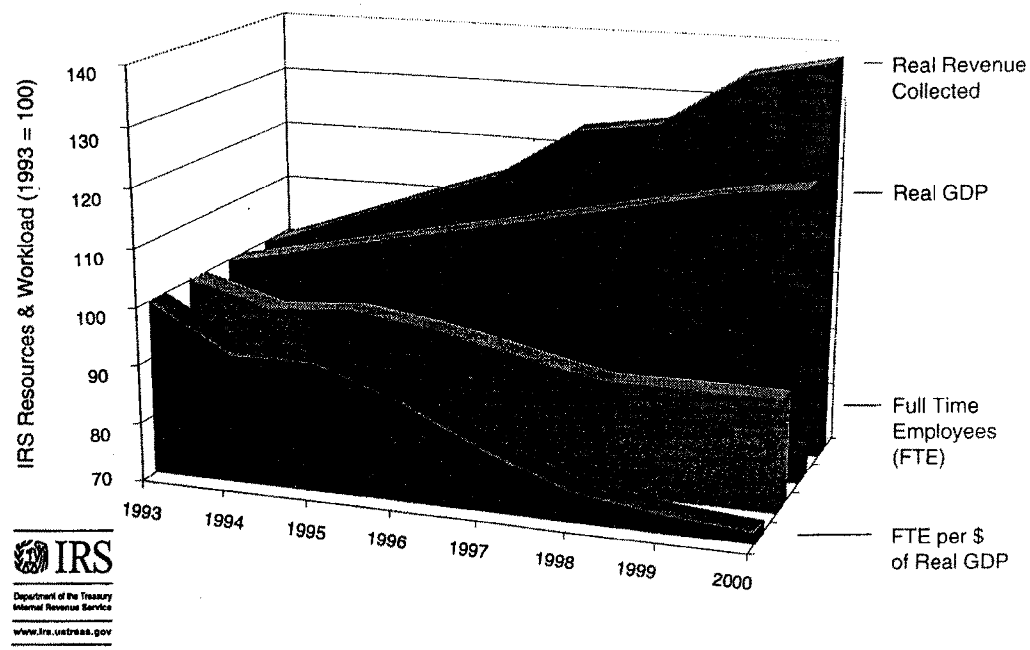
- Increase fairness of compliance
- Increase overall compliance

Productivity Through a Quality Work Environment

- Increase employee job satisfaction
- Hold agency employment stable while economy grows and service improves

IRS
Department of the Treasury
Internal Revenue Service
www.irs.ustreas.gov

IRS SHRINKS AS A FRACTION OF THE ECONOMY



Chairman ARCHER. I have just one question to ask you. Your organization, the IRS, is a very large organization with almost a hundred thousand employees. An effective management reform requires accountability at all levels across the country.

How can you ensure that changes that are directed from the top are actually implemented at all levels of your organization, particularly if there are any people who are resistant to change within the organization?

Mr. ROSSOTTI. Well, of course, this is part of what the change process is like in any large organization; and, I think anyone would say there is no single answer, no one answer to that question.

I will just tick off some of the things that I think are important. One is to make clear what direction the change is supposed to be in. I think this was part of the problem when I arrived. There was talk about change and there were recommendations coming in, but it was hard to act because it was not crystallized.

I think in articulating the goals and principles in our mission statement, we have communicated this very widely throughout the organization.

And, secondly, translate it into job performance, measurement, and appraisals. We are doing that for nearly every employee and certainly every executive and manager.

A third thing is to pick people at the top who can provide leadership. Through the provisions that you have enacted in the Restructuring and Reform Act, we have more flexibility to do that than we had before.

With me today are some of the members who have come in from the outside, as well as some members who have been willing to stay on and take on new responsibilities from the inside, to provide leadership at the top, and we are continuing that process.

The final point is that we are reorganizing. One of the main reasons for reorganizing is to have clearer accountability for actually delivering end-to-end results to a specific set of taxpayers and have a management team that can be held accountable. As it is now, responsibility is pretty fragmented because of the complex evolution of the IRS organization.

Having said all of that, I think those are pretty proven ways of doing as you suggest. I think that, notwithstanding all of those proven ways, it is going to take some time. I don't think that there is any quick solution. I think we have to sustain this activity over a period of years to succeed.

Chairman ARCHER. Thank you. Senator Grassley.

Senator GRASSLEY. Thank you very much for your statement and your good work. I have just two questions.

Enforcement collections may be down, as that has been the trend—my understanding for awhile, but what are the overall numbers for collections? Haven't collections of taxes increased substantially over the last year?

I could just as easily argue that new taxpayer protections have led people to increase their voluntary compliance so that you don't need as much enforcement.

Mr. ROSSOTTI. I don't have all of the numbers here with me, Senator, but certainly overall collections are growing and the enforcement part of that only represents 2 percent of the total amount. So I think the thrust of your statement is accurate.

I think what is important about what has been reported is that we do have to effectively target our enforcement in those places where it really is necessary, where there is deliberate noncompliance and where there are major compliance issues, because that is only fair to the rest of the people.

But I think that the kinds of practices that we have talked about here have the opportunity to allow us to do that by basically more carefully focusing our enforcement resources where there is a real hard-core need to do that and using other techniques to basically encourage, educate, or otherwise prompt and assist people who are willing to comply to do so. And that is what our whole balanced program is all about.

So, I guess my feeling is that I am one who believes that we can achieve all three goals. I don't believe that we have a choice to make between effective tax collection and proper treatment of taxpayers. I think our job is to reconcile all three of these objectives, and I believe that is quite possible to do.

Senator GRASSLEY. My last point would be to ask you in a summary sort of way to tell us what you are doing to make sure that the taxpayers bill of rights are fully implemented?

Mr. ROSSOTTI. Of course, there are over 70 provisions in the RRA that affected taxpayer rights and some are complex.

We have put, since the bill went into effect, a major amount of our resources and leadership into implementing each and every one of those provisions. One of the significant ways of doing this is through training, and we have already delivered in this fiscal year over 2½ million hours of training just on the Restructuring and Reform Act provisions.

Having said that, I will be honest with the committee. We have a great deal more to do. Some of the provisions, in particular, are very, very important; but they also are complex, such as the innocent-spouse provision which was mentioned by the Chairman in his opening remarks.

These provisions come from new and different methods of tax administration than have been used in the past, so we have a significant job of interpreting these provisions and then in training our employees.

We have identified 161 near-term priorities, things to implement in the next 12 to 18 months. More than half of them are items specifically related to implementing the taxpayer rights provisions. So we have made a significant amount of progress.

We have met statutory deadlines in all cases, but we have not fully trained all of our employees to a level that we are satisfied with. So for the remainder of this fiscal year and into the next fiscal year, this will remain a significant priority for all of us in the leadership in the agency.

Senator GRASSLEY. Thank you, Commissioner Rossotti and Mr. Chairman.

Chairman ARCHER. Mr. Portman.

Mr. PORTMAN. Commissioner, I want to commend you for your new mission statement, your goals, and business practices that are in front of us this morning.

I would like to talk about management and some other issues, but I think it is more important to focus on the collection and enforcement side because, in terms of your strategic direction, that is where I am hearing the most concern raised.

GAO commented that the effect of the diversion of resources from traditional collection activities may affect revenues. There have also been reports that collection activities have been reduced. You talked a little about that today.

We have seen some press accounts with regard to a provision of the Reform Act that was enacted last year that has to do with making IRS employees more accountable for their actions by, in essence, saying that they would be terminated for certain very egregious acts.

Press reports have said that IRS personnel are reluctant to engage in enforcement activities because of the fear of reprisal or termination of employment.

First, in general, how do you think changing the way the IRS deals with taxpayers has and will affect revenue going forward? If you can, give us some specifics in terms of the business practices. I look at the chart at improved collections, electronic information exchanges being improved, use of technology being improved, identifying problems earlier. I am giving you some suggestions and maybe some answers, but how do you think that revenues will be affected over time, and we will all be held accountable for this because we will know in a few years.

Secondly, if you can, respond regarding reports about the fear of reprisal or termination because of the Restructuring Act provisions. Do you think that is a widespread problem within the IRS? Do you think that enforcement is not at an appropriate level because of those provisions?

Mr. ROSSOTTI. Well, your question covers a lot of territory. Let me divide the answer into two parts. One is what has actually been happening, a clarification of that and what we can do about it.

When you look at what has been happening in terms of what is called the "traditional case-oriented enforcement," especially on the collections side, there are three things that have been affecting this.

One is simply the budget reductions and the fact that we have fewer staff and since the case-oriented activities are very personnel intensive, if you have fewer staff, you do less case-oriented enforcement actions.

The second thing is that there are significant additional uses of staff as a result of the backlog of old cases and the sort of deficit in customer service that had accumulated, as well as the new procedural provisions that we are implementing from the Restructuring and Reform Act.

For example, the due process and collections provisions, which are very important provisions, require a significant amount of manual intervention before you can take a collection action. In the initial period of implementation, that by itself would have reduced some of the collection activities. So you have those additional requirements.

And, then, third are the psychological factors you mentioned which certainly include the various investigations that we had internally related to misuse of enforcement statistics in the prior period, as well as the new provisions, such as section 1203, which is the one that I think you are referring to which imposes mandatory termination.

Those are issues that have certainly caused confusion and anxiety in our workforce which we need to work on allaying. I don't think that anyone in our workforce would probably dispute the fact that if someone is found guilty of some of these serious issues of misconduct they should suffer a penalty. The difficulty is clarifying what constitutes one of those offenses.

In terms of what we are doing about those three things, we have to divide what we do immediately and longer term. Immediately, we have to work on clarifying and implementing effectively some of the provisions of the RRA. But we have a lot more work to do to implement these provisions effectively.

For example, we have to do more training for our employees to explain how to implement these new taxpayer rights provisions and still operate efficiently. We have to do a better job clarifying what section 1203 means so people can understand what I believe is the intent of the Congress, which is that provisions are not intended to affect good employees who are doing their job in the normal course of events, but are intended only for serious issues of misconduct.

Those are things that we are all working on today and will have in effect in the near term. I also should note in terms of pure revenue effect, in the short term the reduction in collection—our collection actions this year represent about one-tenth of 1 percent of our total revenue collections. So it is not that it is unimportant, but it is not something that is having a major impact overall in terms of total collections in the near term.

Long term is what is most important. If we basically have two paths, we could try to go back to the old path of predominantly case-oriented and relatively slow intervention, which I think is not economical and probably would not be practical given the new provisions that are on the books, or we could try to do business in a more modern way which says basically we do everything that we can through technology and education and other means to head off problems and make taxpayers compliant on their own, which most taxpayers are willing to do, and then be much more effective in intervening quickly and on a very targeted basis where that is necessary.

That is basically the strategy that is behind this. That is not a quick thing to do because technology is a big part of it. Training and organization are a big part of it, but the modernization program is aimed at doing that.

None of this is rocket science. In business and in State tax agencies, some of my colleagues with me have done this in other venues. You can improve collections and improve service at the same time. You have to take enforcement actions in some cases. You have some taxpayers who are not compliant. We don't want to forgo that tool, but it needs to be done at the appropriate time in the appropriate way.

Chairman ARCHER. Senator Kerrey.

Senator KERREY. Thank you very much, Mr. Chairman. Commissioner Rossotti, can you talk about how your life is going to change under the law with an Oversight Board?

Mr. ROSSOTTI. Of course, I can only speculate a little bit because it is not here yet, but I think the predominant aspects of this Board that the authors such as yourself had in mind are going to be extremely valid. Specifically, the notion of having a relatively small, but experienced, group of people who will invest the time to understand in depth what all these different kinds of changes are all about, to challenge these proposals, to be a group that has some credibility to validate that these programs make sense, to help us explain the importance of the changes that we are making, and also, of course, to vet the budget on, hopefully, a multiyear basis.

I can't do this at the appropriation level yet, but at least internally we need to look at the changes on a multiyear basis. With the Board, I would anticipate that, based on the statutory responsibilities and just normal practice, they would look at us to come forward with some multiyear plans for our changes and what we expect to get in return for it.

So I view this Board as potentially a—just as a corporate board would be, as a group of experienced people who are willing to invest their time to understand, in some depth, the issues that face a given organization, to challenge the management to come forward with programs on a multiyear basis, and to solve those problems.

And, if they agree with them, to then be a supporter of those programs and explain to the broader public why those programs make sense.

Senator KERREY. Under the law and, in fact, prior to the enactment of the law, there was a great debate about how much authority to give this Board. We, for example, struck authorities in law enforcement, in tax policy, in the taxpayer advocate—originally the Board was to recommend three individuals to be the taxpayer advocate. In your case you were given new authorities as well as a 5-year term under law.

I appreciate very much that the President selected you and recommended you, but as a consequence of elections, you never know who the new Commissioner is going be. Now we do. Unless you decide to leave, we know that departure won't occur as a result of a political decision. And, as a result, it is easier for you to manage changes, the wrenching difficult changes.

But the Board also has considerable authority. It is not an advisory board. Dare I mention it, it has the authority to recommend your removal to the President. It has authority to review your budget, is directed under law to meet once a quarter, and it is supposed to select the chairman from the private individuals on the Board.

I say that because there is an urgency not just to get the Board over to the Senate and confirmed and appointed, but there is a reason we are anxious to get that Board, because it is difficult to implement the law without that Board there with its full authorities. The vision was that the Board was to establish a relationship between the Congress and the IRS.

It was to help increase Congressional confidence, especially with budgets, but also in other areas. There is this whole issue of compliance versus customer service. That is an issue that the Board is empowered to examine, although with some limits.

I wonder if you can act as the Board because you have given this testimony many times, eight times apparently, but if you were the Chairman of the Board, what would you tell this joint committee as far as the amount of money that has been recommended?

Are there going to be strains internally between the tremendous amount of retraining that has to occur with all of the structural changes and the increase in demand and the increased complexity of returns?

Can you—you said you think you can get the job done, but can you talk to us as if you were the Chairman of the Board about the strains that are going to be there with increased volume and increased complexity and increased training with a budget that is basically inflation adjusted and going to be a cut? I guess $8.1 billion is the President's request.

I am going to be anxious to hear what the Chairman and the Ranking Member have to say in that regard because it is going to be very difficult to carry the law out if you don't get the appropriate amount of resources.

Mr. ROSSOTTI. Yes. One of the things that boards do is to look very carefully at the investments that an organization is proposing to make and whether you are going to get a return and whether that makes strategic sense. We are precisely in a position where we need to make investment in technology and in training and reorganizing, and we are going to have to be making those requests for the investment money every year.

While the nature of an investment is that you put up the money now and you get the return later, I think one of the reasons that you have a board of experienced peopole is to take a close look at those kinds of proposals and say yes, we as a group believe that we should make these investments; that they will achieve appropriate returns in terms of meeting these goals; and that they are the best options that anyone can come up with, and we stand behind the idea that these should be made.

That was contemplated in the legislation and that makes sense to me, especially in a time like we are in now where we do have to make these investments. We know that the IRS has not been that successful in some periods in the past in putting that money to good use. It was understood that it needed to be done, but it didn't always pay off in the way that was expected.

So here is an opportunity to have a group of people who have nothing at stake other than their public service and who have a great deal of experience in terms of their prior life to take an objective look at it and say does it make sense or doesn't it make sense?

If they say it doesn't make sense, we won't do it. If they say that it makes sense, we can, hopefully, come to the Congress and to the public with greater assurance and say look, we have to do this. We have reviewed these and vetted them, and they think this makes sense. That is sort of what I see the process being once we get this process rolling.

Chairman ARCHER. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. Commissioner, if Congress for whatever reason was not to grant the $8 billion request that the President has made for Fiscal Year 2000, what programs would be unfunded or underfunded?

Mr. ROSSOTTI. As you know, it is already a very tight budget. I think there is nothing easy or obvious that you could defer or take out of the budget that I am aware of.

In reality, what would happen, I believe, is that we would have to make a choice between deferring the investments in technology and management, which are going to basically produce these returns that we need to have, or we would continue to do what we have been doing the last years, which is basically not to hire as people leave and reduce the workforce even more, thereby eroding the ability to conduct our daily activities.

So it isn't a choice that is a good one. And even with the funds that are requested in the budget, we will not really have everything that we would have liked to have had, obviously; but it would be at least enough to continue some hiring, to stabilize to some level the workforce, and to make some progress on the investments that we need to make. So the budget situation doesn't have a lot of flexibility in it, is what I think it comes down to.

Mr. COYNE. Thank you. What percentage of individual taxpayers file voluntarily without the need for any IRS enforcement action?

Mr. ROSSOTTI. Well, in terms of filing, virtually all file. But a better way to explain this is that about 98 percent of the money that comes in comes in without any direct intervention by us other than to provide information and assistance. So the enforcement-oriented activities account for about 2 percent of the revenue that is collected, slightly over 2 percent.

Mr. COYNE. So 98 percent of the money due to the IRS from individual taxpayers comes in without any enforcement procedure?

Mr. ROSSOTTI. About 98 percent of the money that is collected comes in without enforcement action.

Mr. COYNE. Thank you.

Chairman ARCHER. Mr. Kolbe.

Mr. KOLBE. Thank you, Mr. Chairman.

Commissioner Rossotti, let me ask you a couple of questions on specific things that I am interested in. I know during the current filing season you have had to reduce some of your activities in terms of getting Y2K compliance. And now that the tax filing season is over, I wonder if you can give us an update as to where you think you are on the testing and readiness for Y2K.

Mr. ROSSOTTI. Yes, I think that is one of the things that is pretty good news in terms of what we were able to achieve. As you pointed out, we were alerting people to the concern that because of all of the changes that had been made in the systems, we might have significant errors or problems during the tax filing season. We actually did not have very many at all which was a great milestone.

We have completed about 93 percent of the renovation work on the systems. We are just cleaning up some smaller pieces that need to be done and what is remaining is further testing and integration.

So beginning actually very soon, we will be beginning another version of our major test where we push the clock forward and test everything from front to back, and then we will be doing a final version of that in the fall beginning October 1.

I don't mean to say that there is still not a lot of work to do—there is—but I think we have passed some very important milestones, especially with the filing season. I think we can have reasonable confidence that we will be able to complete the remaining work on time.

Mr. KOLBE. You are reasonably confident then that you are going to be fully in compliance by January 1?

Mr. ROSSOTTI. Yes.

Mr. KOLBE. I am pleased to hear that report because if does represent a significant improvement over certainly a year ago and over some improvement in March when you appeared before our committee.

Let me ask you about the tax systems modernization. Obviously this ties into much of what has been talked about here. The technology investments are certainly critical for this. You alluded to this when you made mention of the fact that the IRS has not always been successful with its investments in the past. I think we can safely say it has been something of a disaster.

We have really blown somewhere around $4 billion to $5 billion in terms of integrating that into a complete system. I believe you are going to be coming and asking for the money that was appropriated last year; you are going to be asking for the first dollop of that to be spent. And I would like to know where you think we are in terms of the design, the architectural design, of the system, of a new system that you are working on?

Mr. ROSSOTTI. Yes. That is one of the most important and expensive things that needs to be done, and I think having now been here 18 months, I can say, looking at the IRS computer systems, that they truly are one of the real impediments to being able to provide the kind of service and compliance that we want.

We have very old systems, and they present, I think, an ongoing risk of being able to sustain our business. We absolutely need to do this, but it is a huge challenge, because it is so big and so old.

Now, where we are, I think, is that there are several important elements that need to be in place to make this program successful going forward. One is to have an overall architecture and set up some technology standards, how we are going to manage this program, which is something that didn't exist before.

That had been done before I got here. Before I got here, there was a good job of a technology blueprint that was laid out, technology standards and some high level outlines of what needed to be done.

A second thing that needed to be done is that internally we had to reorganize our information technology resources so they could be managed in a coherent and single way, and we did that beginning in October of last year.

We took all of these diverse pieces and put them organizationally under one individual, Mr. Cosgrave, who is here with me, which was the third major piece, recruiting a leader for this organization who had the experience to be able to manage such a huge operation. Mr. Cosgrave came in from the private sector with 25 years of experience and has brought a great deal of leadership to this.

The fourth one was, of course, to go out and engage the services of a private sector contractor, which we call a PRIME contractor, which we did through a competition. As you know, we selected Computer Sciences Corporation. They came on last December.

The final piece of this is to put in place a more detailed plan and a more detailed process for managing all of this which is what we have been working on. We had to get CSC on board to begin to do that, and we have done that.

We have been working on it for 6 months, and now we are just in the process of coming over to the Congress, as provided by the legislation, to ask for just the first set of money out of the information technology account.

We are asking for about $35 million, which will be for detailed planning of the first initiatives that we expect to launch. The first actual development projects that we hope to launch will be actually within the next few months, assuming that we get the funding released; and we will hopefully begin to get some of that implemented in the following calendar year, after the year 2000, before the 2001 filing season.

That will be oriented towards our taxpayer service, our communications, our telephone service, our Internet service with taxpayers. That will be our first project that we hope to begin to implement. That is kind of a broad outline.

By the end of September, we also hope to have an updated plan that will lay out for the next 3 to 5 years the major programs that we will be doing year by year. There will be many that fit into this overall architecture.

I think we have a very organized program. It is a very high-risk and challenging program, but I think we have put in all of the known things or are in the process of putting into place all of the known management techniques that need to be in place to make such a program successful.

Mr. KOLBE. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Forbes.

Mr. FORBES. Following up on Mr. Kolbe's question if I might, Mr. Rossotti—and I think the history is checkered, to be generous, three very critical GAO reports and Congress feeling the need both in fiscal year 1998 and again in fiscal year 1999 to lay out specific instructions to the IRS relative to IRS systems modernization.

I continue to join with many of my colleagues, Mr. Kolbe and others, to express grave, grave concern. Your summarizing of where the IRS is right now in correcting the ills of the past, I hold great hope in what you have laid out initially; but it is continuing to be troubling that almost a decade after the Congress authorized IRS to upgrade and modernize its information technology systems that we seem to be—maybe struggling isn't a fair word now, given what you just told Mr. Kolbe regarding where you are in improving the information systems.

But I don't think that it can be lost on this committee and the Members of Congress that this is a critical part, as you well know, of effecting the IRS's strategic plans and your reorganization plan in a very successful way.

So I would just suggest that I remain very, very concerned that we may be hearing a lot of well-intentioned efforts and plans laid out, but effecting those plans, I think, is very much a concern, I would venture to say, and I would hope that we are going to look favorably a year from now on the great progress that is made on the modernization system.

Please correct me if I'm wrong, but I can't help but think that this is just a critical piece of the restructuring and reform efforts that Congress has asked the IRS to undertake.

Mr. ROSSOTTI. Mr. Forbes, I can't disagree with anything that you have said. It is absolutely critical. I really don't think that you can administer the tax system of the United States in any kind of efficient or effective way over the long term with the computer systems that we have in place.

They really are not acceptable and not adequate in terms of efficiency and service, but also in terms of some of the things that I know Mr. Horn is interested in terms of controls and—financial controls. We just don't have systems that have those things built in to modern standards. It is absolutely true what you say.

Secondly, I can't disagree with the fact or the point that you made that it is a high-risk operation. I mean, it is something that has not been as successful in the past as it should have been. And even in the private sector, this kind of large-scale change coming from way behind to where we are is not an easy thing to do.

I will say this, that it is an important point from my personal point of view and I know that my colleagues that have come in to work on this feel the same way—that we are going to manage this program very, very closely on a project-by-project basis.

We have broad plans that we will come forward with because you need those to set priorities, but when it comes to going forward with any particular project, this will be divided up into many specific projects.

We have an executive steering committee, we have a program management office, and we have the PRIME contractor; and we insist on having a business case and a clear set of proposals for every phase of every project before we move forward, which is why, actually, we haven't even come before the Congress yet—we are now—but for the first 6 months that we had our PRIME contractor we did not come and ask for any of the money sitting out there in the account because we didn't feel that we were ready to say how we were going to manage this next phase. And now we are only coming forward with planning money for the next increment.

This does not guarantee that we won't make some mistakes and some projects won't go awry, because that happens in this kind of a business; but it won't be $4 billion and 5 years before we find out. That is probably one of the few things that we could guarantee.

Mr. FORBES. Thank you.

Chairman ARCHER. Mr. Hoyer.

Mr. HOYER. I would like to follow up with your comment on the 98 percent. What you meant by that, of the 100 percent collected, 98 percent is voluntarily submitted and not the result of enforcement efforts. Am I correct on that?

Mr. ROSSOTTI. Yes. It simply means of the total money that we actually collect, a little over 2 percent comes in from case-oriented actions like audits and collection. It is not the same thing as what would be collected if everybody paid every dollar.

Mr. HOYER. That is the follow-up that I wanted to get. Obviously, although the United States is probably better than any other nation, at least industrial nations in the world, we are—what portion now is paid of what is owed?

Mr. ROSSOTTI. That is the other number. If everybody paid everything that they should pay under the law, how much do we actually pay? Unfortunately, we don't have very reliable information because the last study done is 11 years old.

But the best number extrapolated from the old data says it is about 87 percent. I would not put a lot of faith in that number, Mr. Hoyer, because again it was based on studies that were done 11 years ago.

Again, the Joint Committee staff has done a good job in this report of explaining this problem. Apart from all of the other things that we need to do, we need better information and data. We need to rebuild our capital in that area as well as other areas by coming up with more effective analysis and studies of where noncompliance is and isn't, because these numbers are based on very old studies; and I don't think that—the extrapolations are so old, they are not very reliable.

Mr. HOYER. Clearly that would help us. Let me follow up on the enforcement issue. There was an article that occurred February 28, 1999, by Albert Crenshaw in which Mr. Kolbe, our Chairman, who has been very concerned about doing what the Commission found important, and that was providing the requisite resources to carry out the job—I thought that was a very useful contribution that the Commission made also—and it was incumbent upon the Congress not to change the rules every year so that there would be some continuity to the process.

But with respect to the enforcement side, there have been a number of questions there and we have talked about it, but Mr. Kolbe made a statement that nowhere in the mission was collection of taxes articulated, but we did articulate how we want to be fair to the taxpayer.

Mr. Kolbe made another observation. If you had a police department that all of the time after they made an arrest the person said I didn't do it, and they said, "oh, I am sorry", and left, we wouldn't have an effective law enforcement process.

If you extrapolate 3 to 1, 4 to 1 dollars spent for dollars collected, and we have cut enforcement both in FTEs and in terms of dollars available to them, what impact do you think that is having on collections?

Mr. ROSSOTTI. Could I just go back to one of your other points? There is nothing about our mission statement that says we are not going to be effective in collecting money because part of the mission statement——

Mr. HOYER. I was quoting Mr. Kolbe.

Mr. ROSSOTTI. I think it is a very valid point and that is why I made this chart and showed what is intended. If we administer the law fairly and effectively, we will collect the taxes because that is what it means to administer the law fairly and efficiently and part of that is applying enforcement resources where necessary.

We want to be sure that we use them effectively and target them where they need to be used and provide the right kind of encouragement and service to those who are trying to comply so we get that 98 percent up.

But as far as effect, clearly, if all you do is cut your resources as we have done here, and, as I mentioned in my opening statement, it mathematically follows if you reduce the number of revenue agents and increase the number of returns, you are going to reduce the number of audits. That is going to have some direct revenue effect.

I think the strategy that we need to follow, given that we do have limited resources, is to certainly not continue the shrinkage. I think that is what the budget proposal was. We cannot continue the shrinkage.

We have to have the staff. We cannot just continue reducing while the economy grows. But if we can stabilize the staff and make the investments in improved practices and improved technology, we will use our enforcement resources where they can do the most good, and we will use our other techniques to conserve those resources so they are only used where they need to be used.

I think that is basically the strategy that we are following and we can follow. If you talk about collections, for example, frankly we are not using our collection resources today very efficiently. Mr. Horn and I have talked about this at length.

Part of the reason—a big part of the reason is technology. But a big part is also old practices and old organizational structure. We are using about 90 percent of our collection-officer time and our phone-collection time on very old accounts, more than a year or two old in some cases.

It is not because the collection officers are doing something wrong. It is simply that the whole structure is set up that way. It has evolved that way over many years.

As we reform that process and begin to reorganize, we will be able to focus those resources where we can do both the taxpayer and ourselves more good by getting in there and resolving those issues quicker and getting the money quicker, reducing interest and penalties and conserving the amount of resources that we use.

This does require investments. We cannot just turn on a switch. We need better data about the taxpayers, and a different structure to manage this collection operation. This is just an example of how I think we can improve on all of our goals at the same time if we do it right.

Mr. HOYER. Mr. Chairman, I know my time has expired, but you had indicated getting the 98 percent figure up. My own view is, and one of the things our committee has discussed for a long time, particularly when we had significant budget deficits—and Chairman Archer will remember, certainly, in the 1980s where we had anywhere between $100 billion plus in uncollected revenues due to the Federal Government—if it is 87 percent, whatever that figure is, it seems to me that is the figure that we are really looking at getting up because that is revenue due under whatever tax rates that we have. The failure to pay, putting a greater burden on those who are paying.

Mr. ROSSOTTI. The only point there is that there is more than one way to do that. And some of the ways that we are doing it today are not particularly efficient, and that is what we can improve through this process.

Chairman ARCHER. Mr. Horn.

Mr. HORN. Thank you very much, Mr. Chairman and Commissioner. You are obviously clairvoyant as to what I would deal with here. Is there any further authorization that you need as the Commissioner and that the Internal Revenue Service needs in order to effectively use the authority that you have to collect the debts that are over a hundred billion dollars in one pile and 60 billion dollars or more in the other pile? Do you need anything else under law in order to do your job?

Mr. ROSSOTTI. Well, I think in terms of flexibility to rearrange things and to change the way that we do business, we really got a lot of that in the Restructuring and Reform Act.

What I think we need the most is sustained support in the form of investment funding, especially for technology over a period of years, but not only technology, also to retrain. The training is a smaller part of the money than the technology; but I think, as Senator Kerrey noted, it really is equally critical.

It doesn't do any good to have tools if the people don't know how to use them. We need to retrain—especially our collection officers, but really our whole workforce. They are the first ones to ask for this training. It is not that we are pushing this on them. They are saying give us the help that we need.

What I think we need more than changes in the law is support over a period of years, 3, 4 years, to go down this path, to stay on the course and to get the investment funds that we need which are mainly for technology, but not only for technology because the training and the management piece is also very important.

I think if we get that, the good news here is that we, especially in the collection area, can emulate practices that are proven elsewhere, both in State government and the private sector.

Mr. HORN. When I talked to one of your predecessors years ago, I said what about the use of private collectors, and I was told there are privacy laws. We can't do that.

I said, Wait a minute. All you have to do is give them the address and what they owe the IRS. If there is an argument on what they owe, obviously the IRS personnel ought to work with them on that.

It seems we have been missing a lot when we haven't used private collectors to collect these debts. What is your feeling on that?

Mr. ROSSOTTI. We have discussed this.

Mr. HORN. I would like this one on the record.

Mr. ROSSOTTI. In my previous role in business, we did a lot of work on collections, and we worked with a lot of private collection agencies, and at the right time there could be an opportunity to do that.

I have to say honestly right now we have much preparatory work to get our data organized. One of the things we found when we had an experiment was that the data is so poor that what you would turn over to a private collection agency, if you could get by the privacy laws, isn't going to make them very effective.

I think our first priority has to be to basically organize our information and organize our process. When we get that, I think there might be an opportunity to augment certain segments of collection with the private sector. I have done that previously, but today I would be hard pressed to do that.

Mr. HORN. Would you need authorization in order to use private collectors?

Mr. ROSSOTTI. I don't know. I would have to research that.

Mr. HORN. I would hope when you look at that you would seek the authority if you don't have the authority. You are being crippled. You can't do your job unless you have that additional arm.

One other aspect, bankruptcy laws. A lot of that debt I am told by various and sundry people are people that have gone into bankruptcy. Should some thought be given as to a pattern and practice over time where somebody takes a bankruptcy, has never paid a dime to the Internal Revenue Service, and what do you think? Is there any way you can get a strategy here to get them somewhere down the line? The rest of us pay our taxes, and to see those people getting away with this bothers the average citizen.

Mr. ROSSOTTI. I have to honestly say bankruptcy is a complicated area, and I wouldn't want to venture a comment because I don't honestly know enough—the interaction between bankruptcy law and the tax law gets to be pretty complicated. I would be glad to look into that and get back to you, but I don't feel that I can answer you right now.

Mr. HORN. I would appreciate if you could give some thinking to that.

The last point is interchangeability here of information between Federal agencies. For example, if one is seeking a Pell grant in this country, one of the major means of access to higher education, there is a needs test there.

What is the relationship between the Department of Education and IRS? Can they check your files at all to see if the person is really eligible, because I know one study was done a year ago or so that found here is a guy with a $100,000 who is in for a Pell grant when thousands are standing in line trying to get it.

Mr. ROSSOTTI. Again, this is a specific question and I hate to—I think there is some work going on in that area, but I don't think that we have an accurate answer. But I can get back to you specifically from the Department of Education.

Mr. HORN. Mr. Chairman, I would certainly like the answers at this point in the record.

Chairman ARCHER. Without objection, so ordered.

Mr. HORN. Thank you very much.

THE EFFECT OF SERIAL BANKRUPTCIES ON TAX COLLECTION

The Bankruptcy Code has few restrictions on the filing of successive bankruptcy cases, except that a debtor may not generally obtain a discharge of debts in a Chapter 7 (liquidation) case if the debtor previously obtained a discharge of debts in a bankruptcy case in the prior six years. A debtor may file a succession of Chapter 11 (business reorganization) or Chapter 13 (debt adjustment) cases without seeing any to completion. While a debtor's Chapter 11 or 13 case is pending, the Service is automatically stayed from attempting to collect any prepetition taxes the taxpayer might owe. But serial filings may do more than temporarily disrupt collection.

In the Bankruptcy Code, Congress gave a favored ("Priority") status to many prepetition unsecured tax debts over the prepetition unsecured debts a debtor may owe to other creditors. This priority status is generally given by the Bankruptcy Code to income taxes and to other taxes incurred in the three years preceding the taxpayer's bankruptcy petition. (Trust fund taxes and the trust fund recovery penalty, on the other hand, never lose their priority status under the Bankruptcy Code.) If the Service timely files its claim for priority taxes in a Chapter 11 or 13 case, the debtor is required to pay the priority tax claim in full under the debtor's confirmed plan. Priority taxes are also excepted from discharge. Congress intended that such taxes should be fully paid in bankruptcy or remain collectible from the debtor after bankruptcy.

Taxpayers are able to frustrate the Bankruptcy Code's priority and discharge scheme for taxes by filing successive bankruptcy cases. Income and other non-trust fund taxes entitled to priority status in a taxer's first case may "age" beyond priority status while the first case is pending. By dismissing the first case after taxes have aged sufficiently and then filing a second case in which the taxes are no longer entitled to priority treatment and are no longer excepted from discharge, the taxpayer may escape the obligation to fully pay the liabilities. Many courts have remarked on the abusive nature of this practice. *See, e.g., In re Waugh,* 109 F.3d 489, 493-94 (8th Cir. 1997). Noting that the statute of limitations on collection of a tax debt is suspended under the Internal Revenue Code while collection is prevented by a taxpayer's bankruptcy case, these courts have also suspended the Bankruptcy Code's tax priority and discharge exception periods. Other courts have not, in light of the absence of any express provision for doing so in the Bankruptcy Code.

In an August 28, 1996, letter to the National Bankruptcy Review Commission (NBRC), Chief Counsel proposed that the Bankruptcy Code be revised to clarify that priority tax periods are tolled while collection was prohibited during a prior bankruptcy case. This proposal was approved by the NBRC and is included (as to income taxes) in parallel sections of bankruptcy reform legislation that has been considered by the House and Senate in 1999—section 805 of H.R. 833 and section 705 of S. 625. While the administration has expressed reservations about several other provisions of the bankruptcy legislation being considered this year, the administration letters prepared by the Justice Department have generally supported these tolling provisions.

DISCLOSURE OF INFORMATION TO THE DEPARTMENT OF EDUCATION

The Internal Revenue Service can only disclose tax information to the Department of Education if such disclosure is authorized by I.R.C. § 6103. Section 6103 provides that tax information is to be kept confidential unless the taxpayer consents pursuant to section 6103(c) or disclosure is permitted by some other specific provision of the Internal Revenue Code. Under current law, two Code provisions specifically authorize disclosures to the Department of Education. They are I.R.C. §§ 6103(m)(4) and (l)(13). Under section 6103(m)(4), the IRS may provide the Department of Education, upon written request, the mailing address of taxpayers who owe an overpayment of Pell grants or who have defaulted on student loans administered by the Department of Education for the purpose of locating such taxpayers to collect such overpayment or loan. Under section 6103(l)(13), the IRS may provide the Department of Education, upon written request, certain tax information to carry out its Income Contingent Repayment Program. Theses two provisions do not address disclosures to determine eligibility for financial assistance.

The Higher Education Act Amendments of 1998 added a provision to Title 20 authorizing the Department of Education to confirm with the IRS four discrete items of tax information for the purpose of verifying information reported by applicants on student financial aid applications. This provision, however, did not amend the Internal Revenue Code, nor did it amend section 6103 of the Code, and thus does not operate as an exception to I.R.C. § 6103. Accordingly, there is no present disclosure authority which specifically authorizes the release of tax information to the Department of Education for the purpose of verifying the eligibility of applicants for Pell grants. The Department of Treasury and the IRS are, however, presently engaged in discussions with the Department of Education and the Office of Management and Budget regarding the use of section 6103(c) consents to accomplish this goal.

Chairman ARCHER. Mr. Commissioner, we would like to wind this up no later than 1:00, because I know that you have other things on your schedule. I would like to follow up, if I may, for just a moment or two.

You commented about taxes that are uncollected. Is there any way that you can develop a standard to have some degree of certainty as to what taxes are due that you are not collecting?

Mr. ROSSOTTI. Yes, there is. There was work done on this. There was work done in the 1980s. This is very important to do and can be done and needs to be done in order to help us guide our activities.

I wasn't here, but I understand there was some proposal made to do a study some years ago that was not favorably received by Congress because it was viewed as too burdensome on the taxpayers; and, therefore, that was put on the shelf and nothing has been proposed since then.

I believe it is one of the things that we need. Since I have been here, we have not yet come forward with a proposal on how to solve that, but I think we need to. In order to guide our enforcement activities and inform the Congress and the public and basically to just run the agency effectively, we do need to know what taxes are not collected and where, specifically, those areas of noncompliance are; and, frankly, we are flying blind because the last study was done in 1988.

I don't have a proposal to put on the table now, but over the next year, or perhaps somewhat longer, I believe it is an obligation that we have as an agency to come and propose a solution to that problem that will minimize that impact on taxpayers, but will still give us the information that we need.

Chairman ARCHER. So we may expect that coming from you sometime in the future?

Mr. ROSSOTTI. Yes.

Chairman ARCHER. I worry about that because there are so many gray areas in any income tax, and there are particularly massive gray areas in our income tax that I am not sure how you can ever have a standard with any degree of certainty as to what taxes are owed or not owed without taking an awful lot of cases to court to determine legally what is noncompliance.

And, in addition, I am worried going into the next century about your ability to adequately examine transactions that use, to a greater and greater degree, the smart card which can load up unlimited amounts of money on a computer chip, on a plastic card, and transfer it without trace anywhere in the world.

And that, frankly, is one of the reasons why I want to abolish the income tax and go to a consumption tax where there is a higher degree of certainty and you don't run into those kinds of problems. I don't know whether you have given any thought to that. I am curious as to what you believe might be done if you have given thought to it.

Mr. ROSSOTTI. We have given some thought, but we don't have a proposal to bring forward. There are gray areas, so any estimate you come up with is not going to be extraordinarily reliable; but it can be more reliable than what we have now, which is 11-year-old information.

In terms of the very things that many of the Members of the committee have been mentioning, we need to ensure that there is compliance, and at the same time do it with limited resources and provide good service to taxpayers.

The key to that is using your resources in areas where there is the highest chance of noncompliance. In other words, focusing on where it is going to be necessary and that is what you need information for that we don't have today.

For example, more than half of our audits of individual returns are selective. The decision to select a particular return for audit is done through a statistical formula which attempts to predict statistically what the probability of error is on that particular return. It doesn't mean that it is deliberate, just the probability of error in this return. This precedent is well established in the private sector.

The trouble is, in order to use it effectively, you have to refresh these models. You have to look constantly at what the different pattern of errors is. As tax law changes, you have to adjust for that.

Well, our scores are really based on that data that is over 11 years old, which is really a very unsatisfactory thing. So we need to go through some sort of a process to get this information, and it does require some burden on the taxpayers because you have to do some additional audits to get that information.

I hope in the next year or so we will come up with a proposal that is carefully thought out, how we can meet this need in the least burdensome way to taxpayers, because it is a requirement. GAO has noted it, as has the Joint Committee staff reporting here.

Chairman ARCHER. Thank you, Mr. Commissioner.

Does any other Member wish to inquire? Mr. Portman.

Mr. PORTMAN. Commissioner, this has been very helpful and I want to commend the staff of the Joint Committee on Taxation for putting together an excellent report that was also part of the statutory requirement.

I have one final question. We talked a lot about compliance today and enforcement issues. We talked about some of the taxpayer rights and information technology and some of the challenges that you face in your budget. You have undertaken an ambitious task here with the mission statement and goals and business practices.

I guess the one final thing that I would like to ask you, if you would share with this panel and for the record as you undertake these enormous challenges, what you see as the biggest risks involved in ensuring that this kind of fundamental change does, in fact, occur.

Mr. ROSSOTTI. Well, I think broadly speaking—there are a lot of very specific risks such as specific technology programs. But the biggest risk, the hardest thing is to basically, as I sometimes describe it, we are rebuilding the house as we are living in it.

We are trying to collect the taxes and administer the law and change the—adapt to changes in the law. At the same time, we are rebuilding and rethinking how we are doing this. And, I think Mr. Forbes noted it, frankly this does cause confusion. It causes confusion in our workforce.

It causes potential errors that occur, and I think as long as we can contain those within a reasonable range and we can continue to get support and understanding among especially the Members of our oversight committee, that we are managing these as best as we can, I think we will stay on the path and pick up steam as time goes on in our performance. But we clearly are in a transition period for the next couple of years.

I think this is actually one of the things that the Oversight Board was intended to help us deal with, is to have a group of people that would be looking at this very carefully, and as there are risks and issues that come up, also to help to deal with them, but also to reassure people that we are doing the right thing in our overall programs so we don't get derailed along the way.

I would summarize it by saying we are on a path, and I personally believe that if we get the investments and sustain this path, it will lead us to a better way of doing tax administration and compliance.

But there are ditches on both sides of the path, and we could fall off them on either side. We could get diverted because of budget reasons or crises that come up, because of lack of confidence that this program is going to work, many things like that. So I think if we can manage those risks and stay on this path, I think there is a good destination there at the end.

Mr. PORTMAN. Thank you very much. Let me tell you that I think the Board can help you construct the vehicle that will keep you out of the ditch. Getting the Board in at the ground level with these massive changes, as Senator Kerrey alluded to earlier, now is the time.

We are undergoing this tremendous transition, and they can provide you with the expertise and the continuity also beyond your 5-year term to be able to be sure that these changes are implemented.

Chairman ARCHER. Are there further questions?

Senator KERREY. I have an answer to a question that I asked earlier.

Chairman ARCHER. Wonderful.

Senator KERREY. Before I do, let me publicly say that we wouldn't be here today were it not for you making a decision to support and mark this bill up. The Speaker was supportive. Democratic leader Gephardt was supportive.

It was the House action that tipped this thing and gave us the momentum that we needed for legislation, and I very much appreciate your leadership.

Commissioner Rossotti, the answer to the question that I was asking earlier was next year when you have a budget submission, it is going to be different than this year, and that is, under the law the Board—you will submit a budget to the Board and whatever budget the Board approves, it will then be submitted to the Treasury Secretary, which will then go to the President.

And the President has to submit, unrevised, that budget to the Congress. He can submit his own budget in addition—he may submit the exact same budget, but we will have a comparison. We will have what the Board says is needed for the IRS as well as whatever makes its way through OMB, which we think is very, very important.

We want this independent board—which has 5-year terms just as you do—we want this independent board to be able to do its own independent analysis of what the budgetary needs are for the IRS. It should be an interesting year next year.

Chairman ARCHER. Mr. Hoyer.

Mr. HOYER. I think that will make the budget process even more interesting, Mr. Chairman. I will bet you they don't come in lower. I bet the Board will feel we need to invest more in the IRS and not less, and I think they will probably be right.

Mr. Rossotti, I want to again welcome you; and I want to thank the Chairman for his leadership in convening this joint review. I think if we had more joint hearings of this type we would be a lot more efficient and effective Congress; and very frankly, we would give to our managers a lot more time to manage and a lot less time to come up here and talk to all of us discretely as opposed to collectively.

Senator KERREY. If you would yield. An alternative is we can change the rules of the Senate and the House to give the authorizers the authority to appropriate as well.

Mr. HOYER. Or, we can change the rules to have the appropriators continue to do what they do best without having to involve themselves with the authorizers.

Chairman ARCHER. We may have slightly expanded this joint review beyond our purview.

Commissioner Rossotti, thank you very much. I think you have to feel very good about the bipartisan support that you have with the Members of Congress. We have great reliance and trust in you, and we wish you well; and we are open to any suggestions that you have as to how we need to improve any of the legislative aspects of this to permit you to do your job better. Thank you.

Mr. ROSSOTTI. Thank you very much, Mr. Chairman.

Chairman ARCHER. The committee will be adjourned.

[Whereupon, at 12:55 p.m., the committee was adjourned.]

SUBMISSIONS FOR THE RECORD

STATEMENT OF WILLIAM V. ROTH, JR.
Joint Review of the IRS
May 25, 1999

Thank you, Chairman Archer, for calling this joint hearing to review the IRS. I believe it is vitally important for the Congress to continue vigilant oversight over the Internal Revenue Service to ensure reform of the agency.

On April 14th, the Senate Finance Committee held an IRS oversight hearing where Commissioner Rossotti reported on the status of implementation of the Internal Revenue Service Restructuring and Reform Act of 1998.

The IRS is in the midst of much needed change as required by the new law. Commissioner Rossotti is in the process of reorganizing the IRS into functional divisions to replace the current geographic structure of the IRS. The new law provides additional accountability and oversight with the establishment of an Oversight Board, the creation of a new Treasury Inspector General for Tax Administration, a more independent National Taxpayer Advocate, as well as a more independent appeals function.

While the IRS is making progress, I am disappointed that the IRS Oversight Board nominees have not been submitted by the President to the Senate as required by law before January 22, 1999. Even though the names of some of the potential nominees have been leaked to the press, I question whether two of the potential nominees either have the statutorily required expertise or are truly committed to IRS reform. The Finance Committee will carefully examine each nominee's background and qualifications to ensure that members of the Board have the talent and experience to drive IRS reform.

I am pleased that the first Treasury Inspector General for Tax Administration is now in place to provide independent oversight over the agency.

During the Finance Committee's recent IRS oversight hearing, Commissioner Rossotti discussed how the IRS is implementing the new arsenal of taxpayer protections included in the new law. These include due process protections, expanded innocent spouse relief, examination and collection protections, as well as protections from unfair penalties and interest. To help the Commissioner reform the IRS and oversee this major changes, the law allows for additional personnel flexibilities to allow the Commissioner to hire and retain experts in their fields.

There is no question that the IRS restructuring bill was far-reaching and will take time to implement. One issue that must be discussed today is critical to ensuring success of IRS reform. Some within the agency and administration are reluctant to embrace reform as mandated by Congress, and may even be working against the reforms. This resistance concerns me.

Recent press reports, including last week's New York Times article, state various statistics indicating a drop in seizures of taxpayers' property and garnishment of wages and blame it on the law that requires IRS employees to be terminated if they violate certain provisions.

Unfortunately, taxpayer rights have been swept under the rug over the years to satisfy the Government's insatiable appetite for revenues. The new law, by its very terms, mandates sweeping changes at the IRS and in the substantive tax law including various provisions that bolster taxpayer rights. The new law attempts to ensure that the agency actually complies with the law that prohibits IRS employee performance from being measured based upon enforcement statistics. Measuring employees based upon enforcement statistics is a recipe for disaster.

The new law also provides taxpayers with due process and other rights that were lacking. It is important to understand that new due process rights might carry a one time drop in enforcement activity. The law requires the IRS to give taxpayer notice before it seizes property. While this time period runs, there can not be any enforcement activity under the new law and there in no enforcement activity under the old law because it is no longer in effect.

Moreover, the employees have not been taking certain actions because they have not received adequate training in what needs to be done. This does not indicate a problem with the law, but merely that the law is new.

I believe the IRS is capable of collecting the proper amount of tax while at the same time treating taxpayers fairly and with respect. Of course, tax protesters and others who refuse to pay their taxes should be treated accordingly.

Some critics of reform argue that the new mission statement focuses on taxpayer service and excludes any compliance component. I disagree. The new IRS mission statement says: Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Yes, the tax laws must be applied with integrity and fairness. Yes, the IRS must provide top quality service to help taxpayers understand and meet their tax responsibilities. Do we have a collection problem if taxpayers are meeting their tax responsibilities? Of course not.

I have also heard arguments that IRS employees can't do their job for fear of being fired for violating section 1203 of the IRS Reform Act. This is ludicrous.

Congress was concerned that IRS employees were not being punished for particular egregious behavior. Congress believed that IRS employees should be terminated if there is a final administrative or judicial determination that they engaged in the following egregious activity in their official capacities:

1. Wilful failure to obtain required approval to seize a taxpayer's home, personal belongings or business assets. Should IRS employees be able to get away with this behavior? I don't think so.

2. Committing perjury with respect to a material matter involving a taxpayer. Do you believe IRS employees should be able to get away with perjury to the detriment of a taxpayer? Of course not.

3. The violation of the constitutional or enumerated civil rights of a taxpayer, taxpayer's representative or other IRS employee. This conduct should not be tolerated.

4. Falsifying or destroying documents to conceal mistakes with respect to a taxpayer. Do you want to condone this behavior? I don't think so.

5. Assault or battery on a taxpayer, taxpayer representative or other employee or the IRS, but only if there is a criminal conviction or a final judgment by a court in a civil case. Should IRS employee engage in assault and battery of a taxpayer in the course of their official duties? Absolutely not.

6. Violation of the tax laws, Treasury regulations or IRS policies for the purpose of retaliation or harassment. We certainly do not condone retaliation.

7. Wilful misuse of the confidentiality provisions in the tax laws for the purpose of concealing information from Congress. Again, intolerable conduct should not be permitted.

8. Wilful failure to file a tax return on time (including extensions) unless such failure is due to reasonable cause and not willful neglect. IRS employees must be required to file tax returns like the rest of us.

9. Wilful understatement of Federal tax liability unless there is reasonable cause and not willful neglect. Should IRS employees who lie on their tax returns be able to keep their jobs? My view is absolutely not.

10. Threatening to audit a taxpayer for the purpose of extracting personal gain. Should IRS employees be able to keep their jobs if they engage in this type of activity in connection with their official capacities? I don't think so.

Which of these activities should we condone? I think none.

Let me be clear. There are those out there who don't want IRS reform. They want the status quo. I believe the service must change. And it will. But we must be diligent in prompting the reform.

The purpose of this hearing is to get all the oversight committees together to focus on the future of the IRS. IRS employees must have access to information, receive appropriate training, and be measured in a way that not only provides employees with job satisfaction but also ensures that taxpayers are treated fairly and appropriately. Taxpayers also need access to information. Modern technology is helping the IRS provide information via the Internet and other means.

If we really want change, we must provide Commissioner Rossotti with the resources to restructure the agency. Obviously, the tax writing committees may direct the agency in one direction or another, but that is meaningless without adequate resources to effectuate change. This joint review is a excellent way for the various oversight committees to hear the views of those who focus on different aspects of the IRS. We need to speak with one voice. Last year's restructuring bill passed with overwhelming bipartisan support. We must continue that level of support. The IRS can and will change. It can collect taxes and at the same time treat taxpayers fairly and with respect. To do this, the IRS needs our continued vigilance.

Questions submitted for the record by the Honorable Michael P. Forbes and the responses of the Honorable Charles O. Rossotti

Joint Committee on Taxation Hearing
Relating to the IRS as required by the IRS Reform and Restructuring Act
Questions for Internal Revenue Service Commissioner Rossotti

Brookhaven Service Center:

I have long advocated that employee job satisfaction and productivity are linked to a safe, healthy work environment. That was, in fact one of the reasons I pushed so hard over the last four years for the IRS to move forward with the long overdue renovation and modernization of the Brookhaven Service Center.

One of the principle reasons the Brookhaven project was delayed for so many years, however, was IRS' inability to decide how to best use the facility. Should it be a processing center or a customer service center? That debate appears to be resolved. But, I am very concerned that your reorganization plan could start that debate all over derailing the renovation yet again.

You have talked at various times at length about your organizational restructuring, creating divisions focused on individuals, small business, corporations and tax-exempt organizations. You have acknowledged that the impact of this new concept on the IRS workforce will be significant, requiring relocation of employees realigning of occupation and substantial retraining.

At this year's appropriations Committee hearing I ask you how Brookhaven Service Center fits into the new organizational scheme. For the record you indicated that the Service Centers will report either to the Wage and Investment Operating Division or the Small Business/Self-Employed Operating Division, but that no decision had yet been made as to which. Can you tell me today:

1) If that decision has been made? If so, what was the decision? If not, what is causing the delay and when do you anticipate finalizing that decision?

2) Given that under your new organizational structure each unit will be charged with start to finish responsibility for serving a particular group of taxpayers, should IRS decide to assign the 10 regional service centers to the Small Business/Self-Employed Operating Division, how will that impact walk-in assistance programs at Brookhaven, which is the closest IRS facility for thousands of people in Central Long Island.

Training Budget:

Commissioner, seventy (70) percent of IRS' 100,000 full time and seasonal employees deal directly with taxpayers. Clearly, training of IRS employees in tax proficiency and customer service has been deficient in recent years. Your Fiscal Year 2000 Budget requested $17 million for tax-related training and another $13 million for customer sensitivity training.

I ask you to comment at the Appropriations Committee for the record on how many hours of training will your budget allow. You indicated that the funds would result in an increase in the total training hours, but the number of hours received by individual employees will depend on the delivery method, and the average number of hours for each employee could not be determined until a decision had been reached on training methodology.

1) Have you decided on what training methodology you will employ, interactive videos or computer based training, or classroom instruction? If so, have you calculated the hours each employee would need to receive and the impact those training session will have on your ability to maintain employees in the field to ensure customer satisfaction?

As highlighted in the Joint Committee on Taxation's report (page 21), the GAO has commented that, "while the IRS initiatives related to reorganization, implementation of the IRS Reform Act, and training are critical if the IRS is to provide first-class customer service, the IRS has not provided sufficient information regarding how these elements of the budget request were determined to enable the GAO to determine whether the requested funding levels are reasonable."

1) Can you comment Commissioner on GAO's criticism and provide the committee a clearer understand of how you decided upon your funding requests for training?

Taxpayer Privacy:

Commissioner, one of the most grievous abuses highlighted at the 1997 IRS hearings involved IRS employees improperly searching through taxpayers confidential information. The IRS Reform Act included tough provisions to deal with this problem and you have said many times that you would not tolerate IRS workers who treat taxpayers abusively and would fire such workers as necessary. I think you will agree that improperly searching confidential information qualifies as treating taxpayers abusively. Can you tell me:

1) How many incidences of illegal taxpayer searches you have uncovered in the past twelve months and what has happened to those employees?

2) Also, what safeguards are you installing to ensure that confidential electronic information is not being improperly shared?

Brookhaven Service Center

At this year's appropriations Committee hearing I asked you how Brookhaven Service Center fits into the new organizational scheme. For the record you indicated that the Service Centers will report either to the Wage and Investment Operating Division or the Small Business/Self-Employed Operating Division, but that no decision had yet been made as to which. Can you tell me today:

1) If that decision has been made? If so, what was the decision? If not, what is causing the delay and when do you anticipate finalizing that decision?

Answer

Effective October 1, 1999, the IRS will divide each of the ten service centers into Submission Processing and Customer Service activities. This division will entail the establishment of separate Director positions for each of the activities, Submission Processing and Customer Service. The Brookhaven Service Center will be aligned with the Small Business/Self-Employed Operating Division.

2) Given that under your new organizational structure each unit will be charged with start to finish responsibility for serving a particular group of taxpayers, should IRS decide to assign the 10 regional service centers to the Small Business/Self-Employed Operation Division, how will that impact walk-in assistance programs at Brookhaven, which is the closest IRS facility for thousands of people in Central Long Island?

Answer

Construction that is required to address security concerns at the Brookhaven Service Center makes walk in assistance no longer feasible. Thus, walk in assistance currently provided at the Brookhaven Service Center will be closed on September 30, 1999.

Given that walk-in service no longer will be provided at Brookhaven, the Brooklyn District will provide face to face service. Brookhaven Service Center is three miles from the Brooklyn Post of Duty office at Hauppage, NY, and almost 23 miles from the Riverhead Post of Duty.

In January 1999, we began offering year round walk in assistance at Riverhead. Office hours are 8:00 a.m to 4:30 p.m. Since January, Riverhead assisted 3,601 taxpayers, including preparing returns for 405 people. Hauppauge has always had year round service and this year provided service to 24,043 taxpayers, including preparation of 2,040 returns. Both the Riverhead and Hauppauge offices provided electronic return preparation.

Brookhaven Service Center did not offer return preparation assistance. The vast majority of the taxpayer contacts to the service center concern notices and correspondence. To meet that need, we will provide a small facility at the visitors' parking area, which is some distance from the building. This facility will have a phone line giving direct access to the Customer Service Site. During filing season, we will have tax forms distribution via a forms rack that will be replenished at frequent intervals.

To supplement further our service to taxpayers in eastern Long Island for the next filing season, we plan Saturday and extended hours service for the Riverhead community. This service will be provided either in the Riverhead office or in a non-IRS location, such as a shopping mall, which proved very successful in another Long Island location this year.

The Service is committed to moving ahead with the renovation of the Brookhaven facility as quickly as possible now that the award for the offsite space is completed. Delivery of the swing space is now scheduled for mid-2000. Only then can renovation of the existing space begin. Renovation of the existing building is scheduled for completion by October 1, 2002.

Training Budget

1) Have you decided on what training methodology you will employ, interactive videos or computer based training, or classroom instruction? If so, have you calculated the hours each employee would need to receive and the impact those training sessions will have on your ability to maintain employees in the field to ensure customer satisfaction?

Answer

The funds requested to improve customer service through training will ensure that the Skills Proficiency Training needed by all employees is fully funded. In addition, training dollars will be available to support the customer service training curriculum. The number of hours of training an employee receives depends on the specific position and whether the employee is new to the position, working at the full journeyman level, or is undertaking advanced training. The FY 2000 funds will result in an increase in the total training hours, but the number of hours received by individual employees will depend on the delivery method. For example, we have found that training delivered by Interactive Video or through Computer Based Training frequently can be delivered in fewer hours than classroom training. When choosing a delivery method, our focus will be on delivering quality training in the most cost effective manner.

To ensure that sufficient staffing is available to meet customer needs, while also ensuring that employees receive the training they need to do their jobs, education staff and the operating functions work together to develop work plans and training plans. Where possible, we schedule training during slack periods and offer classes throughout the year to minimize impact on the business. Customer Service Training, in particular, is designed to be delivered at the end of the calendar year as the IRS is preparing for the filing season.

2) Can you comment Commissioner on GAO's criticism and provide the committee a clearer understanding of how you decided upon your funding requests for training?

Answer

The adjustment to the IRS training base was calculated by examining the unmet training needs for prior years and analyzing our capacity to develop and deliver training during the year. This represents our best estimate of technical training that will be needed, however, we believe there may still be some unmet training needs as the specific details of modernization are clarified. To help us more accurately predict training needs and distribute training funds where they are most needed, we will invest in Workforce Modeling that integrates workforce planning with training needs assessment. The model will enable the Service to project the skills needed to meet our objectives based on employees' occupations, their career paths and competencies, and, the business needs of the Service.

Taxpayer Privacy

1) How many incidences of illegal taxpayer searches have you uncovered in the past twelve months, and what happened to those employees?

Answer

The Central Adjudication Unit (CAU) receives all Treasury Inspector General for Tax Administration reports of investigation concerning potential unauthorized access to taxpayer information ("UNAX"). During the period from June 1998 through May 1999, the CAU received 217 reports of investigation. Action has been completed on 114 of those reports. Forty percent of employees involved resigned before action was complete, or were removed. Forty-three percent of employees were cleared, indicating that the results of the investigation show that there was no unauthorized access.

38 employees resigned before action on the report was complete
8 employees were removed
12 employees were suspended
2 employees were reprimanded
1 employee was admonished
1 employee received a caution letter
1 employee received written counseling

49 employees received clearance or closed without action letters
2 cases were not coded, meaning the information system does not indicate the final disposition

On August 5, 1997, the Taxpayer Browsing Protection Act was signed into law. That Act established a criminal penalty for unauthorized access. At that time, the IRS mounted a major effort to ensure that all employees understand the distinction between authorized and unauthorized access to taxpayer information. The IRS also established and publicized a policy that all substantiated unauthorized access cases will result in a proposal to remove the employee, absent mitigating factors. The data cited above includes unauthorized access incidents that occurred before the enactment of the Taxpayer Browsing Protection Act. Since these incidents occurred before the Act, penalties other than removal could be proposed.

Note: this data does not include cases received by the CAU prior to June 1998 that were acted on after that date.

2) Also, what safeguards are you installing to ensure that confidential electronic information is not being improperly shared?

Answer

Since 1997, the IRS has established an improved program to mitigate the unauthorized access and inspection of taxpayer information, which the Service refers to as UNAX. Subsequent to the 1997 IRS hearings, the Department of the Treasury and the IRS sent a report—entitled Controlling Unauthorized Employee Access to Taxpayer Records—to key Congressional Committees on actions being taken to control the unauthorized access and inspection of taxpayer records by IRS employees. This report reflected a study completed by the Internal Revenue Service (IRS) that focused on better addressing unauthorized access and inspection of taxpayer records. The study focused on a four-component solution, which deals with deterring, preventing, and detecting unauthorized access and inspection of taxpayer records, and with administering penalties for these violations. Following is a status report of the actions that have been taken.

Deterring UNAX

- Clarified the IRS' unauthorized access and inspection of taxpayer information (UNAX) policy.
- Negotiated an agreement with National Treasury Employees Union (NTEU) on the implementation of statutory requirements, and continue to work with NTEU to better communicate the IRS' policy on accessing taxpayer records to employees.
- Updated warning notices on computer screens used to access taxpayer records.
- Established a robust awareness program around a contractor-developed theme to "Stop UNAX in its Tracks" which included replacing the term "browsing" with "UNAX" to represent the willful unauthorized access or inspection of taxpayer records.
- Implemented annual agency-wide awareness briefings to inform all IRS employees of the policy and penalties for UNAX starting in 1998.
- Developed UNAX videos and guides for 1998 and 1999 awareness briefings to ensure that managers delivered consistent "Stop UNAX in its Tracks" briefings to all employees.
- Implemented the use of a UNAX certification form that is signed by all employees and their managers to acknowledge attendance at the awareness briefing and receipt of the guides.
- Established a Steering Committee and support team to address UNAX questions and issues raised by managers and employees.
- Established a hotline to answer questions related to the UNAX program.
- Posted questions, issues, and answers on the UNAX bulletin board.

- Completed training modules for courses provided to employees who access taxpayer records as part of their official duties—as of January 1999, over 43,000 employees had received this additional training, which augments the annual awareness briefings to all IRS employees.
- Distributed correspondence and posters to remind employees agency-wide of their responsibility for safeguarding the privacy of taxpayer information.

Preventing UNAX

- Required managers to certify their employees' access rights on the IRS' primary taxpayer information system, and initiated quarterly reviews to frequently align users actual work with their access rights.
- Improved user identification, passwords, and systems file controls on various systems.
- Worked on streamlining the background investigation process. For example, the IRS is working on a pilot with the FBI to electronically check fingerprints.

Detecting UNAX

- Established a consistent and fair investigative process to develop UNAX cases in the Centralized Case Development Center, which is operated by the Treasury Inspector General for Tax Administration (TIGTA). In this regard, TIGTA investigates all allegations of UNAX and, where appropriate, provides the U.S. Attorney and the IRS' Central Adjudication Unit with a formal Report of Investigation.
- Centralized the audit trail analysis system in Information Systems and improved the system's detection capabilities for use by TIGTA's Centralized Case Development Center.

Administering Penalties

- Established a policy that any substantiated UNAX violation requires a proposal for removal.
- Centralized key functions for establishing consistent, timely, and fair processes which are focused on developing UNAX cases, deciding on the adequacy of evidence, tracking and reporting cases, administering penalties, and overseeing the UNAX program.
  - Established the Centralized Adjudication Unit in Labor Relations for tracking, reporting, and coordinating all administrative requirements for UNAX cases to ensure consistent application of policy.
  - Established a central point within the National Office of Chief Counsel to assist the Centralized Adjudication Unit and field counsel in addressing actions regarding unauthorized accesses.
  - Centralized management oversight of the UNAX program in the Office of Systems Standards and Evaluation.

In the longer run modernizing the IRS' systems will allow the IRS to better prevent and detect the unauthorized access and inspection of taxpayer information. This is planned to include (a) expert systems logic that will allow employees to access taxpayer information only if and when they have specific work-related reasons to do so, and (b) data mining techniques to actively uncover suspicious patterns of behavior.

APPENDIX

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

Prepared for the

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

For a Joint Review
Scheduled on May 25, 1999

By the Staff

of the

JOINT COMMITTEE ON TAXATION

May 20, 1999
JCX-24-99

INTRODUCTION

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

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

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

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

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

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

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

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

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

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

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

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

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

A. Overview of IRS's Strategic Goals

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

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

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

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

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

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[7] IRS Reform Act sec. 1002.

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

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

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

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

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

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

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

B. Revision of IRS Business Practices

In general

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

Preventing taxpayer problems or addressing them as early as possible

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

Improving communications with taxpayers

In general

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

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

[11] *Id.* at 17.

[12] *Id.*

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

The Internet and the World Wide Web

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

CD-ROM

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

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[13] *Id.*

[14] *Id.* at 18.

[15] *Id.*

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

[17] *Id.* at 9.

[18] *Id.*

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

<u>TAXI On-Line Learning Lab</u>

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

<u>IRS Local News Net</u>

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

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

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

[21] *Id.*

[22] *Id.* at 10.

[23] *Id.*

Expanding taxpayer rights

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

Broadening the use of electronic tax administration

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

Leveraging IRS resources through effective partnerships

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

Tailoring practices and strategies based on specific taxpayer needs and problems

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

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

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

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

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

Applying risk-based compliance intervention techniques

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

Integrating compliance strategies

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

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

[28] *Id.* at 23.

[29] *Id.*

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

__Management of customer service initiatives__

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

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

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

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

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

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

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

C. IRS Reorganization and Management

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

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

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

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

[35] IRS Reform Act sec. 1001.

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

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

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

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

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

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

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

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

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

[42] *Id.*

[43] *Id.*

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

The reorganization is being staged in phases:[45]

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

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

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

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

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[44] *Id.*

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

[46] *Id.*

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

D. Development of Organizational Performance Measures

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

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

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

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

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

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

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

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

E. Technology Modernization

Year 2000 compliance

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

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

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

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

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

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

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

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

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

Systems modernization

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

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

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

[57] *Id.* at 3.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

F. IRS Budget Request for Fiscal Year 2000

In general

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

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

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

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

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

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

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

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

Funding to maintain current service levels

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

Organizational modernization; implementation of IRS Reform Act; training

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[79] *Id.*

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

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

Year 2000 compliance

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

Information technology

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

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

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[81] *Id.* at 5.

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

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

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

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

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

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

General discussion of IRS budget request

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

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

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

[86] *Id.* at 33.

[87] *Id.* at 38-40.

[88] *Id.* at 40.

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

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

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

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

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

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

II. THE 1999 TAX FILING SEASON

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

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

A. Electronic Tax Administration

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

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

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

[94] *Id.*

[95] *Id.*

[96] *Id.*

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

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

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

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

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[97] *Id.* at 6.

[98] *Id.*

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

[100] *Id.* at 7.

[101] *Id.*

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

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

B. Providing Information and Service to Taxpayers

<u>**Walk-in assistance**</u>

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

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

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

[103] *Id.*

[104] *Id.* at 12.

[105] *Id.*

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

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

Telephone communication

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

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

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

[107] *Id.*

[108] *Id.* at 13.

[109] *Id.* at 10.

[110] *Id.*

[111] *Id.* at 11.

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

Other taxpayer services

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

Forms

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

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

C. 1999 Revenue Protection Strategy

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

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

[114] *Id.* at 14.

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

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

[117] *Id.*

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

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

D. GAO Review of the 1999 Filing Season

In general

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

Decline in telephone service

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

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[118] *Id.* at 16.

[119] *Id.* at 17.

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

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

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

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

Electronic filing

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

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

Errors in calculating the child tax credit

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

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

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

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

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

IRS's computer systems

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

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

[125] GAO Report 99-140 at 50.

III. OTHER MATTERS ADDRESSED BY THE IRS REFORM ACT

A. Establishment of IRS Oversight Board

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

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

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

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

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

[127] Conference Report at 203-204.

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

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

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

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

B. Establishment of Independent National Taxpayer Advocate

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

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

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[129] Code sec. 7802(b).

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

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

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

The Office of the Taxpayer Advocate has four principal functions:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Implementation efforts

Taxpayer Advocate activity report

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

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

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

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

GAO testimony: challenges facing the NTA

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

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

[140] NTA Report at 12.

[141] *Id.* at 74.

[142] *Id.* at 85.

[143] *Id.* at 3.

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

Staffing and operational issues

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

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

Use of advocacy

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

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

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

[145] *Id.* at 6.

[146] *Id.*

[147] *Id.* at 7.

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

Effectiveness measures

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

C. Treasury Inspector General For Tax Administration

Background and provisions of the IRS Reform Act

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

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

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

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

[149] Conference Report at 220.

[150] *Id.*

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

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

Implementation efforts

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

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

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

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

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

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

D. Personnel Flexibility

IRS Reform Act

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

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

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

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

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

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

[156] CRS Report, at CRS-2.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(B) any civil right established under-

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

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

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

(iv) the Age Discrimination Act of 1975;

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

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

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

(continued...)

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

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

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

Implementation efforts

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

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

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[159](...continued)

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

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

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

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

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

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

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

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

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[160] FY 2000 Justification at SD-19.

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

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

[163] *Id.*