

**JOINT REVIEW OF THE STRATEGIC PLANS AND BUDGET OF THE INTERNAL  
REVENUE SERVICE, 2000**

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HEARING  
before the  
Committee on Finance  
Committee on Appropriations  
Committee on Governmental Affairs  
UNITED STATES SENATE  
and the  
Committee on Ways and Means  
Committee on Appropriations  
Committee on Government Reform  
HOUSE OF REPRESENTATIVES

One Hundred Sixth Congress  
Second Session

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May 3, 2000  
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**JCS-4-00**



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**CONTENTS**

**Page**

Press Releases of April 11 and 19, 2000, announcing joint review.....

Opening Statements .....

**WITNESSES**

Internal Revenue Service, Hon. Charles O. Rossotti, Commissioner.....

Department of the Treasury, Hon. David C. Williams, Treasury Inspector  
General for Tax Administration.....

Internal Revenue Service, Mr. W. Val Oveson, National Taxpayer Advocate .....

General Accounting Office, Mr. James R. White, Director—Tax Policy and  
Administration Issues.....

**JOINT REVIEW OF THE INTERNAL REVENUE SERVICE, 2000**

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WEDNESDAY, MAY 3, 2000

The joint review met, pursuant to notice, at 9:30 a.m. in room 215 Dirksen Senate Office Building, Senator Charles E. Grassley, presiding.

[The press releases announcing the hearing follows:]

# JOINT COMMITTEE ON TAXATION

## PRESS RELEASE

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JCT Press Release: 00-03

For Immediate Release: April 11, 2000

For Further Information, Contact: Michael Boren (202-225-3621)

(Michael.Boren@Mail.House.Gov)

The Internal Revenue Service Restructuring and Reform Act of 1998 (the **IRS Reform Act**) requires the chairman 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 before June 1 of calendar years 1999 through 2003. 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, Senator William V. Roth, Jr., Chairman, Joint Committee on Taxation, has scheduled a joint review of the IRS strategic plans and fiscal year 2001 budget for **Wednesday, May 3, 2000, at 10:00 a.m. in room 215 of the Dirksen Senate Office Building**. Witnesses will be announced at a later date. The joint review will be open to the public.

# JOINT COMMITTEE ON TAXATION

## PRESS RELEASE

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JCT Press Release: 00-04

For Immediate Release: April 19, 2000

For Further Information, Contact: Michael Boren (202-225-3621)

(Michael.Boren@Mail.House.Gov)

### JOINT REVIEW OF INTERNAL REVENUE SERVICE ANNOUNCEMENT OF WITNESS LIST AND TIME CHANGE

The joint review of the strategic plans and fiscal year 2001 budget of the Internal Revenue Service will be held on Wednesday, May 3, 2000, in room 215 of the Dirksen Senate Office Building beginning at **9:30 am**.

#### Witness List

##### A Panel Consisting of:

The Honorable Charles O. Rossotti, Commissioner of Internal Revenue,  
Washington, D.C.

##### A Panel Consisting of:

The Honorable David C. Williams, Treasury Inspector General for Tax  
Administration, Washington, D.C.

Mr. W. Val Oveson, National Taxpayer Advocate, Internal Revenue Service,  
Washington, D.C.

Mr. James R. White, Director, Tax Policy and Administration Issues, United States  
General Accounting Office, Washington, D.C.

**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**

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WEDNESDAY, MAY 3, 2000

United States Senate  
U.S. House of Representatives,  
Joint Committee on Taxation  
*Washington, DC.*

The joint review was convened, pursuant to notice, at 9:37 a.m., Senator Charles E. Grassley presiding.

Senators present: Hatch, Kerrey, and Dorgan.

Representatives present: Houghton, Portman, Coyne, Northup, Sununu, Hoyer, and Horn.

**OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR  
FROM IOWA**

Senator GRASSLEY. Good morning, everybody. Thank you for your attention to our statutory responsibility of having this annual joint review of the IRS through our carrying out the responsibilities of the reform legislation that recently passed.

So, on behalf of Senator Roth, I want to thank everyone for attending this very important joint review of the Internal Revenue Service. This is the second time we have held a joint review of the Internal Revenue Service.

As many of you know, I was a member of the IRS Restructuring Commission which was ably co-chaired by Senator Kerrey of Nebraska and Congressman Portman of Ohio. The Commission found that the various congressional committees represented here today focus on different issues that change from year to year.

This creates a sort of lack of coordinated focus on the highest level in strategic matters of the IRS, and blurs the ability of the IRS to set a strategic direction and focus on priorities as law would require. Hence, the joint congressional oversight that we have legislated.

So we alleviate this situation through the IRS Restructuring Act mandating this joint review 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 of Finance, Appropriations, and Governmental Affairs.

In accordance with the intent of the IRS Restructuring Act, the joint review will focus on the long-term objectives and strategic plans of the Internal Revenue Service, the steps that have been and will be taken to achieve those objectives and plans, and whether the IRS budget supports those objectives and plans.

While this joint review is intended to help provide coordinated oversight, I must say that I am disappointed that the IRS Oversight Board nominees that were promptly reported out of the Finance Committee have not been confirmed by the Senate, due, of course, to unrelated issues, as so often happens in the Senate.

The Oversight Board will provide Commissioner Rossotti with continuity and important strategic planning. I hope the nominees are cleared soon so that they may begin immediately doing their very important task.

In the past two years since the IRS Restructuring law was enacted, several press accounts have alleged that the law went too far and the IRS is now prohibited from enforcing the law and collecting taxes.

I believe I can speak for Senator Roth, and I can surely speak for myself, that we strongly disagree. The law constituted one of the largest and most significant government reform efforts in history.

While the IRS is in the throes of this enormous restructuring, we obviously know that it still must collect taxes. However, like the private sector, the agency must provide better service with a focus on efficiency and fairness. Taxpayers must be treated fairly and with due process.

However, taxpayers are still required to pay their taxes that are due. Despite Commissioner Rossotti's great efforts and substantial achievements, we all know the IRS continues to have serious challenges. IRS employees need to be retrained in the new law.

Egregious practices of the past still continue, including the illegal use of enforcement statistics, which may result in the violation of taxpayers' rights. We heard testimony at the Finance Committee hearing in February that over 46,000 innocent spouse claims had yet to be resolved.

In addition, we were greatly concerned to learn that the use of liens and levies had plummeted last year, yet the IRS does not necessarily follow the law or its own procedures a third of the time when it actually files a lien or seizes property.

Also, there is confusion as to how the IRS is interpreting portions of the law, which has made it more difficult to collect taxes owed. These conditions must be changed. We also have heard concerns about IRS funding and its computer modernization efforts.

It is imperative that the IRS be reformed and modernized. We must provide appropriate funding for the IRS, as well as appropriate oversight to ensure that the agency has a strategic plan and does not stray while implementing that plan.

Funding is part of the answer, but, as with most things, just throwing money at a problem will not fix it. I am still hearing from IRS personnel on the ground that money is being wasted and used inefficiently.

Before supporting increased funding, Congress needs to be assured that money is currently being spent as wisely as possible. It is our responsibility, as Members of Congress who hear these things, to point them out in whatever way that the Commissioner would like to have them pointed out.

Today we will hear from Commissioner Rossotti and a panel consisting of David Williams, the Treasury Inspector General for Tax Administration; Val Oveson, the National Taxpayer Advocate; and James White, Director of Tax Policy and Administration Issues at the General Accounting Office. I look forward to their testimony.

Now it is my pleasure to call upon the Congressman from New York.

**OPENING STATEMENT OF HON. AMO HOUGHTON, A U.S. REPRESENTATIVE  
FROM NEW YORK**

Mr. HOUGHTON. Thank you very much, Mr. Chairman. It is always a pleasure to be with you. It is nice to be with you in this review of the strategic plans of the IRS.

A recurring theme, as we have seen in analyzing the operations of the IRS, is the role of new technology, enabling it to better serve the taxpayers. The IRS has long recognized the shortcomings of its computer system.

So, after years of false starts and slow progress, I believe the IRS has learned from its past mistakes. It has embarked on a new approach to computer modernization by retaining a PRIME contractor from the private sector to help design and integrate its new computer system.

But where does the program currently stand? Also, what milestone should we look for over the next 18 months in order to evaluate whether or not this program is on track? Also, how much resources will it require?

The IRS did a great job in terms of the Y2K problem. The effort was successful because the business side of the IRS's operations worked very closely with the information technology side. Hopefully, this will set a pattern for future success in computer modernization.

Mr. Chairman, I am delighted to be here with my associates. I trust that our joint oversight and support will help make this program a success.

Senator GRASSLEY. My list has Senator Kerrey next, then Congressman Portman, Congressman Coyne, Congressman Sununu, and Congressman Horn.

**OPENING STATEMENT OF THE HON. J. ROBERT KERREY, A U.S. SENATOR  
FROM NEBRASKA**

Senator KERREY. Thank you very much, Mr. Chairman.

First of all, it is nice to see Charles Rossotti again. It has been nearly two years since the IRS Restructuring and Reform Act of 1998 was signed into law. I have deep regret, because I think it creates an awful lot of difficulty for Congress in evaluating the work that you are doing; indeed, I think it creates a great deal of difficulty in you accomplishing your mission, that we still, after two years, do not have the very important IRS Oversight Board in place.

First, the delay came about as a consequence of the administration being late in getting the names up, and now it is being held up in the Senate. It is quite unfortunate, in my view, because it makes it very difficult for us to evaluate many of the reports we are hearing about the 1998 Act.

The GAO tells us that the number of seizures by the IRS has declined by 98 percent, from 10,000 annually for 1990 to 1997, to about 200 in 1999. We were either seizing too much from 1990 to 1997 or we are seizing too little now, and it is extremely difficult to evaluate that.

I am sure you have made an evaluation and will talk about that today, but it is an example of the sort of thing that the IRS Board is supposed to be able to assist you in doing so that you are not bouncing around back and forth between one committee and another explaining every single thing in a reactive way.

There are many examples, unfortunately, of situations that have been brought to my attention over the last two years of people saying, --A I think the law created a problem, it did not solve a problem, what do you think,@- or urge me to support some additional budgetary resources, or urge me to take action on a technology plan in one way, shape, or another.

The Board is supposed to provide you, Mr. Rossotti-- and I am preaching to the choir here--with a resource that enables you to not only have an independent voice in dealing with the administration, but also an independent voice in dealing with Congress.

Unfortunately, if we are not happy with you, oftentimes what we do is merely take it out on your budget or take it out in some other way that may end up being counterproductive.

This Board is not the typical advisory board. It is a board with a considerable amount of power and authority under statute and it is quite unfortunate--in many ways, indicative--of why we have trouble with the IRS. The IRS sort of gets caught in between, sometimes, congressional neglect and administrative neglect, and, as a consequence, the taxpayers are the ones that suffer.

The reason, in the first place, that we spent a great deal of time with the IRS Commission and recommended all these changes, is the IRS is a very unique agency and has a mission that contributes enormously to the confidence of the citizens of the United States of America that their government is working for them.

As the IRS Commissioner noted, voluntary compliance over the last 15 to 20 years has been dropping. This raised a great deal of concern on Congress' part that something needed to be changed in order to stabilize what appeared to be a declining confidence that the IRS was an agency working for the people.

You have got a difficult mission in that you have both a service mission and a law enforcement mission to carry out, but the IRS does a lot more than just efficiently collect taxes. It strikes at the heart of our capacity to continue to govern ourselves with the people's confidence that it still is a government of, by, and for the people.

So, Mr. Chairman, I appreciate the hearing and look forward to the testimony of Mr. Rossotti.

Senator GRASSLEY. Thank you, Senator Kerrey. Now, Congressman Portman.

#### **OPENING STATEMENT OF HON. ROB PORTMAN, A U.S. REPRESENTATIVE FROM OHIO**

Mr. PORTMAN. Mr. Chairman, thanks very much. Thank you for convening this very important joint review.

As you noted earlier, this comes right out of the IRS Commission's work and out of the Restructuring and Reform Act. The notion is that we have all six of the committees that deal with the IRS come together, talk together, and communicate better together.

We also have the Joint Tax Committee here with us, a very important part of the oversight responsibility, so really seven committees to better coordinate the strategic plan and budget of the IRS. This is part of our responsibility on the Hill, at this end of Pennsylvania Avenue, to do a better job of, in this case, oversight of the IRS.

I want to commend Commissioner Rossotti for his good work and for staying true to the vision that was laid out in the Commission's report, and in the Restructuring and Reform Act.

I think, since becoming the Commissioner nearly two and a half years ago now, Commissioner Rossotti has done a good job in putting together a good group of top executives.

He has now hired the PRIME contractor, finally, to modernize the technology--and I think that is a very helpful step forward--and steered the agency, I think, very well through the Y2K crisis and had a good filing season. I want to, again, commend him for that.

I think, also, that the Commissioner has laid out a blueprint for a reform of the IRS that is a credible outline and that is very important. I think it is time to go to the next level, though. I think that is what Senator Kerrey, my co-chairman of the Commission, is referring to.

I think that is really the next challenge that we have. We are now entering what I view as a new and, I think, very risky stage of this experiment. If we do not succeed, we are going to have consequences for every taxpayer which are very serious.

I think the next two years are critical for the IRS to move beyond just the plans and blueprints that we have and begin to put together a very detailed strategic plan that actually creates the framework for moving this organization, this bureaucracy into the customer service age and building that modern institution that we all promised in the Commission and the Restructuring and Reform Act.

This is going to be difficult. This will entail bringing together people in the customer focus business unit, while simultaneously providing them with the training and the management, and the information tools that they need to ensure that we collect taxes fairly and with the least amount of burden. Again, the price of failure will be very high, and I think it is critical that we now focus on that.

I do want to mention, Mr. Chairman, if I might, that in order to mitigate those risks and to move forward, we have got to have the Oversight Board in place. I would only make a comment again today that I have made many times, that the basic reasoning behind this Board, continuity, expertise, and accountability, are still lacking at the agency and are still needed, and nothing has changed with regard to the need for those qualities and the need for having the Board in place, frankly, to support Commissioner Rossotti and others who are trying to do the right thing at the IRS.

I am just amazed that, after the administration took 377 days beyond the statutory deadline to send the appointees up, that now there continues to be foot-dragging here in the U.S. Senate. I do not know exactly why; I have heard a lot of different stories.

But the point is, we need this Board in place. We need it in place now. I would hope that those Senators who are holding up the confirmation of the Board members would really think seriously about the impact their foot-dragging is having on the taxpayers of this country.

I wish, frankly, we had more accountability in the process, Mr. Commissioner, of getting your Board in place. Talk about the need for accountability.

I believe this is a very important part of putting together that detailed master plan that Senator Kerrey referred to, and that I think also is needed at this point in terms of IRS reform.

So, again, Mr. Chairman, I thank you very much. I do believe we are going to hear from the Commissioner about the need for some resources, and I support that. We have a job to do here on Capitol Hill, just as we have now come together to coordinate.

We also have a job to provide the IRS with adequate resources to get the job done. If we short-change the modernization effort at this point, I believe we will increase that risk of failure that I mentioned earlier.

So I look forward to hearing from Commissioner Rossotti today, and participating in a good debate and lively discussion on what we need to do to make the goal of IRS restructuring and reform a resounding success.

Thank you, Mr. Chairman.

Senator GRASSLEY. Thank you, Congressman Portman. Now, Congressman Coyne.

**OPENING STATEMENT OF HON. WILLIAM J. COYNE, A U.S. REPRESENTATIVE  
FROM PENNSYLVANIA**

Mr. COYNE. Thank you, Mr. Chairman.

I would like to congratulate the Commissioner and the employees of the Internal Revenue Service on an extremely successful 2000 filing season. Despite the challenges of the ongoing reorganization and the year 2000 roll-over, this year has marked one of the most successful filing seasons in recent memory.

Commissioner Rossotti has testified before the Ways and Means Committee in the House that it is vital that we support full funding for the IRS's proposed fiscal year 2001 budget to continue this trend. Without proper funding, we cannot expect continued improvements in customer service. Also, shortages of personnel, if they continue, could threaten the effective enforcement of the tax laws.

I look forward to this joint session as an opportunity to hear more about the continuing improvements in tax administration at the IRS. We have already come a long way toward making the IRS more accountable and raising customer service levels throughout the country.

This joint hearing of the House and Senate is a great opportunity for us to provide the IRS with clear bipartisan direction and support.

Thank you, Mr. Chairman.

Senator GRASSLEY. Thank you. Congressman Sununu?

**OPENING STATEMENT OF HON. JOHN E. SUNUNU, A U.S. REPRESENTATIVE  
FROM NEW HAMPSHIRE**

Mr. SUNUNU. Thank you, Mr. Chairman.

At the beginning of the hearing this morning I mentioned to the Commissioner that it was good of him to testify, given that he has been before Congress nearly a dozen times this year. He was either polite enough, or pressured enough, to point out that it is an important part of his job.

I welcome him here today and give great credit to the clarity and the candor with which he has testified before our Subcommittee on Appropriations, and all the other House and Senate committees that share jurisdiction over the work that he does.

About two weeks ago on the eve of the filing deadline, I was really fortunate to be able to spend some time at the large New England filing center in Andover with a number of IRS employees, touring the pipeline and looking at the work that they do.

They were rightfully quite proud of the volume of returns that were coming in, the relative level of calm, even in an environment where they knew they were under a deadline to perform, and perform to standards that have been imposed, and a standard that has been elevated by the Restructuring Act.

But, even so, they really recognized that they could do better. They wanted to do better. They understand, probably better than most of the people in this room, that they can improve, that there are weaknesses in the system. I think that really does speak volumes of their dedication, but it also speaks to the opportunity that the Commissioner has and has already begun to take advantage of.

In doing so, I would ask that perhaps you address two points among the many in your testimony today. Those were raised by the employees in Andover. First, is the quality of the information systems, the integration of the databases, and the improvement of those systems so that they can fulfill their mission with regard to customer service, which has really been changing a great deal; and second, in customer service in particular, what can be done to improve the performance standards.

The call pick-up rate is one that is pointed to, one where there was really a slight decrease in performance, and one that the information presented by the GAO seemed to indicate was not

driven by money, but was driven at least as much by organizational/structural issues, training issues, and putting in a good performance system for customer service.

So, I think that is where the opportunity lies. For better or for worse, that is where the majority of Americans interface with your organization and that is, rightfully, where the public deserves to have the highest level of performance.

So I am optimistic, in part, because your employees are optimistic even in the face of great challenges, and I look forward to hearing your testimony today.

Thank you, Mr. Chairman.

Senator GRASSLEY. Thank you. Now, Congressman Horn.

**OPENING STATEMENT OF HON. STEPHEN HORN, A U.S. REPRESENTATIVE  
FROM CALIFORNIA**

Mr. HORN. Thank you very much, Mr. Chairman. I think this is a very worthy endeavor, with all of the committees working together.

I have very high regard for Commissioner Rossotti; I think he has done an outstanding job. But we need to give him a little more help. One of the problems, and this is throughout the executive branch, is the financial management statements of the various agencies. They are really pretty pitiful.

We have asked the Comptroller General to take a look also at the hardware and the software because we need, in Congress, to upgrade that computing ability, and the IRS is among those needing an upgrade, although it is already on the road in some respects in that area.

But the one that concerns me the most, and has since 1996, is that the IRS has not been given the authority by its authorization committees--Finance in the Senate, Ways and Means in the House--to collect the tax debts that are owed the people of the United States.

At a recent hearing by our Government Management Subcommittee, we learned that at the end of fiscal year 1999 the government was owed \$231 billion in unpaid taxes, penalties, and interest. Of that amount, the Comptroller General of the United States and the General Accounting Office say at least \$21 billion is collectible.

The Debt Collection Improvement Act that we put on the books in 1996, provides the Federal Government with a mechanism to collect delinquent Federal non-tax debts. The law provides the Treasury with a variety of tools to go after that delinquent debt, including the use of private collection agencies. The law, however, does not cover tax debt, and I would hope both committees would face up to that.

Senator GRASSLEY. Now, Congressman Hoyer.

**OPENING STATEMENT OF HON. STENY H. HOYER, A U.S. REPRESENTATIVE  
FROM MARYLAND**

Mr. HOYER. Thank you very much, Mr. Chairman. I appreciate this opportunity to join you and other members of the relevant committees. I am pleased to be here representing the Minority side of the House Appropriations Committee at this second joint review hearing.

Mr. Commissioner, as you know and as you stated in our appropriation hearing in March and will again today, the IRS is at a crossroads. I believe Mr. Portman, who has been so involved in this, made a similar comment in his opening statement.

The number of tax returns continues to increase. Returns for those making \$100,000 or more has increased 63 percent since 1993. Yet, I am very concerned that the number of personnel at the IRS continues to decrease, by roughly 17,000 FTEs since 1993. That is a 17,000 FTE decrease.

One of the things that was observed in the document that was the result of the IRS Commission chaired by Senator Kerrey and Mr. Portman was the fact that two things had to be present. One, was that we had to have a relatively stable Tax Code so we were not requiring the IRS to change its processes every year, and second, that we had to have certainty of budgeting so that the funding levels for staff and operations was consistent.

What concerns me about this trend and downturn, is that because of the Restructuring and Reform Act's justified emphasis on taxpayers' rights and customer service, IRS enforcement has, in my opinion, been weakened.

Now, as Mr. Portman and others will recall, I was one of four to vote against the bill the first time it passed the House. I raised the concern that if you were going to be for tax reform and you were going to be for taxpayer-friendly actions, you had to fund the IRS properly and you had to draw the Tax Code so that it was rational, reasonable, and relatively easy to enforce.

Recent research data concerns me greatly, released by Syracuse University, which shows that the poor are now more likely to be audited than the rich. One in every 74 taxpayers reporting income below \$25,000 was audited last year, compared to one in every 87 taxpayers reporting income of over \$100,000.

Since 1988, audits of the self-employed with gross income of \$100,000 or more have been reduced by more than half, 55 percent, and only one in every 66 corporations was audited in 1999, an 86-year low.

On top of this, seizures of property from recalcitrant, non-paying taxpayers have dropped by 98 percent. In other words, we are no longer in that ball game.

Mr. Commissioner, the National Commission on Restructuring the IRS recommended in 1997 that Congress provide the IRS certainty in its operational budget, and that Congress work towards simplifying the tax law whenever possible.

As we continue to review the implementation of the 1998 Act, we must ensure, in my opinion, that the IRS has the resources necessary to have a stabilized workforce, while implementing the very important reforms of the Act.

I congratulate all of you who were so involved in that. I was involved myself, and think the Act is having a positive effect, but we also need to guard against its negative impact.

Thank you very much, Mr. Chairman, for allowing me to make this opening statement.

Senator GRASSLEY. Now, Senator Hatch.

#### **OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH**

Senator HATCH. Thank you, Mr. Chairman.

As I see it, the purpose of this joint hearing is three-fold. First, we are to review the strategic plans and the budget of the IRS, second, is to question the witnesses before us today to learn how Congress can help the IRS to better fulfill its mission; and finally, it is our job to raise concerns, and even criticize the agency when warranted, on behalf of the American people. We must not forget that no other institution of the Federal Government touches the average taxpayer in a more vital and personal way than does the Internal Revenue Service.

Before we begin, especially with the criticism, I would like to make a key distinction between the myriad of rules and regulations that comprise our tax system and the hardworking and honest Americans who are the vast majority of employees of the IRS and who are doing their best to do a good job, in what is often a very difficult environment.

I especially want to highlight the excellent employees in the Ogden, Utah service center who serve taxpayers in 14 States. Since January 1, these employees have processed over 14 million tax returns.

During the peak period from April 12 to 28, Ogden IRS employees processed over 1.5 million payments, and, most importantly to many taxpayers, Ogden posted an excellent record for quick refunds, at an accuracy rate approaching 99 percent, which is pretty incredible.

Meanwhile, customer service representatives in Ogden have helped nearly 800,000 taxpayers by telephone and answered more than three-quarters of a million pieces of mail since last October.

So, Mr. Chairman, amid all the concerns and problems of the IRS, which are serious and many, I hope we can focus on the real issues. One, is the capacity and effectiveness of the IRS to deal with millions of returns and taxpayer questions.

Another, is that too many taxpayers still believe they are being treated unfairly or in a non-responsive manner by IRS employees. Still worse is the byzantine complexity of the Tax Code. I hope we can all agree that a key to solving many of the IRS's problems is to simplify the Tax Code.

So I want to thank the Chair and ask that my full statement be put in the record at this point.

Senator GRASSLEY. Permission granted.

[The statement of Senator Hatch follows:]

**STATEMENT OF SENATOR ORRIN HATCH  
BEFORE THE JOINT REVIEW OF THE  
INTERNAL REVENUE SERVICE  
May 3, 2000**

Good morning, Mr. Chairman. As I see it, the purpose of this joint hearing is threefold. First, we are to review the strategic plans and the budget of the IRS. Second, we are to question the witnesses before us today to learn how Congress can help the IRS to better fulfill its mission. Finally, it is our job to raise concerns and even criticize this agency when warranted on behalf of the American people. We must not forget that no other institution of the federal government touches the average American taxpayer in a more vital and personal way than does the Internal Revenue Service.

Before we begin, especially with the criticism, I would like to take just a moment to make a key distinction between the myriad of frustrating rules and regulations that comprise our federal tax system and the hard-working and honest Americans who are the vast majority of the employees of the IRS and who are doing their best to do a good job in what is very often a difficult environment.

I especially want to highlight the excellent employees in the Ogden Utah Service Center, who serve taxpayers in 14 states. Since January 1 of this year, these employees processed over 14 million tax returns. During the two-week peak period from April 12 to the 28<sup>th</sup>, Ogden IRS employees processed over 1.5 million payments totaling almost \$6 billion. And, most importantly to many taxpayers, Ogden posted an excellent record for quick refunds averaging just 11 days for electronically-filed returns and 32 days for paper returns, all at an accuracy rate approaching 99 percent.

Meanwhile, customer service representatives in Ogden have helped nearly 800,000 taxpayers by telephone and answered more than three-quarters of a million pieces of mail since last October. As with IRS employees throughout the nation, Ogden employees are also good citizens, volunteering in many worthy community activities, such as the Volunteer Income Tax Assistance Program and the "I Can Read" literacy program. Twelve customer service representatives from Ogden volunteered to leave their families for two months last year to help the Federal Emergency Management Agency assist hurricane victims with tax problems.

So, Mr. Chairman, amid all the concerns and problems of the IRS – Which are serious and many – I hope we can focus on the real issues. One is the capacity and the effectiveness of the service to deal with millions of returns and taxpayer questions. Another is that too many taxpayers still believe they are being treated unfairly or in a non-responsive manner by IRS employees. Still worse is the byzantine complexity of the tax code. I hope we can all agree that a key to solving many of the IRS's problems is to simplify the tax code.

I thank the Chair.

Senator GRASSLEY. You should feel good, Commissioner Rossotti, about all of the appreciation that people have for your leadership work; bringing your management skills to the job and worrying about how the operation runs and exactly how the Tax Code is interpreted. We think that that is what is badly needed and we are glad that you are working towards that end.

Would you proceed?

#### **STATEMENT OF HON. CHARLES O. ROSSOTTI, COMMISSIONER OF INTERNAL REVENUE**

Mr. ROSSOTTI. Thank you, Mr. Chairman and distinguished members of the Senate and House committees.

What we at the IRS are doing is following the clear directions that we were given in the landmark Restructuring and Reform Act. Following this direction, we are planning and implementing the most significant changes to organization, technology, and most importantly, the way we serve taxpayers, in half a century.

We think that the Restructuring Act asks the IRS to try to simultaneously achieve three goals. First, we must respect taxpayer rights and provide good service, as many members of the committee said in their opening statements. But, second, we also must ensure that the taxes that are due are paid. Third, in an era of tight budgets, we have to do all of this very efficiently.

I want to stress, as I have to our employees, that we really cannot succeed unless we achieve all three of these goals at the same time. It is not our purpose to move an imaginary

pendulum in one direction or another a few degrees. We think our purpose is really to improve the entire way that the IRS works and to achieve all three goals.

Now, to achieve this, we do have to make many changes. We are already witnessing, I think, some positive results and I very much appreciate the comments that many of the members made in their opening statements about the filing season.

We have also implemented the 71 taxpayer rights provisions of the Restructuring and Reform Act. We have implemented, or at least begun to roll out, a whole new system of performance measures. Our reorganization, which is aimed at increasing focus on serving customers and on management accountability, is progressing rapidly, and we have a whole new top management team in place.

In the filing season that just ended, we did have a very smooth season. We did improve our phone service and we did solve the Y2K problem completely. We also are attempting to respond in the near term, as well as we can, to recommendations that we received from many different sources about how we can improve. We know there are many opportunities to do that.

Since January of 1999, for example, we have received 80 audit reports from the Treasury Inspector General for Tax Administration, with 375 specific recommendations for changes and improvements, and 89 reports from GAO, with 94 specific recommendations. At the present time, we have 174 GAO and TIGTA reports under way.

Mr. Chairman, in the context of all of these demands on us, our first priority over the last 12 months was, in fact, implementing the taxpayer rights and other provisions of the Restructuring and Reform Act. This did stretch our capacity to the limit, and our initial focus was on making sure that we were complying with the provisions of the law.

In fiscal year 1999, for example, we provided our employees over two million hours of training on the Restructuring and Reform Act, and we estimate that we are devoting the equivalent of about 4,560, as shown on this chart on the left, equivalent personnel for performing tasks specifically related to provisions of the RRA.

[Chart D follows:]

Chart D

**FY 2000 Mandatory FTE Increases from RRA '98**  
**FTE by PROGRAM**

Code Section	Total FTE
1203 Termination of Employment for Misconduct; Incl 1203 Training	126
1205 Employee Training Program	368
3001 Burden of Proof	5
3201 Innocent Spouse Case Processing & Adjudication	731
3301 Global Interest Netting	103
3401 Due Process in Collections	356
3417 Third Party Notices	587
3462 Offers in Compromise Case Processing	1,673
3501 Explanation of Joint & Several Liability	20
3705 Spanish language assistance/live assistor option/contact on manually generated notices	63
**** All Other Codes	529
<b>TOTAL</b>	<b>4,561</b>

We are now at the stage, we believe, where we have completed, I will call it, that first phase of complying with the legal provisions. But as many members noted in your opening statements, we have several years of work ahead to really make these provisions work efficiently and with higher quality.

I have to also say, on an overall assessment, Mr. Chairman, despite the fact that we have had some significant accomplishments and improvements, I could not come before you and say today that I think we are meeting legitimate service expectations of the vast majority of compliant taxpayers at the level that they expect to be served.

I think Mr. Sununu mentioned that our employees in Andover said the same thing. I think our employees agree with that. We are making improvements, but we are not at the level that we need to be.

At the same time, as others including Mr. Hoyer mentioned, our compliance activity continues to drop. Finally, as Mr. Horn and GAO have pointed out, many of the systems we use to manage and to account for this \$1.8 trillion of revenue are just inherently deficient. They do not meet acceptable accounting standards.

So these are very severe problems that we will still confront, and if they were not addressed, I think over time they would certainly undermine the fairness and viability of our tax system.

But I think it is also true that these problems are not newly identified. These are not surprises at this point, nor do I believe, after about two and a half years in office, that they are impossible to solve. I think they can be solved, and I think we now have in place the plans, at least at a top level, that we need to follow in order to solve these problems.

This is, however, an enormous program. In order to succeed in this program, we do have to have adequate budget resources in fiscal 2001 to address both our critical near-term operational needs and to invest in new technology.

I would just like to briefly cover this subject, just in a few paragraphs. I think the rapidly expanding economy, which is wonderful news for the American public and also for the Federal budget, does, however, continue to increase the IRS workload.

For example, since 1993, the number of individual tax returns with over \$100,000 of income, which generally are more complex kinds of returns, have increased by 63 percent. In the meantime, our staff has decreased by 17,000.

I think, of course, as was noted in that previous chart, we have been required by the Restructuring and Reform Act to devote specific numbers of personnel to administer certain provisions of the Tax Code.

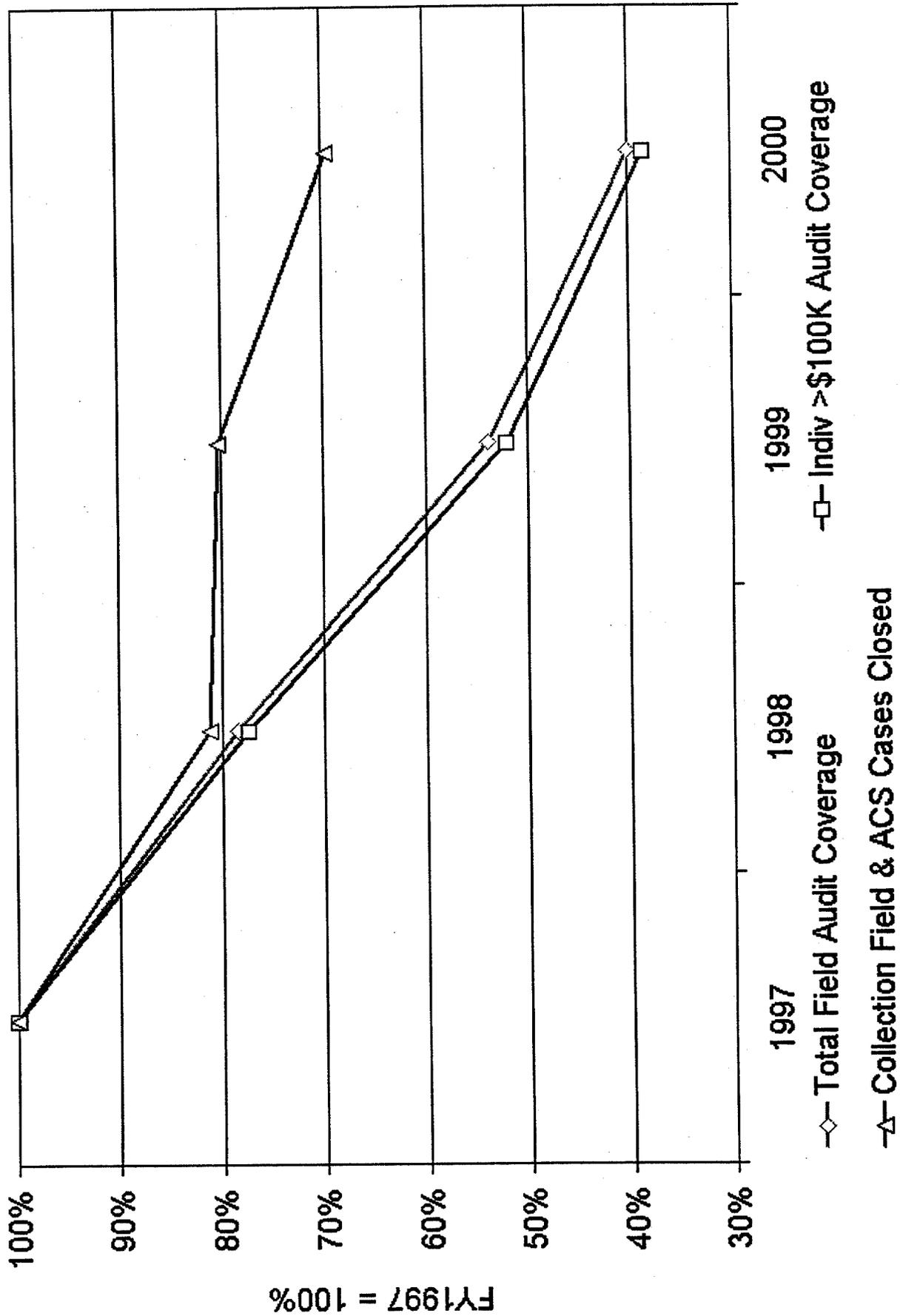
So, as a result, the number of personnel devoted specifically to compliance activities, to audits and collections cases, has decreased even more rapidly than the overall decrease in our staff, which in turn has simply resulted in some of the statistics that were mentioned by some of the members in their opening statements, such as the declines in the numbers of audits.

I have a summary chart here that shows, in the last few years, some of our case coverage. This is auditing and collection cases. As you can see, it has been declining very, very rapidly.

[Chart 1 follows:]

Chart 1

# Reductions in Enforcement Indicators.



That is a function of the decline in resources as well as, I have to honestly say, due to some internal confusion, uncertainty, relearning of how to do our jobs in the IRS among our employees and managers, which has had the effect of not only reducing the number of staff, but also increasing the time that is required to process each case. When you boil it all down, you get what is on that chart.

So to address some of these immediate operational requirements, we have requested an increase in staffing in our fiscal 2001 budget to provide for an additional 28,033 full-time equivalent staff for fiscal year 2001.

We would expect that, if we were granted this request, together with the other management changes we are making, we will be able to stabilize those activity levels. In other words, stop that downtrend, which, by the way, has been going on for almost 10 years. It is not just in the last two years.

So that staffing increase would help us to meet our critical operational needs, while we also then transition to the new, improved organization, and especially to our new technology.

Let me just finish up here a bit on technology. The IRS is totally dependent on technology. Almost every one of our 100,000 employees depends on our computer systems every day to do their job and to collect on a property account for almost \$1.9 trillion of gross revenues that are coming in.

Yet we know that these systems are very, very old and, in many respects, fundamentally, and I would say irremediably, deficient. They cannot be fixed. They need to be replaced.

In my written testimony, we have provided great detail, and even more detail for the Appropriations Committees, on how we propose to go about this during fiscal year 2000 and 2001. In our 2001 budget, we have requested \$119 million to continue progress along the technology dimension.

Let me stress on this point that this is a large and risky program. There is no way to avoid some risks in managing a program of this size. But I believe that we can manage these risks, just as we did with our \$1.4 billion Y2K program. We all recognized that, and several Members here were very active in that effort.

Mr. Horn had several hearings I appeared before which appropriately called attention to the risks that we faced. But, in the end, we did manage our way through that and got through them. I do not have time now, but would be happy to expound if anyone wants on some of the specific things that we have put in place to try to manage these risks.

This, most importantly, takes the form of top management, including myself, my chief information officer, and my top management, constantly monitoring the level of activity we have in these programs to be sure that we are not getting beyond our management capacity.

At the same time, we have to do some things or we will not move forward. We have already made significant adjustments to try to make sure that we have appropriately set the level of activity we take in moving forward on projects in accordance with what we believe is an acceptable level of risk in management capacity.

So, Mr. Chairman, I do think we are making real progress on the goals and mandates that were set for the IRS by the Congress in the Restructuring Act. If the Congress will continue to provide us support in the form of proper oversight and support in that regard, as well as in support for our 2001 budget request, I believe that we will be able to provide visible and tangible changes in service, compliance, and productivity, which I think is what the taxpayers of America expect from us.

Thank you, Mr. Chairman.

[The prepared oral and written statements of Mr. Rossotti follow:]

**ORAL TESTIMONY OF  
COMMISSIONER OF INTERNAL REVENUE  
CHARLES O. ROSSOTTI  
ANNUAL RRA 98 REVIEW  
CONVENED BY THE JOINT COMMITTEE ON TAXATION  
MAY 3, 2000**

Mr. Chairman and distinguished Members of the House and Senate Committees, following the clear directions set forth by the landmark IRS Restructuring and Reform Act, the IRS is planning and implementing the most significant changes to its organization, technology and the way it serves taxpayers in almost a half-century.

Through the Restructuring Act, Congress asked the IRS to achieve three goals. One, we must respect taxpayer rights and provide high quality service to every taxpayer. Two, we must ensure that the taxes that are due are paid. And three, in an era of tight budget caps we must do all of this very efficiently. We must achieve all of our goals to succeed. Our purpose is not to move some imaginary pendulum one way or the other. Our purpose is to improve the entire way the IRS works.

In order to fulfill this mandate, many changes are required in every aspect of how the IRS works. And we are already witnessing some positive results. We implemented the 71 RRA taxpayer rights provisions. We completed the first phase of a new system of balanced measures of performance. Our reorganization to increase customer focus and management accountability is progressing rapidly and we have a new top management team in place. We also delivered on improved phone service and more electronic filing for the 2000 filing season and completed an almost flawless Y2K conversion program.

Recommendations from many sources about other pressing changes were also made to the IRS. Since January 1999, the IRS received 80 audit reports from the Treasury Inspector General for Tax Administration containing 375 specific recommendations for changes or improvements, and 89 reports from GAO containing 94 specific recommendations. In addition, there are 174 TIGTA and GAO audits underway.

Mr. Chairman, in this context, our priority over the last 20 months was implementing the RRA taxpayer rights provisions. Our capacity was stretched to the limit and the initial focus was on ensuring legal compliance. In FY '99, we provided a total of two million hours of training on RRA. We also estimate that nearly 4,560 full time equivalent personnel were required for the specific administrative provisions of RRA 98.

We are now at the stage where we have implemented the Act's legal provisions. We have several years of work ahead to make them work more efficiently and with higher quality.

Mr. Chairman, despite these accomplishments and some improvements, the IRS cannot today meet the legitimate service expectations of the vast majority of compliant taxpayers, while at the same time, compliance activity continues to drop. In addition, as

GAO has pointed out, many of the systems we use to manage and account for the \$1.76 trillion in net tax revenue are inherently deficient.

These problems are severe and if not addressed would certainly over time undermine the fairness and viability of the federal tax system. But the problems are not newly identified, nor are they impossible to solve. We now have in place the top-level plans that will allow us to address them.

However, to succeed in this enormous and vital program mandated by the Restructuring Act, we must have adequate budget resources in FY 2001 to address critical operational needs and to invest in new technology

The rapidly expanding economy continues to steadily increase the IRS workload. For example, since 1993, the number of individual tax returns over \$100,000, which are generally more complex, have increased by 63 percent. Meanwhile, because of budget constraints, the IRS staff has dropped by 17,000 FTE since FY 1993.

On top of these general trends, as shown in the *first chart*, certain specific provisions of the RRA alone have required about 4,560 additional FTE to administer. Since compliance personnel represent the largest component of the IRS budget, and since they are also required to administer most of the RRA provisions, net compliance staffing has declined rapidly, as shown on the *second chart*.

In addition to these direct resource declines, the pervasive change in the way business is done under RRA has understandably caused some uncertainty, confusion and much relearning of basic jobs among our employees and managers. The effect of this has been to increase the time required to complete each case.

The net effect of these conflicting trends is that Exam and Collection cases have been cut almost in half since 1997, even while service levels remain well below acceptable standards.

To address these pressing operational requirements, we have requested an increase in staffing referred to as "STABLE." This initiative requests a total of 2,833 additional staff, split between a FY 2000 supplemental and FY 2001 request, at a total annual cost of about \$188 million.

With this staffing level, we expect that in 2001 the IRS will be able to stabilize the level of Exam and Collection activity while implementing RRA's taxpayer rights provisions, and to maintain, or slightly increase service levels. This staffing increment will enable us to meet critical operational needs while we transition to the new, more efficient organization structure and reengineered technology, which is the second key need in our FY 2001 budget.

Mr. Chairman, the IRS depends almost entirely on its computer systems to administer the tax system and to collect and properly account for \$1.9 trillion of tax revenue, yet these systems are fundamentally and irremediably deficient.

Our plan for reengineering our systems is described in some detail in my written testimony and in the ITIA funding request we submitted to the Appropriations Committees.

In FY 2001, we are requesting \$119 million to continue progress as anticipated on the ITIA funded program. To ensure continued funding, we request an advanced appropriation of \$375 million for FY 2002, increasing the ITIA account by that amount. In addition, we request \$40 million for the Information Systems Account for extremely high priority investments during FY 2001.

Let me stress that although there is no way to avoid risk in a program of this size and complexity, we can manage these risks and achieve our goals, just as we did with the \$1.4 billion Y2K program. We now have in place most of the elements needed to do this properly, which were not in place in the past.

These include: a single, centrally managed information systems organization; a very active top governance process, which I personally chair and which includes all the top executives who manage affected parts of the IRS; rigorous adherence to architectural, technological and methodological standards; reliance on the PRIME contract to manage development and integration activities, and, most importantly, an unwavering commitment to an open process that includes GAO, TIGTA, OMB and Treasury and which forthrightly confronts problems and issues and makes adjustments to schedules and scope as reality dictates.

We have already seen this process in action as we have unhesitatingly revised some initial proposals to slow down certain projects and to rearrange other activities to ensure that management and architectural concerns were adequately addressed. However, I also must stress that there is no way to achieve maturity in the management process without practical experience actually executing projects.

Mr. Chairman, I believe we are making real progress on the goals and mandates set forth by the Restructuring Act. If Congress can provide continued and assured support for IRS modernization, such as that contained in our FY 2001 budget request, we will be able to produce the visible, tangible changes in service, compliance and productivity that America's taxpayers expect and deserve. Thank you.

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Statement of

Charles O. Rossotti

Commissioner  
Internal Revenue Service

Before the

Annual RRA '98  
Joint Hearing on IRS Progress

Convened by the  
Joint Committee on Taxation



Department of the Treasury  
Internal Revenue Service

[www.irs.gov](http://www.irs.gov)

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May 3, 2000

**PREPARED TESTIMONY OF  
COMMISSIONER OF INTERNAL REVENUE  
CHARLES O. ROSSOTTI  
ON THE  
ANNUAL JOINT REVIEW OF  
IRS RESTRUCTURING AND REFORM ACT OF 1998  
CONVENED BY THE  
JOINT COMMITTEE ON TAXATION  
MAY 3, 2000**

**INTRODUCTION**

Mr. Chairman, and distinguished Members of the House and Senate Committees represented today, I am pleased to testify on the Internal Revenue Service's progress in carrying out the IRS Restructuring and Reform Act of 1998.

Following RRA 98's clear directions and intent, the IRS continues to plan and implement the most significant changes to its organization, technology, and the way it serves taxpayers in almost a half-century.

We have implemented the 71 new RRA 98 taxpayer rights provisions. Just as importantly, we are carrying them out in the spirit of the Act, which is to treat taxpayers like people rather than statistics. We have completed the first phase of a new system of balanced measures of performance. Our reorganization to increase customer focus and management accountability is progressing rapidly and we have a new top management team in place for the four new customer-focused operating divisions.

At the same time, the IRS continued to fulfill essential operational requirements including providing service to taxpayers during each filing season (*see Appendix*), administering roughly 801 tax law changes made by the Taxpayer Relief Act of 1997 (TRA), including nearly 300 new provisions. We also completed the enormous and almost flawless Century Date Change program for IRS computer systems.

Building on this foundation, we are beginning the long-term program of reengineering business practices and technology that will allow the IRS to deliver on RRA 98's mandates for improved service and taxpayer treatment while also increasing compliance effectiveness. As the streamlined management and new technology become effective, the IRS can also improve efficiency and maintain a stable workforce in relation to the economy.

However, neither Congress nor the IRS could have anticipated all the implications, including resources, needed to implement the full scope of RRA 98. Yet, in the 21 months since this bill was enacted we have learned a great deal, and at this

point I am convinced we can succeed through the combination of a limited increase in staff resources and critical investments in new technology and organization.

As I have previously testified, the IRS depends entirely on its computer systems to administer the tax system and to collect and properly account for \$1.76 trillion of net tax revenue, yet these systems are fundamentally and irremediably deficient and must be replaced. Let me stress that although there is no way to avoid risk in a program of this size and complexity, we can manage these risks and achieve our goals, just as we did with the \$1.4 billion Y2K program. We now have in place most of the elements needed to do this properly, which were not in place in the past.

These include: a single, centrally managed information systems organization; a very active top governance process, which I personally chair and which includes all the top executives who manage affected parts of the IRS; rigorous adherence to architectural, technology and methodological standards; reliance on the PRIME contract to manage development and integration activities, and, most importantly, an unwavering commitment to an open process that includes GAO, TIGTA, OMB and Treasury and which forthrightly confronts problems and issues and makes adjustments to schedules and scope as reality dictates.

Although we have put in place most of the necessary elements, it will take time and practical experience executing projects for our management process to mature. *Chart A* indicates the expected normal pattern and time frame for this process.

Based on my experience in the industry, if we were to achieve the growth rate depicted in this chart, it would be a very rapid rate of progress and within 1-2 years would put the IRS in the very top category of institutions managing large technology modernization programs. Since this maturity process necessarily depends on practical experience, one of our most important responsibilities as top managers is to adjust the level of activity we are managing to that which is appropriate to level of our management capacity.

We have already seen this process in action as we have unhesitatingly revised some initial proposals to slow down certain projects and to rearrange other activities to ensure that manage and architectural concerns were adequately addressed. On the other hand, I must also stress that there is no way to achieve maturity in the management process without the practical experience of actually executing projects.

Mr. Chairman, I also want to stress that we have instituted a new strategic planning and budgeting process that reflects the modernized IRS, including the new organization structure, mission statement, strategic goals and objectives. Beginning with a strategic assessment, the strategic planning process will drive budget and program execution in a continuing cycle.

The new strategic planning and budgeting process is responsive to GPRA

requirements and is consistent with strategic planning best practices. The process will help IRS senior management to make decisions around the four different operating divisions on the following areas: (1) the mission and goals that drive the IRS' Strategic Plan; (2) the major strategies, operating priorities and improvement projects that will be employed to meet the goals and objectives found in the annual performance plans; (3) resources to be allocated to accomplish these strategies and programs; and (4) the effectiveness of the strategies and programs in helping the IRS achieve its mission, goal and objectives (annual performance report).

Let me underscore that as we develop, refine and adjust our plans, we have been consulting and will continue to consult with the Congress, Treasury Department, Office of Management and Budget and our many stakeholders. We have also initiated the strategic planning and budgeting process for FY 2002. In late March 2000, each of the four operating divisions presented a strategic assessment for the five fiscal years beginning with FY 2002. In addition, we will revise the IRS Strategic Plan during 2000. The recently completed annual program performance report will require modifications to the program (budget) structure to reflect the new processes and operations of the operating divisions, i.e. pre-filing, filing and post-filing.

Mr. Chairman, I believe we are making real progress on the short- and long-term goals and mandates set forth by the Restructuring Act. If Congress can provide continued and assured support for IRS modernization, such as that contained in our FY 2001 budget request, we will be able to produce the visible, tangible changes in service, compliance, and productivity that America's taxpayers expect and deserve.

## **TWO DIFFERENT PATHS: ONE CLEAR CHOICE**

Mr. Chairman, quite apart from RRA 98, or any remedies or initiatives the IRS is pursuing, the expanding economy continues to steadily increase the IRS' workload.

Over a period of years, this expanding workload has compounded to reach fairly significant levels. For example, since 1993, the number of individual tax returns with over \$100,000 in reported income, which are generally the more complex returns, have increased by 63 percent. Meanwhile, because of budget constraints, the IRS staff has dropped by 17,000 FTE since FY 1993. (See *Chart B*) At the same time, the new TRA and RRA 98 taxpayer rights required new procedures and increased time per case. These conflicting trends, increased demands, and reduced staff have not been addressed by new technology. During this period, almost all of the technology spending and focus were devoted to addressing the Y2K problem and responding to TRA and RRA 98.

This conflicting set of trends has left the IRS in a position in which we are not yet meeting the legitimate service expectations of the vast majority of compliant taxpayers who voluntarily pay their taxes, while compliance activity, such as examination coverage and collection enforcement activity, is dropping rapidly, thus potentially undermining the fairness of the whole tax system.

Broadly speaking, one can conceive of two ways to reverse this downtrend. The first is to add staff in the traditional manner to process more returns, answer more telephone calls and letters, and increase casework such as examinations and collection cases. This approach would require hiring more than 8,000 staff just to return to the FY 1997 level of activity and then adding 2,000 more staff annually to remain even with the increasing workload.

Given the growing economy and increased demands of complying with RRA 98, this approach would be extremely expensive. For the vast majority of taxpayers, it would also not meet modern expectations for service levels because no amount of staff can fully compensate for the IRS systems deficiencies. In addition, in today's labor market, the IRS would have difficulty attracting and retaining sufficient and qualified staff.

There is, however, another way, and it is the basis for our FY 2001 budget request. By investing in reengineering IRS' business practices and technology together with limited staffing increases, we will be able to perform all aspects of the IRS mission more effectively and efficiently and in line with the best private and public sector practices. This second approach will, over time, enable the IRS to meet public expectations for its mission with lower growth in staff and future budgets.

Although we need additional staff resources to succeed, the amount is only modestly more than present levels of staff and would still be less than the IRS staffing level of 1997. This approach is possible since our basic strategy to meet increased workload and service demands depends on reengineering business practices and technology. Freeing up positions through business systems investment is a critical requirement. By investing in technology and improved business practices, the FY 2001 budget request avoids the traditional staff increases that would otherwise be required. It is important to stress, however, that the investment in modernization is essential for this approach to work.

## **STRATEGIC DIRECTION: "STANDING UP" THE NEW IRS**

During the second half of FY 2000 and throughout FY 2001 and beyond, we will continue implementing the new IRS. This process includes realigning our personnel resources and putting in place: (1) revised business practices and strategies, (2) a new organization and management, (3) new information technology, and (4) a balanced performance measurement system.

### **Revised Business Practices and Strategies**

How the IRS interacts with taxpayers is defined by its business practices. They determine how tax filing is performed, what notices are sent under what

circumstances, the way phones are answered, how collections of balances due are carried out and how examinations are conducted.

Closely related to business practices are the IRS strategies that guide them, such as how returns are selected for examination, what compliance issues are emphasized, and how we encourage electronic filing. Both strategies and practices are also constrained by, and to a considerable degree determined by, the established organizational structure and the installed technology base. These are the two principal instruments through which the IRS executes its business practices and strategies.

The strategies the IRS will pursue include: (1) preventing taxpayer problems or addressing them as early as possible; (2) improving taxpayer communications; (3) making TRA and RRA 98 taxpayers rights work more efficiently and effectively; (4) broadening electronic tax administration use as mandated by RRA 98; (5) leveraging IRS resources through effective partnerships with tax administration organizations and groups that deal regularly with taxpayers; (6) tailoring practices and strategies to specific taxpayer needs and problems; and (7) addressing serious areas of noncompliance with specific strategies.

### **New Organization and Management**

Why is the IRS reorganizing? A key reason is that our slow progress to make improvements is due in large part to the twin barriers of organizational structure and obsolete computer systems. The traditional IRS structure does not adequately support taxpayer demands. It represents the way many businesses were organized for many years – around internal technical disciplines and geographical locations. Following the directions set by RRA 98, the IRS is creating a modernized structure similar to those widely used in the private sector: organizing around customers' needs, in this case taxpayers. The future customer-focused organization consists of:

- Four operating divisions – Wage and Investment Income (W&I), Small Business and Self-Employed (SB/SE), Large and Mid-Size Business (L&MSB); Tax Exempt and Government Entities (TE/GE);
- Two service organizations – Information Systems and Agency-wide Shared Services;
- Separate specialized independent channels for taxpayers – Appeals and the Taxpayer Advocate Service;
- Criminal Investigation, which is a line unit and will have sole responsibility for investigation of criminal violations of the tax law;
- Chief Counsel, which will provide tax advice, guidance and legislative services to all components of the IRS; and
- A smaller National Headquarters office which will assume the overall role of setting broad policy, reviewing plans and goals of the operating units, and developing major improvement initiatives.

Each operating division will be responsible for creating and executing business practices and strategies to meet those needs, and managers at all levels will be expected to be knowledgeable in the substantive problems and issues that arise in administering the tax law in their respective divisions.

The organization will be led by management teams, including individuals with the broad range of experience needed to lead each unit in the dual task of managing current operations while modernizing business practices and technology to achieve the new mission and strategic goals. The leaders of these units have now all been selected and are rapidly putting in place the remainder of the management structure in each unit.

The new divisions will become fully operational in stages, with Tax Exempt and Government Entities already operational since December. The Large and Mid-Size Business Division will become operational later this spring, to be followed by Wage and Investment and Small Business/Self-Employed in the fall of 2000.

### **New Information Technology**

Reorganizing the IRS' outdated structure and replacing its archaic technology will take years to fully accomplish, but it is absolutely necessary if we are to reach a higher level of performance. For any information-intensive, service-oriented enterprise, such as the IRS, information technology will continue to be an essential resource on which all organizational performance depends.

The IRS is no different from the private sector in this respect, but it faces some unique challenges. IRS' core data systems are fundamentally deficient. The large and extremely fragmented nature of the IRS' technology inventory creates many problems, including poor service to end users, high cost, long timelines to implement changes and improvements, and control and security difficulties.

Technology modernization is essential to carrying out RRA 98, organizational modernization and providing additional services and efficiencies, but it is risky by its very nature, size and complexity. In fact, there is no way to avoid risk. However, we are not repeating past mistakes. As I discussed in the introduction to my testimony, we are prudently and carefully managing the process, providing for a careful review and external validation of each and every part of the program and making necessary adjustments.

The IRS is establishing an overall architecture for a set of new systems that will accommodate all essential tax administration functions according to modern standards of technology and financial management. During this process, the new and old systems must co-exist and exchange data accurately for an extended period until data is gradually converted from old systems to new ones. In 1998, the IRS

established the Core Business Systems Executive Steering Committee to provide a framework for the overall management of this process. This committee consists of top executives, chaired by the Commissioner, and supported by key staff groups.

### **Balanced Performance Measures**

The IRS Balanced Performance Measurement System is being developed as part of the effort to modernize the IRS and reflect the agency's priorities, as articulated in the IRS mission statement and in accordance with RRA 98.

In September 1999, a "Balanced Measures Regulation" was issued to formally establish the IRS' new performance management system. The issuance of the regulation, which followed a public comment period, sets forth the structure for measuring organizational and employee performance within the IRS. The IRS has taken great steps to integrate its budget request with these balanced performance measures to ensure compliance with the Government Performance and Results Act of 1993.

This year the IRS will adopt its strategic goals as its annual performance goals. This framework will assist the IRS in describing how programs and initiatives tie to achievement of the mission and goals as reflected in improvements in the measurement results.

In CY 1999, balanced measures at the operational level were approved for Tax Exempt and Government Entities, Large and Mid-Size Business, Appeals, the Taxpayer Advocate Service, Research, Statistics of Income, and additional Customer Service product lines. These measures are undergoing final design and implementation for use in field operations units. Other measures teams formed in CY 1999 that are expected to have approved balanced measures in early CY 2000 include Information Systems, Criminal Investigation, Counsel, Submission Processing, and Agency Wide Shared Services.

By necessity, our first performance measures priority was to develop measures that were consistent with the IRS' strategic goals and with section 1204 of RRA 98 which prohibits use of enforcement statistics to measure the performance or set goals for any individual. In FY 2000, we largely completed the initial development of operational performance measures, and will begin development of strategic measures. Strategic measures will measure broad performance of our four major operating divisions and for the IRS as a whole. Our strategic performance measures' objective is to provide quantitative indications of the overall success of each major unit and of the whole IRS in reaching our three strategic goals.

### **FY 2001 BUDGET REQUEST**

To deliver on the RRA 98 mandates for improved service and taxpayer treatment

while also increasing compliance effectiveness, IRS requires increased funding in FY 2001. With improved management and technology enabling the delivery of improved service and increased compliance effectiveness, the IRS will be positioned to succeed with limited resources in future years. As the streamlined management and new technology become effective, the IRS can also improve efficiency and maintain a stable workforce in relation to the economy. However, we face a major budget challenge in FY 2000 and FY 2001, which, unless addressed, will threaten not only the IRS reform and restructuring program, but the entire tax system.

The FY 2001 request is \$8.841 billion (without the Earned Income Tax Credit Account), \$769 million more than the final FY 2000 enacted level of \$8.072 billion. This is \$729 million over the FY 2000 proposed funding level of \$8.112 billion, which includes a \$40 million supplemental to stabilize the IRS workforce. Of this increase, \$119 million is for resuming funding of the Information Technology Investment Account (ITIA) for which there was no funding in FY 2000. The IRS requires this increase in FY 2001 to deliver on the RRA 98 mandates, manage organizational modernization, and invest in critically needed information technology.

Our budget request has two broad management categories: (1) Maintaining Current Operations, and (2) Modernization. Increases to maintain current operations include more FTE to assist in stabilizing enforcement activity levels and modestly increasing service levels, and to provide adequate non-labor resources for increasing electronic tax filing capability and contractual support for critical operational activities of the agency. Increases for modernization include funds for completing organizational modernization, business line investments, and replenishing of ITIA. The requested resources provide for full implementation of RRA 98 along with plans to modernize and realign the IRS organization, and fund the workforce.

### **Maintaining Current Operations**

To implement RRA 98, the IRS must modernize its organizational structure and technological base. However, during this time, we must also maintain operational activity at acceptable levels.

As I discussed earlier in my testimony, RRA 98 established 71 taxpayer rights provisions, each of which imposed additional procedures or new requirements for tax administration. This increased the time required to handle existing cases and required the IRS to divert compliance personnel to handle new procedures such as Innocent Spouse and Third Party Notice provisions. In addition, other compliance personnel were re-assigned to provide extended hours of telephone and walk-in service. This came on the heels of declining staffing from FY 1996 through FY 1999.

In part because of these changes and increased workload demands, the number of examination and collection cases handled declined by half. This illustrates

the need to balance the continued improvements in customer service with funding adequate to maintain enforcement activity to collect unpaid taxes and address areas of potential under-reporting of income.

### *Current Services Level*

The IRS is requesting a net increase of \$336 million to maintain the current services level. The IRS is a labor-intensive organization and we must have a stable workforce. To maintain current operations, carry out a successful filing season, oversee tax administration programs, and implement organizational modernization, the IRS must have the resources to pay for the inflationary costs associated with statutory pay and other mandatory increases.

Since 1992, the IRS workforce has decreased more than 16 percent while handling significant increases in workload due to tax law changes and customer demand. The downward trend in FTE is the result of: (1) reduced funding in general; (2) inadequate funding for pay components, such as costs of within-grades (WIGs) and promotions; and (3) insufficient funding of non-labor inflationary costs for required agency-wide shared services support costs. During the last few years, costs for Support Services have been cut to a bare minimum. In addition, the IRS has proactively reduced rent costs. From FY 1996 through FY 1998, the IRS released 2.5 million square feet of space for savings of \$40.8 million. There is little room for further cost reductions. Any further cuts in agency-wide shared services support will result in further FTE reductions.

It is vital to note that the long-term decline in the IRS workforce due to funding constraints has led to a situation where virtually no hiring has been done since 1995 in critical front-line skilled positions. (See *Chart C.*) For example, in a revenue agent workforce that was over 15,000 in 1995 and hovers at 12,000 today, the IRS has only hired 75 revenue agents since 1995. Funding of our current services request, together with the STABLE initiative discussed next, will allow us to begin the process of meeting the need for critical skilled positions.

### *Stabilizing the Workforce (STABLE)*

The IRS is requesting \$144 million and 1,633 FTE to stabilize and strengthen tax compliance and customer service programs in FY 2001 and \$39.8 million and 301 FTE for a FY 2000 proposed supplemental. This request is collectively known as the **STABLE** (Staffing Tax Administration for BaLance and Equity) Initiative. I want to stress that even with the STABLE initiative, the IRS would still be slightly below FY 1997 staffing levels, in other words before RRA 98 was enacted into law.

Efforts have been made to improve toll-free service, improve access to new web-based products and information, and expand electronic filing/payment options. However, staffing resources devoted to critical compliance and enforcement

programs have declined by more than 20 percent over the last five years.

Beyond the reduction in staffing levels, annual growth in return filings and additional workload from RRA 98 contributed to steady erosion of enforcement presence, audit coverage, and case closures in front-line compliance programs. Current estimates of additional work directly related to RRA 98 total nearly 4,560 FTE for Compliance and Customer Service activities. (See *Chart D.*) Although the IRS is fully committed to delivering on every mandate and objective of RRA 98, it is essential that we restore and maintain adequate staffing levels in our key program areas.

To ensure that the benefits of this initiative are realized as quickly as possible, the IRS has proposed a supplemental FY 2000 appropriation, which, if approved by Congress, would allow the hiring of 301 FTE in FY 2000. This would ensure that most training of new hires would be undertaken in FY 2000, allowing the impact of these new hires to be fully maximized in FY 2001.

With this staffing level, we expect that in 2001, the IRS will be able to slightly increase levels of service and stabilize the level of exam and collection activity while complying with the taxpayer rights provisions of RRA 98.

#### *Electronic Tax Administration (ETA)*

The IRS is requesting \$3 million for ETA to continue progress toward achieving the congressional goal that 80 percent of all tax and information returns be filed electronically by 2007. In RRA 98, Congress established the interim goal that all returns prepared electronically, but filed on paper (approximately 80 million) be filed electronically by 2003. Increasing taxpayers' awareness and understanding of IRS *e-file* products, services and benefits will help close the gap between the projected range of 44.1 – 49.4 million returns being filed electronically in 2003 and the aggressive goals established by Congress. This funding will be used to expand marketing efforts that communicate the benefits of IRS *e-file* to both taxpayers and practitioners. The IRS plans to advertise in the television, radio, and print media; continue the launch of a business marketing campaign; and conduct the necessary marketing research to ensure that ETA products and services meet our customers' needs. A detailed description of our ETA progress in meeting RRA's goals is found later in the testimony/

#### *Contract Management*

In FY 2001, we are requesting an increase of \$44 million to fund necessary contracts that support general operations, mandatory contractual arrangements and necessary outside expertise. In prior year budgets, we funded these contracts – which were absolutely necessary to conduct business – by reducing funding available for staffing. This is in contrast to our FY 2001 request that simply requests the necessary

funding. Mr. Chairman, I would like to stress that contractual support is critical to maintaining operations and implementing RRA 98 and the Modernization program. Our contractual support is in three categories: mandatory, operational and expertise contracts. I would like to describe for you the type of contracts and provide examples:

- Mandatory contracts make up 44 percent of the total budget and are required by law, or agreement with other Federal agencies. These include National Archives storage of tax records; Treasury's Financial Management Service activities for tax refunds and lock box collections; and Low Income Taxpayer Clinic grants.
- Operational Contracts make up 32 percent of total budget and support IRS operations. Examples include funding for Currency Transaction Report processing, FedWorld management of the IRS Web Site, and Multilingual Interpretation services for Walk-in offices.
- Expertise Contracts make up the remaining 24 percent and are required to obtain expertise outside the IRS for activities including outside services for customer satisfaction surveys and rewriting of IRS Forms and Publications in plain English.

## **Modernization**

The IRS budget is only a small part of the cost to the public of administering our tax system. Most of the costs, both tangible and intangible, are related to what the public encounters when it must deal with the IRS. The tangible cost is each taxpayer's time and money. The intangible cost is the frustration of being treated poorly when making an honest effort to comply with a complex tax code. Moreover, this frustration has occurred at a time when the level of service that many people are receiving from other service providers has been increasing. In order to provide better service to taxpayers across the board, we need to reengineer the entire way the agency does business.

In addition, the tax system depends on each taxpayer who is voluntarily paying the tax owed having confidence that his or her neighbor or competitor is also paying. Modernization will enable the IRS compliance activities to identify more effectively areas of non-compliance and to address them promptly, accurately and fairly.

### *Organizational Modernization*

In FY 2001, an additional \$42 million is being requested to cover IRS reorganization expenses. These costs will peak in FY 2001, decline in FY 2002, and end in FY 2003. The IRS organizational modernization involves the first complete reorganization of the IRS since 1952. Essentially all management positions above the first line are being redefined; district and regional offices are being eliminated;

and some new front-line positions are being created. This massive change is being done with the objective of minimizing physical relocation and associated costs. However, some relocation of personnel and a great deal of reassigning and retraining are required. In addition, some managerial and administrative positions are being eliminated and it is necessary to assist the incumbents in these positions either to find new positions in the IRS or to retire.

Together with the \$140 million included in the FY 2000 base for this effort, this request will be used to cover all the expenses of the reorganization. These costs include buyouts, recruitment, relocations, employee training, equipment, services and supplies, telecommunications moves and installations, and modifications of information systems to the new organizational structure. Resources are also requested for design work, space alterations, and contract movers to physically align employees with their operating divisions for the Area and Industry Offices, Chief Counsel Headquarters, Information Systems, and the National Office. These resources cover all aspects of organizational change that will complement the IRS' systems modernization efforts and implement the RRA 98 reorganization mandate.

#### *Business Reengineering and Technology Investments*

The IRS depends entirely on its computer systems to administer the tax system and to collect and properly account for \$1.9 trillion of tax revenue. Nearly every IRS employee depends on computer systems to perform his or her daily activities, such as processing returns, answering taxpayer questions, adjusting taxpayer accounts, sending out notices and letters, conducting examinations and collecting overdue accounts.

However, the IRS base of existing systems, which evolved over a 40-year period, is totally inadequate to support these activities at an acceptable level of service to the public, internal efficiency, or acceptable risk. GAO and TIGTA repeatedly identify serious problems and risks in IRS operations and financial management, many of which cannot realistically be rectified except by a near total replacement of IRS' systems.

In addition, nearly all the numerous changes required to improve service to taxpayers under RRA 98, and to increase the effectiveness of compliance activities depend on improvements to IRS' information systems. As indicated earlier in the testimony, it would be extremely expensive and require very large increases in staff to meet the service and compliance demands of an increasing economy and the RRA 98 mandates by simply adding staff. Instead, the IRS must reengineer and replace its archaic processes and systems.

Since reengineering the IRS' business practices and systems is a massive job that will take many years, it is necessary to set priorities and adopt time-phased plans since the needs and opportunities for systems improvements are far greater than can be accommodated in any one year, or even a few years.

### *Business Line Investments*

Most of the largest scale and most complex systems' improvements will be accomplished through the agency-wide Core Business Systems program that is funded by the ITIA and is discussed below. However, there are dozens of smaller and more focused high-priority needs to support and improve operations. They are either too specific to be included in the Core Business Systems program, or, if they were included, would not be delivered for many years. The IRS has gone through a prioritization process for these business line investments and requests funding for \$40 million in FY 2001 for only the highest priority of such projects.

We are requesting the \$40 million to develop, redesign or acquire new systems to improve:

- (1) The Taxpayer Advocate's ability to identify problems and recommend changes to the business process by redesigning and consolidating multiple, stand-alone systems into one management and control system;
- (2) The management and reporting of taxpayer and employee complaints by designing a new system;
- (3) The new Tax Exempt/Government Entities organization's ability to process determination requests, contacts with requestors and track the deposits of fees;
- (4) The notices sent to taxpayers, including clarity and reduction of the need for multiple contacts with taxpayers;
- (5) The Chief Counsel Case Management activities, including modernizing many business rules and updating the system to save costly manual work and improve Counsel's ability to timely deal with the Courts, taxpayers and IRS' needs; and
- (6) The walk-in sites' efficiency and service to taxpayers by providing automated management tools of tax information to about 125 walk-in sites.

### *ITIA Funded Core Business Systems*

The Core Business Systems program is an agency-wide program designed to reengineer all of the basic IRS' business processes and the computer systems that support them. After the award of the PRIME contract in December of 1998, the IRS spent CY 1999 and the early part of CY 2000 building the management and governance process necessary to manage this huge program; developing plans for the near-term and medium-term projects; and beginning to update architectural and technology infrastructure plans. This program is being very carefully managed at the highest levels within the agency and adjustments to plans are made frequently based on experience to date and on risks anticipated.

The first, relatively small projects to be delivered will provide for improved telephone service during FY 2001 and provide improved tax computation capabilities to examiners. Further enhancements to taxpayer service over the Internet and increased

electronic tax administration services will follow. Two critically important projects will be planned in detail in FY 2000 and are expected to proceed to development stages in FY 2001. They will replace incrementally and over time the archaic tape-based system that maintains all taxpayer records and improve our financial management systems. Other critical projects to improve service and compliance programs, including correspondence, collection and exam are in the early states of design and further plans will depend on results of the design efforts.

In support of these business projects, work will proceed in FY 2000 to complete institutionalization of the ITIA governance process and the Enterprise Life Cycle methodology. This will provide for the first complete update of the technology blueprint since 1997 and complete major infrastructure and architectural work necessary to support the other projects. Security issues are being given special attention in this work. In FY 2001, continued update of the blueprint and other architectural and technology standards will be done and additional work on infrastructure will continue as necessary to support the business projects.

The Congress through the specified ITIA wisely planned the funding for this core business systems program. This account represents a practical means of funding a long-term program such as the IRS technology modernization program. Under ITIA, Congress appropriates the funds for the program as a whole and the IRS is allowed to plan for continuity of the program subject to stringent reviews and safeguards. No funds are released from the ITIA until the IRS prepares a plan for specific increments of funding and is reviewed and approved by the Treasury, OMB, GAO and the two Appropriations Subcommittees. This approval, however, still only provides the IRS authority to proceed up to a certain funding level. No funds are actually obligated except through a rigorous internal process within the IRS, which is managed by the IRS Executive Steering Committee chaired by the Commissioner.

In FY 2001, we are requesting \$119 million to continue progress as anticipated on the ITIA funded Core Business Systems program. In FY 2000, we requested no funds for ITIA. Remaining balances from prior year appropriations plus the new \$119 million request will support a spending level in FY 2001 of \$330 million. To ensure continued funding, we are requesting an advanced appropriation of \$375 million for FY 2002.

In order to fulfill the mandate Congress gave us in RRA 98, many changes were required in every aspect of how the IRS works. These include implementing specific provisions of law, such as the taxpayer rights provisions of RRA 98 as well as changes in the way performance is measured, people are managed and evaluated, the way the organization is structured and the reengineering and replacement of nearly every basic business system.

At the same time, the IRS had to continue to fulfill essential operational requirements including providing service to taxpayers during each filing season,

administering roughly 801 tax law changes made by the Taxpayer Relief Act of 1997, including nearly 300 new provisions, and completing the enormous program to make IRS computer systems continue to operate after the Century Date Change.

Over the last two years, we have managed these major changes by grouping them into a few basic change programs, each with a management process and a carefully planned and controlled schedule that reflected our best current judgment about priorities, resource limitations and risks. Broadly, these major change categories were: the Year 2000 program, near-term changes to improve service and treatment of taxpayers, implementation of the balanced measures systems, establishment of the new organizational structure including recruitment of management, and finally, reengineering of major business systems and technology.

### **RRA 98 TAXPAYER RIGHTS IMPLEMENTATION**

As discussed, RRA 98 required the IRS to implement 71 new or modified taxpayer rights provisions, many which were effective either on date of enactment, or within six months of it. At the same time, the IRS received recommendations from many sources about other pressing changes that were required to improve service or fix problems. These included such basic matters as availability and quality of telephone service, rewriting of notices and letters sent to taxpayers, control over inventory of assets and hundreds of other matters.

For example, since January 1999, two-hundred eighteen Treasury Inspector General for Tax Administration (TIGTA) audits and 138 GAO audits have been initiated (both opened and closed). The 89 GAO reports that have been issued so far contained 94 recommendations and the 80 TIGTA reports proposed 375 specific recommendations. The National Taxpayer Advocate identified the top twenty problems affecting taxpayers and made recommendations as to what should be done about them.

Addressing and managing these changes requires significant management attention, and many require additional resources, including information systems resources, to implement.

In this context, the first priority was implementation of the taxpayer rights provisions of RRA 98 in accord with the law. Given the short time frames, and many competing demands, our capacity to provide guidance to the public and to employees and to conduct training for the 100,000 employees affected was stretched to the limit. The initial focus was on ensuring legal compliance. In many cases, we did not know the amount of time and resources that would be needed to carry out these provisions. In FY 1999, for example, we had briefings and training on 55 RRA 98 provisions and provided a total of two million hours of training. We estimate that nearly 4,560 full time equivalent personnel were required for the specific administrative provisions of RRA 98.

We are at the stage where we have implemented the RRA legal provisions. However, we have several years of work ahead to make them work more efficiently and

with higher quality. Our immediate challenges are primarily training and management. We are continuing a high level of training in FY 2000.

I want to stress that we are wholly committed to implementing each and every taxpayer rights provision and making them work as intended, while still fulfilling our mandate to collect taxes that are due. We will get the job done and we will get it right. However, we will also make mistakes along the way and we are not yet at an acceptable level of quality, efficiency and effectiveness in the way that we are implementing some of these provisions.

To describe more concretely some of the issues we face, I would like to cover in some detail our approach to three of the 71 taxpayer rights provisions: innocent spouse, due process in collections and third party notices.

### ***Innocent Spouse***

The innocent spouse provisions are some of the most important in RRA 98 because of the often-difficult personal and financial situations of taxpayers covered by them. They generally permit one of the spouses who files a joint income tax return to be relieved of all or a part of the unpaid liabilities associated with a joint return. Unpaid liabilities can be caused by the failure to pay the amount due on the return when it was filed (underpayment), or because of assessments made by the IRS after the return was filed (understatement).

RRA 98 required the IRS to implement a much more complex innocent spouse program than was previously administered. It added three new innocent spouse provisions to one already existing in the law. (RRA 98 also modified a provision that granted relief in community property states.) Each of these provisions defines a different set of conditions under which one of the spouses may be granted relief from all or part of the liability arising out of a joint return. Moreover, the newly enacted provisions were effective on the date of enactment and had retroactive application, which contributed to a high volume of requests for relief upon the enactment of RRA 98.

The chronology in *Chart E* shows the major steps and actions already taken in the innocent spouse program and some of the additional steps already planned.

Our biggest challenge in implementing the innocent spouse provisions cannot be overstated: learning to apply properly and accurately new and complex statutory provisions to very sensitive taxpayer situations has taken a great deal of time and resources. These provisions contain potentially confusing distinctions that must be understood and explained to the IRS employees who would work these cases. For example, certain provisions require *the spouse requesting relief* to show no "constructive knowledge" of a particular item on the return, while another provision requires *the IRS* to show the requesting spouse had no "actual knowledge" of a particular item on a return.

Certain provisions permit refunds while others do not. Certain provisions permit redress in the Tax Court, and others do not. Moreover, other provisions require examiners to determine whether, considering all the facts and circumstances, it would be inequitable to hold the spouse liable. These equitable relief provisions require special care in IRS interpretation and administration because equitable relief is a broad and relatively rare concept for the IRS to administer. Finally, certain provisions require the IRS to consider the facts and circumstances of both the spouse requesting the relief and the other spouse who would continue to have liability whether relief is granted or not. This introduced a novel concept to IRS employees in that they have to consider not only the interests of the party filing the request but also the interest of a related party.

Addressing this difficult learning curve has limited not only assigning resources or forecasting statistics, but more importantly, improving the timeliness and quality of the process for resolving innocent spouse claims. The learning process required experience in actually adjudicating the claims and in understanding how best to train and manage employees, while resolving a continuing stream of legal and policy questions.

Fortunately, a great deal of progress has been made in this area, and guidance and training materials are now largely complete. Consequently, we estimate that by the end of this fiscal year, our inventory of claims in which the taxpayer has not yet received a determination letter will be in the range of 14,000 claims (about 7400 taxpayers) compared to our long term target of 12,000 (6,300 taxpayers). Of course, we will continue to hold collection action in abeyance pending the resolution of the outstanding claims.

The minimum target level is largely driven by required waiting periods to receive information and to communicate with taxpayers. (*Chart F shows the current flow chart currently used to screen and evaluate requests. Chart G shows the necessary time frames for processing the innocent spouse cases.*) For example, built into the process before we make a determination in a case and notify the taxpayer of that determination is a 45-day waiting period to hear from the non-requesting spouse. Additional waiting periods for communicating with and receiving information from the requesting spouse are also included. Moreover, a 30-day opportunity for a taxpayer to request an administrative appeal and a 90-day period for a taxpayer to petition the Tax Court is part of the post-determination process. The minimum target level recognizes that additional resources will not make these periods shorter and assumes that we will continue to receive about 700 claims per week.

We continue to apply the lessons gained from working cases and an increased understanding of the complex new provisions to improve the quality of the determinations that we make, thus ensuring the proper treatment of the taxpayers involved. Some of the most important steps taken were to: (1) centralize management of the program under a senior manager; (2) develop specific flow charts and other training and job aids for the employees doing the screening; (3) revise the procedures

and training based on initial experience; and (4) institute a 100 percent review of completed claims to ensure quality and consistency. Moreover, a Management Information System to track innocent spouse cases has been operational since March of 1999, and we plan to enhance it and other computer support over the next 18 months.

## **Due Process in Collection**

Section 3401 of RRA 98 provided significant new rights to taxpayers before the IRS can take enforcement actions to collect overdue taxes. Collection enforcement action by the IRS generally takes three forms: (1) a levy on the taxpayer's wages or bank account; (2) placing a lien on the taxpayer's assets; or (3) seizing the taxpayer's business or personal assets.

RRA 98 affects each of these enforcement actions somewhat differently. The IRS must provide the taxpayer with written notification of the right to an impartial hearing before an appeals officer after a notice of lien has been filed or before a notice of levy is sent. The taxpayer has 30 days to request an appeal, and during this period the levy or seizure may not take place. Moreover, if the taxpayer requests an appeal, the levy or seizure may not take place until the appeals officer makes a finding. Finally, the taxpayer also has 30 days to challenge an appeals finding in the U.S. Tax Court or U.S. District Court during which time the IRS may not levy or seize.

In addition to these notices and appeals provisions, the IRS, pursuant to RRA 98, also implemented an approval process under which certain liens, levies or seizures must be approved by a supervisor and/or senior technician who would review the taxpayer's information, verify that a balance is due, and affirm that a lien, levy or seizure is appropriate under the circumstances. The circumstances to be considered include the amount due and value of the asset.

In general, these provisions require the IRS to consider all alternatives to pay off a tax bill, such as installment agreements or offers in compromise, before taking enforcement action. During the appeals process, the appeals officer must consider whether the IRS has considered these options.

These new procedural provisions were added to a collection process that is already quite complex and time consuming because of existing notice and procedural practices, a fragmented collection organization, an existing collection appeals process that predates RRA 98, and IRS' heterogeneous and obsolete computer systems. A chart showing the main steps in the collection process is attached. At a more detailed level, there are now six additional steps required to conduct a seizure for all cases. In addition, for assets owned by an individual and used in the course of a business, approval by the district director is required and an analysis must be conducted to show that the taxpayer's other assets are insufficient to satisfy the liability. Seizure of a principal residence requires a court order and the revenue officer must complete a

recommendation package.

The due process in collection provision became effective after January 18, 1999, six months after the date of enactment of RRA 98. Our first priority was to comply with the provisions of the law requiring notice to taxpayers and review of cases. The Act states that no levy may be made on a taxpayer's property unless the taxpayer has been notified in writing of the right to a hearing before such levy is made. This required significant reprogramming of computers as well as revised instructions for 12,500 collection personnel. This objective was accomplished, although, as the TIGTA and GAO reported, certain problems were encountered.

For example, in its September 28, 1999 report (Reference no. 199910074), TIGTA concluded that, generally, taxpayers were sent the RRA 98 lien notice. However, during the implementation period, the IRS was not consistently implementing RRA 98 when it filed tax liens and the associated IRS procedures. As a result, the IRS was not always informing taxpayers and their representatives of the taxpayers' rights to a hearing once a federal tax lien is filed. In its November 29, 1999 report (GAO/GGD-00-4), GAO concluded that the IRS' use of seizure authority produced mixed results. GAO made 12 recommendations that the IRS agreed to use as guidance to improve the seizure and sale program.

The initial effect of these provisions has been to drastically cut the number of collection enforcement actions instituted, as shown in *Chart H*.

After the initial implementation, our focus has been on understanding how to implement these provisions efficiently and consistently and to train our employees on how to take enforcement actions when appropriate while complying with the provisions of the law.

To this end, substantial amounts of training have been conducted for both managers and collection employees, and new guidance has been issued on how to deal with specific collection situations. Later this year, we expect to provide new check sheets and job aids to assist our collection employees in following all the complex steps needed to take correct enforcement actions. We are currently working on improving the process and training for taking collection action in our automated collection operations. New procedures for processing and accepting offers in compromise have also been issued.

*Chart I* shows a chronology of key events and actions associated with implementation of RRA 98 provisions relating to collection.

More fundamentally, the IRS collection approach needs to be basically reengineered in accordance with generally known best practices and technology. As shown in *Chart J*, the IRS devotes 90 percent of its collection resources to accounts over six months old, when commercial experience shows that the likelihood of collection

is low. In addition, this delay increases the cost in interest and penalties to the taxpayer and makes it harder for the taxpayer to settle the debt. The delays associated with potential enforcement action then come into play and can elongate the process by as much as another year.

A key goal of reengineering the IRS collection process is to greatly shorten the delay until an IRS employee contacts the taxpayer, by phone or in person, when there is a significant risk that a tax debt may not be paid, in order to resolve the issue as quickly as possible. The new modernized organization structure provides the management structure necessary to integrate the management of collection operations, and to manage the reengineering of the process and all underlying technology.

### ***Third Party Notice***

Section 3417 concerning Third Party Notices is another provision that presents implementation challenges. It requires us to give a taxpayer reasonable notice before contacting any other person with respect to the determination or collection of the taxpayer's taxes and then to periodically tell the taxpayer who has been contacted. The brevity and seeming simplicity of this statute belies its complexity. *Chart K* shows the chronology of events in implementing Section 3417.

When we first implemented this provision, we attempted a "one size fits all" approach by sending a broadly written notice to virtually every taxpayer in our administrative stream -- a total of 25 million in all. The reaction was immediate, strong, and negative. We were told that the generic nature of the notice did not provide its recipients with any indication of why we would contact third parties to talk about their tax situations or what information we would seek from third parties. We also were told that the tone of the notice was intimidating, implying that we would talk to anyone and everyone, including neighbors, about private tax return information. The notices caused undue (and certainly unintended) anxiety for many persons.

We clearly needed to try a different approach to implement this provision, and we did. First of all, we listened very intently to the feedback we received, and solicited additional input from practitioner groups, the small business community, and other interested parties. In particular, I thank many of the Committee Members and your staffs who have worked collaboratively with us to enhance the implementation of this provision.

We knew from this input that we should provide a frame of reference for the taxpayer in the notices. For example, we should state that we are seeking unfiled returns or unpaid taxes and that we are following up on prior communications. We should alleviate concerns that we would disregard the privacy protections that are so fundamental to our tax administration system when we make these third party contacts and we should look to the taxpayer first to provide the information that we might obtain from third parties.

Not surprisingly, when we moved to address these issues, we learned that the drafting of the notices, though challenging, was not the most difficult part of administering this provision. We quickly learned that if we did not blanket all taxpayers in our pipeline with a third party notice, we had to isolate those instances where a third party contact was most likely, develop a notice appropriate for that situation, and train our employees on how to identify and handle these situations, including the reporting requirements that occur when third party contacts are made. When all was said and done, our refinements narrowed the universe of taxpayers who may receive the notice to about eight million, with slightly more than half of those notices being sent through an automated process and the remainder being sent by employees only when a third party contact is imminent. Beginning in February, we issued new notices -- about 15 in all -- that are tailored to the specific situation of the taxpayer and that address many of the concerns that we heard.

However, we still have our work cut out for us. One troubling area is how to balance the interests of third parties with the rights of taxpayers and the need for efficient tax administration. We are required to record all third party contacts and to periodically report them to the taxpayer involved, except where the contact was authorized by the taxpayer, is with respect to a criminal investigation, would jeopardize collection, or the third party expresses a fear of reprisal. We have instructed our employees to take reprisal claims by third parties at face value. We made this decision to avoid a situation, where by virtue of our second-guessing of a claimed fear of reprisal, we make the wrong call and disclose the contact, only to have the third party suffer harm as a result.

More difficult is the situation where a third party does not claim a fear of reprisal but asks us not to record their name or provide it to the taxpayer. In this situation, the statute requires us to disclose the name of the third party to the taxpayer. The vast majority of third parties do not wish to get caught up in another person's tax dispute, but nonetheless recognize a public duty to assist law enforcement efforts. I am concerned that they undergo a great deal of anxiety when they learn that the disclosure will be made, and, as a result, become disenchanted with the tax system and their government. Though we do not track the instances where third parties ask not to be identified, I understand from reports from the field that it occurs frequently, which puts our employees in a very difficult position. This ultimately may have the effect of creating unwillingness on the part of third parties to provide any information at all to us in the normal course of business, even outside of the situations contemplated by the statute.

I can assure you that we are committed to implementing this provision in a way that is fair to all of the respective players and carries out the intent of the legislation. While we are working on some of the remaining challenges, such as the ones I have described, we have moved forward with training and implementation. We estimate that we are dedicating approximately 500-600 FTE to administer this provision.

## **Enforcement Statistics and Relation to Resources**

I share the concerns about declining enforcement activity and the difficulties we have in providing both top-quality customer service and collecting the taxes that are properly due. In an era of budget constraints, we are facing an enormous challenge in achieving both of these goals. Our goal is to make the IRS more effective in serving the vast majority of taxpayers who voluntarily pay their taxes and in dealing with those who do not, or will not, pay what they owe.

Since the passage of RRA 98, the number of enforcement actions has declined substantially. For example, the fraction of individual returns examined in "face-to-face" audits has declined by about 40 percent, and the number of collection cases closed has declined by a similar amount. There are a number of reasons behind this decline.

First, it is important to understand that the decline in audit rates has not been principally caused because agents have been transferred out of collecting revenue into customer service. From 1997-1999, less than three percent of total staff years were transferred from examination activities to customer service.

The decline in audit rates was caused by constraints, including the budget, which reduced the total number of employees available to conduct audits, while the number of tax returns increased. Also, the Restructuring Act imposed time consuming, but important, new administrative requirements to administer an increasingly complex tax code.

Second, the Restructuring Act and the IRS' plans for reform represent a major and pervasive change in an organization that for decades had a more single focus in which success was measured predominantly by money collected through enforcement actions. The Restructuring Act placed increased demands on the organization at a time when overall staff resources had been declining, not increasing. The IRS is also still dependent on some of the country's most obsolete computer systems.

Let me be clear that the IRS is not stepping away from its commitment to ensuring compliance with the tax law. But it is important for the IRS to stabilize the level of enforcement activity so that the proper action can be taken in each case. We have included additional compliance staffing in our 2001 budget proposal to help address the problem. While it will take some time and additional resources to better IRS overall performance in this area, we are taking some specific steps now to improve compliance levels in particularly critical areas. For example, we have begun an initiative this year to address the growing problem of corporate tax shelters -- complex transactions that have little or no business purpose other than the generation of tax benefits.

There has also been some recent discussion regarding examinations of taxpayers earning \$25,000 or less. Most of the examinations of \$25,000 or less involve asking taxpayers to substantiate a single item on their return, such as EITC or

exemptions, by mailing documentation to one of our customer service centers. This is what the IRS calls a “correspondence exam.” Because these examinations take relatively little time per return compared to all other examinations, the number is disproportionately high compared to the Examination resources used. Although more than half of the individual returns examined in FY 1999 were correspondence, they represent only 11 percent of total Examination resources. (See *Chart L.*) The overall Examination activity includes individual and corporate income taxes as well as estate and gift, employment and excise taxes.

## **ELECTRONIC TAX ADMINISTRATION**

The IRS has made significant progress in implementing the RRA 98 provisions regarding electronic tax administration. (*The 2000 Filing Season initiatives can be found in Appendix A.*) In the nearly two years since the bill was enacted, IRS *e-file* receipts increased from 24.6 million in 1998 to 29.3 million in 1999 and are expected to reach 35 million in 2000. Through April 21, 2000:

- Almost 35 million taxpayers filed electronically; a 20.4 percent increase over the prior year.
- Over 24.9 million taxpayers e-filed through an authorized e-file provider; a 18.7 percent increase over last year.
- On-line filing has also continued its dramatic growth, increasing over 104 percent with 4.9 million returns being filed on line via a home computer through a third party transmitter.

Contributing to this year's successful filing season was IRS' brand new marketing campaign, “30 Million Americans Use IRS *e-file*.” In conjunction with its advertising agency, and as authorized by RRA '98, the IRS developed a fully integrated campaign with TV, radio and print advertising.

The IRS also continued its efforts to move toward entirely paperless electronic filing. For the second year in a row, the IRS tested the use of a Personal Identification Number (PIN) code as the taxpayer's signature, eliminating the need to file the paper *jurat*. The tests have been a resounding success.

- 5.4 million taxpayers participated in the Practitioner PIN pilot compared to 499,606 taxpayers for all of 1999. Taxpayers were able to select a PIN when filing through 18,000 participating preparers.
- Use of the on-line filing Customer Numbers also increased significantly from 660,209 to 1.4 million this year. Under this pilot, the IRS distributed Customer Numbers to taxpayers who prepared their own returns using tax preparation software to file from their home computers.

This filing season, more electronic payments options have been made available to taxpayers, such as accepting debit payments through TeleFile and accepting credit cards for Forms 1040ES, estimated tax payments, and Forms 4868, extensions of time to file. As of April 22nd, 186,512 payments averaging \$2,882 were made via credit card and another 231,108 payments averaging \$1,617 were made by Automated Clearing House (ACH) Direct Debit where taxpayers can authorize either their checking or savings account to be debited.

The IRS also continues to expand the electronic filing options that are available to businesses. As authorized by RRA 98, payors who electronically transmit their information returns to the IRS had an extra month this year – from February 28 to March 31 – to file over IRS' new filing system -- Filing Information Returns Electronically. Partnerships were able to file Forms 1065 and related Schedule K-1s electronically as well. In April, employers had the added option of filing their quarterly Form 941 from their office computer in addition to current methods.

In addition, as required by RRA 98, the IRS issued its first Strategic Plan for Electronic Tax Administration, entitled *A Strategy for Growth*, in December 1998 and issued an updated Strategic Plan the following year. The Strategic Plan is designed to eliminate barriers, provide incentives, and use competitive market forces to make significant progress toward the Congressional goal of 80 percent of all tax and information returns being filed electronically by 2007.

The IRS also established the Electronic Tax Administration Advisory Committee (ETAAC) in September 1998 to provide an organized public forum for the discussion of electronic tax administration issues in support of paperless filing. The ETAAC, which is comprised of representatives from various groups, was established to provide continuing input into the development and implementation of IRS' strategy for electronic tax administration. The ETAAC issued their first report to Congress in June 1999, stating that "the IRS made a good start in setting out a program to achieve the electronic filing goals established by Congress."

## **CONCLUSION**

Mr. Chairman, I believe we are making real progress on the goals and mandates set forth by the landmark IRS Restructuring and Reform Act and to bring meaningful, positive changes to the IRS and America's taxpayers. It is true that no one fully understood everything that would be required to implement this far-reaching Act. However, if Congress can provide continued and assured support for IRS modernization, such as that contained in our FY 2001 budget request, we can succeed.

## **APPENDIX A – THE 2000 FILING SEASON, ELECTRONIC FILING AND CUSTOMER SERVICE IMPROVEMENTS**

By continually managing all of the change and risk in an orderly and integrated fashion, I am pleased to report to the subcommittee that the 2000 tax filing season has been smooth and almost error free. Of equal importance, the 2000 filing season demonstrates some very important and positive trends in service to taxpayers on which we can build in the coming years, especially as our major technology and organizational initiatives take effect.

Projected net collections for FY 2000 are \$1.767 trillion. During FY 2000, we also project to receive 213.1 million returns, including over 127.3 million individual returns, and expect to issue over 93 million individual refunds. As of April 14, 2000, the number of refunds is up 1.95 percent over last year, and the average refund is \$1,640 up 5.8 percent over the same period last year. On-line filing is running 104.2 percent ahead of last year's pace and already exceeded last year's total volume by 2.5 million.

### ***Electronic Tax Administration***

#### **Meeting the Challenge**

The IRS Restructuring and Reform Act of 1998 set forth the mandate that at least 80 percent of returns be filed electronically by 2007. We know that the stakes are high in Electronic Tax Administration (ETA), but so are the potential benefits to taxpayers, practitioners and our tax administration system. There are, of course, the obvious rewards. Increased electronic filing of returns can improve tax administration by speeding refunds to taxpayers, providing positive acknowledgment that a return has been received and reducing the need to correct errors.

However, on a broader scale, improved electronic exchange of information with taxpayers and practitioners advances all three of the IRS' strategic goals: service to each taxpayer, service to all taxpayers and productivity through a quality work environment.

A robust ETA program will reduce time spent by taxpayers dealing with the IRS. We will reduce the number of phone calls we have to answer and because of these two factors we will free up our compliance employees to focus on real compliance issues, rather than just retrieving or correcting information.

The IRS has made considerable progress in expanding electronic filing. During 1999, approximately one out of every four taxpayers, over 29 million individuals, filed electronically using one of three convenient *e-file* options: filing through an IRS-authorized Electronic Return Originator, filing on-line via home computer through a third party transmitter, and filing over the telephone via TeleFile. The IRS expects to receive more than 34 million electronically filed individual income tax returns in 2000.

Businesses also enjoy the benefits of electronic filing and payment. During Fiscal Year 1999, taxpayers made over \$1.3 trillion in tax deposits through the Electronic Federal Tax Payment System (EFTPS). This system allows taxpayers to make their federal tax deposits over the telephone or using the computer, eliminating the need for paper deposit coupons, checks, or trips to the bank. In addition, well over two million employment tax returns were filed electronically or over the telephone during Fiscal Year 1999.

### **The 2000 Filing Season**

The 2000 filing season is turning out to be another growth year for ETA as more taxpayers than ever before are enjoying the benefits of filing taxes electronically. Through April 21, 2000, almost 35 million individual taxpayers filed using one of the three *e-file* options; a 20.4 percent increase over the same period last year.

- ? Over 24.9 million taxpayers *e-filed* their tax returns electronically through an IRS-authorized Electronic Return Originator (ERO); a 18.7 percent increase over the same period last year.
- ? Approximately 4.9 million taxpayers have filed their tax returns on-line via their home computer through third party transmitters. On-line filing is running 104.2 percent ahead of last year's pace and exceeded last year's total volume by 2.5 million returns.
- ? Almost 5.1 million taxpayers filed their returns over the telephone using the award winning TeleFile system. For the first time, taxpayers in Indiana and Kentucky were able to file both their federal and state returns in a single telephone call during the pilot of the first Federal/State TeleFile option.
- ? Overall, 11.8 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, many of the volunteer sites under the IRS-sponsored Volunteer Income Tax Assistance or Tax Counseling for the Elderly programs offer free *e-filing* to those seeking help. Taxpayers can locate the nearest volunteer site by calling the IRS at 1-800-829-1040. As described in the following section, the IRS is undertaking several initiatives to further expand the program this year. Individuals, businesses and practitioners are also seeing many improvements in 2000 and will see even more in future filing seasons.

#### ***New in 2000 for Individual Taxpayers***

Expansion of Signature Pilots: More individual taxpayers are able to file totally

paperless returns in 2000 because the IRS expanded its Practitioner PIN Pilot to include about 18,000 tax preparers. The IRS also continued the On-Line ECN Pilot by mailing 11 million postcards containing e-file customer service numbers (ECNs) to taxpayers who used a computer to file their own returns last year. In 1999, over 650,000 taxpayers participated in the On-Line PIN Pilot, while nearly 500,000 participated in the Practitioner PIN Pilot.

Expansion of Electronic Payments: More electronic payment options (credit card and ACH debit payment) have been made available to taxpayers this year, such as accepting debit payments through TeleFile and accepting credit cards for Forms 1040ES, estimated tax payments, and Forms 4868, extensions of time to file. Last year, over 53,000 tax payments were made by credit card and approximately 75,000 payments were made by ACH Debit.

Additional Forms and Schedules Accepted: More forms and schedules, including Schedule J, Farm Income Averaging, and Forms 8271, Investor Reporting of Tax Shelter Registration Number, 8582-CR, Passive Activity Credit Limitations, 6781, Gains and Losses from Section 1256 Contracts and Straddles, and 8586, Low Income Housing Credit, are being accepted through IRS *e-file*, making the program available to more taxpayers. In addition, the IRS is finalizing its plans for accepting all forms and schedules via IRS *e-file*; half of the remaining forms and schedules should be added for 2001, with the balance by 2002.

Web-based e-file Options: Millions of taxpayers have discovered that the IRS home page on the World Wide Web is an excellent and convenient source for tax forms and tax information. They are also discovering that the IRS *e-file* Partnerships page on the IRS Web site provides links to various private industry companies that provide affordable, convenient, user-friendly *e-file* options. In the spirit of RRA 98, the IRS is partnering with the private sector to provide IRS *e-file* and electronic payment options for individuals and businesses.

2000 Marketing Campaign: To help move us toward the goal Congress set for us, ETA launched a brand new marketing campaign this year, "30 Million Americans Use IRS *e-file*." It is a fully integrated campaign with new TV, radio and print advertising.

### ***New in 2000 for Business Taxpayers***

Form 941 On-Line Filing: This April, employers will have the added option of filing their quarterly Forms 941 from their office computer, in addition to *e-filing* and TeleFile.

Electronically Filed Information Returns: Effective for 2000, payors who electronically transmit information returns to the IRS will have an extra month – from February 28 to March 31 – to file over IRS' new system, Filing Information Returns Electronically (FIRE).

## ***New in 2000 for Practitioners***

Account Management Pilot: The IRS is piloting an Accounts Management Program in the Kansas-Missouri and Southern California Districts to serve the needs of Electronic Return Originators (EROs), financial institutions, large and small employers, and payroll service providers who distribute ETA products and services to taxpayers.

Debt Indicator Pilot: Through the Request for Agreement (RFA) process, selected tax professionals are participating in the debt indicator pilot.

## **Providing Information And Service**

From web-based technology to 24 hours-a-day/7-days-a-week phone service to sitting down face-to-face with a taxpayer with a problem, the IRS continues to work 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 site on the WorldWide Web (the "Digital Daily") is an excellent and convenient source for tax forms and tax information. In preparation for the 2000 filing season, the IRS also has a shorter and easier to remember Web site address – [www.irs.gov](http://www.irs.gov). Since coming on line in January 1996, taxpayers have downloaded over 201 million forms, publications and products. Through February 2000, there have been over 51.5 million downloads as compared to 24.3 million for the same period in 1999 – an increase of almost 112 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 all taxpayer information publications, including the very popular Publication 17, "Your Federal Income Tax"; all TeleTax topics; answers to the most frequently asked tax questions; a library of tax regulations; and the weekly Internal Revenue Bulletin, which contains all the latest revenue rulings, revenue procedures, notices, announcements, proposed regulations and final regulations.

The IRS Web site also now has a W-4 Calculator in its "Tax Info for You" section. In addition, expanded use of online customer service technologies provides greater taxpayer access to IRS help while on the Digital Daily.

### *Web Site and Innocent Spouse*

The IRS Web site has become an important tool in the IRS' efforts to educate and inform taxpayers of their rights under the new RRA 98 innocent spouse provisions and to help them to make correct and accurate claims. To this end, we developed an

interactive application on our Web site that provides taxpayers a general explanation of eligibility for spousal relief. This application has also been distributed to 50,000 tax practitioners nationwide and assists taxpayers in understanding the information IRS needs in order to evaluate innocent spouse claims.

The interactive application includes not only innocent spouse provisions, such as separation of liability and equitable relief, but it also takes taxpayers through injured spouse and community property issues, as well. Moreover, the interactive application will give taxpayers direct access to forms and publications so they can apply for any of the applicable relief options. We have shared this interactive Internet application with 11 Internet sites associated with spousal issues, including the Oprah Winfrey Television Show Web site.

### *Web Site and Installment Agreements*

In August 1999, the IRS announced a new aid for those interested in paying their taxes on an installment plan. The IRS Web site now has an interactive calculator that helps a person figure the monthly payment amount, and then prints out an installment agreement form for the taxpayer to file.

The calculator is for individuals who have filed their returns and are not already paying taxes under an installment agreement. It is available through the "Interactive Installment Payment Process" link on the "Tax Info for You" page of the IRS Web site.

Those qualifying for a "streamlined" agreement – generally, taxpayers with a tax debt of not more than \$25,000 that they will be able to pay off within five years – will find out how long their proposed monthly payments would last. Taxpayers who do not meet the criteria for a streamlined agreement can compare their monthly expenses to the amounts allowed under the IRS' Collection Financial Standards, to help determine an appropriate tax payment amount.

Users may print out the Form 9465, Installment Agreement Request, from the Web site – with the allowable expense worksheet, if used – and mail it to the IRS for review and approval. The Web site does not store or transmit any personal data. Persons who are already paying back taxes under an installment plan must pay all subsequent taxes on time or they will default on their agreement.

### *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 Corner offers practitioners the opportunity to order electronically tax products, including the Federal Tax Forms CD-ROM. Practitioners can also subscribe to electronic e-mail information services, such as the Digital Dispatch and Local News Net, giving them access to instantaneous news and information direct from national and local IRS offices. The Web site also provided highlights of the first conference on IRS Modernization, a joint effort between the IRS and private sector partners, including the American Tax Policy Institute, American Bar Association, American Institute of Certified Public Accountants, National Association of Enrolled Agents and Tax Executives Institute.

### Web-based Customer Service

This filing season, the IRS continues to provide interactive electronic tax law assistance to taxpayers via its Web site. Users click on the mailbox icon on the Digital Daily home page and then proceed to the Tax Law Question section. This is not intended for highly complex tax issues or questions regarding specific tax accounts. Specific tax account or refund questions must still be handled by telephone or in person. IRS customer service staff will provide answers to “general” tax law questions to assist taxpayers in preparing their returns. Taxpayers select one of a number of categories, provide an *e-mail* address, and submit their questions. To answer taxpayers accurately, economically and quickly, the IRS will provide a “pre-prepared” response, if available.

### CD-ROMs

The Federal Tax Forms CD-ROM contains more than 600 tax forms and instructions for the current tax year, and an archive of forms and instructions dating back to 1992, and some 3,000 pages of topic-oriented tax information. Users can electronically search, view-on-screen, or print any of the items contained on the CD on their own printers. The two-issue subscription is conveniently available through the *Digital Daily* for \$21. If ordered by fax, mail, or telephone, the cost is \$28. As of April 26, 2000, over 104,520 subscriptions were sold through all venues.

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.” Last year’s prototype CD-ROM received highly favorable reviews from small businesses and external stakeholders. As a result, the Year 2000 version of the CD-ROM is being made available free of charge, one-per-customer, by calling our toll-free number at 1-800-TAX-FORM. It can also be ordered on the IRS Web site.

The CD-ROM is an interactive multi-agency product utilizing the latest technology

to provide the small business taxpayer with easy-to-access and understand information. The CD-ROM provides an array of helpful information for business operators, including actions to take before going into business and tax filing and reporting responsibilities when starting, expanding, closing and selling a business. In addition, it includes all of the business tax forms, publications and instructions for *e-filing*. The CD-ROM also allows users with Internet access to link to other helpful federal and state web sites.

We are working with the SBA, the Association of Small Business Development Centers and the Service Corps of Retired Executives (SCORE) to help publicize and distribute the new CD-ROM so that we can get it to the people it will help most. Combined, these organizations have over 1,500 locations and the IRS is sending each site 100 free copies of the CD-ROM to share with their small business clients. Each Member of Congress will soon receive two copies, as well.

### *EITC CD-ROM*

IRS' Earned Income Tax Credit CD-ROM is now available. The first EITC CD-ROM was shipped to the three IRS distribution centers on February 17th. Thirty thousand disks were produced. The EITC CD-ROM is aimed primarily at tax practitioners and contains hundreds of forms, along with electronic documents and publications to help tax professionals meet their obligations related to EITC due diligence. It is the IRS' hope that the electronically searchable publications and electronically fillable forms will reduce practitioner burden and help in compliance.

### *New TAXi Module Debuts/TAXi CD-ROM Nears Completion*

The new Tax Interactive module, "The Real Planet" debuted this year. Tax Interactive is IRS' Web site for teens and is part of the "Digital Daily." The original TAXi concept was created and produced through the joint efforts of the IRS and the American Bar Association's Section of Taxation.

The new TAXi module is a Web talk show about "teens in business for themselves" and explains planning and operating a business, with an emphasis on business related taxes. The module helps teens learn in the same relaxed and fun style as the other TAXi modules. "The Real Planet" gives teens a practical introduction to owning a business and the related tax obligations.

IRS is again working with the American Bar Association's Section of Taxation to develop a companion CD-ROM product for TAXi. When it is completed, teachers will be able to use the Tax Interactive materials on their local computers and networks, without an Internet connection. The CD-ROM will be completed next month.

### **Telephone Assistance**

#### ***24/7 Phone Service and Access***

One of the hallmarks of the IRS' commitment to providing top quality service to taxpayers is 24 hours-a-day/7 days-a-week toll-free telephone service (1-800-829-1040). So-called "24/7" phone service became a permanent IRS service feature on January 4, 1999, and we offer it throughout the filing season. After April 17, we will continue to offer around-the-clock service for refund and account callers, and service will be available for tax law assistance Monday through Saturday from 7:00 AM until 11 PM. As of March 31, 2000, more than 37 million taxpayers have been served on all product lines in FY 2001, compared to almost 43 million over the same period last year.

As the subcommittee is aware, the expansion to 24/7 service last year, combined with increased training demands to implement the new tax law requirements, caused the effective level of service to decline, especially during the beginning of the filing season. However, we believe we have turned a corner this filing season. The upward trends across the board in phone service are most encouraging and show that our investments in training, management and technology are beginning to pay dividends. For this filing season as a whole, our level of service is 63 percent so far compared to our target of 58 percent. In the last four weeks, the level of service averaged 66 percent.

Some of our toll-free telephone strategies and initiatives for the 2000 filing season include: the Customer Service Field Realignment, implemented October 1, 1999, that will help us to make the best use of staffing by routing calls to where we have trained people available; the increased ability to answer tax law inquiries by assigning additional compliance staff during regular hours and overtime and supplementing them with Appeals officers; improved accessibility to and service from the National Taxpayer Advocate; and expanded Spanish Language Assistance.

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.

For 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.

To promote consistency in call accounts quality, we established a Centralized Quality Review Site in October 1999 to replace the field review process we had previously employed. The reported quality rate is lower in FY 2000 because the IRS is reviewing more stringently for adherence to Internal Revenue Manual requirements. If Customer Service representatives do not perform all action required by the IRS, the call is marked as incorrect.

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 long-term objective of our overall modernization program.

### ***Forms By Fax***

Taxpayers can receive more than 150 frequently used tax forms 7 days a week, 24-hours-a-day from IRS TaxFax. Taxpayers can request up to three items per call. Taxpayers use the voice unit of their fax machine to dial the service at 703-368-9694. 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, and dependents or other topics, such as electronic filing, which form to use, or what to do if you cannot pay your taxes. Nearly 11.5 million taxpayers used TeleTax last year for recorded tax information; as of March 25, 2000, over 22 million have taken advantage of the service so far this fiscal year.

### ***Automated Refund Information***

In FY 1999, more than 34 million taxpayers used the Automated Refund Information system on TeleTax to check on the issuance of their refund checks. As of April 15, 2000, the number stands at over 26 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. to 5:30 p.m. for rotary or pulse service.

### ***Taxpayer Assistance Centers***

#### ***Saturday Service***

Delivering on our promise to supply even more reliable and helpful taxpayer assistance, the Internal Revenue Service is providing Saturday service for the entire 2000 filing season at 275 locations nationwide, and for the first time, Sunday service on April 16th. Through April 8, we served 107,050 taxpayers on weekends. So far this filing season, we have served over 4.9 million taxpayers at all Taxpayer Assistance Centers – a six percent decrease from last year.

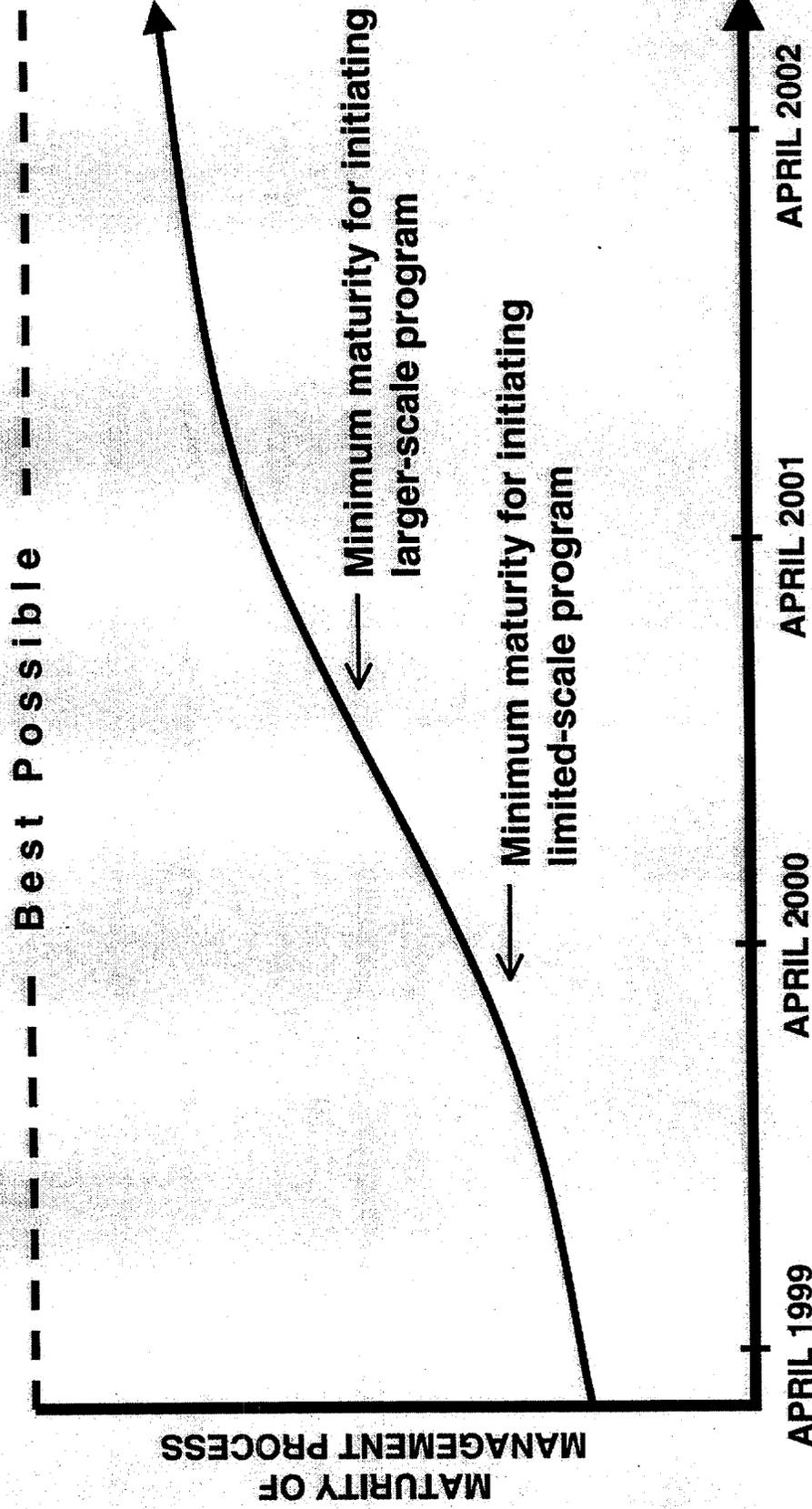
The Saturday Service sites were selected based on their weekend accessibility, year-round operational status, and high traffic volume and include non-traditional locations, such as shopping malls, community centers and post offices.

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; (4) processing of alien clearances; (5) acceptance of payments; and (6) return preparation.

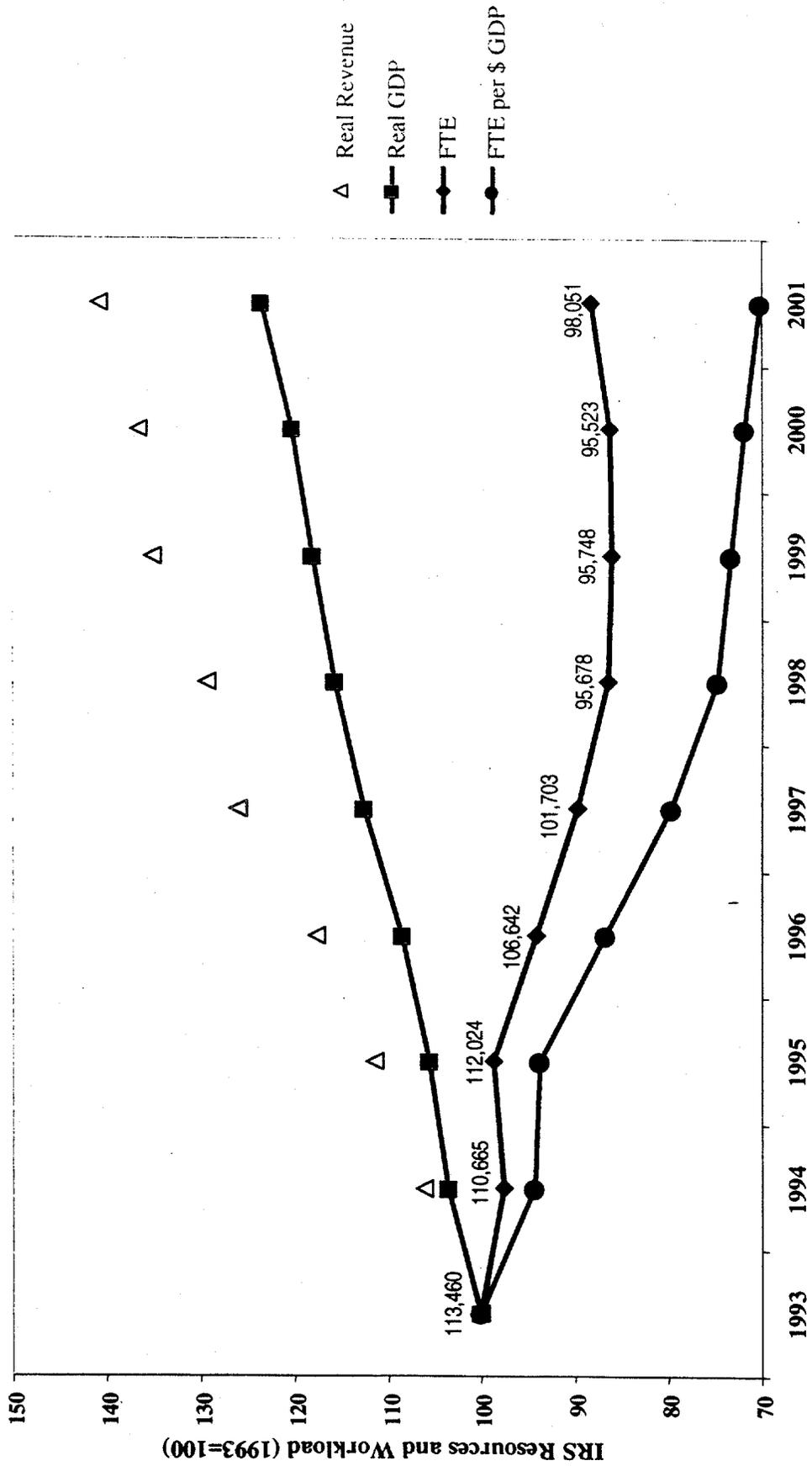
While some taxpayers prefer face-to-face meetings with IRS personnel to resolve their problems, we believe that in the long run, most taxpayers can be best served over the toll-free telephone services and the Internet. We also believe that by energizing the VITA return preparation program and co-locating these activities at the Taxpayer Assistance Centers, the IRS will be able to focus on simple account and collection issues.

# IRS TECHNOLOGY MODERNIZATION MANAGEMENT PROCESS



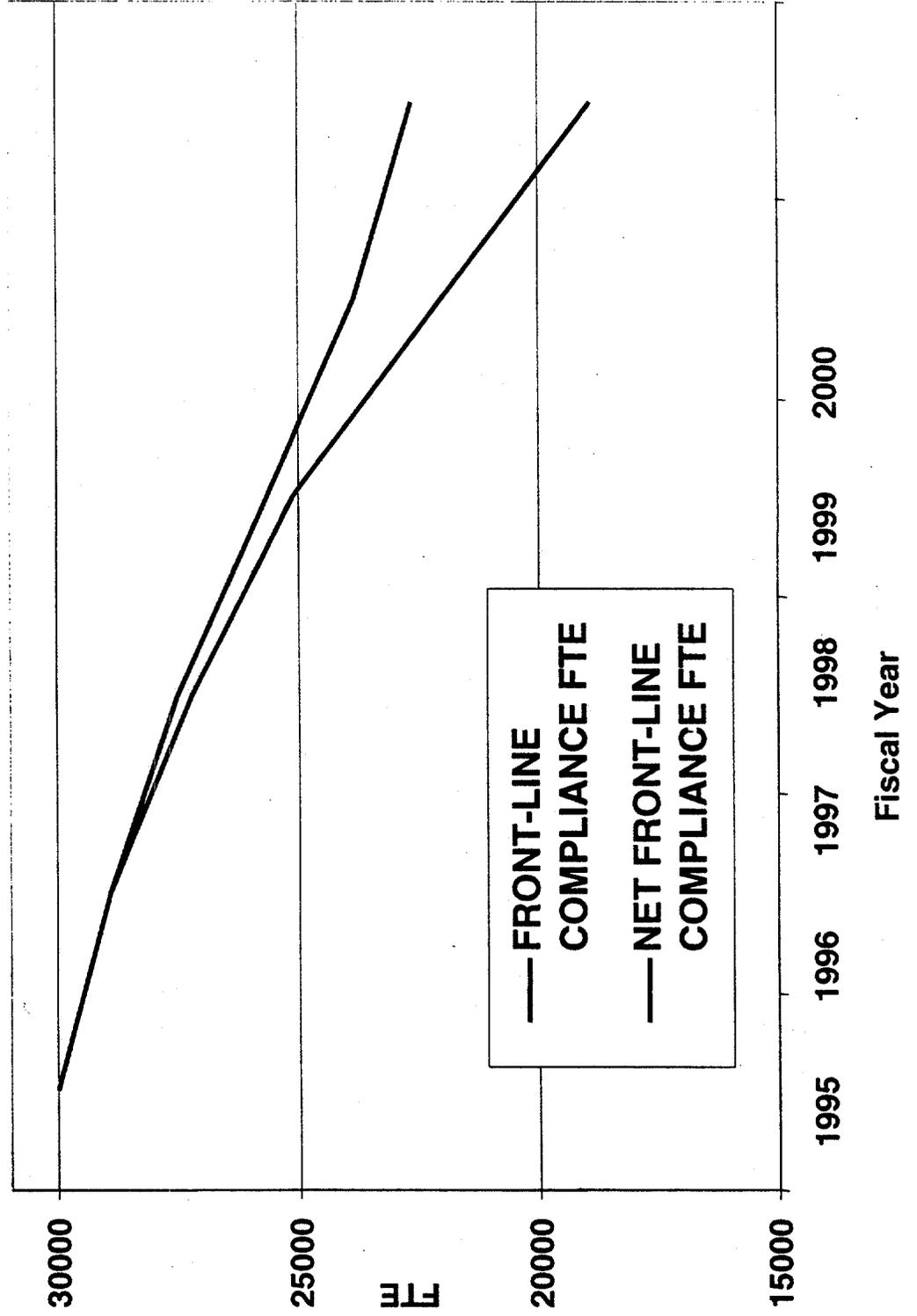
- ELEMENTS OF MATURE MANAGEMENT PROCESS:**
- Program Management
  - Enterprise Life Cycle
  - Acquisition Management
  - Change Management
  - Architecture and Standards Management
  - Technology Infrastructure

# IRS SHRINKS AS A FRACTION OF THE ECONOMY



FTE excludes EITC (starting in 1998) and Inspection (starting in 1999).

# FY 1995 - FY 2000 FRONT-LINE FTE COMPARISON



# FY 2000 Mandatory FTE Increases from RRA '98

## FTE by PROGRAM

	Code Section	Total FTE
1203	Termination of Employment for Misconduct; Incl 1203 Training	126
1205	Employee Training Program	366
3001	Burden of Proof	5
3201	Innocent Spouse Case Processing & Adjudication	731
3301	Global Interest Netting	103
3401	Due Process in Collections	356
3417	Third Party Notices	587
3462	Offers in Compromise Case Processing	1,673
3501	Explanation of Joint & Several Liability	20
3705	Spanish language assistance/live assistor option/contact on manually generated notices	63
****	All Other Codes	529
	<b>TOTAL</b>	<b>4,560</b>

## Chronology of Section 6015, Innocent Spouse

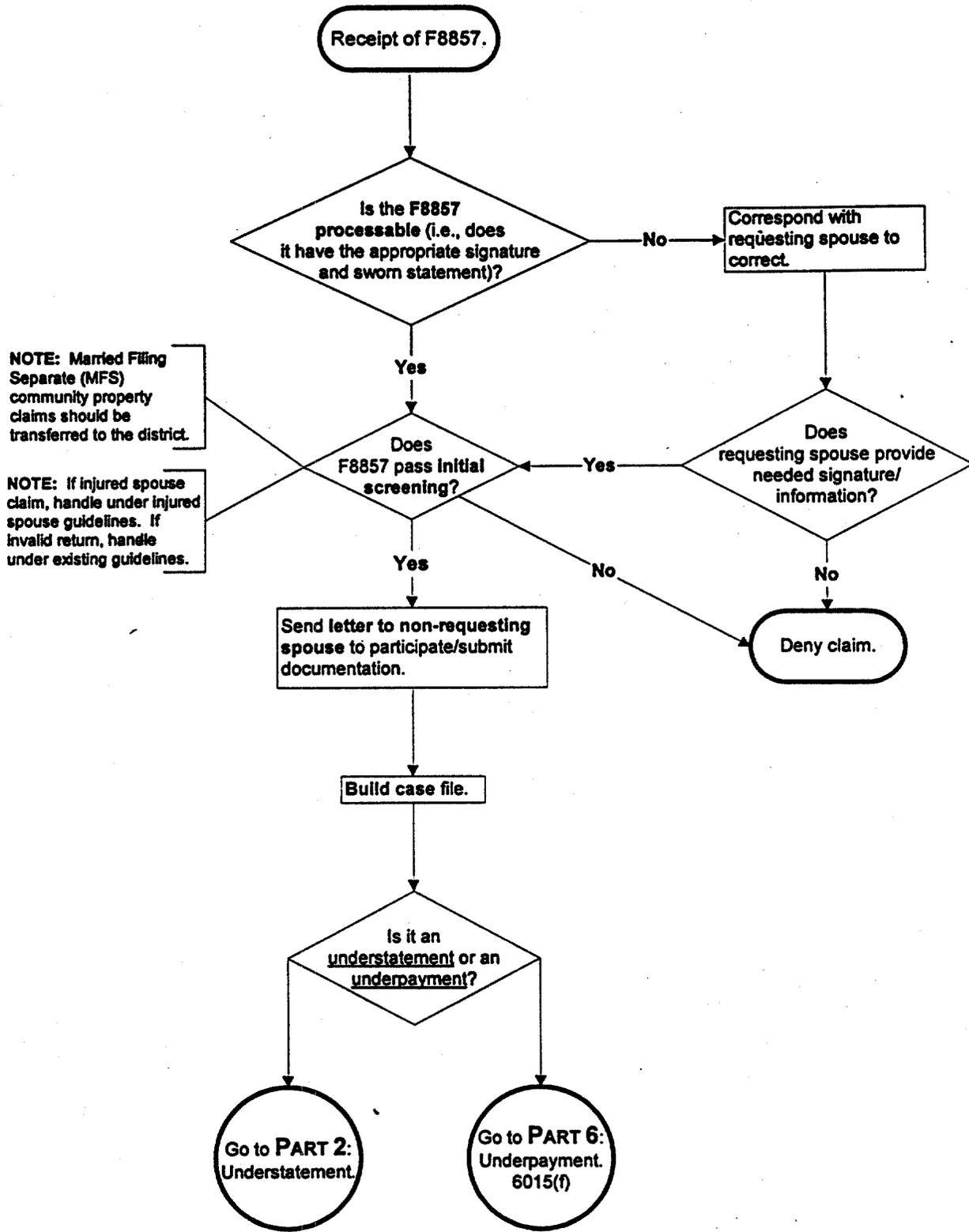
- January 1998      **Action plan** developed by Chief Office of Management Operations. Action items included revision of claim form, creation of new publication, an external communication strategy, and internal reminders.
- March 1998      **Cincinnati Service Center** chosen as centralized site for handling of Innocent Spouse Claims. Pipeline procedures developed including local tracking system.
- March 1998      Revised **Form 8857**, Request for Innocent Spouse Relief, published
- April 1998      **New Publication 971, Innocent Spouse Relief**, published
- April 1998      **Centralized Innocent Spouse Unit in Cincinnati Service Center** operational
- 07/22/98**      **Passage of RRA 98, Section 3201, new Innocent Spouse Provisions**
- July 1998      **IVT Training** available to all employees and RRA coordinators
- September 1998      **IRS Executives' Conference** - Innocent Spouse training
- September 1998      **RRA 98 Training, Phase I**, included new Innocent Spouse provisions
- November 1998      **Innocent Spouse Coordinators** designated for regions, service centers, districts, and Appeals
- November 1998      Targeted **training for compliance employees** who handle Innocent Spouse cases
- December 1998      **Notice 98-61 (1998-51 IRB 13), Interim Guidance for Equitable Relief from Joint and Several Liability**, was issued 12/07/99, to provide interim guidance to requesting spouses seeking equitable relief under Code section 6015(f). Public comment was solicited in developing final guidance.
- December 1998      **Taxpayer Advocate Directive 1998-1** issued on 12/7/98, directing waiver of accrued penalties on claims placed in suspense pending issuance of equitable relief procedures

December 1998	Cincinnati Service Center - in <b>depth technical and procedural training</b> for 6015(f) reviewers, district coordinators, and tax auditors
December 1998	Team from counsel, national office, management and front line worked cases to aid in IRM revision. <b>Flow chart developed, tested, and revised.</b>
December 1998	<p><b>Publications</b> were revised to include explanations of new law and required notifications:</p> <ul style="list-style-type: none"> <li>• <b>Form 8857, "Request for Innocent Spouse Relief," and instructions incorporating new provisions of law</b></li> <li>• <b>Publication 971, "Innocent Spouse Relief"</b></li> <li>• <b>Publication 1, "Your Rights as a Taxpayer"</b></li> </ul>
January 1999	<p><b>Publications</b> were revised to include required notifications:</p> <ul style="list-style-type: none"> <li>• <b>Forms 1040</b></li> <li>• <b>Publication 1660, "Collection Appeal Rights"</b></li> <li>• <b>Publication 594, "The IRS Collection Process"</b></li> </ul>
January 1999	Temporary <b>National Centralized Review</b> of all <b>equitable relief cases</b> established to ensure consistency in application of law
February 1999	<b>Week long training</b> for coordinators, reviewers, PRP/TAO, collection, appeals functions, and CSC
February 1999	<b>Publication 556</b> , "Examination of Returns, Appeal Rights and Claims for Refund" was revised to include Innocent Spouse Reference
March 1999	<b>Innocent Spouse Tracking System (ISTS)</b> went online
April 1999	National Office <b>Training</b> of all District Innocent Spouse <b>Coordinators</b> completed
April 1999	<b>Mass shipment</b> of cases from Cincinnati Service Center to districts because of backlog due to unexpected high volume of claims filed
May 1999	<b>National Innocent Spouse Project Manager</b> selected
June 1999	<b>National office quality review</b> of sample of cases

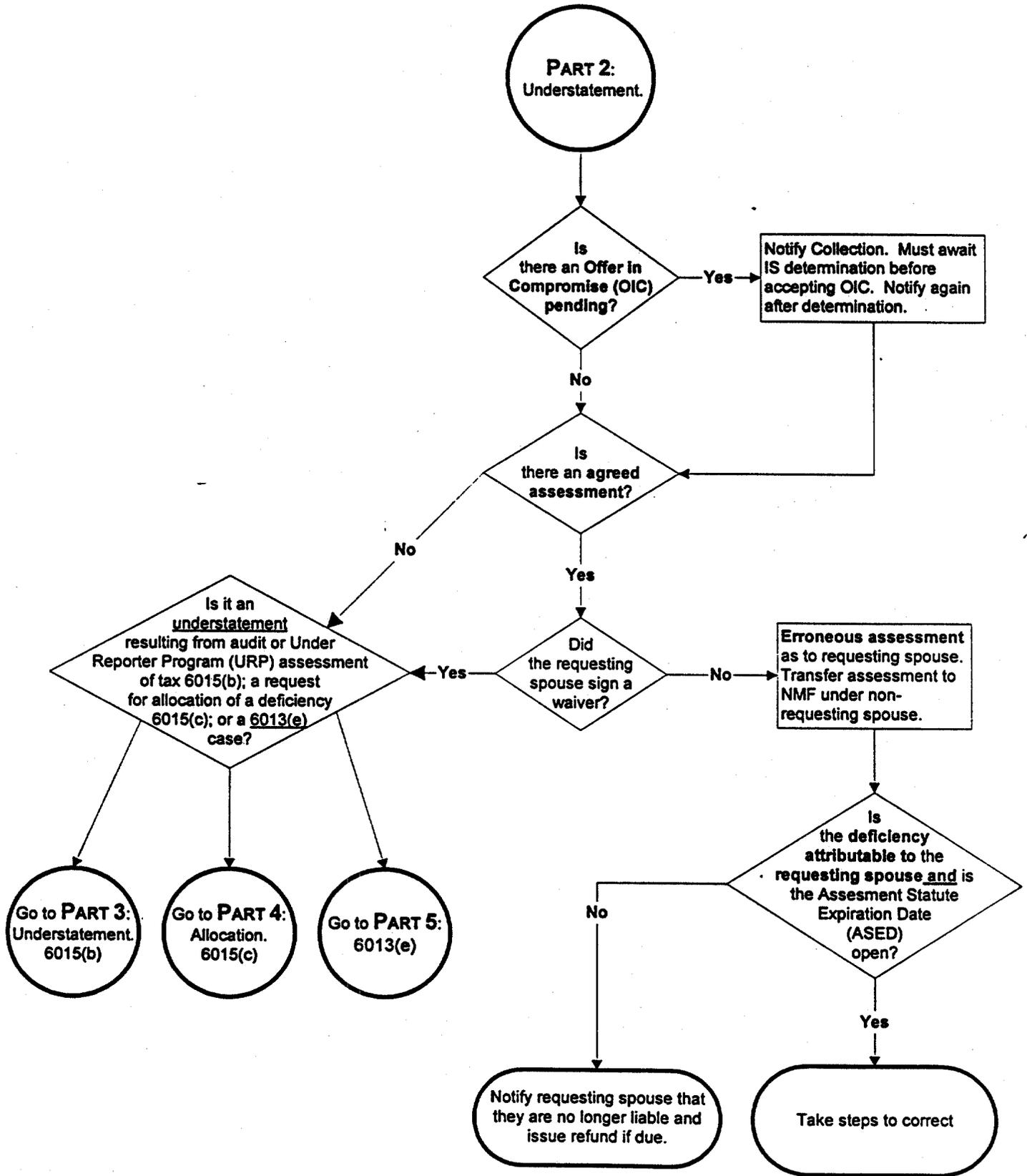
June 1999	<b>National meeting</b> of all District Innocent Spouse <b>Coordinators</b> to discuss barriers and direction of program
June 1999	<b>Appeals Centralized Post Review of equitable relief cases</b> established
July 1999	<b>Special Assurance Reviews</b> conducted in Cincinnati Service Center and 5 districts
July 1999	<b>Decision Tree</b> document created to assist in determining whether cases should be worked in Cincinnati Service Center or district
August 1999	<b>Decision Tree Training</b> conducted for all District Innocent Spouse Coordinators, their managers and branch chiefs.
August 1999	<b>Interactive Video Training (IVT)</b> broadcast to employees focusing on difficult provisions of innocent spouse law
August 1999	<b>CPE</b> for all employees included Innocent Spouse
August 1999	<b>Executive Steering Committee convened</b> with program, function, national office and taxpayer advocate representatives
September 1999	Temporary <b>National Centralized Post Review of Innocent Spouse</b> cases established to review quality and conduct trend analysis. Superseded national review of equitable relief cases
October 1999	<b>Form 8857, Request for Innocent Spouse Relief</b> , and instructions, revised again to be more taxpayer-friendly, to eliminate the filing of claims not truly Innocent Spouse Claims and to refer taxpayers to Injured Spouse relief
October 1999	Debut of <b>Interactive Internet Application</b> - "Spousal Tax Relief Eligibility Explorer" - shared with 50,000 practitioners and on web site
November 1999	<b>3 Issue Specialists</b> selected (for Cincinnati Service Center, community property and overall)
December 1999	Publication of <b>new/revised letters</b> to requesting and non-requesting spouses
January 2000	<b>Formal training course</b> on Innocent Spouse piloted

January 2000	<b>Multi-functional team pilot</b> started in 4 districts to make innocent spouse determinations, drawing on expertise of various functions to reach determinations and handle account processing
January 2000	<b>Issuance of Revenue Procedure 2000-15, Guidance for Equitable Relief from Joint and Several Liability (2000-5, IRB 447)</b> , on 01/18/2000, superceding interim guidance contained in Notice 98-61
January 2000	Phase I of IV for <b>Integrated Case Processing (ICP) System</b> for Innocent Spouse
January 2000	<b>Test of 1,000 CSC and 500 District cases</b> to enhance criteria used to assign cases to appropriate personnel in CSC or field
January 2000	<b>IRS Executives' Continuing Professional Education - Innocent Spouse training</b>
March 2000	<b>Formal Innocent Spouse training material</b> published
April 2000	<b>Innocent Spouse Web Site</b> available for employees. Access to handbook, memoranda and job aides
May 2000	<b>Innocent Spouse Tracking System training</b> scheduled
May 2000	<b>Quarterly National Meeting</b> of all regional and district Innocent Spouse <b>Coordinators</b> scheduled
Short term goal	<b>Issuance of Regulations</b> on Innocent Spouse Relief

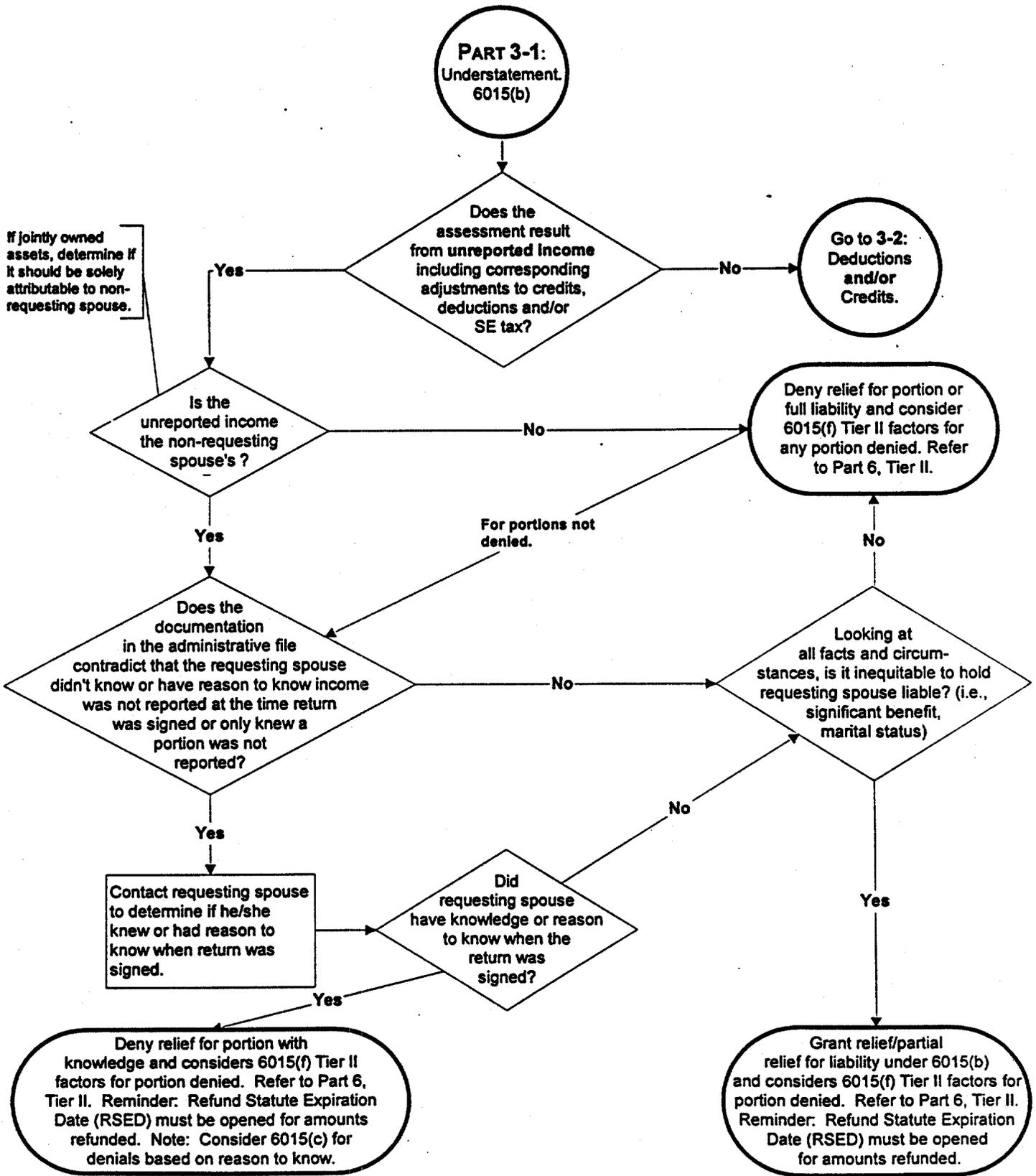
**Innocent Spouse  
Decision Tool for Full Scope Determinations  
Part 1: Initial Screening**



**Decision Tool for Full Scope Determinations  
Part 2: Understatement of Tax**

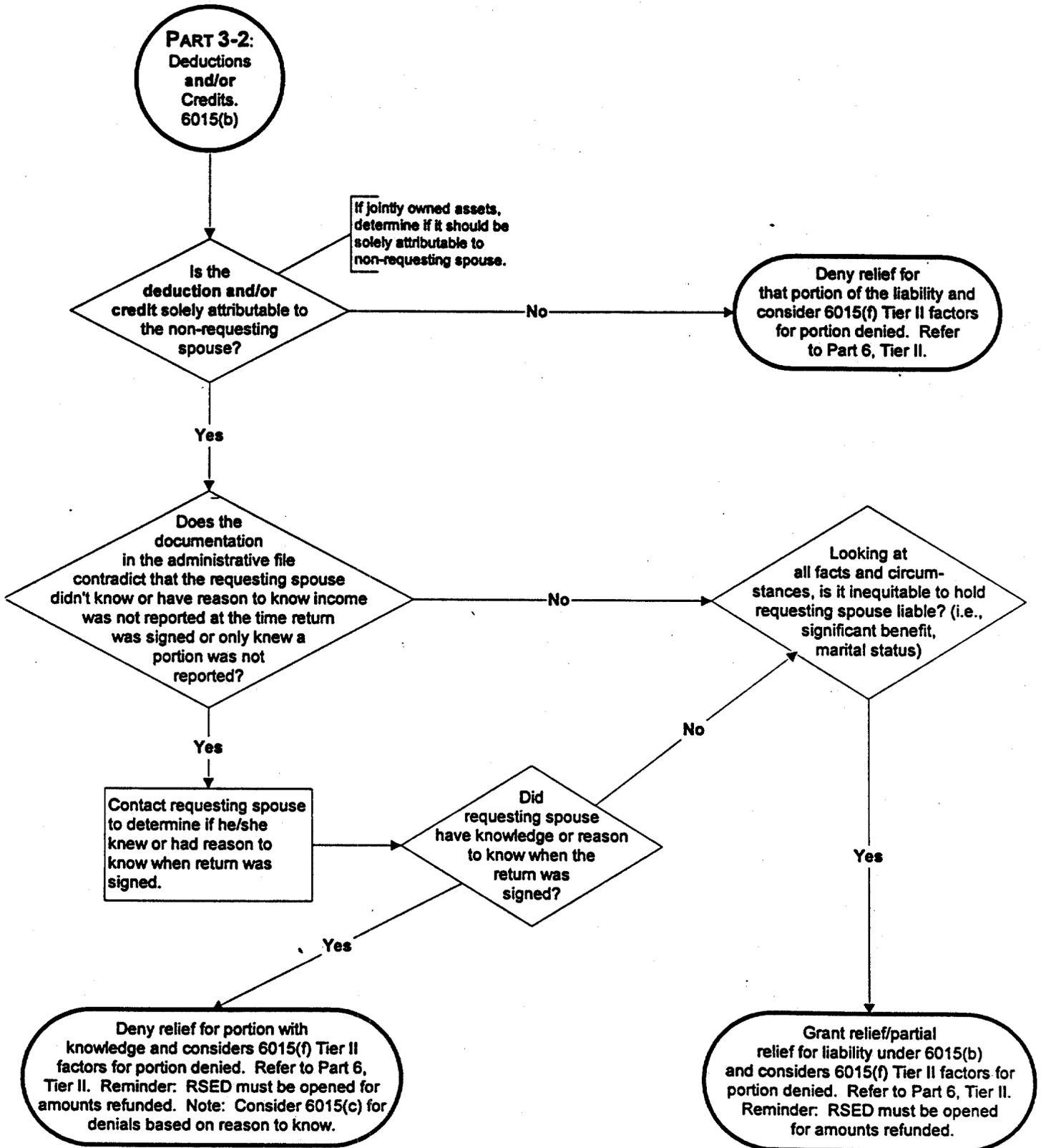


**Decision Tool for Full Scope Determinations  
Part 3-1: Understatement of Tax - 6015(b)  
Assessment from Unreported Income**

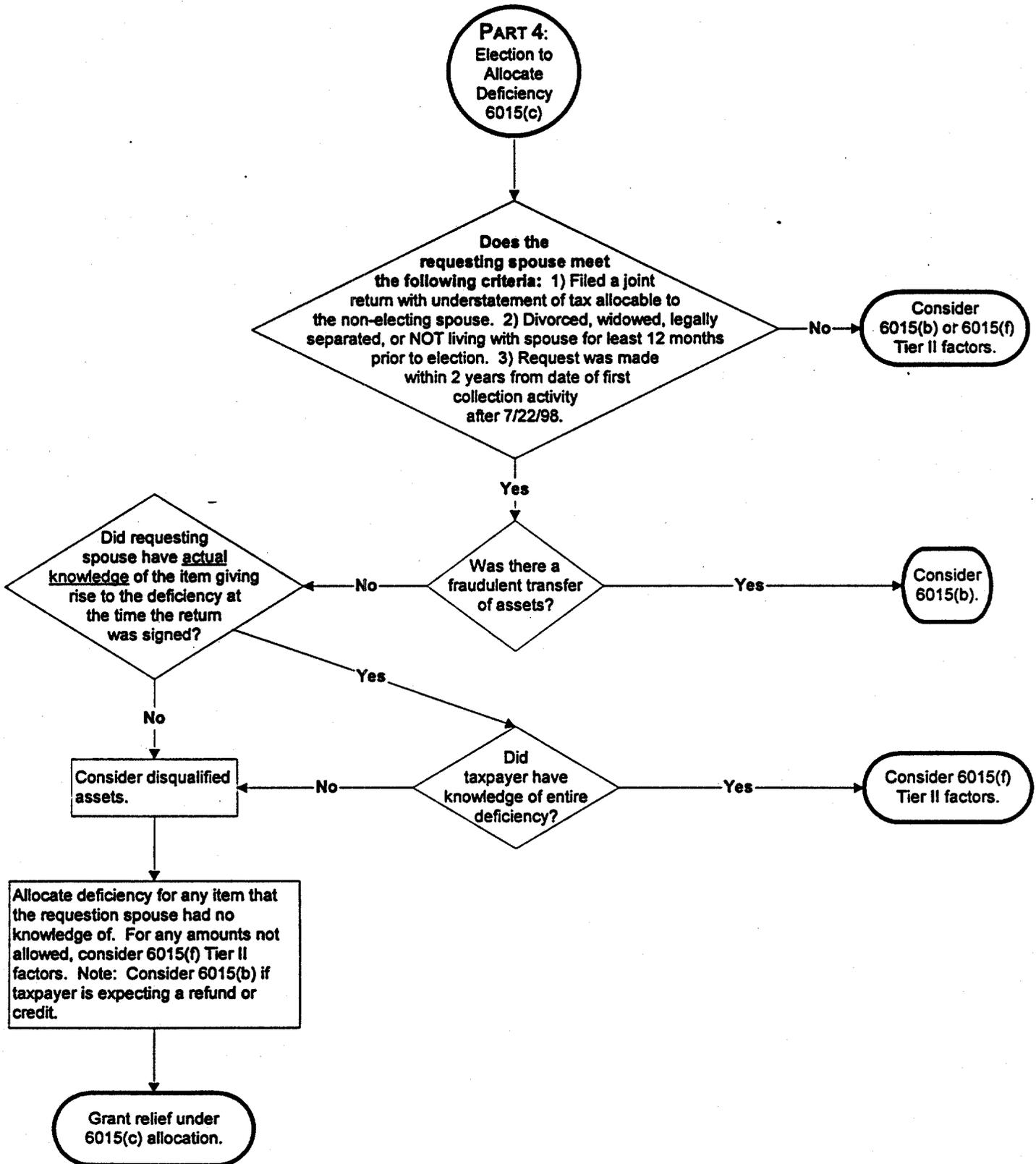


If jointly owned assets, determine if it should be solely attributable to non-requesting spouse.

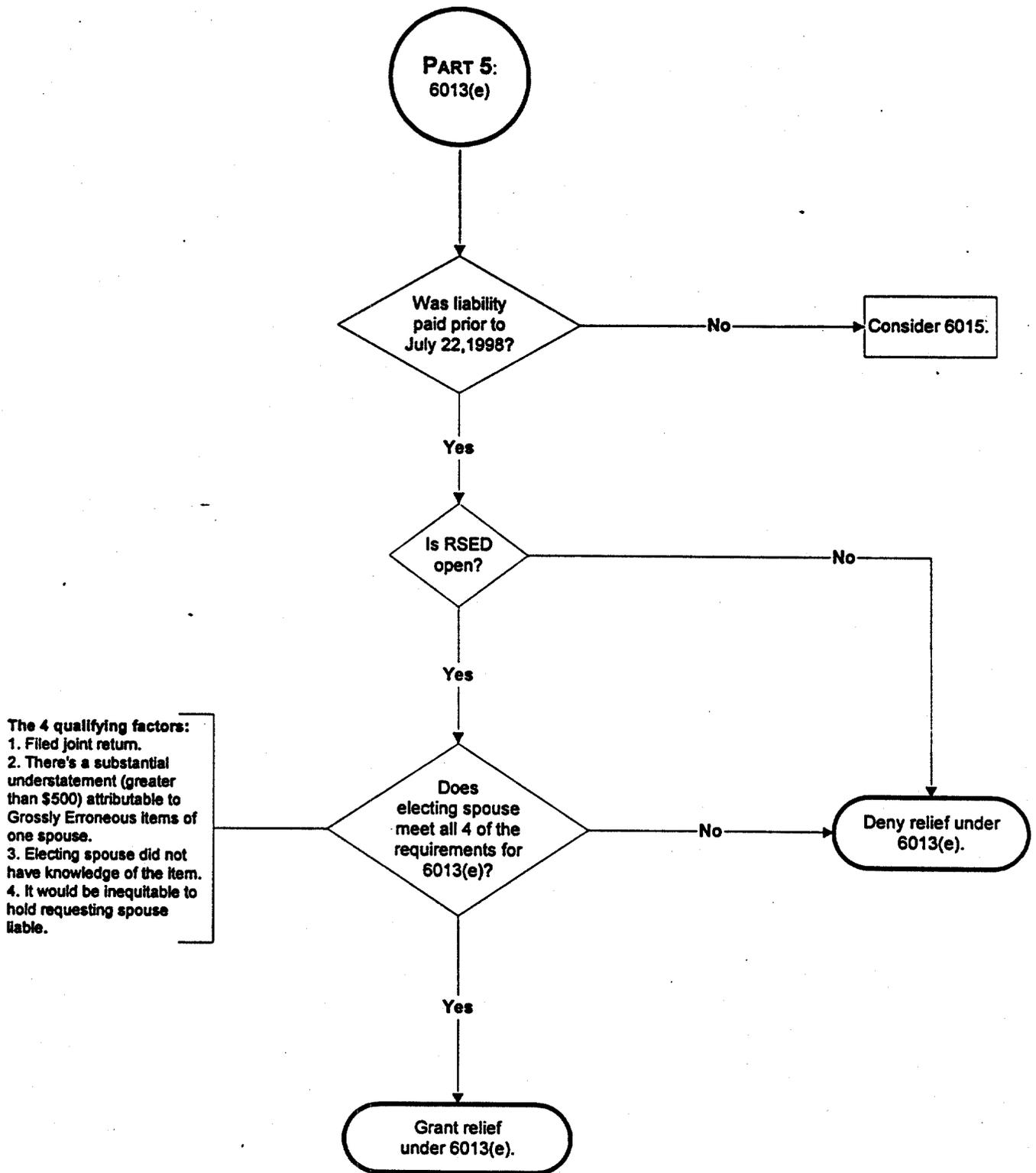
**Decision Tool for Full Scope Determinations  
Part 3-2: Understatement of Tax - 6015(b)  
Assessment from Deductions and/or Credits**



**Decision Tool for Full Scope Determinations  
Part 4: Election to Allocate Deficiency - 6015(c)**



**Decision Tool for Full Scope Determinations**  
**Part 5: IRC Section 6013(e) - Applies to liabilities paid prior to July 22,1998**



# Decision Tool for Full Scope Determinations Part 6: 6015(f)

**PART 6:  
6015(f)**

- Seven Requirements:**
1. Joint return.
  2. Relief unavailable under (b) or (c).
  3. Time limitation.
  4. Tax Unpaid.
  5. No fraudulent transfer of assets.
  6. No transfer of disqualified assets.
  7. No fraudulent return.

Are all 7 eligibility-threshold requirements met?

No

Disallow case under 6015(f).

Is it an understatement or underpayment?

Underpayment

Considering all facts of the case and information provided by the requesting spouse. Are all four qualifying factors met (Tier I)?

No

Are all facts of the case provided by the requesting spouse?

No

- Tier I Factors:**
1. Divorced, separated, widowed or living apart for 12 months prior to requesting relief.
  2. Belief tax was to be paid.
  3. Economic Hardship.
  4. Liability attributable to non-requesting spouse.

Contact requesting spouse to obtain information about one or more qualifying factors. Also request information pertaining to Tier II factors.

Yes

Yes

Is it inequitable to hold requesting spouse liable?

Yes

Does the requesting spouse meet all Tier I factors?

No

No

Grant relief under 6015(f).

Yes

Reconsider all facts of the case and information provided by the requesting spouse. Do the relative merits of the Tier II factors support relief?

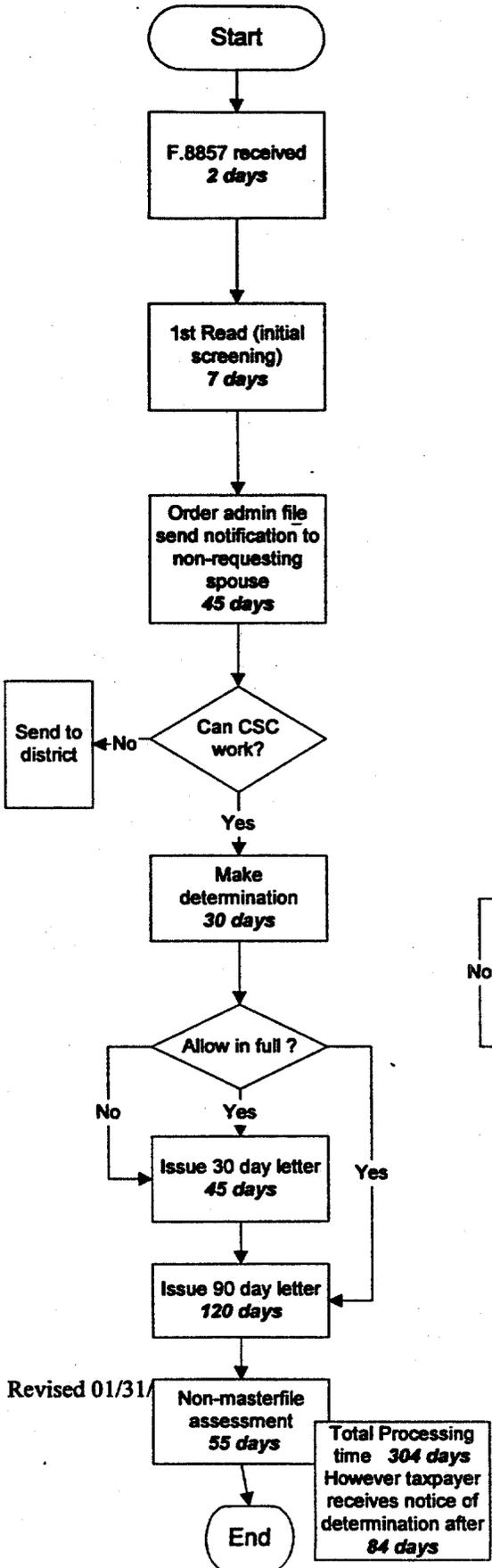
No

Disallow case under 6015(f).

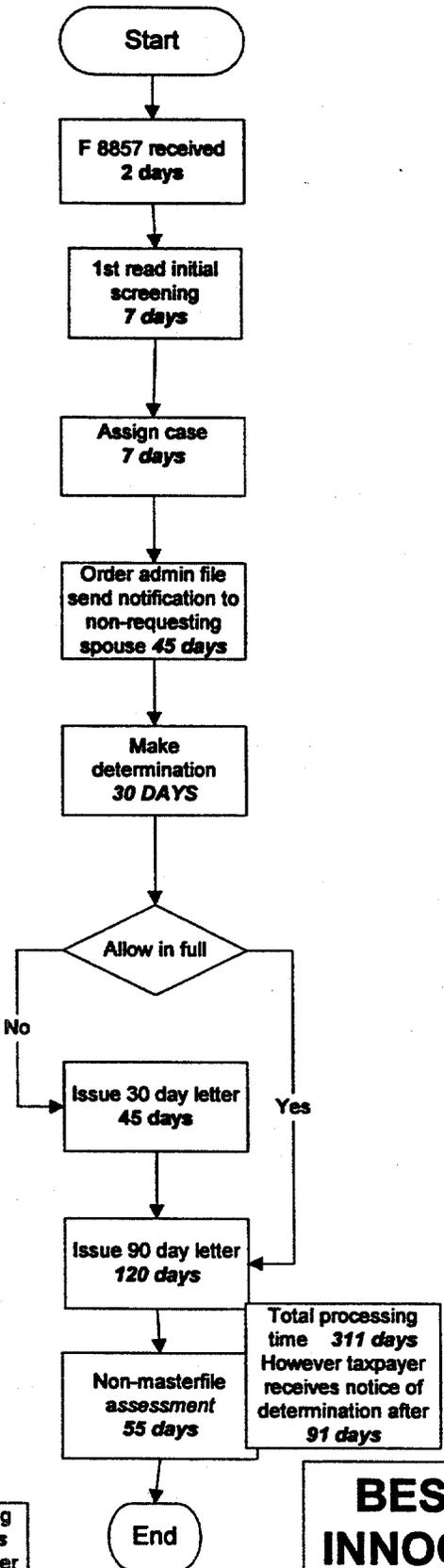
- Tier II Factors:**
1. Marital Status.
  2. Hardship on requesting spouse.
  3. Marital abuse.
  4. Claimant's legal obligation.
  5. Non-requesting spouse's legal obligation.
  6. Unpaid liability attributable to the requesting spouse.
  7. Knowledge of unpaid liability.
  8. Significant benefit received from unpaid or understated liability.
  9. Noncompliance.

Understatement

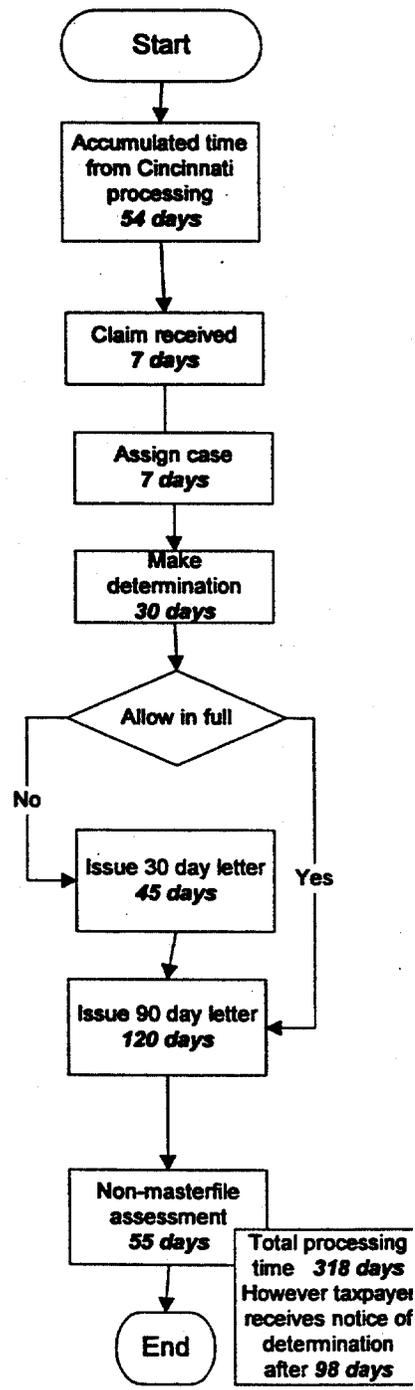
**Claim received and work at Cincinnati Service Center**



**Claim received and worked in the district**



**Claim received in Cincinnati and sent to the district to be worked**



**BEST CASE SCENARIO INNOCENT SPOUSE CASE HANDLING TIME FRAMES**

**DELINQUENT COLLECTION ENFORCEMENT ACTIVITY**

Category	Apr 97 - Dec 97	Apr 98 - Dec 98	Apr 99 - Nov 99	Apr 00 - Dec 00 (Projected)
Liens				
Non-CFf (ACS)	114,087	56,153	4,343	2,000
CFf	254,614	175,065	86,198	96,250
Total	368,701	231,218	90,541	98,000
Levies				
Non-CFf (ACS)	2,100,152	1,288,995	16,063	53,500
CFf	509,595	247,654	49,071	47,250
Total	2,609,747	1,536,649	65,134	101,000
Seizures	6,242	744	59	50

Source: NO-5000-23 Report

**DELINQUENT COLLECTION ENFORCEMENT ACTIVITY**

Category	FY 97	FY 98	FY 99	FY 00 (Projected)
Liens				
Non-CFf (ACS)	176,926	99,402	23,180	2,700
CFf	366,687	283,353	144,687	128,000
Total	543,613	382,755	167,867	130,000
Levies				
Non-CFf (ACS)	2,968,489	2,029,928	397,656	72,000
CFf	690,928	473,481	106,747	63,000
Total	3,659,417	2,503,409	504,403	135,000
Seizures	10,090	2,307	161	100

Source: NO-5000-23 Report

Note: Consistent with the spirit of RRA98, ACS no longer issued systemic (machine generated) levies as of 12/15/98. The requirement for human review on each case reduced volumes by 100's of thousands a month. Implementation of the Collection Due Process procedures created a period from mid-January to April where no levies could be issued while the initial notices ran through the period of time for taxpayers to respond or appeal. When we began issuing levies again in April, both provisions were in effect.

## **Chronology of Section 3401, Collection Due Process**

- 07/22/98 Passage of RRA 98, Section 3401, Collection Due Process (CDP) Provisions
- July 1998 Convened Executive Steering Committee to oversee implementation of RRA 98 provisions.
- August 1998 Developed National Resource Center web site to provide updated information to employees to answer questions relating to various RRA provisions. Multifunctional working group, including counsel, established to respond to 3401 issue. Approximately 40 Q&As regarding 3401 are on this site.
- August 1998 Cross-functional working group established to implement provisions of Section 3401. Representatives include Chief Counsel, Collection, Customer Service, Appeals, and Taxpayer Advocates.
- August 1998 Issued memorandum on Collection Procedures for Implementation of the Internal Revenue Service Restructuring and Reform Act of 1998. Included overview of Section 3401 provisions.
- August 1998 Suspend the issuance of levies against delinquent taxpayers under the State Income Tax Levy Program until programming is completed to ensure compliance with Section 3401.
- September 1998 3401 Action Plan developed. Action items include developing regulations for section 3401, developing new and revised CDP letters, publications, and CDP hearing request forms, and developing new procedures.
- October 1998 The Notice of Intent to Levy had previously been sent as a routine notice within the notice stream, prior to assignment of the case to Customer Service or Collection. With the passage of RRA 3401, the decision was made to provide the new Notice of Intent to Levy and Notice of Your Right to a Hearing only after the case has been assigned to Customer Service or Collection.
- October 1998 Corporate Ed developed and delivered RRA 98 Training for Collection Employees, Self-Study Reference Guide Training. It included provisions of Section 3401. Field Collection employees were required to complete this self-study course.

- November 1998 Conducted numerous meetings, including meetings with Chief Counsel to develop draft regulations for IRC Section 6320 and IRC 6330. Regulations were drafted and published within about a two-month timeframe.
- December 1998 Collection IRM procedures for Section 3401 issued to the field. Managers directed to review procedures with employees by January 15, 1999.
- December 1998 Customer Service IRM procedures for Section 3401 shared with the Customer Service employees.
- December 1998 Appeals IRM procedures for Section 3401 shared with Appeals Office employees.
- January 1999 The following new and revised letters, forms, and publications published to implement the provisions of Section 3401.
- LT11 and L1058, Notice of Intent to Levy and Notice of Your Right to a Hearing.
  - L3172, Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320.
  - CP 504/523, Notice of Intent to Levy State Income Tax Refund.
  - Form 12153, Request for Collection Due Process Hearing
  - Publication 1660, Collection Appeal Rights.
  - Publication 594, The IRS Collection Process.
- January 1999 The following Appeals letters and form were cleared and available for use.
- Letter 3193, Notice of Determination Concerning Collection Action(s) Under Section 6320 and/or 6330 (For Tax Court Jurisdiction cases).
  - Letter 3194, Notice of Determination Concerning Collection Action(s) Under Section 6320 and/or 6330 (For District Court Jurisdiction cases).
  - Letter 3210, Decision Letter Concerning Equivalent Hearing Under Section 6320 and/or 6330 of the Internal Revenue Code.
  - Form 12218, Waiver Form for Right to Request a New Settlement/Appeals Officer Under Section 6320 and/or 6330.
- January 1999 Implementation of the CDP procedures created a period from mid-January to March when no levies could be issued by the Collection field function. No levies could be issued in ACS for the period mid-January to April. This time period allowed for initial CDP notice processing and to provide time for taxpayers to respond or appeal.

January 1999 Conducted weekly telephone conference calls with the regions to address procedural questions and issues related to Section 3401 and other RRA provisions. After January, telephone conferences conducted on a monthly basis.

January 1999 Temporary regulations issued for IRC 6320, Notice and Opportunity for Hearing upon Filing of Notice of Lien and for IRC 6330, Notice and Opportunity for Hearing before Levy.

January 1999 We implemented a systemic indicator to identify when CDP Levy Notice is issued. This indicator alerts employees to the timeframe the taxpayer has to request a timely CDP hearing request.

January 1999 Counsel has issued numerous legal opinions on issues related to implementation of Section 3401.

February 1999 Appeals trained 250 people on an overview of CDP, including 30 managers. This was in preparation for receipt of an unknown amount of CDP cases.

February 1999 Memorandum of Understanding between Collection and Appeals provides for detailing revenue officers to Appeals in the event the workload in Appeals warranted additional resources.

March 1999 Appeals started issuing numbered Electronic messages on significant topics to Appeals regional and local management. E-mail #6 was issued on January 10, 2000.

March 1999 Collection Quality Measurement System (CQMS) standards were revised to include new taxpayer rights under Collection Due Process.

March 1999 Customer Service issued additional guidance with respect to the issuance of the LT 11 (Final Notice – Notice of Intent to Levy and Notice of Your Right to a Hearing) in Automated Collection System (ACS). Added requirement to attempt to contact the taxpayer prior to issuing the LT 11.

April 1999 Provisions of Section 3401 included in the Executive CPE.

May 1999 Issued procedural clarification to the field that the Notice of Intent to Levy and Notice of Your Right to a Hearing is only to be issued when levy is the next planned action and that a levy source needs to have been identified. This procedure ensures that the Notice of Intent to Levy and Notice of Your Right to a Hearing is not routinely

issued but issued only when there is a specific intent to levy.

- May 1999 Issued procedural clarification regarding processing of CDP hearing requests. Employees instructed to include the envelope the CDP hearing request is received in since the envelope could be critical in determining whether or not the request is timely.
- May 1999 Emphasize to the field employees IRM procedures with respect to the documentation required for processing CDP hearing requests, Managers were instructed to review the summary statement to ensure that the reason for the lien or levy action, collection alternatives considered, and why these options were not viable are clearly addressed in the case file forwarded to Appeals.
- May 1999 Phase 2 RRA 98 Training for Collection Employees included Collection Due Process Training.
- May 1999 Appeals made an assistance visit to Baltimore and assessed implementation of CDP procedures.
- June 1999 Conducted focus group interviews of field employees and managers to assess impact of 3401 on workload and to get feedback regarding the training and instruction they received.
- June 1999 Collection conducted conformance reviews in two districts in each region. The districts visited were Kansas/Missouri, Los Angeles, Manhattan, North Florida, North Texas, Pacific-Northwest, Pennsylvania, and Virginia/West Virginia. The visits were conducted in June, July, and August.
- June 1999 Appeals made an assistance visit to Boston and assessed implementation of CDP procedures.
- July 1999 Form 12256, Withdrawal of Request for Collection Due Process Hearing implemented and procedures issued to the field.
- August 1999 Conducted CLEs (Continuing Legal Education) courses for district counsel throughout the country on RRA 98. Provisions of Section 3401 was one of the courses taught. The CLEs were conducted in August and September of 1999.
- August 1999 Appeals conducted a CDP training class covering the collection process and significant statutes in detail. The training was for Appeals Officers who were not familiar with Collection issues. Additional training classes for Appeals Officers conducted in

September and December.

August 1999 Supplemental 3401 training provided to ACS customer service representatives.

September 1999 The Integrated Collection System (ICS) has been changed to ensure taxpayers are notified of their right to request a hearing and of the IRS' intent to Levy before a levy is issued.

October 1999 CP 92/CP 242, Notice of Levy on Your State Tax Refund and Notice of Your Right to a Hearing, was approved for use in the State Income Tax Levy Program anticipated to resume in April 2000.

October 1999 Customer Service began visits to various ACS call sites to assess implementation of new procedures including Section 3401 procedures.

November 1999 New manual transmittal issued for the Notice of Levy Handbook with revised and updated CDP procedures. The IRM emphasized the need to attempt contact with the taxpayer prior to issuing the Notice of Intent to Levy and Notice of Your Right to a Hearing with limited exceptions.

December 1999 Appeals conducted a review of approximately 300 CDP cases closed during the last quarter of FY 1999.

January 2000 Implemented systemic indicator to identify when a CDP hearing has been requested under IRC 6320 or IRC 6330.

January 2000 After considering the result of our review of closed CDP cases, Appeals determined that they need to provide more comprehensive training on collection issues for the Appeals employees. A multi-phase training package is being developed. Mentors with collection experience will work with appeals officers after each level of training. Appeals believes this new approach will better equip the Appeals Officers with the tools needed to work CDP and other collection related cases. The training pilot planned for March 2000.

January 2000 Memorandum from Assistant Commissioner (Collection) to Western Region Chief Compliance Officer, copies to all other RCCOs, advising field offices that revenue officers in the Collection Field function may work with taxpayers to resolve their issues, if the taxpayer is willing, after a CDP hearing request is filed. Customer Service issued similar instructions.

January 2000      Memorandum from Assistant Commissioner (Collection) to RCCOs informing field offices that a Trust Fund recovery Penalty may be asserted while a CDP/equivalent hearing (EH) is pending.

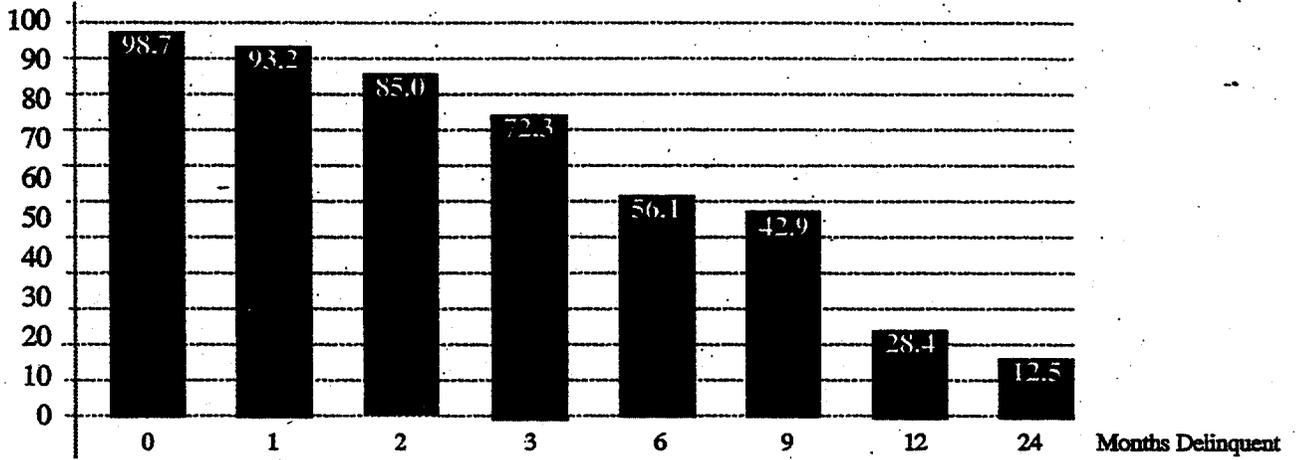
February 2000      Total CDP/EH receipts in Appeals as of February 19, 2000: 7676.

March 2000      Managers at all Collection front-line managers meeting in Chicago express concerns that CDP cases going to Appeals take overly long to be resolved.

April 2000      Appeals is assembling an executive task group to review CDP/EH case processing and to make recommendations for improvements.

### Collectability of Delinquent Commercial Debts

% Collectable



**IRS Telephone and Field Collection**

**90% of IRS Collection Resources**

## Chronology of Section 3417, Third Party Notice

- 07/22/98**            **Passage of RRA 98, Section 3417 Third Party Notice**
- July 1998            Convened **Executive Steering Committee** to oversee implementation of RRA 98 provisions
- August 1998        **Initial coordination meeting** with representatives from all functions to discuss impact of legislation
- August 1998        **Developed National Resource Center web site** to provide updated information to employees to answer questions relating to various RRA provisions. Multifunctional working group, including counsel, established to respond to 3417 issue. Approximately 300 Q&As regarding 3417 are on this site.
- October 1998        **Action plan** developed by Section 3417 provision owner and approved by Executive Steering Committee. Action items included development and utilization of database for tracking contacts, creation of notice, determination of day-to-day application of provision, and assessment of training needs.
- October 1998        **Working group** including counsel and function representatives established to interpret legislation and develop operational procedures
- November 1998      **Notice to taxpayers** of potential third party contacts (letter 3164) drafted and shepherded through clearance process.
- November 1998      Development of **Systems of Records Package** for contact database
- December 1998      **Letter 3164** submitted to forms and publications unit for printing
- December 1998      **Developed and distributed to all heads of office interim operational procedures** for initial implementation
- December 1998      **District and Service Center Third Party Notice coordinators** selected
- December 1998      **Initial mandatory training** on interim operational procedures for all employees who make third party contacts

December 1998	Initiated <b>negotiations with National Treasury Employees Union (NTEU)</b> regarding <b>Memorandum of Understanding</b> on impact and implementation of section 3417
January 1999	Issued <b>revised operational procedures</b> to clarify application of statute and information necessary to track third party contacts
January 1999	<b>Instruction on revised operational procedures</b> provided to all employees who make third party contacts
January 1999	<b>Letter 3164 issued</b> to first wave of approximately 25 million taxpayers
January 1999	Began <b>development of database</b> to track third party contacts
February 1999	Established <b>Executive Oversight Sub-Committee</b> to review impact of RRA 3417 on customers and employees and to address concerns relating to letter 3164
February 1999	<b>External stakeholders raised concerns</b> that letter 3164 was too generic and intimidating
March 1999	Chief Operations issued instructions <b>to letter 3164</b> would be used in situations where a third party contact was likely
March 1999	Mandatory training on targeted use of letter 3164
March 1999	<b>Meeting with external partners</b> to identify specific issues resulting from 3417 implementation
March 1999	Issued revised <b>3417 operational procedures</b>
April 1999	Worked with <b>TIGTA</b> on preparations for 3417 review
April 1999	<b>Revision to letter 3164</b> issued for <b>field test</b> to external/internal partners
April - June 1999	Held <b>meetings with each function</b> to identify unique policy, legal and operational issues arising from 3417, such as who is the taxpayer, who is a third party, and what constitutes a contact
June 1999	Finalized <b>report on policy, legal and operational issues</b> and developed revision to letter 3164 based on meetings, field tests, and external partners
June 1999	<b>3417 Systems of Record</b> Notification published in Federal Register

July - September 1999 Conducted **focus group interviews** in all regions with employees from all functions and field tested revised letter 3164

July 1999 **Provided testimony** on status of RRA 98 implementation

July 1999 Development of **third party database** completed. **Training** of all third party contact coordinators conducted.

August - September 1999 Established Detroit host site **for input of third party contact data** gathered from January 1999 through August 1999, approximately 75,000 contacts. **Provided training** to Detroit employees on review of input documents and appropriate data entry techniques.

August 1999 Provided **status update** on 3417 to representatives from the **Oversight Committee**, Briefing included a discussion on impact of implementation on taxpayers and third parties and the policies, operational and legal issues for the service.

August 1999 Finalized negotiations **with National Treasury Employees Union** and issued **Memorandum of Understanding** to all employees

September 1999 Provided **training to all employees** on Memorandum of Understanding between IRS and NTEU relating to initial implementation of 3417

September 1999 **Final revision to letter 3164** developed based on input from internal and external partners and placed in clearance.

September 1999 Provided **status update** on 3417 to representatives from **the Small Business Committee**. Briefing included a discussion on impact of implementation on taxpayers and third parties, and the policies, operational and legal issues for the service.

September 1999 **Met with Treasury** representatives to discuss impact of implementation on taxpayers and third parties, and the policies, operational and legal issues for the service.

October 1999 Provided **status update** on 3417 to representatives from **the Finance Committee**. Briefing included a discussion on impact of implementation on taxpayers and third parties, and the policies, operational and legal issues for the service

- November 1999     **Approved revised letters 3164** forwarded for printing and distribution, effective date 2/1/2000
  
- November 1999     **Updated operational procedures** to include information on the use of the new letters 3164.
  
- November 1999     Provided **training on revised procedures** and new letters 31 64 to representatives from all district off ices and customer service sites.
  
- November 1999     Provided **status update** on 3417 to representatives **from IRS Advisory Committee**. Briefing included a discussion on impact of implementation on taxpayers and third parties, and the policies, operational and legal issues for the service
  
- November 1999 -  
January 2000     **Provided training** to all employees who make third party contacts in all functions throughout the service
  
- January 2000     -     **Executive training** on RRA 3417
  
- February 2000     Effective date for **new letters** and **revised procedures**
  
- Short Term Goal     **Issuance of Regulations** on Third Party Notice

**Individual Returns  
FY 1999**

	Coverage		% of Total Exam Resources
	Correspondence	Field	
<b>Individuals &lt; \$25,000</b>	1.01%	0.23%	11%
<b>Individuals \$25,000 to \$100,000</b>	0.14%	0.29%	9%
<b>Individuals \$100,000 &amp; Over</b>	0.37%	1.03%	13%

Senator GRASSLEY. Thank you for your report to us. We will go to questions now. My staff suggested that Senator Dorgan wants to make a statement.

Senator DORGAN. I will defer the statement until we have questions.

[The statement of Senator Dorgan follows:]

**Opening Statement  
Senator Byron L. Dorgan**

**Joint Committee on Taxation Review Hearing  
of the Internal Revenue Service**

**May 3, 2000**

Thank you, Mr. Chairman.

Commissioner Rossotti, I am pleased that you and the other witnesses are able to join us today and I welcome you to this hearing. I appreciate the opportunity to speak with you about the IRS' progress to date in implementing the IRS Reform and Restructuring Act of 1998. I also look forward to hearing from the next panel, Mr. David C. Williams, Treasury Inspector General for Tax Administration, Mr. James R. White, Director, Tax Policy and Administration Issues from the General Accounting Office and, especially, Mr. W. Val Oveson, National Taxpayer Advocate, who is to be commended for his excellent work and dedication in the area of taxpayer advocacy. Thank you all for being here.

The Reform and Restructuring Act of 1998, has tasked the IRS with 98 new mandates in addition to the voluminous duties already performed by your agency. Commissioner Rossotti, I know that you have taken the restructuring of the IRS very seriously and that you are committed to making the IRS an organization that respects the rights of the American Taxpayer and an organization that we can be proud of. We have discussed many of your actions at hearings over the past few months before the Treasury Appropriations Subcommittee.

My concern is that the Reform Act of 1998 requires the IRS to take on additional responsibilities while not receiving the full resources required to manage those new responsibilities. As an appropriator, I must remind my colleagues that if Congress is serious in its desire to reform the IRS and require it to undertake many new and laudable missions, Congress must also be willing to provide the agency with the resources to accomplish this. The Treasury Subcommittee, of which I am the Ranking Member, is expected to receive an allocation - as a result of the budget resolution - that is fully \$2 billion below what the President requested. In the House, it is even worse. We cannot be serious about IRS reform if we refuse to provide the dollars to do it.

With limited resources and new mandates, obviously priorities must be set. I am interested in hearing your testimony about the priorities that the IRS has set in terms of tax collection and tax auditing. Has there been a shift in these activities toward the lower and middle individual income taxpayer as opposed to corporate taxpayers? Where do you see the IRS heading in this area in the next few years?

The Reform Act itself is a very complex and involved piece of legislation. I would like to know what has worked and has been successful and what has not? What can we do to address those problems? Perhaps there are modifications to the Act which you can help us to identify so that we may all better serve our constituents, the American taxpayer.

As you are aware, one of the reasons for the enactment of the Reform and Restructuring Act of 1998, was to curb the abuses levied against the taxpayer by IRS employees. As I have mentioned in the past, I believe that the vast majority of IRS employees are hard working, honest, and dedicated individuals, who perform a

very difficult task and do it very well. However, like any other agency the IRS had employees that clearly abused their authority. I would like to know what is being done to weed out those individuals. I am also concerned about the effect the Act has had on the morale of the agency, particularly section 1203 of the Act.

I have recently received information from an employee of the IRS alluding to the fact that since the enactment of section 1203, which governs IRS employee conduct, employees feel more concerned about losing their jobs and less concerned with being as thorough as they should be in their official duties for fear of having a complaint lodged against them. I was also made aware that a company exists that assists taxpayers - for a fee - in filing complaints against IRS employees under section 1203. I assume you are aware of this predatory practice and I would like for you to speak on this issue and tell us what might be done to quell this concern.

Finally, I would like for you to identify what have been the major roadblocks in enacting the initiatives under the Reform Act and what the Congress can do to assist you in fair and effective implementation.

I thank you and the distinguished panel for being here today and I look forward to your testimony.

Senator GRASSLEY. All right. We will do it in five-minute turns for each individual, and that will be in the order in which people arrived.

In your testimony, you argued that improved business practices will help the IRS meet its goals with lesser funding increases. Obviously, this is worthy and sounds very good, and we do not dispute your willingness to do that.

I would like to point out, though, a few problems that have been relayed to me by IRS employees from the field. I understand that one of your modernization efforts is to have collection managers manage auditors as well as have audit managers oversee some collections.

One analogy that I have heard is comparing one to an engineer of a train and the other to a pilot of a large aircraft; they both have specialized jobs, but you would not want the pilot of the plane to try to engineer the train, or vice versa.

There are different types of time reporting, different kinds of reports, different computer programming, and different educational backgrounds. I am hearing that it is just a matter of time before the two-- meaning the collection manager and the audit manager-- crash into one another.

I am also hearing that agents are working without a manual. Everything is done, supposedly, by memorandum. Things do change, but it leads to confusion and frustration in the field. These employees say that they go to training which we're spending millions of dollars on, and no one seems to have answers. This leads to less audits and collections.

So I would like to have you respond to those criticisms, even to the point that you do not think that they are true, but I wanted to report to you what we hear.

Mr. ROSSOTTI. I appreciate that. And, of course, I travel around quite a bit and hear the same things. I have gone, so far, to every district, every service center, about 60 or 70 different locations, and met with employees. I think I have got a pretty good idea of what is on their mind.

I think, first, let me say that some of those things that you said, and I could make a list of 10 or 20 more, in part, just reflect the changes that we are going through. We are definitely making changes, which is what was required and requested. Whenever you change any large organization, there is a period of relearning that takes place.

Some could say it is confusion, and that would be another way of looking at it that would say the glass is half empty. If you want it to be half full, you say it is relearning. I think with respect to the issue of the manual, let me take that one, first, because that is the most vital one.

Certain sections of the Internal Revenue Manual-- which is an enormous set of documents that no one is really expected to read altogether but it is more of a reference document--particularly those that were most impacted by the Restructuring and Reform Act,

have been rewritten and are in the process of being rewritten quite significantly, probably more than they have ever been rewritten, to try to conform with the Restructuring and Reform Act.

Quite honestly, it is a learning process to learn how to do that. The Restructuring Act gives some specific requirements for things like due process and collection. I could show you--I did not bring a chart here--that it takes about six or seven pages to outline on a flow chart exactly what that means, exactly when you have to notify a taxpayer when, for example, they have an appeal right.

What happens if they respond in so many days, what happens if they do not respond in so many days? Those are quite intricate kinds of things that have to be determined. We have been working very hard on that for the 18 months or almost two years since the law has passed.

It is absolutely correct, what the employees say, that the manual has not been fully updated in one place-- this is the collection part of the manual--to reflect all of those changes.

We have an initiative under way right now to bring in employees from the field together with people from our national headquarters to rewrite some sections of that manual in a more comprehensive and clear way. But this is an excellent example of something that is probably going to occupy us at least another year to 18 months.

I said we had met the legal requirements of the law, but we still had a couple years' worth of work to really make it work. This is a perfect example. We have put out documents that tell people how to comply with these intricate requirements, now we have to really go back and put it all together and put it in a more efficient way.

On the other point, in our reorganization we are making some changes which have been based on very careful analysis of what is the best interests of the taxpayer. One of the main criticisms from taxpayers, if you will recall in your hearings, is that they would get bounced from one place to another and never get a resolution.

From a taxpayer point of view, we expect the taxpayer to comply with the Tax Code. We do not tell the taxpayer that, well, this half of your brain is an exam brain and this half of your brain is a collection brain. They just say, if we have to comply with the Tax Code, they want to come in and deal with somebody inside the IRS to solve their problem.

At the same time, we do have these special areas of the law that need to be done. So what we have done in our reorganization--and I know I am getting my yellow light here--is we have----

Senator GRASSLEY. I am getting the yellow light, not you.

Mr. ROSSOTTI. Oh. All right. I am sorry. I do not mean to take too long to answer your question, but it is a very important question. The first thing we have done, is we have

tried--we have not tried, we are-- reorganizing in such a way that we will not be expecting all managers as they are today to administer all the law for all forms of taxpayers.

Today, if you go into a district, they cover everything from the largest corporation to a simple tax return for somebody that just has some wages on a simple form. No one in the business world tries to do that because there is no manager that can be expert in that many things.

So what we are doing, is we are dividing it up according to the customer. In one of the divisions, for example, which is the small business division, we will have some managers that oversee all the compliance activities for those sets of taxpayers.

There will still be specialists and specialist managers that will be technical experts in those fields, but at a lower level than exists today. You will have someone that is in charge of that whole thing for the real purpose of just making sure that the taxpayer gets a solution closer to home. That is the purpose of it and it is very responsive to what we found in our problem-solving days.

I remember, Senator, when I came out to Iowa, you remember one of those special days that we had, those have become very, very successful in getting people's problems solved. Well, the reason is, we had all the people from the specialties there at once. That is the principle that we are trying to build into the organization so that it is there every day, not just on a special day once a month.

Senator GRASSLEY. Congressman Houghton?

Mr. HOUGHTON. Thank you, Mr. Chairman.

I have three or four questions, Mr. Commissioner, I would like to ask you, but I think I would really like to concentrate on one aspect of this.

We ask you to do certain things, you ask of yourself, you ask of the people to do certain things, and you talked about respecting taxpayer rights, making sure taxpayers pay taxes that are due, and also working efficiently.

If I understand it, we have increased your budget periodically and you are now asking for roughly 3,000 more people. Are we giving you the tools that you need to do the job? I think you have two and a half more years, and maybe many more after that, to do the job in the time that you have allotted for yourself to turn this thing around.

Mr. ROSSOTTI. I think that several Members in their opening statements said that we are at a crossroads. I think, just as I said in my statement, we have made some progress and we clearly have in mind what needs to be done. I really think we, collectively, know what needs to be done to really fulfill the vision of the Restructuring and Reform Act and the IRS Commission. I also believe it can be done.

I do believe that we are at a crossroads where we are going to either show that this will or will not happen in the next, about, 18 to 24 months. I believe that the 2001 budget is particularly critical for that purpose.

The Congress did grant us our full request last year. We did not ask for any increase; in fact, we had about a level or slightly declined workforce last year. We did not know exactly where we were going to need these resources. I think today we do.

We also were only at the very, very beginning. In fact, we are still at the beginning of our technology modernization, but we are now in the ramp-up stage. So I think that we are in that period where we really need to implement and make these things work at this point, and I think that in the next 18 to 24 months, which is the period of the rest of this fiscal year and the 2001 fiscal year, will be critical to making that happen.

Mr. HOUGHTON. Thank you.

Senator GRASSLEY. Congressman Portman?

Mr. PORTMAN. Thank you, Mr. Chairman.

Mr. Commissioner, I have a lot of questions. I am going to try to focus on two, partly to get you on the record on a couple of tough issues. One is with regard to this IRS public/private Oversight Board.

You mentioned in response to Mr. Houghton that you think we now know what needs to be done. I am not sure that is true. I know that I believe that you know what needs to be done. I do not know how long you are going to be in this job; I hope it is for a long time. But one of the issues with the Board is to have some continuity.

If we found anything in our two years of studying the IRS, it was that every time there was a great-sounding reform, then a new administration would come in or a new Deputy Secretary, new Commissioner, or new Deputy Commissioner and things would change. Folks in the field kind of got to the point where they were going to outlive the latest reform.

I guess I have a very specific question for you in hopes of getting this Oversight Board in place. That is, you are a professional manager, you have an information technology background, you are an executive from the private sector, you have credibility on this issue. Do you believe that in the last year it would have benefitted you and the IRS to have had the Oversight Board in place?

Mr. ROSSOTTI. The answer to that is, unequivocally, yes. I did not mean to imply that we had all of the answers and we did not need any more help. I did not mean to say that. I just meant that we had made a lot of plans, we have done a lot of work, but it is absolutely true that we have to have continuity.

Mr. PORTMAN. My point was the continuity. My point was, people will change, personnel will leave. I know you have got some good, private sector people you have brought in. I know they are also getting a lot of offers from the private sector right now, and it is going to be tough to keep everybody.

I just think we need to have some long-term continuity. You know we have five-year staggered terms on the Board. We have this ability to see these reforms through.

The second issue has to do with this notion that was raised by my friend Mr. Hoyer earlier, and I wish he were still here, which is enforcement. He essentially said, which has been repeated in a couple of articles recently, that the IRS is focusing more on the poor than on the wealthy in terms of enforcement.

The one point that we have made continually, is there is nothing inconsistent with better taxpayer service and customer service and good compliance and enforcement. Those two are not inconsistent at all. In fact, we believe that they are not only consistent with one another, but they complement one another.

I would just like to focus on this poor versus wealthy issue that seems to be coming up more and more. Again, with regard to the lower income audits, what portion of the audits of lower income taxpayers are correspondence audits? In other words, letter audits rather than face-to-face audits.

Mr. ROSSOTTI. I do not have exact numbers, but almost all of them, upwards of 90, 95 percent of them, are letter audits. I think that is really a key point about this whole thing. If we have 10 revenue agents spend a year auditing a corporation, which we frequently do, that counts as one audit.

If we send a letter to a taxpayer, and this is frequently the case with the EITC audits, saying please send us some backup as to why you claimed this particular individual as a qualifying child, that still counts as one audit.

So if you just add up these numbers, you do come up with a large number of letter audits on the EITC because we had a special appropriation that was directed towards working on better administration of the EITC program.

If you look at it in terms of resources, it is about 6 percent. About 6 percent of our examination resources were devoted to the EITC program. But in terms of just numbers, it shows up as a higher number because of the relative scale of these things.

Mr. PORTMAN. Thank you. That is very important, and I am delighted that you got that on the record.

I would also like to point out with regard to the EITC, we do not have good data from the last couple of years. The best data we have indicates--this is from the IRS and from the Treasury Department--that there is at least a 20 percent mispayment rate with regard to EITC. It is not a job I personally believe the IRS ought to be doing, but you have to do it, and that is trying to enforce the EITC through the tax system.

Now, that means there is at least \$6 billion in mispayments with the EITC every year, at least. You are devoting six percent of your resources to it when it is about the same as your budget, probably. In other words, the mispayments, the lack of revenue coming into the Federal Government because of the EITC, and a lot of that is fraud. We do not know how much of it is fraud.

But I just would make the point that folks ought not to be too critical of the IRS and the reform efforts in terms of focus of enforcement or uneven enforcement until they understand better what this results in. I am told that, for instance, upper income taxpayers are six times as likely to be audited, which seems appropriate to me.

But it is inappropriate to have the impression left out there that somehow the IRS has decided to focus on folks who make less than \$20,000 a year. They are trying to make the EITC work better, and frankly, we have a long way to go on that as well.

One final point I just want to make and to be sure this is on the record, because there has also been some misunderstanding out there about your budget. The Congress has not cut your budget since the Restructuring and Reform Act.

In fact, we have had a stable budget, which is what, as Mr. Hoyer said, we recommended in the recommendation of the commission, and in the RRA it reflects the fact that a stable budget is needed. There needs to be certainty in budgeting. There needs to be a simpler Tax Code.

I personally support an increase in spending this year for some very specific purposes in order to make that transition. I do believe we are at a crossroads. I believe that there is a great risk if Congress and the IRS do not continue to focus on this.

We said at the outset this would be a three- to five- year process. Maybe that was a little optimistic. But we are now going into the third year, and it is absolutely critical that we have the resources available to be able to carry out the reforms that are so desperately needed.

Thank you, Mr. Chairman.

Senator GRASSLEY. I overlooked Senator Kerrey, so I will go back to Senator Kerrey.

Senator KERREY. I want to give Mr. Rossotti a chance to give his response.

Senator GRASSLEY. If you do, it will not count against Senator Kerrey.

Mr. ROSSOTTI. I would just add, back on the point of the Oversight Board on the matter of continuity, that one of the questions that I often get from employees--and I talk to hundreds of them all the time, and it really reinforces your point as well--we think that these things may work. There is always a little skepticism.

But how do we know that there is going to be continuity, that we are not going to go down this road and commit ourselves to it and then somebody else is going to come in? I do point out that I have, myself, a five-year term.

I also always point to the Oversight Board as another element that was put into the law by the Congress and that they do have the staggered terms. I think that has a significant effect on reassuring people that we are not just on kind of something that is going to turn around very quickly, that we do have continuity. So I would completely agree with the points you made about continuity being important and the Oversight Board being able to provide that.

Senator GRASSLEY. Now, Senator Kerrey.

Senator KERREY. Thank you, Mr. Chairman.

First of all, just keying off of what Congressman Portman was asking you, the stories that were reported about the likelihood of being audited increasing the lower your income was, is a very unhealthy story. I am not saying the story should be stifled in any way, shape, or form, but again, it illustrates why the Board is so important. This is a very politically charged issue.

My guess is, the facts would show that that did not occur as a consequence of the 1998 Act at all. But, again, an independent board is much more likely to be able to provide both the people and the people's Congress with the information that they need to make a determination of whether or not, in fact, that is going on.

From what I have heard from you, the answer is that is not what is going on. You are more likely to get audited if you have higher income than if you have lower income. But, again, we have a voluntary system. If the sense of the taxpayers is that you are more likely to be audited if your income is low, that could contribute to our difficulty in achieving voluntary compliance.

So it is just one more example of why I think we have been negligent in providing you with support. I am concerned. If you and Mr. Cosgrave decide you want to leave all of a sudden, for whatever the reason, we may be back to where we were in 1997.

We could lose a lot of ground just with a couple of key people saying, **AI** understand Congress has difficulty getting things done, but if you do not get the Board up and running, I just cannot continue to operate here in this purgatory that you have put me in.@

Second, let me say that it appears to me that the IRS is continuing to achieve, compared to other industrial nations' tax collection agencies, rather impressive success. You collected, in the 2000 season, about \$1.76 trillion. Less than half a percent of that collection is your budget,

so you have less than half percent cost, which puts you at the top of the pack in terms of industrial nations that collect taxes.

Third, I am encouraged as well by the increase in electronic filing. Over 10 percent of the 210 or so million tax filings were done electronically, and there has been an increase both there and in web activity. Part of what we attempted to do with the legislation was increase the likelihood that you will have more electronic filing.

The reason is that the error rate is so much lower than it is in a paper world and it increases the likelihood that you will have lower costs of administration.

One other thing I would like to talk about is your budget. Again, I would just underscore that, under the law, the Oversight Board would be making that presentation of the budget rather than just you, and I think it makes it easier to get people to understand what you are trying to do. You have got an increase of \$769 million, \$729 million if the \$40 million supplemental is funded.

Can you describe, just sort of briefly, and perhaps you did in your opening statement and I missed it, what you intend to do there with some of that money to improve the quality of the data? I noticed in the *Wall Street Journal's* tax report this morning that the last major study of compliance was done in 1988.

That would make it very difficult to know whom to audit and increase the likelihood that you have to resort to random audits, which can be very annoying and not very productive.

It is much better, it seems to me, to use accurate, up-to-date data about who has been good, who has been bad, and go after people who have been bad in a more precise fashion.

It seems to me it gets back to the central question, which is, when are we going to have a database that allows you, in a very real-time fashion, to answer taxpayers' questions about how much they owe and when do they owe it?

Mr. ROSSOTTI. That is very true. I mean, the whole strategy of our budget is that there are really two major pieces of this. One, is providing some additional staff, which we just badly need in the short run just to cope with the specific mandates of the Act and to avoid having these audit rates and other enforcement statistics go down, because until we can make some of the other improvements we just have to do that with staff.

But the longer term is exactly as you say, to leverage the people we have to make them more effective by using information more effectively. Part of that is information technology computer systems, which is what our whole technology modernization is about.

I mean, we are in the situation today where employees are like employees in a bank that do not know precisely, up-to-date, how much money the customers of the bank actually have on

deposit in that bank. They kind of know, but they do not exactly know. That creates all kinds of problems for the employees and the taxpayers.

The other kind of information you mentioned in your statement, Senator Kerrey, is information about taxpayers' behavior. It is true that we do not really know what the compliance with the tax laws that Congress passes is. I mean, we have these numbers that say it is 87 percent compliant, and those are extrapolations from numbers of studies that were done in the 1980s.

I think it is extremely important that the IRS come up with a practical way of measuring what voluntary compliance is. We are working internally very hard on a project which I hope we will be able to get to a point where we can lay it out this year, which has the objective of getting the information we need about the amount of voluntary compliance the taxpayers have with significantly less intrusive a process than the IRS used in the past, which is really the hard part of this. So, we are working on that very hard.

Senator KERREY. I appreciate that.

I just have a yes or no question, Mr. Chairman, if I could, even with the red light being on, ask it.

Senator GRASSLEY. Yes.

Senator KERREY. I have heard a number of concerns that Congress, in trying to correct the problem with Treasury employees doing things that should obviously result in termination, we may have made it difficult for you to manage the agency and may have also, by the way, set a double standard in place, since one of the things was delinquent taxes could cause you to be terminated from employment. At least, there has been some published analyses that show there is more delinquency of paying taxes in Congress than there is in Treasury employees themselves.

Have you done any independent evaluation, and if so, would you provide that to me, of those rules that we put in the statute, those provisions we put in, is it section 1203?

Mr. ROSSOTTI. 1203. We can certainly provide you with the details.

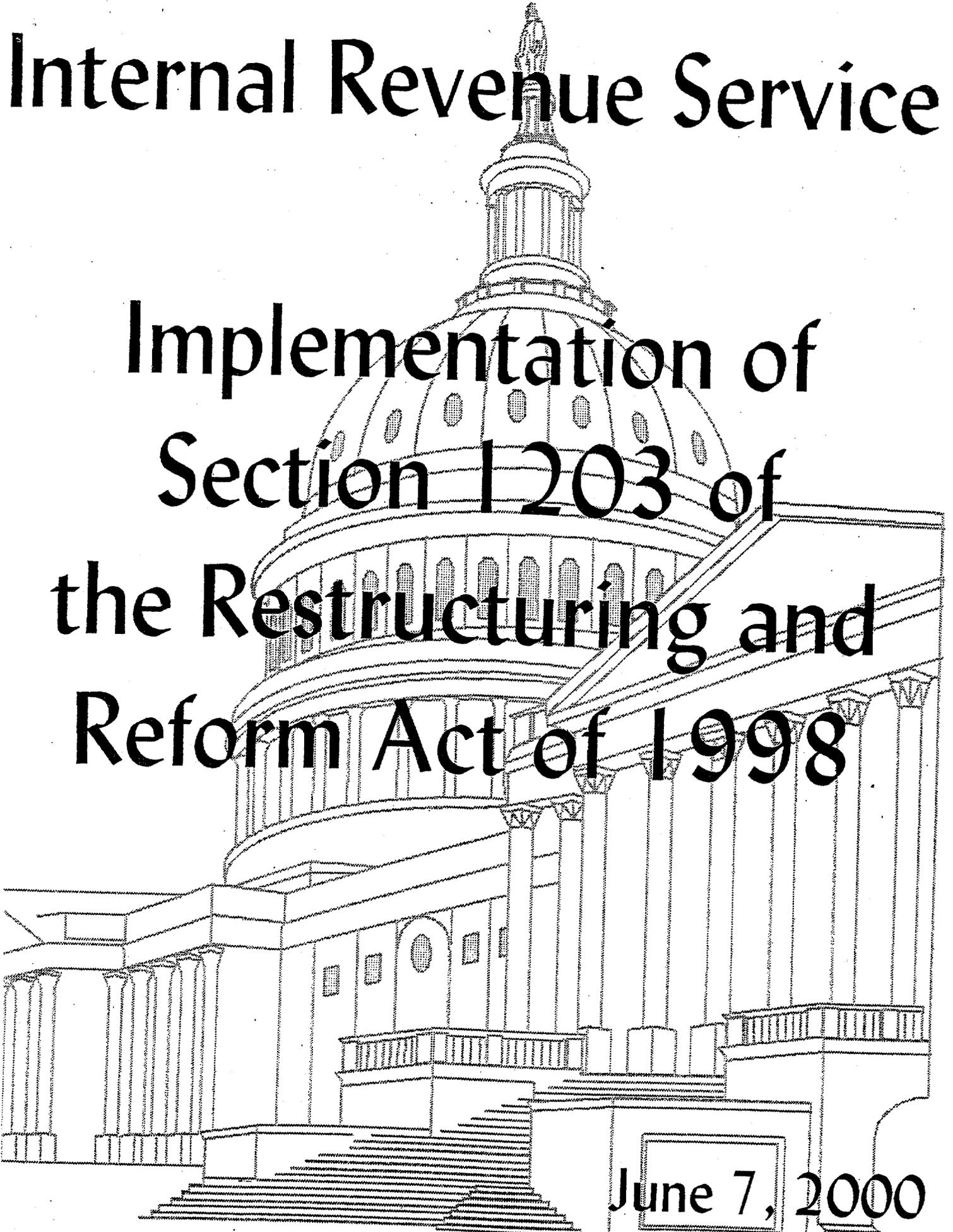
Senator KERREY. Have you done an independent analysis of that?

Mr. ROSSOTTI. We have quite a bit of analysis. I would be happy to provide it to you.

Senator KERREY. I would appreciate it.

[IRS report on section 1203 follows:]

# Internal Revenue Service



## Implementation of Section 1203 of the Restructuring and Reform Act of 1998

June 7, 2000

SUMMARY OF SECTION 1203 .....	2
The Law .....	2
Willfulness Criteria .....	3
Standards Are Not New.....	3
IMPLEMENTATION OF THE LAW.....	4
Procedural Guidance .....	4
Training and Outreach.....	4
ACTING ON SECTION 1203 ALLEGATIONS.....	7
Life Cycle of an Allegation.....	7
Receipt and Initial Analysis .....	7
Inquiry or Investigation .....	8
Evaluation .....	8
Local Disciplinary Processes Under Section 1203 Procedures.....	8
National Office Review .....	9
Processing Tax Compliance Cases .....	9
STATISTICS AND CASE EXAMPLES.....	10
Allegations Received, Investigated and Resolved.....	10
Removals Under Section 1203.....	12
Case Examples .....	13
CONCERNS RAISED BY EMPLOYEES AND MANAGERS.....	15
General Concerns .....	15
Specific Concerns .....	16
"The Fear of Section 1203 Allegations Discourages Proper Actions" .....	16
"The Tax Compliance Provisions Impose Excessively Severe Penalties In Some Cases" .....	17
APPENDICES.....	18
1. Section 1203 of RRA '98 .....	18
2. IRS Definitions of "Willful" .....	18
3. Flowcharts.....	18

## SUMMARY OF SECTION 1203

### *The Law*

Section 1203 of the IRS Restructuring and Reform Act of 1998 (P.L. 105-206) provides that the Commissioner of Internal Revenue shall terminate the employment of any employee of the Internal Revenue Service if there is a final administrative or judicial determination that the employee committed any of 10 enumerated acts or omissions. The Commissioner has the authority to mitigate the penalty, but may not delegate this authority to any other officer. The Commissioner's determination on penalty, whether to remove or mitigate, may not be appealed in any administrative or judicial proceeding.

The penalty provisions of Section 1203 reflect the view that certain acts or omissions by IRS employees are intolerable, and the normal sanction for those offenses should be removal. Acts or omissions covered by Section 1203 are:

1. Willful failure to obtain required approval signatures on documents authorizing a seizure
2. Providing false statements under oath with respect to a material matter involving a taxpayer or taxpayer's representative
3. Violation of the rights protected under the Constitution or six listed civil rights laws, with respect to a taxpayer, taxpayer representative or other employee of the IRS
4. Falsifying or destroying documents to conceal mistakes in a matter involving a taxpayer or taxpayer representative
5. Assault or battery on a taxpayer, taxpayer representative or other employee of the IRS
6. Violations of the Internal Revenue Code, Treasury Regulations or IRS policy to the purpose of retaliating against or harassing a taxpayer, taxpayer representative or other employee of the IRS
7. Willful misuse of the provisions of Section 6103 of the Internal Revenue Code for the purpose of concealing information from a congressional inquiry
8. Willful failure to timely file any Federal tax return, unless the failure is due to reasonable cause and not to willful neglect
9. Willful understatement of Federal tax liability, unless the understatement is due to reasonable cause and not to willful neglect

10. Threatening to audit a taxpayer for the purpose of extracting personal gain or benefit

(The full text of Section 1203 is attached as Appendix 1)

### ***Willfulness Criteria***

Each of the ten offenses under Section 1203 includes an element of intent. The IRS has emphasized that simple mistakes and unintentional errors made in good faith are not Section 1203 violations. For example, intent for Section 1203(b)(1) is shown when the employee has actual knowledge or acts with reckless disregard of the requirements to obtain required approval signatures before proceeding with a seizure. For Section 1203(b)(8), the employee's failure to timely file a Federal tax return must reflect the voluntary intentional violation of a known legal duty for which there is no reasonable cause. The IRS included definitions of willfulness and intent in the "RRA '98 Section 1203 Procedural Handbook," (Document 11043 (5/99)). An extract from that document, which was distributed to all employees, is enclosed as Appendix 2.

### ***Standards Are Not New***

The conduct addressed in Section 1203 has always been regarded as serious misconduct. What has changed is the penalty imposed for violations. Prior to the enactment of Section 1203, the general rules for imposing discipline required a deciding official to consider a wide range of factors in arriving at the appropriate penalty. These factors include the nature and seriousness of the offense, the employee's work record, the notoriety of the offense, and the impact of the offense on confidence in the employee's ability to perform his/her duties. When these factors were applied to specific cases, a range of penalties was imposed. Section 1203 eliminated the variation in penalty, unless the Commissioner of Internal Revenue personally decides to reduce the penalty from removal to some lesser sanction.

While the general statement that the conduct covered by Section 1203 was always regarded as serious misconduct is true, there is one area where Section 1203 has changed the significance of an offense. Prior to Section 1203, the IRS viewed untimely payment of Federal tax liability as a more serious offense than late submission of a return. Late payment of a balance due was regarded as serious misconduct, depending on the amount due and the degree to which the payment was overdue. A return filed late with a minimal balance due, or a refund return, was not treated as a serious offense. Section 1203 does not address late payment, but makes all willful late filing a removal offense.

## IMPLEMENTATION OF THE LAW

### *Procedural Guidance*

The IRS recognized that Section 1203 reflected a renewed emphasis on employee conduct issues, and that employees needed a clear statement from the IRS on the impact of the law on their daily work. Guidance for employees has taken many forms—memoranda, voice mail messages from the Commissioner and Deputy Commissioner for Operations, a procedural handbook and training guides. A chronology of the procedural guidance appears as in a table below, under "Training and Outreach."

The most important procedural guidance is contained in "RRA '98 Section 1203 Procedural Handbook" (Document 11043, 5/99). The Handbook contains an all-employees memorandum from the Commissioner, an overview of Section 1203 and the implementing procedures, plain language definitions of "intent" and "willfulness," and detailed procedures. The procedures are designed to ensure that each allegation of a Section 1203 violation is dealt with in a manner that protects the rights of the employee accused of the violation as well as those of the accuser.

### *Training and Outreach*

The IRS emphasized the importance of Section 1203 through training for all employees, as well as through special training for managers and labor relations specialists on their responsibilities under the law. Initial all employee training, involving in-person classes for about 100,000 employees, was conducted beginning in late 1998 and early 1999. After feedback and numerous focus group interviews indicated that employees were still uncertain about their rights, responsibilities and risks under the law, and that the initial training had created unnecessarily inflated fears, the training was revised and a new round of training was conducted in May 1999.

Outreach to employees began with the enactment of Section 1203, and continues to this day. The Commissioner and other senior executives take questions from employees during "town hall" meetings as they travel around the country, and Section 1203 is usually a topic in these discussions. A page on the IRS intranet is devoted to Section 1203, including frequently asked questions. The intranet page also provides sample case scenarios to illustrate the application of the tax compliance provisions, which account for almost all of the removals under Section 1203. In addition, a March 2000 conference of front line Collection managers included presentations on Section 1203 from several IRS senior executives and the Treasury Inspector General for Tax Administration.

A list of the major training and outreach publications and events appears in the table below. The publications emphasize that employees are not at risk of removal for conscientiously performing their duties, even if they make a mistake in doing so. Section 1203 only addresses willful and intentional misconduct.

**Table 1: Training and Outreach Publications and Events**

**July 1998 to April 2000**

July 1998	Highlights of the Restructuring and Reform Act of 1998, "Significant Issues Effective Upon Date of Enactment", Document 10829
August 1998	Labor Relations Continuing Professional Education on Restructuring and Reform '98 Conduct Provisions
September 1998	Memorandum for All Employees: "IRS Restructuring and Reform Act of 1998 Conduct Provisions"
	IRS Restructuring and Reform Act of 1998 (RRA '98) Conduct Provisions "Employee's Guide", Document 10848
October 1998	Interactive Video Teletraining for Heads of Office and Executives
	Restructuring and Reform Act of 1998, Title I §1203 Process Overview, "Instructor's Guide"
	IRS Restructuring and Reform Act of 1998, §1203(b) Conduct Provisions, "Instructor's Guide", Training 9990-103
	IRS Restructuring and Reform Act of 1998, §1203(b) Conduct Provisions, "Employee's Participant Guide", Training 9990-102
	IRS Restructuring and Reform Act of 1998, §1203(b) Conduct Provisions, "Manager's Participant Guide", Training 9990-101
December 1998	<u>STRAIGHT TALK NEWSLETTER</u> : "Title I: IRS embarks on training," including training on Section 1203
January and February 1999	All Employees Briefings on Section 1203
February 1999	<u>STRAIGHT TALK NEWSLETTER</u> : Question and Answer on "quotas" for Section 1203 discipline
	Memorandum for All Employees: "Employee Tax Compliance Obligations"
	Section 1203 Training Implementation Plan
March 1999	Memorandum for All Employees: "Section 1203 (Termination of Employment for Misconduct) Training and Communication"
	<u>What you Need to Know About Section 1230</u> , Tri-fold publication, Document 10997; included with paychecks

April and May 1999	All Employees Briefings on Section 1203
	"RRA '98 Section 1203 Resource Guide", Document 11042
	"RRA '98 Section 1203 Procedural Handbook", Document 11043
	Procedures for Processing Allegations for §1203 Violations (for Labor Relations Staff)
	<i>STRAIGHT TALK NEWSLETTER</i> : Announcing opportunity for public comment on Section 1203 regulations
July 1999	Video Broadcast of Commissioner meeting with Virginia-West Virginia District managers question and answer session
September 1999	All Employee Memorandum from Commissioner "Report on Actions Concerning Misconduct Allegations and Disciplinary Actions" provided Section 1203 statistics and summary case information
	<i>STRAIGHT TALK NEWSLETTER</i> : Announcing availability of All Employee Memorandum, and providing Section 1203 Questions and Answers
January 2000	<i>STRAIGHT TALK NEWSLETTER</i> : Announcing availability of data on Section 1203 allegations and disciplinary actions
March 2000	Meeting of first-level Collection managers, to discuss the importance of their work and their role in the new IRS organization. Included presentations by TIGTA and IRS executives on Section 1203 issues.
	<i>STRAIGHT TALK NEWSLETTER</i> : Describing results of meeting with Collection managers, including discussion of Section 1203
April 2000	<i>STRAIGHT TALK NEWSLETTER</i> : Describes actions needed to address taxable local travel reimbursements, and the impact of Section 1203 on corrected Federal tax returns
	<i>IRS Headlines Voice Message</i> : A reminder to file Federal tax returns timely to avoid a Section 1203 violation

## ACTING ON SECTION 1203 ALLEGATIONS

### *Life Cycle of an Allegation*

An allegation of a violation of Section 1203 must go through five stages before an employee is removed. These include receipt and initial analysis, inquiry or investigation, evaluation, local disciplinary processes, and National Office review. Tax compliance issues normally arise through the Employee Tax Compliance program, and are addressed separately below. Appendix 3 contains a general process flowchart, as well as specific flowcharts for particular provisions of Section 1203.

### Receipt and Initial Analysis

A Section 1203 allegation may be made to the Treasury Inspector General for Tax Administration (TIGTA), or to any employee of the IRS. In some cases, an employee accused of misconduct by a taxpayer self-reports the allegation to a supervisor or TIGTA. Regardless of who receives the allegation, the first step is to evaluate the allegation to determine whether it should be pursued as a Section 1203 matter.

Allegations under Subsections (b)(1), related to seizures, (b)(3)(A), related to Constitutional rights, and (b)(6), related to harassment or retaliation, are evaluated by Division-level management or above to determine whether the threshold established in the law has been met. For example, Subsection 1203(b)(6) addresses violations of the Internal Revenue Code, Treasury regulations, or IRS policies for the purpose of retaliating against or harassing a taxpayer, taxpayer representative or other employee of the IRS. The initial analysis of such an allegation would be done by Division-level management, to determine whether there was a violation of the Internal Revenue Code, Treasury regulations, or IRS policy. If a violation of the Internal Revenue Code, Treasury regulations, or IRS policy, is found, the allegation is investigated to determine whether there was an intent to retaliate or harass.

Subsection (b)(3)(B) provides that a violation of one of six Civil Rights statutes is covered by the mandatory termination of employment provisions of Section 1203. Violations of these statutes with respect to a fellow IRS employee are also covered by the Equal Employment Opportunity program, which includes processes for an employee to seek relief from discrimination. Upon the completion of Equal Employment Opportunity program process, whatever the outcome may be for the employee seeking relief, a special unit reporting to the National Director, Equal Employment Opportunity and Diversity, reviews the file to determine whether the matter warrants a referral for investigation under Section 1203.

Initial analysis of alleged violations of the remaining non-tax provisions of section 1203 is performed by the TIGTA. Any IRS employee receiving such an allegation is instructed to refer it immediately to the TIGTA. In addition, any allegation of criminal misconduct is immediately referred to the TIGTA, as are allegations against managers, GS-15s, Senior Executives and Criminal Investigations employees.

#### Inquiry or Investigation

The TIGTA has primary responsibility for investigations of allegations under Section 1203. These investigations are conducted by TIGTA special agents, and the results are reported to the IRS for evaluation. In some cases, facts developed during the initial analysis of an allegation are sufficient to resolve the matter. For example, the initial analysis may establish that an employee violated IRS policy by acting unprofessionally in dealing with a taxpayer. The information necessary to establish that the employee acted unprofessionally may also be sufficient to establish that the behavior was not intended as an act of retaliation or harassment, and the matter may be dealt with as a non-1203 misconduct or performance matter.

#### Evaluation

Once the facts are established through an inquiry or investigation, IRS managers must evaluate the information to determine whether a violation of Section 1203 has occurred. This determination is made by a Division-level or above manager, with the assistance of local labor relations specialists and the staff of the Centralized Adjudication Unit (CAU). The CAU participates in all determinations under Section 1203, to ensure consistency throughout the IRS.

Evaluation of the results of the investigation or inquiry may lead to a finding that there was no misconduct, that there is insufficient evidence to prove misconduct, that there is sufficient evidence to charge non-1203 misconduct, or that there is sufficient evidence to charge 1203 misconduct. A finding of no misconduct, or of insufficient evidence to prove misconduct, results in a "clearance letter" or a "closed without action letter," respectively. A finding of non-1203 misconduct results in discipline under regular disciplinary procedures. Depending on the nature of the misconduct, the employee's work record, and other factors, the discipline could range from informal counseling to termination of employment. A finding of sufficient evidence to support a 1203 charge results in local disciplinary action under Section 1203 procedures.

#### Local Disciplinary Processes Under Section 1203 Procedures

When Division-level management or above finds sufficient evidence to charge under Section 1203, the employee is given a letter advising that the IRS proposes to remove him or her from the Federal service. The employee has a

right to respond to the proposal letter, and may do so orally and in writing. Many bargaining unit employees exercise their right to representation by the NTEU at an oral reply. After the reply, a deciding official determines whether the 1203 charge has been sustained by a preponderance of the evidence. This factual determination is reviewable through arbitration or an appeal to the Merit System Protection Board. If the deciding official determines that the 1203 charge is sustained, the case file is forwarded to the National Office for consideration by the Section 1203 Review Board.

#### National Office Review

The Section 1203 Review Board examines all cases in which a 1203 charge has been sustained to determine whether a penalty less than termination of employment may be appropriate. The current Review Board members are the Deputy Commissioner for Operations, who serves as Chairman, the Assistant Deputy Commissioner for Operations, the National Director, Equal Employment Opportunity and Diversity, and the Regional Commissioner for the Western Region. Case files are assembled by the Centralized Adjudication Unit, and a representative of the Office of Chief Counsel attends and participates in all Review Board meetings.

Recommendations from the Review Board for mitigation of penalty are submitted to the Commissioner of Internal Revenue for decision. If the Review Board does not recommend mitigation of the penalty, the case is not submitted to the Commissioner and the statutory penalty of removal is imposed. After National Office review, all case files are returned to the local management official for notification to the employee and implementation of the decision.

#### *Processing Tax Compliance Cases*

Potential violations of the two tax compliance provisions of Section 1203 are generally identified through the Employee Tax Compliance program. Computer files identifying IRS employees are matched against tax administration files to find employees who appear to have tax compliance problems. If inquiries from the Employee Tax Compliance Unit do not resolve the matter, the case is forwarded to local management for action. Cases involving apparent willful failure to timely file a Federal tax return or apparent willful underreporting of income are flagged as potential 1203 (b)(8) and (b)(9) cases, respectively. The process described above is then followed, except that the fact finding inquiry is conducted by IRS management rather than by the TIGTA.

## STATISTICS AND CASE EXAMPLES

### *Allegations Received, Investigated and Resolved*

The statistics on Section 1203 indicate that allegations of violation of law or policy for the purpose of retaliation and harassment under subsection (b)(6) are the most common, but very few of those allegations are substantiated. Employee tax compliance cases based on willful failure to timely file account for the next largest group of cases, and most of the substantiated cases.

Data in the following tables reflect the allegations received by the TIGTA and the allegations received by the IRS. The numbers should not be added. Allegations received by TIGTA include some matters referred by the IRS, which would also be counted in the IRS numbers. There is also a large number of reporting offices contributing to these statistics. We know that some IRS offices were very conservative in counting potential 1203 allegations, including in their count matters that other offices did not. For example, we do not believe Section 1203 was intended to cover routine workplace disputes between employees and their managers. Nevertheless, we understand that some offices reported potential 1203 (b)(6) retaliation or harassment cases based on the use of either word in an employee grievance. Others did not include these harassment claims unless they appeared to be more than an aggressive pleading in an otherwise routine grievance.

**Table 2: 1203 Allegations Received and Investigated**

July 1998 to May 2000

Allegation Type	TIGTA Receipts*	IRS Receipts*	Investigations or Inquiries Completed	Substantiated Violations of Section 1203**
Seizure Without Approvals (b)(1)	14	8	7	0
False Statement Under Oath (b)(2)	15	8	5	0
Constitutional or Civil Rights Violation (b)(3)	169	193	170	0
Falsifying or Destroying Records (b)(4)	38	46	24	1
Assault or Battery (b)(5)	0	7	3	0
Retaliate or Harass (b)(6)	399	990	830	0
Misuse of 6103 (b)(7)	0	3	3	0
Failure to Timely File Federal Tax Return (b)(8)	5	443	256	102
Understatement of Federal Tax Liability (b)(9)	30	31	15	2
Threat to Audit For Personal Gain (b)(10)	13	52	36	4
<b>Total</b>	<b>683*</b>	<b>1781*</b>	<b>1349</b>	<b>109</b>

\*Most of the allegations received by TIGTA are referred to the IRS for action, either as a report of investigation or a referral for a management inquiry. The numbers in these columns should not be added.

\*\*Allegations are considered "substantiated" if the TIGTA investigation or management inquiry develops information sufficient to support the allegation. As the case is considered at various stages of the discipline process, additional information may be developed that results in a finding that there was not a violation of Section 1203. The numbers that appear in this column are adjusted to reflect the most recent information available.

Some allegations reveal improper conduct or poor performance that is not within the scope of Section 1203. For example, approximately 40 complaints considered under section 1203(b)(6) as potential harassment or retaliation resulted in discipline for unprofessional conduct. Several of these cases are described in the case examples that appear after the next table.

### **Removals Under Section 1203**

The 109 substantiated Section 1203 violations cited above include all cases in which a TIGTA investigation or management inquiry resulted in a finding of sufficient evidence to support a Section 1203 charge. If an employee presents information in response to a proposed removal that refutes the charge, the case is no longer counted as a substantiated 1203 allegation.

An employee is not removed under Section 1203 until after his or her case has been considered by the Section 1203 Review Board. Some employees elect to resign or retire before the case completes this process, and a small number are removed under other authorities, such as termination of employment during probation. The table below reflects the current status of the substantiated Section 1203 allegations.

**Table 3: Status of Substantiated 1203 Allegations**

**As of May 16, 2000**

	Failure to Timely File Federal Tax Return (b)(8)	Other Provision of §1203
Removals	26	2
Employee Separated From IRS By Resignation, Retirement, or non-1203 Action	26	1
Case In Process	50*	4
<b>Total</b>	<b>102</b>	<b>7</b>

\* Of the 50 cases in process, the Review Board has concluded that it will recommend to the Commissioner mitigation of penalty to something less than removal on some these cases. The Review Board deferred action on specific recommendations on the level of discipline until its June 2000 meeting.

## **Case Examples**

The following examples illustrate the common fact patterns in Section 1203 cases. The definition of "willful" under the Subsection 1203(b)(8) is the voluntary intentional violation of a known legal duty, for which there is no reasonable cause. Thus, these case examples include information about the employee's knowledge of his or her responsibilities, including the briefings the employee may have received on those responsibilities.

### **Case 1 Section 1203(b)(8) Timely File Federal Tax Return—Removal**

The employee was appointed to her position on February 4, 1996. She acknowledged receipt of the IRS Rules of Conduct on that date, and acknowledged receipt of the OGE Standards of Ethical Conduct on February 18, 1997. She had been reminded annually by the Service Center Director, via an All Employee memorandum, of her obligations to timely file her Federal income tax return, accurately report income, and timely pay tax due.

The employee was a GS-3 Clerk at the time of the violation. She did not file her 1996 Federal income tax return until March 23, 1999, and only after managerial intervention, and three notices from the Service Center. The return reflected a balance due. She attributed the filing delay to a difficult pregnancy, however, provided no medical evidence in support of her contention that the condition precluded her from meeting her tax compliance obligations. Accordingly, her failure to file was found to be attributable willful neglect, and not to reasonable cause.

### **Case 2 Section 1203(b)(8) Timely File Federal Tax Return—Removal**

The employee did not file her 1996 Federal income tax return until October 9, 1998. She was a GS-4 Mail Clerk at the time of the violation. The employee stated she did not file the return because it required payment of taxes and she did not have the funds available at the time it was due. All employees of the organization are reminded yearly of their tax compliance obligation. The employee did not offer a valid explanation for her late filing and had not applied for a filing extension. Accordingly, the employee's tax non-compliance was deemed willful.

### **Case 3 Section 1203(b)(10) Threat to Audit For Personal Gain—Removal**

The employee was identified as the driver of a vehicle involved in a hit and run accident. He was subsequently arrested for driving while intoxicated and leaving the scene of an accident. While in custody, the employee identified himself as an IRS employee and declared that he would "find out" about the arresting officer, and would have "a good time" with him. The employee's assertion that his judgment was impaired due to intoxication, was not accepted. He had not only been able to drive home without further incident following the accident, but also responded coherently to the arresting officer's questions, and engaged him in

conversation. Although the employee did not specifically use the word "audit," his remarks to the arresting officer were clearly interpreted as such, and were made for personal gain.

#### Case 4 Section 1203(b)(8) Timely File Federal Tax Return—Removal

The employee was a GS-9 Revenue Officer and had been employed with the IRS for five years. The employee acknowledged receipt of IRS Interim Handbook of Employee Conduct and Ethical Behavior on two occasions (shortly after her appointment in 1995, and again in June 1998). The handbook specifically addresses employee tax obligations. Additionally, an annual memorandum was issued by the employee's District Director to all employees, reminding them of their tax obligations and responsibilities.

The employee received a counseling letter in February 1996 regarding the late filing of her 1993 Federal tax return. Despite the counseling, she again failed to file her return timely for tax year 1997. The employee raised unfamiliarity with "extension to file" provisions, and a missing/inaccurate Form 1099, as defense. Evidence was developed which proved neither to be creditable. Accordingly, the employee's tax non-compliance was deemed willful.

#### Case 5 Section 1203(b)(8) Timely File Federal Tax Return—Not Willful, Other Disciplinary Action

The employee, a GS-4 Clerk, filed her 1997 tax return on January 20, 1999. The non-compliance was identified and raised by the employee herself. Shortly after attending a Section 1203 training session, the employee notified her supervisor of the matter. She learned in the training session that ALL returns must be filed timely. She advised her supervisor that for the past several years, she had not filed timely because she had always been entitled to a refund (this was subsequently corroborated). At no time prior to the training session had the Service notified her of a non-compliance matter. She acknowledged that she now fully understands her filing obligations and would ensure that they are met in the future. Accordingly, the non-compliance was not deemed willful and removal was not effected.

#### Case 6 Section 1203(b)(6) Violation of law or procedure to Harass and Retaliate—Not Substantiated as 1203 violation, Counseled for Unprofessional Conduct

A taxpayer representative alleged that a revenue agent used a hostile approach in conducting an audit, appearing to have reached conclusions before the audit started. A management inquiry found that the revenue agent speculated about the potential outcome of the audit and the consequences of such an outcome, but was not harassing the representative. The revenue agent was counseled that speculation is inappropriate.

Case 7 Section 1203(b)(6) Violation of law or procedure to Harass and Retaliate—Not Substantiated as 1203 violation, Counseled for Unprofessional Conduct

A taxpayer complained that a revenue agent's information request was an effort to intimidate the taxpayer. A management inquiry found the revenue agent issued a 25 page request to the taxpayer, most of which was legal references. The revenue agent explained that he was attempting to document the legal support for the Government's position, and was not attempting to intimidate the taxpayer. The revenue agent was counseled for demonstrating poor judgement.

Case 8 Section 1203(b)(6) Violation of law or procedure to Harass and Retaliate—Not Substantiated as 1203 violation, Counseled for Unprofessional Conduct

An employee was accused of harassment of a fellow employee, which involved spreading rumors about the fellow employee's military record. The subject of the complaint was counseled for causing dissension and discord in the workplace.

Case 9 Section 1203(b)(6) Violation of law or procedure to Harass and Retaliate—Not Substantiated as 1203 violation, Letter of Reprimand for Unprofessional Conduct

During a continuing professional education class, the employee questioned a guest speaker about a case both had worked on. The guest speaker had reversed the employee's action on the case. After the class session concluded, the employee again confronted the speaker about the case, and got within inches of the speaker's face. The speaker reported that he thought the employee was going to strike him. Management proposed a three day suspension for unprofessional conduct, which was reduced by the deciding official to a one day suspension. The employee grieved the suspension, and the case was settled with a reprimand.

## **CONCERNS RAISED BY EMPLOYEES AND MANAGERS**

### ***General Concerns***

When Section 1203 was enacted, the initial reaction from employees and managers was confusion and concern. RRA'98 modified many of the rules for dealing with taxpayers and taxpayer representatives, and it took some time before definitive guidance could be distributed and absorbed by our front-line employees and managers. Many comments focussed on the changing expectations, and reflected concerns that employees could be removed for violating rules they did not understand. Training and procedural guidance on new tax administration rules and on Section 1203 have addressed some of these issues, although the vast size and number of changes in IRS procedures cause

continuing anxiety and uncertainty among employees and managers. This concern is closely related to concerns about section 1203 because some of the section 1203 offenses refer to IRS policy or procedure. The Internal Revenue Manual, which is the principal document for defining IRS policy and procedure, exceeds 50,000 pages and is constantly changing. In conditions of uncertainty and anxiety, it is sometimes viewed as the safest course to take no action or to take action very slowly.

### ***Specific Concerns***

There remain two persistent themes in employee and manager feedback regarding Section 1203. The first is that the fear of a Section 1203 allegation discourages proper action by an IRS employee; the second is that IRS employees are subject to unduly severe penalties for certain tax offenses.

#### **"The Fear of Section 1203 Allegations Discourages Proper Actions"**

The most common allegation under Section 1203 is that an employee has violated the Internal Revenue Code, Treasury Regulations or IRS policy for the purpose of retaliating against or harassing a taxpayer, taxpayer representative or other IRS employee (1203(b)(6)). Many employees believe this provision encourages taxpayers and their representatives to make unfounded claims when the employee is simply doing his or her job. IRS managers raise similar concerns about employees who claim harassment or retaliation when a manager takes proper action to correct conduct or performance problems.

The fear of being the subject of a 1203 complaint and the subsequent investigation, even if the complaint is eventually not substantiated, is frequently cited by employees and managers as a major concern in their everyday work. Our data provides some support for the perception of significant numbers of unsubstantiated complaints that trigger investigations. The IRS and TIGTA have completed 830 inquiries or investigations under 1203 (b)(6). About 40 of these allegations involved some lapses in professional behavior, but none was substantiated as a 1203 violation and the vast majority, over 95%, involved no misconduct.

The IRS has not conducted a comprehensive review of the unsubstantiated allegations, but the staff who deal with the allegations on a daily basis report many allegations fit the patterns cited by employees and managers. Common fact patterns include

- Taxpayers who claim harassment after receipt of a series of proper notices of tax delinquency
- Taxpayers who claim that the routine enforcement of the Internal Revenue Code is unconstitutional

- Employees who claim harassment or retaliation when relief sought through a grievance or Equal Employment Opportunity complaint is denied

Some of the complaints under 1203(b)(6) can be readily dismissed as unfounded, but many cannot. The inquiry and analysis called for in the 1203 procedures is designed to establish the relevant facts, and enable managers to make a fact-based determination about the allegation. The need to conduct a careful investigation also means that cases stay open for a considerable period of time. Employees cite the anxiety of this period when they know an allegation has been made but they have not been advised of the findings.

The IRS has attempted to deal with employee and manager concerns about the impact of unfounded allegations by publicizing the results of the inquiries, including the low number of substantiated cases. In addition, the IRS re-emphasized the importance of timely feedback to employees who are the subject of a specific allegation on the findings of the TIGTA investigation or management inquiry. We have also stressed the fact that complaints and allegations would have to be investigated regardless of the specific provisions of Section 1203.

#### "The Tax Compliance Provisions Impose Excessively Severe Penalties In Some Cases"

The employee tax compliance provisions of Section 1203 cause concern for employees and managers who believe the sanction imposed is too severe in some cases. IRS employees and taxpayers know that they must file an accurate return and pay their taxes on time, and that failure to do so can result in penalties, as this has been longstanding policy. However, the concern arises because of the Section 1203 requirement to remove an employee on the first offense in situations where non-IRS taxpayers would face little or no punishment.

The clearest example of this severity of treatment is in cases involving failure to file a refund return on time. A non-employee taxpayer who fails to file a refund return on time may forfeit the refund if the return is not filed within three years of the due date, but will otherwise suffer no penalty. An IRS employee is subject to removal on the first such offense. While the Commissioner can reduce the penalty in a circumstance such as this, the employee is subject to the threat of removal and an extended period of uncertainty while the case is processed.

Similar considerations sometimes apply when an employee with no prior tax compliance problems files a late balance due return. Some of the cases considered as potential Section 1203 violations involve relatively short periods of delinquency and relatively small amounts due. A non-employee taxpayer would be subject to a late filing penalty of up to 25% of the balance due, plus interest. For a late filed return with a \$2,000 balance due, the late filing penalty for a non-employee taxpayer is \$500 penalty, plus interest and an estimated tax penalty. The employee bears the same penalties and interest sanctions, and loss of his or her employment.

We have tried to address the concerns over the tax provisions of section 1203 by stressing that termination is required only if the employee cannot show reasonable cause, and also by exercising our authority to mitigate the penalty when termination is excessively harsh under the circumstances.

## **APPENDICES**

***I. Section 1203 of RRA '98***

***II. IRS Definitions of "Willful"***

***III. Flowcharts***

[§ 8035] ACT SEC. 1203. TERMINATION OF EMPLOYMENT FOR MISCONDUCT.

(a) IN GENERAL.—Subject to subsection (c), the Commissioner of Internal Revenue shall terminate the employment of any employee of the Internal Revenue Service if there is a final administrative or judicial determination that such employee committed any act or omission described under subsection (b) in the performance of the employee's official duties. Such termination shall be a removal for cause on charges of misconduct.

(b) ACTS OR OMISSIONS.—The acts or omissions referred to under subsection (a) 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;

(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.

(c) DETERMINATION OF COMMISSIONER.—

(1) IN GENERAL.—The Commissioner of Internal Revenue may take a personnel action other than termination for an act or omission under subsection (a).

(2) DISCRETION.—The exercise of authority under paragraph (1) shall be at the sole discretion of the Commissioner of Internal Revenue and may not be delegated to any other officer. The Commissioner of Internal Revenue, in his sole discretion, may establish a procedure which will be used to determine whether an individual should be referred to the Commissioner of Internal Revenue for a determination by the Commissioner under paragraph (1).

(3) NO APPEAL.—Any determination of the Commissioner of Internal Revenue under this subsection may not be appealed in any administrative or judicial proceeding.

(d) DEFINITION.—For purposes of the provisions described in clauses (i), (ii), and (iv) of subsection (b)(3)(B), references to a program or activity receiving Federal financial assistance or an education program or activity receiving Federal financial assistance shall include any program or activity conducted by the Internal Revenue Service for a taxpayer.

[CCH Explanation at ¶ 976. Committee Reports at ¶ 10,195.]

# RRA '98 Section 1203 Procedural Handbook



Department of the Treasury  
Internal Revenue Service

[www.irs.ustreas.gov](http://www.irs.ustreas.gov)

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## *What do the concepts of willful and intent mean?*

- For a violation to occur under any Section 1203 provision, some degree of intent must be present. This concept means that unintentional errors in the course of doing your job in good faith are not Section 1203 violations.
- Four of the provisions in Section 1203 refer to willfulness. Willfulness is the degree of intent required for a Section 1203 violation to have occurred for the following provisions: seizures, improper use of disclosure statutes, failure to timely file Federal tax obligations, and understatement of Federal tax liability.
- When applied to the Sections 1203 provisions associated with seizures and the improper use of disclosure statutes, willful means:

*“Actual knowledge of or reckless disregard of requirements”*

- When applied to the Sections 1203 provisions associated with failure to timely file Federal tax obligations and understatement of Federal tax liability, willful has a unique definition that parallels the concept found in the Federal Tax Code. In these instances, willful means:

*“Voluntary intentional violation of a known legal duty, for which there is no reasonable cause”*

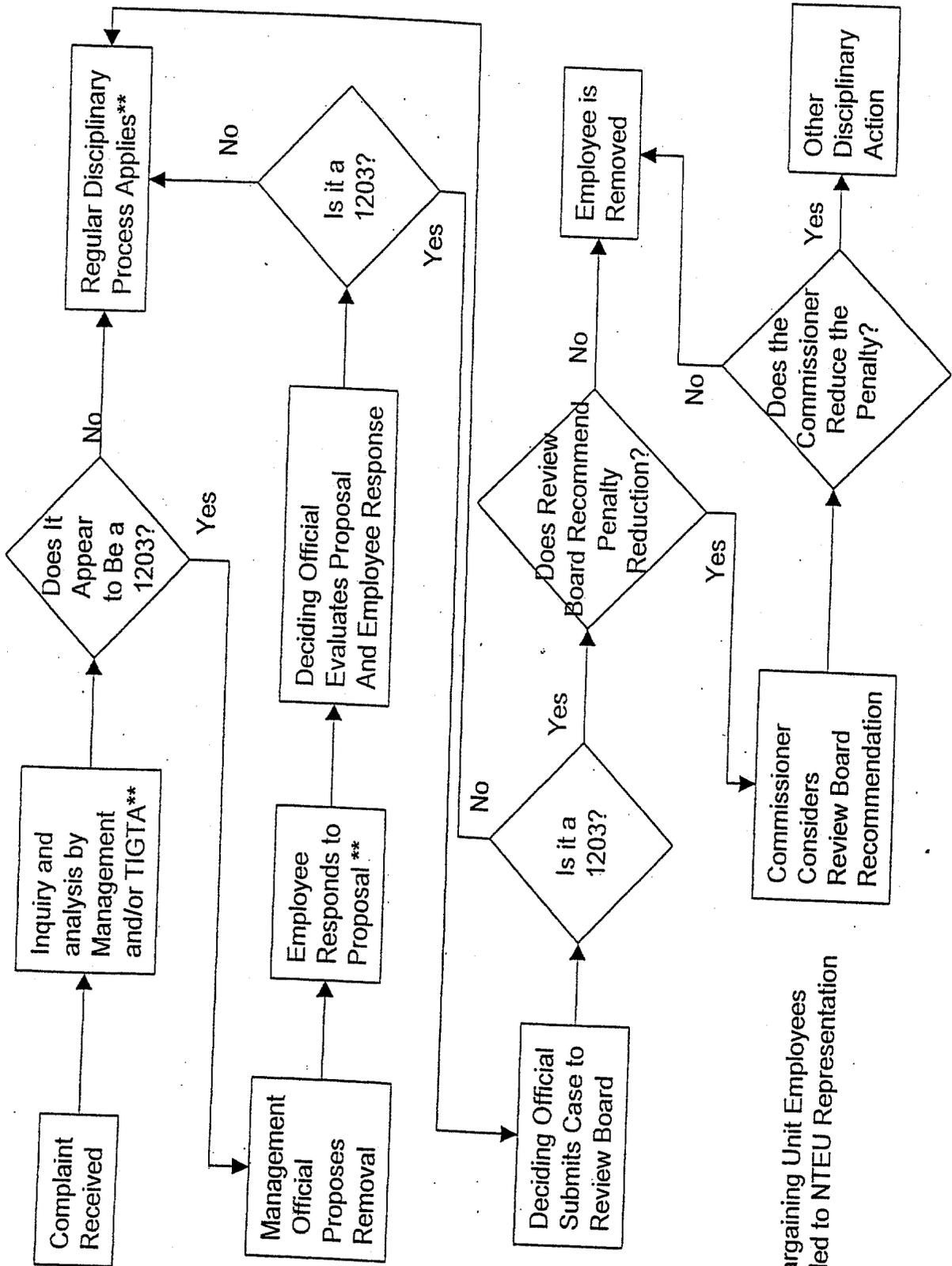
The following table should help keep the concepts of intent and willful clear for all of us.<sup>1</sup>

Section 1203 Provision	Statutory Language	Intent Requirement
§1203(b)(1)	Willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets;	Willful means actual knowledge or reckless disregard of the requirements to obtain signature approvals.
1203(b)(2)	Providing false statements under oath with respect to a material matter involving a taxpayer or taxpayer's representatives;	Intent in this provision requires that the employee (1) knew the statement was incorrect or made recklessly without an honest belief in its truth, and (2) made it to mislead or deceive.
1203(b)(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;	Intent means that:  (A) The employee's conduct must violate clearly established constitutional rights, of which a reasonable person would be aware.  (B) The employee's conduct must be motivated by discrimination (i.e. treating employees, taxpayers, or taxpayer representatives differently on the basis of race, sex, color, religion, national origin, age, or disability as defined by the civil rights statutes).
1203(b)(4)	Falsifying or destroying documents to conceal mistakes made by any employee with respect to a matter involving a taxpayer or taxpayer representative;	Intent in this provision requires that the falsification or destruction of the document must have been done to conceal mistakes.
1203(b)(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 adverse judgment by a court in a civil case, with respect to the assault or battery;	Intent means that the assault (imminent threat of a battery) or battery (an unwanted touching) must have been done deliberately or purposefully.

<sup>1</sup> This chart provides a general, plain language presentation of the intent requirements of Section 1203 (b).

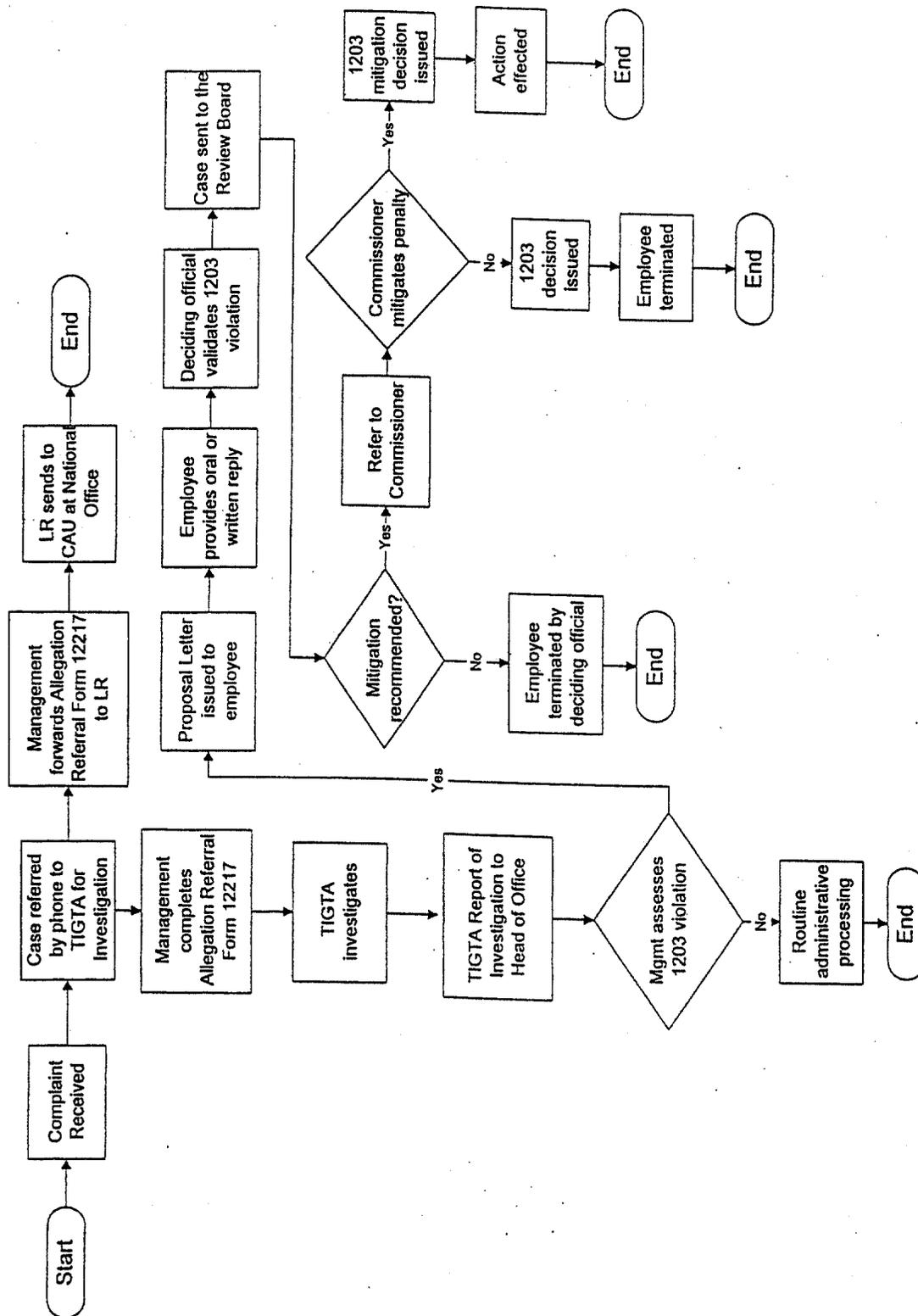
1203(b)(6)	Violations of the Internal Revenue Code of 1986, Department of Treasury regulations, or policies of the Internal Revenue Service (including the Internal Revenue Manual) for the purpose of retaliating against, or harassing, a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service;	Intent means that the violation of Code, regulations, or policies (including the IRM) must have been done for the purpose of retaliating against or harassing a taxpayer, taxpayer representative or other IRS employee
1203(b)(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;	Willful in this provision means the actual knowledge of or reckless disregard of the statutory provisions for disclosing information in response to a congressional inquiry.
1203(b)(8)	Willful failure to file any tax return required under the Internal Revenue Code of 1986 on or before the date prescribed therefore (including any extensions), unless such failure is due to reasonable cause and not to willful neglect;	Willful means the voluntary intentional violation of a known legal duty (timely filing of tax return), for which there is no reasonable cause.
1203(b)(9)	Willful understatement of Federal tax liability, unless such understatement is due to reasonable cause and not to willful neglect; and	Willful means the voluntary intentional violation of a known legal duty (accurate reporting of tax obligation), for which there is no reasonable cause.
1203(b)(10)	Threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.	Intent in this provision means that the threat to audit must have been made to extract personal gain or benefit.

Process for Resolving Section 1203 Allegations



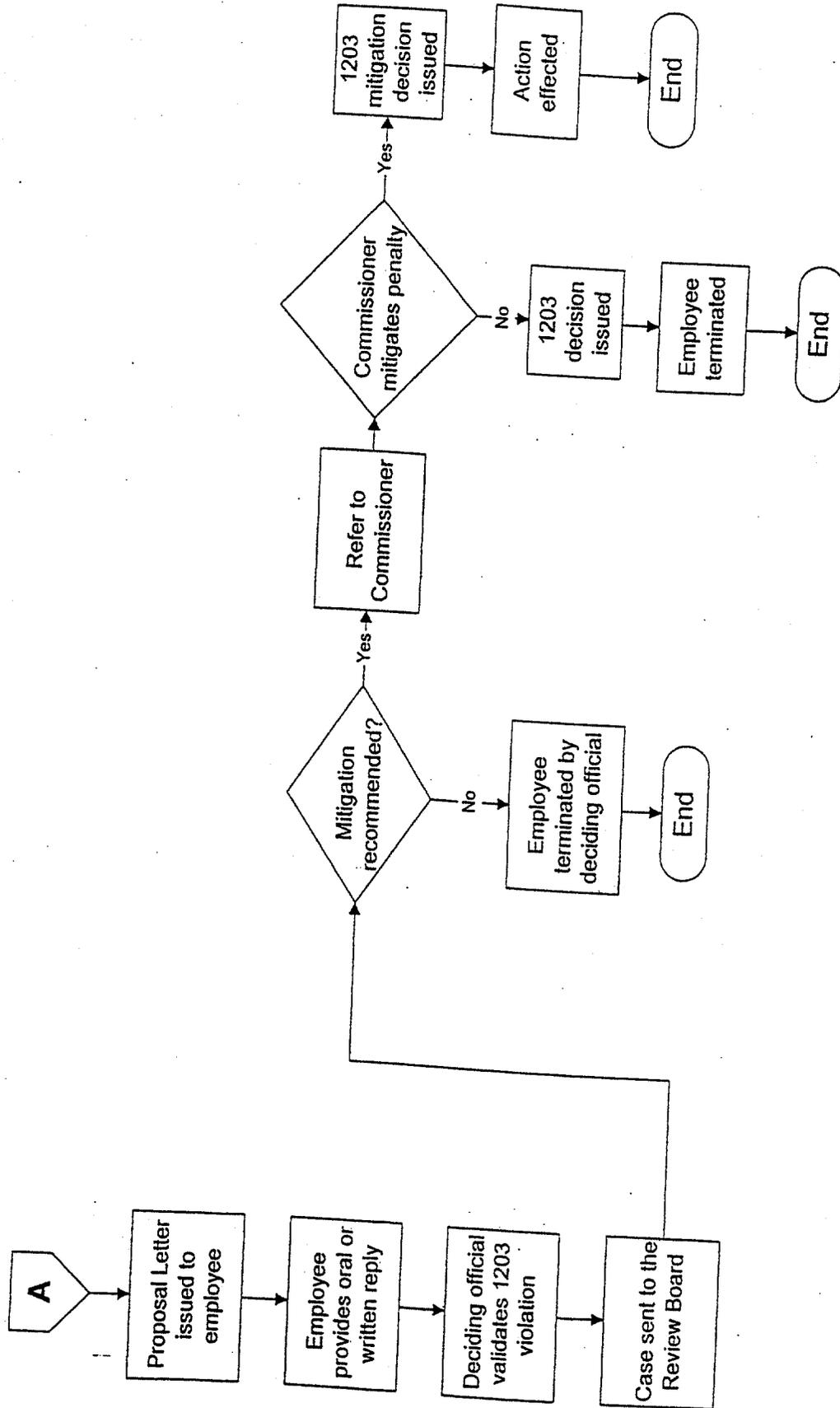
\*\* Bargaining Unit Employees Entitled to NTEU Representation

Procedures for Handling Allegations, 1203(b)(2), (4), (5), (7), and (10)

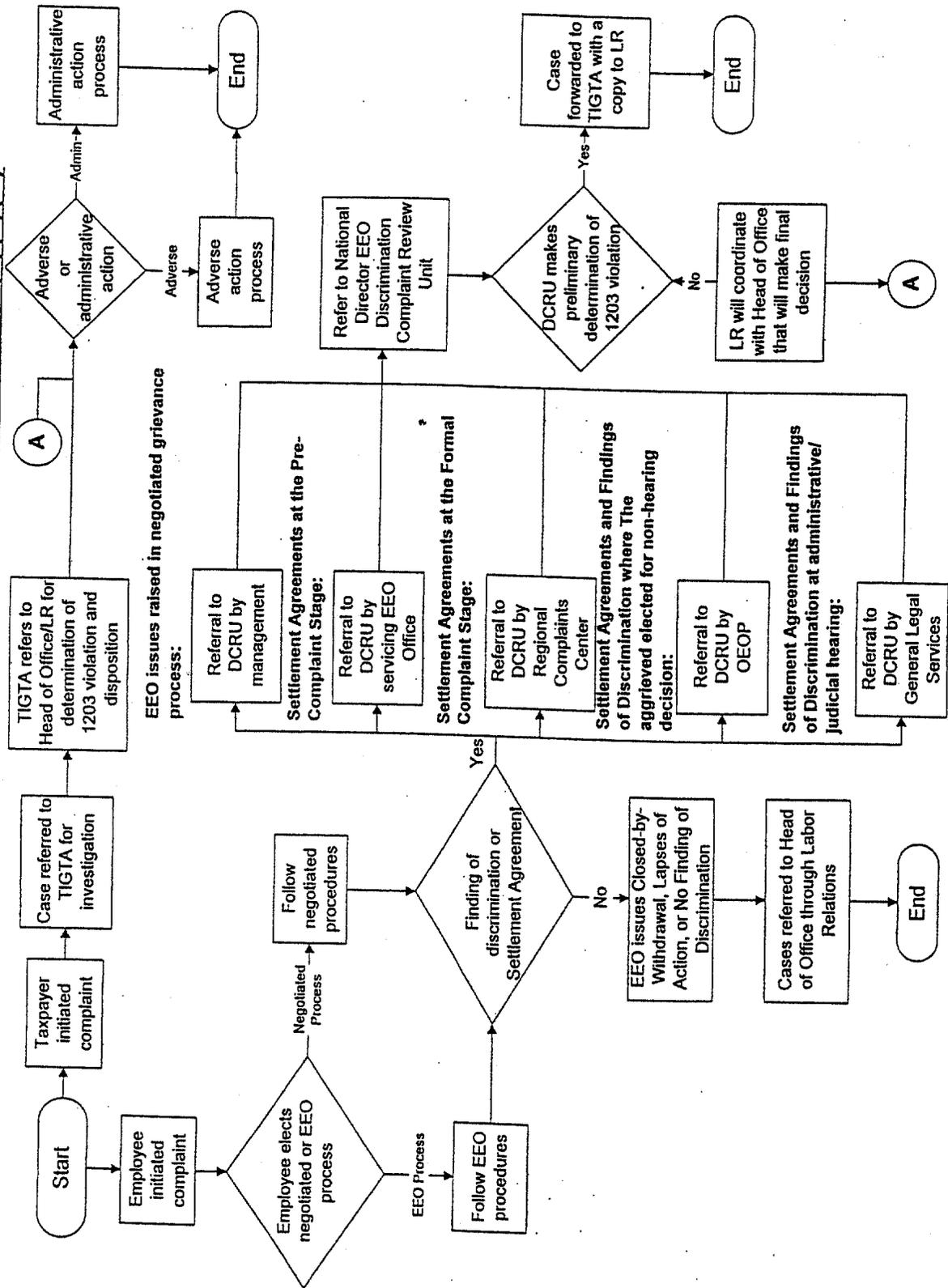




**Procedures for Handling Allegations, 1203(b)(1), (3)(A), and (6) Page 2 of 2**



Procedures for Handling Discrimination Allegations, 1203(b)(3)(B)





Senator GRASSLEY. Now it is Congressman Coyne's opportunity.

Mr. COYNE. Thank you, Mr. Chairman.

Commissioner Rossotti, you indicated that the audit rate for higher income individuals has been declining for the last 10 years and that this decline was not a result of the recent structural reform.

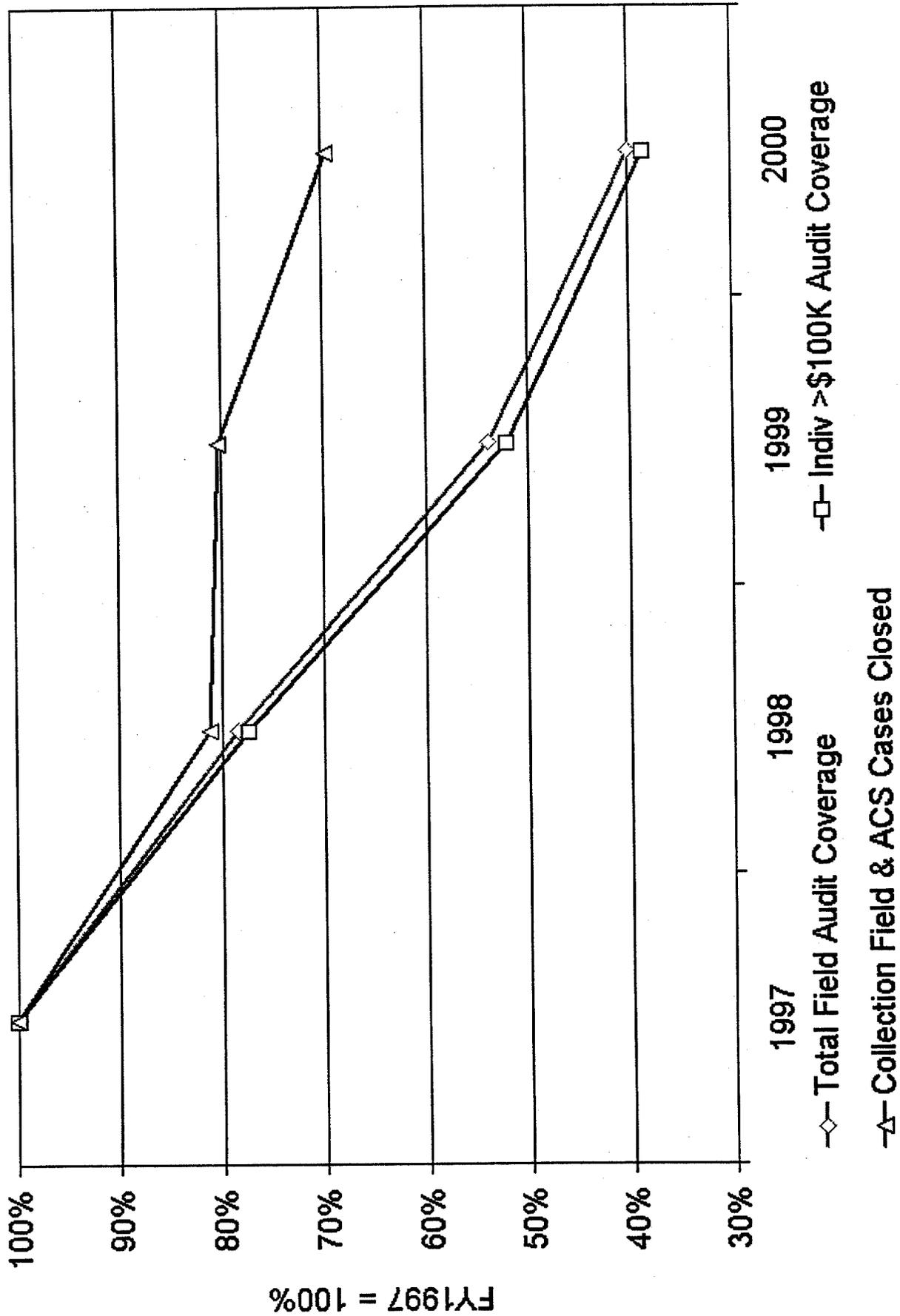
Do you have any statistics that show that this trend did accelerate in the last two years, however?

Mr. ROSSOTTI. Well, yes, it did. All right. In fact, if you could put that chart up, you can see that it declined significantly in the last two years. As a matter of fact, the red line on this is audit coverage for individual returns over \$100,000.

[Chart 1 follows:]

Chart 1

# Reductions in Enforcement Indicators.



You can see, it has declined about 60 percent just in the last two years. That is basically due to two things. One, again, is a lot more returns, fewer people. I mean, it takes a person to audit a person. We have fewer persons. That is one reason. That is the biggest reason.

But there is another reason, which is that, as Senator Grassley commented he heard from some IRS employees, there is partially a relearning process. The way of doing it is not the same as it was before, so it is taking our employees more time to complete each case.

We hope that, over time, as we train them better, that may level off. But it is really a combination of more returns, fewer people to do them, and the additional learning, additional requirements of the Act that has led to that red line.

Mr. COYNE. So the decline in audits has accelerated at a faster pace over the last two years than the prior eight years.

Mr. ROSSOTTI. Yes. I did not have on the chart the eight years, but it did go down faster. It was on a steady decline, and then it took, as you can see, a rather strong decline in the last two years, three years.

Mr. COYNE. All right.

On March 28, when you testified before the Ways and Means Committee, you indicated that there was a study under way to determine the extent of EITC fraud that may exist within the Code, within the IRS. When do you expect that study to be completed?

Mr. ROSSOTTI. Are you speaking of the EITC program?

Mr. COYNE. Yes.

Mr. ROSSOTTI. Well, we have most of it done and I am hoping that we can get it out within the next several months.

Mr. COYNE. But certainly before the end of the year?

Mr. ROSSOTTI. We would hope so, yes.

Mr. COYNE. When Senator Dorgan was in the House of Representatives, he served on the Ways and Means Committee and he was always making a point about the outstanding debt owed to the IRS from people not paying their fair share.

At that time, I recall, he made the point about \$119 billion being outstanding. Now we find out it is in the neighborhood of \$231 billion. Is there anything that can be done about collecting that outstanding debt?

Mr. ROSSOTTI. Well, first, let me just say that I think it is important to get these numbers straight. I think with the help of GAO, we have been able to get a clearer picture on this.

There is a number which is published which is around \$220 billion, which is simply the accumulation, including interest and penalties, of every debt that has ever been incurred for 10 years, because by statute we are required to keep it on the books.

Most of that debt represents companies that have gone out of business, bankrupt companies, assessments that have not been agreed to. It is not, frankly, a realistic number.

In the financial statements for fiscal 1999 which GAO audited, we estimated, and they audited, that it was about \$21 billion of that which is actually collectible money. So that is really, I think, if you want to use a number, a better number to use as to what is collectible.

Now, of course, as a percentage of the total amount that is paid, \$1.8 trillion, it is actually not that large a number and it has not increased, actually, a great deal in the last year.

But I think what is most important, is that our own internal collection activities, which have, as you can see on that chart, declined some, not be allowed to continue to decline, because then what will happen is that will continue to go up. So that is part of the reason for our budget request, so we can get on that debt and collect it.

Now, I also think, if you look longer term, this is, again, an immediate, what we can do in 2001. There are significant opportunities to improve the way we collect debt in the IRS, and they basically get to the same kind of practices people in the private sector use.

The principle thing is just to get to those debts a lot faster than we do now. We are probably the slowest- reacting debt collection agency of any sort that I have ever been involved with, and a lot has to do with our computer systems, it has to do with organizational practices that have existed for a long time.

As we move forward in the modernization process, one of our objectives, and this is something that is very doable but is not easy to do because there are so many pieces to it, is to greatly speed up the way that we go after collecting this debt, which actually is good for the taxpayer because if we get to collecting it sooner there is less interest and penalties and the chances of them being able to actually pay the debt rather than getting to a hopeless situation is greater.

So I think that there is great opportunity to improve the way we do debt collection in the IRS. I think we can do it. There are some immediate things that we need to do, which our budget will help us do, so that we do not get even further behind than we are, which is my immediate worry, and then we can go to work, as we already are, on redesigning completely the way we do debt collection so that we will be much more efficient. I think it is clear that we can be much more efficient and effective in collecting debt.

Mr. COYNE. Thank you.

Senator Grassley. Congressman Sununu?

Mr. SUNUNU. Thank you.

Senator Kerrey raised the issue of electronic filing, and I would like to begin by asking for a little bit more information about the initiatives regarding electronic filing.

What was the rate of returns filed electronically this year, and what is your goal for next year?

Mr. ROSSOTTI. Well, actually, that was a really great result, we think, of the filing season. We hit slightly over 35 million individual returns filed electronically this filing season, which represents a little more than 27 percent of the total returns filed.

It also represents a 20 percent increase over last year in the number filed, and it also represents more than a million over what we had previously estimated. So, no matter how you figure it, that was a very successful result and certainly is a very good trend in terms of where we want to go.

We have not yet reset our goal for next year. We still have to do that. But certainly we will increase it over what it previously was, because we are starting at a better level.

We also, in our technology program, have quite a few initiatives under way to make it more attractive for people to file and pay electronically, as well as to promote the service more extensively.

Mr. SUNUNU. I guess that means that I am not going to get you to give a number today for next year. But it would seem to make sense, and I recognize the amount of material that is on your plate already, to try to forecast out not just one year, but two, three, or four years, because, clearly, a 20 percent growth rate in electronic filing, it is going to make an enormous difference in terms of not only the overall level of work load, but also in the type of work that your employees are going to have to deal with.

Mr. ROSSOTTI. We do have those forecasts, and we do have them out. It is just that we are now about to re-update them, because of two reasons. One, frankly, is we have been more successful.

I mean, as a matter of fact, we have to update quite a few numbers because this filing season was significantly, in a number of ways, more than we anticipated. But we definitely are going to do that and we are building that into our strategic plans out five or six years.

The other thing is, we are very much updating our plans for the electronic filing based on what we are able to do with the technology modernization, because that will enable some additional kinds of returns to be filed.

[Data on electronic filing follows:]

The Office of Research within the IRS released the following preliminary projections of electronic filing on May 30, 2000:

**Preliminary Calendar Year Projections of the Percent of Individual Returns to be Filed Electronically 2000-2010 for the United States**

	Total Individual Returns (millions)	Total e-file Returns (millions)	e-file percent of total
1999	124.9	29.3	23.5
2000	127.4	35.3	27.7
2001	129.8	42.3	32.6
2002	131.9	50.1	38.0
2003	133.4	56.9	42.7
2004	135.0	62.0	45.9
2005	136.8	66.1	48.3
2006	138.9	69.7	50.2
2007	141.2	72.8	51.6
2008	143.4	75.7	52.8
2009	145.4	78.1	57.7
2010	147.0	80.2	54.6

Mr. SUNUNU. What is the savings to the agency from electronic filing?

Mr. ROSSOTTI. Well, I think that we have to look at the savings in two parts. The direct savings from just the mechanics of processing the returns are perhaps not as significant as you might think. They are certainly there, but only about---

Mr. SUNUNU. Has the agency quantified those direct savings?

Mr. ROSSOTTI. Yes, we have got that. But, roughly speaking, about 6 to 7 percent of our budget-- that is a lower number than most people realize--actually goes to just the processing of the returns, and about 60 percent of that is for individual returns, 40 percent is for business returns.

So I think you can see, it is not the biggest portion. When you went into the Andover Service Center and you went through it, the people in what is called the pipeline that actually

process the return, there are a lot of them there during the filing seasons, but then they go away during most of the non-filing season. Really, most of the people up at Andover are not processing returns. What they are doing, is they are answering questions on the phone with taxpayers, and that sort of thing. That is where most of the money really goes, is one-on-one service to the taxpayer.

So we will save. It is really one of the things that we are counting on to be able to improve compliance and improve service. We want to save money in things like just raw processing, which is really something that we can use technology to do and use that as the way of meeting the gaps we have in service.

We still only answered 65 percent of the phone calls this year in the filing season, which is a heck of a lot better than 50 percent last year and 20 percent a few years ago, but it is still only 65 percent and we need to get to 90 or 95 percent.

Mr. SUNUNU. Which provides an outstanding segue to my second set of questions which deals with customer service. In the GAO material, the most recent material that they prepared for this hearing, they highlight organizational structure, problems with information systems and human capital management as underlying some of the weaknesses in the customer service delivery rate that you talked about.

Can you elaborate a little bit on those weaknesses and how you prioritize improvements and changes for dealing with them?

Mr. ROSSOTTI. Those are absolutely accurate assessments of the problems we have. I tend to look at them as opportunities. I mean, it says we have got opportunities to improve significantly.

We have taken advantage of some of those opportunities already in this filing season, which is why we got the rate of answering up to 65, and actually it went up to 70 percent during some parts of the year, which was more than we had forecast, and significantly more than last year.

It was not primarily due to more personnel being put on, it was primarily due to major reorganization, getting planning done sooner, and better use of some call routing technology that we put in. However, it is still a long way from the goal.

Next year, what we are hoping is that we will be able to do an even better job of planning. We have some additional new technology that we hope to get in, and we will need somewhat more staff.

Mr. SUNUNU. If I might ask one final question about the call routing approach and technology, in particular. As I have talked to taxpayers and IRS employees about this, it seems to me that, unfortunately, there can be a conflict between the goal of answering as many calls as possible and the goal of actually providing good customer service.

You want the customer service representative to have some flexibility to stay on the phone to make sure the problem gets resolved, and to be able to call back a taxpayer without necessarily having to go through a chain of command to get approval.

You want calls to be routed on the basis of where cues exist, not just on the basis of, well, send 50 calls, or 100 calls, or 1,000 calls to every center regardless of the ability to really deal with them effectively.

Where, in the organization, have you seen those kinds of problems, and do you feel that your approach to call routing is really on par with a private sector company, a Fidelity, or something along those lines?

Mr. ROSSOTTI. Actually, your question is, I think, very perceptive as to what the challenge is. The answer to your final question is, no, we are not on a par. But I think, again, we know where we need to go, and we have been making some major changes.

I mean, if we go back to where I came in two years ago, we had 25 different call sites, each run their own way, and it was kind of a rough allocation. Furthermore, the way the performance was managed was almost entirely quantitative and basically just said, get as many calls through as you can.

I heard some cases where people were saying, well, we are being asked to get taxpayers off the phone just so we can take another call, which is not really good customer service. We got rid of that, actually, partly because of the Restructuring Act.

That was the reason why, on a statistical basis, our performance actually slipped last year a little bit compared to the previous year. That is one of the main reasons why, because we got rid of some of those, what I would consider, artificial kinds of statistical measurements.

But now what we are doing, is we are now climbing back up. The goal is to provide both access and quality service when people get through by directing the call to the right person, taking every call and directing it to the person who is best qualified and best available to answer that call, which is what the private sector is all about. When you are getting 160 million incoming calls and you are starting with a system that, two years ago, was based on 25 independently managed call centers, that is a pretty big transition. But I think this is one area where we have some of the better plans, and really the progress will be more rapid than in some other areas.

I think if I were to look ahead over the next two or three years, I think we will get to the point in this area where, if we do get some additional resources and we can implement the technology, you will see, as we have had actually this season, significantly improved progress.

Ultimately, the point being exactly as you say, the taxpayer, when they call, they get

through. Or not only call, but actually increasingly, hopefully, over the Internet and through other means, that they get to the person that can answer their question and get an accurate quality response quickly. That is what taxpayers want.

Senator GRASSLEY. Now we go to Senator Hatch.

Senator HATCH. Commissioner, the National Taxpayer Advocate has suggested repealing the individual alternative minimum tax, with which I wholly agree.

In your view, would this be a significant step towards easing the complexity burden that will come upon what Treasury estimates will be 17 million AMT taxpayers by 2010? Does not the AMT also place a big complexity burden on the IRS?

Mr. ROSSOTTI. Yes. I think there is no question, and anyone that has studied it has indicated that the AMT is a very complex provision. Unfortunately, there were some provisions enacted in the tax bill last year that eliminated what could have been a large number of middle income taxpayers being potentially subject to this. But, of course, as time goes on, more and more could get back in.

Senator HATCH. It is still estimated that there will be about 17 million for 2002.

Mr. ROSSOTTI. I think, from a purely administrative standpoint, anything that could be done to reduce the number of taxpayers that might be subject to that kind of a confrontation would certainly be beneficial.

Senator HATCH. Would it not be just better to get rid of it?

Mr. ROSSOTTI. Well, I think that---

Senator HATCH. Say yes. Say yes. It would be really helpful. [Laughter].

Mr. ROSSOTTI. I think, clearly, the policy angle has to be weighed there, which is not my job, but certainly administratively, it would simplify things.

Senator HATCH. Well, we would like your advice. I am concerned about the integrity of our voluntary compliance system. It seems to me that the system rests, perhaps, on three pillars: understandability of the tax rules by taxpayers; the perception by taxpayers that the system is fair; and the belief of taxpayers that tax cheating carries a significant risk.

Now, what more can we in Congress, and you the Commissioner, do to ensure our voluntary compliance system does not disintegrate?

Mr. ROSSOTTI. Well, I think that, really, as I indicated, we really have to stop that downtrend, because the point that you made, if people begin to think that their neighbor or their competitor across the street is not paying their fair share or paying what is due and we are not

able to do anything about it, that, I think, is a danger.

I am not saying that we are at that point now, because actually we have been pretty effective in using what resources we have to try to find where there is non-compliance. But, I mean, if you extrapolate that downtrend further, it gets to the point where the probability that we can find the person that is not paying gets too low. Then we also have the uncollected tax debt issue.

So I think that it is very important that we at least stabilize this. I think then we need to invest in ways of improving the way we target our compliance resources. Those are the things that we can do to solve that problem.

Senator HATCH. All right. The IRS proposes billions of dollars in adjustments and penalties to taxpayers each year as a result of mistakes and other problems discovered upon the examination of returns.

Can you estimate the percentage of these adjustments in penalties that result from taxpayers not understanding the tax law, and what percentage results from tax avoidance? In other words, let me put it this way. Can we estimate how much the complexity of our tax system contributes to IRS adjustments and penalties?

Mr. ROSSOTTI. Unfortunately, Senator, I am not aware that we have any studies. That is a very important question, and I have asked it myself internally, but I am not aware that we have any. It is a very hard question to answer.

Senator HATCH. What is your view? Even though you do not have the studies, what would be your view?

Mr. ROSSOTTI. I really do not have a percentage. I do believe that there is some of each.

Senator HATCH. But do you not think the highest percentage would be those who do not understand the tax laws and have difficulties?

Mr. ROSSOTTI. Well, let us put it this way. We believe that, whether it is the most percentage or a large percentage, it is certainly a significant problem. It is a significant part. In our whole reorganization, we are acting on that because a large part of our strategy is to try to use somewhat more resources to work with taxpayers. It is especially true in the small business arena.

In the small business area, the small business person gets into some additional complexity that an individual taxpayer does not have, yet they do not have the tax professional resources to deal with it.

So we are going to put significantly more emphasis, exactly for the reason you say, on

trying to work with taxpayers up front, and especially small business. We have had some pilot programs. They have been quite successful. We are trying to work with things like the Small Business Administration, Small Business Community Development Centers.

We have programs that help. There are almost one million start-up businesses a year, for example, in this country and many of them have limited knowledge of what they need to do from a tax standpoint. Well, they can get into trouble, be in business a year, before they even realize it.

So we really think there is a real opportunity, as you say, to head off those problems by making sure that people do not make mistakes unintentionally, or just because they do not have the time to deal with it.

Senator HATCH. Well, based upon what I have read, there has been a drastic decline in IRS enforcement action since 1998. Now, this, I would think, must be the result of changes from the restructuring legislation. Now, I applaud your focus on taxpayer service. I am not sure I am ready to refer to taxpayers as customers, but I believe the shift is a good one.

However, like you, I am also concerned that Americans should pay their taxes. Do you have all of the tools you need to reach the appropriate balance between treating taxpayers with the respect they deserve and still collecting the taxes that are really due?

Mr. ROSSOTTI. Well, I think that the two principal tools we need are what we have asked for in the budget. In the short term, we do need some more staffing because we have been given some additional requirements. I think in the long term, with the reorganization and the better management we are doing, better technology, we can then leverage those people to do a job on both better service and better compliance.

Senator HATCH. Well, thank you, Mr. Commissioner.

Thank you, Mr. Chairman.

Senator GRASSLEY. The secretary of the committee said that Congresswoman Northup is next, but Mr. Horn was here previously. Under the practice of the Senate, we would call on Congressman Horn.

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

Commissioner, in my opening remarks I noted that the government was owed \$231 billion in unpaid taxes, penalties, and interest, and the Comptroller General informs us that, of that amount, \$21 billion is collectible, according to the General Accounting Office.

I would just like you, maybe, to explain to the joint review group, what your feeling is on the debt collection system of the IRS you inherited from others, and what your plans are to improve it. It makes me pretty angry when the rest of us pay our taxes, and you have got people

that are let off.

And it was not you that did it, it was way back in 1990, 1991, when it started. The pile got up, which got my attention, over \$100 billion, and that is when I talked to your predecessor.

I said, frankly, I think it is a national scandal that we are not making those collections. We did start that way in the Debt Collection Act of 1996, but it did not have the tax collections, it had only non-tax, because nobody wanted to face up to it.

Mr. ROSSOTTI. Well, I think, Mr. Horn, as we have discussed at length, and you have called attention to this very well in your committees, the IRS is a large debt collection agency.

I think, for a variety of reasons having to do with historical evolution of this system and very much related to the technology, it is a very slow system, which is really the wrong word that you want to use, if you want to have effective debt collection.

Ninety percent of our debt collection resources, in terms of our people that collect debts, are currently working on accounts that are more than six months old, and many of them are working on very old accounts. That is partly because of the complexity of what you have to do before we get to actually applying those resources. So, I think our approach is to really reengineer this completely.

This is part of what we are going to be doing as part of our technology modernization. We now, at least, or will very soon by the end of this year, have our collection resources more centrally managed so that at least we will have the first step, which is the management process.

The next step, is we need to reengineer this with better technology. Of course, we can, and are, going to use best practices and people from the private sector to help us do that.

Mr. HORN. Do you feel that you could use some more authority from the Congress in order to get at the debt deadbeats, shall we say? And have you ever had a chance--and I do not expect you to do it right now--to look at the 1996 Act which applies everywhere but here?

Mr. ROSSOTTI. Yes. I would be glad to look at that. I do not think I can answer that right off the top of my head, but I would be glad to look at that.

Mr. HORN. Yes. Mr. Chairman, if the response of the Commissioner would be put in this part of the record, I would be most grateful. So, we would be delighted to hear from you.

Mr. ROSSOTTI. Yes, sir. We will.

[The requested information follows:]

Currently the provisions of the Debt Collection Improvement Act of 1996 (Public Law 104-134) do not apply to the collection of delinquent tax debts. The legislation uses the

term non-tax debt throughout and amends section 3701 of title 31, United States Code, in subsection (a) by adding at the end a new paragraph; "(8) 'non-tax' means, with respect to any debt of claim, any debt or claim other than a debt or claim under the Internal Revenue Code of 1986." At this time, we are not asking for additional authority from Congress pertaining to this legislation. As we consolidate the organization, we will have a more managed, intergrated collection process, which should allow us to work more rapidly to resolve debt issues. We will use our existing technologies to accelerate some steps in the debt collection process and will continue to evaluate the possibility of contracting portions of the debt collection process to private sector debt collection agencies.

Mr. HORN. But do you have in your next go-around improvement of the existing collection system within the IRS?

Mr. ROSSOTTI. We do. Again, we are trying to tackle that, short-term, by just doing some patches and by applying some additional staff where we can. There are some things we can do immediately.

In fact, we are going to be doing some within the next few months just within our current systems. But, frankly, as you will remember the chart that I brought to your hearing, it is not something that you can get very far on just by patching. It has to be redesigned.

The basic principles are quite simple. It is basically, find out where your risks are and get to those people as quickly as possible, resolve the case quickly so it does not build up and become an impossible case. Right now, our employees are working on, in some ways, mission impossible. They are trying to collect money much later than anyone else would try to collect money.

Mr. HORN. Are you willing to use private collectors to help in this?

Mr. ROSSOTTI. I think that, as we get to the point where we are reengineering the whole thing, there could very well be a role for them. I have worked with these people before.

I think this is a particular issue that we are going to face that we have not figured out how to solve. If we want to transition to a much more proactive debt collection approach, what do we do with the old inventory that we have got that is currently what most of our employees are working on? We need to study that and there might be an opportunity there, for example.

So, we will consider all those options. I think if we needed legislation at that point, and I am not sure we do because I do not know enough at this hearing to say, but we would certainly be willing to come in and talk about that.

Mr. HORN. When I raised that in 1996, I was told by some in IRS at that time that, well, gee, we have privacy problems. It just seems to me, it is not a privacy problem if you give them the address and say, here is what they owe the taxpayers. If you feel that is a problem,

maybe we need some exceptions.

If it has something to do with the fact that they do not feel they should pay that tax, that is your job and that of your experts and professionals. But we ought to at least collect. I guess we ought to also think about all these bankruptcies, and is there a pattern and practice where they take the taxpayers right down the primrose road.

Thank you, Mr. Chairman.

Senator GRASSLEY. Thank you, Representative Horn.

Now, Representative Northrup.

Mrs. NORTHUP. Thank you. I would like to return to what the previous two questioners discussed and follow up. I am looking at the IRS mission statement, and I appreciate all of the services that the mission statement reflects are the IRS's goal to meet, and the three strategic goals, too. I am not sure, under any part of those, where enforcement and debt collection fall.

Mr. ROSSOTTI. Well, actually, it is in the mission statement. I mean, that is two of the three goals. One of them is to provide each taxpayer with proper service and respect their rights, and the second one is to provide service collectively to all taxpayers by making sure that people comply with the law.

We put it in terms of, apply the law with integrity and fairness because we think that is the way we should do it. We should apply the law with integrity and fairness. But that is using our enforcement powers and our other tools to make sure that people comply with the law.

We have translated that even further into a specific series of what we call balanced measures, which have now been rolled out throughout the organization, which, again, track with those goals. One of them is what we call the business results goals.

We are constrained, in some ways, by how we do that in the collection area and in the exam area by Section 1204 of the Restructuring Act, which prohibited the use of enforcement statistics to set targets or measure the performance of any individual.

So we have set a regulation. This was one of the things that we worked on the hardest over the last two years, and finally last September we published the regulation which specifically said how we were going to interpret Section 1204 in the enforcement area, how we were going to measure performance, and it laid out certain quantities that we can use. For example, we can set goals on the number of cases that we do. We cannot set goals on precisely how many dollars we collect.

But we have developed those balanced performance measures and they have been rolled out throughout major parts of the agency. I have stated repeatedly to every group that I have

been before, including the first testimony that I ever presented, that I thought we could not succeed unless we did both of these things, unless we provide taxpayer rights, provide good service, but also collect the money that is due.

I think this is a harder job than just looking at one or the other, but it is what we are expected to do. I mean, it is just like a business. You have to keep your customers happy, but you also have to make a profit.

Mrs. NORTHUP. And I agree. I am thinking of Senator Hatch's earlier question, where he asked, I think, do you have the tools you need? You talked about the financial tools, but my question is, do you also have the legislative tools that you need? Do you think that the balance is there for you, and if not, do you intend to send us legislation to meet the need?

Mr. ROSSOTTI. Let me say that I think at this point, with respect to the Restructuring Act, it was a very comprehensive and pervasive act. I have to say, I think we are still learning. We are learning, really, how to make it work. I think, for example, in Section 1204, which is directly at the heart of your question, how do we measure performance, this was at the heart of some of the problems that were raised at hearings, and even internally in the agency.

Prior to that, the focus was almost entirely on enforcement dollars in terms of the way performance is measured. I think it is clear at this point it would not be appropriate to return to that. The question is how to put something positive in its place.

We have developed something that I think is well- received as positive, which is our balanced measure system. We have only got six months of experience with really learning how that works, and I think that we need to get a little bit more experience with that before we see---

Mrs. NORTHUP. So the answer about legislation is, yes, you think you have the balance and the tools you need.

Mr. ROSSOTTI. I think that we have, as best as I can tell. There are clearly some sections that are difficult to administer. I think, as we get a little bit more experience with them, if we feel that there are adjustments that are needed, we would certainly ask for them.

At the moment, I think, though, our job is to try to work with these tools. I do not know how much time we have to go into it, but certainly some sections of this law have proven to be difficult to administer and have had some either direct administrative or psychological effects.

Obviously, I am sure you have heard from employees that Section 1203, which is the one that deals with the so-called 10 Deadly Sins, creates a great deal of consternation.

Mrs. NORTHUP. Let me just follow up, because I see my time is limited. If there are things in the law that need to be changed, I asked, and I will just leave it because I want to ask one more question, if you would be proposing changes.

I also have heard that you have changed the all-or-nothing requirements of collections, that it used to be the IRS would negotiate with delinquent taxpayers, people that perhaps have gone out of business, have lost money, in order to at least recover some.

Mr. ROSSOTTI. Right.

Mrs. NORTHUP. The employees seem to be discouraged by the fact that there is only an all-or-none policy now, and if they cannot collect all, that they are precluded from collecting any.

Mr. ROSSOTTI. That is another one of those complicated provisions. I mean, actually, we are not an all-or-none. We have a program called Offer in Compromise, which has actually been expanded, which deals exactly with the situation you are talking about. It is a little more technical. There was a particular technique that was used at the IRS for dealing with that situation which, under the law, has been stopped. But there is another technique which has been used to replace it.

So there is a way to deal with that, and we think we have got it largely solved, but there has been some confusion in getting from here to there. I would be glad to come and talk to you about that.

That has been one of the trickiest provisions to deal with in the law. There are three or four of these that are very tricky, and we are working on trying to see how well we can make them work. I would be more than happy to come visit with you and talk about those.

Mrs. NORTHUP. Or you might submit them for the record.

Mr. ROSSOTTI. Sure.

[The requested information follows:]

The Offer in Compromise (OIC) program is a collection tool used to resolve outstanding tax debts when the Internal Revenue Service (IRS) will not be able to collect the tax in full or when there is doubt as to whether it is owed. The purpose of the OIC program is to allow certain taxpayers who may be in financial trouble to settle their tax debt for the maximum amount they can pay.

### **The OIC Process**

Most of the OICs submitted by taxpayers are based on doubt as to collectability. Taxpayers must submit Form 656, Offer in Compromise, and 433-A, Collection Information Statement for Individuals, or 433-B Collection Information Statement for Businesses, for consideration of an OIC. The IRS corresponds with taxpayers or their representatives to correct omitted items on Forms 656 and/or 433-A or 433-B.

The offer is evaluated to determine if the taxpayer is offering the maximum amount that he or she can pay after basic living expenses. Internal and external information is used to verify the taxpayer's financial statement. Taxpayers may also be required to submit information to substantiate asset values, expenses, etc. If necessary, the IRS employee will negotiate an acceptable offer amount.

The final disposition of the offer will be acceptance, rejection, return or withdrawal.

### **Changes to the OIC Program**

The IRS may now legally compromise the tax liability for one of the following reasons:

**Doubt as to Liability:** Doubt exists that the tax assessment is correct.

**Doubt as to Collectability:** Doubt exists that the taxpayer could ever pay the full amount of tax owed.

**Effective Tax Administration (ETA):** There is no doubt the tax is correct and no doubt the amount owed could be collected, but an exceptional circumstance exists that allows the IRS to consider the taxpayers' offer. To be eligible for the compromise on this basis, taxpayers must demonstrate the collection of the tax would create an economic hardship or would be unfair and inequitable. *(ETA is new based on the provisions from RRA 1998 and allows access to taxpayers that were omitted from the OIC process in the past.)*

Taxpayers can now pay the offer amount in three ways:

1. Cash (paid in 90 days or less),
2. Short-term Deferred Payment (more than 90 days, up to 24 months), or
3. Deferred Payment (offers with payment terms over the remaining statutory period for collecting the tax). With this option, the taxpayer is best able to settle the tax debt by paying it off over a period of time. It was simplified, effective January 1, 2000, to provide taxpayers a fixed monthly payment option.

This new Deferred Payment option will also assist taxpayers and practitioners in situations where taxpayers are willing to pay their debts, but the maximum amount they can pay is not sufficient to pay off the full amount of the debt. In this situation, taxpayers are not eligible for ordinary installment agreements, but they will be eligible for the new, fixed monthly payment option under the OIC program. The IRS anticipates that this will not only help taxpayers but will also translate into increased collections in these situations.

Other changes have also been made recently to enhance the program. These include all instructions for an OIC and are now contained in the New Form 656 package. This consolidated package replaces Form 656-A, which appeared as a new, separate form last year. This means that taxpayers who previously had to fill out two forms – 656 and 656-A – will now just fill out one. Also, Form 656 is now available on the Internet at [www.irs.gov](http://www.irs.gov). The IRS now uses OIC specialists to process OICs (facilitates case processing and timely resolution) and established a quality review system for OIC cases to provide data for continuous improvement of the OIC process.

Senator GRASSLEY. I thank everybody.

Before you go, I just was going to ask a question, but it has already been twice asked, once by Representative Northup, and then by Senator Kerrey, about the assault on and lack of cooperation on what are called the 10 Deadly Sins.

We want to make sure that you report to us according to what Senator Kerrey asked you to do, and I may have some follow-up on that because I want to make sure that there is not an attempt out there to sabotage what we wanted to accomplish through our legislation and make it more egregious, purposely, for the purpose of doing that. So, I want to associate myself with those questions and tell you of my interest in that area.

Then, one thing that is a little bit afar from what we are talking about here, but it is in regard to the efficiency of taxpayer processing. This is what I heard, that our Treasury Department is helping the country of Romania to implement scanners for paper returns, and apparently we do not even have scanner processing of paper returns in our own country, and for the most part we are doing this by hand.

Now, is that true, that we are trying to bring those reforms to some other country, and efficiencies, and not to our own?

Mr. ROSSOTTI. I honestly do not have any idea what might be being done in Romania.

Senator GRASSLEY. No. Our Treasury. Our Treasury is advising them. So we are involved.

Mr. ROSSOTTI. Yes. I do not know what the Treasury program is in that area.

Senator GRASSLEY. All right.

Mr. ROSSOTTI. It is true that scanners are not used. Scanning is one particular kind of technology which the IRS does not use. It is really quite difficult to use that technology on a very large scale. It is much easier on a small scale.

One of the programs that was attempted in the earlier days, the prior technology

modernization that did not succeed, was to use some scanning technology for tax returns. That was abandoned as not successful.

So at the present time, we key in the paper returns as traditionally done, then of course we use the electronic returns, which are really our main strategy for reducing the burden of filing.

There is a possibility of using scanning technology for certain limited purposes, and we are studying that as part of our technology modernization program.

Senator GRASSLEY. All right. Thank you very much. We appreciate very much your cooperation with us.

I will call the second panel now. I have already announced who the second panel is, so I will not go through any further introduction. Would the panel please come? Unlike Commissioner Rossotti that we gave 10 minutes to, we have asked this panel to summarize their statements in 5 minutes each, and then we will go to questioning.

I would like to have Mr. Williams start first, then Mr. Oveson, then Mr. White.

Mr. Williams?

**STATEMENT OF HON. DAVID C. WILLIAMS, TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION**

Mr. WILLIAMS. Thank you, Mr. Chairman and members of the Joint Review. I appreciate the opportunity to appear here today to discuss the IRS's progress in implementing the long-term objectives of the Restructuring and Reform Act of 1998.

While some of the IRS's reforms are complete, several major initiatives are in the early stages of implementation where risks are high. In this regard, my office is focusing on programs, activities, and functions that are at the most vulnerable stages of their development.

It should also be noted that the IRS's capacity for change is quickly reaching a saturation level, particularly when we consider that its many reforms are occurring against a backdrop of implementing complex tax legislation and processing increasing numbers of tax returns.

Because of the significant role that it plays in carrying out the 1998 reforms, we are closely monitoring the IRS's progress in modernizing its organization.

A cornerstone of the IRS's restructuring efforts is the initiative to reorganize the agency into four operating divisions that will have end-to-end responsibility for a defined group of taxpayers with similar characteristics.

Of these four, the tax-exempt and government entities operating division is the first to begin operating under the new structure. The division started operating on December 5, 1999, and is currently in the adjustment phase.

The other three divisions and support units are in various stages of development with questions remaining about how they will be organized. Despite its effort to stay on track, the IRS is experiencing delays in its computer systems modernization efforts.

The IRS recently reviewed its key systems initiatives and found that about half of the work products required during the planning phases of these projects had not been completed.

Had an effective performance monitoring process been in place, the IRS would have identified these problems sooner and perhaps taken actions to avoid scaling back and delaying projects intended to provide improved service to taxpayers in 2001.

Additionally, we have identified weaknesses in security controls over IRS computer systems. Until these weaknesses are resolved, the IRS systems and taxpayer data are vulnerable to tampering, loss, and unauthorized use.

Even though the IRS has improved many of the controls, its computer systems are still vulnerable to threats such as unauthorized use. For example, in the six months ending March 31, our Strategic Enforcement Division has opened 120 investigations regarding possible violations of the Taxpayer Browsing Protection Act.

My office is also involved in investigating allegations of willful acts by IRS employees involving the taxpayer 10 Deadly Sins specified in Section 1203 of the Restructuring and Reform Act.

Since passage of the Restructuring and Reform Act, my office has opened 279 of these investigations. Of these, 159 have been completed and referred to the IRS for action. The IRS has notified us that 17 employees have been removed or resigned as a result of the investigations and IRS's own efforts.

On a broader scale, the IRS's progress in improving customer service and lessening the burden on taxpayers brings with it new vulnerabilities. The Restructuring and Reform Act requires that the IRS receive 80 percent of all returns and information electronically by the year 2007.

As of April 23, the IRS reported that it had received approximately 35 million individual Federal income tax returns electronically. This is an increase of about 20 percent over 1999. While this improvement is noteworthy, IRS stress tests in the processing system indicate that it may not have the capacity needed to handle the 80 percent requirement.

By their nature, the current reforms are at a high- risk stage where there is little immediate return on the investments. Additionally, some of the declining trends in revenue

collection activities have continued. For example, the IRS's internal management reports show that there were only 28 seizures in the first five months of fiscal year 2000, compared to 10,000 in fiscal year 1997.

Furthermore, the IRS's progress is hard to monitor because of weak or incomplete management information systems, and some reforms are proceeding more slowly than had been planned.

The computer modernization is particularly worrisome because of the IRS legacy involving costly and wasteful efforts that have previously been experienced.

I am dedicated to accurate reporting on the process of these reforms and making recommendations to stakeholders to improve the direction and the pace of the progress. The agency's initiatives, while unfinished, are vital if the IRS is to achieve real reform.

The committee's continued attentiveness to the issues under examination today is critical to helping the IRS accomplish those objectives.

I would be pleased to respond to any questions at the appropriate time. Thank you.

[The prepared oral and written statements of Mr. Williams follow:]

**PROGRESS AND PROBLEMS IN IMPLEMENTING THE  
INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM  
ACT OF 1998**

**JOINT HEARING BEFORE COMMITTEES OF THE UNITED  
STATES SENATE AND HOUSE OF REPRESENTATIVES**

**MAY 3, 2000**



**OPENING COMMENTS**

**THE HONORABLE DAVID C. WILLIAMS  
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION**

Mr. Chairman and Members of the Joint Committees, I appreciate the opportunity to appear here to discuss the IRS' progress in implementing the long-term objectives of the Restructuring and Reform Act of 1998 (RRA 98).

While some of the IRS' reforms are complete, several major initiatives are in the early stages of implementation, where the risks are high. In this regard, my office is focusing on the programs, activities and functions that are at the most vulnerable stages of their development.

It should also be noted that the IRS' capacity for change is quickly reaching a saturation level. Particularly, when we consider that its many reforms are occurring against a backdrop of implementing complex tax legislation and processing increasing numbers of tax returns.

Because of the significant role it plays in carrying out the RRA 98 reforms, we are closely monitoring the IRS' progress in modernizing its organization. A cornerstone of the IRS' restructuring efforts is the initiative to reorganize the agency into four operating divisions that will have end-to-end responsibility for a defined group of taxpayers with similar characteristics. Of these four, the Tax Exempt and Government Entities Operating Division is the first to begin operating under the new structure. This Division started operating on December 5, 1999, and is currently in the adjustment phase. The other three divisions and support units are in various stages of development, with questions remaining about how they will be organized.

Despite its efforts to stay on track, the IRS is experiencing delays in its computer systems modernization efforts. The IRS recently reviewed its key systems initiatives and found that about half of the work products required during the planning phases of these projects had not been completed. Had an effective performance monitoring process been in place, the IRS would have identified these problems sooner and perhaps taken actions to avoid scaling back and delaying projects intended to provide improved service to taxpayers in 2001.

Additionally, we have identified weaknesses in security controls over the IRS' computer systems. Until these weaknesses are resolved, the IRS' systems and taxpayer data are vulnerable to tampering, loss or unauthorized use. Even though the IRS has improved many of the controls, its computer systems are still vulnerable to threats such as unauthorized use. For example, in the six months ending March 31, 2000, our Strategic Enforcement Division opened 120 investigations regarding possible violations of the Taxpayer Browsing Protection Act of 1997.

My office is also involved in investigating allegations of willful acts by IRS employees involving "the 10 deadly sins" specified in Section 1203 of RRA 98. Since passage of RRA 98, my office opened 279 of these investigations. We have referred 159 of these completed investigations to the IRS for action. The IRS has notified us that 17 employees have been removed or resigned as a result of the investigations and IRS' own efforts.

On a broader scale, the IRS' progress in improving customer service and lessening the burden on the taxpayer brings with it new vulnerabilities. The RRA 98 requires the IRS to receive 80 percent of all tax returns and information electronically by the year 2007. As of April 23, 2000, the IRS reported that it had received approximately 35 million individual federal income tax returns electronically. This is an increase of about 20 percent over 1999. While this improvement is noteworthy, IRS' stress tests of the processing system indicate that it may not have the capacity needed to handle the 80 percent requirement.

By their nature, the current reforms are at a high-risk stage, where there is little immediate return on the new investments. Additionally, some of the declining trends in revenue collection activities have continued. For example, the IRS' internal management reports show that there were only 28 seizures during the first five months of Fiscal Year 2000, compared to more than 10,000 in Fiscal Year 1997.

Furthermore, the IRS' progress is hard to monitor because of weak or incomplete management information systems, and some reforms are proceeding more slowly than planned. The computer modernization is particularly worrisome because of the IRS legacy involving the costly and wasteful efforts previously experienced.

I am dedicated to accurate reporting on the progress of these reforms and making recommendations to stakeholders to improve the direction and pace of progress. The agency's initiatives, while unfinished, are vital if the IRS is to achieve real reform. The Committees' continued attentiveness to the issues under examination today is critical to helping the IRS accomplish those objectives.

I would be pleased to respond to your questions at the appropriate time.

**PROGRESS AND PROBLEMS IN IMPLEMENTING THE  
INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM  
ACT OF 1998**

**JOINT HEARING BEFORE COMMITTEES OF THE UNITED STATES  
SENATE AND HOUSE OF REPRESENTATIVES**



**MAY 3, 2000**

**STATEMENT FOR THE RECORD**

**THE HONORABLE DAVID C. WILLIAMS  
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION**

Mr. Chairman and Members of the Committees, I appreciate the opportunity to appear before you today to discuss the progress the Internal Revenue Service (IRS) has made in implementing the Restructuring and Reform Act of 1998 (RRA 98). In July of this year, we will be observing the second anniversary of the RRA 98.

During these past two years, the IRS has undertaken a complex and multifaceted approach to restructuring the way it conducts business. As an example, the IRS has been transforming itself so that it will operate better and serve its customers more efficiently. In this regard, the IRS has changed its mission statement to more clearly address its role in helping taxpayers meet their legal obligations.

Some of the positive results the IRS is achieving can be seen in the outcomes of the recent filing season. By April 23, 2000, the IRS reported that it had processed 83.1 million tax returns, which is 3.2 million more than the same period last year. The IRS also reported that it had certified over 73 million refunds, which is an increase of 2.9 percent over the 1999 filing season. For Fiscal Year 2000, the IRS estimates it will collect more than \$1.9 trillion in revenue, which is an increase of one percent over Fiscal Year 1999. However, there are still some challenges facing the IRS in reversing some of its declining trends in collection activities. For example, during the first 5 months of Fiscal Year 2000, the IRS had only conducted 28 seizures, compared to 10,000 in Fiscal Year 1997.

While some of the agency's efforts are complete, several major reforms are in the early high-risk stages of implementation. Full implementation of the RRA 98 provisions should result in enhanced taxpayer protection and rights, as well as organizational changes intended to achieve a more efficient and responsive agency. As we monitor the progress that the IRS is making, the Treasury Inspector General for Tax Administration (TIGTA) is focusing on those programs, activities and functions that are subject to the highest risk.

#### The IRS Restructuring and Reform Act of 1998

The Office of Inspector General was created to replace the IRS Inspection Service. This transition was successfully completed in January 1999. Since that time, TIGTA has been dedicated to ensuring that IRS employees treat taxpayers with the highest degree of integrity and fairness so as to maintain trust in our tax administration system. To better accomplish our mission, we immediately abolished the regional structure of our predecessor organization, which eliminated an unnecessary and remote layer of management. We reorganized the Office of Investigations into direct report field offices, and we have assumed comprehensive responsibility for investigating internal misconduct cases. The Office of Audit also reorganized into specialized issue areas that parallel the new IRS business unit structure. In addition, we created an Office of Investigations'

Strategic Enforcement Division (SED) to meet threats of computer crimes against the IRS, and to ensure that these irregularities are prosecuted to the fullest extent of the criminal and civil law.

In carrying out our new statutory responsibilities, TIGTA has issued 10 reports in response to specific requirements for evaluating the IRS' compliance with key RRA 98 provisions. We evaluated the IRS' compliance with these provisions, starting from their effective dates. We concluded that, although the IRS has made some progress in implementing the RRA 98, the requirements addressing taxpayer protection and rights issues had not been successfully implemented.

At a Senate Finance Committee hearing on February 2, 2000, I reported that:

- The IRS identified approximately 525 violations of the prohibition against using records of tax enforcement results to evaluate employees during its first independent reviews and quarterly certifications. TIGTA identified an additional 96 violations where IRS management used tax enforcement results to evaluate employees, or imposed or suggested employee production quotas or goals (e.g., evaluations contained references to fraud referrals, dollars assessed or collected, or case closures).
- The IRS did not consistently implement federal tax lien provisions. Thirty-three percent of the cases TIGTA reviewed involved potential violations of legislative or procedural requirements. For example, taxpayers were not given the full 30 calendar days to request a hearing, or sufficient documentation was not retained to prove that lien notices were sent to taxpayers, or that they were sent timely.
- The IRS did not always follow all legal and internal guidelines when conducting seizures. Thirty-six percent of the 92 taxpayer seizure cases reviewed did not follow all legal and internal guidelines, including business property that was seized without obtaining the required approvals, or taxpayers who were not personally warned before the seizure occurred.
- The IRS had not fully implemented new procedures to notify taxpayers before taking funds for payment. Thirty-two percent of the 284 taxpayer accounts reviewed did not follow legal provisions in that taxpayers were not notified of the IRS' intent to levy or of their appeal rights before levies were issued.

In our Fiscal Year 2000 audits, TIGTA is following up on the IRS' corrective actions for most of the previously reported problem areas. In addition, we are reviewing one new provision, Assessment Statute Extensions, that became effective January 1, 2000. We are conducting, too, an audit related to one of the RRA 98 provisions to determine the effectiveness of the IRS' actions for identifying and reporting potential Fair Debt Collection Practices Act violations.

The IRS has completed some of its corrective actions in response to our recommendations in the prior report. The early analyses of our Fiscal Year 2000 audits indicate that the IRS has significantly improved its compliance with two of the RRA 98 provisions, as follows:

- All 35 seizures conducted by the IRS from May 1 to September 30, 1999 were in accordance with legal seizure provisions and agency guidelines. We identified significant improvement in the way the IRS conducted seizures and disposed of properties compared to our prior review. For example, all of the seizures were reviewed and approved by the Collection Division Chief (third level of management in the district). In addition, the IRS implemented a pre-seizure checklist in April 1999 to assist employees in meeting legal and internal guidelines. All 23 seizures approved after that date had a completed checklist in the file. While the IRS has improved its procedures, the continued reduction in the number of seizures raises questions about potential problems with the sufficiency of the IRS' collection efforts.
- The IRS has significantly improved its compliance with legal and internal guidelines to notify taxpayers of their rights at least 30 days before levies are issued. We believe these improvements are the result of several enhancements to computer systems and the implementation of new procedures to ensure legal requirements are met when issuing levies. For example, a national computer change was made in April 1999 to systemically prevent district office employees from issuing levies before the 30-day period has ended. Another national computer change, made in June 1999, systemically prevents Customer Service computers from automatically generating levies on past due accounts.

We will not be able to determine the IRS' compliance with three of the RRA 98 provisions--Direct Contacts with Taxpayers and their Representatives, Joint Filer Requests, and Taxpayer Complaint Processing--because the IRS does not have management information systems that specifically track these activities. Accordingly, our Fiscal Year 2000 audits of these areas will be limited to the IRS' internal procedural changes to correct some of the previously identified problems.

In addition to our audit responsibilities, the RRA 98 charges TIGTA with investigating Section 1203 violations. Section 1203 provides that the IRS Commissioner shall terminate the employment of any IRS employee found guilty of misconduct as defined by ten acts or omissions. This firm approach to employee discipline caused some confusion and consternation among IRS employees. There were rumors that thousands of investigations were opened and employees would be terminated for unintentional errors. Because of this, we participated in IRS briefings in Chicago, Illinois and Washington, DC to help ensure that IRS managers have an accurate understanding of the Section 1203 requirements they convey to their staffs. The presentations focused on the following results of our experience to date.

The majority of Section 1203 allegations we received claimed that an IRS employee violated a provision of the Internal Revenue Manual or the Internal Revenue Code in

order to retaliate against or harass someone. The second largest type of allegation we received involved civil rights violations, including EEO violations. These are followed by allegations of willful destruction of documents and understatement of federal tax liability.

Since passage of the RRA 98, TIGTA has received 683 allegations involving Section 1203 violations. These allegations resulted in 279 investigations by TIGTA. We have closed or referred 159 investigations to the IRS. The IRS has notified us that 17 employees have been removed or resigned as a result of TIGTA and IRS investigations.

Ten investigations by TIGTA resulted in a lesser discipline. IRS management is emphasizing to its employees that disciplinary action will not be imposed on those employees who make honest mistakes.

### Strategic Planning

The IRS developed a Balanced Measurement System as part of its effort to modernize and to reflect the agency's priorities. This approach to measurement is intended to help shift the focus of employees and the agency away from achieving specific production targets or numbers to achieving the overall mission and strategic goals of the IRS. While these changes are in response to the RRA 98, they are also related to the implementation requirements of the Government Performance and Results Act of 1993 (GPRA).

TIGTA previously reported to the Commissioner that the IRS' strategic plan demonstrated progress. However, the plan did not explain how performance measures and strategic goals relate to each other, did not address external factors that impact its mission and goals, and did not describe program and system evaluations. TIGTA recommended, and the agency agreed, to designate an office responsible for oversight and coordination of GPRA implementation activities throughout the IRS.

The IRS' first Annual Program Performance Report was recently submitted with its Fiscal Year 2001 Congressional Justification. A TIGTA audit of the Annual Program Performance Report found that the IRS' processes used to generate the report did not provide adequate time for management to assemble and analyze the data for the report or to ensure that the report clearly assessed program goals. Additionally, we reported that the IRS needs to develop a process for ensuring that data are verified and validated before being reported. This problem may be resolved when the IRS implements its plan to establish an office with the responsibility to oversee the verification and validation of data included in future Annual Program Performance Reports.

## Modernization of the Agency

Commissioner Rossotti first introduced the concept of modernizing the IRS in January 1998. A cornerstone of his initiative was to organize the IRS into four operating divisions. Each operating division will have end-to-end responsibility for a defined group of taxpayers with similar characteristics. The four operating divisions are:

- Tax Exempt and Government Entities Operating Division
- Large and Mid-Size Business Operating Division
- Wage and Investment Operating Division
- Small Business and Self-Employed Operating Division

The Tax Exempt and Government Entities Operating Division is the first and only Division to stand up.<sup>1</sup> This Division has been standing up since December 5, 1999, and is currently in the adjustment phase of its modernization efforts. During the adjustment phase, the Division will be formulating plans to meet and discuss issues concerning changes in conditions of employment with the National Treasury Employees Union (NTEU).

The Large and Mid-Size Business Operating Division is now scheduled to stand up in June 2000. The Division is currently in the establishment phase, and the NTEU will be provided with an advanced copy of a placement notice. IRS employees will also be given the opportunity to request a review of the placement notice. The Division will be in the establishment phase for at least 90 days.

The remaining two Divisions are scheduled to stand up in October 2000. The Commissioner is expected to approve the Divisions' design packages in May 2000. After approval by the Commissioner, the Divisions will begin the establishment phase of their modernization efforts.

Additionally, the following nine functional divisions will provide support to the four operating divisions:

- Taxpayer Advocate
- Customer Service/Submissions Processing
- Information Systems
- Appeals
- Communications and Liaison
- Agency Wide Shared Services
- Criminal Investigation
- Chief Counsel

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<sup>1</sup> Standing Up: The establishment of a new organization with at least the minimum requirements of operating, including a finance office, separate budget, key management positions filled, temporary solutions to problems, personnel actions for realignment completed, and necessary business authorities in place.

- National Office Headquarters

Only three of the nine functional divisions--Taxpayer Advocate, Information Systems and Customer Service/Submissions Processing--have stood up and are in the adjustment phase. Two divisions--Communications and Liaison and Agency Wide Shared Services--are in the establishment phase and should stand up in either the early summer or fall of 2000. The remaining four divisions are in the design phase.

### Computer Systems Modernization

Key IRS goals, such as receiving 80 percent of tax returns electronically by the Year 2007 and significantly improving service levels in answering taxpayers' questions, are contingent on the development of new technology. For more than a decade, the IRS has been attempting to modernize its outdated, paper-intensive tax processing systems.

During that period, the IRS spent over \$3 billion with minimal improvement, despite intense scrutiny from the Congress. The IRS is now in the early stages of a new effort to modernize its systems and is employing contractors to assist in this effort at an estimated cost of over \$5 billion.

Previous General Accounting Office audits of computer systems modernization initiatives identified serious management and technical weaknesses. A recent TIGTA audit indicated that the IRS has made progress in correcting the organizational weaknesses of past systems modernization efforts by ensuring that top level IRS executives, including the Commissioner, are heavily involved in the modernization initiative. These executives have recognized the need to build systems modernization program management disciplines, risk management processes and quality assurance policies and procedures.

While the involvement of top management is noteworthy and is essential to the success of systems modernization, the IRS stumbled out of the starting blocks in executing the early phases of the effort. A recent IRS review of key systems modernization initiatives found that as many as 68 percent of the work products required during the planning phases of these projects had not been completed. One of the primary reasons these problems were not identified earlier is the lack of a stable program management organization to oversee the modernization initiative. For example:

- Key processes for managing the risks in the modernization effort and monitoring the performance of the contractor need to be improved.
- Roles and responsibilities inside the program management organization and between the IRS and the contractor are not clearly defined.
- Program management<sup>2</sup> staffing needs have not been determined.

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<sup>2</sup> Program management is the coordinated support, planning, prioritizing and monitoring of a portfolio of projects to achieve the objectives of systems modernization.

These growing pains were a primary cause of the IRS' decision to scale back or delay delivery of several modernization initiatives originally slated to provide improved service to taxpayers by the 2001 tax filing season. These first projects were intended to improve communications with taxpayers by centralizing IRS' nationwide call screening/routing for selected toll-free numbers, providing telephone and Internet automated self-service applications, and providing upgraded electronic filing and research technology. However, the IRS still believes it is on track to deliver some of the scaled-back systems enhancements in 2001 that will improve responsiveness to taxpayers, such as increasing the capacity for handling and routing incoming telephone calls. Examples of initiatives that have been delayed include:

- A telephone application that would allow taxpayers to determine whether their tax returns have been received.
- An Internet application that would allow taxpayers to determine the status of their refunds.
- An application that would provide taxpayers electronic access to their tax account information.

These problems could have been identified much sooner and corrective actions taken without the delays the projects are now facing if an effective performance monitoring process had been in place. If the IRS does not address these issues soon, there is a risk that the planned systems enhancements for 2001 may not be delivered on time.

Some of the actions the IRS has underway to address these problems include:

- A proposed organizational structure to oversee systems modernization with associated roles and responsibilities.
- A redefined relationship between the IRS and the contractor to build in more accountability.
- A draft listing of reporting requirements for modernization projects.
- A request that the contractor develop a "get well" plan to deliver needed performance monitoring information.
- A plan to implement systems modernization program-wide and project level risk management policies and procedures.
- An identification and evaluation of the top risks to systems modernization.

The IRS is beginning to make progress toward implementing an effective systems modernization management approach. However, significant risks need to be addressed to ensure that the IRS overcomes the management and technical weaknesses that plagued its prior efforts for more than a decade.

Another significant initiative involves the system used for receiving electronic tax returns. The RRA 98 requires that the IRS receive 80 percent of all tax returns electronically by the Year 2007. As of April 23, 2000, the IRS reported receiving

approximately 35 million electronic income tax returns, which represents 30 percent of all individual federal tax returns filed. The electronic filing system had sufficient telecommunications capacity to receive and store the expected tax return volumes this year. However, a TIGTA audit of the system showed that the IRS needs a performance and capacity management plan to determine whether the system is capable of handling 80 percent of all transactions electronically. The IRS completed stress tests in late 1999 that indicated the system might not have the capacity needed for these higher volumes.

### Computer Security

Progress has been made in bolstering computer security at the IRS, but further improvements are needed. The IRS has conducted comprehensive security reviews of its major facilities and has significantly reduced the number of security weaknesses previously identified by the General Accounting Office. These efforts should help reduce the risk of unauthorized access to sensitive taxpayer information and/or destruction of major IRS systems and data.

However, recent TIGTA audits and investigations have identified additional weaknesses in security controls over the IRS' computer facilities, networks and systems, including:

- Most IRS systems containing sensitive taxpayer information were not certified as having adequate security controls. This has been an issue for years that has not been resolved.
- The IRS does not effectively use audit trails to detect unauthorized access or abuse of taxpayer data, except for the Integrated Data Retrieval System.
- The IRS needs to improve its program for computer virus prevention and detection.
- The IRS needs to develop plans and increase the resources available to more effectively recover from disasters or failures at its facilities. This issue has been reported to the IRS before, but adequate actions have not been taken.
- Approximately 35 million electronically filed individual federal income tax returns are grouped and transmitted in batches from third parties over public telephone and data communications lines without being encrypted.
- The IRS has not developed overall policies and guidance for securing its local area networks and related telecommunications processes.
- The IRS needs to do more to protect its critical infrastructure by defining which of its systems are critical to its operation, and taking actions to reduce vulnerabilities to disruptions in service.

Striking an appropriate balance between maintaining systems' security and conducting day-to-day operations is not simple. In some cases, adding security controls may slow systems down and result in less timely service to taxpayers. However, until these weaknesses are resolved, IRS systems and taxpayer data are vulnerable to tampering, loss or unauthorized disclosure. We believe the IRS should strengthen security in its

existing computer systems, networks and facilities and ensure that adequate controls are built into new systems before they are rolled out.

To address computer issues, TIGTA has developed a computer security program to investigate improper internal and external access to IRS computers. TIGTA's SED is responsible for developing an aggressive program to investigate any attempts to interfere with the operation and security of the IRS' computer systems. In the six months ending March 31, 2000, our SED opened 120 investigations regarding possible violations of the Taxpayer Browsing Protection Act of 1997.

The SED's operation is a collaborative effort between the IRS and TIGTA involving the use of computer technology and computer matching to identify criminal violations, secure evidence, and detect and prevent improper accesses. This group focuses on the threat posed by IRS employee misconduct as it relates to misuse of taxpayer information. The group is also responsible for identifying and investigating internal and external unauthorized electronic accesses to federal taxpayer records.

The SED also maintains computer research and reference equipment and assesses technical threats to the integrity of the IRS computer network. The Division conducts proactive security testing to ensure that adequate safeguards are in place to defend against newly identified network vulnerabilities, as well as newly disseminated hacker tools found throughout the Internet. Our work transcends tax administration as we disseminate threat advisories beyond the IRS to the Department of the Treasury and to a number of other federal agencies.

### Conclusion

Improvements emanating from the IRS' current reform efforts will not be immediately apparent. The full impact of the reforms may only be recognizable once the RRA 98 has been completely implemented and managers and employees have embraced cultural changes. However, I do believe that the current approach, while daunting, is the right one. Past efforts at reform have been ineffective and focused on symptoms and surface issues, rather than on the ailments that have plagued this agency.

Instances of faltering speed and misdirection for the RRA 98 reforms dictate that the IRS and its stakeholders need to closely monitor the outcomes. All participants in these reforms need to maintain a determination that this time they are committed to making long-term improvements in the IRS. It will be a while before the American public can readily identify the benefits of these reforms, but the initiative is vital if we are to provide the quality service that taxpayers should expect and are entitled to from their government.

Senator GRASSLEY. Mr. Oveson? Is that right?

Mr. OVESON. Yes, it is.

**STATEMENT OF W. VAL OVESON, NATIONAL TAXPAYER ADVOCATE,  
INTERNAL REVENUE SERVICE**

Mr. OVESON. Thank you, Mr. Chairman and distinguished members of the Joint Review. Thank you for inviting me to testify before you today. I have now served as the National Taxpayer Advocate for 20 months and have implemented the provisions within the Restructuring and Reform Act for the Taxpayer Advocate Service.

I have worked with the old organization and experienced the changes, challenges, and opportunities with the restructuring. I firmly believe that the restructuring will provide taxpayers the opportunity to have their problems with the IRS resolved faster and more completely.

The Restructuring and Reform Act amended the Tax Code, creating my position and strengthening the independence of the office. In the spirit of this legislation, we restructured the organization, we revised our mission statement, and we renamed the organization the Taxpayer Advocate Service. I am pleased to report that we officially transitioned as a modernized organization within the IRS on March 12 of this year.

The Taxpayer Advocate Service continues to be a geographically-based organization. Every State now has at least one taxpayer advocate who works to resolve taxpayer problems with the IRS on a local basis.

Between October 1 of last year and April 21 of this year, we dealt with 127,000 taxpayer cases. During fiscal year 1999, we worked with more than 292,000 taxpayers to resolve their issues, and 93,000 of those met the expanded hardship criteria as called for in the Restructuring and Reform Act.

We also identify, recommend, and monitor systemic changes designed to benefit taxpayers. In this process, we also seek the input from stakeholder groups as we identify the administrative and legislative changes and recommendations that we make, many of them to you.

In my last report I included several recommendations related to penalty and interest. I also proposed that you give the IRS the authority to correct errors in a comprehensive manner, which they do not have today, amazingly enough. I am pleased that some of these provisions are included in the proposed Taxpayer Bill of Rights 2000.

The IRS faces many challenges in the years ahead; implementing the modernization is one of the biggest. Four other issues deserve attention and mention today.

First, I have stated before that Congress had liberated the IRS from the philosophy of maximizing revenue.

That philosophy is epitomized by the phrase "protecting the interests of the government," which you hear all the time in tax administration. I asserted that the new mission of the IRS was to balance the interests of the taxpayer with the interests of the government.

It is imperative that we stay the course so that the changes that have been undertaken take root and become a part of the IRS culture, and it will take some time for that to happen.

Second, the IRS must be able to communicate with taxpayers regarding their account activity, as any financial institution would be required to do. This means that toll-free telephone service must be expanded. The IRS must dedicate the resources necessary to answer the phones.

There have been substantial improvements made during the last year, as mentioned before during this hearing, but still the IRS is not meeting the standards demanded by the public. The IRS budget request is the first step in addressing the need to improve taxpayer service.

Third, the handling of innocent spouse cases must be improved. The new statute expanded the relief available to taxpayers, who are filing these claims in large numbers, and the IRS faces a major challenge in properly staffing the program, reducing the processing times, and ensuring that all levels of the organization internalize the philosophical shift that is embodied by the new law.

Fourth, the Offer and Compromise program must be improved. The IRS has new authority to compromise cases. Again, the challenge is to adequately staff the program to deal with the increased volume and to ensure that the spirit, as well as the letter of that statute, is followed.

Thank you very much for inviting me to be with you today. I am confident that, with the sustained commitment of all of us, we can provide better service and greater equity to America's taxpayers. Thank you.

Senator GRASSLEY. Before Mr. White begins, just a comment. Not on anything you said now, but the extent to which we worked very hard in the IRS Commission to make sure that there was considerable independence for your office. I do not know to what extent that is being carried out. I hope fully, and I hope you will fight for that independence.

If there is anybody above you that makes a decision on the amount of that independence, I hope they take into consideration at least the spirit of the law, which is independence, and there ought to be considerable deference to that independence. In fact, there ought to be some sort of caution to make sure that we lean over backwards to maintain that independence.

[The prepared statement of Mr. Oveson follows:

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**Statement of**

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*Reorganization  
of the  
Independent  
Taxpayer  
Advocate  
Service*

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**W. Val Oveson**  
**National Taxpayer Advocate**

**For the  
Annual Joint Review of the  
Internal Revenue Service Restructuring and Reform Act of 1998**

**Convened by the  
Joint Committee on Taxation**

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**May 3, 2000**



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Internal Revenue Service  
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Taxpayer Advocate Service

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**Statement of  
W. Val Oveson  
National Taxpayer Advocate  
Internal Revenue Service**

**For the  
Annual Joint Review of the  
Internal Revenue Service Restructuring and Reform Act of 1998**

**Convened by the  
Joint Committee on Taxation**

**May 3, 2000**

Mr. Chairman and distinguished members of the Committee:

Thank you for inviting me to testify before the Joint Committee on Taxation regarding the restructuring of the Taxpayer Advocate Service. I have served as the National Taxpayer Advocate since September of 1998. During this time, I have seen the old Taxpayer Advocate organization and have experienced the challenges and opportunities presented by the restructuring. I firmly believe that the restructuring will provide taxpayers the opportunity to have their problems with the IRS resolved faster and more completely through Taxpayer Advocates across the country who are better positioned, better-trained and more focused.

**Implementing the Internal Revenue Service Restructuring and Reform Act of 1998**

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA '98) amended Internal Revenue Code sections 7803 and 7811, creating the position of the National Taxpayer Advocate and strengthening the Taxpayer Advocate organization by making it independent within the IRS. In the spirit of the legislation and the IRS' modernization, we restructured the Advocate Organization, revised our mission and renamed the organization the Taxpayer Advocate Service. I am pleased to report that

the Taxpayer Advocate Service officially transitioned as a modernized organization on March 12, 2000.

Unlike most of the Service, the Taxpayer Advocate Service continues to be a geographically based organization (see attached map and organizational chart). We have a National Office component to handle our budget, technology, human resources, communications and equal employment opportunity, as well as a small staff that coordinates casework with the field. Our field organization consists of nine Area Taxpayer Advocate Directors, seven of whom oversee casework by Local Taxpayer Advocates in assigned territories and two of whom oversee casework from Service Center Advocates. Our field organization also includes two Operating Division Taxpayer Advocates, who are responsible for our advocacy efforts. Both the Area Taxpayer Advocate Directors and the Operating Division Taxpayer Advocates report directly to the Deputy National Taxpayer Advocate and me. Seventy-four Local Taxpayer Advocates report to the Area Taxpayer Advocate Directors and are responsible for handling taxpayer cases at the local level.

Implementing our new organization had a profound impact on Taxpayer Advocates. In the past, most of the Problem Resolution staff received program direction from the Taxpayer Advocate but reported to the local District or Service Center Director. As called for in RRA '98, we created an entirely new reporting structure and using a competitive selection process, hired taxpayer advocate staff to implement an independent organization. Through this process, we hired employees on a full-time basis where under the Problem Resolution Program (PRP) most worked only part time on the PRP casework. Our new positions called for cross-functional expertise and,

frequently, resulted in higher grade levels for employees. Unfortunately, the human resource rules and regulations would not allow us simply to reassign people to our new organization in these situations. We are interviewing and selecting staff to fill approximately 2300 positions.

We selected our top-level management team in June of 1999 and together we drafted our new mission and vision statements. Our mission "*We help taxpayers resolve problems with the IRS and recommend changes to prevent the problems*" reflects our commitment to deliver service to each taxpayer through our casework and to every taxpayer through outreach, systemic analysis and advocating program changes.

Once the top-management team was in place, we hired Local Taxpayer Advocates and filled other management positions in July of 1999. Every state now has at least one Local Taxpayer Advocate to manage local Taxpayer Advocate casework. The Taxpayer Advocate Service is structured around geographical areas rather than taxpayer segments like the rest of the Service. Taxpayer Advocates will handle all categories of taxpayer issues, irrespective of the subject matter, in their assigned territories. Thus, all taxpayers in a specific locality will go to the same advocate office, whether a taxpayer is a small business, a large corporation, a wage earner, or a government entity.

We also hired analysts who are assigned to and remotely managed by Operating Division Taxpayer Advocates. They will work on issues that affect a large segment of taxpayers or that recur with some frequency. Depending on the nature of the problem presented, the Operating Division Taxpayer Advocates will recommend either

administrative solutions to the Service or legislative solutions to the Congress through the Annual Report.

We have hired approximately 70 percent of our staff and plan to be fully staffed in June of 2000. The process was exhausting. We piloted many new and innovative approaches during the hiring process. For example, we centralized employee application receipt and processing and we utilized an automated ranking process for our casework vacancies. Many employees were concerned that they had to apply for positions and others were unhappy with the application process. We worked closely with the National Treasury Employees Union throughout this process to ensure that employee concerns were addressed and we thank them for all their help and support.

However, the recruitment process resulted in several benefits. Those hired into the new organization made a decision to join the Taxpayer Advocate Service and to work in this challenging and important field. They also have a new commitment to our mission. We were able to refresh the organization with the perspective of many new employees with multi-functional experience. We also have new upgraded positions, a new case processing guide and training for our new skill requirements. This has been a year of incredible challenge and change but I am confident that we are better positioned to provide the assistance to taxpayers called for in RRA '98.

## **Current Activities**

### **1. Casework**

Between October 1, 1999 and April 21, 2000 Taxpayer Advocates closed 126,874 cases. During fiscal year 1999, Taxpayer Advocates worked on 292,843 cases of which 92,852 met the expanded hardship criteria defined in RRA '98 Section 1102, (amending Section 7811 of the Internal Revenue Code). We also worked on 199,991

other cases where taxpayers were seeking assistance. The expanded hardship criteria caused us to change the way we classify cases and resulted in nearly a threefold increase in hardship criteria cases and a decrease in the old Problem Resolution cases of 81,704 from the previous fiscal year. The expansion of the hardship criteria was so dramatic, that we collapsed the traditional problem resolution criteria into the statutorily based, hardship criteria. This made it easier for the taxpayers and the IRS staff to understand the types of cases that qualify for Taxpayer Advocate assistance.

RRA '98 expanded the authority of the National Taxpayer Advocate to issue Taxpayer Assistance Orders when the taxpayer is suffering or is about to suffer a significant hardship as a result of the manner in which the tax laws are being administered. We work with front-line IRS employees in an effort to resolve taxpayer problems, and knowing that the Taxpayer Advocate has the authority to issue a Taxpayer Assistance Order is usually enough to convince a functional IRS employee to work with the taxpayer to resolve the issue. The functions can appeal a Taxpayer Assistance Order, and we encourage them to do so, if they are convinced that the action they proposed appropriately balanced the interests of the Government with the rights of the taxpayer. So far this fiscal year, we have issued three Taxpayer Assistance Orders. During Fiscal Year 1999, we issued five.

## **2. Systemic Change**

Taxpayer Advocates analyze the major issues reported on cases and look for systemic problems. As a result of this analysis, they identify proposals to improve service and reduce taxpayer burden. Many of these proposals result in changes to processes and procedures. For example, we worked with IRS Operations to delay the implementation of some of the processing changes related to secondary social security

numbers. If the name reported to IRS did not match the name reported to the Social Security Administration, refunds were delayed. Most frequently, this mismatch occurred when a married taxpayer did not report a name change to both IRS and Social Security. By negotiating a change to the implementation date, we prevented refund delays and communications frustrations for thousands of taxpayers.

In addition, Taxpayer Advocates and a variety of internal and external stakeholders routinely identify situations where current law may prevent the resolution of taxpayer problems. We carefully evaluate all suggestions and include legislative proposals in the annual report that are designed to reduce complexity for taxpayers or to increase the ability of IRS to provide relief. In the Fiscal Year 1999 report, I included several recommendations related to penalty and interest provisions that provided clarification on interest accrual, provided IRS more ability to abate interest or waive penalties, and simplified penalty administration. I also submitted a proposal that would allow IRS to correct its errors in taxpayer cases and thus provide relief to taxpayers that is now prevented by law in many cases. I am pleased to report that some of these provisions are included in the proposed Taxpayer Bill of Rights 2000.

The Deputy National Taxpayer Advocate chairs the Taxpayer Equity Committee. IRS employees from various functions and locations are members of this group. Their role is to identify processes and procedures that contribute to taxpayer burden and recommend solutions that will improve IRS service and responsiveness to taxpayers. Members of this committee provide a valuable service to taxpayers because they are in an excellent position to influence changes to IRS operations. The Taxpayer Equity Committee is in transition this year as the new Operating Divisions are being

established. Committee members are working together to ensure that we continue to provide the service even though the structure and make-up of the Taxpayer Equity Committee may change.

In addition to supporting systemic change efforts within the Taxpayer Advocate Service and the IRS, we support the Citizen Advocacy Panels. The panels were created as part of the effort to reinvent the IRS and they provide a public forum for independent citizen input. Four panels are established in the Brooklyn, South Florida, Midwest and Pacific Northwest Districts. We are working closely with these panels as they identify areas for improvement and champion their recommendations within the IRS. One of the panels advocated a proposal to include an information sharing provision with a check box on the Form 1040 and IRS is implementing the suggestion. This recommendation will greatly improve the ability of practitioners to communicate with the IRS and to resolve taxpayer problems more timely. The decision to establish more panels will be made after an evaluation of the original four panels is conducted later this year.

### **Challenges Facing the Taxpayer Advocate Service**

In an effort to create a participative management structure for the new Taxpayer Advocate Service, I established the Advocate Policy Board. Top-level managers are on the board and they develop operating policies and procedures consistent with our mission statement to carry out the activities of assisting taxpayers.

Most recently, the Advocate Policy Board drafted a strategic plan for the Taxpayer Advocate Service. The plan is guided by our mission and results will be monitored using our balance measures. One challenge we face is that we must not only deliver on our own objectives, but also work to influence the objectives of the new

Operating Divisions. We must establish an effective partnership with the new IRS Operating Divisions and ensure that actions necessary to correct the problems taxpayers face are incorporated into strategic plans and budgets.

The new Taxpayer Advocate Service is designed to help taxpayers in two ways:

- 1) In those cases where errors and mistakes have been made and the taxpayer is having trouble getting them fixed, we will analyze the situation and take whatever action is needed to resolve the problem. Usually there is no disagreement by the IRS or the taxpayer as to what needs to be done. Our job is to make sure the problem is resolved. Our authority to deal with this type of case comes through the Commissioner.
- 2) In the more complex cases, we have the statutory authority of the Taxpayer Assistance Order (TAO). Armed with the ability to issue the TAO, we usually are able to negotiate an acceptable solution with the IRS. If an acceptable solution can not be reached, we will use the TAO to order the IRS to take the action we feel is legal and appropriate under the circumstances.

We are in the process of matching our new organizational design with the authority we have from the Commissioner and the legislative authority we have with the TAO. I am confident that we will find the right combination to efficiently serve the taxpayers. We will monitor the situation closely and, if required, make adjustments along the way.

We have also had discussions about TAO's and how such an order could be appealed through the organization. Ultimately, the statutes are clear that only the Commissioner, the Deputy Commissioner or the National Taxpayer Advocate have the authority to modify or rescind a TAO issued in the field by a local Taxpayer Advocate.

We have had a high-level task force working on this and related issues. I am confident that the results of the task force will strengthen our ability to assist taxpayers by clarifying the use of the TAO and making it a more efficient tool.

Regardless of authority, Taxpayer Advocates can only provide assistance when the law permits, and there are many areas where the law prevents us from helping taxpayers. In some circumstances, we identify legislative proposals for you to consider in our Annual Report. We also recognize that some taxpayers do not want to pay tax or are requesting us to take actions that may be legal but we feel are inappropriate under the circumstances. We are not providing assistance in these cases.

### **Challenges Facing the IRS**

The Service will face many challenges during the next year. Implementing the modernization is one of the biggest for the IRS and the Taxpayer Advocate Service. Four other issues that are very important to taxpayers deserve further mention.

Last year, I stated that Congress had liberated the IRS from maximizing revenue, which was oftentimes epitomized by the phrase, "protecting the interests of the government." I asserted that the new mission of the IRS should be to balance the interests of the government with the interests of the taxpayer. I also commented that to balance these interests, it would require the IRS to back away from positions and issues that they had pursued in the past. If this new philosophy is to take root and grow to its full potential, the IRS modernization efforts must have the sustained support of the Congress, the Treasury, and the American people. It is imperative that we stay the course and see the changes through. If the IRS is going to provide the level of service demanded by the public then enforcement levels of the past cannot be achieved with

the existing organization and resources. The IRS budget request is a first step in addressing the need to improve customer service.

The Service must be able to communicate with taxpayers regarding account activity and computer generated compliance notices. This means the toll-free telephone service must be improved. The Service instituted major improvements in the technology and infrastructure for this service. Many taxpayers report that if they get through and can talk to a customer service representative, they are getting excellent service. However, many are not getting through. To meet customer service objectives, the Service must ensure that taxpayers can get in by assigning the staff and resources necessary to answer the telephones. It is equally important that Congress provide the funding required to support this critical component of IRS customer service.

The third challenge concerns the law regarding innocent spouses. The RRA '98 provisions expanded the relief available to taxpayers, who are filing claims in large numbers. The sheer volume of cases stretches the ability of the system. The IRS faces a major challenge ahead in reducing processing times, increasing training in a complex area of the law and ensuring that all levels of the agency internalize the philosophical shift now required by law.

A fourth challenge is Offers-in-Compromise. RRA '98 gave the Service new authority to resolve collection cases. Now in addition to the doubt as to collectibility and the doubt as to liability, the Service has the authority to compromise when it will promote effective tax administration. This additional basis for compromise allows the Service to consider equitable factors in compromising cases. Again, the training needs are tremendous because of the changes, and the volumes are much greater than

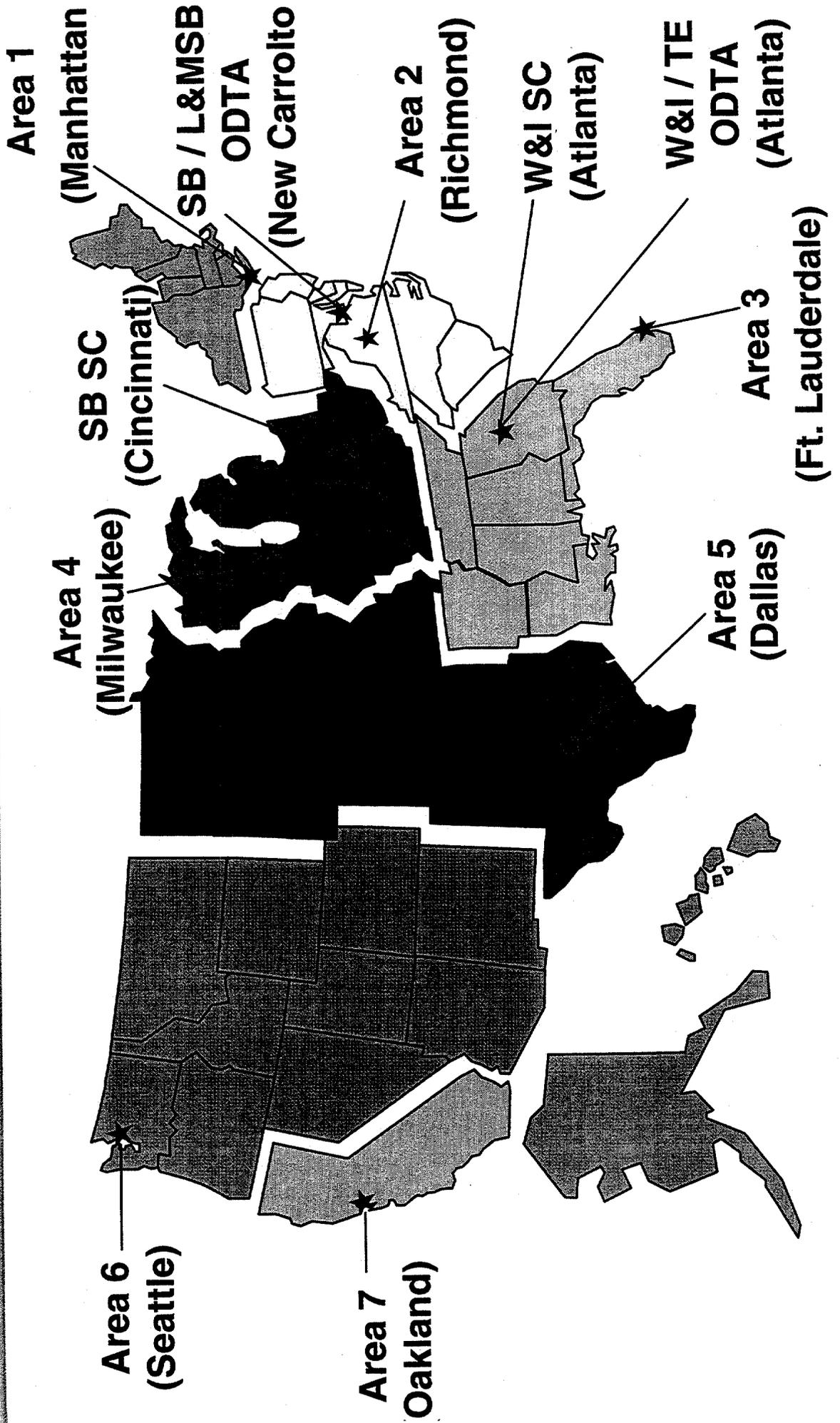
anticipated. The management task will be to find a way to speed up the process so that the taxpayers can get timely decisions.

### **Conclusion**

Taxpayer Advocates, the IRS, Congress and taxpayers are all partners in our system of voluntary compliance. I believe that RRA '98 challenged all partners to work for more effective tax administration. The Taxpayer Advocate Service has implemented RRA '98. We now have the organization and people to provide an independent review and assessment of taxpayer issues and concerns. IRS has accelerated modernization efforts and the new Operating Divisions will soon be in place. Congress and taxpayers are monitoring our progress and responding to our proposals. The Taxpayer Advocate Service will continue to work with you, your local staff and your constituents to improve service and recommend ideas that will eliminate problems that taxpayers face.

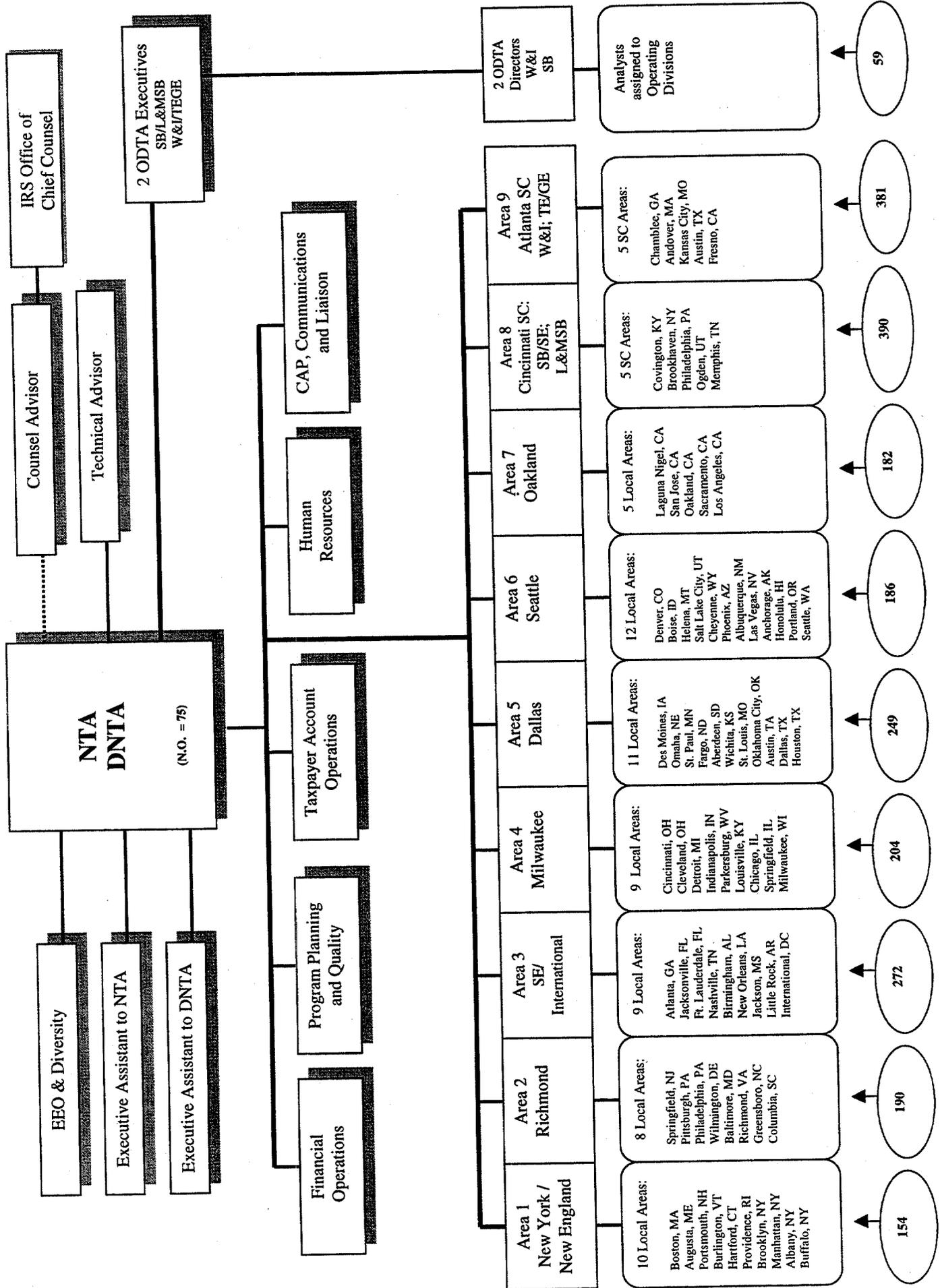
Collecting taxes has never been easy. However, it is essential and we must all ensure that we continue to work as partners. I look forward to working in the new IRS and am confident that with the sustained commitment of Congress, Treasury, the Commissioner and IRS employees, we can meet the challenge and provide better service and greater equity to America's taxpayers.

# Taxpayer Advocate Service Areas



# Taxpayer Advocate Service Organization

Figure 4.3-2



Senator GRASSLEY. Mr. White?

**STATEMENT OF JAMES R. WHITE, DIRECTOR, TAX POLICY AND  
ADMINISTRATION ISSUES, U.S. GENERAL ACCOUNTING OFFICE**

Mr. WHITE. Mr. Chairman and members of the committee, I am pleased to be here today to discuss IRS's modernization progress as we approach the second anniversary of the IRS Restructuring and Reform Act. In the Act, Congress signaled its concern that IRS has been over-emphasizing revenue production at the expense of fairness and consideration of taxpayer interests.

Building on the direction set forth in the Act, IRS has embarked on a multi-faceted, integrated modernization effort. This effort, more so than past efforts, has the potential to provide improved service to taxpayers and to address IRS's long-standing management weaknesses.

Our statement today discusses IRS's progress in implementing its modernization and the challenges that lie ahead. Specifically, we make three points. First, IRS is as challenged today as it was almost two years ago when the Restructuring Act was passed.

Despite successes such as managing to process hundreds of millions of tax returns with its fragmented organizational structure and antiquated information systems while making Y2K fixes, IRS continues to face serious operational issues in its two key mission areas, enforcement and customer service.

With respect to enforcement, we have seen instances where IRS collected amounts from taxpayers who were actually due refunds, and many cases where collection should have been pursued but was not, leaving potentially billions of dollars in lost revenue to the government.

Further, liens are down 69 percent, levies are down 86 percent, seizures are down 98 percent, and audit coverage of high income taxpayers is down from 2 percent in 1996 to less than half that now.

With respect to customer service, taxpayers continue to be frustrated by their inability to reach IRS by telephone. The answer rate this filing season is below what it was in 1998.

The root causes of such problems are complex, interrelated, and longstanding and reflect weaknesses in fundamental IRS operations such as its organizational structure, information systems, performance management, and human capital management.

My second point today is that, recognizing the complex and interdependent nature of its longstanding problems, IRS has developed a massive modernization effort encompassing changes to its organizational structure, performance management system, information systems, and business practices.

About two years into a process that is likely to take more than 10 years, IRS has begun to lay a foundation that should facilitate further changes. For example, IRS has developed a modernization strategy integrated across all of IRS, something missing from previous modernization efforts. Also, IRS's reorganization into four operating divisions focused on particular taxpayers is going reasonably well.

However, substantial challenges remain. One challenge is revamping business practices to better meet taxpayer needs. Responsibility for finding better ways of doing business with taxpayers rests with the four new operating divisions, but the effort will require overcoming IRS's internal cultural barriers in order to assure that the new business practices are properly supported by new information systems.

Information systems modernization itself is a challenge. Work this past year fell well short of expectations, and IRS is trying to get it back on track. Yet another challenge is performance management, where IRS lacks a measure of voluntary compliance.

Now, my third point. In implementing its long-term modernization, IRS is taking an incremental approach, an approach recognized by Congress in the Clinger-Cohen Act of 1996 as a best practice. One advantage of this approach is that it provides some indicators for gauging IRS's progress in the coming year.

Such indicators for this year include: improved performance in customer service, where IRS's telephone customer service should improve based on investments being made this year; improved performance in enforcement, where the Commissioner has said he expects to see a reversal in the downward trend in enforcement actions; progress in developing a measure of voluntary compliance, which would monitor a key aspect of IRS's performance and help target compliance and customer service resources where they can do the most good; incremental implementation of a new employee evaluation system designed to create incentives to support the agency's new mission; and, last, satisfaction of systems modernization commitments such as development of an updated modernization blueprint and business cases laying out the justification for proposed spending. Actually, I have got a last one: improvements in basic internal controls, such as security for handling receipts.

While the benefits to taxpayers from some of these incremental steps will not be felt for years, the steps should indicate whether IRS's multi-year modernization effort is on track.

Mr. Chairman, this concludes my statement and I would be happy to answer questions.

[The prepared statement of Mr. White follows:]



Testimony

Before Congressional Committees

For Release on Delivery  
Expected at  
9:30 a.m. EDT  
on Wednesday  
May 3, 2000

IRS MODERNIZATION

Long-term Effort Under  
Way, but Significant  
Challenges Remain

Statement of James R. White, Director  
Tax Policy and Administration Issues  
General Government Division  
and  
Randolph C. Hite, Associate Director  
Governmentwide and Defense Information  
Systems Issues  
Accounting and Information Management Division  
and  
Gregory D. Kutz, Associate Director  
Governmentwide Accounting and Financial  
Management Issues  
Accounting and Information Management Division



GAO

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# IRS Modernization: Long-term Effort Under Way, but Significant Challenges Remain

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Mr. Chairman and Members of the Committees:

We are pleased to be here today to discuss the Internal Revenue Service's (IRS) modernization progress as we approach the second anniversary of the passage of the IRS Restructuring and Reform Act of 1998 (Restructuring Act).<sup>1</sup> The Restructuring Act signaled strong congressional concern that IRS had been overemphasizing revenue production at the expense of fairness and consideration of taxpayer interests. To deal with this concern, the Restructuring Act mandated specific taxpayer protections as well as more fundamental changes to IRS' mission and organizational structure.

Building on the direction set forth in the Restructuring Act, Commissioner Rossotti established a new mission statement and supporting strategic goals,<sup>2</sup> then embarked on a multifaceted, integrated modernization effort that encompasses changes to IRS' organizational structure, business practices, performance management system, and information systems. As we have said in the past, this modernization effort, more so than past efforts, clearly has the potential to provide improved service to taxpayers and to address IRS' long-standing management weaknesses.<sup>3</sup>

Our statement today discusses IRS' progress in implementing the modernization effort and the challenges that lie ahead. It is based on our past work on IRS management and operations. Specifically, our statement makes the following three points:

- IRS is as challenged an agency today as it was almost 2 years ago when the Restructuring Act was passed. IRS continues to face serious operational issues in its two key mission areas—enforcement and customer service. For example, deficiencies in controls to properly manage billions of dollars in unpaid tax assessments have resulted in both taxpayer burden and potentially billions of dollars in lost revenue to the government. Also, taxpayers continue to be frustrated with their inability to reach IRS by

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<sup>1</sup>P.L. 105-206, July 22, 1998.

<sup>2</sup>IRS' new mission statement reads as follows: "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." IRS' supporting strategic goals are to (1) provide top quality service to each taxpayer, (2) provide service to all taxpayers by applying the law with integrity and fairness, and (3) increase productivity by providing a quality work environment for its employees.

<sup>3</sup>IRS Management: Formidable Challenges Confront IRS as It Attempts to Modernize (GAO/T-GGD/AIMD-99-255, July 22, 1999), IRS Restructuring Act: Implementation Under Way but Agency Modernization Important to Success (GAO/T-GGD-00-53, Feb. 2, 2000), and Financial Audit: IRS' Fiscal Year 1999 Financial Statements (GAO/AIMD-00-76, Feb. 29, 2000).

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telephone. Once they do get through, taxpayers are further frustrated by IRS employees' inability to quickly and accurately answer questions and resolve problems. Root causes underlying these problems are complex, interrelated, and long-standing and reflect weaknesses in fundamental IRS operations, such as its organizational structure, information systems, performance management system, and human capital management.

- Recognizing the complex and interdependent nature of its long-standing problems, IRS has developed a massive modernization effort—encompassing major changes to its organizational structure, performance management system, information systems, and business practices. About 2 years into a process that will likely take more than a decade, IRS has begun to lay a foundation that should facilitate further changes to IRS' business practices. However, substantial challenges remain in the areas of performance management and information systems modernization. For example, some initial systems modernization work fell well short of expectations, and IRS is trying to get it back on track.
- As Congress recognized in the Clinger-Cohen Act<sup>4</sup>, it is best practice to manage long-term modernization efforts incrementally and to measure progress against incremental goals. IRS is following such an incremental approach in implementing its modernization effort and certain areas will be critical to monitor for progress over the next year. These areas include, among others, improvements in enforcement and customer service performance and fulfillment of systems modernization commitments.

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## IRS Is as Challenged an Agency Now as It Was When the Restructuring Act Was Passed

Given IRS' fragmented, hierarchical organizational structure and antiquated information systems, it is no easy feat that, year after year, IRS is able to process hundreds of millions of tax returns. In fact, despite the potential for complications due to massive Year 2000-related changes, IRS reports that its tax processing systems have processed returns and issued refunds without significant disruptions.

Nevertheless, IRS remains as challenged an agency now as it was almost 2 years ago when the Restructuring Act was passed. As highlighted in the following examples, IRS continues to face serious problems in its two key mission areas—compliance and customer service.

- IRS is struggling with its responsibility to enforce tax laws while it proceeds with its efforts to improve customer service. In reviewing its role as the nation's tax collector, we continue to see instances of taxpayer

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<sup>4</sup> P.L. 104-106, February 10, 1996.

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burden in which IRS has pursued and collected amounts from taxpayers who were actually due a refund. At the same time, we identified many instances in which accounts that had collection potential were not being actively pursued, thus resulting in potentially billions of dollars in lost revenue to the government. Further, according to IRS data, 1999 collections from delinquent taxpayers were down about \$2 billion from 1996 levels. Similarly, comparing pre-Restructuring Act data with 1999 figures, lien filings were down 69 percent, levies were down about 86 percent, and seizures were down about 98 percent. According to IRS, audit coverage for high-income taxpayers<sup>5</sup> has dropped from 2 percent in 1996 to an estimated 0.76 percent for 2000.

- Taxpayers continue to be frustrated with IRS' inability to provide customer service. With respect to telephone customer service, taxpayers have difficulty getting through to IRS by telephone. Although IRS' answer rate for the 2000 filing season was 62 percent as of April 15, 2000, the rate has not reached the 90 to 95 percent level IRS says many private sector companies achieve, much less the 73 percent level IRS achieved in the 1998 filing season. Once taxpayers do get through, they are often frustrated when IRS employees cannot quickly and accurately answer questions and resolve problems.

There is no single cause underlying each of these problems. Instead, root causes are complex, interrelated, and long-standing and reflect weaknesses in fundamental facets of IRS operations, such as its organizational structure, information systems, financial management, performance management, and human capital management.

With respect to its responsibility for enforcing the tax laws, IRS asserts that the recent decline in enforcement activity is due to budget constraints and staff shortages and to a substantial increase in the amount of time required per case caused by provisions of the Restructuring Act. While declining resources and additional requirements imposed by the Restructuring Act may certainly be factors, performance management issues also play a role. In our recent review of IRS' use of seizure authority, for example, we found that neither IRS managers nor front line staff felt that seizure authority was being used when appropriate, and that employees were concerned with the lack of guidance regarding when to make seizures in light of the Restructuring Act.<sup>6</sup> Limitations in IRS'

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<sup>5</sup> IRS defines high-income taxpayers as those with taxable income of more than \$100,000.

<sup>6</sup> IRS Seizures: Needed for Compliance but Processes for Protecting Taxpayer Rights Have Some Weaknesses (GAO/GGD-00-4, Nov. 29, 1999).

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information systems also contribute to difficulties in managing enforcement activities. For example, as a result of system limitations, IRS is unable to promptly identify and focus collection efforts on accounts most likely to prove collectible. System limitations also impede IRS' ability to prevent, detect, or correct errors to taxpayers' accounts. As a result, IRS continues to experience delays in posting activity to taxpayer accounts. These system problems contribute to potentially billions of dollars in lost revenue to the government and undue taxpayer burden.

Similarly, taxpayers' frustrations with respect to customer service stem from several causes. For example, IRS' premodernization structure was organized by function, with different employees responsible for answering taxpayer inquiries, clarifying and correcting tax returns, and collecting unpaid taxes. Since each function maintained separate taxpayer databases, taxpayers were often referred to offices other than those they had initially contacted. Without employees trained to handle taxpayer concerns from beginning to end, and until IRS integrates its stove-piped information systems and creates an accurate and up-to-date taxpayer accounts database, IRS will have a difficult providing top-notch customer service. IRS also lacks important performance data on the results of various efforts to improve customer service. This lack of performance data, coupled with the lack of data on the number of employees that provide customer service and the absence of a supporting cost accounting system, seriously undermines managers' abilities to determine whether various customer service initiatives are, in fact, resulting in quality service at reasonable costs.

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## Modernization Is Under Way, But Substantial Challenges Remain

Recognizing the complex and interdependent nature of its long-standing problems, IRS has developed an integrated long-term strategy for change to be implemented through a massive modernization effort that encompasses major changes to its organizational structure, performance management system, information systems, and business practices. About 2 years into a process that is likely to take more than a decade to fully implement, IRS has begun to lay a foundation that should facilitate further changes to IRS' business practices. However, substantial challenges remain in the areas of performance management, information systems modernization, and revamped business practices.

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## Progress Thus Far Is in Laying a Foundation for Further Change

IRS' development of and commitment to an integrated modernization strategy is itself a significant achievement. The Commissioner is actively engaged in all aspects of the modernization effort and is committed to making it successful. We agree with the Commissioner that the success of the modernization effort is contingent upon implementing it in an

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integrated fashion—something that was missing from previous modernization efforts. IRS has focused much of its initial energy on reorganizing around taxpayer segments, developing a new performance management system, and modernizing information systems.

## Reorganization

The reorganization is an important piece of IRS' modernization process. Under IRS' past organizational structure, authority for administering the tax code and serving taxpayers was decentralized to 33 districts and 10 service centers. To better meet its new mission and strategic goals, IRS identified its primary taxpayer segments and the key processes—prefiling, filing, and postfiling—that are to define IRS' primary interactions within each of these segments. IRS is reorganizing around four operating divisions, each with end-to-end responsibility for all of the key processes for their respective taxpayer segment. Teams of IRS employees have developed highly detailed blueprints outlining how each new organizational unit should function. While taxpayers may not notice many tangible benefits from the reorganization itself, we agree with IRS that this streamlined management structure and institutionalized focus on taxpayer segments should facilitate clearer authority and accountability for managers and, as a result, aid IRS in tailoring business practices to taxpayer needs.

Our monitoring work indicates that the reorganization is proceeding reasonably well. The Commissioner has selected executive leadership teams, which combine career IRS employees with outside hires, and IRS is shifting employees to the new organizational structure in phases. Of the four main operating divisions, one is officially up and running and the remaining three are scheduled for start-up this year.<sup>7</sup>

## Performance Management

No matter what the strength of IRS' top leadership or its organizational structure, successful modernization ultimately depends on whether the employees who are to lead, manage, and carry out agency programs and services can deliver IRS' new mission. As we have said, an organization's human capital policies, including the performance management system it uses to manage and motivate its people, must be aligned to support its

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<sup>7</sup>The four operating divisions and their start-up dates are (1) Tax Exempt and Government Entities, serving pension plans, exempt organizations, and governments (up and running since December 1999); (2) Large and Mid-Size Business, serving businesses with assets over \$5 million (June 2000); (3) Wage and Investment Income, serving individual taxpayers with only wage and investment income (October 2000); and (4) Small Business and Self-Employed, serving fully or partially self-employed individuals and small businesses with assets under \$5 million (October 2000).

mission and expectations of itself.<sup>8</sup> At the heart of a performance management system is a set of balanced measures that, if properly used, helps organizations assess progress toward achieving strategic goals and improving operations. When aligned with an employee evaluation system, the measures can serve as a powerful tool by creating incentives that encourage employees at all levels to work together toward a common end.

IRS has recognized that a system of balanced measures might help achieve its new mission, and it has become one of the leaders in bringing the concept to the federal sector. In the past, IRS had focused heavily on indicators related to revenue production, and it took steps so that its performance management system supported this emphasis. Over 2 years ago, we highlighted our concerns about overreliance on enforcement revenue as a measure of performance.<sup>9</sup> We concluded that such overreliance could create undesirable incentives for IRS auditors to recommend taxes that would be unlikely to withstand taxpayer challenges, imposing an unfair and unnecessary burden on some taxpayers. To revise its performance management system to better reflect its new mission, IRS is developing a new suite of measures to address three strategic goals: service to each taxpayer, service to all taxpayers, and productivity through a quality work environment. For each strategic goal, IRS is developing a discrete corresponding measure--customer satisfaction, business results, and employee satisfaction, respectively.

## Systems Modernization

IRS recognizes that revamping its time-worn tax processing systems is a critical aspect of modernization and has taken several steps toward this end. Specifically, in December 1998, IRS hired a prime contractor to, among other things, assist IRS in completing and updating the modernization blueprint that IRS developed in 1997. This update is to account for changes due to organizational restructuring, new technology, and Restructuring Act requirements. IRS also has developed a business systems plan that outlines a 5-year business modernization strategy, including a listing of priority projects for the next 3 to 5 years. It has also largely developed a systems life cycle process to govern cradle to grave management of its system investments.

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<sup>8</sup>Human Capital : A Self Assessment Checklist for Agency Leaders (GAO/GGD-99-179, September 1999) and Human Capital: Key Principles From Nine Private Sector Organizations (GAO/GGD-00-28, Jan. 31, 2000).

<sup>9</sup>Tax Administration: Taxpayer Rights and Burdens During Audits of Their Tax Returns (GAO/T-GGD-97-186, Sept. 26, 1997).

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## Significant Challenges Lie Ahead

While IRS has made some initial headway in laying the foundation for further modernization, significant challenges lie ahead in three areas. These include: (1) completing all elements of a performance management system; (2) revamping its business practices; and (3) effectively and efficiently building modernized systems, using requisite management and technical controls, to support performance management and revamped business practices.

### Completing Key Elements of the Performance Management System

IRS is at risk of failing to achieve the congressional intent behind the Restructuring Act until it implements all the key elements of its revamped performance management system. Two critical parts of this system not yet completed are (1) a full set of balanced performance measures that is based on reliable data and (2) an employee evaluation system that provides employees with a clear line of sight from their performance to the balanced measures. IRS is working to develop both.

While IRS has clearly made progress in implementing balanced measures to serve as the foundation of its revamped performance management system, it is still missing a measure of voluntary compliance. Although it will be difficult to reliably estimate voluntary compliance, such a measure is essential for a number of reasons. Regularly measuring progress in voluntary compliance is important in order to gauge whether IRS is accomplishing a key aspect of its mission. Also, the information about taxpayers to be generated as part of measuring voluntary compliance may help IRS identify the characteristics of taxpayers who have difficulty understanding and meeting their tax responsibilities. Finally, the data IRS would develop as part of any voluntary compliance measurement effort may allow IRS to better direct its enforcement resources to those taxpayers who willfully flaunt the tax laws, thus reducing the burden on compliant taxpayers. IRS recognizes that it needs a reliable and meaningful measure of voluntary compliance and is working with a contractor to determine how to measure compliance with the least burden on taxpayers. However, that effort is still in its early stages.

Regardless of the set of balanced measures that IRS ultimately develops, collecting meaningful, reliable performance data will be difficult given IRS' ongoing problems with data integrity and its lack of a cost accounting system. Until such time as IRS resolves these fundamental data issues and has reliable performance data, it will be difficult to hold managers accountable for their results.

The second critical part of performance management is an employee evaluation system that reflects the agency's mission. Guided by concerns

that IRS employees were focused on revenue production rather than service to taxpayers, the Restructuring Act included explicit prohibitions against using enforcement statistics to evaluate employees. IRS now recognizes that employees must have a clear line of sight between their day-to-day activities, their resulting performance evaluations, and the agency's broader goals. IRS is still exploring several different approaches for revising its employee evaluation system to make the relationship between employee performance and agency performance more transparent.<sup>10</sup>

### Revamping Business Practices

IRS has started to revamp its business practices to better meet taxpayer needs and improve agency operations. However, implementing business practice changes will not be easy. In the coming years, responsibility for taking a hard look at how IRS can enforce the tax laws and meet customer needs in new and better ways will rest with the new operating divisions. This will be a challenge both in overcoming cultural barriers to "thinking outside the box" as well as in coordinating the requisite human capital, data, and information system support across IRS.

One example of this rethinking is IRS' fresh look at how it provides face-to-face customer service. Based on the conclusion that, from a taxpayer's perspective, a single point of contact for resolving issues is a better way of doing business, IRS is creating a new Tax Resolution Representative (TRR) position. TRRs are to be permanent staff at IRS walk-in sites who perform traditional prefilling duties, such as answering tax law questions and helping taxpayers prepare their returns, as well as postfiling compliance duties, including installment agreements, account adjustments, and simple audits.

The concept of combining prefilling and postfiling service embodied in the TRR position is compelling and fits neatly with IRS' goal to improve service to each taxpayer. As with other business practice changes, however, implementing the TRR concept will require investments in human capital and information systems. Probably the greatest human capital challenge will be training. The initial cross-functional training needs will be significant because the TRR position combines elements from several current positions, and ongoing training to keep such a broad array of skills up-to-date will be a continuing challenge. We also expect that the TRR position will require strong interpersonal skills. In addition

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<sup>10</sup>IRS Personnel Administration: Use of Enforcement Statistics in Employee Evaluations (GAO/GGD-99-11, Nov. 30, 1998) and IRS Employee Evaluations: Opportunities to Better Balance Customer Service and Compliance Objectives (GAO/GGD-00-1, Oct. 14, 1999).

Building Modernized  
Information Systems

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to training, TRRs will also need enhanced information system support to do their jobs effectively. For example, providing high-quality service to taxpayers will be difficult without access to an information system that contains accurate and up-to-date information on taxpayer accounts, something that IRS plans to deliver as part of its information systems modernization effort.

Until IRS' antiquated information systems are replaced, they will continue to hinder efforts to manage agency operations and better serve taxpayers through revamped business practices. Unfortunately, IRS' progress over the past year on the systems modernization front has fallen well short of expectations, in large part because IRS did not implement management and technical controls needed to guide the systems modernization process. IRS has recognized that it must first put in place the requisite modernization management capabilities and thus has scaled back its new system projects until it has done so.

Before IRS can actually build modernized systems, it needs to fully implement key controls that are necessary to effectively guide and constrain modernization initiatives. These controls include (1) completing its modernization blueprint; (2) implementing a "systems life cycle" process, including development of business cases, to manage system investments; (3) establishing a fully operational management structure to oversee systems modernization; and (4) clearly defining and implementing IRS and contractor roles and responsibilities.

In a systems modernization expenditure plan submitted to Congress in mid-1999,<sup>11</sup> IRS committed to having selected controls in place by October 1999 and established milestones for progress on individual systems projects. As of March 31, 2000, however, IRS either had not met, or did not yet know whether it had met, most of the commitments that it made in that plan. For example, IRS had committed to full implementation of the systems life cycle process by October 31, 1999, but in March 2000 reported that it still had not completely defined or implemented it. In fact, until only recently, none of the individual systems projects were following the systems life cycle process, because IRS and contractor staff had not been trained in its use. This is important because failure to adhere to the

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<sup>11</sup>Pursuant to the fiscal year 1998 Treasury and General Government Appropriations Act (P.L. 105-61) and the fiscal year 1999 Omnibus Consolidated and Emergency Supplemental Appropriations Act (P.L. 105-277), IRS and the Department of the Treasury are required to submit to Congress, for approval, an expenditure plan that meets certain conditions (e.g., implements IRS' Modernization Blueprint and meets IRS system life cycle management program requirements) before IRS can obligate funds for systems modernization.

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management and engineering discipline embedded in the process seriously jeopardizes a project's ability to deliver promised capability, on time, and within budget. As of March 31, 2000, IRS had neither completed its modernization blueprint, nor clearly delineated IRS and contractor roles and responsibilities. Also, IRS systems modernization management organization was not fully operational.

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## Key Indicators for Gauging IRS' Progress in the Coming Year

As Congress recognized in the Clinger-Cohen Act, it is best practice to manage long-term modernization efforts incrementally and measure progress against incremental goals. IRS is following an incremental approach in implementing its modernization effort and below are a few areas that will be critical to monitor for progress over the next year.

- Improved performance in enforcement and customer service functions: Specifically, the Commissioner has said that he expects to see a reversal in the downward trend in enforcement statistics. In terms of customer service, taxpayers' ability to reach IRS by telephone should improve in the 2001 filing season because IRS plans to spend some of its systems modernization funds for a project that is designed to increase the telephone answer rate. IRS expects to finalize its estimate of the expected level of improvement from this project, as well as its cost, in early May 2000.
- Progress in developing a measure of voluntary compliance: While it may take several years to develop reliable estimates of voluntary compliance, it will be important for IRS to define the measure and develop a strategy for obtaining the necessary data for such a measure. Doing so will provide stakeholders with an opportunity to begin a dialogue of how best to obtain data without placing an undue burden on taxpayers.
- Incremental implementation of a new employee evaluation system: For IRS employees to have a clear line of sight to IRS' new mission, IRS needs to stay on track for implementing a new employee evaluation system. IRS hopes to implement some aspects of the new system for 60 percent of its bargaining unit employees in October 1, 2000. In July 2000, IRS expects to begin efforts to apply aspects of the new systems to other employees who comprise another 20 percent of IRS' bargaining unit employees.
- Satisfaction of systems modernization commitments: IRS' March 7, 2000, spending plan specifies a number of commitments, such as implementation of its systems life cycle process by June 30, 2000, and development of an updated modernization blueprint by September 30, 2000. Per our recommendation in June 1999, IRS' next systems

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modernization expenditure plan should fully disclose IRS' progress in meeting these commitments.<sup>12</sup>

- Improvements in basic internal controls: In addition to making incremental progress toward long-term modernization goals, improvements in basic internal controls and processes during fiscal years 2000 and 2001 should occur. Such controls include prohibiting employees from handling receipts and taxpayer data until their background checks are satisfactorily completed, and properly accounting for property acquisitions and dispositions.

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Mr. Chairman, this concludes our prepared statement. We would be happy to answer any questions you or other Members may have.

### **Contacts and Acknowledgments**

For further information regarding this testimony, please contact James R. White at (202) 512-9110, Gregory Kutz at (202) 512-9505, or Randolph Hite at (202) 512-6240. Sherrie Russ, Deborah Junod, Jackie Nowicki, Gary Mountjoy, Charles Fox, and Agnes Spruill made key contributions.

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<sup>12</sup>Tax Systems Modernization: Results of Review of IRS' Initial Expenditure Plan (GAO/AIMD/GGD-99-206, June 15, 1999).

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Senator GRASSLEY. I thank all three of you. We will, again, take five-minute turns at questioning.

First of all, I am going to start with you, Mr. White. What I am going to raise as an issue, it is my understanding you did not oversee an investigation that I am going to criticize, so I am not here to point criticism at you. But I am asking you, as a bottom line, the extent to which you could arrange a meeting based upon what I am going to say now.

That would be to comment and express concern over the General Accounting Office report that was tasked with corroborating witness testimony from our 1998 Finance Committee hearings. I have had a chance to look over a redacted version of what was recently given to the media.

From what I have seen, it does not look like the General Accounting Office did any real investigating at all. And this is uncharacteristic for me to criticize the General Accounting Office because, through my work as chairman of the Aging Committee and through all the work I have done on Department of Defense reform and investigation, I have been very, very satisfied with the professional work of the General Accounting Office.

We have seen media headlines like the one in *The Washington Post* that said, "GAO Report Exonerates IRS on 1998 Accusations." I am already hearing negative comments about the witnesses that had the courage to come forward and to testify.

The point is, the General Accounting Office absolutely did not exonerate anybody, if you read the report and actually looked into the matter itself. Unfortunately, most reporters for the papers apparently have not actually looked into the cases.

At most, the report says that the General Accounting Office was not able to substantiate many of the allegations. That certainly does not mean that the allegations are not true, especially since there was not really an investigation.

First of all, the released report does not even cover a number of the most important witnesses at our hearing. There is no mention of Jennifer Long, Tom Henderson, Bruce Strauss, and others.

The fact is, the General Accounting Office never even interviewed these witnesses, which I find unbelievable, if you are really going to get to the bottom of anything. At least some of the witnesses GAO says it did talk to claim nothing was done with the many documents provided to the General Accounting Office.

I am told that the General Accounting Office investigators never even asked the witnesses about the documents provided them, and in one case, I am told, the investigator opened up the interview with one of the whistle-blowers by saying, "So you ratted on your boss."

Now, reading the report, you find that mostly what the General Accounting Office did, was talk to IRS supervisors or review people and files that were involved in already-completed internal investigations, so there was no real independent investigation, is my conclusion.

I have been involved with many GAO investigations. I have had some very good experiences with what the General Accounting Office does. So I am coming to you, realizing that you did not oversee this investigation, but I would like your help in setting things straight.

I would like our staffs to sit down and go over what was done, or what was not done, and how it was done, because from my perspective the so-called investigation of these allegations is not one of GAO's finer moments.

Could you help with this?

Mr. WHITE. Yes, Mr. Chairman. I can set up such a meeting. The work was led by our Office of Special Investigations. They have teams of people there who are experienced at gathering information to support these kinds of allegations, and that is why they were assigned to the work.

I would say that the work that they did was exhaustive. They interviewed the witnesses many, many, many times, and it was not just one person doing these interviews, there were a number of people involved in this work. They interviewed the witnesses many, many times. They reviewed all the files that they could find.

Part of the reason for the many interviews was to make sure that all of the information that was available was uncovered and reviewed. But I would be happy to set up the briefing that you asked for.

Senator GRASSLEY. Yes. The only addition I would make to what you just said is that some of the most important witnesses were not contacted by your investigators.

Mr. Oveson, in your 1999 report to Congress you had 53 legislative recommendations to help taxpayers. Some of those would have been addressed in last year's tax relief bill if the President had not vetoed it.

Out of those 53, or any new ones you have come up with, what are the top two or three issues that stand out in your mind that you believe are essential for Congress and the administration to act on?

Mr. OVESON. I mentioned in my testimony the abatement of interest. Expanding the authority to abate interest and dealing with penalty administration, which has been called for in the Restructuring and Reform Act, has been the subject of a lot of study. An excellent study was done by the staff of the Joint Committee on Taxation. I think that would rate number one.

The Earned Income Tax Credit has been talked about quite a bit here today. Reconciling the confusing definitions and the conflicting definitions in the administration of that program, I think, would be number two.

Senator GRASSLEY. Thank you.

Now we go to Congressman Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Williams, you indicated in your testimony that there has been a dramatic reduction in seizures--you cited a 98 percent reduction.

Mr. WILLIAMS. Correct, sir.

Mr. COYNE. To what do you attribute that?

Mr. WILLIAMS. We are seeking to understand that completely. The factors that are at play are that the IRS got off to a slow start. The IRS could not implement the law immediately. It had to develop procedures and train people, and then it had to pull people off-line in order to develop the procedures for the training.

There was some concern on the employees' part with regard to the 10 Deadly Sins. In taking those most aggressive actions that this agency takes, they are on the line for the kind of allegations that might be leveled against them. I think there was a kind of wait-and-see attitude with regard to how those were going to be implemented.

As the Chairman said, there was some information that circulated in the beginning that caused those fears to be heightened that were not warranted and were ungrounded. We have taken pretty aggressive action to try to put those back in perspective, and I can share some of that with you.

I think that those are the principal actions. Some of the enforcement actions take longer than they used to take. That would be a marginal factor.

The decline in enforcement actions is troubling and everyone is worried about it, and we do not completely understand, but those are some of the factors that are most important.

Mr. COYNE. From the testimony that the committee has received today, both from Mr. Rossotti and the panel that is here now, one common thread in the testimony is the need for human resources.

I wonder if any of you want to comment on that? Could you let us know your feelings about the human resource concerns expressed today? To what extent do our tax administration problems stem from human resource concerns?

Mr. WILLIAMS. I am new to IRS oversight, but I clearly have the sense that in the areas touched by the budget request, IRS is not keeping up.

I think that some of those additional manpower requests might be a kind of bridge effort. IRS does have the computer modernization coming to the rescue, but it is not going to be quick, and it might even be slower than we had hoped. So my general feeling is that the resources are badly needed. IRS is not keeping up in vital, important areas that I know that you want IRS to be on top of.

Representative COYNE. Does anyone else care to comment?

Mr. WHITE. I would like to pick up on the point that Mr. Williams made. IRS staff need support to be able to do their functions well, to be able to provide good customer service to taxpayers.

Right now, for example, they do not have real access to up-to-date taxpayer accounts. The accounts that they have access to on the computer systems at IRS can be a week or two out of date. This creates all kinds of problems for both taxpayers and IRS staff.

So part of the human capital management problem at IRS is developing the kinds of systems and information systems to adequately support IRS staff. At the management level, the same sort of point applies.

The Commissioner has provided very strong leadership. He has a clear vision of where IRS needs to go. But implementation, as has been discussed here today, is key to this restructuring effort or modernization effort at IRS. For that to succeed, implementation has to be carried out by managers below the level of the Commissioner.

The Commissioner cannot implement this. IRS management has a history--we have pointed this out for many years--of weaknesses. Part of these weaknesses were due to lack of support in the areas that I mentioned, cost accounting systems and information systems.

Mr. COYNE. So your response would indicate that it is not necessarily a matter of volume of personnel, but in the way that they approach the responsibilities that they have.

Mr. WHITE. Yes.

Mr. COYNE. Thank you.

Senator GRASSLEY. Thank you, Congressman.

Now, Congressman Horn.

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

First, Mr. Oveson, I want to congratulate you, at least from my experience. As you know, we have got 435 Members from the States and 5 from the territories, and they have district offices. We have 900 cases, not, thank heavens, with IRS, in our district office in Lakewood.

But with those cases we have had with IRS, your people at Laguna Niguel have done an outstanding job and we congratulate you on that. There is no question that part of the IRS has been putting a lien on a person, then the other person wants to get the money from them, and there had not been coordination before. I think we are finally getting at that.

Now, let me ask Mr. Williams, on page 2 at the bottom, you note that, "In addition, we are reviewing one new provision, Assessment Statute Extensions, that become effective January 1, 2000. We are also conducting an audit related to one of the RRA 98 provisions to determine the effectiveness of the IRS actions for identifying and reporting potential Fair Debt Collection Practices Act violations."

I just wonder, since that opens the situation, to what degree is the Treasury Inspector General for tax administration concerned about the uncollected debts within IRS? I would just like your feeling for that since you obviously have a lot of knowledge about it.

Mr. WILLIAMS. Well, we know that that is an important area for us to audit in the coming year, and we wanted to let you know that that was a body of work that we were about to undertake. Knowing of your interest, we certainly want to make sure that your office is aware of it.

We have immersed ourselves in the philosophy that the Commissioner has put us all in mind of, IRS has to make efforts much earlier than they have been made in the past if collection efforts are to be successful. They have tried to learn from the private sector the dangers of delaying and taking a slow approach to collections.

At the same time, they need to have the balance between the aggressive collection and fairness in making those collections. That is a very difficult area. We hope that our audit efforts inform the debate and we are pleased to know that we have at least one customer for that body of work when it arrives.

Mr. HORN. Well, we thank you, because under Secretary Rubin I think the Treasury did a very fine job of going after the non-tax debt throughout the administration, and we appreciate that. But I am obviously beaming in on where the bank money is, as Willie Sutton says, and that bothers me when you have got billions to be collected on the IRS side.

That is not letting the people know the fairness of it. Because if you can get away with it for years, and pretty soon everybody forgets it and the taxpayer that has violated it a number of times, I just feel when you have got people that consistently go in and out of business and declare bankruptcy, they are just cheating us. It seems to me we have got to get at that. I would hope the new Secretary of the Treasury would be doing that and would continue to find work

that started under Secretary Rubin with non-tax debt.

Mr. WILLIAMS. I do not think there was much of an understanding in the past, at least I have not found evidence of it, as to the nature of debt collection. The figure was so large that IRS could not really find the opportunities among that enormous front that IRS was trying to cover.

I think now that the IRS has focused on these more modern approaches to understanding debt and debt collection, it has set up the possibility of being increasingly effective, and TIGTA wants to monitor IRS= efforts.

Mr. HORN. When I talked to Mr. Rossotti's predecessor, there was about \$110 billion in one pile. When I said, can you collect it and are you organized to have a collection system, well, I was dubious about it when she said, Aoh, we have \$60 billion we think we can collect.@

Well, the figure I read into the record earlier shows that the General Accounting Office does not think it is \$60 billion, it thinks it is in the \$20-30 billion range, as I remember.

Somehow we have got to get a handle on it, because every day that there is another lag, some taxpayers are cheated by the government not doing what it should do as a government.

Mr. WILLIAMS. I gather that the GAO work was very good, and it did help us. We relied on it in helping to understand the nature of the problem and the opportunities to be more aggressive.

Mr. HORN. Well, the Commissioner, in response to one of my queries, said he is not against private collectors. Do I feel that you, as the Treasury Inspector General for Tax Administration, are not against private collectors either if they get the job done?

Mr. WILLIAMS. At this point, we would be very open- minded to any approaches that the study group comes up with. We certainly would not enter it with any bias or closing off any options, and we would be very pleased to look at that as an option.

Mr. HORN. Well, I am glad to hear that, because before Commissioner Rossotti became the Commissioner, the IRS put in some really phony collections.

They were five years old--already dead,--and never really had been collected. They said, well, let us give those to the private collectors. Clearly, they had no interest in it, and they had this phony competition, and it did not go anywhere.

Thank you, Mr. Chairman. I appreciate the opportunity.

Senator GRASSLEY. Mr. Horn and Mr. Coyne, I am going to follow up on what you just asked. But before I do that, we are about ready to close this down. Since I have a couple of

more questions, I should have deference to you to have the same privilege if you had anything that did not get done.

Mr. White, let me follow up where he left off, or where this discussion left off. Since your agency did suggest \$20 billion in uncollected taxes could be collected, just your opinion, why is that not being done?

Mr. WHITE. Part of it is the antiquated information systems at IRS, the point that the Commissioner made about needing to get to these debts sooner. Right now it takes too long to get to them, and by the time we finally get to them, businesses have gone bankrupt. Many of these debts represent employment taxes, for example. A business has gone bankrupt and it is too late.

Senator GRASSLEY. All right. Thank you.

I want to read into the record the last point I made with Commissioner Rossotti, which was following up on questions that Senator Kerrey was asking about the 1203 regulations, and I think Congresswoman Northup also discussed that, so at least everybody, including you, Mr. Williams, will know where I am coming from on this point. It is not something we have to discuss right now.

But I mentioned in my opening statement what I believed is an effort by some within the IRS to undermine the law, and particularly the so-called 10 Deadly Sins that have come under fire.

I think most of this criticism is misplaced. All of these provisions require some kind of willful misconduct or assault and battery, retaliation or threats.

Unfortunately, it appears that employees in the field are being told otherwise. For instance, we have heard that some employees are being told that if they make mistakes on their own W-2 form they can be fired. Now, Senator Kerrey already referred to that, so my statement on that is not any different than what he has been told.

These employees are also being told that if they make a typographical error and somebody's tax return pops up accidentally, that they can be punished. So it seems like some managers are almost trying to scare employees in order to undermine the law.

On top of that, it appears that the 1203 regulations are only being applied against the employees and not the managers, at least I am being told this is the case. So I know that we will get comment from Commissioner Rossotti on this for me and Senator Kerrey, but I am specifically asking that I be provided, for me and the committee, with statistics on the number and type of 1203 sanctions that have been taking place since 1203 was implemented.

Now, one closing comment from me. This is an admonition to the Senate, because I cannot admonish the House, under comity. That is, we are just finishing the second annual

multi-committee oversight of the IRS, put in the statute because we wanted, at least once a year, a unified approach of all three of the Senate committees and the three House committees that sporadically, and maybe not often enough, deal with the IRS in our constitutional responsibility of oversight.

As we were proceeding up to the Restructuring Commission's work of a year and a half, through that year's work, and then through the period of time that the Finance Committee had our oversight hearings of the IRS that kind of laid the groundwork for eventually getting the restructuring bill passed, I came to the conclusion that maybe over the last 20 years we in Congress do not do our job of oversight adequately.

Consequently, it leads to a mind-set within various bureaucracies--in this case the IRS--of a great deal of independence, and it can get away with things of that nature. I think we found that to be the case in our Commission's work.

So just to avoid, not only through this process that we have gone through today, which is a partial step in that direction, allowing bureaucracies to get too far outside the law, I think we ought to keep in mind whether or not on a very regular basis, not just once a year, we are doing an adequate job of oversight of bureaucracies generally, and in this case, and for the Senate Finance Committee, the IRS.

That is not a criticism of anybody's leadership, that is just a statement of what I have observed in the 20 years that I have been a member of this committee.

I thank you all. Consequently, the hearing is adjourned, since there are no more questions.

[Whereupon, at 11:55 a.m., the hearing was concluded.]