

STATUS OF IRS REFORM

HEARING
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
ONE HUNDRED SIXTH CONGRESS
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STATUS OF IRS REFORM

WEDNESDAY, FEBRUARY 2, 2000

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:09 a.m., in room SD-215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Coverdell, Moynihan, Breaux, Conrad, Graham, and Kerrey.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please be in order.

Let me begin by welcoming the committee back, and to you, Pat Moynihan, from what I hope has been a relaxing but productive recess.

I think you will agree with me there is much to be done in the months ahead, particularly as we are entering a new millennium. I think we need to focus our attention on bringing government into the 21st century.

I can think of no more important objective for Congress. I think it is appropriate to begin our committee work with an overview of how the IRS is implementing the IRS Restructuring and Reform Act of 1998.

That law, of course, constituted one of the largest and most significant government reform efforts in history. It set the framework by which the IRS would enter a new era. I believe it serves as a blueprint of what can be done to make other departments and agencies more effective, more efficient, and more responsive.

Pat, I want to welcome the nominees to the IRS Oversight Board who are with us this morning. That board was created in the new law, and I am happy to see that the board members have finally been named and that they are ready to go to work. I know we all look forward to hearing from them at the nomination hearing on Thursday.

There is no question that with the Restructuring and Reform Act, that Congress provided the authority for a massive overhaul of the IRS. Our intention was, and is, to improve things to make the agency better, fairer, more user friendly for the taxpayer, and, I also want to emphasize, better for the employees.

It is an enormous task that the Congress and Commissioner Rossotti have undertaken, and I must say that I have full faith in

the Commissioner. I believe, Pat, he is the right man for the job, with proven management skills that are necessary for this reform to succeed.

As part of bringing the agency into the 21st century, the IRS is restructuring—and this is most important—33 districts and 10 service centers into 4 efficient operating divisions.

At the same time, Commissioner Rossotti is modernizing an antiquated computer system. This should allow the IRS to provide better service to taxpayers, and, I emphasize, make tax collection more efficient, especially as Congress has set a goal that 80 percent of all returns filed by 2007 will be done electronically.

While the IRS is in the throes of this enormous restructuring, it must continue to collect taxes. After all, that is its basic mission. Like the private sector, however, the agency needs to enter the new millennium providing better service, a focus on efficiency and fairness, and I am optimistic that, with the new law and under Commissioner Rossotti, the agency is moving in the right direction.

But I also realize that it faces some very serious challenges. There is no question that the IRS employees need to be retrained. Many of the egregious practices of the past continue.

Enforcement statistics are still illegally being used in the IRS, which, as this committee revealed, may result in violation in taxpayer rights. Over 46,000 innocent spouse claims have yet to be resolved. In many cases, taxpayers are not being afforded due process.

The use of liens and seizures have plummeted, yet the IRS does not follow the law or its procedure one-third of the time when it actually issues a lien or seizes property. These conditions must change.

Another issue of concern is the mistaken belief by some IRS employees that Congress has tied their hands and is keeping them from doing their job. Some fear that Section 1203 is written so strictly that they cannot use enforcement measures against delinquent and dishonest taxpayers, or effectively manage employees. That is just plain wrong.

Much needs to be done to educate and train these employees to help them understand that the new law in no way prevents them from doing their job. It simply requires taxpayers to be treated fairly and it protects the rights of employees.

I am convinced that the IRS can carry out the important responsibility, that taxes can be fairly and appropriately collected, and that employees can work free from the threat of intimidation and retaliation.

Progress has been made thus far, and we will hear about this progress in this hearing. But we still have a way to go and we will address that as well. Amid this change, one thing remains certain: the Internal Revenue Service will be reformed. I believe that is the desire of our committee, it is the desire of Congress, and the American people.

It is also the desire of a vast majority of agency employees who are doing a good, but extremely difficult, job for our great Nation.

It is now my pleasure to call on Senator Moynihan.

**OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN,
A U.S. SENATOR FROM NEW YORK**

Senator MOYNIHAN. Well, Mr. Chairman, first, to agree with everything you have said, but to add what you would not on your own say. Which is, of all the things our committee has done under your leadership, I think nothing equals the initiative of 2 years ago to restructure and revive the Internal Revenue Service under Commissioner Rossotti, whom we are going to hear from later this morning.

There is a fundamental characteristic of government—there is no point in calling it a problem, because it is not going to go away—which is that there is no market test to determine the viability of an organization. Whereas, in the private sector, organizations thrive and decline, come on and disappear, and so forth. Nothing comparable happens in government.

At the Brookings Institution a while ago, a scholar published a study called "Are Government Organizations Immortal?" And he concluded, yes, evidently. He went back to 1923 and found some 175 organizations, moved 50 years ahead, and all sorts of things have happened in the world, and all but 27 of those organizations were still there. Some had three name changes and things like that, but they were still there.

How to bring into this particular operation the extraordinary effect and consequences of the digital age is just a challenge it has never faced, we have never faced. Well, the Pentagon faced up to it about 20 years ago, and now it is up to us.

I think the effort is going well. I think it is thanks to your continued attention. It would have been easy to have passed that legislation and said, well, that is done. Now, what next? But here we are having an oversight hearing with some very distinguished public servants to testify. I look forward to that testimony.

But, once again, I want to testify to your leadership and thank you for what you have done. Not every committee in this Congress can say it got anything done, and we did. I see our colleague is back from the wars, right up in the morning as if nothing had happened.

The CHAIRMAN. Well, thank you for those gracious remarks, Pat. Frankly, it could not have been done without you or without the bipartisan spirit that has characterized our committee.

We are anxious to move ahead, but I think it is important that we hear from a gentleman who has played such a key role in the development of this legislation, including the board, Bob Kerrey.

Again, he has announced he is not running for reelection. I told Pat Moynihan, and I will tell Bob Kerrey, you cannot do that without the approval of the Chairman. [Laughter.]

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

Senator KERREY. First of all, Mr. Chairman, I want to thank you for holding these hearings. It would be very easy just to enact this legislation, then move on.

As former President Ronald Reagan once said, it is important for us to trust, but verify. I appreciate very much these hearings be-

cause I think it is going to give us a pretty good view of what has happened since the legislation has been enacted.

Also, if you do not mind, Mr. Chairman, I would like to make some comments about this IRS Oversight Board. I know that they are not going to testify, but many, if not all of them, are in the audience and observing the hearing.

The CHAIRMAN. They will testify tomorrow, you know.

Senator KERREY. Tomorrow they are going to testify?

The CHAIRMAN. Yes, they will.

Senator KERREY. I would like to just describe, and I will cut this down to size so I do not take up too much of the witnesses' time, but the purpose the IRS commission and the subsequent legislation had for this board. It is an extremely important role. It is not an advisory board, it is a board with real statutory authority.

The members of the commission believed that the IRS would be better able to create and maintain a customer service-driven organization if it had a credible and a competent governance body with real power to oversee its strategic direction and operation.

We believed that an effective board had to encompass four key elements: expertise, continuity, clear lines of authority, and focus.

First, we believed that a successful board needed to have a high level of expertise in customer service, in technology, and the operations of large service organizations.

The commission felt that this meant that the majority of the board members needed to come from outside of the Washington political arena and not represent the traditional spheres of influence, important as they may be, and expertise of law, of enforcement, of accounting, and government. Those are traditionally things that guide the agency, and they will continue to exert considerable, understandable, and necessary influence.

Second, the board needed continuity of membership. In other words, the board needed to outlive any particular administration or group of political appointees. That is why we have not only strong majority members coming from outside, coming from private life, but they are appointed for at least 5-year terms.

Third, the board needed very clear lines of authority that would make certain that we do not further muddle who was ultimately responsible and make Commissioner Rossotti's job even more difficult than it already is.

The Commissioner reported, in the old world, directly to the Deputy Secretary, but a number of other Treasury officials also reviewed and approved the IRS budget and operation of strategic plans.

The commission and this committee, Mr. Chairman, believe that the multiple lines of authority diffused throughout the department contributed significantly to IRS's problems, so we tried to clarify in statute the situation by proposing a board with expertise and continuity of membership that brings together various lines of authority to run through our governing entity.

Finally, the commission members spent a considerable amount of time, as did this committee, attempting to shape a board that would focus less on the day-to-day details of operating the IRS, and more on the big-picture strategic and operational issues.

They believe that a part-time board increased the likelihood that board members would remain focused on the big picture and, therefore, increased the likelihood of success.

The commission members also believed strongly in the importance of having a worker representative as a full-fledged member of the board. The union representative would ensure that employees have a voice in major strategic decisions and that there would be less chance for an impasse in implementing major reforms.

It is good for taxpayers because, in the end, their contact with the IRS is through its employees. If the employees are not fully behind the reforms, then ultimately taxpayers will be the ones to suffer.

Mr. Chairman, I repeat all this, hopefully briefly enough, only to refocus attention on why the commission and this committee established the IRS Oversight Board. I hope that Board will be up, running sooner rather than later.

I urge each nominee to review very thoroughly the recommendations of the IRS commission and, the report prepared by this committee on the powers and responsibilities of the board and its members.

The IRS has proceeded quite a ways on many of the reforms mandated by the Congress. One of the first jobs of the board will be to review many of these decisions and sort out whether these reforms are headed in the right direction.

Again, Mr. Chairman, I want to thank you for holding these hearings. I think they are terribly important and will enable us to determine what kind of progress we are making and what kind of course corrections are needed.

The CHAIRMAN. I have to advise that we have stacked votes at 12:00, so it is important that we proceed. I am going to ask all other members of the committee, if they have any opening statements, to include them as if read.

With that, I would like to proceed to our first panel, which includes Hon. David C. Williams, who is the Treasury IG for Tax Administration, which, of course, is an oversight office created by the IRS reform legislation.

Next, we have Mr. W. Val Oveson, the National Taxpayer Advocate, a most important position. Then Mr. James R. White, Director of Tax Policy and Administration Issues at the U.S. General Accounting Office.

Gentlemen, it is a pleasure to welcome you. Your entire statement will be included as if read, but I do ask that you limit your statements to 5 minutes because of the vote at noon.

Mr. Williams, please.

STATEMENT OF HON. DAVID C. WILLIAMS, TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, WASHINGTON, DC

Mr. WILLIAMS. Thank you, Mr. Chairman, Senator Moynihan, and members of the committee. I appreciate the opportunity to appear here today to discuss several points from my written testimony.

The Internal Revenue Service is engaged in a complex set of interdependent reform and restructuring initiatives across a broad

front and on a huge scale. It has entered into a computer modernization contract worth up to \$10 billion over a 15-year period.

It is reorganizing into operating units to serve groups of taxpayers with similar needs. It changed its mission statement to emphasize helping taxpayers meet their tax obligations. These actions require a major redesign of IRS business processes and procedures.

Against this difficult backdrop, the IRS must implement new tax legislation and continue normal operations. While progress is often occurring at a slow pace, positive results are being realized. The IRS has begun restructuring the organization into four operating divisions with new leaders now on board.

Electronic filing programs, popular with taxpayers, increased substantially last year and provided the ability to file returns online, producing faster returns and reducing errors and costs.

While we are pleased with this progress, my office also has some concerns.

Financial management improvements have been made, but inadequate accounting systems will (1) not meet financial standards for several years, (2) impose ongoing costs, (3) impede the ability to serve taxpayers adequately, and (4) prevent the IRS from effectively addressing material weaknesses cited by the GAO.

Although the IRS is making progress, RRA provisions that assure taxpayer protection and rights have not yet been successfully implemented.

Section 1204 prohibits IRS management from using tax enforcement statistics to evaluate employees or set quotas. During its reviews, the IRS and TIGTA identified approximately 621 violations.

IRS did not successfully implement RRA provisions for liens, levies, or seizure actions in one-third of the cases that my office reviewed.

With regard to 1203, or the "10 Deadly Sins," employees were concerned that they could be fired if they made honest mistakes, and TIGTA had a huge volume of these cases.

The Commissioner delivered a message explaining that only intentional wrongdoing would be punished. While my office received over 900 complaints, only 218 warranted investigation, and 87 have been referred to the IRS for adjudication.

Despite serious efforts to improve customer service, the cost of toll-free telephone service operation increased, while the level of service decreased, from 73 percent in 1998 to 51 percent in 1998.

Antiquated management information systems cannot adequately monitor financial and mission operations, often making it difficult to assess progress, compliance with the reforms, and identify vulnerabilities.

IRS enforcement activities have significantly declined. While IRS statistics indicate that in 1999 collections of corporate income taxes decreased by 2 percent, enforcement revenue has decreased by 13 percent, or \$5 billion, between 1996 and 1999, and seizures have dropped from over \$10,000 in 1996 to \$161 in 1999.

Modernization of the IRS's antiquated computer systems have been a major concern for more than a decade and is crucial to implementing the new business vision of providing world-class service. Although it is in its infancy, some of the short-term milestones

are behind schedule and hiring experienced technology staff is challenging.

Computer security weaknesses. Identification and security certification of sensitive computer systems continues to be a material weakness for the IRS. A disaster recovery plan should be improved and a more effective virus protection program is needed. Until these weaknesses are resolved, IRS systems and data are vulnerable to tampering, loss, and unauthorized disclosure.

Once the IRS has mapped its computer structure, it will be better able to identify security vulnerabilities and to detect access anomalies.

In closing, the IRS is undergoing significant challenges as it restructures, modernizes its systems, and redesigns its business processes. I feel that the current approach, while daunting, is the right one. Past efforts at reform have been ineffective and focused on symptoms rather than the ailments that have plagued the agency.

IRS and its stakeholders need to closely watch the velocity of the reforms, yet understand the magnitude of what is being done. Together, we need to maintain a determination that, this time, we are committed to making long-term improvements in the IRS. The IRS is an essential element of the Federal Government and must reflect the highest values of the American character.

I would be pleased to respond to questions that you have at the appropriate time.

The CHAIRMAN. Thank you, Mr. Williams.

Mr. Oveson?

[The prepared statement of Mr. Williams appears in the appendix.]

STATEMENT OF W. VAL OVESON, NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE, WASHINGTON, DC

Mr. OVESON. Thank you, Mr. Chairman, Mr. Moynihan, and other distinguished members of the committee. Thank you for inviting me to address you at this time and to talk about my annual report, as well as other topics.

This last year has been a year of incredible change for the Taxpayer Advocate Service and the Internal Revenue Service as a whole. Implementing the RRA 1998 provisions has been a major challenge.

The Taxpayer Advocate Service will continue to modernize during this coming fiscal year, and the new operating divisions of the IRS are currently beginning the process as well.

The process has been extremely painful for the Taxpayer Advocate Service, and it will be painful for the rest of the IRS. However, I firmly believe that taxpayers will only realize the improvements that you intended through the legislation if the modernization is allowed to continue over a long period of time.

We have finalized the independent reporting structure that you called for in the legislation. Every State has at least one taxpayer advocate now, and separate addresses, telephone numbers, and fax machines are available for the local advocates, as they are being published in the updated telephone directories around the country.

We have selected our leadership of the Taxpayer Advocate organization within the last year and are now completing the selection process for the remaining staff.

Aligning the leadership with the employees who are actually working on taxpayer cases is a critical objective of the reorganization and, I might add, it is a major objective of the reorganization of the IRS as a whole, to align the program managers with the line responsibility.

During fiscal year 1999, the taxpayer advocates worked on 293,000 taxpayer cases to help them resolve their problems with the IRS. 93,000 of those cases met the expanded criteria for hardship that you put in the legislation, and 200,000 of these cases were taxpayers seeking assistance under the old criteria.

Last year, there were only 32,000 taxpayers out of 300,000 that met the criteria. This change demonstrates your intent of having more cases qualify for consideration for taxpayer assistance orders is being achieved.

The dedicated employees of the Taxpayer Advocate Service are going the extra mile to assist taxpayers who need help. But even with a solid record of success, we know we must do more to search out and help those with more difficult problems that we have been struggling to deal with in the past.

While the ranking may have changed, the 20 most serious problems facing taxpayers and the 10 most litigated issues remain the same from last year, as I have reported in my annual report.

I believe that the changes being made as a result of the modernization are placing the Service in a better position to understand these problems and to make progress toward eliminating some of them for next year. Hopefully, that will happen, but there is a great deal that needs to be done in order for those to come off the list.

As I testified before this committee in April, I believe that the frequency and number of tax law changes over the last 15 years is one of the major causes of complexity, incidentally, the number one problem facing taxpayers in my report. I encourage you to slow down the rate of change or to ensure that future changes ~~simplify~~ rather than complicate.

I did identify 53 legislative proposals designed to reduce complexity and/or increase the ability of the IRS to provide relief to taxpayers. If you do change the Code, please carefully consider these proposals in your continued quest to help taxpayers.

The IRS faces many challenges during the next year, four of them I am going to single out for mention. First, I stated that Congress has liberated the IRS from the philosophy of maximizing revenue, as oftentimes epitomized as protecting the interest of the government.

I asserted that the new mission of the IRS was to balance the interest of the taxpayer with the interest of the government. It is imperative that we stay the course so that these changes can take root and become a long-term part of the IRS culture.

Second, the Service must be able to communicate with taxpayers regarding their account activity. This means that toll-free telephone service must be improved. To meet customer demand and

objectives, the Service must dedicate the resources necessary to answer the telephones timely.

Third, the handling of innocent spouse cases must be improved. The RRA 1998 provisions expanded the relief available to taxpayers, who are filing claims in record number.

The IRS faces a major challenge in reducing the processing times, increasing the training of staff, and ensuring that all levels of the agency internalize the philosophical shift now required by law in this area.

Fourth, the offer in compromise program must be improved. The legislation gave the Service new authority to compromise cases when it will promote effective tax administration.

Again, the challenge is to reduce the processing times, increase the training, and ensure that the spirit of this legislation is accomplished, as well as the letter of the law.

Thank you for giving me this opportunity to report on my office and to share my vision of the future. The taxpayer advocates are better positioned to help taxpayers because of the legislation and your work. I am confident that, with your sustained commitment and support, we can continue to do this.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Oveson.

Now, we will turn to Mr. White.

[The prepared statement of Mr. Oveson appears in the appendix.]

STATEMENT OF JAMES R. WHITE, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

Mr. WHITE. Mr. Chairman, Mr. Moynihan, and members of the committee, I am very pleased to be here today to discuss IRS' progress in implementing the taxpayer rights and protections mandates of the IRS Restructuring and Reform Act of 1998.

I will also discuss a related topic, the challenges IRS faces in its efforts to modernize. As Congress recognized in the Restructuring Act and as my statement today underscores, modernization is key to improving the way IRS interacts with taxpayers, including protecting their rights.

My statement today makes three points. First, IRS is making a concerted effort to implement the taxpayer protection provisions of the Restructuring Act. For each of the provisions in the Act, IRS has delegated lead responsibility for implementation to the affected organizational unit and required those units to develop detailed implementation plans.

According to IRS officials, the agency has met all of the statutory requirements for the provisions whose effective dates have passed.

Not surprisingly, given the magnitude of the changes in the Act, there are implementation steps that remain. For some provisions, IRS has issued temporary procedures pending final rulemaking.

In other cases, we questioned the sufficiency of the planned implementation. As an example, we identified some basic problems with IRS' process for selling seized assets, such as lack of competitive bidding, that were not being addressed by IRS' implementation of the Act's new requirements regarding seizures. We made several

recommendations, and IRS generally agreed to adjust its implementation plans.

Another area where steps remain in implementing the Act is evaluating the effectiveness of implementation. Here, an example is the prohibition on use of enforcement statistics when evaluating employees. IRS has taken a number of steps to implement this mandate; however, IRS does not yet have data, such as employee survey results, to know whether the steps taken have been effective.

My second point today is that IRS has experienced some difficulties in implementing the Restructuring Act. Two notable examples are the decline in the number of enforcement actions, particularly liens, levies and seizures, and the backlog of innocent spouse cases.

IRS' use of enforcement actions to collect delinquent taxes has declined significantly. Comparing pre-Restructuring Act data to fiscal year 1999 data shows that lien filings were down 69 percent, levies were down 86 percent, and asset seizures were down 98 percent.

We do not know the precise number of enforcement actions that IRS should take, but we do know, based on our work, that the number of seizures is now probably too low. We base this conclusion on the fact that, in fiscal year 1997, about 42 percent of seizure actions resulted in delinquent taxpayers producing funds to fully pay their tax debts and having their assets returned. This was after they had been unresponsive to other IRS collection efforts, including letters, phone calls, personal visits, and levies of bank accounts and wages.

As to the causes of the decline, front-line employees repeatedly expressed concerns to us about lack of adequate guidance on when to make seizures in light of Restructuring Act changes.

For this reason, and because voluntary tax compliance depends on taxpayers having confidence that their neighbors or competitors are complying with the tax laws, we made recommendations to IRS aimed at clarifying when seizures ought to be made, and how. IRS has generally agreed to implement the recommendations.

A second difficulty in implementing the Restructuring Act has been the volume of innocent spouse cases. As of October 1999, 41,000 relief requests had been received, and about 12 percent of those had been processed. This is one example of the importance of achieving efficiency gains at IRS. Efficiency gains are needed if IRS is to be able to reallocate resources to better serving taxpayers.

My third point today is that IRS' modernization efforts hold promise for creating a culture that is focused on better service to taxpayers and generating efficiency improvements. Both are necessary if the IRS is to fulfill the Restructuring Act's mandate to place greater emphasis on taxpayer rights and needs.

To better serve taxpayers and generate efficiency gains, the IRS has begun to implement a multi-faceted modernization strategy. The strategy includes an organizational structure centered on four types of taxpayers, more accountability for managers, a performance management system that aligns strategic level, program level, and employee level performance measures and creates incentives to support agency goals, and modern information systems to better identify taxpayer needs and manage IRS programs.

Successfully implementing such a comprehensive modernization strategy will be a challenge. However, we believe the strategy has IRS headed in the right direction. If successful, IRS will be better able to create a culture focused on serving the public.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or other members of the committee may have.

[The prepared statement of Mr. White appears in the appendix.]

The CHAIRMAN. Gentlemen, thank you for your testimony.

I would like to say to the panel, I am going to try to complete as expeditiously as possible the questioning of these witnesses because, of course, we have the Commissioner coming before us, and then we are bound on the other side with the vote. So I will try to complete, and would hope that we could all complete, by 11:00. All will be entitled to submit written questions, throughout today to the panel.

Now, a number of you have mentioned the innocent spouses. We understand that the IRS has a backlog of over 46,000 innocent spouse claims. My question is, is the IRS resolving these claims? What must be done to provide relief to innocent spouses who have a valid claim? I would invite any of you to respond.

Mr. WILLIAMS. I could begin. That is a concern. I know the Commissioner takes it very seriously. Some of this was a readiness issue. I think, as I said, the Commissioner inherited a poor management information system and it blinded us to what was coming in the direction of the IRS, and we understaffed the effort considerably. The backlog a year ago was 6,000, in April it grew to 11,000, and, as you said, Mr. Chairman, it is currently at 46,000.

In December, we did begin to match the amount of outgoing cases with the amount of incoming cases, so we think we might be learning at this point exactly what is coming in our direction. That leaves us with a serious backlog, and I know that you want that backlog addressed in a timely fashion.

With that many cases, I think there is the danger that this could take months or years to cause the backlog to be worked down, which I know is not acceptable. I would say that is the risk that we have if the current staff levels remain. There can be efficiencies, but I think the current staff levels are small for the size of the backlog.

The CHAIRMAN. Any other comment?

Mr. OVESON. Yes, I would like to comment. Again, the volume of cases were not totally expected. The statute that you passed is very complicated, and a lot of training needs to be done.

And, as I mentioned in my testimony, I believe that catching the spirit of the legislation and allowing that spirit to permeate the process is also an issue that needs to be addressed more thoroughly.

I am in contact with Commissioner Rossotti day to day on this issue, and I do not know that I have seen him spend as much time and attention on an issue as he has this one, other than the Y2K issues and some of the computer issues that have come up. He understands the gravity of the situation, and I am confident that resources and effort are being put to the issue to solve it.

But I am extremely concerned about it. A high number of our cases come from these individuals that have not been assisted, and helped, or do not know what their status is at this time. I am very concerned about it, but I am optimistic that the appropriate amount of resources are being placed to address it.

The CHAIRMAN. Mr. White?

Mr. WHITE. Mr. Chairman, I would just say that this highlights the importance of efficiency gains throughout IRS as the result of modernization. Dealing with the innocent spouse cases is a labor-intensive process that requires, in many cases, face-to-face interaction with the taxpayers. Moving resources from one part of IRS into this program means getting efficiency gains elsewhere so that those resources are freed up.

The CHAIRMAN. Well, I would just conclude, and I agree with what you said, Mr. Williams, it is not satisfactory. We do have to find some answers. I think our taxpayers are entitled to prompt resolution of their problems.

Let me also mention this question of seizure and levying taxpayers' property. Now, I think we would all agree, we did not want computers kicking out liens, levies, and seizures without due process.

However, I have to say that I am concerned about the 98 percent decrease in seizures and 68 percent decrease in levies. The IRS is in the business of collecting taxes, but, at the same time, it must treat taxpayers fairly.

I believe that this drastic decrease is probably due to the transition to the new law, a new organization, and the learning curve. I would like to hear your comments on why you think this happened, and what we should be doing about it.

Mr. Williams?

Mr. WILLIAMS. I think that those were probably the most objective account of what occurred. I think that, in addition to those—and those factors do explain the decline—there was, and continues to be, concern on the part of the employees. They are going through a transition.

It is quite a diversion for them. There was concern with the provisions of 1203 that the Commissioner addressed and that I know you addressed. I think the psychological factors are an element of the problem that I would identify.

Primarily, our manpower levels were down at the start. We did need to implement the new law. We could not use the old rules. That caused a bit of a delay, and then the resources to implement the new law all caused a decline.

I believe the ship was turning, though, as you said, and I would imagine that, as calm and normal sea returns to the organization, we will see those come back up. But it is certainly something where we are going to keep our finger on the pulse of for that particular indicator.

The CHAIRMAN. Any further comments? Mr. White.

Mr. WHITE. I think, Mr. Chairman, there are probably multiple factors at work. In the course of our work on seizures, we talked to many revenue officers, front-line field staff. They told us repeatedly that one of the problems they perceived from their point of view was lack of adequate guidance on when to conduct seizures.

So in that report, we made recommendations to IRS about when and how to conduct seizures, providing better guidance on when and how to conduct seizures, and they agreed that they would change their implementation plans.

The CHAIRMAN. Thank you.

I now will turn to Senator Moynihan.

Senator MOYNIHAN. Thank you, sir. Thank you for excellent testimony, all.

I would like to use my time to concentrate, if I may, on Mr. Oveson's remark that complexity "remains the single most complicating factor in tax administration." That it is. It is the frequency and number of changes to the tax law. He hopes this Congress will do something to reduce the complexity of the existing laws, or at least slow down the frequency of the changes.

If I can give my colleagues an example, the House Committee on Ways and Means, at 2:00 today, will start marking up legislation to get rid of the marriage penalty.

I am prepared to say here that it will not be less than a 50-page bill, adding—I do not know what the factor is—another 10 pages to the Internal Revenue Code. You could accomplish what they putatively desire with one line which says that all married taxpayers are free to file a joint return or two single returns. That is all. Then everybody would have their options and they could pick them. But that is too simple. Somehow, sir, we have lost, if we had it—I think we had—some legislative pride in the simplicity of our measures.

It is common in the last hours of a Congress for the White House and the House negotiators to come up with this 1,200-page monster, we vote for it, nobody knows what is in it. It is left to the poor souls in the IRS to figure it out, and if they do not do very well, Mr. Oveson is surely correct. I think we have to change our ethos. We have to reward a quest for simplicity.

And, Mr. Chairman, I make so bold as to suggest we could not do better than to follow up on the National Commission on Restructuring the IRS—that Senator Kerrey and Senator Grassley did such a brilliant job with—headed by these two same distinguished persons, and say, how do you bring simplicity, to agree that, if rewarded in our legislation and not derided or whatever else. I just think it is so important, and I hope when Mr. Kerrey has a chance to speak, he will comment on that.

The CHAIRMAN. Thank you.

Let me just point out, I think our manner of addressing the marriage penalty last time was pretty much what you must outlined. We could have probably said it in eight pages, but that's part of the problem.

Senator MOYNIHAN. Which will suggest to the House that you are not serious, if you do it simply.

The CHAIRMAN. Again, we are trying to push on because we want to give the Commissioner sufficient time, and we do have these votes.

I think our next in line is Mr. Kerrey.

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

Well, I agree with Senator Moynihan. The problem with tax simplification is that additional tax breaks almost always produce a

round of applause, and sometimes even a standing ovation. I counted. I stood 88 times during the State of the Union, and I may have stood 20 times for tax breaks that the President proposed.

Under the law, we did give the Commissioner authority to comment and to tell us what those additional things might cost in terms of taxpayer compliance. It is estimated to cost \$200 billion for taxpayers just to get through the filing season. So, it may be that the law itself is all we need.

I know that the IRS Oversight Board will give the Commissioner some additional, dare I say the word, cover when that occurs, because the problem is, of course, he may be commenting negatively on the President's own proposal, or perhaps one of our own proposals, and we politicians do not take kindly to being criticized.

It seems to me that that is what we need, some mechanism that enables us to measure whether or not the round of applause can be checked with reality to determine whether or not there is a benefit to what we are trying to do.

So certainly if the Chair and Ranking Member were interested in doing it, I would not be hesitant to volunteer, along with Senator Grassley, to examine that.

Mr. Williams, you did not comment on this in your testimony, but one of the things that it seems to me we need to think about as we try to figure out how to make technology work is what the private sector itself is doing.

I know that when Commissioner Rossotti and I had some conversations as we were writing the law about making certain that the IRS was not prohibited from making offerings on the web or electronically, we wanted to make sure the IRS was not prohibited from making offerings at the same time that we were trying to increase the likelihood in the marketplace that private sector offerings would be used by filers as well.

During the commission's deliberations, we were quite impressed with how the private sector thinks because the marketplace has real penalties. If you do not get it right with customers out there, the customers are going to go someplace else. There is no monopoly out there in the private sector.

As a consequence, they are thinking about the customer all the time. They cannot afford to have the kind of percentage of customer dissatisfaction, phones not being answered, and so forth. They just will not survive if that is going on.

I am wondering if you have given some thought, or if you have considered, how can we use the forces of the marketplace, without surrendering the IRS's right to have offerings as well? How can we use the forces of the marketplace to get this technology thing right? Because it is quite expensive when we get it wrong.

Mr. WILLIAMS. Yes, it is, sir. The IRS is hovering, I hope, above a terrible crash site in an earlier computer investment that spent \$4 billion and produced almost nothing. A lot of lessons were learned from that, and your study provided light as well, to lead the IRS to where it is today. It is a huge investment, \$10 billion that we are poised to invest this time.

There are some differences. The differences begin with the Commissioner. He comes from the private sector, the leading edge of the private sector, with 20 years of developing systems.

Another difference, is that there is a steering committee this time to watch and to monitor closely whether progress is being made or whether plans are slipping.

We also brought from the private sector a prime contractor to work in partnership with the government-executives. You also allowed personnel provisions to permit the IRS to bring in some people that were willing to provide public service, but unable to afford to allow them higher salaries. So we see a much closer partnership and integration between the private sector and the government this time.

Senator KERREY. What I am thinking, Mr. Williams, is that it does not matter. If the customer is happy, it does not matter who is doing the work. If the filer is happy, the citizen is happy with the work, it does not matter to me if it is being done by Acme Tax Filing Service out there in the private sector or it is being done by the IRS, if you have a happy customer, that is all the matters.

It does seem to me, and I suspect Commissioner Rossotti would agree from his own experience in the private sector, that the discipline of the marketplace increases the chances that the customers are going to be happy as a consequence of what happens if you do not have a satisfied customer, at least in a non-monopoly situation.

The question is, how can we use that discipline to increase the chances that the couple hundred million people or more that are filing with the IRS get that same kind of satisfied attention?

Mr. WILLIAMS. We have measured our success as a government agency in a set of balanced measures. Some of them involve performance, but also a very strong emphasis on customer service.

Senator KERREY. The light is going on. This is, perhaps, something we are going to have to talk about at a later time, because I would really like to see the IG's Office evaluate whether or not we could use the forces of the market more, again, without surrendering the IRS's right to be able to offer competitive service as well. The playing field needs to be leveled.

But I am quite impressed with what the market is doing. If you watch what market businesses are doing out there, if they know they have got to innovate and they have to innovate according to customer demand—if they do not innovate according to customer demand, they do not survive.

In that kind of environment, the chance is, the customer is going to say, this is great, I am happy, the web site is terrific, I got my question answered. It is much more likely that the customer is going to be happy. If the customer is happy, the Restructuring Act is going to work.

So, I would appreciate it if the IG's Office could give a little more attention to that question.

Mr. WILLIAMS. We would, and we would be pleased to come and talk with you and your staff as well to make sure that we understand your concerns.

Senator KERREY. Thank you.

The CHAIRMAN. Thank you, Senator Kerrey.

Senator Graham?

Senator GRAHAM. Thank you, Mr. Chairman.

I would like to commend you and Senator Moynihan for holding this hearing. I think that too frequently Congress creates legislative orphans.

We pass legislation and then abandon it, often turning it over to a hostile and abusive foster home in the Executive Branch, and the very reasons that led to us to want to bring the child into the earth are defeated by the failure to properly nurture the child. So I am glad that we are looking out for this child and seeing how well he or she is maturing.

One of the concerns that was expressed when we were having the hearings on the IRS reform effort, is that we might go too far and adversely affect one of the fundamental missions of the IRS, which is to be a revenue collection agency.

Each of you has commented to some degree on that, including the specific suggestion that agents did not feel as if they had adequate direction and, therefore, were inhibited from taking more aggressive collection action.

Based on the limited amount of experience that we have had, are you at a point to recommend any, either budgetary supplements such as an areas of training, or legislative law changes that would establish the proper balance between service to taxpayers and ability to meet the broad needs of society for a fair and equitable tax collection system?

Mr. WILLIAMS. I have the sense that I expressed earlier that a lot of the loss of activity on the enforcement side was transitional. I think that when the guidance is implemented and the new regulations are on stream and familiar, those figures will rise again.

We also know that the 2001 budget allows the IRS to stop borrowing from the enforcement side for things like customer service. It right-sizes the various initiatives and divisions including enforcement.

I have the idea that things are going to be all right. There was a difficult transition, a dramatic change for the agency, both exciting and traumatic, and that some of the setbacks that I outlined today are going to right themselves with actions that you have already taken.

Mr. WHITE. Senator, I think you mentioned training. Training is obviously important. I think training needs to be complemented, though, by, for example, performance measures that create incentives to perform in accordance with the spirit of the Restructuring Act so that it is not just the letter of the law that is being complied with, but the spirit of the law.

That requires a different set of incentives for middle level managers at IRS and front-line employees at IRS than they have had in the past. The new performance measures that are part of this integrated approach to modernization that the Commissioner is leading are designed to create those new incentives.

The other point I would make here, again, is that efficiency gains throughout the agency hold the promise of allowing resources to be reallocated inside IRS to some of these needs created by the change in emphasis to more and better service to taxpayers.

Mr. OVESON. Senator, throughout my testimony and in my annual report, I have emphasized the importance of sticking with the

plan that you have outlined for the IRS in the legislation that you passed a year and a half ago.

There is no question that enforcement activity has decreased, and there are lots of different reasons for that, including a decrease in the overall employment at the IRS, the shifts that have been made, the innocent spouse issue that we have already talked about.

The shifting away from other compliance activity in order to address the backlog of innocent spouse cases is one of the reasons that compliance activity has gone down. But it is critical that we not overreact to that and scrap the progress that is being made and the plans that have been laid out.

We need to let it mature, as you have said. We have not only an adolescent child, we have got a 2-year-old out here that we need to nurture and let become an adult. When that happens, I think there will be a lot of progress made, but it is going to be rocky.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Breaux?

Senator BREAU. Thank you, Mr. Chairman.

I was just wondering. Reading some of the material that I have seen on this matter gives me a little bit of concern. After we did the IRS Restructuring and Reform Act, everybody felt we had made some real progress in giving the IRS some new tools, but also some new focus on how we would like to see the agency treat taxpayers and protect taxpayer rights. But we did not send any kind of message that there should be less enforcement. At least, hopefully, I do not think we did that.

But some of the information I would like to ask you to comment on, seems to me, a little disturbing. The GAO and the Treasury Inspector General for Tax Administration, and I am sure the Commissioner, are all concerned with what I see as a large drop in collection and some enforcement activities which seems to have occurred after we passed the reform bill. I am wondering, what is the connection here?

For example, the New York Times reported in December that seizures had dropped from 10,000 in fiscal year 1997 to 161 in fiscal 1999. The number of audits from fiscal year 2000 will be down 30 to 40 percent, which is already down from a record low of 2 years ago.

There is also some evidence that there is a relative decline in the collection of corporate tax receipts as well. GAO, as in your testimony here this morning, continues this by saying that, in fiscal year 1999, the number of lien filings decreased 69 percent, number of levies decreased 86 percent, number of seizures decreased 98 percent, and that collections from delinquent taxpayers were down \$2 billion from fiscal year 1996.

Is all this the result of the bill we passed, and if so, can we withdraw it? I mean, is there a connection here, and if not, what is happening out there? Can anybody comment on this?

Mr. WHITE. Senator, I think there is a distinction that needs to be made between the bill and implementation of the bill. Our findings in the seizure work we did in talking to front-line IRS employees was that they felt they had a lack of guidance from manage-

ment at IRS on how they should behave, given the changes made by the Restructuring Act.

Senator BREAUX. Is that the same for levies and seizures, everything?

Mr. WHITE. Well, the most in-depth work we did on the seizures issue.

Senator BREAUX. Do you think the same reason is related to the drop of 69 percent in lien filings, the decrease of 86 percent in levies against taxpayers?

Mr. WHITE. The nature of the comments we were getting from IRS front-line staff would suggest that. Again, we did more in-depth work on the seizure side. We also talked to IRS officials about this issue. They understand it is an issue.

They agreed with us that there was a need for better guidance there, and took steps, or are in the process of taking steps, to provide that kind of guidance. They also told us—and this gets to the transition point—that they believe that the number of enforcement actions will rebound.

Senator BREAUX. Well, I can understand that there would be a period to try and adjust to the new rules, new standards, and the new regulations, but these are really significant statistics in all of these areas of enforcement.

I do not think anyone in Congress said, do not enforce the legitimate laws against taxpayers. I think we were talking about how we treat taxpayers, and in giving them a fair opportunity to be heard and represented, to have someone on their side.

But in no way do I think this Congress, and particularly this committee, tried to send a signal that we do not want you to do the things that are necessary to collect legitimately-owed dollars to the U.S. Treasury. This is really alarming. If it is just one snapshot of a significant drop, that is one thing.

I will tell you, if we think this is going to happen again the next year and the next year, how long is it going to take for people to adjust to what Congress did? I have just got some real concerns about that.

Mr. WILLIAMS. There were some variables at work that were unrelated to the passage of the restructuring, and the restructuring is a variable as well. The reforms hit the IRS at a moment when their staff levels had been down from traditional levels in the compliance area. Revenue officers were down 14 percent, revenue agents 13 percent, tax auditors 24 percent at the moment of passage. The second factor, is there had to be a time in which the IRS implemented the law, and that did cause a gap and a decline. We could not enforce it on the first day of passage; there needed to be time to train and to develop procedures. That was one of the things that caused a hit on performance, too.

Senator BREAUX. I am not trying, obviously, to berate the agency. I have a great deal of respect for Charles and for what you all are trying to do. You are good people, trying very hard.

But I think that the message has to clearly go forth that we are not indicating, as a result of the Restructuring and Reform Act, that the IRS is not going to use to the fullest extent of the law, the legitimate and legal enforcement mechanisms that we have.

If people somehow think that this is going to continue, there is going to be a huge, I think, by human nature, attitude of, "well, maybe I can get away with it because I am not going to be facing a lien, or a seizure, or an audit, and I can get away with not following the law." That should not be the impression, and I know that you do not intend to convey that.

Thank you very much.

The CHAIRMAN. Just let me make the observation that there is nothing in the reform legislation that says the IRS is not to enforce our tax laws. Of course they are. The fact is, we want to make sure that, in enforcing the tax laws and securing the revenue, we treat taxpayers fairly and with due process. That is all we are suggesting. But there is nothing in the legislation to deny or take away their responsibility to enforce the tax laws.

Now I would be happy to call on Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

I would like to pick up on this same theme, because these numbers really do leap out at you. It follows very much what I have heard via the grapevine, and I think it is a real concern. I used to be a tax administrator. I was North Dakota's tax commissioner for 6 years and chairman of the Multi-State Tax Commission during part of that time.

I found very few people who were happy about paying taxes, but they became a lot less happy when they found out somebody else who had a requirement to pay was not paying and even more of the burden was being shifted to the vast majority of honest taxpayers. My experience is, the vast majority of people are honest. I know that is the case in North Dakota; I believe that is the case in the rest of the country.

So when I see an 86 percent reduction in the number of levies and a 69 percent reduction in lien filings, that sends a message to me that we have a problem. We have a problem that, in part, from what I have heard via the grapevine, was created by us because I have heard employees of the IRS say that they think Congress was sending a message that they do not want them to vigorously enforce the law, and if they do vigorously enforce the law, we are going to come after them.

Somehow, we have got to be very clear here that we intend to enforce the laws that are on the books with everyone in this country. There is not going to be a small group of people here who have a tax liability and they do not have to pay, and the rest of us do. That is not right, that is not fair, that is not acceptable.

At the same time, we have got to send the very clear signal that we will not tolerate abusive activity. There is a real difference here between not tolerating abusive activity and sending a message that we do not intend to enforce the law.

I think we have had an overreaction. I think, in part, we are responsible for that. We have got to do a better job of sending the very clear message that everybody in America is subject to the law. Everyone is under the law.

I would be very interested in what the witnesses believe we could do to make sure that message is received. Mr. Williams?

Mr. WILLIAMS. Well, actually, the hearing today could become very important, and everyone's statement and firm position on this

factor. Of all the trends inside the IRS that I see, this is the one that worries me the most and this is the one that we need to most closely keep under surveillance.

Earlier, in addition to the things I just said, we did talk about the psychological factor. I think the employees did feel somewhat wounded by the legislation and the need to reform. I think they felt there was some legitimate fear on their part that I believe has declined.

With regard to the provisions of 1203, those are intangible, but real. I think, along with the other things that are righting themselves, there has been progress in that area, too. There has certainly been a commitment on the part of the Commissioner and the Deputy Commissioner to try to express what you just expressed to all the employees.

I think they are also seeing that the history of 1203 enforcement is showing that only actions are being taken in very egregious cases, and those are being communicated clearly and well, and that no harm will befall you for honest mistakes.

Senator CONRAD. Mr. Oveson?

Mr. OVESON. I talked about this, again, in my testimony, my report, and in other questions here today, one of the most important things for you to not do is to overreact to those statistics. Changes did need to be made, and cultural changes are happening within the IRS. It is important that we do not have an overreaction taking us back the other way at this point in time.

In fact, many of the problems that we have seen in the past with the abuses and the problems that you attempted to correct through this legislation were a result of overreactions in the past.

Big swings in the pendulum cause this problem, but to chart a reasonable course that has excellent customer service as its base which includes reasonable enforcement and that is sustained over time, is what we need. We need your support in order to sustain that reasonable course.

Senator CONRAD. I agree, it is important not to overreact. But I will tell you, many times I have seen people who have gotten very clear signals being sent them that there is a problem that do not react at all, and I hope that that does not happen either.

These numbers, if they are accurate, and I assume they are, send a very clear message. We have had an overreaction going the other way.

I will tell you, when I was tax commissioner I found that there is a group of people out there who think they are above the law. They think everybody else should pay and that they are exempt. Well, the message ought to go out very clearly and very directly, that is not the way it works.

I thank the Chairman.

The CHAIRMAN. Thank you, Senator Conrad.

Mr. White, did you have any comment you wanted to make?

Mr. WHITE. Just on that point, Mr. Chairman. I would add that I mentioned the recommendations regarding clearer guidance that we made. The point of that recommendation was that we felt that the front-line revenue officers needed some positive guidance, so they had not just guidance on what not to do, but also guidance

on when seizures ought to be taken. Their direct supervisors had similar guidance and were held accountable for that.

The CHAIRMAN. I think that is a very important point.

Gentlemen, I want to thank you. I think the testimony of the three witnesses has been outstanding. We appreciate your candor.

As I mentioned, we will submit written questions. We would ask for them to be returned promptly. We are going to have continuing oversight to ensure that we keep on course, and I want to thank you for what you gentlemen have done.

Thank you very much.

Senator MOYNIHAN. Thank you very much.

The CHAIRMAN. I now call forward the Commissioner of Internal Revenue, Charles O. Rossotti.

Charles, it is always good to see you. I appreciate your being here today, and appreciate the leadership you are showing.

As you well know, your entire statement will be included as if read, so please proceed.

STATEMENT OF HON. CHARLES O. ROSSOTTI, COMMISSIONER OF INTERNAL REVENUE, WASHINGTON, DC

Commissioner ROSSOTTI. Thank you very much, Mr. Chairman, Senator Moynihan, Senator Breaux. I really appreciate the opportunity to come here and talk about the progress, as well as the problems, we are having in implementing this landmark Act which you were so instrumental in passing 18 months ago.

In this Act, I believe Congress set forth three goals for the IRS to achieve. One of them, is to respect taxpayer rights and provide high-quality service to every taxpayer. The second one, is that we must ensure that the taxes that are due are paid. Third, in an era of tight budget caps, we have to do all this with increasing efficiency.

I just want to stress, especially in light of the comments just finished, that I do not think we can be successful unless we achieve all three of these goals.

Our purpose is not to swing a pendulum back and forth a few degrees, it is actually to improve the entire way that the IRS works.

Now, in order to fulfill this mandate, many changes are required. These include implementing many provisions of the law, as well as changes in the way people are managed and evaluated, the way the organization is structured, and reengineering and replacing nearly every one of our business systems.

For the last 18 months while beginning this pervasive change, the IRS also had to continue to provide service to taxpayers during each filing season, administering over 800 tax law changes, and completing the critical programs related to the century date change, making sure our computers would continue to work.

In addition, we received recommendations from many other sources about pressing changes that needed to be made either to improve service or to fix problems. For example, over the last year, the IRS received 58 audit reports from the Treasury Inspector General for Tax Administration with 314 recommendations for changes and improvements, 74 reports from GAO, and at the present time there are 127 IG and 36 GAO audits under way.

So, in this context, our priority over the last 18 months was implementation of the taxpayer rights provisions of the Act in accord with the law. Our capacity was stretched to the limit. Our initial focus was on ensuring legal compliance.

As an example, in fiscal 1999 we provided over two million hours of training to our employees just on the provisions of the Act, and we estimated that about 3,000 full-time personnel equivalents were required just for the administration of these provisions.

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

Just to describe a little more concretely some of the issues we face, I would like to summarize how we have managed just one of the 71 taxpayer rights provisions, and this is the innocent spouse provision, which generally permits one spouse who filed a joint income tax return to be relieved of part or all of the unpaid liabilities associated with a joint return.

In the 1998 Act, Congress added three new provisions to one that was already in the law, and each of these provisions defined a different set of conditions under which one of the spouses may be granted relief from the originally filed return.

This chart on your left, which I do not expect you to be able to see but is in the written testimony, is just to illustrate what is involved in processing one innocent spouse claim. It is a flow chart that we are providing to our employees to guide them through the decision process for providing a decision on one claim.

This particular provision, as with some of the others, presented a situation in which we had many unknowns, both as to how to interpret and explain the law to taxpayers and to our own employees, as well as uncertainty as to the number and factors of the requests we would encounter.

Over the last 18 months, we have taken many actions to learn how to manage this program effectively and efficiently. We are making, now, some substantial progress.

There is another chart which is about to be put up which is simply a chronology of the steps that we have already taken, the major steps that we have taken to manage and improve the way the we are managing this program, and some of the additional steps are on there as well.

By the end of this year, we expect to reduce the inventory of cases from 46,000 at the present to under 30,000 and to be on a path to reduce it further. I think, really, this particular provision, as well as the others, really illustrate both the difficulties that we have to overcome in trying to administer this law efficiently, but also the reasons why, if you look at the things we have been able to do, we think that it is possible to achieve efficient administration in a fair and effective way in accord with the intentions of Congress.

Now, one of the most difficult managerial challenges we face is reconciling the need to achieve near-term progress on things like innocent spouse with the need to address the fundamental factors that have caused many of IRS's problems to persist over a period of time.

Most of the improvements identified by our stakeholders require a combination of top management attention, staff and financial resources, and information systems improvements. The dilemma we face every day, is that these resources are scarce.

Sometimes the short-term solutions conflict with the approach we need to take to address the more fundamental underlying problems, and nowhere is that dilemma more excruciatingly difficult than with our information systems.

For these reasons, we are very carefully planning our near-term changes while aggressively pursuing our plan to modernize the organization structure, our business practices, and our technology.

We are learning from other large organizations best practices and creating an organizational structure with four customer-focused operating units, each serving taxpayers with similar needs.

I am pleased to say that the commissioners for each of these four divisions have now been selected and sworn into office, and will eventually replace 43 heads of office as the new divisions become fully operational.

The heads of other key units, including Taxpayer Advocate, who was here today, Criminal Investigation, Information Systems, and agency-wide shared services have also been recruited.

The backgrounds of these outstanding individuals are included in my written testimony. These people, I believe, have accepted these very demanding jobs simply because they are committed to making the modernization of the IRS work. I want to thank this committee for supporting the personnel flexibilities that made it possible to assemble this team.

Now, over a year ago the IRS awarded the PRIME contract that helped begin the long process of modernizing our core business and technology systems. We have now defined our major projects and expect to begin delivering some new capabilities in 2001.

I spoke earlier of the need for continued support and commitment to carrying out the Act's goals. I want to note that, over the last 5 years, we have seen a budget trend that has been characterized by increasing work load, increasing public expectations, and decreasing staff resources.

These budget constraints have also often meant providing less than acceptable service to our compliant taxpayers, while reducing the level of enforcement activity.

We believe an ongoing investment in reengineering business practices and technology will allow us to deliver on the Act's mandates for both improved service and taxpayer treatment, and increase the compliance effectiveness.

This approach will require adding limited numbers of staff in particular functions and locations. But most of the demand for additional workload and service will be met by reassigning or increasing the effectiveness of staff to reengineering and technology.

The President's budget request for fiscal 2001 will provide for these two key elements, limited increases in the number of staff and adequate investments in business and technology reengineering. It is extremely important for successful implementation of the Act that the President's budget request be funded by the Congress.

Mr. Chairman, I believe we are making progress on the goals and mandates of the Act. It is true that no one fully understood how to implement all these provisions and exactly how they would play out, but I do believe we have set into motion a mechanism that will enable us to be successful if we sustain our course.

If we can provide our employees with continued and assured support, I think they will provide visible, tangible changes in service, compliance, and productivity, and I think that is what the taxpayers and the Congress expects.

Thank you, Mr. Chairman.

[The prepared statement of Commissioner Rossotti appears in the appendix.]

The CHAIRMAN. Well, thank you, Mr. Commissioner. Let us go over some of the ground you have raised, because I think it is of such critical importance.

What we are really trying to do here is to bring the IRS into the 21st century. This is a major, major reform effort. When you stop and consider what it entails, you are trying to reduce, for example, something like 43 different districts and service center offices, however you want to characterize them, into four operating offices focusing on the taxpayer.

You are also trying to correct the problems we have been having with computers. Before you took over, there was a loss of something like \$4 billion that was spent with little result. You are moving on that.

You have brought in a new management team. I think it is critically important to understand that, by giving some flexibility in the legislation, you were able to attract the kind of people that too often, for obvious reasons, do not choose to leave the private sector. So, you were given the tools to develop a top-notch management team.

Now, as you have said, we are entering a very, very critical transition period. Could you briefly summarize, where IRS reform is today, when taxpayers will actually feel tangible benefits and the importance of this year?

Commissioner ROSSOTTI. Yes, certainly, Mr. Chairman.

First of all, as far as taxpayers, although I would be the first one to acknowledge we have so much more to do, I also believe that many taxpayers have already seen some tangible benefits. For example, in our filing season activities this year, I think we will see some improved service. We have extended our hours of service.

The Taxpayer Advocate who was here today has done excellent work in resolving some of the more difficult kinds of cases that you highlighted in your hearings. We have done a large number of other, smaller things, such as rewriting certain kinds of notices that are helping taxpayers. These are short-term improvements.

I think that, however, our pace of improvement will begin to pick up, particularly in 2001, because this is the year, really, where we are completing many of the transition stages, completing the organizational changes.

And, as I had mentioned, we have now implemented at a first level our legal compliance with the many provisions of the Act, and we now have the opportunity to work on improving the quality, effectiveness, and efficiency, which is really what we have to do.

Our goal was to have some visible improvements year by year. I think we have done that. I think the pace of those improvements that are visible to the taxpayers will begin to pick up as we deliver new technology and we complete some of our restructuring at the end of this year.

The CHAIRMAN. Let me go back to the problem that there are a lot of people around the country who feel that they do not see any benefit. Yes, they say, it may be reformed, but what good are its provisions, and they point to the question of the 46,000 innocent spouse claims, they have heard that the number of seizures has dropped significantly, yet over one-third of seizures actually taken violated the law. What is our explanation? What do we say to the taxpayer?

Commissioner ROSSOTTI. Well, I think that with respect to the innocent spouse claims, it is really a different issue than the seizures, as I tried to say in my oral testimony.

The CHAIRMAN. Right.

Commissioner ROSSOTTI. The real problem with the innocent spouse claims, in addition to just the sheer numbers, was simply learning how to adjudicate these claims effectively, and that is why I showed the large flow chart that we are trying to use.

There are four different sections, and each claim has to be evaluated against each one. We are really quite determined to get it right, and get each claim right. In order to do that, at the present time we are actually reviewing each claim twice because some of the provisions, especially the section that deals with equitable relief, are still a bit unclear.

So we have invested time to try to get it right, and in some cases this has meant taking more time to get the results out to the taxpayer.

Fortunately, I think that, in this particular case, as a result of many of the actions we have taken, we did reach a break-even point in the fourth quarter of last year where the number of claims coming in was about equal to the number that we were deciding. Our best estimate is that we are beginning now, during 2000, to start to work off this backlog.

So I think that what we really expect to happen this year, is two things. One, is we will continue to get each one right. That is what we are determined to do. We are now somewhat well up the learning curve where we can begin to process enough of them to meet the backlog.

I would note that, in some cases, out of the 46,000, there are about 7,000 of those where the taxpayer has actually been notified of the determination and we just have some post processing, accounting and reviews.

So, there is really about 39,000 that are in the backlog that the taxpayer has not been notified, and I would expect that we will get that down significantly this year.

The CHAIRMAN. Let me turn to Section 1203, the so-called "10 Deadly Sins." There appears to be a great deal of confusion among IRS employees regarding the interpretation of this section relating to IRS employee misconduct.

Now, you and I know that an employee should not, and would not, be fired under this section merely because of a simple mistake

or taxpayer complaint. IRS employees will not be terminated for doing their jobs in the course and scope of their duties. Employees must engage in egregious activity to be fired.

What is the IRS doing to try to clarify this misconception among employees?

Commissioner ROSSOTTI. Well, first of all, Mr. Chairman, I appreciate that statement, because that is precisely the message that I have been trying to get across to our employees.

I have to be honest with you and tell you that I think that we in the IRS exacerbated this perception by the initial training that we got out, because, remember, every employee, all 100,000 of them, were affected by this section and it was effective on the date of enactment.

So, instantaneously, so to speak, we had to inform our employees of something that they really had to know about because, potentially, they could be terminated for this.

In the initial stages of the training, we had many unknowns ourselves about how this exactly would work and how the procedures would work, so we got out some training to inform our employees on this section. I have to honestly tell you that that training did not achieve its intended purpose.

It did achieve the purpose of explaining that this section existed, but it did not explain it well enough to note what the reality was, that it was only intended really for very serious acts. We got a great deal of feedback very quickly from employees about this. This was early last year.

We then took many steps over the course of the year, including, for example, one of the immediate steps was to put a little flyer in every employees' paycheck—because we know everybody looks at their paycheck—to make the exact point that you made, that this is not intended for willful violations.

We had follow-up training that was much more specific that clarified this issue. In August, I issued a memo to all 100,000 employees, providing them the actual data on how many cases there were. Of course, there were many, many fewer cases than some of the rumors indicated.

I think that, as a result of that, we have assuaged some of the fears. But I think we also have to look at, if I could just take one more minute, Mr. Chairman, and say, with this whole issue of enforcement and the whole issue of the implementation of the taxpayer rights provisions, what I think in a bigger way is really the explanation of what has happened here.

We had an agency that was going on a certain course for many, many years. As was really noted, I think, correctly in some of the TIGTA audits and some of the things that were noted from many sources, a good deal of the management approach was numbers driven in the IRS, and many of the numbers that were used had to do with enforcement revenues and enforcement statistics, even before the implementation of the Act, because of hearings, because of just management attention to this problem, all statistics were withdrawn.

So for almost 2 years, we went from one extreme to the other. We went from, I will not say, an extreme end, but a relatively far

end of being a very numbers-driven organization with a lot of focus on enforcement to where no numbers were used for almost 2 years.

We had no measurement system. One of our highest priorities was, in fact, implementing the new measurement system, which is the balanced measurement system. So, that was a broader context that we operated under.

Then on top of that, in July of 1998, the specific provisions of the Act were passed, which implemented Section 1203, as well as many of the other procedural taxpayer rights protections.

So what we had, was a period of real confusion, I would say, and anxiety about, what are we really supposed to do, and retraining and rethinking a large workforce with this level of change is a very, very challenging thing to do.

I think that it will take some additional period of time for all of the efforts that we have made to really become effective, but I do think that we have gotten past at least the first stage of clarifying these things.

We do have guidance in place for all of these provisions now, we have gone through several rounds of additional training, we have the new measurement system in place, and I think that some of the more general messages that we have tried to get across, such as at this hearing, and I have tried to do in many forums, as well as my Deputy Commissioner and my other new executives, will gradually have the effect of clarifying what I think the intent is, which is exactly that we want to respect taxpayer rights, but we also want to collect the taxes and we need to do both efficiently.

The CHAIRMAN. Well, my time is up. Let me make a couple of observations. First of all, it is very refreshing to have someone come before us and be as candid as you are about what is taking place.

Too often, everything is going hunkey-dory and you get no understanding of what the problems are. I think it is critically important that the public fully understands the tremendous scope of this restructuring, of this reform, and that it will take major efforts and significant time to implement. But we are going to stay the course, make no mistake about that.

One of the things that has concerned me, is I do know that some of middle management has felt, because of the limitations on the use of data and statistics, that they could not give any guidance in some of these areas. That is plain wrong, as you indicated.

We expect management to discuss how particular cases should be handled, how much time it should take, and so forth. We do not want an employee or a manager to be judged by how much money they have collected per hour. That, as we have seen, is wrong.

I am going to turn to some of the other people, but I will have some more questions.

Senator Moynihan?

Senator MOYNIHAN. Mr. Chairman, at the outset, I fear it is my painful duty to inform you that our chief of staff, Mr. Frank Polk, does not believe the 21st century has begun yet. I do not know whether the IRS can adjudicate, but it does matter.

The CHAIRMAN. Is that adequate grounds for removal? [Laughter.]

Senator MOYNIHAN. Well, neither of us are the chief of staff. If we have got it wrong, well, I have to think he is right.

First, just to repeat what the Chairman has said, it is extremely cheering to us and reassuring to us to find you appearing with such candor, competence, and command. It is a desperate problem of government of how to get persons of such competence in the public service and keep them in the public service, and it is one of the arguments we shall have to be making for outsourcing, and so forth.

The Federal Government, 50 years from now, cannot be the civil service organization that matured around the turn of this last century or the present century, I do not know. The 1900's. So, thank you.

Second, congratulations on handling the Y2K matter so efficiently. That could have been just a disaster, and it just went by unnoticed and perfectly well.

If I can return, Mr. Chairman, to a subject we brought up earlier about complexity in the Tax Code. In your testimony, sir, you said at the same time you were trying to do all this reorganization, you had to deal with administering roughly 801 tax law changes made by the Taxpayer Relief Act of 1997, including nearly 300 new provisions. That is a great taxpayer relief, to add another 500 pages to the Internal Revenue Code.

Could you talk about that a bit? Because I really do think we have to address it. We are beginning to write tax measures late at night behind closed doors. The open and accessible procedures I remember on this committee a quarter of a century ago no longer exist. Bills come to the floor that no one has read. Probably no one person, even on the staff level, has read the whole of this bill.

Would you speak to that, and be as candid as you can?

Commissioner ROSSOTTI. Well, I can only say that, of course, the whole issue of what provisions should be put into the Tax Code is, as we know, primarily the role of Congress and the President. The IRS has a limited role.

We were going to try to fulfill it, and we did, I think, last year, in providing comments on certain complexity analyses with certain provisions, where provided. Mr. Oveson, I think, has made some recommendations for simplification which I think is part of his statutory duty.

I would just add one point that I think, from a purely administrative standpoint, is relevant, if there are going to be changes of whatever kind, it is very important to give us enough time to implement those changes.

It is better if there are not too many changes because that adds to the burden, but if there are going to be changes, the one thing that I think would be extremely helpful is to have enough lead time.

It really is not very practical to have tax law changes enacted in the middle or late part of the year and have them effective the same year because, by the time July or August comes, we are already finished planning, or we would like to be finished planning, for what we need to do for our computer system and our training of our employees, nor do we have time to educate the taxpayers. I will limit my comment to that one point, which is almost entirely an administrative point.

Obviously, as Mr. Oveson said, something that can be done more broadly to simplify some of the key provisions would be extremely helpful. But, in the absence of that, at a minimum, if we have enough time, that would be an excellent thing to have.

Senator MOYNIHAN. A fair point. Perhaps as we develop this subject we can be in touch with you about complexity analysis, and times, and such-like. We have a large political movement in this country that says we can solve all of these problems by abolishing the Tax Code and having a flat tax, and things like that. This is a response to increasing complexity. I have to believe that. It was not heard 30 years ago. It is our doing. I mean, we are the ones that do it, not the Internal Revenue Service.

Just one detail. It used to be very helpful. We used to get from the IRS a measure of voluntary compliance levels in the taxpaying public, and we do not seem to get it anymore. I found it very helpful. I believe you went out and audited tax returns without any intention of letting the person involved know if they had done something wrong, you were just sampling to see how many people got it right.

I believe the returns were usually, about half the taxpayers got it right, about 10 percent paid too much, and about 40 percent paid too little, but the degree of obvious attempt to defraud was rather small.

Are you familiar with that data?

Commissioner ROSSOTTI. Yes. Yes. Yes. Absolutely, Senator Moynihan. I think this lack of this measure of compliance is really a very serious problem for the long run in terms of being able to manage the agency. We really have not had that kind of data. The last time that kind of measurement was done was 1988. That is 12 years ago, and a lot has changed.

Senator MOYNIHAN. Yes.

Commissioner ROSSOTTI. You do sometimes see these numbers, but they are just extrapolations of the basic work that was done so many years ago.

I think it is not only useful from the point of view of the Congress to know whether people are complying with the law, but I think in terms of meeting our strategic goals, providing good service to the compliant taxpayer and focusing our enforcement resources where they really need to be, if we do not have this information it makes it, over time, much less effective in our ability to focus our enforcement resources where they really need to be, and we then take the risk of, for example, doing audits of taxpayers who should not be audited in the first place.

One of the things that I have been doing, and this has been a longer range project, is trying to work with our research staff to devise a way of developing those measurements that would get us the information we need, but would be as least intrusive on taxpayers as possible.

The objection in the past was that it is a very intrusive process, doing these audits. I am hopeful that we can come forward with a plan reasonably soon that would allow us to gather this information in an acceptable way.

Senator MOYNIHAN. Well, I think that is excellent. It is not surprising that you are on top of it. We thank you, and we will hear about it when it comes along.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Moynihan.

Senator Breaux?

Senator BREAU. Thanks, Mr. Chairman.

Mr. Rossotti, thank you for being with us. I had raised a point earlier about the dramatic drop in the numbers of levies, seizures, and lien filings, and also a drop in collections.

I was just starting to think, and I was wondering whether there was any connection with that drop with the seemingly huge amount of requests that you get from us and from everybody else that the IRS must spend a great deal of time doing.

In your testimony, you pointed out that this last year the IRS received 58 audit reports from the Treasury Inspector General for Tax Administration containing 314 specific recommendations for changes or improvements. You also received 74 reports from GAO containing 42 specific recommendations.

In addition, there are 127 Treasury Inspector General for Tax Administration and 36 GAO audits currently under way. That is 163 audits currently in progress. Obviously, you have to devote a degree of resources and people to just keep up with the requests that agencies within our government, including Congress, are asking you, while you are also supposed to be running the department.

I guess I would like you just to comment. Is this affecting the overall duties of the Internal Revenue Service? How much time do you have to spend on this, how many people do you have doing all these responses to the audits and recommendations that you are getting?

Commissioner ROSSOTTI. Well, let me respond and comment this way. In my testimony, I said that one of the most difficult management challenges we have is how to balance the fact that we have more need to make improvements and changes right away than we possibly could manage or deal with.

One of the sources of those recommendations, and they are often very good ones—we almost always agree with the recommendations that the TIGTA and GAO have. Rarely do we disagree. The difficulty, is that there is more capacity to generate recommendations than we have to implement solutions in the short term.

So the difficulty that we have, and it is just part of our job of managing, is that, much as we might like to solve all of those problems immediately, we have to sometimes set priorities, we sometimes cannot implement them as quickly as we would like, sometimes we have to put them on a longer time scale.

So the issue that we face is not that these are not good studies and recommendations, and it is not so much the time we spend working with them on the studies, it is the challenge that we have of taking these recommendations in from these different sources and then figuring out how to fit them into a realistic plan of implementation.

The real problem with the IRS is not coming up with good ideas, because we have more good ideas that have been coming from many sources than one could implement. I gave a speech recently

and someone asked if we were visionaries at the IRS, and I really do not agree with that at all. I do not think we are visionaries, I think we are project managers. We are implementers.

I mean, we know from the direction that has been given to us, and from many other sources, what we need to do. What our challenge is, is making all these things actually happen while still, as you noted in the earlier things, keeping the current operations going at an acceptable level.

Senator BREAUX. How are you doing with the budgetary appropriations as far as having the tools and the manpower, people power that you want?

Commissioner ROSSOTTI. Well, again, I think if we look back over the last 5 years, we have had, every year, a decline in staff resources. In the meantime, the number of tax returns have gone up, and now we have the additional requirements of the Restructuring and Reform Act. I have to say, these provisions of the Act do require resources to administer. If you take innocent spouse, 46,000 claims, we have to put people on that.

So this has not been a good trend, and clearly the solution has not been that we have had great, new technology over the last 3 years, because mostly what we have been doing is fixing Y2K over the last three years, which is just a fix.

So, we do need some budgetary resources. I know that the budget is coming out next week. In the President's budget for 2001, I feel very satisfied with what is included in there because it does provide for the two main things that we need.

We do need some additional staff resources in the short run to cope with some of these additional demands, including making sure that we can keep up the number of audits and enforcement actions. But we equally need the investment money to improve and reengineer our technology and our practices, because it is really the combination of those two.

If we tried to do everything that is expected of us just by adding staff resources and adding budget, we would have to request so much money that it would be out of the question to ask for.

So what we have tried to come up with is a plan that asks for very limited amounts of staff resources for some very specific things, but money that we need for the investments that we think will allow us to leverage our staff to really deliver better service and better technology. In the 2001 budget request, I believe that we do have those priorities covered.

Senator BREAUX. All right. Well, that is good news.

Thank you, Mr. Chairman. No further questions.

The CHAIRMAN. Let me just make one observation. According to the IRS gross revenue collections reported in fiscal year 1999 were \$1.7 trillion. That is the highest amount in the history of the country, is that correct?

Commissioner ROSSOTTI. Yes, that is true. According to my numbers, yes, a little over \$1.7 trillion.

Senator MOYNIHAN. Do you not wish you were a private corporation? [Laughter.]

Commissioner ROSSOTTI. I wish we had some stock options, but we do not have those to give out.

The CHAIRMAN. Let me just say, if I understand your testimony, what you are saying is that, by 2001, you see the major reforms being pretty much in place. There is still much to do. For example, a computer system will take a much longer period to modernize to give you the kind of data that is essential.

Commissioner ROSSOTTI. Yes.

The CHAIRMAN. But, fundamentally, you think the major reforms are being put in place and that, by the year 2001, in a significant way, the taxpayer will begin to see the benefits of these changes. Is that a fair statement?

Commissioner ROSSOTTI. Yes, it is. Actually, as I said, I think some taxpayers are already seeing the benefits, because we are getting some feedback.

The CHAIRMAN. Absolutely.

Commissioner ROSSOTTI. But what I think we will see, is, kind of, let's call it the preparatory work, the laying of the foundation, will be done, in major part, by the end of this year.

For the subsequent years, 2001, 2002, 2003, I really hope that we will see a somewhat increased rate of improvement, in both compliance and in service for the compliant taxpayer.

The CHAIRMAN. One final question. Tomorrow, we will have before us the nominees for the Board. How important do you see their role? As you know, too often in government we create boards and advisory groups and people get their name put as being chairman of this or whatever, but they never do anything. What do you see as the role of this board, as the Commissioner?

Commissioner ROSSOTTI. I hope they are not going to just get their names in it and not do anything. I think the people that I have talked to, and we have met them all now and they are all here, I believe, have taken on this assignment with all seriousness because they really believe in the need to improve the IRS, and they understand that it is going to take some time to do that.

I think that the intent of the board, as I understand it, and I think I understand it better now that I have been in office for a while, is precisely to provide a resource, a group of people who will invest the time and have the experience to really understand what is needed to really make this whole program work and can provide the sustained support and course corrections, if need be, that we need to make.

I think there is also a very important statutory responsibility with respect to strategic planning and budgeting, which is critical, because we really have to think multiple years in terms of our planning in order to make this work. That is one of the statutory responsibilities of the board, a very important one.

So I am very much looking forward to it. Assuming that the nominees are confirmed, we are going to try to work with them very quickly to help them become educated and knowledgeable about the operations of the IRS and really, I hope, make the board a very important factor in making this whole program work.

The CHAIRMAN. Well, thank you very much, Charles, for being here today. I think this information is most helpful. We will continue to have oversight hearings, but I do think significant progress is being made. Still, there are a lot of problems ahead for us, but I appreciate what you are doing.

Senator MOYNIHAN. Mr. Chairman, just before we close out, I have a question that Senator Robb would like submitted for the record to Commissioner Rossotti. It concerns the tobacco farmers in Virginia who are receiving forms regarding the payments they received from the tobacco master settlement between the State's attorneys general and the tobacco companies.

A letter was sent yesterday to the Secretary of the Treasury, copied to you. I know he would appreciate a response at your earliest convenience, and I would put this in the record, if I may do.

The CHAIRMAN. Please, without objection.

[The questions appear in the appendix.]

The CHAIRMAN. As I announced earlier, written questions can be submitted until the end of the day to the clerk, and we would ask those questions to be answered promptly.

Thank you very much for being here, Mr. Rossotti. We look forward to continuing working with you.

I would just say to the nominees, we thank you for being here today. We look forward to seeing you tomorrow.

With that, I think the committee is in recess.

[Whereupon, at 12:01 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF W. VAL OVESON

Mr. Chairman and distinguished members of the Committee:

Thank you for inviting me to testify before the Committee on my second annual report. I welcome the opportunity to share the progress we made during fiscal year 1999 and the challenges we are facing in the next year.

The last year has been a year of incredible change for the Taxpayer Advocate Service. Implementing the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA '98) has been a major challenge and the process of modernizing the Taxpayer Advocate Service has energized us and exhausted us. Because of the restructuring, we will be better positioned, better trained and more focused to address the problems facing taxpayers. The new Operating Divisions within the IRS will soon begin the modernization process and they will experience the turmoil involved in restructuring a major business. However, I firmly believe that taxpayers will only realize the improvements you intended in RRA '98 if the modernization is allowed to continue over the long term.

I. STATUS OF THE TAXPAYER ADVOCATE SERVICE REORGANIZATION

I am pleased to report that the Taxpayer Advocate Service is in the process of implementing a modernized structure as called for in RRA '98. To accomplish this, we finalized the independent reporting structure. During this process, we worked to ensure that our design met the needs of American taxpayers, in some cases with the help of members of Congressional staff. Every state now has at least one Taxpayer Advocate. Separate addresses, telephone and fax numbers for Taxpayer Advocates are being published as the telephone directories are updated. They are also included on notices of deficiency.

We developed a modernized organization to deliver service to each taxpayer through our casework, and to every taxpayer through outreach, systemic analysis, and advocacy. Our new organization established a career path for Taxpayer Advocates. Caseworkers begin working on routine cases and, based upon their skill level and our workload, they can be promoted to more complex cases, become technical advisors or advocacy analysts.

We selected Taxpayer Advocate managers in fiscal year 1999 and our managers are completing the selection process for the remaining staff. While I was pleased with the number of employees interested in positions in the Taxpayer Advocate Service, the process to qualify and rank over 8,000 applications has proved challenging. Until this hiring is completed, employees who report to IRS Operations are working Taxpayer Advocate cases under direction from the Local Advocate in most locations. Aligning the management of the employees working on the Advocate's cases with the program responsibility is a major objective of the modernized Taxpayer Advocate Service as well as the broader IRS modernization.

Our new balanced measures were approved and reflect the IRS commitment to quality driven productivity, customer satisfaction and employee satisfaction. We evaluated our old business measures, and made many changes. We designed new measures to monitor the quantity and quality of our casework, outreach and advocacy programs. We also designed measures to assess customer and employee satisfaction. Not all measures will be in place this year, but we are taking the actions necessary to enable us to collect the data, evaluate our success, and identify areas for improvement. All measures will be in place by the beginning of fiscal year 2001.

The dedicated employees of the Taxpayer Advocate Service have internalized our Mission Statement "We help taxpayers solve problems with the IRS and recommend changes that will prevent the problems." They are going the extra mile to assist taxpayers who need our help. I have talked to scores of taxpayers and practitioners

who rave about the service they have received. For twenty years, this program has been fixing problems and making the system better. But, even with a solid record of success, we must do more to implement the new statutes and meet your expectations, and the expectations of the public.

II. HIGHLIGHTS OF THE REPORT

A. Taxpayer Advocate Service—Accomplishments

A1. Casework

The Taxpayer Advocate Service helps taxpayers resolve problems with the IRS. During fiscal year 1999, Taxpayer Advocates worked on 292,843 cases of which 92,852 met the expanded hardship criteria defined in RRA '98 and 199,991 were other cases where taxpayers were seeking assistance. This nearly 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 assistance 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.

A2. Interaction With Taxpayers

We established a separate toll-free telephone number to provide an additional entry point for taxpayers having difficulty with the IRS. We expanded the service to 24 hours per day, seven days per week (except on major holidays) late in the fiscal year. When taxpayers call this number, we determine if their specific question or issue meets Taxpayer Advocate criteria. We attempt to resolve the problem during the contact or transfer the call to the appropriate office or Taxpayer Advocate. We answered 442,053 calls on the Taxpayer Advocate toll-free number during fiscal year 1999 alone.

Last year, we issued five Taxpayer Assistance Orders: two on refund offsets, one for interest abatement, one to issue a refund to avoid foreclosure, and one to stop an audit where the taxpayer felt harassed. While I am unwilling to make an estimate of how many Taxpayer Assistance Orders should have been issued, I am concerned that the number is low. An analysis of the reasons that the number is not larger results in the following explanations: 1) 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; 2) the taxpayer is asking the Taxpayer Advocate to do something that we do not have the authority to do because the law does not provide for the relief requested; and 3) the Taxpayer Advocate Service is in the process of being reorganized and we have yet to clarify the extent of the authority of the Taxpayer Assistance Order, and communicate that policy to employees. The process to clarify this policy is underway and will be communicated in the early part of this calendar year. I am confident that we are working hard to resolve problems brought to us by taxpayers. I am less confident that we have perfected the use of the new tools that we were given in the legislation. This will be an area of focus during the current fiscal year.

In my first report, I testified that I would evaluate the style and format of the report, and develop new ways to communicate the recommendations. We made several improvements as a result of this evaluation. As required by law we report on the 20 most serious problems facing taxpayers. This year, we ranked the problems by assigning equal weights to input received from individual and small business groups, tax practitioners, IRS officials and Taxpayer Advocates. We included comments from external stakeholders, the direct input from senior IRS officials on actions taken to correct the problems, and my personal assessment of the scope and status of the problem. We also categorized and indexed our legislative proposals to assist the readers.

B. The Twenty Most Serious Problems Facing Taxpayers

While the ranking may have changed, the 20 most serious problems facing taxpayers and the ten most litigated issues remain the same. We identified more clearly the senior IRS officials who were responsible for the areas identified in the top 20 problems. We reported the actions they said they were taking to address the problems in fiscal year 1999 and the many activities planned for the future. The changes being made as a result of the modernization are placing the Service in a better position to understand the problems, frustrations, and needs of taxpayers. The new Operating Divisions, which have been designed around customer bases, will also be a catalyst to improve service to taxpayers and make progress in eliminating problem areas from the top 20 list.

Complexity remains the most serious problem taxpayers face, as I have testified both to this Committee and to the Subcommittee on Oversight of the House Committee on Ways and Means. I stated then, and still believe, that the single most complicating factor in tax administration is the frequency and number of changes to the tax law. I encourage you to reduce the complexity of the existing laws or at least to slow down the frequency of the changes.

C. Legislative Proposals

Even with my views on complexity and changes to the tax law, I identify legislative proposals as directed by Congress. This section of my report is used to recommend changes in the Internal Revenue Code where current Internal Revenue Code requirements create inequitable treatment or where such change will alleviate barriers to tax compliance. Taxpayer Advocates and a variety of internal and external stakeholders routinely identify situations where current law may prevent the resolution of taxpayer problems. They also identify proposals to improve service and reduce burden. We carefully evaluated all suggestions and included 53 legislative proposals in this report that are designed to reduce complexity for taxpayers or to increase the ability of IRS to provide relief. We identified 19 new proposals and included 12 first identified in fiscal year 1997 and 22 first identified in fiscal year 1998. I am pleased to note that Congress has considered several of our proposals over the past few years.

On January 27, 2000 I testified before the Subcommittee on Oversight for the House Committee on Ways and Means on the penalty and interest provisions of the Internal Revenue Code. I recommended a deliberative review leading to changes in the penalty and interest systems. To assist in that process, I identified six provisions related to interest and five provisions related to penalties in my report that I recommend be changed. My recommendations provide clarification on interest accrual, provide IRS more ability to abate interest or waive penalties, and simplify 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. This broad reaching proposal does not apply to a particular code section. Rather, it allows IRS to provide relief to taxpayers from the effect of any provision where (1) the IRS makes a clear and demonstrable error in handling a taxpayer case, (2) the taxpayer has operated in good faith and has not contributed to the error, and (3) the taxpayer's tax position has been impaired by the error.

I hope you carefully review the proposals and continue to help taxpayers by including these proposals in future tax legislation.

III. CHALLENGES AHEAD

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 mention.

1) 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. We have already seen the backlash begin: news reports decry the lack of enforcement, and different corners of society call for a return to traditional compliance approaches and a reversal of the new direction towards stronger taxpayer service. 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.

2) 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 being helped. 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.

3) 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.

4) 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.

IV. CONCLUSION

Thank you for giving me this opportunity to report on the activities of the office and to share my vision for the future of the program. Taxpayer Advocates are better positioned to help taxpayers because of the authorities granted in RRA '98. We invested much of the past year in developing the framework for the new program. Now we execute our plan. I 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.

RESPONSES TO QUESTIONS FROM SENATOR ROTH

Question 1: While the use of levies and seizures has plummeted, the Tax IG and GAO have found that when the IRS did engage in this activity, it violated the law or IRS procedures in 33% of the few levies and seizures made over the past year. What can be done to ensure that levies and seizures are done in accordance with the law?

Answer: Any violation of the law or IRS procedures is unacceptable. I think we need to acknowledge, however, that the changes made in the Restructuring and Reform Act were significant and will take time to implement fully. The IRS must ensure that all employees are trained adequately and that proper procedures are in place to protect taxpayer rights. It is my understanding that the training either has been conducted or is being conducted.

As the employees of the Taxpayer Advocate Service discover these kinds of issues in casework, we are reporting them to the proper authorities and assisting taxpayers to the extent possible.

Question 2: We have heard a great deal about "balanced measures" for evaluating employees. Please explain to the committee how you interpret "balanced measures?"

Answer: Balanced measures are not used to evaluate employees directly, but to evaluate the programs of the IRS. Balanced measures simply means that customer satisfaction, employee satisfaction and business results will be considered equally as measures of success for each program being conducted. This concept has not been used in the IRS before and will ensure that taxpayers have a major voice in telling the IRS how it is doing.

Question 3: Mr. Williams' office found numerous violations of the law that prohibit IRS employees from being evaluated based on enforcement statistics. In 1998, we outlawed this practice with respect to collection employees. We found that the IRS ignored the law. In the Restructuring Act, we prohibited any IRS employee from being evaluated based upon enforcement statistics. This could result in taxpayer rights being violated. It seems we are going down the same path. What are the panel's view? Are we going down the same path?

Answer: I do not think the IRS is going down the same path. As I said in answer to the previous question, balanced measures are not being used to evaluate employees directly and will not have outcome-based results included in them at all. I believe the IRS is attempting to comply with your mandate in this area. In my opinion, violations found in the past year and a half most likely result from the difficulties of removing such an ingrained and long-standing practice from the organization.

Question 4: The Tax IG and GAO have found that the IRS management information system needs work. Management must have access to information in a usable format. For example, the Tax IG notes that the IRS does not have a database to reliably track innocent spouse cases? Do you all agree this is an issue? What impact does this lack of information have on taxpayer rights?

Answer: As you know, the IRS management information system is a major problem, which is why the new computer system is so critical to the IRS operations. There has been a desperate need to overhaul the legacy systems for some time and that need is currently being addressed. Creating individual information systems

throughout the organization with separate data entry and maintenance places a tremendous burden on the system resources.

It is essential that information systems be available to manage critical programs such as innocent spouse. Until the capacity exists through the legacy systems, it needs to be done on a stand-alone basis. The IRS was slow in recognizing this need with the innocent spouse issue. This has been corrected and a system is now in place to manage this program.

Question 5: Does the panel believe the IRS has effectively implemented the Restructuring Act's taxpayer protections?

Answer: Basically, I believe the IRS has effectively implemented the Restructuring Act's taxpayer protections. The Act was so large in scope and mandated changes so deep in the organization, however, that it will take some time to complete the training, correct all references in manuals and forms and change the practices and culture of the organization. This is why I have said many times that I believe it is critical that the Service has the sustained commitment of Congress and the public to continue the modernization over the long-term.

RESPONSES TO QUESTIONS FROM SENATOR HATCH

Question 1: I have been looking over the annual report you sent up last month. I find your list of 20 most serious problems facing taxpayers to be a useful roadmap that this committee should take a close look at. In addition to this list, you have compiled a list of 53 legislative proposals that would simplify and improve the fairness of the tax system. Of all these proposals, what are the two or three most important changes Congress should make to simplify the lives of taxpayers?

Answer: Taking into account the number of taxpayers affected, the dollar amounts involved and the common sense appeal of each of the 53 proposals, I have ranked the top five proposals as follows:

- (1) Ability to correct errors made by the IRS—Proposal #23
- (2) Simplify Eligibility Requirements for EITC—Proposal #10
- (3) Expand the ability of the IRS to abate interest in cases of hardship Proposal #22
- (4) Consider postmark date the same as filing date for late filed returns Proposal #25
- (5) Eliminate the Alternative Minimum Tax—Proposal #50

Question 2: One of the more prominent suggestions you made in your report is to repeal or reform the individual alternative minimum tax. This is something I have long advocated. Unfortunately, President Clinton vetoed last year's tax bill, or the AMT's days would be numbered right now. I find it interesting that the President's budget includes a proposal to alleviate the AMT, but not repeal it, as you and Congress have suggested. In fact, the new Clinton AMT proposal sounds to me like it will be long on additional complexity, and short on relief. Do you think the Clinton AMT plan would add more complexity to the Code, as compared with repeal, as well as fail to solve the burden of the AMT for millions of families?

Answer: My report makes several suggestions for dealing with Alternative Minimum Tax for individuals based on numerous comments from taxpayers, practitioners and other stakeholders. Because there are many ways to deal with the complexity of the AMT, the report recommended creating an Adjusted Gross Income or Taxable Income level below which taxpayers would not need to consider the AMT and indexing the AMT rate bracket and exemption amount. My preferred recommendation was the outright elimination of AMT, not because I disagree with the policy objectives underlying the AMT, but rather because of the complexity it creates in its current form.

Question 3: In your report, you suggested first that Congress stop making so many changes to the Internal Revenue Code. Then, you turn around and suggest 53 legislative changes yourself. Can you reconcile these seemingly conflicting suggestions?

Answer: When I testified before you about complexity in the Internal Revenue Code, I encouraged you to slow the rate of change or ensure that future changes simplify the law rather than complicate it. I continue to believe that this is the best course of action. I realize, however, that changes to the tax laws are likely. In light of that and the responsibility you gave me to identify legislative changes designed to reduce complexity and decrease burden for taxpayers, I made the 53 recommendations in my report for you to consider if and when you do change the tax laws. I believe that those recommendations, if enacted, will reduce taxpayer burden and complexity.

PREPARED STATEMENT OF CHARLES O. ROSSOTTI

INTRODUCTION

Mr. Chairman and distinguished Members of the Committee, I welcome this opportunity to discuss the progress the IRS has made on meeting the goals of the landmark IRS Restructuring and Reform Act of 1998 (RRA 98). I also want to thank the Chairman and Ranking Minority Member for their guidance, counsel and support since the passage of the Act a year and one-half ago. With your continued support and that of the Congress, I believe we can create the modernized IRS envisaged in RRA 98 and which the American people expect and deserve.

GOALS AND EXPECTATIONS

Mr. Chairman, before I discuss the implementation of some specific RRA 98 provisions, our modernization initiatives and milestones, I believe it is important to restate what the Restructuring Act asked us to achieve as an organization. If one looks at this Act as a whole, including all that preceded it, it is clear that the IRS was given a new direction and a new challenge—namely to measure its success or failure in terms of its effect on the people it serves as well as the taxes it collects.

We were being told that we must respect taxpayer rights and provide high quality service to every taxpayer. We must ensure that the taxes that are due are paid. Moreover, in an era of tight budget caps we must do all of this very efficiently.

Collectively, these expectations define what we mean by the new IRS. We have translated them into three strategic goals and further into a system of balanced measures that we will use to measure performance throughout the organization. If we achieve all three of these goals at a high level, we will achieve our mission and we will meet the public's expectations.

We Must Achieve All Three Goals To Succeed

I want to make an important point about having three goals that I believe has been lost in some of the recent discussions about the IRS' new direction. The point is this: We must achieve all of our goals to succeed. We cannot succeed if we collect the taxes but do not provide good service and respect taxpayer rights. The reverse is equally true. Customer satisfaction is not achieved by failing to collect taxes that are properly due. Nor can we succeed if we cannot use our limited resources productively, or if we fail to provide employees with the tools and training needed to do a quality job.

Our purpose is not to move some imaginary pendulum one way or the other. That would be relatively easy but not particularly useful or long lasting. Our purpose is to improve the entire way the IRS works.

Granted, this is a much tougher job than merely focusing on one dimension or one goal. But working in multiple dimensions reflects the way most of the business world works today.

In the business I was in for many years, we had to keep our customers satisfied or they would go to the competition and we would also go out of business. But we also had to make a profit every quarter or our stock would go down and eventually the company would have to close its doors. So we had to get adequate prices for our services from our customers and we had to collect receivables. And if we didn't treat our employees right, they would probably quit and go to our competitors.

And this is true of virtually every successful business I know of, and today, it is increasingly what the public expects from any public institution, such as the IRS. So what we are being asked to do is more demanding than our job in the past, but it is in line with what other successful private and government organizations are doing. In the long run, it is also a more satisfying way to run an organization for all stakeholders.

Given the magnitude of our challenge, it is not surprising that there are risks and setbacks. It is not surprising that we are encountering obstacles that must be overcome. It is not surprising that there are people who are confused or have their doubts.

Before even taking office more than two years ago, one thing was very clear to me. Rebuilding a 20th century IRS to meet the public's and the Congress' 21st century expectations would require years of sustained efforts and would involve many risks. Yet today, I am more convinced than ever that we can succeed. We can build an IRS that scrupulously respects taxpayer rights. We can build an IRS that provides top quality service. And we can build an IRS that collects taxes efficiently and fairly.

However, as the National Taxpayer Advocate stated in his 1999 Report to Congress: "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."

WHAT IS DIFFERENT THIS TIME

Given the somewhat long history of piecemeal improvements at the IRS, the natural question is, "What's different this time?" First, let me say what is not different. Good recommendations for improvement have been in plentiful supply at the IRS. These came from dozens of internal studies, General Accounting Office (GAO) and Inspector General (IG) reports. The National Commission on Restructuring the IRS, co-chaired by Senator Kerrey and Congressman Portman, put these ideas together in a very useful and coherent package. The National Partnership for Reinventing Government's (NPR) study sponsored by the Vice President came up with a long list of very specific proposals. The Restructuring Act put into law the direction and authority to implement these ideas.

It is not that suddenly someone came up with a better idea this time. Instead, what is different is that the accumulation of all these recommendations, and the work of so many people, such as the Members of this Committee, culminated in RRA 98. And that law created the special opportunity for those of us who are here now to implement these ideas. We are not visionaries. We are implementers.

I am not the only one who concluded that there's a special opportunity to put into operation the many good ideas and best practices that can benefit the IRS. One of the principal reasons that I believe we can succeed is because of the team of senior leaders we have assembled since I last appeared before the Committee—all of whom agreed to be members of this team because of the opportunity they see to improve the IRS. Our new leadership team consists of the following individuals:

- Deputy Commissioner of Operations Bob Wenzel who has 37 years of experience with the IRS and played a leadership role on the NPR customer service task force;
- Deputy Commissioner of Modernization John LaFaver who most recently was Kansas State Tax Commissioner and has made a career of implementing modern tax administration practices;
- National Chief, Appeals Dan Black who was National Director of Appeals at the IRS and began his IRS career almost 30 years ago as a Revenue Agent and has served in senior positions in Districts and Appeals;
- Chief of Agency Wide Shared Services William Boswell who was Senior Vice President of Shared Services for BP America;
- Chief Counsel Stuart Brown, who has held that position since 1994 and was previously a partner at the law firm of Caplin and Drysdale;
- Chief Information Officer Paul Cosgrave who prior to coming to the IRS was Chairman and CEO of the Claremont Technology Group and a partner in Anderson Consulting;
- Commissioner of the Wage and Income Division John Dalrymple who was our Chief Operations Officer and began his service at the IRS 25 years ago as a Revenue Officer;
- Commissioner of the Small Business/Self Employed Division Joseph Kehoe who was Global Leader, Service Sector Consulting for PricewaterhouseCoopers;
- Commissioner of the Large and Mid-size Business Division Larry Langdon who was Vice President, Tax, Licensing and Customs for Hewlett-Packard;
- Chief of Criminal Investigation Mark Matthews who joins the IRS after being in private law practice at Crowell and Moring and who served as Deputy Assistant Attorney General for Criminal Tax at the Justice Department;
- National Taxpayer Advocate Val Oveson who was Chairman of the Utah State Tax Commission;
- Commissioner of the Tax Exempt and Government Entities Division Evelyn Petschek who served as IRS Assistant Commissioner for EP/EO and was a partner in the law firm of Patterson, Belknap, Webb and Tyler; and
- Chief Communications and Liaison David R. Williams who previously worked in the Treasury Department and the United States Senate.

MANY CHANGES ARE REQUIRED TO MEET THE MANDATES OF RRA 98

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, re-engineering of major business systems and technology.

Near-term changes to improve service and treatment of taxpayers

RRA 98 required the IRS to implement 71 new or modified taxpayer rights provisions, many of 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, over the last year, the IRS received 58 audit reports from the Treasury Inspector General for Tax Administration (TIGTA) containing 314 specific recommendations for changes or improvements and 74 reports from GAO containing 42 specific recommendations. In addition, there are 127 TIGTA and 36 GAO audits underway. 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 FY1999, 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 3,000 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 RRA legal provisions. We now 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 these provisions.

The innocent spouse provisions generally permit one of the spouses who filed a joint income tax return to be relieved of part or all of the unpaid liabilities associated with a joint return.

Unpaid liabilities can be caused by 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). In RRA 98, Congress added three new provisions to one already in the law, each of which defined a different set of conditions under which one of the spouses may be granted relief from the liability for all or part of the unpaid amounts arising out of the originally filed joint return. These con-

ditions differ under each of the four provisions, but include such factors as whether the spouse requesting relief had "constructive knowledge" or "actual knowledge" of a particular item on a return and whether, considering all facts and circumstances, it would be inequitable to hold the spouse liable.

RRA 98's innocent spouse provisions contain two special challenges for tax administration. First, in each innocent spouse request, the IRS considers the facts and circumstances of both the spouse requesting the relief and the other spouse who would continue to have the liability whether relief is granted or not.

Second, one of the three provisions of RRA, section 6015(f) provides for "equitable relief" in situations in which relief is not available under the other sections. Since equitable relief is a broad and relatively rare concept for the IRS to administer, it is particularly important that we provide the best possible guidance and oversight to our employees as to how to interpret this provision fairly and consistently. In addition, since this provision is potentially applicable whenever the other provisions are not, every request for innocent spouse relief that is not granted in full based on the other provisions must then be reviewed against this provision.

The passage of RRA 98 and increased awareness of the availability of innocent spouse relief resulted in a very large increase in the number of innocent spouse requests filed with the IRS. In the nearly four months preceding the passage of RRA 98, the IRS received 3,000 innocent spouse requests. Since the passage of RRA 98, we have received 63,906 requests, and we are continuing to receive over 2,800 per month.

As the innocent spouse provisions of RRA became effective and the large number of requests began to come in to the IRS, we faced some difficult management issues. We were and are determined to apply each innocent spouse provision carefully and to provide no more and no less than the relief Congress intended in each and every case. We are determined to work with taxpayers to inform them of their rights and to assist them in providing us the information needed to qualify for relief. We also knew that we did not have experience with administering these new provisions and had to provide guidance and training to our employees before we could expect them to apply these provisions correctly. The equitable relief provisions of Section 6015(f) required special care in interpretation and administration.

At the start, we had no employees trained in applying these new provisions and no training materials. We had no computer systems support to track the evaluation process since our basic taxpayer master files system does not provide for accounting for separate liabilities arising from a single return. This imposed very labor intensive and error-prone accounting procedures after relief was granted.

Finally, we had no experience to predict the particular fact patterns that were contained in the large number of requests. For example, we have now learned that significant numbers of the requests received represent situations in which the basic requirements of the innocent spouse provisions, such as having filed a joint return, are not present.

Tax administration consists of applying provisions of law to the individual facts and circumstances of each case. The innocent spouse provisions of RRA98 presented a situation in which we had many unknowns—both as to how to interpret and explain the law and as to the fact patterns that we were encountering. For these reasons, the process has been and continues to be a learning experience for the organization. Over the past 18 months, we have taken many actions to learn how to manage the program effectively and to evaluate each request fairly and efficiently, and we are now making substantial progress. The chronology in Chart A shows the major steps and actions already taken in the innocent spouse program and some of the additional steps currently planned.

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. Computer support is being developed in increments and will greatly increase productivity over the next 18 months. Claims are now being tracked through 19 discrete steps in the process.

Chart B shows the current flow chart being used to screen and evaluate requests. Chart C shows the results of the initial screening of requests.

As of December 31, we had 46,665 cases in inventory. Of course, collection action is suspended for these taxpayers while the cases are under evaluation. In the most recent quarter, which ended December 1999, we reached a breakeven point in which the number of determinations equaled the number of new requests received. We expect progress to pick up in the current quarter. By the end of this year, we expect to reduce this inventory of pending cases to under 30,000 and to be on a path to

reduce it further. We estimate that this will require an assignment of 362 full time equivalent (FTE) personnel including 153 revenue agents in FY 2000.

Since the implementation of our Innocent Spouse Tracking System, 8,037 claim years (i.e. one return for one year) have been evaluated and a determination made based on the merits. Of these, full relief was allowed in 40 percent, partial relief was allowed in 6 percent and relief was disallowed in 54 percent of the claims. In addition, the IRS appeals office has made a determination in 27 cases and a handful have gone to litigation.

We have also continued our efforts to educate and inform taxpayers of their rights and to help them to make correct and accurate claims. To this end, we developed an interactive application on our web site at www.irs.gov 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 website.

The innocent spouse provisions of RRA98 represent a very important and difficult aspect of RRA98. The experience so far illustrates both the difficulties the IRS must overcome in administering this law and also why we believe that with sustained management attention it is possible to administer these provisions efficiently and fairly for every taxpayer and in accord with the intentions of Congress.

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 D.

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 E 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 F, 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. *171Third 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 G 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 you, Mr. Chairman, the Members of the Committee and your staffs for working 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 unfilled 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 this month, we are issuing 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 her 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.

NEEDED: NEW ORGANIZATION AND MODERN TECHNOLOGY

By its very nature, the reorganization of the IRS deals with the internal structure of the Agency. Frankly, that is something that most taxpayers, and even most practitioners, do not know or care that much about. The same could be said about our computer systems.

What taxpayers really care about is how well we serve them. That means taxpayers getting through to the IRS on the phone and getting accurate information. That means resolving cases and issues promptly. That means producing notices and correspondence that do not require a law degree to read. That means dealing with people who understand the taxpayer's business and can make reasonable judgments about how the law applies to the facts of that business.

Many informed taxpayers also care a great deal about how well the IRS ensures compliance with the tax laws. They know full well that those who do not comply burden everyone else who does. That means dealing promptly and effectively with taxpayers who do not, or will not, pay their taxes that are due.

Of course, we heard loud and clear that there were, and are problems in the IRS. However, progress to make any improvements has been painfully slow. In fact, if there are two words that capture the frustrations that many people have about the IRS, it is "too slow"—too slow to fix problems, make clearly needed improvements, make decisions, start new cases and close cases.

A key reason behind our reorganization is that our slow progress to make improvements is due in large part to the twin barriers of organization structure and obsolete computer systems that reinforce each other.

In the last two decades, most large businesses, especially those that were knowledge-based, such as professional service firms, moved away from a geographic structure to a customer-focused one. These companies made this transition for two important reasons.

First, the technology revolution of the past 30-40 years was the great enabler. Reorganizing and managing a large organization by customer-service lines simply wasn't possible 40 years ago. Without computer networks, faxes, e-mail and low-cost long distance phone service, the only way to manage was to be physically close by. Technology shrank distances and made it possible to create new forms of organization.

Second, if technology was the great enabler, getting closer to the customer and understanding the customer's needs were the great drivers of change. If you think about it, the IRS fits hand in glove with this scenario. We have the most to gain from being customer focused. Everyone is a customer of the IRS, giving us one of the world's most diverse sets of customers. It is obvious the service and compliance issues of a middle-income wage earner are vastly different from those of a large corporation.

New Organization Structure

In modernizing our organization, the IRS is learning from the best practices of other large organizations that serve many different kinds of customers. Following Title I of the Restructuring Act, we are creating an organizational structure with operating units serving taxpayers with similar needs. We have created four Operating Divisions that will be fully responsible for all of the tax administration needs of specific corresponding taxpayer segments. They are: the Wage and Investment Division; the Small Business/Self-Employed Division; Large & Mid-size Business Division; and the Tax Exempt & Government Entities Division.

Beginning last month, IRS teams began to refine implementation details with the goal of having the modernized four-division structure, including executive leadership and budget authority, in place by October 2000. The Commissioner and Deputy Commissioners for all four divisions have been selected and sworn into office. 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 becomes operational in March 2000, followed by Wage and Investment and Small Business/Self-Employed Division in the fall of 2000.

In addition to the top leadership teams, we will put in place in the new organization, management that is accountable and is better informed of what is really going on in the field. It will understand specific taxpayers and be capable and empowered to improve the way we serve them and be more effective in identifying and addressing compliance problems.

Through this structure, we can attack the slowness problem. We can provide faster solutions to problems, faster decisions and improve our ability to deploy new technology. We will also build into the organization the basic quality principle that it is faster, more efficient and better for everyone to prevent a problem than to solve it. In making cars, for example, it's very expensive to issue a recall. It's cheaper to fix a defect before the car leaves the factory. It's best of all to improve the design and manufacturing process so no defect occurs in the first place.

That is why we have built into all of the business divisions the principle of working with taxpayers before they file their returns. We want to get it right the first time. Should we have to intervene through the collection or exam process, we want to identify and act on these problems as quickly as possible.

We want to be fast, but we also want to be consistent. Another important facet of the organizational design is to promote nationwide consistency in the way we do business with taxpayers, and the way we do business internally. One way we can achieve consistency is through the four operating divisions, each of which will have full responsibility nationwide for a major group of taxpayers.

At the top, we've established clear mechanisms for establishing and coordinating everything that goes into the Internal Revenue Manual that these divisions will use to administer the tax system.

This process will be greatly simplified by two factors. One, there are only four divisions that need to coordinate. Two, much of the tax code is not applicable to the taxpayers in all of the divisions. For example, the Wage and Income Division has the responsibility for 75 percent of the nation's taxpayers. However, 82 percent of the tax code doesn't generally apply to them.

Modern Technology

Updating our business practices to better serve taxpayers requires almost a complete replacement of IRS' information technology systems. They are built on a 30-year old fundamentally deficient foundation that cannot provide accurate up-to-date information about taxpayer accounts. GAO has repeatedly reported that IRS cannot provide reliable taxpayer account and financial information to manage the Agency. As Treasury Secretary Summers recently observed, "Critics of the IRS have noted that it has the best 1960s technology money could buy. We can no longer afford to wait for 30 years for major technology enhancements. Technology is moving too fast and America's expectations are too high."

Implementing new technology based on revamped business practices is critical to properly supporting our modernization concept and fully complying with the mandates of RRA 98. Over one year ago, the IRS awarded a Prime Systems Integration Services Contract (PRIME) to Computer Sciences Corporation (CSC) and their partners to help begin the long process of modernizing IRS' core business and technology systems.

Last July, we received from the Appropriations Committees authorization for the release of \$35 million in funding from the Information Technology Investment Account (ITIA). This is a first installment toward developing a new computer set of systems and a significant financial investment in our overall modernization plan.

With this money, a second installment of \$33 million released in December and the expected release of additional funds from the ITIA in the near future, we can begin to roll out improvements beginning in 2001. Some of these include enhancing our customer service call-management capabilities, improving electronic tax administration, and upgrading systems security.

The funding will also allow us to complete a business systems plan which will define the major projects to be undertaken over the next two to five years, including transitioning taxpayer accounts from a tape-based Master File to a more modern database.

This past year, IRS successfully delivered several technology improvements even as we worked on what has proved to be so far a very successful Y2K conversion project. The new Integrated Submission and Remittance Processing System (ISRP) combines and improves the processing of return submissions and payments. The consolidation of mainframe computers into central computing sites upgraded the IRS' disaster recovery capabilities. These efforts will need continued support over the next few years. In addition, IRS will continue the Service's commitment to ensure adequate testing of its tax systems.

One of the most significant challenges over the next few years will be system realignments and technology changes needed to implement the new IRS organization. These requirements include applications changes to align taxpayer segments and employees with the new operating divisions and modifications in payroll, financial management, personnel, accounting, reporting relationships, and workload management. Finally, determining changes and reworking infrastructure based on capacity, performance, and telecommunications assessments for the new organization structure are a major part of our modernization effort.

In June 1999, Paul Cosgrave was named IRS modernization executive with overall responsibility for managing and integrating the Core Business Systems programs. Also reporting to him is the Enterprise Management Program (EPMO) that was created to perform overall integration and management of all the projects in the program. The EPMO leadership includes an IRS business executive, an IRS IS executive and a PRIME executive.

In addition to establishing some key technology modernization operating guidelines, one of the principal objectives of the Core Business Systems program was to develop a definition of and priorities for the major projects to be carried out over the next five years. This process included an analysis of projects previously proposed or in process, as well as those needed to implement the modernization blueprint. The results of this process are summarized in Chart H from the year 2000 edition of Modernizing America's Tax Agency.

ADEQUATE RESOURCES TO CARRY OUR RRA 98

In the introduction to my testimony, I spoke of the need for continued support and commitment to carrying out RRA 98 and the IRS modernization process. That commitment means continuing to ensure that the IRS has adequate resources to confront the challenges it faces. It also means learning from the experiences of the past two years and providing resources that adequately meet the demands of RRA 98.

In fact, Mr. Chairman, over the last five years, the broad trend for the IRS budget has been increasing workload, increasing public expectations and decreasing staff resources. Because of budget constraints, in FY 2000 the IRS will have 14,808 fewer staff (FTEs) than in 1995. However, during this five-year period, a growing economy caused the workload to increase by 19 percent. In addition, legislation such as the Taxpayer Relief Act of 1997 (TRA) and RRA 98 also dramatically increased workload. By some counts, the TRA made more than 801 amendments to the Code, including 300 new provisions. RRA 98 created 71 new taxpayer rights requiring new procedures and increased time per case. It also broadly set forth higher expectations for the way taxpayers would be served.

These conflicting trends have not been reconciled by new technology because almost all technology spending during this period has been devoted to fixing the Y2K problem and responding to the needs of TRA and RRA 98. To this day, the IRS still depends on some of the most obsolete computer systems of any large institution in America.

Instead, the constraints, including budgetary, have meant providing less than acceptable service to compliant taxpayers, while drastically reducing the level of enforcement for such staff intensive and expensive procedures as case work in exam, collection and criminal investigation. Unless this trend is reversed, IRS will certainly fail to meet the public's expectations for the IRS.

Ultimately, the tax revenue of the United States will also be placed at risk. Our entire tax system depends on the vast majority of taxpayers who attempt to pay their taxes that are due having confidence that they are being treated fairly and that their competitors and neighbors are also paying what is due. If the public concludes over a period of time that the IRS cannot meet these basic expectations, the risk to the tax system will become very high and the effects very difficult and extraordinarily expensive to reverse.

Broadly speaking, there are two ways to reverse this downward trend. The first is to add staff in the traditional way to process more returns, answer more phone calls and letters, perform more examinations and do more casework of all kinds.

Given the growing economy, and the increased demands of complying with RRA, this approach would be extremely expensive. For the vast majority of taxpayers, this method would also not meet modern expectations for service levels. In addition, in today's labor market, the IRS would have difficulty attracting and retaining sufficient and qualified staff.

There is, however, another way. By investing in reengineering business practices and technology, all aspects of the IRS will be able to perform more effectively and efficiently, and in line with established best practice in the public and private sectors. This approach will still require adding limited numbers of staff in particular functions and locations. However, most of the demand for additional workload and service will be met by reassigning staff from those areas where technology can reduce or limit demand for staff. For example, by increasing electronic filing, the number of data transcriber temporary positions can be reduced. With the help of technology, these positions and related funding can then be used to improve service to compliant taxpayers needing answers to tax law questions and to make more outbound calls to collect overdue balances.

This second approach requires an on-going investment in business and technology reengineering, including retraining, but will enable the IRS to meet public expectations for its mission, but with much lower growth in staff and future budgets.

At a recent conference on IRS modernization, co-sponsored by the IRS and a number of practitioner groups, Treasury Secretary Larry Summers reported that it is expected that the President's budget for fiscal year 2001 will allow the IRS to continue to make the investments in its people and in technology that are critical to the modernization process. Most importantly, the Secretary went on to say, "our budget proposal will allow the IRS to end the shrinkage of its workforce that has in recent years only added to its challenges as it makes this difficult transition."

With this anticipated level of adequate funding, the IRS will be able to deliver on the RRA 98 mandates for improved service and taxpayer treatment while also increasing compliance effectiveness. In other words, we will be able to better deliver on all three of our strategic goals—not just one or the other. Once again, our goal is not to move some imaginary pendulum; our goal is to improve the entire way the IRS works.

CONCLUSION

Mr. Chairman, I believe we are making real progress on the goals and mandates set forth by the Restructuring Act. It is true that no one fully understood all of the consequences, particularly the budget consequences, of implementing the Act. There have been delays and there have been mistakes along the way, but we are addressing them. I firmly believe that we have set into motion the mechanism that will enable the IRS to change and enable us to put into place the men and women who will lead this change. If we can provide them with continued and assured support, they will produce the visible, tangible changes in service, compliance and productivity that America's taxpayers deserve and will finally see. Thank you.

Attachments.

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	RRA 98 Training, Phase I , included new Innocent Spouse provisions
September 1998	IRS Executives' Conference -- Innocent Spouse training
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 12/07/98, 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

CHART A (cont.)

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

CHART A (cont.)

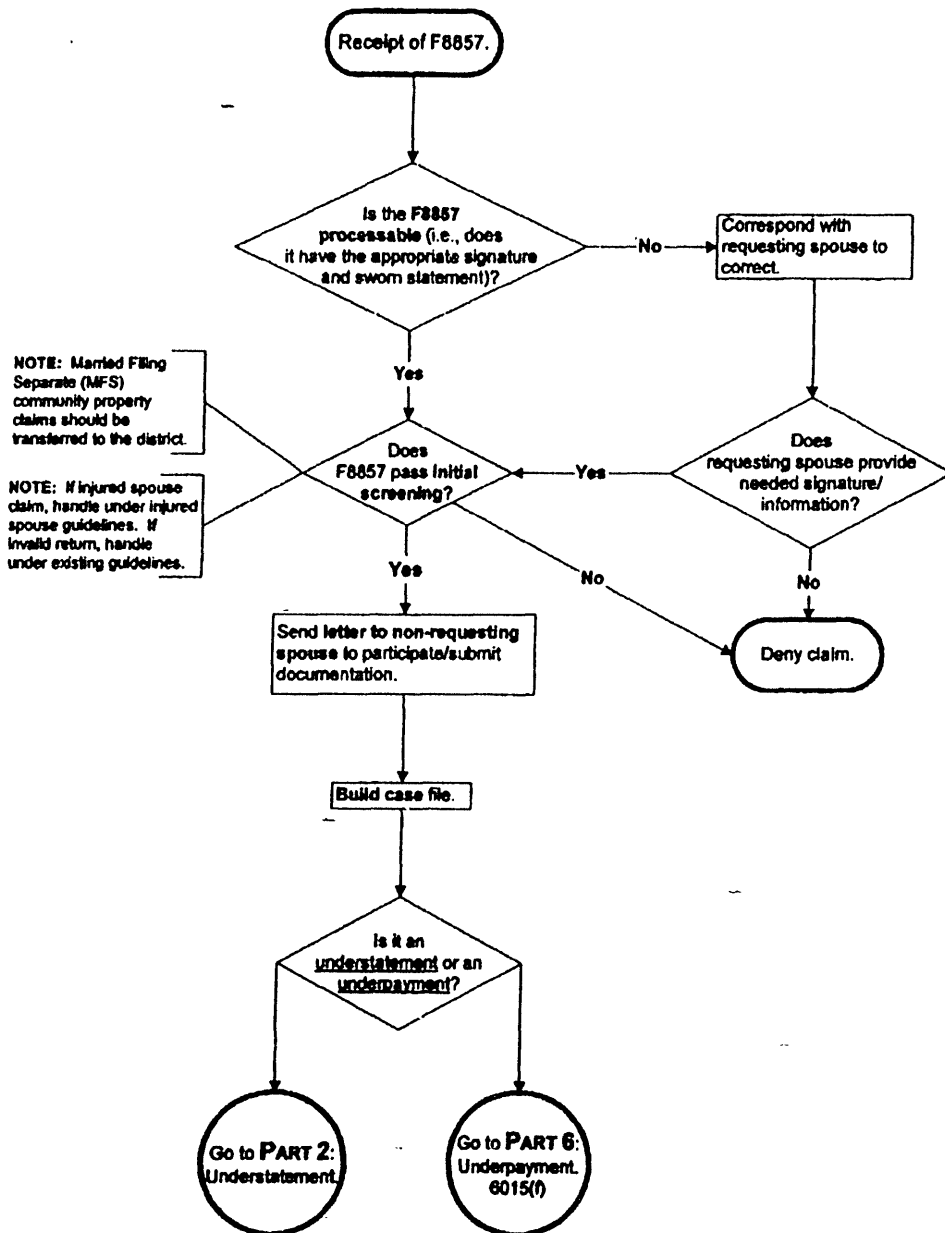
June 1999	National meeting of all District Innocent Spouse Coordinators to discuss barriers and direction of program
June 1999	Appeals Centralized Post Review of equitable relief cases established
July 1999	Special Assurance Reviews conducted in Cincinnati Service Center and 5 districts
July 1999	Decision Tree document created to assist in determining whether cases should be worked in Cincinnati Service Center or district
August 1999	Decision Tree Training conducted for all District Innocent Spouse Coordinators, their managers and branch chiefs.
August 1999	Interactive Video Training (IVT) broadcast to employees focusing on difficult provisions of innocent spouse law
August 1999	CPE for all employees included Innocent Spouse
August 1999	Executive Steering Committee convened with program, function, national office and taxpayer advocate representatives
October 1999	Form 8857, Request for Innocent Spouse Relief , 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 Interactive Internet Application – "Spousal Tax Relief Eligibility Explorer" – shared with 50,000 practitioners and on web site
September 1999	Temporary National Centralized Post Review of Innocent Spouse cases established to review quality and conduct trend analysis. Superseded national review of equitable relief cases
November 1999	3 Issue Specialists selected (for Cincinnati Service Center, community property and overall)
December 1999	Publication of new/revised letters to requesting and non-requesting spouses
January 2000	Formal training course on Innocent Spouse piloted

CHART A (cont.)

January 2000	Multi-functional team pilot started in 4 districts to make innocent spouse determinations, drawing on expertise of various functions to reach determinations and handle account processing
January 2000	Issuance of Revenue Procedure 2000-15, Guidance for Equitable Relief from Joint and Several Liability , on 01/18/2000, superceding interim guidance contained in Notice 98-61.
January 2000	Phase I of IV for Integrated Case Processing (ICP) System for Innocent Spouse
January 2000	Test of 1,000 CSC and 500 District cases to enhance criteria used to assign cases to appropriate personnel in CSC or field
Short term goal	Issuance of Regulations on Innocent Spouse Relief

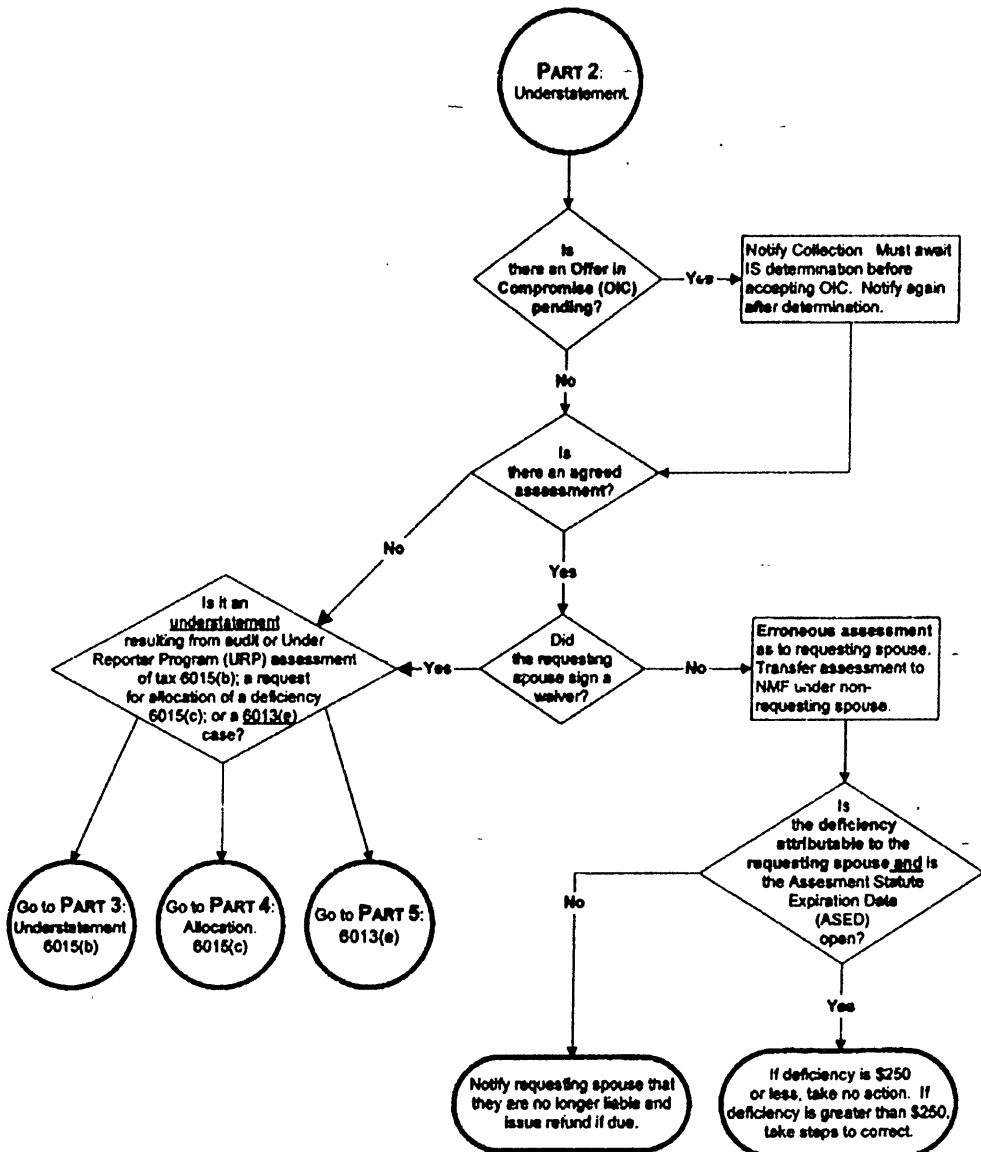
**Innocent Spouse
Decision Tool for Full Scope Determinations
Part 1: Initial Screening**

CHART B



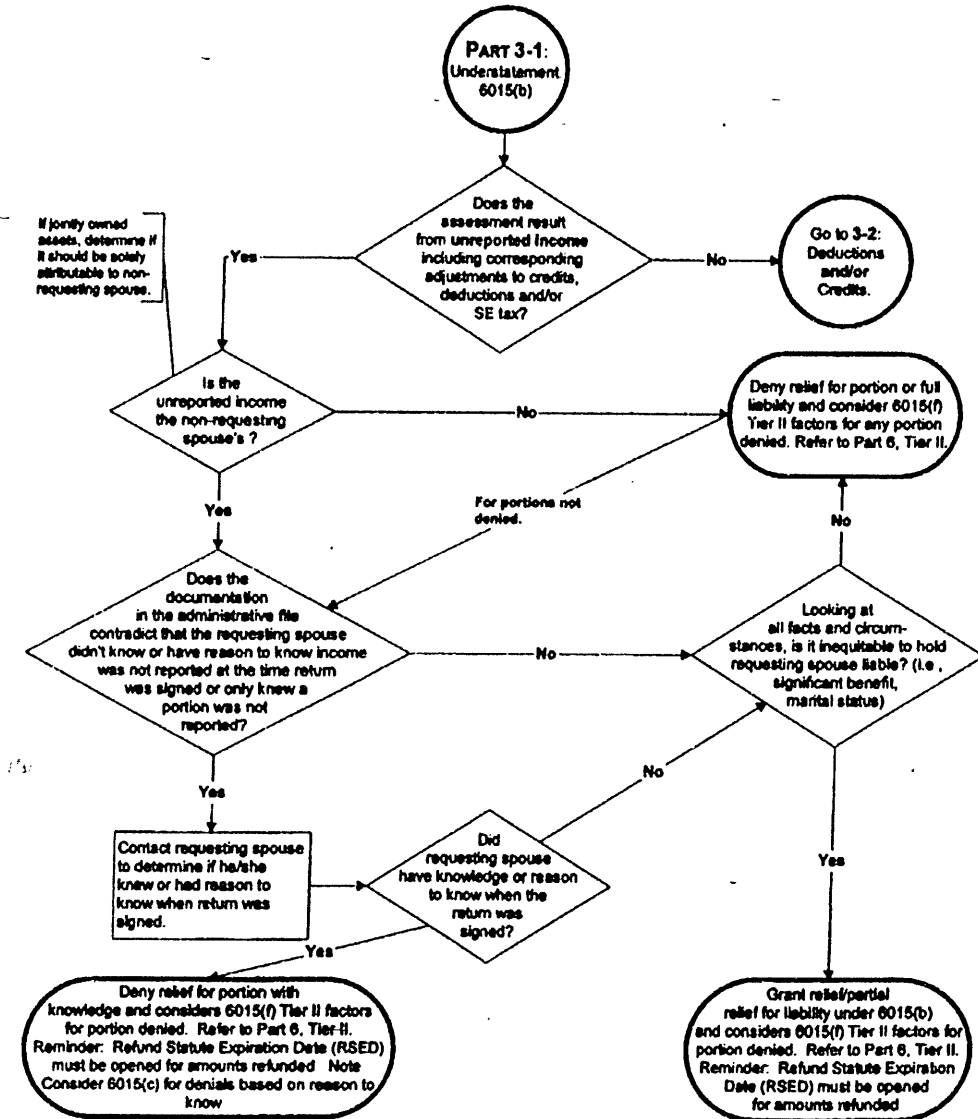
Decision Tool for Full Scope Determinations
Part 2: Understatement of Tax

CHART B (cont.)



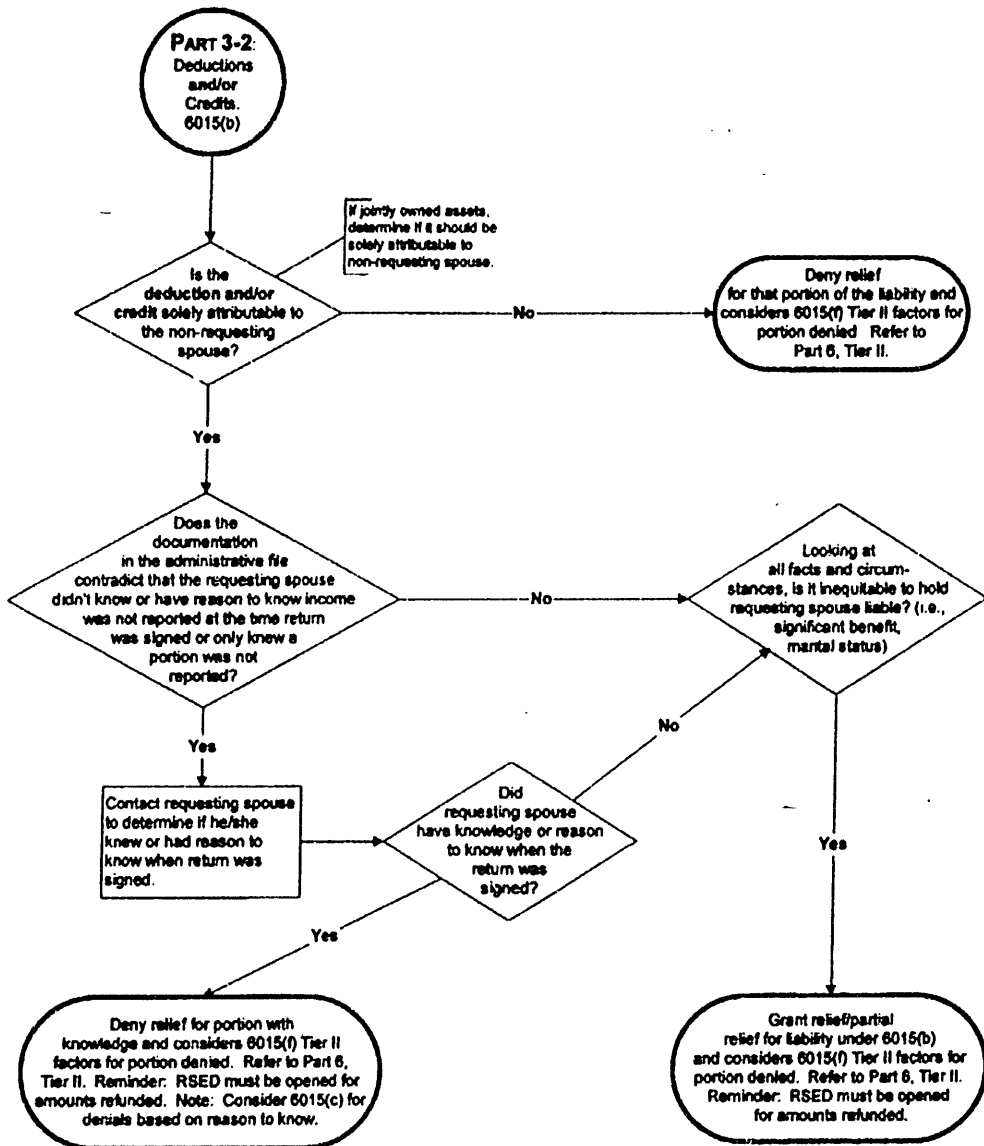
Decision Tool for Full Scope Determinations
Part 3-1: Understatement of Tax - 6015(b)
Assessment from Unreported Income

CHART B (cont.)



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

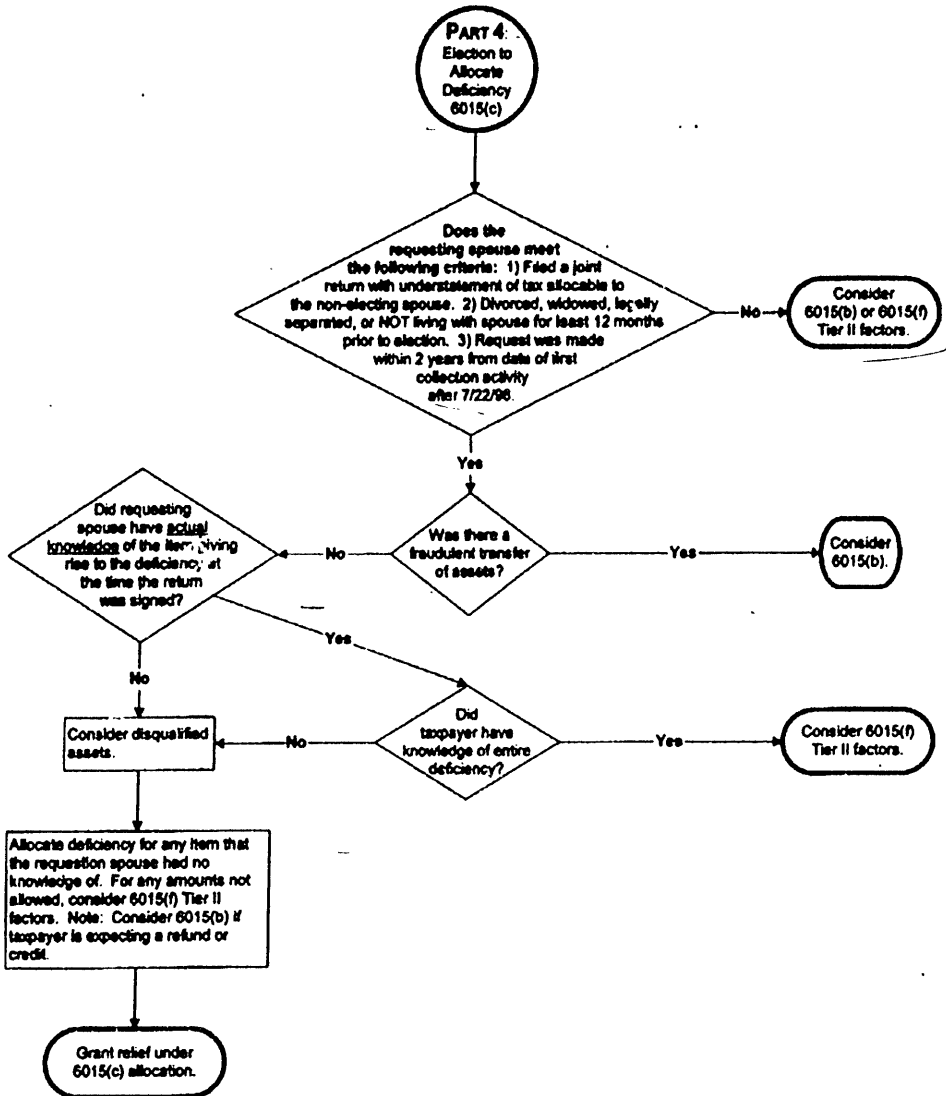
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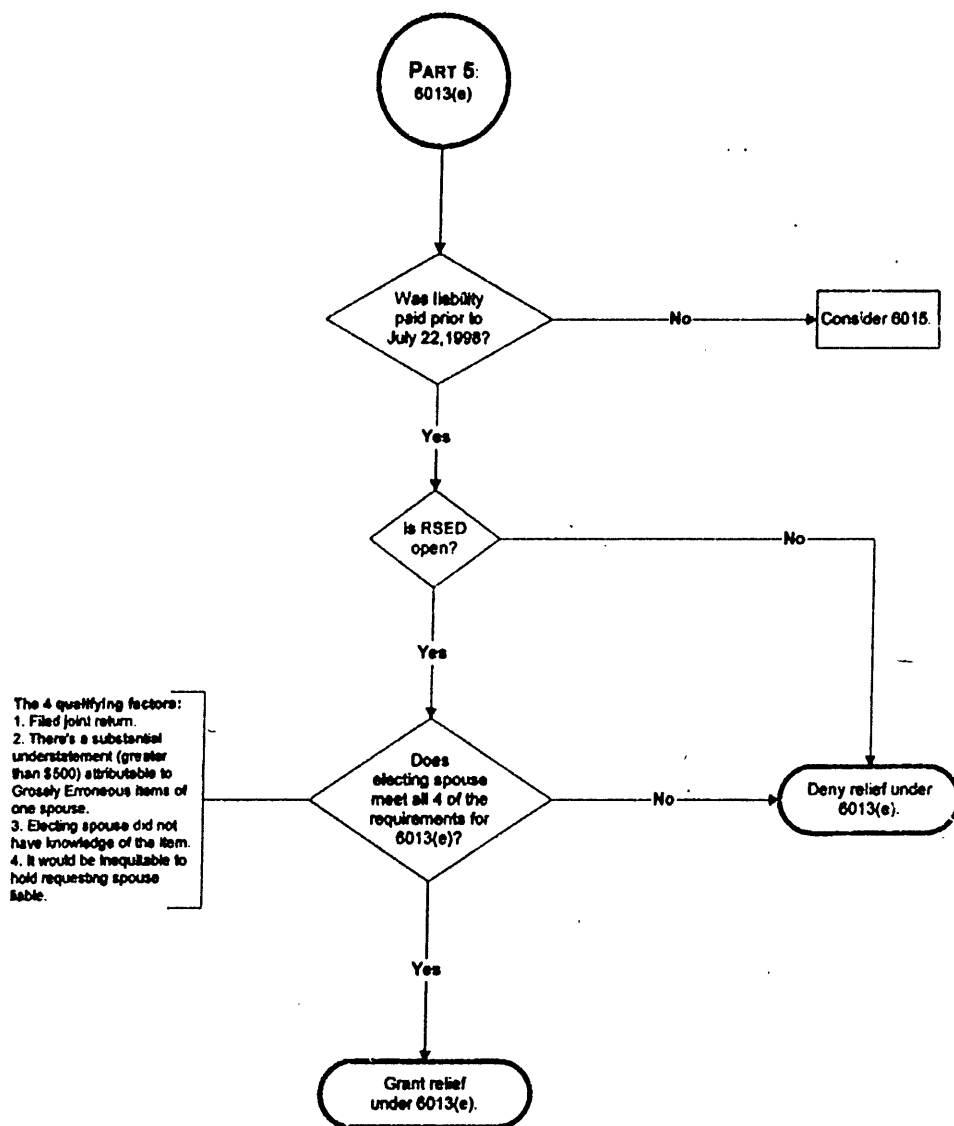
01/21/00

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

CHART B (cont.)

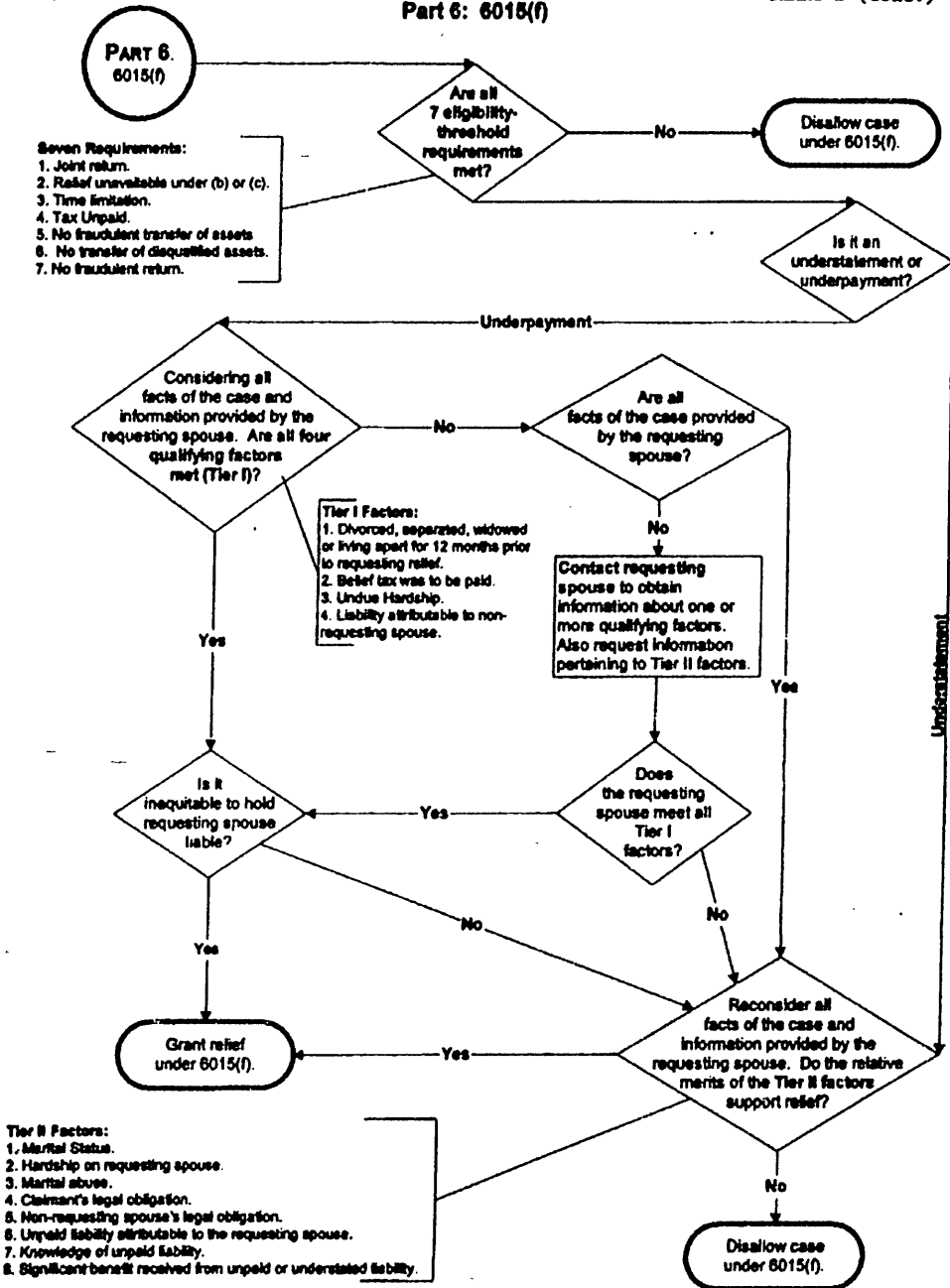


Decision Tool for Full Scope Determinations
Part 5: IRC Section 6013(e) - Applies to liabilities paid prior to July 22, 1998



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

CHART B (cont.)



01/21/00

CHART C

INNOCENT SPOUSE CLAIM YEARS CONSIDERED				
revised				
Claims Received and Input Into the Innocent Spouse Tracking System (ISTS) *				56,906
Claims Not Meeting Basic Requirements *				9,137
Taxpayer Withdrew Claim	539	5.9%		
No Remaining Liability (past collection statute)	2,286	25.0%		
Injured Spouse	1,328	14.6%		
Taxpayer Did Not Provide Required Information	961	10.5%		
Incorrect Filing Status	2,634	28.8%		
Paid Prior to Effective Date of RRA	280	3.1%		
Past Statute for Refund	86	0.9%		
6013(a) Dollar Threshold	45	0.5%		
Original Assessment	812	8.9%		
Offer in Compromise Accepted	59	0.6%		
Not Income Tax	107	1.2%		
		100.0%		
Claims Awaiting Mandatory Local Review				5,513
Claims Evaluated Based on Merit *				8,037
Fully Allowed	3,217	40.0%		
Partially Allowed	493	6.1%		
Disallowed	4,327	53.8%		
		100.0%		
Claims in Appeals *				599
Total Claims Awaiting Determinations				33,620

* These totals do NOT include approximately 7,000 claims received and closed prior to implementation of the Innocent Spouse Tracking System (ISTS).

Figures are from 5/18/98 through 12/31/99

Source: Innocent Spouse Tracking System

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	4,500
Cff	254,614	175,065	86,198	90,000
Total	368,701	231,218	90,541	94,000
Levies				
Non-Cff(ACS)	2,100,152	1,288,995	16,063	17,000
Cff	509,595	247,654	49,071	70,000
Total	2,609,747	1,536,649	65,134	87,000
Seizures	6,242	744	59	100

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	25,000
Cff	366,687	283,353	144,687	150,000
Total	543,613	382,755	167,867	175,500
Levies				
Non-Cff(ACS)	2,968,489	2,029,928	397,656	421,500
Cff	690,928	473,481	106,747	150,000
Total	3,659,417	2,503,409	504,403	571,500
Seizures	10,090	2,307	161	272

Source: NO-5000-23 Report

Chronology of Section 3401, Collection Due Process

07/22/98	Passage of RRA 98, Section 3401, Collection Due Process (CDP) Provisions
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.
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.

CHART E (cont.)

January 1999	<p>The following new and revised letters, forms, and publications published to implement the provisions of Section 3401.</p> <ul style="list-style-type: none"> ▪ 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 1880, Collection Appeal Rights. ▪ Publication 594, The IRS Collection Process.
January 1999	<p>The following Appeals letters and form were cleared and available for use.</p> <ul style="list-style-type: none"> ▪ 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	<p>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.</p>
January 1999	<p>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.</p>
January 1999	<p>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.</p>
February 1999	<p>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.</p>
February 1999	<p>Memorandum of Understanding between Collection and Appeals provides for detailing revenue officers to Appeals in the event the workload in Appeals warranted additional resources.</p>

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.

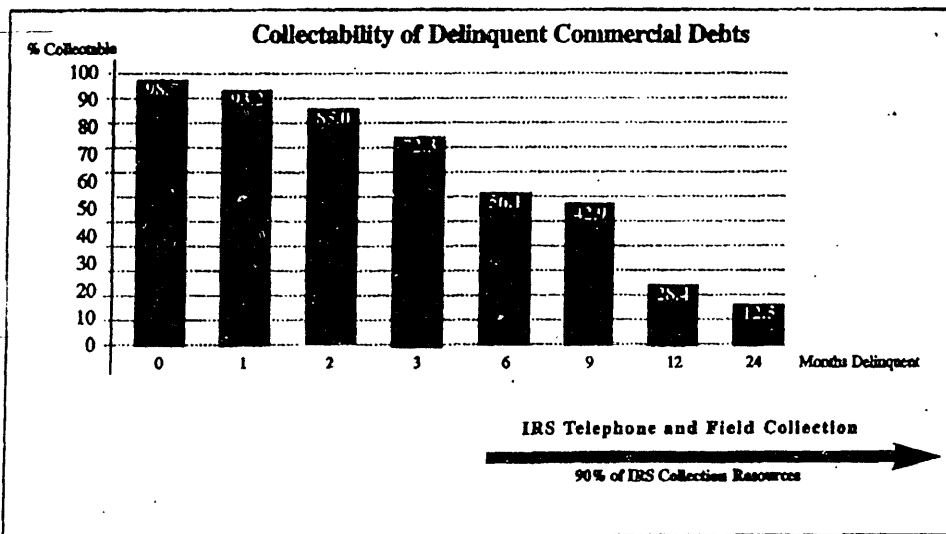
CHART E (cont.)

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	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.
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. Meriters with collection

CHART E (cont.)

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.

CHART F



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

CHART C (cont.)

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

CHART G (cont.)

June 1999	Finalized report on policy, legal and operational issues and developed revision to letter 3164 based on meetings, field tests, and external partners
June 1999	3417 Systems of Record 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 3164 to representatives from all district offices 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

CORE BUSINESS SYSTEMS - INITIAL PROJECTS		
PROJECT	OBJECTIVE	INITIAL RELEASE BUSINESS
Customer Communications	• Improve taxpayer access to service via telephone and Internet	OWNERS WAGE & INVESTMENT
e-Services: Near Term	• Create an integrated, Web-based replacement for the existing value-adding third-party tools and data collection vehicles	ELECTRONIC TAX ADMINISTRATION
Customer Account Data Engine	• Build modernized database for managing customer information	WAGE & INVESTMENT
Correspondence and Document on Demand Imaging	• Build systems to store and display on-line images of correspondence and selected returns	TAX EXEMPT & GOVERNMENT SERVICES
CRM Collections	• Modernize collection processes and policies to enable faster case resolution	SS/SE
Customer Relationship Management (CRM) Exam	• Modernize examination processes, providing improved tools to agents and faster case resolution	LARGE & MID-SIZE BUSINESS
e-Services: Strategic	• Foster the creation & marketing of easy-to-use electronic products & services, targeted at specific customer segments, to inform, educate & service the taxpaying public - including secure electronic interactions & customer account self-management	ELECTRONIC TAX ADMINISTRATION
Integrated HR System: Integrated Personnel System	• Implement a single system for IRS employee data and human resource services	MANAGEMENT & FINANCE
Integrated Finance/ System: Revenue Accounting	• Improve financial management and reporting, and provide service employees with greater access to taxpayer payment data	MANAGEMENT & FINANCE
Integrated Financial System: Managerial Accounting/Budgeting	• Provide greater access to operational information to support timely, data-driven, managerial decision-making • Provide general ledger and budget execution	BUSINESS SYSTEMS MODERNIZATION

RESPONSE TO A QUESTION FROM SENATOR ROBB

Question: Currently, Virginia tobacco farmers are receiving 1099s for the payments they received in 1999 from the Tobacco Master Settlement Agreement. There is some concern that the IRS will treat these payments as income. At least, in the case of quota holders, these payments should be treated as a return on capital and not as income. Furthermore, these payments should not be taxable as a capital gain until the quota holder's basis is reduced to zero. Once the taxpayer has no basis in the quota then all payments received, or proceeds from the sale or the quota, should be treated as capital gain. I ask for your assistance in addressing this problem before the start of filing season for tobacco farmers.

Answer: The Internal Revenue Service Office of Chief Counsel has been assigned to study the issue you have raised and is working with Treasury's Office of Tax Legislative Counsel to determine the proper tax treatment of payments from the Tobacco Master Settlement Agreement (MSA). We have determined that tobacco growers and quota owners using the cash method of accounting are not required to include in gross income for 1999 payments from the National Tobacco Grower Settlement Trust that were received in 2000. Thus, payments received pursuant to the MSA by a calendar year, cash method taxpayer would be reportable in 2000, rather than 1999 as the Forms 1099s received by taxpayers may have implied. This conclusion allows additional time to analyze fully the proper characterization of these pay-

ments. We will keep you informed of our progress and will let you know once a final conclusion is reached.

PREPARED STATEMENT OF JAMES R. WHITE

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the Internal Revenue Service's (IRS) progress in implementing the taxpayer rights and protections mandates of the IRS Restructuring and Reform Act of 1998 (Restructuring Act).¹ I will also discuss a related topic—the challenges IRS faces in its ongoing efforts to modernize. The connection is important, as was recognized by Congress in the Restructuring Act. As my statement today underscores, modernization is key to improving the way IRS interacts with taxpayers, including protecting their rights.

Passage of the Restructuring Act signaled strong congressional concern that IRS had been overemphasizing revenue production and compliance at the expense of fairness and consideration of taxpayer interests. To deal with this concern, Congress mandated that IRS make numerous changes. Many of these changes, such as provisions governing the seizure of delinquent taxpayers' assets and innocent spouse relief, were designed to address specific taxpayer protection issues. Others, like the mandate to reorganize IRS into units serving specific groups of taxpayers, were broader in scope. In their totality, the Restructuring Act's provisions were aimed at fundamentally changing the way IRS interacts with taxpayers and otherwise conducts its business.

My statement is based on our past work, principally our reviews of IRS' reorganization process, performance management system, systems modernization efforts and use of collection enforcement authority. My statement makes the following points regarding IRS' progress in implementing the act's requirements.

- First, IRS has embarked on a concerted effort to implement the taxpayer protection provisions. In some instances, implementation is not complete, and in some others, it is too early to tell if implementation is successful.
- Second, IRS has experienced difficulties in implementing some aspects of the mandates. These difficulties included determining when enforced collection actions, such as the seizure of delinquent taxpayers' assets, are appropriate and dealing with requests for relief under the innocent spouse provisions.
- Third, we believe that IRS' ongoing efforts to modernize its organizational structure, performance management system, and information systems are heading the agency in the right direction. IRS' modernization is a long-term effort that, if successful, should help IRS create a culture focused on serving the public and generate efficiency improvements throughout the agency. Both are necessary—a culture change to institutionalize taxpayer service as a core value, and efficiency gains to allow IRS to better target its resources to promote compliance and taxpayer service.

IMPLEMENTATION UNDER WAY BUT WORK REMAINS

IRS has made a concerted effort to implement the Restructuring Act's taxpayer rights and protections mandates. Not surprisingly, given the magnitude of change required by these provisions, work remains in completing, and in some instances expanding on, current implementation efforts.

To manage Restructuring Act implementation, IRS delegated lead responsibility for each of the provisions to the affected organizational unit and required those units to develop detailed implementation plans. For example, IRS assigned to its Collections unit the lead responsibility for implementing the 22 collection-related taxpayer protection provisions in title III of the act. Our review of each of these plans identified numerous action items, such as developing tax regulations, forms, instructions, and procedures, as well as milestones for completing the actions. According to IRS officials, although IRS has met all of the legal requirements of the provisions whose effective dates have passed, it is still in the process of completing several actions or implementation steps. For example, in order to meet the effective dates of some provisions, IRS issued temporary procedures until the final rule-making could be completed.

Despite the rather detailed nature of the implementation plans, in some instances we have questions concerning the sufficiency of those plans. For example, with respect to selling assets seized from delinquent taxpayers to resolve their tax debts, the Restructuring Act mandated IRS, by July 2000, to remove revenue officers from

¹ Public Law 105-206, July 22, 1998.

any participation in such sales and to consider "outsourcing." In our November 1999 report on IRS seizures, we reported on IRS' implementation efforts, including establishment of a study group to develop implementation plans.² Given the study group's preliminary work, however, we concluded that removing revenue officers from the sales process was not, by itself, sufficient to ensure that some basic problems that we identified in the sales process would be corrected. These problems involved the sale of taxpayer assets without competitive bidding, sales based on unreliable minimum prices, and insufficient controls to establish accountability and control over assets. Accordingly, we made a number of recommendations to IRS regarding these problems and are awaiting a final response concerning its plans to implement the recommendations.

In another instance, IRS has made changes to meet the Restructuring Act's mandate but does not have information necessary to determine whether the implementation steps have been sufficient. The act prohibits IRS from using enforcement statistics to impose or suggest production quotas or goals for any employee, or to evaluate an employee based on such enforcement quotas. IRS has taken a number of actions to implement this mandate, such as issuing a handbook on the appropriate use of performance measures and conducting agencywide training sessions. IRS has also taken action on our recommendations,³ such as by clarifying the requirements for IRS managers to certify that they have not used enforcement statistics inappropriately. In its spring 1999 survey, IRS found that about 7 percent of Collections employees and 9 percent of Examination employees reported that their supervisors had either discussed enforcement statistics with them or used statistics to evaluate their performance. Until it has more recent comparison data, IRS will not know if its actions were sufficient to fulfill the Restructuring Act's mandate.

IRS' DIFFICULTIES IN IMPLEMENTING THE RESTRUCTURING ACT

IRS has also experienced some difficulty in implementing the Restructuring Act. Two notable examples are the decline in enforcement actions, particularly liens, levies, and seizures and the backlog of "innocent spouse" cases.

IRS' use of enforcement actions to collect delinquent taxes has declined significantly since passage of the act. Comparing pre-Restructuring Act data on IRS' use of liens, levies and seizures, with fiscal 1999 data shows that lien filings were down about 69 percent, levies down about 86 percent, and seizures down about 98 percent. Moreover, according to IRS, collections from delinquent taxpayers were down about \$2 billion from fiscal year 1996 levels.

We do not know the appropriate number of enforcement actions that IRS should take because such decisions necessarily involve the use of judgment by IRS officials. However, based on our review of fiscal year 1997 seizure cases, the current number of seizures is probably too low. In fiscal year 1997, the last full year before passage of the Restructuring Act, about 42 percent of seizures resulted in the tax debt being fully resolved. In most cases, the debt was resolved when the taxpayers produced funds to fully pay their tax liabilities and have their assets returned. Prior to the seizures, the involved taxpayers had been unresponsive to other IRS collection efforts, including letters, phone calls, personal collection visits, and levies of bank accounts and wages. We concluded from these observations that there was little likelihood that the tax debts would have been paid without the seizure actions.

At the conclusion of our seizure work in 1999, it was clear to us that neither IRS management officials nor front line employees believed that seizure authority was being used when appropriate. Front line employees expressed concerns about the lack of guidance on when to make seizures in light of Restructuring Act changes. Accordingly, we made recommendations aimed at (1) clarifying when seizures ought to be made, (2) preventing departures from process requirements established to protect taxpayer interests, and (3) delineating senior managers' responsibilities for ensuring that seizures are made when justified. Effective use of tax collection enforcement authority, such as seizing delinquents' property to resolve their tax debts, plays an important role in ensuring voluntary compliance—a practice dependent on taxpayers having confidence that their neighbors or competitors are complying with the tax law.

A second example of IRS difficulty in implementing the Restructuring Act is related to "innocent spouse" cases. The Restructuring Act expanded innocent spouses' right to seek relief from tax liabilities assessed on jointly filed returns. IRS pub-

² See *IRS Seizures: Needed for Compliance but Processes for Protecting Taxpayer Rights Have Some Weaknesses* (GAO/GGD-00-4, Nov. 29, 1999).

³ See *IRS Personnel Administration: Use of Enforcement Statistics in Employee Evaluations* (GAO/GGD-99-11, Nov. 30, 1998).

lished forms and temporary guidance to implement this provision and has just recently issued permanent guidance on equitable relief provisions.⁴ However, as Commissioner Rossotti has acknowledged, IRS was administratively unprepared to deal with the volume of requests for relief because its data systems did not allow the separation of single tax liability for spouses into multiple liabilities. Thus, IRS established manual processes and controls to deal with the requests, a measure requiring about 330 additional staff. As of October 1999, of the 41,000 relief requests received, only about 12 percent had been processed to the point where at least a preliminary determination had been reached. IRS considers the remaining relief requests to be a significant backlog that will require an average of about 12 staff hours per case to resolve.

TO MAKE LASTING PROCESS AND EFFICIENCY IMPROVEMENTS, IRS FIRST NEEDS TO
ADDRESS SYSTEMIC BARRIERS

Underlying the Commissioner's modernization strategy is the understanding that fulfilling the Restructuring Act's mandate to place greater emphasis on taxpayer rights and needs while ensuring compliance depends on two key factors. First, IRS must make material improvements in the processes and procedures through which it interacts with taxpayers and collects taxes due. Second, IRS must make efficiency improvements that will allow reallocation of its limited resources. Historically, however, IRS has not had much success designing and implementing these kinds of process changes. The Commissioner has argued, and we agree,⁵ that this difficulty is due in large part to systemic barriers in IRS' organization, management, and information systems. Accordingly, and in compliance with the Restructuring Act, the Commissioner has begun to implement a multifaceted modernization strategy, the first stages of which are designed to address these systemic barriers.

CREATING A TAXPAYER-FOCUSED STRUCTURE AND CLEARER LINES OF AUTHORITY AND
ACCOUNTABILITY

Notwithstanding a reduction in the number of its field offices, IRS' organizational structure has not changed significantly in almost 50 years. Under this structure, authority for serving taxpayers and administering the tax code is decentralized to 33 districts and 10 service centers, with each of these geographic units organized along functional lines—such as collection, examination, and taxpayer service. This has resulted in convoluted lines of authority. In the collection area, for example, IRS has three separate kinds of organizations spread over all 43 operational units that use four separate computer systems to collect taxes from all types of taxpayers. This decentralized structure has also allowed disparity among districts in their compliance approaches and, as a result, inconsistent treatment of taxpayers. To illustrate, in our review of IRS' use of its seizure authority, we found that seizures were as much as 17 times more likely for delinquent individual taxpayers in some district offices than in others.⁶ Similar variations exist in other IRS programs as well.

To streamline its management structure and create a more taxpayer-focused organization, IRS is in the midst of instituting a major reorganization. IRS' new organizational structure is built around four operating units, each with end-to-end responsibility for serving a group of taxpayers—such as individuals or small businesses—with similar needs and tax issues.⁷ Through its new taxpayer-focused operating divisions, IRS is centralizing management of key functions and creating narrower scopes of responsibility. For example, IRS estimates that individual taxpayers account for 75 percent of all filers, yet only 17 percent of the tax code is ordinarily relevant to them. By creating a division devoted solely to individual taxpayers, IRS is creating a situation in which managers and employees in that division will be able to focus on compliance and service issues related to individual taxpayers and will need expertise in a much smaller body of tax law.

Creating a simpler, more coherent organization and management structure is an important step, but it does not guarantee good management. IRS' managers, at all

⁴ See Revenue Procedure 2000-15 issued January 18, 2000.

⁵ See *IRS Management: Business and Systems Modernization Pose Challenges* (GAO/T-GGD/AIMD-99-138, Apr. 15, 1999) and *IRS Management: Formidable Challenges Confront IRS as It Attempts to Modernize* (GAO/T-GGD/AIMD-99-255, July 22, 1999).

⁶ Our comparisons among district offices showed differences in the likelihood of seizure ranging from 1.25 times to 17 times.

⁷ IRS' four operating divisions are: (1) Wage and Investment, serving individual taxpayers; (2) Small Business and Self-Employed, serving fully or partially self-employed individuals and small businesses with assets under \$5 million; (3) Large and Mid-Size Business, serving businesses with assets over \$5 million; and (4) Tax Exempt and Government Entities, serving pension plans, exempt organizations, and governments.

levels, need to be skilled in results-oriented management, including planning, performance measurement, and the use of performance data in decisionmaking. Without these skills, IRS cannot be assured that its employees and the agency as a whole are performing as expected with regard to both taxpayer rights and enforcement. Our work has shown that ensuring that IRS has the capacity it needs in this area will be a challenge.

For example, in our recent work on IRS seizures, we found that IRS did not generate information sufficient for senior managers to use in monitoring the program. IRS did not have a fully developed capability to monitor the quality of seizure work in terms of the appropriateness of seizure decisionmaking or the conduct of asset management and sales activity. In addition, collection managers were not systematically provided with information on the type of problems experienced by taxpayers involved in a seizure or on the resolution of those problems. We concluded that IRS managers were not collecting the information needed to effectively oversee the program and made recommendations to improve oversight. Our point today, however, is that generating and using basic management information needs to be routine among IRS managers at all levels and across all taxpayer groups and functions.

DEVELOPING PERFORMANCE MEASURES AND EVALUATION SYSTEMS THAT SUPPORT AGENCY GOALS

The organizational and management changes I've described, while significant, will not be sufficient to achieve IRS' mission. As an agency still dealing with the repercussions of a performance system that was, for many years, based on enforcement statistics, IRS well knows that performance measures can create powerful incentives to influence both organizational and individual behavior. Consequently, IRS needs to develop an integrated performance management system that aligns employee, program, and strategic performance measures and creates incentives for behavior supporting agency goals, including that of giving due recognition to taxpayers' rights and interests.

Developing and implementing performance measures are difficult tasks for any organization, but especially for an organization like IRS that must ensure both quality taxpayer service and tax law compliance. At the operational level, IRS is measuring its progress toward these goals through customer satisfaction surveys and through the business results measures of quality and quantity. Mindful of concerns that the Service had focused on revenue production as an end in itself, IRS established what it believes are outcome-neutral quantity measures. For example, instead of measuring the revenue generated by compliance employees, IRS is generally monitoring the total number of cases closed, regardless of how those cases were closed.

We have reported in the past that IRS employees' performance focused more on IRS' objectives of revenue production and efficiency than on taxpayer service.⁸ Guided by these concerns and the Restructuring Act's explicit prohibitions against using enforcement statistics to evaluate employees, IRS now recognizes that employees must have a clearer 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.

MODERNIZING INFORMATION SYSTEMS TO SUPPORT BUSINESS MODERNIZATION

IRS' system difficulties hinder, and will continue to hinder, efforts to better serve taxpayer segments. IRS has dozens of discrete databases that are function specific and are designed to reflect transactions at different points in the life of a return or information report—from its receipt to disposition. As a consequence, IRS does not have any easy means of accessing comprehensive information about individual taxpayer accounts or summary data on groups of taxpayers. Without this type of data, IRS managers will continue to have a difficult time monitoring and managing program outcomes—including identifying taxpayer needs and evaluating the effectiveness of programs to meet those needs. In doing our work on small business compliance issues, for example, we found that IRS could not reliably provide data on the extent to which small businesses filed various required forms, when they made tax deposits, or the extent to which they were involved in a variety of enforcement processes.

⁸ *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).

For years, IRS has struggled to modernize its information systems to support high quality taxpayer service and management information needs. In 1995, we made over a dozen recommendations to correct management and technical weaknesses that jeopardized the modernization process.⁹ In February 1998, we made additional recommendations to ensure, among other things, that IRS develops a complete systems architectural blueprint for modernizing its information systems.¹⁰ Subsequently, in fiscal years 1998 and 1999, Congress provided IRS funds for systems modernization and limited their obligation until certain conditions, similar to our recommendations, were met.¹¹ While IRS has made progress in addressing our recommendations and complying with the legislative conditions, the Service has not yet fully implemented our recommendations.¹² As a result, at the direction of the Senate and House appropriation subcommittees responsible for IRS' appropriation, we have continued to monitor and report on IRS' system modernization efforts.

**IRS IS RELYING ON SUCCESSFUL MODERNIZATION TO CREATE GREATER OPPORTUNITY
FOR FRONTLINE IMPROVEMENTS**

We believe that IRS' modernization efforts to date are heading the agency in the right direction. Without integrated improvements to its organization, management, performance measures, and information systems, IRS is at risk of being unable to achieve the Restructuring Act's overall mandate. If successful, however, IRS will be better able to create a culture focused on serving the public and to generate efficiency improvements throughout the agency. Both are necessary—a culture change to institutionalize taxpayer service as a core value, and efficiency gains to allow IRS to better target its resources to promote compliance and taxpayer service.

Mr. Chairman, this concludes my prepared statement. I would be happy to answer any questions you or other Members of the Committee may have.

RESPONSES TO QUESTIONS FROM SENATOR ROTH

Question: While the use of levies and seizures has plummeted, the Tax IG (Treasury Inspector General for Tax Administration) and GAO have found that when IRS did engage in these activities, it violated the law or IRS procedures in 33 percent of the few levies and seizures made over the past year. What can be done to ensure that levies and seizures done in accordance with the law?

GAO Response: In our report on IRS' use of its seizure authority, we concluded that because IRS' controls were not sufficient to prevent departures from pre-Restructuring Act process requirements, it was unclear to us how a continued reliance on manual reviews of revenue officer case file information would be sufficient to prevent departures from requirements in the future. Thus, we looked for a relatively "fail-safe" check that could stop a collection case from advancing to seizure if a requirement was not met. During our review, we found that IRS was expanding an automated field collection system to cover the seizure process, including plans for the computer generation of seizure forms. This automated system had linkages to other information systems in IRS, such as the masterfile, which contain account data and notification data. In discussions with the IRS personnel developing the automated system, we learned that programming could be done to prevent the generation of forms, such as the form needed for seizure approval, if taxpayer protection requirements were not documented as met. Also, expanding the capabilities of this system to automate checks that process requirements were met would allow the managerial review to focus largely on judgmental areas, such as the adequacy of revenue officer contacts with taxpayers. Accordingly, we recommended that IRS build controls into the automated field collection system that would act as a check to prevent departures from seizure process requirements that are verifiable on an automated basis (e.g., required taxpayer notifications made and time requirements followed).

Committee Question: We have heard a great deal about "balanced measures" for evaluating employees. Please explain to the Committee how you interpret "balanced measures."

⁹ See *Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is To Succeed* (GAO/AIMD-95-156, July 26, 1995).

¹⁰ *Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire System* (GAO/AIMD/GGD-98-54, Feb. 24, 1998).

¹¹ Public Law 105-61, October 10, 1997, and Public Law 105-277, October 21, 1998.

¹² See *Tax Systems Modernization: Results of Review of IRS' Initial Expenditure Plan* (GAO/AIMD/GGD-99-206, June 15, 1999) and *Major Management Challenges and Program Risks: Department of the Treasury* (GAO/OCG-99-14, Jan. 1999).

See *IRS Seizures: Needed for Compliance but Processes for Protecting Taxpayer Rights Have Weaknesses* (GAO/GGD-00-4, Nov. 29, 1999).

GAO Response: IRS' balanced performance measurement system is intended to ensure that IRS does not focus on revenue production at the expense of taxpayers' interests. IRS is currently using three types of measures to assess how well it is meeting its overall mission to provide quality customer service and to enforce the tax law. The three measures are (1) customer satisfaction, (2) business results (quality and quantity data), and (3) employee satisfaction. Given concerns regarding IRS' past use of enforcement statistics to measure performance, IRS has established what it believes are outcome-neutral quantity measures. For example, instead of measuring revenue generated by compliance employees, IRS is monitoring the total number of cases closed, regardless of how those cases were closed.

To date, the balanced performance measurement system has not been applied to employee evaluations. IRS is still exploring the best way to link the employee evaluation system to its overall strategic goals and measures. In the meantime, we recently reported that IRS could use to greater advantage several features of its existing evaluation process, such as the narrative comments and field visits, to reinforce the importance of customer service among enforcement employees.

Committee Question: The Tax IG's office found numerous violations of the law that prohibits IRS employees from being evaluated based on enforcement statistics. In 1988, we outlawed this practice with respect to collection employees. We found that the IRS ignored the law. In the Restructuring Act, we prohibited any IRS employee from being evaluated based upon enforcement statistics. This could result in taxpayer rights being violated. It seems we are going down the same path. What are your views? Are we going down the same path?

GAO Response: As we noted in our testimony, IRS has made changes intended to prevent misuse of enforcement statistics. Some of these changes—such as expanding the number of employees who may not be evaluated on the basis of enforcement statistics—were made immediately or shortly after the enactment of the Restructuring Act. Others—such as IRS' issuance of a handbook on the appropriate use of performance measures and clarification of the requirements for certifying that IRS managers have not used enforcement statistics inappropriately—are more recent. Neither we nor IRS have evaluated the effectiveness of these changes. At present, IRS has some but not all of the performance information it needs to make such an assessment. Specifically, IRS' spring 1999 employee survey found that about 7 percent of Collection employees and 9 percent of Examination employees reported that their supervisors had either discussed enforcement statistics with them or used statistics in their evaluations. The results of IRS' next survey should provide comparative data to assess whether the agency's actions have made progress in reducing these numbers.

Committee Question: The Tax IG and GAO have found that IRS' management information systems need work. Management must have access to information in a usable format. For example, the Tax IG notes that IRS does not have a database to reliably track innocent spouse cases. Do you agree this is an issue? What impact does this lack of information have on taxpayer rights?

GAO Response: Lack of adequate management information is a serious issue at IRS. We have reported on a number of occasions that IRS' systems difficulties hinder efforts to manage its operations and better serve taxpayers. These difficulties will continue until IRS successfully modernizes its information systems. At the most fundamental level, IRS does not have the ability to access up-to-date, comprehensive information about individual taxpayer accounts, and as demonstrated by IRS' inability to track innocent spouse cases, this lack clearly undermines IRS' ability to provide top-quality service to taxpayers. IRS' management information systems are also not structured to provide comprehensive summary data for taxpayer segments, such as small businesses, or groups of taxpayers undergoing enforcement actions. In doing our work on small business compliance issues, for example, we found that IRS could not reliably provide data on the extent to which small businesses filed various required forms, when they made tax deposits, or the extent to which they were involved in a variety of enforcement processes. Without these types of data, IRS managers will continue to have a difficult time monitoring and managing program outcomes—including identifying taxpayer needs, evaluating the effectiveness of programs to meet those needs, and ensuring protection of taxpayer rights.

IRS Employee Evaluations: Opportunities to Better Balance Customer Service and Compliance Objectives (GAO/GGD-00-1, Oct. 14, 1999).

IRS Restructuring Act: Implementation Under Way but Agency Modernization Important to Success (GAO/GGD-00-53, Feb. 2, 2000).

As we testified before the Senate Committee on Small Business, IRS is taking some interim steps to address its data problems. However, IRS' interim steps will not provide real-time infor-

Continued

Committee Question: Do you believe that IRS has effectively implemented the Restructuring Act's taxpayer protections?

GAO Response: To date, IRS has issued instructions, procedures, and regulations to implement the legal provisions of the act. As Commissioner Rossotti has testified, however, IRS has several years of work ahead to make the provisions work efficiently and effectively. To do so, he sees training and management as immediate challenges. We agree that these are important areas that must be addressed. But we would add an additional area to his list, that is, the systematic capture of data that would be useful for assessing the effectiveness of Restructuring Act implementation. For example, we concluded in our report on seizures that:

IRS had no plans to change its management information reporting on seizure results from what was in place in fiscal year 1997. This was a management information system that collection officials said provided little or no insights on the appropriate or consistent use of seizure authority or the resolution of problems experienced by taxpayers.

IRS had not fully developed the capability to monitor the quality of seizure work in terms of the appropriateness of seizure decisionmaking or the conduct of asset management and sales activities.

Accordingly, to strengthen oversight of seizure activities, we recommended that IRS (1) expand a recently reconstituted collection quality review program to include an assessment of the use of seizure authority and of asset management and disposal activities and (2) establish a method for providing IRS senior managers with useful information to monitor the use of seizure authority and resolution of taxpayer complaints.

Committee Question: GAO recently completed a study of IRS seizure authority and made various recommendations to IRS on how to implement the taxpayer protections included in the Restructuring Act. The report also noted some startling examples of problems with IRS' sale and custody of seized property. Please comment on your findings and recommendations.

GAO Response: The tax system depends on taxpayers voluntarily paying their taxes, a practice dependent on taxpayers having confidence that their neighbors or competitors are also complying. The use of seizure authority is a necessary part of a tax enforcement program that is intended to help provide this confidence. Taxpayers with substantial amounts of delinquent taxes, long-standing delinquencies, repeated failures to respond to nonseizure collection actions, and substantial assets cannot be allowed to evade payment without risking the credibility and fairness of the tax system. However, the protection of those taxpayers' rights and interests is also crucial to a credible and fair tax system. In this regard, IRS' seizure process had a number of weaknesses—weaknesses that are not all being addressed by changes being made pursuant to the Restructuring Act. Accordingly, we made recommendations in four key process areas.

First, to strengthen IRS' processes for ensuring that seizure authority is appropriately exercised—that is, taxpayers are made aware of their responsibilities and provided time to comply, proposed seizure actions are evaluated for necessity and appropriateness, and seizure actions are conducted appropriately—and when warranted is exercised, we recommended that the Commissioner of Internal Revenue

build controls into the automated field collection system, currently under development, that would act as a check to prevent departures from seizure process requirements that are verifiable on an automated basis (e.g., required taxpayer notifications made and time requirements followed);

provide guidance that describes the lengths that revenue officers are to go to (1) personally contact delinquent taxpayers, (2) obtain financial information from delinquent taxpayers or develop such information from alternative sources, and (3) develop and document estimates of the minimum sales price at which the seized assets could be sold;

require revenue officers to document the basis for judgments made (e.g., the basis for determining that sufficient attempts were made to gain taxpayer cooperation to pay delinquent taxes and the basis for determining the impact on taxpayer dependents) to facilitate managerial review of case files; and

provide written guidance on when seizure actions ought to be taken, that is, the conditions and circumstances that would justify seizure action and the responsibilities of senior managers to ensure that such actions are taken.

mation about the full range of transactions currently ongoing for a particular taxpayer. See *Small Business: Taxpayers Face Many Layers of Requirements* (GAO/T-GGD-99-76, Apr. 12, 1999).

GAO/GGD-00-4, Nov. 29, 1999.

Second, to improve IRS' process for controlling assets after seizure, we recommended that the Commissioner fully implement federal financial management guidelines to include

- ensuring that revenue officers document basic asset control information, including detailed asset identity descriptions, asset condition, and custody information;

- ensuring that basic control information is entered in a timely manner and included in the revised automated inventory control system;

- ensuring asset security and accountability through scrutiny of decisions regarding security and periodic reconciliation of inventory records to assets-on-hand (periodic physical inventories); and

- requiring revenue officers to record and account for all theft, loss, and damage expenses of each asset and document efforts to obtain reimbursement for the expenses in collection case files.

Third, to strengthen the sales process for ensuring that the highest prices are obtained from seized asset sales, we recommended that the Commissioner

- develop guidelines for establishing minimum asset prices to preclude the use of arbitrary percentage reductions or the amount of the delinquency as the minimum price and

- take the steps necessary to promote reasonable competition among potential buyers during asset sales.

Fourth, to strengthen oversight of seizure activities, we recommended that the Commissioner

- expand the quality review of collection cases to include an assessment of the use of seizure authority and of asset management and disposal activities and

- establish a method for providing IRS senior managers with useful information to monitor the use of seizure authority and resolution of taxpayer complaints.

Committee Question: IRS should collect taxes in a lawful manner from taxpayers who refuse to pay. You noted in your written testimony that IRS management officials and frontline employees believed that seizure authority was not being used when appropriate. What can be done?

GAO Response: In developing the recommendations for our report that deal with ensuring the appropriate use of seizure authority, we took a systems approach for evaluating seizure decisionmaking. The systems approach required us to look at the published guidance on the appropriate use of seizure authority, the case file documentation of the decisionmaking to facilitate managerial review, the nationwide postreview of the decisionmaking for quality and consistency and the reporting of the review information to senior management. Given the deficiencies identified in each area, we recommended that the Commissioner

- provide written guidance on when seizure actions ought to be taken, that is, the conditions and circumstances that would justify seizure action and the responsibilities of senior managers to ensure that such actions are taken;

- require revenue officers to document the basis for judgments made (e.g., the basis for determining that sufficient attempts were made to gain taxpayer-cooperation to pay delinquent taxes and the basis for determining the impact on taxpayer dependents) to facilitate managerial review of case files;

- expand the quality review of collection cases to include an assessment of the use of seizure authority and of asset management and disposal activities; and

- establish a method for providing IRS senior managers with useful information to monitor the use of seizure authority and resolution of taxpayer complaints.

PREPARED STATEMENT OF DAVID C. WILLIAMS

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you today to discuss the progress the Internal Revenue Service (IRS) has made in the past year and the challenges that lie ahead.

I agree with Commissioner Rossotti's statement that, "Modernizing the IRS is a massive undertaking and will take years to complete and depends upon changes in the organization and technology." The IRS is undertaking a complex, multifaceted approach to restructure its processes and operations. The changes that are taking place within the IRS affect almost every aspect of its operations. Also, modernization of its computer systems is crucial to implementing the new business vision of providing world-class service to taxpayers.

Progress is often occurring at a slow and methodical pace, but some positive results are being realized. In response to the IRS Restructuring and Reform Act of 1998 (RRA 98), the IRS has begun to transform itself so that it will operate better and service its customers more efficiently. It has also begun the process of restructuring the organization into four new operating divisions that serve groups of tax-

payors with similar needs. The leaders of these units are now in place, and the Tax Exempt/Government Entities Division is beginning operations.

The IRS is also expanding its operations through the use of technology. Electronic filing programs such as Telefile, E-file, and On-line filing increased substantially last year, providing taxpayers with the ability to file returns from their home computers. This type of technology produces faster refunds, reduces errors, and reduces costs. The IRS has also introduced a 24-hour-a-day/7 day-a-week telephone service, expanded its walk-in service hours, and provided translators for taxpayers who do not feel comfortable using English.

The IRS has changed its mission statement to stress its role in helping taxpayers meet their tax obligations. 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 organization. As we observe the progress being made, my office is focused on certain aspects that bear close observation or that we believe could inhibit the success of current operations or planned initiatives.

The IRS must continue to address management and operational issues to provide first-rate customer service and ensure compliance with the tax laws. The challenge for the IRS is to achieve both of these goals within the constraints of existing resources. The global economy is also growing rapidly and is generating increasingly sophisticated and complex business transactions. The IRS must develop effective compliance programs for this expanding segment of taxpayers.

Financial Management

Improvements have been made, but the IRS' accounting systems do not conform to federal accounting standards, nor will they for several years. The lack of standard accounting tools imposes ongoing costs, impedes the ability of the IRS to serve taxpayers adequately and prevents the IRS from effectively addressing material weaknesses cited by the General Accounting Office (GAO). In addition, the GAO, which has overall responsibility to audit the IRS' financial statements, has reported six material weaknesses involving the following: inadequate financial reporting processes, supporting subsidiary ledger and documentation for unpaid assessments, controls over refunds, controls over fund balance with the Department of Treasury, controls over property and equipment, and computer security.

The Government Performance and Results Act of 1993

The IRS uses a strategic planning process that describes how goals and objectives are to be achieved and provides clear links between performance measures and the funding requests. However, TIGTA's review found the IRS' overall strategic plan and its Fiscal Year 2000 Annual Performance Plan were not in complete compliance with the Government Performance and Results Act of 1993 (GPRA), Office of Management and Budget (OMB), and Department of the Treasury guidelines. The IRS' strategic plan did not: explain how performance measures and goals relate to each other, address external factors that impact its mission and goals, and describe program and system evaluations. TIGTA recommended to the IRS, and they agreed, to designate an office responsible for oversight and coordination of GPRA requirement activity throughout the IRS.

Because the IRS is undergoing such a complete transformation of its business processes, its performance measures are being re-evaluated. The IRS is developing a new balanced performance measurement system that will focus on accomplishments in three major areas: business results, customer satisfaction, and employee satisfaction. Commissioner Rossotti has indicated that it will take several years to achieve a fully acceptable set of balanced measures that can be used at all levels of the organization.

Management Information Systems

IRS management should be able to rely on computer programs and applications that provide timely and accurate data for analysis and functional control. Management information is a critical tool in monitoring progress and identifying vulnerabilities and production concerns. Not all IRS management information systems provide sufficient data to ensure taxpayer rights are protected and its financial management systems do not provide reliable data for the IRS' financial statements. For example, the IRS did not have a reliable management information system to measure the Innocent Spouse Program accomplishments and results. The IRS also did not have a database to reliably track innocent spouse case closures. As a result, accurate information was not available on the number of innocent spouse cases closed, how they were closed, or the status of claims in inventory.

Taxpayer Compliance

Voluntary—IRS statistics indicate that collections from personal income taxes increased by almost eight percent in 1999, while collections of corporate income taxes decreased by two percent during a dramatic economic upturn.

Enforcement—From Fiscal Year 1996 to Fiscal Year 1999, enforcement revenue collected by the IRS has decreased by 13 percent, or \$5 billion, and seizures dropped from over 10,000 to 161. These issues can be largely attributed to the IRS' shrinking workforce, budgetary constraints and resource management decisions. In addition, a significant number of Examination and Collection resources have been reassigned to work for the IRS' Customer Service Division and also to help implement restructuring and reform activities.

In an effort to resolve these situations, Commissioner Rossotti has stated that the President's Fiscal Year 2001 IRS budget would allow the agency to move more resources into the Compliance area. Even so, as noted by this committee, all of the changes being made by the IRS will not be immediately apparent. Some differences may only be recognized once the RRA 98 is completely implemented and understood by IRS employees.

Customer Service

Providing top quality service to each taxpayer is one of the strategic goals of the IRS' modernization plans. Although the IRS implemented numerous initiatives during the 1999 filing season that were intended to enhance customer service, the IRS was not able to satisfactorily handle the level of customer demand on its toll-free telephone lines. The cost to provide toll-free telephone service during the 1999 filing season increased while productivity decreased. About 19.5 million calls resulted in busy signals and the level of service provided declined from 73 percent for the 1998 filing season to 51 percent for the 1999 filing season.

In addition, the IRS' written communications, such as notices, are widely criticized as hard to understand. For example, to claim the Additional Child Tax Credit, taxpayers must have three or more qualifying children. Taxpayers who claimed this credit, but had fewer than three qualifying children, were sent a generic notice which stated, "You incorrectly figured your Additional Child Tax Credit on Form 8812. We adjusted your credit accordingly." Taxpayers receiving this notice would not necessarily know they did not have enough qualifying children to claim the Additional Child Tax Credit.

Information Technology

Modernization of the IRS' antiquated computer systems has been a major concern for more than a decade. A prime integration vendor has been contracted to coordinate with the IRS in implementing the overall IRS Modernization Blueprint. This initiative is anticipated to be a multi-billion dollar contract up to a 15-year period.

The IRS is in the very early phases of its computer modernization efforts. Initiatives to date, which have been funded for about \$68 million, have primarily focused on establishing program management processes and architectural standards for the computer modernization, developing partnership roles and responsibilities with the PRIME contractor, and building business cases for the first of the planned modernization projects. The IRS has also identified, and is addressing, risks to the success of the computer modernization.

The IRS may be at risk of not meeting its schedule to deliver its initial modernization projects, scheduled for rollout in the Year 2001 filing season, which includes improving service to taxpayers who call the IRS for help. This potential condition is due to delays in finalizing business cases for the projects and difficulties in filling critical vacancies on the project teams. The delays are also putting the IRS at risk of running out of modernization funding, which the Office of Management and Budget is releasing from the congressionally appropriated Information Technology Investments Account on an incremental basis only as business cases are approved. This situation could result in projects being shut down for periods of time until business cases are approved and funding is released.

Key goals, such as 80 percent of tax returns being filed electronically by the Year 2007 and significantly improving levels of service in answering taxpayers' questions, are contingent on the development of new technology. While the development of new technology evolves, existing operations must continue. However, a significant challenge is the ability of the IRS executives and managers to oversee a project as large as their modernization project, while effectively transitioning employees and processes into a new organization.

One of the biggest concerns in the area of information technology was the effect the century date change had on agency systems. Although the IRS' computer systems did not experience any major problems as a result of the century date change,

the IRS has not yet processed all taxpayer returns through all of its production cycles. The IRS will need to continue monitoring its systems to assure that production glitches do not impair its ability to process tax information and compute tax liabilities, including interest and penalties, accurately. TIGTA will pay close attention to this concern during its ongoing tax filing season audits.

Computer Security

The IRS has made progress in addressing computer security issues, but significant risks still exist. The IRS is addressing these vulnerabilities through a risk-based approach, which was initially geared to identifying and correcting security weaknesses at its major computing and tax processing centers. Over the past two years, the IRS has expanded its computer security assessments to other IRS facilities. 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 have identified additional weaknesses in the areas of security controls over the IRS' computer facilities, networks and systems. For example, the certification of security controls for sensitive computer systems continues to be a material weakness for the IRS, disaster recovery plans should be improved, and a more effective virus protection program needs to be established. Until these weaknesses are resolved, IRS systems and data are vulnerable to tampering, loss or unauthorized disclosure. Once the IRS has mapped its computer architecture, it will be better able to identify security vulnerabilities, and detect systems anomalies and suspicious activity.

TIGTA has developed a computer security program to investigate indications of both external and internal improper access to IRS computers. TIGTA's Office of Investigations' Strategic Enforcement Division is responsible for developing an aggressive program for the investigation of any attempts to interfere with the operation and security of IRS computer systems. While TIGTA will continue to be responsible for pursuing intentional attempts to interfere with IRS computer systems, the IRS remains responsible for the overall security protection of its systems.

Another TIGTA group focuses on the threat posed by IRS employee misconduct as it relates to misuse of taxpayer information. This group is responsible for identifying and investigating unauthorized electronic accesses to Federal taxpayer records.

Electronic Filing

TIGTA has conducted recent reviews of the IRS' controls over selected components of the Electronic Filing Program. These reviews focused on the process and standards for admitting preparers to the Return Preparer Program and on procedures to identify and remove dishonest preparers. TIGTA concluded that IRS management needs to increase emphasis and oversight to ensure the Return Preparer Program activities are monitored and potentially fraudulent return preparer schemes are identified. IRS management also needs to eliminate the appearance of a conflict of interest by separating duties so that coordinators responsible for promoting the Electronic Filing Program are also not responsible for disqualifying preparers who fail to comply with electronic filing procedures.

The IRS Restructuring and Reform Act of 1998

Although the IRS is making progress in its implementation of the RRA 98 provisions, TIGTA's audit work indicates that the provisions surrounding taxpayer protection and rights issues have not yet been successfully implemented. For example, the IRS:

- identified approximately 525 violations during its first independent reviews and quarterly certifications; and 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.
- did not consistently implement federal tax lien provisions—33 percent of the 157 cases TIGTA reviewed involved potential violations of legislative or procedural requirements, e.g., taxpayers were not given the full 30 calendar days to request a hearing, and sufficient documentation was not retained to prove that lien notices were sent to taxpayers or were sent timely.
- did not always follow all legal and internal guidelines when conducting seizures—36 percent of the 92 taxpayer seizure cases reviewed did not follow all legal and internal guidelines, e.g., business property was seized without obtaining the required approvals, and taxpayers were not personally warned before the seizure action occurred.

- had not fully implemented new procedures to notify taxpayers before taking funds for payment—32 percent of the 284 accounts reviewed did not follow legal provisions, e.g., taxpayers were not notified of the IRS' intent to levy and of their appeal rights before levies were issued.

Section 1203 Violations—As you know, there has been much confusion and consternation surrounding Section 1203. For several months, baseless rumors circulated throughout the IRS that thousands of Section 1203 investigations were being conducted. Many employees voiced concerns about this section of the Act and the investigation of allegations made under it. While TIGTA has received over 900 complaints, we determined that only 218 of these complaints warranted investigation as possible Section 1203 allegations. We referred 87 of these completed investigations to the IRS for adjudication. IRS management is emphasizing to its employees that disciplinary action will not be imposed on those employees who make honest mistakes.

TIGTA's Role—Another provision of the RRA 98 was the creation of our office.

TIGTA is 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 prior regional structure, which eliminated an unnecessary and remote layer of management. In addition, we reorganized the Office of Investigations into direct report field offices, and we have assumed responsibility for investigating internal misconduct cases. We have worked with the IRS to understand this new workload. The Office of Audit also reorganized into specialized issue areas that parallel the new IRS business unit structure. Finally, as previously mentioned, we created the Office of Investigations' Strategic Enforcement Division to meet threats of computer crimes within the IRS and to pursue external intruders through cyberspace and to bring criminal charges and civil monetary actions against them.

The IRS is modernizing, reforming and restructuring business processes and its organizational structure. The size of the agency, the absence of reliable management information, and employee fears and resistance to change hamper its speed.

I believe that the current approach, while daunting, is the right one. Past efforts at reform have been ineffective and focused on symptoms rather than the ailments that have plagued the agency. Ultimately, the past patchwork of repairs failed, with the IRS falling back into chronic problems.

The IRS and its stakeholders need to closely watch the velocity of the reforms, yet understand the magnitude of what is being done. Together, we need to maintain a determination that this time we are committed to making long-term improvements in the IRS. It will be some time before all of the benefits of the reform can be realized by the American public, but the initiative is vital. The IRS is an essential element of the Federal government and must reflect the highest values of the American character.

RESPONSES TO QUESTIONS FROM SENATOR ROTH

Question 1: While the use of levies and seizures has plummeted, the Tax IG and GAO have found that when the IRS did engage in this activity, it violated the law or IRS procedures in 33% of the few levies and seizures made over the past year. What can be done to ensure that levies and seizures are done in accordance with the law?

TIGTA Response: The IRS has designed a workable process for obtaining compliance with the statutory levy and seizure requirements. What it needs to do now is maintain its emphasis on improving compliance and to continue the progress that has been made so far. For example, our current audits examining the implementation of RRA98 levy provisions indicate that:

- The IRS is enhancing the Integrated Collection System (ICS)¹ to prevent the issuance of a levy unless the due process procedures have been followed.
- In March 1999, the IRS instituted a policy designed to ensure that all levies requested by the Customer Service function are subject to a 100 percent quality review before issuance.

¹ICS is a computer system specifically dedicated to collection processing. It is designed to provide management information, create and maintain case history, generate documents, and allow on-line approval of case actions.

- In June 1999, the IRS implemented changes that prevent its Automated Collection System (ACS)² computers from prematurely issuing systemic due process notices. Now the due process notice only issued when collection action is imminent.

Similarly, the IRS has recently implemented new procedures to help ensure that seizures are conducted in compliance with the law. For example:

- In April 1999, the IRS incorporated a Seizure and Sale Handbook into its Internal Revenue Manual (IRM). The handbook consolidated, into one location, legal provisions and internal seizure procedures that had been scattered among several IRM sections. The handbook also incorporated the RRA98 changes.
- The IRS developed a pre-seizure and approval checklist, which incorporated the legal and procedural prerequisites for conducting a seizure. The IRS requires that the Collection Division Chief sign off on the completed checklist before the seizure is conducted.
- The IRS has reinforced with all of its field offices the importance of complying with the laws when conducting seizures. In addition, the IRS implemented a web site on its Intranet home page that disseminates to the field offices data regarding the RRA98 procedures.
- In Fiscal Year (FY) 1999, the IRS held mandatory training classes to explain the RRA98 provisions and proper implementation for all Collection personnel. In FY 2000, the IRS plans to provide revenue officers with Critical Skills Proficiency Training, which includes a mandatory seizure and sale workshop.

We will advise you of our Fiscal Year 2000 audit efforts to address the status of the IRS' actions.

Question 2: We have heard a great deal about "balanced measures" for evaluating employees. Please explain to the committee how you interpret "balanced measures."

TIGTA Response: The IRS has developed a strategic vision using "balanced measures" as catalysts for changing the IRS' culture. These measures are designed to achieve specific outcomes as well as the IRS' overall mission and strategic goals. The three measures (Customer Satisfaction, Employee Satisfaction and Business Results) are to be integrated and have equal weight when assessing the success of the new business units and related staffs. In the past, the over reliance on only one performance indicator significantly contributed to the perception that the IRS was using only enforcement statistics to measure its employees' performance.

The IRS is in the process of re-writing all employee performance appraisal critical elements to reflect the significance of the employee's particular role in accomplishing the overall mission of the organizational unit. For the three levels of management (executives, managers and management officials), the IRS has established three common critical elements:

1. Customer Satisfaction
2. Business Results
3. Employee Satisfaction

For non-management employees, it has established five common critical elements:

1. Employee Satisfaction
2. Customer Satisfaction Knowledge
3. Customer Satisfaction Application
4. Business Results Quality
5. Business Results Quantity

The IRS has established and assigned new critical elements to nearly all of the three levels of managers. Additionally, it is developing the critical elements for over 50 percent of the employees; these are in the process of being approved by the National Treasury Employees Union and Commissioner Rossotti. Critical elements for the remaining IRS employees are expected to be developed later this fiscal year.

Several audit reviews are underway to assess the IRS' initiatives for Customer Satisfaction and we will advise you of the results.

Question 3: Mr. Williams' office found numerous violations of the law that prohibits IRS employees from being evaluated based on enforcement statistics. In 1988, we outlawed this practice with respect to collection employees. We found that the IRS ignored the law. In the Restructuring Act, we prohibited any IRS employee from being evaluated based upon enforcement statistics. This could result in taxpayer rights being violated. It seems we are going down the same path. What are the panel's views? Are we going down the same path?

TIGTA Response: The IRS has taken a number of actions to stop these practices, but it has not been totally successful. During our Fiscal Year (FY) 1999 audit, we

²ACS is a telephone collection system where telephone assistants collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous service center notices.

determined that the IRS is not in full compliance with the RRA 98 Section 1204 requirements concerning the basis for evaluation of IRS employees. For example, we identified 96 potential Section 1204 violations where IRS management used tax enforcement results to evaluate employees, or imposed or suggested production quotas or goals. In addition to these 96 potential violations, the IRS identified approximately 525 documents containing potential violations during its quarterly certification and independent review process.³

IRS concurred with our findings and has a number of initiatives under way to enforce the Section 1204 requirements. In addition to the establishment of the independent review process I previously mentioned, the IRS has created the Office of Managing Statistics to help ensure that statistics are not used improperly, and IRS is in the process of training managers on the RRA98 Section 1204 restrictions and how to ensure compliance with them.

My office is currently reviewing IRS' actions to ensure compliance with the Section 1204 requirements and to determine if any additional violations have occurred. The results of our current work will provide comparative data to use in determining whether or not the corrective actions have reversed this trend. I will share the results of our Fiscal Year 2000 assessment with this Committee as soon as possible.

Question 4: The Tax IG and GAO have found that the IRS management information system needs work. Management must have access to information in a usable format. For example, the Tax IG notes that the IRS does not have a database to reliably track innocent spouse cases. Do you all agree this is an issue? What impact does this lack of information have on taxpayer rights?

TIGTA Response: TIGTA's audit work has found this to be an issue. For example:

- Tests conducted by TIGTA auditors showed that the database used to track innocent spouse claims was not reliable, was incomplete, contained errors, and did not show how old the innocent spouse claims were. Also, there were problems with dates being overwritten when cases were updated. As a result, the IRS was unable to determine the number of cases closed or how they were closed during the first year after enactment of the RRA98. IRS management has recognized the problems that exist with the innocent spouse database and has taken actions to make improvements to the database. They expect to implement these improvements in January 2001.
- Existing management information systems do not separately record or monitor cases where taxpayers requested representation during an interview. As a result, the auditors could not determine whether IRS employees complied with the required procedures or protected taxpayer rights because the auditors could not identify or review cases. It should be noted that there is no requirement for the IRS to maintain separate records for these situations.
- Individual written requests for joint filer collection activity are not tracked on existing management information systems. The IRS, therefore, cannot determine how often these requests are received or whether employees are protecting the taxpayers' right to obtain a written response regarding collection information on their joint return liabilities. As a result, the auditors could not readily identify joint filer requests or determine whether the IRS properly addressed the requests.
- The IRS currently does not have an integrated complaint processing system for identifying and reporting taxpayer complaints and allegations of employee misconduct. Instead, it uses various existing systems and procedures that were implemented prior to the RRA98.

We will advise you of our Fiscal Year 2000 efforts to identify the impact ineffective management information systems have on taxpayer rights.

Question 5: Does the panel believe the IRS has effectively implemented the Restructuring Act's taxpayer protections?

TIGTA Response: The IRS has not yet completed implementation of all RRA98 taxpayer protection provisions. Accordingly, we are unable to render an opinion on the totality of the IRS' efforts. However, our work so far has identified many instances in which the IRS did not fully complete its planned actions or ensure full compliance with the RRA98 requirements.

For example, the IRS did not always follow its own internal procedures and legal guidelines for:

- Sending levy notices before issuing levies.
- Approving seizures and conducting sales of seized property.

³The IRS established an internal independent review process to identify violations that were not reported in the quarterly certification process. These IRS reviews must include a review of the employee performance files and employee evaluations and may include other documents, such as award narratives, minutes of meetings, case reviews, or local memoranda.

- Timely sending lien notices after liens were generated.
- Not using records of tax enforcement results to suggest production quotas or goals.
- Ensuring requested information is not improperly withheld under the Freedom of Information Act.
- Notifying taxpayers of their rights regarding the Failure to Deposit Penalty.

In addition, training and written guidance for front-line employees who interact with taxpayers were not completed until after the effective date of the provision because it was not possible for the IRS to deliver immediate, up-to-date manuals or technical guidance to front-line employees.

To address these issues, the IRS has taken a proactive approach in implementing the RRA98. For example, the IRS Chief Operations Officer assigned individual implementation ownership of the provisions of RRA98 to IRS Assistant Commissioners. The IRS has also worked to update manuals, technical guidance, and training classes to provide clarification to IRS employees on the RRA98 provisions. In addition, the IRS has strengthened controls and increased its reviews and follow-up efforts to better ensure procedures are followed and taxpayer rights protected.

We are assessing the IRS' actions for correcting previously identified problems and its current activities for implementing the RRA98 requirements in our Fiscal Year 2000 reviews. Several of these reviews are underway, and we will advise you of the results.

Question 6: A recent Joint Tax report (p.175) on taxpayer confidentiality stated that the Tax IG substantiated 198 cases of browsing of taxpayer information. Of 162 substantiated cases your office referred, the U.S. Attorneys declined to prosecute 127 cases. It is shocking that Congress passed a law to prohibit browsing of confidential taxpayer information and the law is not being enforced. Mr. Williams, what is going on here? Are employees who browse confidential information at least being fired?

TIGTA Response: The Treasury Inspector General for Tax Administration investigates indications of unauthorized access to taxpayer information. Substantiated investigations are referred to the U.S. Attorney's Office for prosecution. For the period of August 5, 1997—August 4, 1999, TIGTA referred 162 cases of which 127 were declined for prosecution. A TIGTA effort is ongoing to bring to the attention of the various U.S. Attorney's Offices the seriousness of these violations and Congress' interest in prosecuting individuals who misuse their access to taxpayer information. Any further expression on this issue by Congress to the Department of Justice would be helpful.

Regarding the question as to whether IRS employees are being fired for unauthorized access, the answer is yes. The IRS maintains a Zero tolerance policy on unauthorized access to taxpayer information. Absent any mitigating circumstances the IRS will terminate the employee. For the period August 5, 1997—August 4, 1999, 34 IRS employees were removed or terminated from employment and another 37 employees resigned prior to the adjudication of their case. Every federal employee facing termination action has appeal rights to a third party arbitrator or the Merit Systems Protection Board. In some instances the employee termination action has been overturned and the employee was given a reduced penalty.



Treasury Inspector General for Tax Administration

Semiannual Report to the Congress

April 1, 1999 – September 30, 1999

...the 105th Congress created a statutory Inspector General, specifically for oversight of the Internal Revenue Service

"The Treasury Inspector General for Tax Administration shall exercise all duties and responsibilities of an Inspector General of an establishment with respect to the Department of the Treasury and the Secretary of the Treasury on all matters relating to the Internal Revenue Service. The Treasury Inspector General for Tax Administration shall have sole authority under this Act to conduct an audit or investigation of the Internal Revenue Service Oversight Board and the Chief Counsel for the Internal Revenue Service."

...Section 1103 of Public Law 105-206, The Internal Revenue Service Restructuring and Reform Act of 1998, enacted July 22, 1998...



INSPECTOR GENERAL
for TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 29, 1999

The Honorable Lawrence H. Summers
Secretary of the Treasury
Washington, D.C. 20220

Dear Mr. Secretary:

I am forwarding to you the Treasury Inspector General for Tax Administration's (TIGTA) Semiannual Report to the Congress for the six-month period ending September 30, 1999. I am pleased to report that we have successfully completed our transition period and our new processes have stabilized. We are well positioned to devote our full attention and focus to the complex issues that face the Internal Revenue Service (IRS).

During this period, our organization delivered audit reports and investigative services that promote economy, efficiency and the highest level of integrity within the IRS organization. We issued 47 final audit reports that included \$169 million in financial accomplishments. We also closed over 1,600 investigations of alleged criminal wrongdoing and administrative misconduct. Court ordered fines and restitution totaled almost \$13 million.

In the Office of Audit, significant resources were devoted to fulfilling the requirements imposed by the IRS Restructuring and Reform Act of 1998 (RRA 98). We issued 16 audit reports to meet our RRA 98 statutory requirements, including reports on IRS' compliance with new seizure, lien and levy procedures, prohibitions on the use of enforcement statistics and the adequacy and security of information technology. Audits were also completed on other taxpayer protection and rights issues, such as treatment of taxpayers during office audits and selecting returns for examination, and on IRS' Year 2000 compliance efforts.

TIGTA's investigative activities also focused on RRA 98 requirements including developing procedures to process Section 1203 misconduct allegations, implementing a new system to track complaints and referrals, and providing guidance to IRS on establishing a compatible IRS complaint tracking system. Investigative efforts also included significant work with the Unauthorized Access to Taxpayer Accounts (UNAX) Detection Project which identified 478 leads of potential illegal access of taxpayer accounts.

I look forward to working with you in addressing the many challenges of overseeing the nation's tax administration system.

Sincerely,

David C. Williams

David C. Williams
Inspector General

Enclosure

Semiannual Report to the Congress

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Office of the Treasury Inspector General for Tax Administration

INFORMATION ABOUT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

The Office of the Treasury Inspector General for Tax Administration (TIGTA) was established in January 1999, in accordance with the Internal Revenue Service Restructuring and Reform Act of 1998¹ (RRA 98). TIGTA provides independent oversight of Internal Revenue Service (IRS) activities, the IRS Oversight Board and the IRS Office of Chief Counsel. As mandated by RRA 98, TIGTA assumed most of the responsibilities of the IRS' former Inspection Service, with the exception of performing background checks and providing physical security to IRS employees.

TIGTA is organizationally placed within the Department of the Treasury, but is independent of the Department and all other Treasury offices, including the Treasury Office of the Inspector General. TIGTA's focus is devoted entirely to tax administration. TIGTA includes the Office of Audit, Office of Investigations, Office of Chief Counsel and a Management Services function. There are approximately 960 auditors, special agents, attorneys and support staff nationwide.

TIGTA's audit and investigative activities are designed to:

- Promote economy, efficiency, and effectiveness in the administration of the internal revenue laws.
- Prevent and detect fraud and abuse in the programs and operations of the IRS and related entities.

TIGTA is responsible for:

- Conducting and supervising independent and objective audits and investigations relating to IRS programs and operations.
- Protecting the IRS against external attempts to corrupt or threaten its employees.
- Reviewing and making recommendations regarding existing and proposed legislation and regulations relating to the programs and operations of the IRS and TIGTA.
- Recommending actions to resolve fraud, abuses and deficiencies in the programs and operations of the IRS.
- Informing the Secretary of the Treasury and the Congress of problems and the progress made in resolving them.

TIGTA's programs emphasize deterrence and detection approaches to assist IRS in ensuring the highest degree of integrity and ethics in its workforce. TIGTA also has responsibility for investigating allegations of misconduct by IRS employees.

AUTHORITIES

TIGTA has all the authorities granted under the Inspector General Act of 1978². TIGTA also has access to tax information in the performance of its responsibilities and the authority to report criminal violations directly to the Department of Justice. The Inspector

¹ Pub. L. No. 105-206, 112 Stat. 685

² Pub. L. No. 95-452, 92 Stat. 1101, as amended, at 5 U.S.C. app. 3 (1994 & Supp. II 1996)

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General and the Commissioner of IRS have established policies and procedures delineating responsibilities to investigate offenses under the internal revenue laws.

In addition, RRA 98 amended the Inspector General Act of 1978 to give TIGTA statutory authority to carry firearms and execute the provisions of I.R.C. Section 7608(b)(2). These provisions include the law enforcement authority to execute and serve search warrants, serve subpoenas and make arrests.

MAJOR ISSUES FACING THE IRS

The IRS collects over \$1.7 trillion annually to fund the nation's government. This requires the processing of over 200 million tax returns, issuing over 90 million refunds, distributing over 1 billion tax forms and publications, and assisting over 130 million taxpayers. The IRS must continually strive to achieve these tasks while maintaining the highest level of integrity and assuring taxpayer privacy. IRS implements a continuous influx of tax law changes and must enforce tax laws to ensure that all parts of the taxpaying public pay the proper amount of tax.

In executing its daily responsibilities, IRS faces many management issues. In January 1999, TIGTA advised the House Committee on Ways and Means of the following serious management issues facing the IRS:

- Implementing taxpayer protection and rights provisions of RRA 98.
- Implementing technology investment management.
- Progressing in its Year 2000 (Y2K) compliance efforts.
- Managing finances.
- Implementing the Government Performance and Results Act of 1993¹ (GPRA).

- Processing returns and implementing tax law changes during the tax filing season.
- Implementing quality telephone and walk-in customer service.
- Minimizing tax filing fraud and protecting revenue.
- Selecting and controlling tax returns for examination.

TIGTA reported on some of these issues in the March 1999 Semiannual Report to the Congress. TIGTA continued to provide audit coverage and investigative support on these issues during the remainder of Fiscal Year (FY) 1999.

Most of the management issues reported in January 1999 will continue to pose risks for the IRS in FY 2000. In addition, two other areas will present challenges for the IRS. First, the IRS must address equally important issues, providing first rate customer service and ensuring compliance with the tax laws. The challenge for IRS is to execute both of these activities within the constraints of existing resources. For example, a significant number of Examination and Collection resources have been reassigned to Customer Service and implementing RRA 98. As a result, the inventory of delinquent cases in the collection process is increasing and the amount of tax assessments is decreasing.

Secondly, the global economy is growing rapidly and is generating increasingly sophisticated and massive business transactions. IRS must develop effective compliance programs for this expanding segment of taxpayers.

All of these areas will be the focus of TIGTA's audit and investigative activities during FY 2000.

The following sections provide a summary of the major issues in the IRS and what TIGTA has done to address them during this reporting period.

¹ Pub. L. No. 103-62, 107 Stat. 285

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Implementing RRA 98

IRS continues to confront the challenges of implementing RRA 98. RRA 98 mandates significant changes to the way IRS does business. In part, RRA 98 was passed due to Congressional hearings which focused on the misuse of enforcement statistics and abusive treatment of taxpayers. Several taxpayers testified to unfair and unreasonable treatment by IRS employees. Implementation of the legislative provisions imposed on IRS will result in enhanced taxpayer protection and rights, as well as organizational changes intended to achieve a more efficient and responsive organization.

TIGTA placed significant emphasis on the implementation of RRA 98. Although IRS is making progress, TIGTA's audit work indicates that IRS is not in full compliance with all RRA 98 provisions. For example, TIGTA reported that IRS was not in compliance with the taxpayer rights provisions as they relate to seizures, liens, levies, use of enforcement statistics and Freedom of Information Act¹ (FOIA) requests.

TIGTA also conducted reviews of other taxpayer rights issues, such as treatment of taxpayers during office audits and selecting returns for examination. TIGTA's Office of Audit concluded that because of weaknesses in controls and inappropriate actions on cases, the IRS did not always provide fair and equitable treatment to taxpayers.

A significant number of the RRA 98 provisions deal with improving treatment of taxpayers and preventing abuse by IRS employees. Section 1203 of RRA 98 provides for the mandatory termination of IRS employees for specific categories of employee misconduct, including: violation of Constitutional or civil rights of taxpayers or IRS employees; intentional misconduct involving a taxpayer matter; threatening

audits for personal gain; or willful understatement by an employee of his or her own federal tax liability. The misconduct identified in Section 1203 has always been subject to discipline by IRS; however, the mandatory penalties imposed by RRA 98 served notice that a high standard of conduct is expected of IRS employees to ensure the trust and confidence of the public.

To address employee misconduct issues, TIGTA's Office of Investigations worked with IRS to develop procedures regarding assessment, referral and investigation of allegations of misconduct that are covered by Section 1203. TIGTA also operates a toll-free hotline number, an e-mail account and a central post office box to receive complaints of alleged wrongdoing by IRS employees. Information on how to report misconduct has been published in IRS Publication 1, *Your Rights as a Taxpayer*, which is provided to taxpayers that are likely to have direct contact with IRS employees. The toll-free number, e-mail account and address have also been published on TIGTA's public Internet site.

Calls and complaints are received by TIGTA's Complaint Management Division. This Division manages the complaints tracking system which became operational on July 19, 1999. This system provides a central accounting of all complaints received and the disposition of those complaints. In addition, TIGTA is working with IRS' Complaint Processing and Analysis Office to provide guidance on establishing an IRS complaint tracking system that is compatible with TIGTA's system.

Providing Information Technology and Computer Security

Modernization of the IRS' computer systems and security of taxpayer information have been major concerns for the past several years. For more than a decade, at a cost of \$4 billion, the IRS has been attempting to modernize its antiquated tax systems. These

¹ 5 U.S.C. § 552 (1996)

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efforts have fallen far short of what is required to prepare IRS for the next century. Modernization of IRS technology is crucial to implementing the new business vision of providing world-class service to taxpayers. Key goals, such as 80 percent of tax returns being filed electronically by the Year 2007 and significantly improving levels of service in answering taxpayers' questions, are contingent on the development of new technology.

IRS' computer security continues to need attention. The IRS Commissioner has stated that, "protecting taxpayer information and the systems used to deliver services to taxpayers are key to the success of a customer-focused IRS."¹ In the past, the security of taxpayer data has been an Achilles' heel for the IRS, particularly in the area of unauthorized access of taxpayer records.

TIGTA's Office of Investigations continues to operate an aggressive unauthorized access detection program. The Unauthorized Access to Taxpayer Accounts (UNAX) Detection Project detects potential unauthorized accesses to electronic taxpayer records on IRS systems. During this reporting period, TIGTA identified 478 potential leads of which 175 were referred to TIGTA field offices for investigation.

Despite increased publicity about unauthorized access and more stringent sanctions, these abuses comprised the largest segment of investigations of IRS employees initiated by TIGTA in this reporting period.

In addition, TIGTA's Office of Audit conducted several reviews of IRS' information systems. These reviews indicate the IRS is still vulnerable in the area of system security. In addition, computer applications need to be enhanced to ensure functional needs are met effectively and efficiently.

¹ General Accounting Office Report on IRS Systems Security, GAO/AIMD-99-38, pg. 17, December 1998.

Implementing the Century Date Change

Further complicating IRS' tax administration duties is the upcoming century date change and how it will affect IRS computer systems. Every aspect of tax administration could be affected by the century date change since all IRS functions rely, to some degree, on automated computer processes. In February 1999, the IRS Commissioner testified before the House Committee on Ways and Means, stating that the project life cycle costs for Y2K conversion could total \$1.3 billion.² In addition, the IRS has 1,400 minicomputers, over 100,000 desktop computers, over 80 mainframe computers, and data communications networks comprising more than 100,000 individual product components that are affected by Y2K.

TIGTA's Office of Audit conducted numerous audits of the IRS' efforts to ensure systems, applications and infrastructure are compliant with Y2K requirements. These audits found that IRS' executive management is aggressively managing the Y2K issue and significant progress has been made. However, the Office of Audit identified two fundamental weaknesses that increase the risk of Y2K problems after December 31, 1999. First, inaccurate inventories hamper IRS' ability to identify, track and monitor all components that need to be made Y2K compliant. Second, several aspects of the Y2K conversion effort are behind schedule and the time to make the needed changes and to deal with unexpected problems is growing shorter.

TIGTA is currently conducting follow-up reviews to determine if the IRS has taken appropriate actions to correct the problems noted above, including progress in developing contingency plans if Y2K problems do occur.

² Statement of Charles O. Rossotti, Commissioner of the Internal Revenue Service, Before the House Committee on Ways and Means (Y2K), February 24, 1999.

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Improving Financial Management

Financial management continues to be a concern for the IRS. The General Accounting Office (GAO) could not issue an opinion on most of IRS' administrative financial statements for FY 1998. In addition, the IRS' Senior Council for Management Controls' 1999 Annual Assurance Review included financial accounting of revenue as an open material weakness, an issue which has been outstanding since 1995.

TIGTA's Office of Audit continues to perform audit tests in support of GAO's audit of the IRS' FY 1999 financial statements. This assignment is part of a training effort that will position TIGTA to assume responsibility for auditing the IRS' financial statements. In addition, TIGTA conducted a limited review of IRS' proposed actions to resolve long-standing concerns around its financial statements. The auditors concluded that the actions are an improvement over prior efforts to address administrative accounting problems; however, IRS can further improve its ability to address systemic deficiencies. The Office of Audit will continue closely monitoring IRS actions that relate to improving long-standing financial management concerns.

Implementing GPRA

The IRS has made significant strides in implementing GPRA. IRS is developing a new balanced performance measurement system that will focus on accomplishments in three major areas: business results, customer satisfaction and employee satisfaction. The IRS Commissioner has indicated that it will take several years to achieve a fully acceptable set of balanced measures that can be used at all levels of the organization.

TIGTA's Office of Audit initiated a series of reviews around the IRS' GPRA efforts. The audit work indicates a need to evaluate the IRS' customer service survey process and to

assess the reliability of the data IRS uses to evaluate the customer satisfaction measures. TIGTA will complete ongoing reviews and conduct data validation and customer survey process reviews in FY 2000.

Processing Tax Returns and Implementing Tax Law Changes

The IRS' 1999 filing season was impacted by numerous organizational and legislative changes. Delivering a successful filing season is always a high priority and challenge for the IRS. It is particularly challenging at this time because of the computer programming changes and testing surrounding Y2K compliance. The IRS' limited programming resources must be effectively managed to ensure a well planned and executed filing season that appropriately includes tax law changes on computer systems that are Y2K compliant.

In a review of IRS' quality assurance efforts over key tax law changes for the 1999 filing season, the Office of Audit reported that the IRS needs to develop and improve processes to ensure that the status of programming changes for the 2000 filing season is adequately monitored and accurately reported. In addition, the Office of Audit has identified several smaller segments of tax processing that can be further enhanced by programming changes. For instance, the Office of Audit indicated that some computer programs could more effectively identify and resolve incorrect and missing taxpayer identification numbers on tax returns.

The Office of Audit will continue to conduct reviews before and during the upcoming filing season to assess IRS' ability to effectively and efficiently process tax returns and implement tax law changes.

Providing Quality Customer Service

The IRS has heavily invested in technology but has not improved telephone service to

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taxpayers. Recent IRS statistics indicate that only 53 percent of taxpayers using IRS' various telephone services receive the level of service they need. Providing better service to taxpayers is the key concept behind the Commissioner's plans to modernize the IRS. In addition, RRA 98 requires IRS to place greater emphasis on serving the public and meeting taxpayer needs.

In an audit that evaluated assistance provided to taxpayers, the Office of Audit concluded that taxpayers were generally provided accurate tax information. However, telephone assistants could have been better prepared to answer taxpayers' questions and responses to e-mail questions could have been more complete, concise and clear. The Office of Audit also completed reviews of IRS' walk-in services and the strategy to increase taxpayer access to toll-free telephone services.

Protecting Revenue and Minimizing Tax Filing Fraud

The IRS has significantly increased its efforts to guard against tax filing fraud over the past several years. However, fraudulent refund schemes, especially related to the Earned Income Tax Credit, are still of concern. For example, TIGTA recently investigated a

scheme involving a former IRS employee who prepared fraudulent tax returns claiming the Earned Income Tax Credit. Fraudulent schemes are not just limited to those with inside knowledge of tax processing and the IRS must remain diligent in its efforts to prevent and identify these unscrupulous activities.

The Office of Audit continues its efforts in reviewing the IRS' revenue protection strategy. TIGTA performed reviews of the IRS' controls over selected components of the electronic filing program. These reviews focused on the process and standards for admitting preparers to the electronic return preparer program and on procedures to identify and remove dishonest preparers. Overall, the Office of Audit concluded that management needs to ensure that procedures are consistently followed, controls are improved over removal of preparers, computer enhancements are made, and additional emphasis is placed on return preparer fraud activities.

Details of the specific audit and investigative activities, as well as information on statutory requirements, can be found on pages 7 through 21, 23 through 36, and in Appendix VI, respectively.

Semiannual Report to the Congress

Treasury Inspector General for Tax Administration Office of Audit

INTRODUCTION

The Office of Audit identifies opportunities to improve administration of the nation's tax laws by conducting comprehensive, independent performance and financial audits of IRS programs and operations to:

- Assess efficiency, economy, effectiveness and program accomplishments.
- Ensure compliance with applicable laws and regulations.
- Prevent, detect, and deter fraud, waste, and abuse.

THE AUDIT PROGRAM

To accomplish its mission, the Office of Audit published an Annual Audit Plan for FY 1999 that described its audit focus and direction. The audit plan included both statutory and discretionary reviews. Statutory reviews are governed by legislation, while discretionary reviews are identified through the Office of Audit's risk assessment process, and input from the IRS Commissioner, IRS executives, and the Congress.

As part of implementing RRA 98, IRS is reorganizing into four organizational units focused on specific groups of taxpayers. The Office of Audit has reorganized from an organization based on geographic location to a functional structure which reflects the new IRS organization. The Office of Audit is now organized by the following areas: Information Systems Programs, Headquarters Operations and Exempt Organizations Programs, Wage and Investment Income Programs, and Small Business and Corporate Programs.

SIGNIFICANT AUDIT RESULTS

During this reporting period, the Office of Audit issued 47 reports. Appendix IV provides a complete listing of the reports issued.

The results of the most significant reviews are discussed in the following sections and represent the major issues and concerns identified during this reporting period.

RRA 98

TIGTA is required to report on IRS' compliance with various provisions of RRA 98. This semiannual report contains the results of the Office of Audit's reviews to determine whether the IRS is complying with these provisions and protecting taxpayer rights while it carries out tax administration activities. RRA 98 also requires TIGTA to assess the adequacy and security of IRS' information technology systems.

The Office of Audit focused significant audit resources in this area during FY 1999. Sixteen audit reports related to the RRA 98 provisions were issued during the reporting period. This includes eight reports on IRS' information technology systems. Two additional reports will be issued in the next reporting period and one of the provisions will not be reviewed until its effective date in January 2000. In addition, nine audit reports were issued regarding other taxpayer protection and rights issues. Appendix VI provides an explanation of the specific RRA 98 provisions and a list of the reviews conducted in these areas.

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Statutory Requirements

Highlighted final audit reports for the RRA 98 statutory provisions include:

The Internal Revenue Service Should Continue Its Efforts to Achieve Full Compliance with Restrictions on the Use of Enforcement Statistics (Report No. 199910073)

In September 1997, the Senate Finance Committee ascertained that in certain IRS offices, employee performance was evaluated in a manner resulting in a work environment driven by statistical accomplishments. This placed both taxpayer rights and the employee evaluation system at risk. As a result, Section 1204, *Basis for Evaluation of Internal Revenue Service Employees*, was included in RRA 98. This Section prohibits IRS management from using records of tax enforcement results to evaluate employees, or to impose or suggest production quotas or goals for such employees. Instead, one of the standards for evaluating employee performance must be the fair and equitable treatment of taxpayers.

The IRS adopted certification procedures to identify violations of Section 1204. The certification is performed quarterly by first-line managers, and then cross-functional management teams perform an annual independent review. These reviews must include an assessment of the employee performance files and employee evaluations. They may also review documents such as award narratives, minutes of meetings, case reviews, or local memoranda.

The auditors determined the IRS is currently not in full compliance with Section 1204 and some employees still believe IRS managers use records of tax enforcement results inappropriately. The auditors noted the following:

- In 28 IRS offices reviewed, 96 Section 1204 violations were identified.
- Based on questionnaires, 124 (27 percent) of 456 managers and employees perceived records of tax enforcement results had been considered when their last performance evaluations were prepared and communicated to them, or were used as performance expectations or goals.
- During its quarterly certifications and independent reviews, IRS management identified approximately 525 violations.

The Office of Audit did not present recommendations for corrective action beyond IRS management's proposed regulations for a balanced system of business measures. This system appears to be an appropriate first step in resolving these problems.

In FY 2000, the Office of Audit will assess the effectiveness of the progress and implementation of the balanced system of business measures as it relates to the use of enforcement statistics. In addition, the auditors will evaluate the results of IRS management's review of the violations identified in this report.

In response to the audit report, IRS management generally agreed with the conditions identified, and stated that they will take whatever steps are necessary to eliminate violations.

The Internal Revenue Service Should Improve Its Federal Tax Lien Procedures (Report No. 199910074)

A federal tax lien (FTL) protects the government's interest by attaching a claim to the taxpayer's assets for the amount of unpaid tax liabilities. RRA 98 and I.R.C. Section 6320 require the IRS to notify taxpayers that a FTL has been filed. Taxpayers may request a hearing with the IRS if they believe the FTL is not appropriate. These new requirements became effective for liens filed after January 18, 1999.

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During the initial implementation period, IRS management was not consistently implementing the FTL provisions of RRA 98. Taxpayers and their representatives were not always informed of the taxpayers' right to a hearing once a FTL was filed.

The auditors reviewed 473 cases, of which 157 cases (33 percent) involved 176 potential violations of legislative or procedural requirements (some cases had multiple violations). The auditors' sample was not statistically valid; therefore, the results may not be representative of cases nationwide. The following are examples of the apparent noncompliance with the provisions of RRA 98 or IRS' procedures contained in the Internal Revenue Manual:

- Taxpayer representatives (e.g., attorney, accountant, etc.) were not sent a lien notice.
- Lien notices were not mailed to taxpayers within five business days of the FTL filing.
- Taxpayers were not given a full 30 calendar days to request a hearing.
- Undelivered lien notices were not re-sent when another address was available.
- Sufficient documentation was not retained to prove that lien notices were sent to taxpayers or were sent timely.
- Responsible spouses or individual partners in a partnership were not sent a copy of the lien notice.

The Office of Audit recommended that the IRS:

- Change systems to automate the mailing and re-issuance of undeliverable lien notices to all responsible taxpayers.
- Revise procedures to ensure that: (1) the government's interest is protected, (2) returned mail is researched completely and processed efficiently, (3) adequate documentation is maintained, and (4) management information systems

measure compliance with the new FTL notification requirements.

IRS management agreed with the findings and recommendations and will take corrective action.

The Internal Revenue Service Needs to Improve Compliance with Legal and Internal Guidelines When Taking Taxpayers' Property for Unpaid Taxes (Report No. 199910072)

IRS procedures and provisions in I.R.C. Sections 6331 through 6344 (1986) are specific as to how to seize taxpayer property. If seizure procedures are followed correctly, taxpayers' rights and the government's interest will be protected. RRA 98 places particular emphasis on taxpayer rights and it contains several new provisions for conducting seizures (e.g., approval levels for seizing business assets, exemption of personal residences from seizures if the tax liability is \$5,000 or less, etc.).

The Office of Audit evaluated whether the IRS conducted seizures according to legal and internal guidelines. The auditors reviewed all 124 seizures (involving 92 taxpayers) conducted by the IRS during a six-month period beginning July 22, 1998, the date RRA 98 became law.

The IRS did not follow all legal and internal guidelines when conducting seizures in 33 (36 percent) of the 92 taxpayer cases reviewed and 32 of those cases potentially impacted the rights of the taxpayer. The auditors concluded further action is needed to ensure that all guidelines are consistently followed.

Legal seizure provisions were not followed in 19 (21 percent) of the 92 cases. Examples included:

- The IRS did not thoroughly investigate the status of the property before seizing property with little or no value, or did not consider alternatives to the seizure.

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- Business property was seized without obtaining the required approvals.
- A notice advising the taxpayer of enforcement action was not provided on all tax periods before the IRS seized the taxpayer's property.

IRS procedures were not followed in 21 (23 percent) of the 92 cases. Examples included:

- Case histories were not documented to indicate Publication 1, *Your Rights As A Taxpayer*, was provided to the taxpayer.
- Taxpayers were not personally warned before the seizure action occurred.
- Expenses of the seizures were not added to the taxpayers' tax liabilities when the property was released.

The Office of Audit recommended that IRS management should:

- Emphasize the need to use the appropriate checklists for all seizures conducted.
- Request an opinion from the IRS Office of Chief Counsel on those seizures that did not follow legal guidelines to determine if the IRS should make restitution to those taxpayers.

IRS management agreed to complete the checklists and to review the applicable seizure cases to determine if any monies should be returned to the taxpayer as a result of an inappropriate seizure.

The Internal Revenue Service Has Not Fully Implemented Procedures to Notify Taxpayers Before Taking Their Funds for Payment of Tax (Report No. 199910071)

Effective in January 1999, the I.R.C. Section 6330 (1986) requires the IRS to advise taxpayers of their right to have their case heard by the Appeals Office, and potentially a court, prior to the IRS taking money from taxpayers' bank accounts, employers or other parties to pay delinquent

taxes. The IRS must wait at least 30 calendar days from the date the taxpayer is notified of the intent to levy and of the taxpayer's appeal rights before issuing a levy.

The auditors reviewed 284 taxpayer accounts, involving 291 levies requested between mid-January and mid-April 1999, to determine if the IRS was in compliance with the new levy provisions, as well as its own internal levy procedures. In the nine offices tested, the auditors reported that the new procedures have not been effectively implemented. The IRS did not consistently notify taxpayers of the intent to levy and of their appeal rights. As a result, the rights of 204 taxpayers were impacted which could result in the IRS having to make restitution to some of the taxpayers.

Legal provisions were not followed in 92 (32 percent) of the 284 taxpayer accounts reviewed. Internal procedures were not followed in 88 (31 percent) of the taxpayer accounts reviewed. Examples of the provisions and procedures not followed included:

- Taxpayers were not notified of the IRS' intent to levy and of their appeal rights before levies were issued.
- Taxpayers were notified of the IRS' intent to levy and of their appeal rights after the levies were issued.
- Taxpayers were notified of the IRS' intent to levy and of their appeal rights, but levies were issued by the IRS during the 30-day waiting period.
- Taxpayers did not have appropriate information added to their computer account history to show the taxpayer had been notified of the IRS' plans to levy.
- Taxpayers did not have appropriate information added to their computer account history to show the initially requested levy had been destroyed.

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The Office of Audit recommended that IRS management:

- Develop methods to ensure taxpayers are notified of the IRS' intent to levy and of their right to a hearing before a levy is issued.
- Develop safeguards, such as a quality review system, to prevent notices from being mailed to taxpayers unless issuing a levy is the next planned case action.
- Identify all levies that were issued without properly notifying the taxpayer. Determine, with advice from the IRS Office of Chief Counsel, what steps should be taken regarding any money received as a result of improper levies.

IRS management agreed with the recommendations and has initiated corrective action.

Other Taxpayer Protection and Rights Issues

Other reviews on taxpayer protection and rights issues involved: selecting tax returns for audit; protecting tax return data in IRS systems; conducting employment tax examinations; and, making adjustments to taxpayers' accounts.

Highlighted final audit reports include:

The Internal Revenue Service Needs to Improve Treatment of Taxpayers During Office Audits (Report No. 093602)

Historically, the Discriminant Function (DIF) methodology has been the primary workload identification system used by the IRS to select individual tax returns for office audit examinations.

In the last several years, the IRS has migrated from using the DIF and has begun identifying innovative ways of doing business, such as using the Midwest Automated Compliance System (MACS). The MACS provides IRS

district office employees the ability to use locally derived, and possibly subjective, criteria to identify and select returns for audit.

The auditors identified weaknesses in the MACS control environment and in actions taken by examiners and managers during the initiation and closing of non-DIF audits. The audit showed that IRS employees accessed over 3,600 accounts over a two-month period and the accesses were not supported by a valid business purpose. Given the extent of control breakdowns identified, the auditors could not give assurance that IRS employees selected returns for examination fairly, or that taxpayers' personal and financial data was protected from unauthorized and improper disclosure.

The auditors also noted inappropriate actions taken by examiners and managers during the initiation and closing of audits that may have led to improper taxpayer treatment. For example, the auditors could not always find evidence that the IRS had properly informed taxpayers of their rights at the initiation of the audits. In other cases, IRS procedures were not always followed. In two districts, the IRS used discretionary enforcement powers in a way that appeared to create an unnecessary hardship and burden on taxpayers. The two districts mailed a six-page questionnaire requesting more than 80 items of information to 3,500 low-income taxpayers who claimed the Earned Income Tax Credit.

The Office of Audit recommended that the IRS:

- Improve separation of duties by locating MACS in offices other than where the audits will be worked. IRS employees that are responsible for identifying potential MACS returns for audit should not be responsible for working the audits.
- Strengthen specific controls and procedures for initiating and closing audits.

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With the exception of centralizing MACS sites, the IRS management agreed to take corrective actions that are consistent with all Office of Audit recommendations. IRS management believes that the management of MACS should be centralized rather than centralizing the MACS sites. In addition, Examination personnel will review alternative approaches to separating case selection and case assignment practices.

The New Jersey District Needs to Execute Levy Actions Consistent With Sound Tax Administration and Concern for Taxpayer Treatment (Report No. 199930069)

The IRS has a legitimate need to use levy action as an administrative means to enforce the collection of taxes. However, when levying taxpayers, the IRS must ensure that appropriate legal and procedural requirements are followed and taxpayers are treated properly.

The Office of Audit conducted a review of levy actions initiated by the New Jersey Collection Division. The review was a follow-up review of two FY 1998 audits which showed significant problems in the district's use of performance measures and statistics, and in the use of seizure authority.

The Office of Audit reported that the New Jersey District violated IRS policy and procedural requirements in its use of levy authority. These procedures are designed to assess a taxpayer's ability to pay, and ensure both that the levy is the proper course of action and that taxpayers are notified prior to levy action.

The auditors noted that procedures were not followed in 92 percent of the 264 levies reviewed. Also, taxpayers were not afforded their right to legal notification prior to the levy issuance for five percent of the levies.

The auditors also reviewed the levy case files and noted that 35 levies were issued to taxpayers who were deceased, experiencing

medical or financial hardships, not liable for the tax or under audit in the Examination Division.

The district's practice of levying, as the first action on a taxpayer case without attempting to contact taxpayers, conducting initial analyses, or researching case histories was prevalent in most cases reviewed. This practice was most prevalent in the Department of Labor (DOL) Project, where levies were generally issued as the first action in an effort to close taxpayer cases quickly and help meet statistical goals. The auditors concluded that about 56,000 taxpayers were potentially at risk for improper levy actions.

Although the district's "Best Practice" documentation indicated that the basis for the DOL initiative was to identify "uncooperative" and delinquent taxpayers for enforcement action, there was virtually no attempt to assess taxpayers' willingness to cooperate and/or their ability to pay prior to the levy actions.

The Office of Audit recommended that:

- Emphasis be placed on policy and procedural requirements regarding the use of levy authority.
- The district review levy actions taken during the past nine months to identify instances that meet criteria requiring remedies to taxpayers.

IRS management agreed with the auditors' findings and recommendations and implemented corrective actions to ensure at least one attempt to contact the taxpayer is made prior to the levy action.

The Examination Returns Control and Integrated Data Retrieval Systems Can Be Improved to Protect Taxpayer Rights During the Audit Process (Report No. 094206)

The Office of Audit initiated a follow-up review of its October 1996 report (Report No. 070106), which identified control

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weaknesses in the Examination Returns Control System (ERCS) and the Integrated Data Retrieval System (IDRS). The Examination Division uses these systems to select cases for audit, and to control and dispose of each case. These control weaknesses could adversely impact the public's confidence in IRS' ability to protect the privacy and security of taxpayers' personal and financial information.

While IRS management had made improvements to enhance ERCS and IDRS controls since the prior audit, the auditors noted that the IRS needed to take additional actions to enhance the effectiveness of Examination controls and to provide further protection of taxpayer rights and tax return information.

The Office of Audit recommended that IRS management:

- Improve ERCS audit trail functionality to include a process for reviewing user activities and providing data to users of the audit trail.
- Improve ERCS controls to eliminate acting managers from having the ability to approve any changes to their inventory.
- Provide more effective oversight over examiners' capabilities to order tax returns and establish, update, and close Examination records.
- Report the results of Examination management's analyses of case closures due to errors or unlocatable returns.

IRS management agreed with the facts and recommendations and has agreed to take corrective action.

Internal Revenue Service Procedures Were Not Consistently Followed When North Florida District Revenue Officers Attempted to Improve Tax Compliance in the Construction Trades Industry (Report No. 190303)

The IRS Southeast Regional Commissioner requested that the Office of Audit evaluate complaints made by a former employee regarding the treatment of taxpayers during a Regional Compliance Program (RCP). Revenue officers were alleged to have used unauthorized techniques to work RCP leads on employment tax issues in the construction trades industry project.

In responding to members of the Congress about these complaints, IRS Collection management stated the revenue officers in the RCP group had acted in accordance with IRS policies and procedures. However, the opinions and conclusions of the auditors differed from those offered by Collection management.

The auditors reviewed case files and concluded that taxpayers were treated inconsistently because of how RCP employment tax leads were worked. This occurred because management did not ensure revenue officers working the RCP cases received adequate training, followed appropriate procedures when expanding the leads into examinations and followed Internal Revenue Manual procedures when conducting audits.

IRS management agreed that insufficient training was provided to the revenue officers assigned to the project and that different procedures were used. IRS management also agreed to conduct an independent review of the cases the auditors questioned to determine if Examination audits were conducted instead of the less intrusive compliance checks. IRS management will ask its Chief Counsel to determine any remedial actions that must take place for affected taxpayers.

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Information Technology

The Office of Audit evaluates the adequacy and security of IRS technology on an ongoing basis. Reviews focused on assessing the IRS' progress in implementing its modernization initiatives and the security and adequacy of selected IRS tax processing systems.

Highlighted final audit reports include:

The Service Center Mainframe Consolidation Project Has Made Significant Progress, But Project Execution and Administration Risks Remain (Report No. 199920068)

The Service Center Mainframe Consolidation (SCMC) Project's goal of consolidating the mainframe processing at ten service centers into two computing centers is a very complex task and requires extensive coordination and effort by several contractors and IRS functions.

While the Project is making significant progress toward its goal, the IRS needs to ensure that future service center consolidations, technical contract administration, and budget accounting are improved. The auditors noted that the IRS had taken actions to define delivery orders that resulted in cost savings of \$19 million. However, several procurements, estimated at \$7 million, were made without following proper procurement procedures. In addition, the complete cost of the consolidation was not being effectively budgeted, captured and reported by the SCMC Project Office. The auditors estimated that there were approximately \$1.07 million in unreported staffing costs in FY 1998 for the three sites tested.

The Office of Audit recommended that IRS management ensure:

- All critical operational and technical aspects of consolidation at computing centers and service centers are standardized, thoroughly tested,

appropriately documented and included in employee training.

- Computing centers are adequately staffed.
- Contract requirements were defined by June 1999 and proper procurement procedures were followed to obtain goods and services.
- All consolidation costs were accurately budgeted and reported.

IRS management provided an adequate, detailed response to the first summarized recommendation which was included in a memorandum issued during the audit. However, IRS management did not provide an official response to the draft report that included the remaining recommendations.

The General Controls Environment Over the Internal Revenue Service's Unisys 2200 Systems Can Be Improved (Report No. 199920063)

The Unisys 2200 mainframe computers are an integral part of IRS' tax processing system. Virtually all transactions affecting a taxpayer's account are processed through these systems. They house databases for on-line retrieval of taxpayer information; therefore, it is critical for the systems to have an effective general controls environment.

The Office of Audit reviewed the general controls over IRS' Unisys 2200 Operating System Environment and concluded that the general controls are adequate to protect sensitive data. However, there are several areas in which controls could be adhered to more uniformly, and where procedures should be established to provide improved system control, security, and standardization.

The auditors recommended several ways to improve controls over taxpayer data files and the common system and database files. In addition, the auditors recommended:

- Modification of the control settings for files that may potentially complicate the mainframe consolidation process.

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- Development of a process that will improve the accountability of individuals using the system security user identification.
- Re-issuance of the policy for accounting for deviations of user access profiles from IRS standards.
- Development of C2-level security documentation, security policies, and documentation of risk factors for the Unisys consolidated mainframe environment.

IRS management agreed with the findings and recommendations and has initiated appropriate corrective action.

Review of the Electronic Fraud Detection System (Report No. 093009)

The number of electronically filed tax returns claiming fraudulent refunds has risen dramatically since electronic filing began in 1986. As a result, the Electronic Fraud Detection System (EFDS) was developed to automate the screening process and identify and review returns with the highest potential for fraud. EFDS improves the detection of fraud by increasing data sources and enhancing scheme development for referral to the districts for criminal prosecution.

The auditors concluded that while EFDS is a significant improvement over the manual procedures previously used, there are still changes that can be made to further improve and manage EFDS. The auditors also found discrepancies in the accounting records that amounted to \$22.3 million in understated total costs. The Office of Audit recommended IRS management should:

- Strengthen existing security controls.
- Develop all EFDS applications and ensure the applications are properly functioning.
- Implement controls to maintain accurate and complete cost data for EFDS.

IRS management agreed with the findings and recommendations and has initiated appropriate corrective action.

Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service (Report No. 093103)

The IRS uses the Automated Non-Masterfile (ANMF) computer system to process tax returns and transactions that cannot be processed on its primary Masterfile computer system. Each of the ten IRS service centers has a separate ANMF database that is not connected with any other ANMF system, or other IRS computer system.

As of September 30, 1997, the ANMF contained 101,216 balance due accounts totaling over \$14 billion. The auditors concluded that, overall, the transactions were accurately input to the ANMF and to the accounting system. However, inherent processing problems resulted in the IRS not mailing annual reminder notices of balance due accounts to taxpayers in violation of the Taxpayer Bill of Rights 2 (TBOR2). The accounts also contained incorrect interest and penalty computations. The processing inefficiencies and errors resulted in undue taxpayer burden, increased operating costs, and lost revenue.

The auditors also reported:

- The ANMF contained many old accounts. Over 6,700 accounts were over 10 years old and 220 were over 20 years old. The 6,700 balance due accounts exceeded \$750 million in tax, penalty and interest.
- The IRS did not establish the required "freeze" code (used to prevent the issuance of refunds) on the related Masterfile accounts on 21,700 (34 percent) of the 64,000 individual accounts on the ANMF.
- The IRS did not issue a Statement for Recipients of Interest Income,

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Form 1099-INT, as required by law, to report interest paid to taxpayers in 27 percent of the 142 cases reviewed. During the first nine months of FY 1997, the IRS issued approximately 1,500 refunds in which a Form 1099-INT should have been issued.

The Office of Audit recommended that the IRS:

- Expedite changes to allow the processing of ANMF accounts on the Masterfile.
- Consolidate the existing ANMFs.

IRS management agreed with the findings and recommendations and prepared requests for computer programs. These include programs to: correct programming errors in penalty and interest computations; identify address changes; and, freeze the refund on Masterfile accounts where there is a related liability on the ANMF. In addition, the IRS plans to conduct a massive cleanup of old accounts on the ANMF to determine if the accounts are valid. The IRS also will generate annual reminder notices in Calendar Year 1999.

With these changes, the IRS will be in compliance with the law by issuing TBOR2 notices and Forms 1099-INT. In addition, receiving these notices will reduce taxpayer burden and could increase taxpayer compliance in reporting interest income.

Century Date Change

The Office of Audit has conducted several reviews to assess IRS' efforts in ensuring all systems and programs are Y2K compliant. Reviews focused on project management and oversight, testing efforts and exchanging data with outside parties.

Highlighted final audit reports include:

Increased Validation and Oversight of Year 2000 Minicomputer Conversion Efforts Are Needed to Strengthen Testing and to Avoid Further Delays (Report No. 199920054)

The Office of Audit assessed IRS' efforts to prepare its minicomputer systems for the century date change (CDC) and concluded that the IRS has improved its management of the minicomputer conversion effort. Increased involvement by the CDC Project Office has resulted in assignment of monitoring responsibility, identifying sites where systems are located, issuance of guidance for converting systems, and development of conversion schedules.

However, initial monitoring of the conversion progress was based on self-reporting of critical conversion data, with minimal on-line validation. As a result, the Office of Audit identified weaknesses in systems testing and unmet target dates.

The Office of Audit recommended that:

- The IRS properly classify the risk level for minicomputer systems that did not meet the January 1999 target conversion date.
- The CDC Project Office representatives should independently validate:
 - (1) conversion dates for systems that did not meet the target,
 - (2) testing performed on each mission critical minicomputer system, and
 - (3) contingency procedures for all systems that were not compliant by March 31, 1999.

The audit resulted in increased oversight of the minicomputer conversion effort. In addition, the audit identified weaknesses that management is addressing to ensure that minicomputer systems that process electronically filed tax returns, answer incoming taxpayer telephone calls, and

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process employee payroll will run in the next century.

IRS management has agreed to all recommendations and will initiate corrective actions.

Review of the Internal Revenue Service's Year 2000 End-to-End System Integration Test Efforts – Overall Planning and Execution of Test 1 (Report No. 094002)

IRS created an off-line test environment to replicate its tax processing environment. The purpose of this test environment is to serve as a final phase for assessing Y2K compliance of IRS' tax processing software, hardware and communications capabilities. The Information Systems' Product Assurance function controls this test along with significant levels of contractor support.

Despite initial delays in planning and conducting the End-to-End System Integration Test activities, IRS' Information Systems Division made significant progress in preparing an overall approach to conducting the test. The auditors noted that the End-to-End System Integration Test Team met their limited objectives for executing Test 1. However, the Office of Audit identified the need for the IRS to prepare a systematic risk analysis of its systems and provide improved oversight over key support

systems that will not be included in the nationwide End-to-End test. They also identified the need for the IRS to better coordinate its planning efforts for the End-to-End System Integration Test.

To improve the End-to-End testing, auditors recommended that IRS management:

- Perform a detailed analysis of the IRS systems inventory to assess the business value and potential risk exposure of all its major systems and establish a priority ranking.
- Identify all key operations support systems not selected for the nationally coordinated End-to-End System Integration Test.
- Establish centralized oversight and control over the testing of key support systems within the operations functions.
- Mandate that key operations systems owners use the Product Assurance test bed to perform their Y2K compliance testing.

IRS management agreed to two of the recommendations and has taken corrective action. However, IRS management did not agree to perform a detailed analysis of the business value and potential risk exposure of all major systems because all IRS systems will be end-to-end tested. They also did not agree that the use of the Product Assurance



TIGTA Audit Manager Vincent Dell'Orto was recognized at the May 1999 Department of the Treasury Annual Awards Ceremony for his leadership and assistance in identifying critical issues relating to the IRS' Year 2000 efforts. Shown here is Treasury Secretary Lawrence Summers offering his congratulations to Mr. Dell'Orto.

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test bed should be mandated.

Opportunities Remain for the Internal Revenue Service to Further Minimize the Risks Associated With Implementing Year 2000 Compliance for External Trading Partners (Report No. 095202)

In 1996, IRS established the CDC Project Office with an objective to ensure that all systems are Y2K compliant by January 1, 2000. This requires close coordination with many External Trading Partners (ETPs). ETPs are organizations that exchange data with IRS, such as: state, local, and foreign governments, banks, and other federal agencies.

This review was a follow-up audit to a report issued in November 1998 (Report No. 091303). During the current audit, the auditors noted that the CDC Project Office has made considerable progress in identifying ETPs and communicating the IRS' Y2K standards to them. The Office of Audit recommended continued emphasis in the following areas:

- Implementation of an oversight process to ensure accurate ETP information. One audit test showed that 22 percent of exchange files sampled contained inaccurate dates.
- Delayed project milestones should be completed prior to the final phase of the End-to-End system testing. One audit test showed that approximately 12 percent of the files remain untested.

Reliable management information is needed to assure that IRS' tax systems will accurately and timely process returns and collect revenue after December 31, 1999. Taxpayer burden will increase if the IRS' tax systems are not timely prepared to process returns and collect revenue.

IRS management concurred with the facts in the report and has agreed to take corrective action.

Processing Tax Returns and Implementing Tax Law Changes

The Office of Audit initiated various reviews to evaluate IRS' progress in effectively preparing for filing season activities.

A highlighted final report includes:

The Internal Revenue Service Needs to Improve Information Systems Quality Assurance Efforts Over Key Tax Law Changes for the 2000 Filing Season (Report No. 199920066)

The Taxpayer Relief Act of 1997¹ (TRA 97) contained over 800 I.R.C. amendments and nearly 300 new provisions, most of which went into effect prior to the 1999 filing season. As a result, the IRS was required to prepare its systems and programs to properly process tax return information mandated by the new legislation for the 1999 filing season. At the same time, IRS had other initiatives for which its limited programming resources were needed. These initiatives included consolidating the computer operations of ten service centers into two computing centers and preparing all IRS systems for Y2K compliance.

The Office of Audit reported that the IRS incorporated key legislative changes into programs and ensured programs were tested and implemented. However, for the 2000 filing season, the IRS faces even tighter time and resource constraints due to the Y2K conversions and End-to-End testing. Therefore, the Office of Audit recommended that:

- Information Systems management ensure the Filing Season Project Office has

¹ Pub. L. No. 105-34, 111 Stat. 788

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controls in place to monitor and oversee the progress of all filing season changes.

- Product Assurance Division management ensure that the progress of testing for the 2000 filing season is consistently monitored and reported.
- Any testing delays need to be timely reported and discussed at Executive Steering Committee (ESC) and weekly filing season meetings.

IRS management agreed with the findings and has initiated corrective actions. However, Product Assurance Division management did not believe it would be appropriate to raise all program testing delays to the ESC.

Customer Service

The Office of Audit conducted reviews to evaluate whether the IRS is improving operations and providing taxpayers with quality customer service in accordance with Congressional and administrative direction.

A highlighted final report includes:

Improvements Can Be Made In Providing Assistance to Taxpayers (Report No. 199940065)

This review was initiated as part of the Office of Audit's coverage of the implementation of key legislation and National Performance Review recommendations affecting the 1999 filing season. The auditors evaluated the effectiveness of the IRS Customer Service Division's efforts to ensure employees were prepared to assist taxpayers with TRA 97 tax law questions. The auditors also assessed the IRS' TeleTax, Internet web site, toll-free telephone number, and e-mail activities.

The review showed that the IRS' toll-free automated telephone tax and refund information system (i.e., TeleTax) and Internet web site provided accurate information on key TRA 97 provisions. However, the IRS Customer Service

telephone assistants were not adequately prepared to answer current year tax planning questions. In addition, IRS' answers to 130,000 e-mail questions were not always complete, concise, or clear.

The Office of Audit recommended that the IRS could further its goal of improving customer service to taxpayers by:

- Ensuring prompt distribution of new tax law materials to telephone assistants.
- Establishing a process that ensures all telephone assistants are adequately trained.
- Establishing uniform program policies and procedures that will ensure quality responses to taxpayers' e-mail questions.

IRS management agreed to the recommendations and has initiated corrective actions.

Protecting Revenue and Minimizing Tax Filing Fraud

The Office of Audit conducted reviews to assess the IRS' efforts to properly protect revenue and minimize tax filing fraud.

Highlighted final audit reports include:

Weak Internal Controls Exposed Taxpayer Payments to Embezzlement in the Delaware-Maryland District (Report No. 190103)

The Office of Audit conducted this review in conjunction with the Office of Investigations' inquiry involving the embezzlement of delinquent taxes collected by a revenue officer. Approximately \$77,000 was embezzled by a revenue officer as a result of improper and undetected adjustments to taxpayer accounts. The review did not identify any similar instances of embezzlement by other revenue officers in the district.

IRS district management agreed that their procedures lacked proper separation of duties.

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New procedures have been implemented to address these weaknesses. IRS district management has taken corrective action. Training was conducted for all persons involved in the processing of taxpayer account adjustments. IRS management also conducted quarterly post reviews to assure that proper guidelines were followed.

The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations (Report No. 094505)

The IRS issues Individual Taxpayer Identification Numbers (ITINs) to undocumented aliens to improve nonresident alien compliance with tax laws. This IRS practice seems counter-productive to the Immigration and Naturalization Service's (INS) mission to identify undocumented aliens and prevent unlawful alien entry.

The Office of Audit reviewed the ITIN Program for conflicts with laws and regulations, its impact on other IRS programs, and operational effectiveness. The review indicated that the ITIN Program will adversely affect tax administration. The program raises several concerns, from tax policy to operational implementation.

The auditors reported:

- The ITIN Program conflicts with a general statute, The Illegal Immigration Reform and Immigrant Responsibility Act of 1996¹.
- The IRS disregarded its own procedures and did not verify both the identity and foreign status of the applicant. This action resulted in over 834,000 applicants receiving an ITIN without providing documentation establishing foreign status. Of these, over 340,000 applicants identified themselves as illegal aliens.

To address tax policy and operational issues, the Office of Audit recommended that IRS management:

- Bring legal issues to the attention of the Joint Committee on Taxation for the Confidentiality of Tax Information Study.
- Bring to the attention of the IRS Commissioner the taxation of illegal aliens.
- Implement revenue protection actions.
- Correct operational conditions.

IRS management generally agreed with the report recommendations. However, the revenue protection actions are seen as requiring legislative remedy. The Office of Audit disagreed that IRS management should not take any action on this recommendation.

Controls Should Be Strengthened Over Business Taxpayer Accounts with Frozen Million Dollar Refunds (Report No. 199940057)

The Office of Audit performed a limited review to determine whether the IRS was properly releasing the automatic hold placed on business taxpayer accounts when a credit balance reaches an amount that would cause a refund of \$1 million or more. Limited analysis showed that the IRS could provide better customer service and reduce interest expense by ensuring the holds are properly and timely released. The IRS incurred additional interest expense of approximately \$17.5 million on 44 business taxpayer accounts that had a "Million Dollar Refund Freeze."

The auditors advised IRS management of these conditions in an April 1998 memorandum. The memorandum included a list of 411 business taxpayer accounts with this freeze condition.

The Office of Audit also recommended that service center management:

¹ Pub. L. No. 104-208, 110 Stat. 3009-546

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- Modify the "Million Dollar Refund Freeze" indicator program in the IRS computer system.
- Generate follow-up transcripts for business taxpayer accounts with a "Million Dollar Refund Freeze" periodically.
- Ensure that the "Million Dollar Refund Freeze" is shown on critical IRS computer display screens.

- Enhance current IRS procedures to identify and expedite the resolution of a "Million Dollar Refund Freeze."

The IRS Executive Officer for Service Center Operations responded to the interim memorandum and began immediate corrective action to resolve the noted "freeze" conditions. However, IRS management did not respond to the draft report which contained the four highlighted recommendations.

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**Treasury Inspector General for Tax Administration
Office of Investigations**

INTRODUCTION

The Office of Investigations is responsible for the development and execution of the nationwide investigative programs relating to oversight of IRS activities and operations.

The Office of Investigations is responsible for protecting the integrity of the IRS and for protecting employees of the IRS and related entities against external attempts to corrupt or threaten them when carrying out their responsibilities. This includes investigating allegations of criminal wrongdoing and administrative misconduct by IRS employees.

Other areas of responsibility include:

- Administering programs to protect IRS employees from violence.
- Operating a national complaints center, including a hotline, to receive and process allegations of fraud, waste or abuse.
- Providing forensic examination of documentary evidence.
- Providing technical and investigative assistance, equipment, training, and other specialized services to enhance investigative operations.
- Administering a proactive program to detect and deter fraud in IRS programs and operations.

INVESTIGATIVE ACTIVITIES

The Office of Investigations focuses on investigating allegations of administrative or criminal misconduct that may involve IRS employees, such as unauthorized access and disclosure of confidential taxpayer information, bribery, financial fraud, false statements, and abuse of taxpayer rights.

During this six-month reporting period, the Office of Investigations completed 603 employee misconduct investigations.

The Office of Investigations also investigates individuals who attempt to interfere with or corrupt the administration of the federal income tax system, to include investigations of bribery, assault, threat, theft and embezzlements. During this reporting period, the Office of Investigations completed 1,039 investigations involving these types of allegations.

TIGTA special agents routinely conduct integrity awareness presentations for IRS employees and various professional organizations. These presentations are designed to heighten awareness of integrity and to provide a deterrent effect against fraud and abuse involving IRS programs and operations. During this reporting period, the Office of Investigations conducted 368 presentations for 17,178 individuals.

PROTECTION OF TAXPAYERS AND IRS EMPLOYEES

When Congress passed RRA 98, it created essential taxpayer rights and protections against IRS employee misconduct and abuses. The Office of Investigations is dedicated to serving the public by conducting investigations that protect the taxpayers from employees who commit criminal and administrative violations.

The Office of Investigations is also committed to protecting and supporting IRS employees as they carry out the mission of the IRS. IRS employees have the right to work in a safe and trustworthy environment. TIGTA is dedicated to ensuring taxpayers and IRS employees the highest degree of integrity,

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fairness and trust in our tax administration system.

Complaint Management Division

During the 1998 Senate Finance Committee hearings involving IRS activities, including the activities of the former Inspection Service, the IRS was criticized for its inability to track the receipt and disposition of taxpayer complaints, including any subsequent action taken on those complaints. Accordingly, TIGTA developed a new complaint tracking system that provides a centralized accounting of all complaints received by TIGTA and the dispositions of those complaints. This system, the Investigations Management Information System Complaint Management Screen, became operational on July 19, 1999. This system has the capability to document and track complaints where there are multiple subjects.

To receive complaints of wrongdoing by IRS employees, TIGTA operates a toll-free telephone number, an e-mail account and a central post office box. Allegations are received at TIGTA's Complaint Management Division, which acts as a national center to process and track allegations of fraud, waste, abuse and other forms of wrongdoing.

To assure TIGTA has all the relevant information available to evaluate a complaint, complainants are interviewed, to the extent possible, by TIGTA personnel. Complainants are also provided with a Complaint Number which can be used to track the complaint's disposition.

During this reporting period, TIGTA received 5,092 complaints. Of these complaints, 2,071 (41 percent) warranted further investigation (see Appendix II).

Section 1203 Violations

Section 1203 of RRA 98 addresses a Congressional objective to ensure the protection of taxpayers and IRS employees from intentional, willful misconduct by IRS employees. RRA 98 provides for the termination of employees who commit specific categories of misconduct (see Appendix V for a summary of Section 1203 standards). During this reporting period, TIGTA initiated 122 investigations relating to alleged 1203 violations. Of these, 101 are currently ongoing, 4 were closed to file and 17 have been closed and referred to the IRS for administrative adjudication. The IRS terminated three employees under Section 1203 during this reporting period.

In addition, TIGTA received 365 information items relating to Section 1203 that were provided to IRS managers for action, as they deemed appropriate. These information items are complaints or allegations where TIGTA determined that an investigation was not warranted.

IRS Employee Found Guilty of Battery and Resigns Position Based on a 1203 Violation

On May 6, 1999, an IRS employee was found guilty of a charge of battery. The employee also resigned from her IRS position prior to administrative action based on a 1203 violation related to this incident. TIGTA initiated an investigation after several police officers reported that an IRS employee had threatened them during a traffic stop. During the traffic stop, the employee identified herself as an IRS employee, displayed her IRS credentials, threatened the officers with IRS audits and used abusive language. After scribbling her name on the traffic citation, the IRS employee threw the ticket book and pen at an officer, striking the officer. TIGTA special agents worked with the local authorities on the investigation. The IRS employee was sentenced to six months

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probation and ordered to pay court costs in the amount of \$263 and attend an anger management program.

Strategic Enforcement Division

The Strategic Enforcement Division (SED), formerly called the Centralized Case Development Center, executes an aggressive proactive effort to detect fraud and misuse in IRS computer systems and operations. The program uses advanced computer technology and computer matching to identify criminal violations modeled from criteria identified in prior investigations.

SED's operation is an intense, collaborative effort between auditors, special agents and computer programmers. SED has been successful in identifying possible fraudulent activities and control weaknesses in IRS operations.

National Integrity Projects

The principal component of SED's operation is the national integrity project. Projects are initiated from information developed during a successful investigation. The methodology of a crime becomes the basis for developing proactive computer database applications that will identify other individuals who may be perpetrating the same crime. These proactive national integrity projects are included in Computer Matching Act¹ agreements approved by the Treasury Department's Data Integrity Board and published in the Federal Register.

UNAX Detection Project

The UNAX Detection Project is SED's most aggressive national integrity project. The Audit Trail Lead Analysis System (ATLAS) is designed to detect potential unauthorized accesses to electronic taxpayer records on IRS computer systems. ATLAS became

operational in March 1999, and replaced the antiquated IRS Electronic Audit Research Log that was in operation in the ten IRS service centers.

The UNAX Detection Project continues to identify solid leads. During the reporting period, TIGTA primarily used ATLAS to identify 478 leads of potential unauthorized access to tax information by IRS employees. Analysis of these leads has resulted in 175 referrals to TIGTA field offices for investigation of violations of the Taxpayer Browsing Protection Act of 1997².

As a result of this ongoing project, several UNAX cases have been further developed and identified fraud issues in addition to the unauthorized access issues. These issues involved potentially fraudulent returns and adjustments, and unauthorized disclosure of tax information. Some examples of these cases are highlighted on page 28.

TECHNICAL AND FORENSIC SUPPORT DIVISION

To support its operations, the Office of Investigations maintains the Technical and Forensic Support Division (TFSD). TFSD is responsible for directing programs concerning Technical Services, the Forensic Computer Laboratory (FCL) and Forensic Science Laboratory (FSL). Each TFSD program provides technical expertise throughout the development and the adjudication process of investigations.

Technical Services

Technical Services is responsible for providing technical and investigative assistance, equipment, training, and other specialized services to enhance TIGTA's investigative activities. Technical Services' personnel provides crucial support in the

¹ Pub. L. No. 101-56, 103 Stat. 149

² I.R.C. § 7213A

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collection and enhancement of evidence. Technical Services provides audio and video investigative equipment and support in collecting evidence. Some examples of significant investigative support provided by Technical Services include:

- An individual was captured on videotape, through the use of covert video equipment, offering a "silent" bribe to an IRS employee by passing notes and without talking.
- A covert video was utilized to collect evidence of an IRS employee making \$13,000 in telephone calls to sexually oriented "900" numbers from a government office.
- A covert video was instrumental in capturing an IRS service center employee stealing cash from IRS mail during a remittance test.
- A former IRS employee was observed, through the use of covert video, committing Worker's Compensation fraud.
- An IRS employee was observed, through the use of covert video and audio equipment, preparing and falsifying taxpayer documents.
- Covert video and audio equipment was instrumental in monitoring a tax preparer soliciting bribes from an individual in return for preparing and submitting false IRS tax documents.



Forensic Computer Laboratory

The FCL provides TIGTA special agents with on-site expertise and assistance during the search and seizure of computers and computer data. The FCL directs investigations involving external "hacking" or intrusion into IRS computer systems. The FCL maintains an investigative computer research and reference facility to enhance technical skills in the investigative use of computers. Furthermore, the FCL formulates and conducts computer investigative training for TIGTA employees and performs tests of the security of automated information systems nationwide. Examples of FCL support include investigating threats against IRS employees and other government officials made through the Internet. Support also includes safeguarding and inspecting IRS computer systems against outside intrusions through electronic means.

The following is a significant case developed with support from the FCL.

Joint Procurement Fraud Task Force Investigation Results In IRS Employee and Co-Conspirators Entering Guilty Pleas for Bribery

A procurement fraud task force comprised of personnel from TIGTA's Office of Investigations and Office of Audit, IRS' Criminal Investigation Division, and IRS' Examination Division determined that an IRS employee accepted bribe payments in exchange for directing IRS contracts to two companies. As a Contracting Officer's Technical Representative, the employee had a role in awarding contracts to perform computer maintenance. The bribe payments were made to the employee by two intermediaries, as well as the president of one of the companies. One of the intermediaries was the employee's former father-in-law. The scheme called for the employee and intermediaries to receive a percentage of the

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gross billings from the contracts. The intermediaries received payments from the two companies, and in turn, paid the employee his share. Between 1991 and 1996, the companies received approximately \$57 million in contracts from IRS. The FCL conducted analysis of computer data secured as a result of a search and seizure.

As of August 30, 1999, the now former IRS employee has pled guilty to bribery and filing a false income tax return and was sentenced to 37 months imprisonment, followed by 3 years supervised release. The employee's former father-in-law pled guilty to conspiracy and paying bribes and gratuities and was sentenced to 46 months imprisonment. The other intermediary pled guilty and is currently serving a 67-month sentence. One of the company presidents pled guilty to paying unlawful kickbacks in conjunction with a contract with the Federal Aviation Administration (FAA), and is awaiting sentencing. Investigation of the FAA contract was also a result of the task force.

Forensic Science Laboratory

Criminal investigations often depend upon the forensic analysis of evidence. Fingerprint and handwriting examination, photography and chemical analysis are just a few of the laboratory tools that assist special agents in identifying subjects.

The FSL supports field investigations through timely processing of documentary, physical and chemical evidence. Additional high-tech equipment moves the FSL toward accreditation and provides expanded services to special agents. The FSL recently added a new digital camera to its laboratory. The digital camera provides state-of-the-art investigative support for the examination of physical evidence, from documents to fingerprints. This camera is a stationary unit capable of capturing top quality images of

evidence to accurately record the results of examination and to create courtroom demonstration charts.

During this six-month period, the FSL received 80 case submissions, issued 57 reports of laboratory examination, and evaluated 3,200 items of physical evidence. Included in the evidence analyzed was \$14.4 million in tax payments, tax refunds and other financial documents.

During the reporting period, the FSL examined a number of cases that resulted in confessions and court rulings in favor of the government. Some examples include:

- Handwriting examinations identified a suspect as the probable author of letters sent to a news publisher describing threats to kill IRS employees and federal judges. A latent print examination identified the suspect's fingerprints on the pages of the threats. The case went to trial and the defendant was found guilty. The defendant was sentenced to 37 months imprisonment, followed by 3 years of supervised release.



Developed latent print on threat letters.

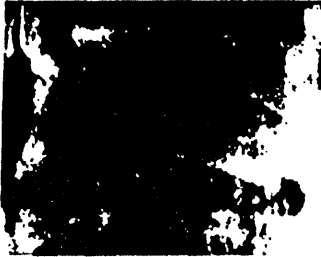
- On June 28, 1999, two former IRS employees were arraigned on charges involving the theft and destruction of IRS tax returns, records, and other government property. The shredded documents were painstakingly reassembled by the FSL and were found to include original tax returns, as well as other IRS documents and files. Both IRS employees' fingerprints were identified on the reconstructed documents. As part of a negotiated plea agreement, one employee pled guilty to one count of destruction of government property. The other IRS employee pled guilty to one felony count of theft of government property. As part of their plea agreements, the United States Attorney's

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Office agreed not to file additional charges involving theft, destruction of records, failing to perform official duties, and making false statements to investigators.

- The FSL examined evidence in a homicide case and was able to link the suspects to the evidence. Attempts to decipher illegible entries on an ATM receipt were made by a State Crime Lab and the Federal Bureau of Investigation, with little success. The FSL, using a sensitive infrared camera and imaging software, examined the receipt and was able to decipher additional entries. The FSL examiner testified for 3 1/2 hours



ATM receipt evaluated by the FSL using digital imaging.

in a pretrial hearing where the defendant motioned to suppress the FSL analysis in this death penalty murder case. The judge denied the defendant's motion. When the defendant was again confronted with the TIGTA laboratory report, he admitted to his involvement in the crime, and implicated the second defendant, the victim's nephew, as the one who committed the murder. The defendant pled guilty to third degree murder and the nephew pled guilty to first degree murder.

- A joint investigation by TIGTA and IRS' Criminal Investigation Division involved a kickback scheme related to a FAA contract. Due to the varied content of the investigative documents, the FSL provided guidance to investigators in

obtaining handwriting exemplars from the suspected writers. Upon its comparison with the investigative documents, the FSL identified two of the three principals as authors of the questioned material. The defendants pled guilty in July 1999.

- An individual claimed that he gave an IRS revenue officer, now deceased, cash in the amount of \$22,000 as full payment for his tax liability. IRS records reflected no such payment. The individual contended that he owed no taxes and as proof, produced photocopies of two IRS notices, each with a handwritten notation indicating taxes paid in full. An investigation, including forensic analysis of handwriting on purported receipts, found no evidence supporting the individual's claim that the revenue officer had made the handwritten notations. A TIGTA FSL examiner provided expert testimony in United States District Court. The government was pursuing a civil collection suit against the individual. The Petit Jury ruled in favor of the government.

SIGNIFICANT INVESTIGATIONS

Disclosure and Improper Computer Access Investigations

The following investigations resulted from national integrity projects, including the UNAX Detection Project, and investigative strategies involving abuse of IRS computer systems, unauthorized accesses and disclosure of confidential taxpayer records by IRS employees.

IRS Employee Indicted for Unauthorized Access of a Federal Computer in Furtherance of a Criminal Act

An IRS service center employee was indicted on August 3, 1999, for unauthorized access of

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a federal computer in furtherance of a criminal act. Based on that charge, the employee's related criminal acts, solicitation for murder, intimidation of a witness, and armed robbery, were also charged federally.

TIGTA's investigation began after local police arrested two individuals for an attempted bank robbery. Following the arrest, one of the individuals admitted attempting to rob the bank at the direction of an unidentified IRS employee. The individual also admitted that the IRS employee asked him to kill a witness against the employee in a criminal matter, but that the individual refused. TIGTA was contacted by the local police and advised of the unidentified IRS employee's involvement.

After TIGTA determined the identity of the IRS employee, it was further determined that the employee had been charged with the gunpoint robbery of a taxpayer making a bank deposit of business receipts. The employee then used IRS computer systems to improperly access the taxpayer's account. The employee used the information to further his attempts to intimidate and silence her. Due to the severity surrounding the improper use of IRS computer systems, the United States Attorney's Office assumed jurisdiction of all of the employee's criminal acts. The employee was terminated from IRS employment.

IRS Employee Pled Guilty to False Statement Charges

On April 7, 1999, an IRS employee was charged in a three-count indictment for false statements and was subsequently arrested by TIGTA special agents. An investigation was initiated after TIGTA identified an improper computer access by an IRS employee to the account of a relative. The investigation revealed that the IRS employee made 170 unauthorized computer accesses to the tax accounts of 20 individuals identified as friends, relatives and neighbors of the

employee. During the investigation, TIGTA developed information that the IRS employee also submitted false statements to maintain a residence that was subsidized by the federal government. During a joint investigation with the Department of Housing and Urban Development Office of Inspector General, it was determined the IRS employee defrauded the federal government of approximately \$15,000 in rent subsidies during 1994-1995 and 1996. The employee resigned from the IRS during the investigation. The employee entered a guilty plea to the charges on August 3, 1999.

IRS Employee Sentenced for Disclosing Confidential Information

On June 3, 1999, an IRS employee was sentenced to two years probation and ordered to pay a \$1,000 fine and a \$100 special assessment after pleading guilty to disclosing confidential information. TIGTA's investigation revealed that an IRS employee was recommending an accountant to taxpayers under collection activity by the employee. TIGTA identified 12 taxpayers who were clients of the accountant and whose tax records were accessed on multiple occasions in an unauthorized manner by the employee. With the accountant's cooperation, it was determined that for the last several years the accountant prepared federal and state tax returns for friends and relatives of the employee at no cost. The accountant did this in exchange for tax information and records on his clients. The accountant confirmed that the employee had recommended several clients to the accountant's practice. One taxpayer told TIGTA special agents that he retained the accountant based on the employee's recommendation thinking that it would be beneficial in resolving his tax matters. The IRS employee retired during the investigation.

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IRS Employee Pled Guilty to Disclosing Confidential Information

On June 22, 1999, an IRS employee pled guilty to one count of disclosing confidential information and was subsequently sentenced to one year probation. This investigation was initiated after the United States Attorney's Office reported that an IRS employee may have disclosed confidential information regarding an IRS criminal investigation and federal grand jury investigation to the subject of the investigation and to a third party. Both persons were alleged to be personal friends of the subject.

The investigation determined the employee contacted the third party and disclosed that their mutual friend was the subject of a criminal investigation and that they discussed how best to inform their friend. The employee and the third party then met with the subject of the investigation and had a "hypothetical" discussion during which the subject was informed he was in fact the subject of a criminal investigation. It was also determined that the employee contacted the third party again and informed him of scheduled investigative activity regarding the subject. The IRS employee retired while under investigation.

IRS Employee Indicted for Unauthorized Access to IRS Computer System

In June 1999, an IRS employee was indicted by a federal grand jury on eight counts of unauthorized accesses to tax return information. The investigation confirmed that the employee had no authorized reason to access the accounts. On August 11, 1999, the employee pled guilty to unauthorized access.

An IRS Employee Entered Pretrial Agreement for Unauthorized Access to a Federal Computer

On May 13, 1999, an IRS employee entered into a 12-month pretrial agreement that

required him to resign from his position with the IRS and not seek re-employment. The employee was indicted by a federal grand jury on two counts of exceeding his authorized access to a federal interest computer. TIGTA's investigation disclosed that the employee made unauthorized computer accesses of the Treasury Enforcement Communications System (TECS). TECS is a computer system designed to identify individuals involved or suspected of involvement in violation of the laws of the United States. The employee utilized TECS on multiple occasions to research confidential information regarding a taxpayer and his business.

Bribery Investigations

As a result of the frequent contacts IRS employees have with taxpayers, their positions and responsibilities make them potential targets for bribery attempts. Their positions also provide opportunities to extort and solicit bribes from taxpayers and to conspire with individuals who would threaten the integrity of the tax administration process.

Bribery is often a focus of TIGTA's integrity awareness presentations. IRS employees are educated on how to recognize bribe overtures and their responsibilities in reporting bribe attempts. TIGTA also educates employees about their responsibility to maintain a high standard of integrity. TIGTA presentations have a deterrent effect and could dissuade employees from taking inappropriate advantage of their positions.

During this reporting period, the Office of Investigations completed 49 bribery investigations.

IRS Employee Assisted Car Broker in \$20,000 Bribe Pay-Off to Cooperating Revenue Agent

On June 9, 1999, an IRS employee and a car broker were indicted by a federal grand jury

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for bribery and conspiracy. The investigation began when TIGTA agents received information alleging that an IRS employee, behind in rent payments, had threatened her landlady with an IRS audit if further attempts to collect the rent and/or eviction procedures were undertaken. It was alleged that the employee had accessed the IRS computer system for tax account information of the landlady and property owner. The investigation confirmed the employee's threats of IRS retaliation against the landlady and improper access to the tax accounts.

Subsequently, the employee initiated contacts with a revenue agent and suggested that if the revenue agent could possibly help the car broker, the revenue agent could receive a car. The revenue agent contacted TIGTA and cooperated in the investigation.

The IRS employee introduced the revenue agent to the car broker who offered \$20,000 to secure his IRS audits and prepare fraudulent reports, and another \$10,000 to initiate an audit on a former business partner. The IRS employee insisted to the revenue agent that she deserved half of every bribe payment as a finder's fee. The car broker paid \$20,000 to the revenue agent in return for fraudulent audit reports. TIGTA special agents arrested the IRS employee and the car broker on June 10, 1999.

Four Individuals Pled Guilty to Bribery

On July 26, 1999, the last of four individuals entered a guilty plea to federal bribery charges. The four individuals paid a cooperating IRS employee bribes totaling \$68,080 for negating approximately \$675,000 in delinquent tax liabilities. One individual offered to pay the IRS employee a bribe for negating his delinquent tax liabilities. The bribe was subsequently paid to the cooperating employee. This individual then introduced three additional individuals to the cooperating IRS employee. These individuals also offered and paid the cooperating IRS

employee bribes for negating their delinquent tax liabilities. Three of the four individuals were sentenced to a total of 31 months imprisonment, 8 years supervised release and \$22,000 in fines. The fourth individual is awaiting sentencing.

Five Individuals Pled Guilty to Bribery Charges

In July and August 1999, four individuals and an enrolled agent were sentenced after pleading guilty to bribery charges. The investigation began after an IRS employee reported a possible bribery overture. The enrolled agent and his client paid a total of \$15,000 to the IRS employee for a fictitious tax examination report. The enrolled agent told the IRS employee that he had other clients that would need help if they were audited. A review of tax returns prepared by the enrolled agent was conducted to identify other questionable returns. Audits of two returns resulted in bribes being paid to a second cooperating IRS employee. To eliminate any taxes owed, one individual and his wife paid \$1,300 and the other individual paid \$2,250 in bribes to the IRS employee.

The enrolled agent received six months jail time, two years supervised release and a \$2,000 fine. The initial client received eight months jail time, two years supervised release and a \$2,000 fine. The individual and his wife each received two years probation, including five months home detention. The last individual received two years probation and a \$1,000 fine.

Theft, Embezzlement and Fraud Investigations

TIGTA investigates incidents of theft, embezzlement, and fraud committed by both internal and external sources. TIGTA also investigates incidents of impersonation where individuals attempt to defraud taxpayers.

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Major Tobacco Company Pled Guilty to Illegal Smuggling, Forfeited \$10 Million and Fined \$5 Million

On July 9, 1999, a major tobacco company forfeited \$10 million to federal and state governments, over half of which was deposited into the United States Treasury Asset Forfeiture Fund, after the company pled guilty to charges of illegal smuggling. The company fraudulently transported and sold cigarettes within the United States that had been intended for exporting. The company was fined \$5 million. There have been more than 20 individual felony convictions of participants in the operation. TIGTA participated in the multi-agency task force investigating the smuggling operation because of allegations regarding an IRS employee. It was alleged that an employee was misusing IRS computers in connection with the operation; however, the employee was cleared of these allegations.

Two IRS Employees Pled Guilty to Theft of IRS Tax Remittances

Two IRS service center employees entered guilty pleas after being indicted on federal charges of theft of public money and theft of mail. A proactive initiative to detect thefts of taxpayer remittances identified the two employees that inappropriately handled controlled tax remittance items. On April 1, 1999, TIGTA special agents confronted the employees immediately after they failed to properly process the tax payments during separate incidents. Both employees confessed to the thefts and turned over the stolen money. IRS immediately terminated the employees.

Nine Individuals Indicted in Scheme That Included Thefts of Taxpayer Remittances

On May 18, 1999, nine individuals were indicted for conspiracy in a scheme that included the thefts of taxpayer remittances,

bank fraud and credit card fraud. The investigation was initiated from information developed from investigations of thefts of tax remittances from a lockbox facility. Lockbox facilities receive and process tax payments and credit the payments to a depository clearing account for subsequent transfer to the IRS. The investigation revealed that the individuals purchased the stolen checks from a variety of sources and deposited the checks in bank accounts that were established in fictitious or assumed identities. The individuals depleted the funds before the taxpayers or IRS knew that the checks were stolen. The investigation revealed that the individuals were responsible for over \$1.2 million of fraudulent activities. Two of the individuals were in the process of preparing false identity documents to aid them in the fraudulent use of credit cards that were in their possession when they were arrested. Six of the individuals pled guilty to the charges and three individuals are fugitives.

IRS Employee Charged With Wire Fraud, Money Laundering and Filing False Tax Returns

On July 22, 1999, a federal grand jury indicted an IRS employee on 48 counts for violations of wire fraud, money laundering and filing false tax returns. The employee's wife, a night manager at a local grocery store, defrauded her employers of over \$400,000 through various means, including stolen and converted money orders and wire transfers. The United States Secret Service notified TIGTA after receiving a report concerning the wife's theft. An investigation of the wife by the Secret Service and IRS' Criminal Investigation Division resulted in the wife being charged with eight counts of stealing money orders and filing false tax returns. A subsequent investigation by TIGTA and IRS' Criminal Investigation Division of the IRS employee determined that he used the embezzled money to fund numerous gambling trips and pay gambling debts. The income

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derived from this scheme was not reported on the employee and his wife's jointly filed federal income tax returns for tax years 1992-1996.

IRS Employee Found Guilty of Theft of \$31,150 in Tax Remittance Checks and Destruction of a Tax Return

On April 20, 1999, a federal grand jury indicted an IRS employee on three counts of theft of public money and destruction of a tax return. The investigation began when a taxpayer reported that her \$8,000 tax remittance check, made payable to the IRS, was altered to be payable to an individual. Review of IRS records identified the individual as an IRS employee. Bank records confirmed that the \$8,000 check was deposited into the employee's bank account. Bank employees later notified TIGTA agents that the employee had deposited a second check for \$23,150 into her account. A review of that check revealed that it was also altered to the name of the employee. The employee was arrested and admitted that she threw away the tax return that was attached to the \$23,150 check. On July 28, 1999, the employee was found guilty of all three counts. The employee was terminated from IRS.

Former IRS Employee Charged in Refund Scheme

A former IRS employee, while employed by the IRS, agreed and colluded with an individual to release or cause the release of a total of 219 Earned Income Tax Credit refunds without the proper justification. The former IRS employee accepted between \$150 and \$200 from a co-conspirator in exchange for releasing each refund. The refund would typically be claimed in the name of migrant farm workers who failed to present the necessary documentation to claim the refund, and in some cases, failed to file a tax return altogether. The former employee accepted a total of \$14,000 in payments for illegally releasing Earned Income Tax Credit refunds.

The former employee entered into a plea agreement that charged felony violations of conspiracy by an employee of the United States Government.

Lockbox Manager Arrested for Embezzlement of Tax Payments

As the result of a taxpayer complaint that a tax payment had not been credited to the taxpayer's federal income tax liability, a manager at a lockbox facility was arrested on embezzlement charges. When interviewed, the lockbox manager admitted to the theft and negotiation of five tax payments. An inventory of the contents of the employee's desk revealed 426 personal checks and money orders from taxpayers, totaling in excess of \$1.3 million. A federal magistrate ordered that the employee be held without bond based on the discovery that he was an illegal alien using a social security number not officially assigned to him by the Social Security Administration. The INS subsequently placed a detainer on the employee.

Fugitive Sentenced in Multi-Defendant Telemarketing Scheme

On May 28, 1999, an individual, after remaining a fugitive for approximately three years, was sentenced to 30 months imprisonment and three years supervised probation, and ordered to pay \$7,573 in restitution to victims for operating a telemarketing scheme. On March 27, 1996, the telemarketer had failed to appear for his sentencing hearing after his conviction on fraud charges, and a fugitive warrant was issued for the individual for violating the conditions of pretrial release. This individual and six conspirators defrauded taxpayers of \$141,556 by contacting victims and telling them that they won an automobile, a \$5,000 shopping spree or a \$2,500 cashier's check. The victims were told that the company was authorized to collect federal taxes on behalf of the IRS and that the taxes needed to be paid before their "prize" could be awarded.

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Individual Arrested for Impersonating an IRS Employee and Mail Fraud

On June 21, 1999, an individual was arrested for a scheme to defraud a taxpayer, his elderly cousin. The individual arranged a telephone call to the taxpayer from a fictitious IRS employee who claimed that the taxpayer owed \$11,000 to the IRS. The individual, who prepared the taxpayer's returns, told the taxpayer to withdraw \$10,000 from the bank in cash and he would settle the tax deficiency. The elderly taxpayer provided the individual with \$10,000 for the IRS and \$500 for his handling of the matter. During conversations recorded by TIGTA special agents, the individual admitted to another relative of the taxpayer that he extorted the funds. The individual was charged with two counts of mail fraud and one count of impersonating a federal officer.

Inmate Indicted for Submitting False Request for Information

On April 13, 1999, a federal grand jury returned an indictment charging an inmate with forgery and false statements. The investigation began after an inmate falsely submitted a tax authorization form to the IRS requesting employer information on a third party. The investigation determined that the inmate had forged the form in an attempt to obtain an address on a taxpayer who the inmate had a history of stalking and harassing. The local IRS disclosure office suspected the form to be forged and forwarded it to TIGTA before any records were released to the inmate. The inmate was identified by his return address that was a corrections facility.

Threat, Assault, and Harassment Investigations

While serving the taxpayers, IRS employees face a difficult and challenging mission. While incidents and threats of violence and harassment are extremely rare when

compared to the millions of taxpayer contacts made yearly by IRS employees, sometimes individuals do resort to violent acts. The Office of Investigations is committed to providing the highest priority in terms of responsiveness and investigative emphasis to threats and assaults against IRS employees. This Office also investigates incidents of harassment by individuals who attempt to undermine IRS employees as they carry out their duties. During this six-month period, the Office of Investigations completed 271 threat and assault investigations.

Individual Threatens to Bomb World Trade Center Building and Other IRS Offices

On May 21, 1999, after receiving notice that his recent appeal in an United States Tax Court had been rejected, a New York resident made threatening telephone calls to IRS District Counsel attorneys. In two separate phone calls, he threatened to bomb the World Trade Center building and several other IRS locations in the New York area. He also threatened to kill several IRS employees and their families and claimed that he had taken a contract out on everyone in the World Trade Center building. An Assistant United States Attorney immediately authorized TIGTA special agents to arrest the individual.

Individual Charged With Threatening to Blow Up IRS Building

On May 26, 1999, an individual who had been charged with attempting to interfere with the administration of internal revenue laws using corrupt or forcible interference pled guilty and subsequently received a three-year suspended sentence. The individual telephoned an IRS service center regarding a notice she received and stated she did not owe taxes to the IRS. She then said she wanted to "bomb the IRS building without anyone in the building." The individual had been the subject of a 1991 investigation where she threatened to kill several IRS employees. That investigation

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led to her arrest and conviction on the same charge.

Individual Arrested After Making Telephonic Threat to IRS Employee

On May 7, 1999, an IRS employee reported that an individual made a telephonic threat during a call concerning his tax liability. The individual stated he knew about ammonium nitrate and that it was used in the bombing of the Oklahoma City building. Based on the severity of his statements, an Assistant United States Attorney agreed to the issuance of an arrest warrant. TIGTA special agents affected the arrest after successfully negotiating with the individual who was armed with knives. After relinquishing his weapons, the individual admitted to making the threatening call to the IRS.

Individual Arrested for Making Threatening Statements

On July 12, 1999, an individual, in a conversation with her accountant, made threatening comments regarding IRS employees. The woman stated to the accountant that she was going down to the IRS office and blow it up. She further indicated she would shoot anybody she saw at the IRS and that she did not care if she went to jail. The accountant reported the comments to TIGTA. When interviewed by TIGTA special agents, she stated she could say anything she wanted. Shortly after this interview, the woman called the accountant's office and stated she would blow up his office first if he had reported her. The United States Attorney authorized the arrest of the woman.

Individual Pleads Guilty to Threatening Communications

On June 2, 1999, an individual pled guilty to making threatening communications and received two years probation after making hundreds of telephone calls to a local radio station. The individual harassed and

threatened employees of the station and an IRS employee who had recently appeared on the station to provide taxpayer education. The subject was arrested and confessed to placing the threatening calls because he was angry with the IRS employee for being on the show and was also angry with the radio station employees for putting the IRS employee on the air.

Individual Injures IRS Employee During an Assault in IRS Office

On June 30, 1999, an individual entered a guilty plea and was sentenced to one year probation, was fined \$250, and ordered to pay restitution of \$2,058 for medical expenses for assaulting and causing injury to an IRS employee who was on official duty. TIGTA special agents responded to a call for help from an IRS employee who had been assaulted by an unknown man upset over the inconvenient hours for the IRS Customer Service Lobby. The employee had to be taken to the emergency room for treatment. The individual was identified and arrested by TIGTA special agents.

Individual Pleads Guilty to Threatening to Blow Up a Federal Building

On May 28, 1999, an individual entered a guilty plea on charges of attempting to interfere with the administration of internal revenue laws by threats of force. A TIGTA investigation was initiated after an IRS employee reported that the individual called the IRS and threatened to blow up a federal building where IRS employees were located. Earlier that day, the individual had to be removed from the federal building by security guards after causing a disturbance in the IRS office. TIGTA's investigation disclosed that the individual made numerous telephone calls to various IRS call sites located throughout the country, making additional threatening remarks and referencing the Oklahoma City bombing. On August 13, 1999, the individual

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was sentenced to 2 years probation and 50 hours of community service.

Individual Found Guilty of Interfering with the Administration of Internal Revenue Laws

On July 8, 1999, after a three-day trial, an individual was found guilty of attempting to interfere with the administration of internal revenue laws and bankruptcy fraud. This individual filed fraudulent court documents to

illegally encumber the personal property of two IRS employees. This action caused difficulties for one of the employees who was attempting to re-finance his personal residence prior to his retirement. Also, in an attempt to avoid payment of taxes, the subject filed bankruptcy, appointed himself as trustee and transferred \$40,000 to overseas accounts, beyond the reach of the government.

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Appendix I
Statistical Reports for the Office of Audit

Audit Reports With Questioned Costs

Three audit reports with questioned costs were issued during this semiannual reporting period.

The term "questioned cost" means a cost that is questioned because of: (1) an alleged violation of a provision of a law, regulation, contract, or other requirement governing the expenditure of funds; (2) a finding that, at the time of the audit, such cost is not supported by adequate documentation ("unsupported cost"); or (3) a finding that expenditure of funds for the intended purpose is unnecessary or unreasonable. The term "disallowed cost" means a questioned cost that management, in a management decision, has sustained or agreed should not be charged to the government.

Audit Reports With Questioned Costs (4/1/99 - 9/30/99) Report Category:	Number of Reports¹	Questioned Costs² (In Thousands)	Unsupported Costs (In Thousands)
1. For which no management decision had been made by the beginning of the reporting period.	0	0	0
2. Which were issued during the reporting period.	3	\$325	0
3. Subtotals (Item 1 plus Item 2)	3	\$325	0
4. For which a management decision was made during the reporting period.	0	0	0
- Dollar value of disallowed costs	0	0	0
- Dollar value of costs not disallowed	0	0	0
5. For which no management decision had been made by the end of the reporting period. (Item 3 minus Item 4)	3	\$325	0
6. For which no management decision was made within six months of report issuance.	0	0	0

¹ See Appendix IV for identification of audit reports involved.

² "Questioned Costs" include "Unsupported Costs."

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Appendix I
Statistical Reports for the Office of Audit

Audit Reports With Recommendations That Funds Be Put To Better Use

Three reports with recommendations that funds be put to better use were issued during this semiannual reporting period.

The term "recommendation that funds be put to better-use" means a recommendation that funds could be used more efficiently if management took actions to implement and complete the recommendation, including: (1) reductions in outlays; (2) deobligations of funds from programs or operations; (3) costs not incurred by implementing recommended improvements related to operations; (4) avoidance of unnecessary expenditures noted in pre-award reviews of contract agreements; or (5) any other savings which are specifically identified. The term "management decision" means the evaluation by management of the findings and recommendations included in an audit report and the issuance of a final decision concerning its response to such findings and recommendations, including actions concluded to be necessary.

Reports With Recommendations That Funds Be Put to Better Use (4/1/99 - 9/30/99)		Number of Reports ¹	Amount (In Thousands)
Report Category			
1.	For which no management decision had been made by the beginning of the reporting period.	0	0
2.	Which were issued during the reporting period.	3	\$169,175 ²
3.	Subtotals (Item 1 plus Item 2)	3	\$169,175
4.	For which a management decision was made during the reporting period.	3	\$169,175
•	Dollar value of recommendations that were agreed to by management		
-	Based on proposed management action	3	\$169,175
-	Based on proposed legislative action	0	0
•	Dollar value of recommendations that were not agreed to by management	0	0
5.	For which no management decision had been made by the end of the reporting period. (Item 3 minus Item 4)	0	0
6.	For which no management decision was made within six months of issuance.	0	0

¹ See Appendix IV for identification of audit reports involved.

² \$150 million of the total represents the annual reduction of interest costs, as estimated by the IRS in their response to the report, that would result from the accelerated processing of individual and business paper check refunds (see Report No. 093309).

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Appendix I
Statistical Reports for the Office of Audit

Audit Reports With Additional Quantifiable Impact on Tax Administration

In addition to questioned costs and funds put to better use, the Office of Audit has identified additional measures that demonstrate the value of audit recommendations on tax administration and business operations. These issues are of interest to the IRS and Treasury executives, the Congress, and the taxpaying public, and should be expressed when possible in quantifiable terms to provide further insights to the value and potential impact of the Office of Audit's products and services. Including this information also advances adherence to the intent and spirit of GPRA.

Definitions of these additional measures are:

1. **Taxpayer Rights and Entitlements at Risk:** The protection of due process (rights) that is granted to taxpayers by law, regulation, or IRS policies and procedures. These rights most commonly arise in the performance of filing tax returns, paying delinquent taxes, and examining the accuracy of tax liabilities. The acceptance of claims for and issuance of refunds (entitlements) are also included in this category, relating to instances when taxpayers have a legitimate assertion to overpayments of tax.
2. **Reduction of Burden on Taxpayers:** Decreases by individuals or businesses in the need for, frequency of, or time spent on contacts, record keeping, preparation, or costs to comply with tax laws, regulations, and IRS policies and procedures.
3. **Increased Revenue or Revenue Protected:** Assessment or collection of additional taxes (increased revenue), or proper denial of claims for refund, including recommendations that prevent erroneous refunds or efforts to defraud the tax system (revenue protection).
4. **Taxpayer Privacy and Security:** Protection of taxpayer financial and account information (privacy). Processes and programs that provide protection of tax administration, account information and organizational assets (security).
5. **Protection of Resources:** Safeguarding human and capital assets, used by or in the custody of the organization, from inadvertent or malicious injury, theft, destruction, loss, misuse, overpayment, or degradation. This measure will often be expressed as a value of the entity or program affected by the issue(s) described in the audit report.
6. **Reliability of Management Information:** Ensuring the accuracy, validity, relevance, and integrity of data, including the sources of data and the applications and processing thereof, used by the organization to plan, monitor, and report on its financial and operational activities. This measure will often be expressed as an absolute value (i.e., without regard to whether a number is positive or negative) of overstatements or understatements of amounts recorded on the organization's documents or systems.

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Audit Reports With Additional Quantifiable Impact on Tax Administration

The number of taxpayer accounts, hours, and dollar values shown in this chart were derived from analyses of historical data, and are thus considered potential barometers of the impact of audit recommendations. Actual results will vary depending on the timing and extent of management's implementation of the corresponding corrective actions, and the number of accounts or subsequent business activities applicable from the dates of implementation. Also, a report may have issues that impact more than one outcome measure category.

Reports With Additional Quantifiable Impact on Tax Administration (4/1/99 - 9/30/99)	Number of Reports in Category ¹	Number of Taxpayer Accounts	Number of Hours	Dollar Value (In Thousands)	Other
1. Taxpayer Rights and Entitlements at Risk	8	1,758,385 ²		\$16	
2. Reduction of Burden on Taxpayers	2	3,500		—	130,000 ³
3. Increased Revenue or Revenue Protected	2			\$430	
4. Taxpayer Privacy and Security	3	122,703,600 ^{2,3}			
5. Protection of Resources	4			\$39,040	
6. Reliability of Management Information	5			\$101,384 ⁴	See Note ⁶

¹ See Appendix IV for identification of audit reports involved.

² Controls in the Examination Returns Control System are not adequate to protect both taxpayer rights and privacy for the 1.7 million examinations conducted annually.

³ Taxpayer accounts on the Electronic Fraud Detection System are at risk of unauthorized access unless security controls that protect taxpayer data are strengthened. In FY 1998, the Electronic Fraud Detection System contained 121 million accounts.

⁴ Dollar value represents incorrect information contained in reports and information systems designed to assist management in making business decisions concerning reimbursable agreements with other agencies (\$77.5 million); cost of an information system project (\$22.3 million); and, labor costs applied to a customer service program (\$514,000) and development of a tax processing system (\$1.07 million).

⁵ Consists of 130,000 electronic mail inquiries from taxpayers seeking assistance who may receive answers that are not always complete, concise or clear.

⁶ Consists of the following measure: 22% of the 125 files exchanged with external trading partners that were not correctly displayed on the Integrated Network and Operations Management System (INOMS).

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Appendix II
Statistical Reports for the Office of Investigations

Investigative Results
April 1, 1999 – September 30, 1999

Investigations Opened and Closed

Total Investigations Opened	2,071
Total Investigations Closed	1,642

Financial Accomplishments

Bribe Payments (Seized/Recovered)	\$3,000
Embezzlement/Theft Funds (Recovered)	\$48,030
Fines Ordered by the Courts	\$129,629
Restitution Ordered by the Courts	\$12,822,199

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Status of Closed Criminal Investigations

	Employee Subject	Non-Employee Subject	TOTAL ¹
Referred - Accepted for Prosecution	43	104	147
Referred - Declined for Prosecution	214	323	537
No Referral ²	491	437	928
Referred - Pending Prosecution Decision	13	90	103

Criminal Dispositions³

	Employee Subject	Non-Employee Subject	TOTAL ¹
Guilty	24	89	113
Nolo-Contendere	1	1	2
Pretrial Diversion	5	6	11
Not Guilty	0	1	1
Dismissed	1	1	2

¹ The above statistics include both federal and state dispositions.

² Includes investigations in which the allegation was disproved and/or insufficient evidence was obtained.

³ Due to the time involved in criminal adjudication, there is most often no correlation between the data reflected as "Referred-Accepted for Prosecution" in the Status of Closed Criminal Investigations chart and the data in the Criminal Dispositions chart.

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Appendix II
Statistical Reports for the Office of Investigations

The following tables summarize the number of complaints received by TIGTA and various components within the IRS and the status and dispositions of serious allegations against IRS employees. [I.R.C. 7803(d)(2)(A)(i - iv)]

Complaints/Allegations Received by TIGTA

	TIGTA Cases	TIGTA Information Items	TOTAL
Number of Complaints Received by TIGTA	2,071	3,021	5,092
Complaints Against IRS Employees	833	2,227	3,060
TIGTA Proactive Cases on IRS Employees	210		210
Complaints Against Non-Employees	959	794	1,753
Other Proactive TIGTA Initiatives	69		69

Complaints/Allegations Received by IRS

	TOTAL
Number of Complaints Received by IRS ¹	
Customer Feedback System (CFS) ²	2,110
Problem Resolution Program (PRP) ³	152,073
EEO Informal Complaints ⁴	1,158
EEO Formal Complaints ⁴	437
Other Employee Misconduct ⁵	235

¹ Number of complaints are not totaled because of significant differences in the nature of issues raised in each complaint system and the potential for duplication.

² CFS data reflects complaints made by taxpayers regarding IRS employee conduct, as required by the Taxpayer Bill of Rights 2.

³ PRP data reflects efforts to solve individual taxpayer problems, using criteria established by the National Taxpayer Advocate. Since the management information system does not specifically identify complaints, it is not possible to separate complaints from other taxpayer communications involving inquiries and problems.

⁴ EEO data on formal and informal complaints includes duplication. The EEO process includes attempts at informal resolution before the case goes into the formal complaint process. Cases in which the informal complaint process was initiated and completed during the reporting period could be counted as received in both categories during the reporting period.

⁵ Other employee misconduct includes misconduct allegations addressed through management inquiries, as reflected in two information systems, the Executive Control Management System and the Automated Labor and Employee Relations Tracking System. The IRS believes that an unknown but possibly significant percentage of the allegations are reported in both systems.

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Statistical Reports for the Office of Investigations

Administrative Status and Dispositions on Closed TIGTA Investigations¹

Removed, Terminated, or Other	108
Suspended/Reduction in Grade	67
Oral or Written Reprimand/Admonishment	84
Closed - No Action Taken	196
Clearance Letter Issued	45
TOTAL DISPOSITIONS	500
Employee Resigned Prior to Adjudication	85

¹ Cases which were referred and/or cases on which action was taken by the IRS during this reporting period. Additionally, TIGTA referred 451 cases during this 6-month period that remain pending administrative adjudication by the IRS.

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Appendix III
Statistical Reports—Other

Audit Reports With Unimplemented Corrective Actions

The Inspector General Act of 1978 requires identification of significant recommendations described in previous semiannual reports on which corrective actions have not been completed. The following list is based on information from the Office of Management Control's automated tracking system maintained by Treasury management officials.

(F = Finding Number, R = Recommendation Number, P = Plan Number)

Report Number	Issued	Report Title and Recommendation Summary
041403	January 1994	<i>Review of the Nonresident Alien Information Documents</i> F-1, R-2, P-1. Management should ensure that obvious noncompliance with applicable tax laws and regulations be identified during processing.
061610	January 1996	<i>IRS' Efforts in Monitoring Trust Fund Recovery Penalty Assessments Need Improvement</i> F-2, R-3, P-1. IRS should automate the processing of adjustments resulting from payments or credits on related Trust Fund Recovery accounts, as part of the Service's modernization efforts. F-4, R-1, P-1. The Chief Financial Officer and Assistant Commissioner (Collection) need to define accounts receivable as it relates to Trust Fund Recovery (TFR) assessments. Management should re-evaluate the definition of accounts receivable related to TFR assessments and make the necessary changes to ensure TFR assessments are accurately represented.
060402	January 1996	<i>Review of the Early Intervention Contact Processing</i> F-2, R-1, P-2. Early Intervention should consider alternate methods to obtain the most current taxpayer locator information.
064102	May 1996	<i>Review of the Preparer Program</i> F-1, R-1, P-1. Associate the preparer Taxpayer Identification Number with each individual return in the audit stream.
064008	June 1996	<i>The Financial Accounting and Reporting of Collection's Seized Assets Could Be Improved</i> F-2, R-1, P-4. Management should incorporate a systemic interface between the Automated Work Control System seizure module and the general ledger as part of Revenue Accounting Control System replacement.
065002	July 1996	<i>Review of the Validity of Assessments</i> F-1, R-1, P-1. The Service should review a sample of "No Change" and abated Combined Annual Wage Reporting and Social Security Administration penalty cases after the processing season to evaluate causes of unproductive cases and identify where additional program improvements can be made. F-1, R-3, P-1. The Service should continue pursuing the capability to access Social Security Administration (SSA) data via computer to enable quick, economical processing of Combined Annual Wage Reporting and SSA penalty cases.

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Audit Reports With Unimplemented Corrective Actions

Report Number	Issued	Report Title and Recommendation Summary
065503	August 1996	<p><i>Review of The Employment Tax Nonfiler Program</i></p> <p>F-2, R-1, P-1. When Form W-3 information is received from the Social Security Administration match the employer identification number and name control to those on the Business Masterfile.</p> <p>F-2, R-2, P-1. When the Service Center Unpostable function cannot perfect an Employer Identification Number (EIN)/name from the Form W-3, initiate Collection contact with the employer to secure any delinquent returns rather than terminating processing of those Form W-3 with unperfected EINs.</p> <p>F-2, R-3, P-1. Establish a Form W-2/Business Masterfile (BMF) check of Employer Identification Numbers (EINs) that appear on Forms W-2 attached to electronically filed Forms 1040. Establish employment tax filing requirements for those EINs that match an existing BMF account if the account does not have a filing requirement and does not contain a subsidiary indicator.</p>
066401	September 1996	<p><i>Follow-up Review of Information Security Over Small Scale Computer Systems</i></p> <p>F-1, R-1, P-24. Require Regional Commissioners to conduct another self-assessment and certification of systems, to be followed by a validation.</p>
071404	February 1997	<p><i>Productivity of the Underreporter Program</i></p> <p>F-1, R-1, P-1. A Gross Assessment Method should be used to calculate the Underreporter Program productivity.</p> <p>F-2, R-1, P-1. A Gross Assessment Method should be used to calculate yield to cost ratios, determine productivity rankings, and select inventory for the Underreporter Program.</p> <p>F-3, R-1, P-1. Actual site costs should be used when calculating productivity to increase the accuracy of productivity rankings and obtain a more precise measurement of efficiency.</p>
071304	March 1997	<p><i>Quality of Information Document Processing</i></p> <p>F-1, R-1, P-3, P-4. Review IRS reports (Martinsburg Computing Center Report 405-02-12) to determine whether large variances exist between processing years in the volume and dollars of information documents.</p>

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Report Number	Issued	Report Title and Recommendation Summary
072208	April 1997	<p><i>Review of Service Efforts to Ensure Compliance of Taxpayers Receiving Foreign Sourced Income</i></p> <p>F-1, R-1, P-1, P-2. The Assistant Commissioner (International) should work in coordination with the Executive Officer for Customer Service to measure the overall impact of Foreign Information Returns Program (FIRP) documents and the role FIRP should play in relation to overall compliance efforts.</p> <p>F-2, R-1, P-1. The Service should commit to the development of a system to process foreign information records received magnetically in the standard Organization for Economic Cooperation and Development format.</p> <p>F-2, R-4, P-1, P-2, P-3. The Assistant Commissioner (International) should coordinate efforts with the Executive Officer for Customer Service and the National Director, Submission Processing, to ensure that late filed and prior year Foreign Information Returns Program documents are processed and available for inclusion in the Information Returns Program initiative, when it becomes operational.</p>
072303	April 1997	<p><i>A Review of Cyberfile</i></p> <p>F-1, R-2, P-1. To reduce the chance of a recurrence of the types of problems that impacted Cyberfile's development, management should ensure that IRS guidelines are strengthened to specify project management procedures regarding tracking funds paid to vendors for services and vendor purchases/leases of IRS-funded equipment.</p>
073804	July 1997	<p><i>Review of the Inventory Delivery System Development</i></p> <p>F-2, R-4, P-1. The Service should review and update the sampling plan to ensure it includes criteria for the evaluation of each sampled account within a sub-group to ensure consistency.</p> <p>F-2, R-6, P-1. The results of the Self-Monitoring Program should be included as one of the factors for determining whether and when Inventory Delivery System features should be scheduled for national implementation.</p>
075404	September 1997	<p><i>Review of the Office of Disclosure</i></p> <p>F-3, R-2, P-2. The Office of Disclosure should ensure that all requests for tax checks, both internally and externally, are properly tracked and controlled.</p> <p>F-3, R-3, P-2. The Office of Disclosure should take appropriate measures to ensure sensitive data maintained on the inventory control system is properly protected. The system should meet C-2 requirements and provide an adequate audit trail to monitor users' activity on the database.</p>
080303	November 1997	<p><i>Implementation of the Taxpayer Bill of Rights 2</i></p> <p>F-1, R-1, P-1. Alternative methods of obtaining feedback from taxpayers about how they were treated should be considered, rather than relying solely on employees and managers for input.</p> <p>F-1, R-2, P-1, P-2. Form 1040 should be redesigned to capture more specific information that can be used for analysis to identify trends for corrective action.</p>

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Report Number	Issued	Report Title and Recommendation Summary
081004	December 1997	<i>Taxpayer Walk-in Program for the 1997 Filing Season</i> F-2, R-1, P-2. Develop a customer-based strategy and a related program with applicable goals and measures to evaluate performance of the Walk-In Program.
082204	January 1998	<i>Review of the Initial System Development Activities on the Integrated Submission and Remittance Processing System</i> F-3, R-1, P-1. Ensure that the pilot's evaluation plan contains sufficient measures and data capture to develop quantitative support for projected productivity increases if labor savings are claimed as a cost benefit. F-3, R-5, P-1. Assess the risks associated with not having the systems developer under contract during the Year 2000.
083008	April 1998	<i>Review of the Service's Electronic Federal Tax Payment System Implementation and Enhancements</i> F-4, R-2, P-1. IRS management should provide a process for electronic submission of authorization data to eliminate manual transcription. F-4, R-5, P-1. For the long-term, management should use the authority given by the Taxpayer Bill of Rights 2 for alternative forms of authorizations to re-engineer the enrollment and authorization processes in the Electronic Federal Tax Payment System and substantially reduce, and perhaps eliminate, paper enrollments and authorizations.

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Audit Reports With Unimplemented Corrective Actions

Report Number	Issued	Report Title and Recommendation Summary
083322	May 1998	<p><i>Math Error Processing for Revenue Protection Issues</i></p> <p>F-1, R-1, P-2. Implement the remaining provisions of new laws designed to combat filing fraud by budgeting the resources needed to work invalid primary and secondary Taxpayer Identification Number cases.</p> <p>F-2, R-2, P-1. Change math error notices and Integrated Data Retrieval System correspondence dealing with invalid Taxpayer Identification Numbers for dependent and Earned Income Tax Credit qualifying children to alert taxpayers that the problems may be the result of incomplete or inaccurate name information.</p> <p>F-3, R-1, P-2. Send notices to taxpayers who used invalid Taxpayer Identification Numbers on their previous returns for themselves and their spouses.</p> <p>F-5, R-1, P-1. Develop programming to automate the research of prior year return data by Error Correction when dependent and Earned Income Credit Taxpayer Identification Numbers are invalid or missing.</p> <p>F-6, R-1, P-3. Develop a job aid or guide for Code & Edit function.</p> <p>F-6, R-2, P-1. Develop an error code for returns without dependents but claiming Child and Dependent Care Credit.</p> <p>F-6, R-3, P-1. Develop an error code for missing provider Taxpayer Identification Numbers.</p> <p>F-9, R-1, P-2. Provide more training for Error Correction function.</p> <p>F-9, R-2, P-1. Develop an error code to identify returns claiming Head-of-Household filing status when no valid dependent Taxpayer Identification Number is present.</p> <p>F-10, R-1, P-1. Include an informal checklist in Revenue Protection Strategy math error notices listing the information taxpayers should provide when writing or calling the IRS.</p>
083605	June 1998	<p><i>Review of the Service's Year 2000 Conversion and Testing for Phase III</i></p> <p>F-4, R-1, P-3. Information Systems management needs to develop a process to trace components from the Application Program Registry to executable elements on production libraries.</p>
084407	July 1998	<p><i>Use of Seizure Authority in the Collection Field Function</i></p> <p>F-1, R-2, P-3, P-6. Communicate new and enhanced procedures during upcoming Continuing Professional Education sessions and in appropriate training class modules for revenue officers, group managers, and the Special Procedures Function.</p> <p>F-7, R-1, P-2. Develop a comprehensive certification/review checklist that can be used by appropriate levels of management to attest that all legal and procedural requirements have been met.</p>

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Report Number	Issued	Report Title and Recommendation Summary
084803	July 1998	<p><i>Review of the Integration Support Contract</i></p> <p>F-1, R-1, P-2. Procurement and Information Systems should ensure that in-depth analysis of contractor labor hours and costs is performed prior to payment of the invoices.</p> <p>F-3, R-1, P-1. Information Systems should monitor the Government Furnished Equipment/Government Furnished Information by establishing a database to capture all the equipment and information provided to the vendor under the life of the contract.</p>
085812	September 1998	<p><i>Readiness for Service Center Mainframe Consolidation</i></p> <p>F-2, R-1, P-1. Unless assurances can be made that experienced Service personnel can be relocated when and where needed, Service management should develop a contingency plan to provide the needed staffing for critical positions at all affected sites.</p> <p>F-5, R-1, P-1. Management should ensure security and disaster recovery risks are mitigated through a proactive approach of determining the final disaster recovery strategy and funding security certification and accreditation activities.</p> <p>F-10, R-1, P-1. The Project Management Office should ensure vendor site surveys are completed and issued within the 15-day requirement per the Service Center Support System contract, and reviewed by Information Systems personnel for accuracy and completeness.</p> <p>F-11, R-1, P-4, P-5. The Project Management Office should provide additional resources to adequately define and validate the delivery order requirements and to coordinate with Procurement until all requirements are definitized for price negotiations.</p>
090403	October 1998	<p><i>Review of Phase IV Year 2000 Conversion and Testing</i></p> <p>F-1, R-1, P-1. The Century Date Change Project Office should ensure that the Assistant Commissioner (Product Assurance) monitors organizational efforts to re-certify the data on the Application Program Registry (APR), ensuring also that components tracked and reported on the APR are linked with the correct phase and status.</p>
091502	November 1998	<p><i>Evaluation of the Service's Efforts to Acquire a New Federally Funded Research and Development Center Contractor</i></p> <p>F-1, R-2, P-1. Information Systems personnel should ensure tasks issued to each contractor are sufficiently defined to assure the work of the various contractors will not overlap.</p>
091903	December 1998	<p><i>Executive Compilation and Interpretation of the 1998 Filing Season</i></p> <p>F-1, R-2, P-1. Establishing a taxpayer profile database to allow for quicker verification of taxpayer account information.</p> <p>F-1, R-4, P-3. Eliminating the extra burden placed on taxpayers with balance due returns who file electronically.</p> <p>F-2, R-1, P-1. To simplify return filing, the Service should improve the process used to evaluate the burden placed upon taxpayers by the various tax laws and publications.</p>

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Report Number	Issued	Report Title and Recommendation Summary
091804	January 1999	<p><i>IRS Employee Outside Employment Requests</i></p> <p>F-1, R-1, P-2. Update and clarify national guidelines on the processing, approval, and annual review of applications for outside employment. Clearly define the role and authority of both management and Labor Relations.</p> <p>F-3, R-1, P-1. Require a one-time re-submission of all outside employment requests (using Form 7995 revised 1993 or after, which provide for the Social Security Numbers), to enable a national cleanup of Labor Relations' and managers' records.</p>
092402	February 1999	<p><i>Review of the Internal Revenue Service's Year 2000 Efforts to Inventory Telecommunications and Commercial Off-the-Shelf Products</i></p> <p>F-2, R-3, P-1. The Century Date Change Project Office should independently verify that the Integrated Network and Operations Management System (INOMS) inventory of Commercial Off-the Shelf (COTS) products is complete for all Tier I systems. This verification could be accomplished by sampling COTS products present on several machines and comparing them to the INOMS inventory.</p>
092705	March 1999	<p><i>Review of the Internal Revenue Service's Year 2000 Contingency Planning Efforts</i></p> <p>F-1, R-1, P-1. Review and correct Year 2000 inventory files on a recurring — basis to ensure information used to identify the need for contingency plans is accurate and complete.</p> <p>F-1, R-2, P-1. Establish validity checks for the Year 2000 inventory files.</p> <p>F-5, R-1, P-2. Assign responsibility for the IRS' overall contingency management strategy, including Year 2000, and the coordination of resources to one area.</p>

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Appendix III
Statistical Reports—Other**Access to Information**

The Inspector General Act of 1978 requires Inspectors General to report on unreasonable refusals of information available to the agency which relate to programs and operations for which the Inspector General has responsibilities. There were no instances where information or assistance requested by TIGTA was refused.

Audit Reports Issued in Prior Reporting Period With No Management Response

The Inspector General Act of 1978 requires a summary of each audit report issued before the beginning of the current reporting period for which no management response has been received by the end of the current reporting period. There are no prior reports where management's response was not received.

Revised Management Decisions

The Inspector General Act of 1978 requires Inspectors General to provide a description and explanation of the reasons for any significant revised management decisions made during the reporting period. There were no such decisions during this six-month reporting period.

Disputed Audit Recommendations

The Inspector General Act of 1978 requires Inspectors General to provide information on significant management decisions in response to audit recommendations, with which the Inspectors General disagree. As of September 30, 1999, there were no significant recommendations that were disputed.

Review of Legislation and Regulations

The Inspector General Act of 1978 requires Inspectors General to review existing and proposed legislation and regulations and to make recommendations concerning the impact of such legislation or regulations. TIGTA's Office of Chief Counsel reviewed 158 proposed legislation and regulations during the six-month reporting period.

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Appendix IV

TIGTA Audit Report Listing

April 1, 1999 - September 30, 1999

Report Number	Issued	Report Title
093207	April 1999	The Internal Revenue Service Can Improve Its Reimbursable Program Funds Put to Better Use: \$ 175,000 ¹ Protection of Resources: \$ 3,840,000 at risk Reliability of Management Information: \$ 77,500,000
093602	April 1999	The Internal Revenue Service Needs to Improve Treatment of Taxpayers During Office Audits Taxpayer Burden: 3,500 taxpayer accounts at risk Taxpayer Privacy and Security: 3,600 taxpayer accounts at risk Taxpayer Rights and Entitlements: 1,328 taxpayer accounts at risk
093802	April 1999	Internal Revenue Service's Invoice Processing for AT&T Toll-Free Telephone Service
094002	April 1999	Review of the Internal Revenue Service's Year 2000 End-to-End System Integration Test Efforts - Overall Planning and Execution of Test 1
094106	May 1999	Improving Internal Revenue Service Processes for Evaluating and Publicizing Walk-In Services
094206	May 1999	The Examination Returns Control and Integrated Data Retrieval Systems Can Be Improved to Protect Taxpayer Rights During the Audit Process Taxpayer Privacy and Security and Taxpayer Rights and Entitlements: 1,700,000 taxpayer accounts at risk
C94800	May 1999	Cost Verification on Contract TIRNO-94-0028, Modifications 164 and 184
092903	June 1999	The Cost Effectiveness and Security of Taxpayer Data in the Electronic Transcript Delivery System
093009	June 1999	Review of the Electronic Fraud Detection System Taxpayer Privacy and Security: 121,000,000 taxpayer accounts at risk Reliability of Management Information: \$ 22,300,000 understated costs
095001	June 1999	The Internal Revenue Service Has Improved Controls Over the Use of Interagency Agreements
190103	June 1999	Weak Internal Controls Exposed Taxpayer Payments to Embezzlement in the Delaware-Maryland District Revenue Protected: \$ 77,000 Protection of Resources: \$ 10,700,000 at risk
C95100	June 1999	Contract Audit Closing Statement TIRNO-94-C-00084 Questioned Costs: \$ 98,158
091104	July 1999	The Internal Revenue Service Should Improve Procedures to Identify and Resolve Incorrect and Missing Taxpayer Identification Numbers Revenue Protected: \$ 352,622 Taxpayer Rights and Entitlements: \$ 15,617

¹ This figure represents a five-year projection.Treasury Inspector General for Tax Administration
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Appendix IV

TIGTA Audit Report Listing

Report Number	Issued	Report Title
190303	July 1999	Internal Revenue Service Procedures Were Not Consistently Followed When North Florida District Revenue Officers Attempted to Improve Tax Compliance in the Construction Trades Industry <i>Taxpayer Rights and Entitlements:</i> 664 taxpayer accounts at risk
1999-1C-055	July 1999	Report on Audit of Public Vouchers Numbered 1 through 18 TIRNO-98-C-00041 <i>Questioned Costs:</i> \$ 119,517
095202	August 1999	Opportunities Remain for the Internal Revenue Service to Further Minimize the Risks Associated With Implementing Year 2000 Compliance for External Trading Partners <i>Reliability of Management Information:</i> 22% files with incorrect dates
093402	August 1999	The Internal Revenue Service Could Reduce the Burden Placed on Business Taxpayers When Resolving Account Overpayments
093903	August 1999	The Internal Revenue Service Can Improve Customer Service by Accelerating Refund Payments <i>Funds Put to Better Use:</i> \$ 150,000,000
1999-1C-056	August 1999	Audit of Firm Fixed Price Proposal for Contract Modification Number 240 TIRNO-94-D-00028 <i>Questioned Costs:</i> \$ 107,400
092303	August 1999	The Internal Revenue Service Needs to Increase the Capacity, Follow Up on Reported Problems, and Encourage Voluntary Use of the Electronic Federal Tax Payment System
1999-1C-059	August 1999	Audit of Fiscal Year 1996 Incurred Costs For TIR-95-0062
199920054	August 1999	Increased Validation and Oversight of Year 2000 Minicomputer Conversion Efforts Are Needed To Strengthen Testing and To Avoid Further Delays
093708	August 1999	The Internal Revenue Service's Efforts to Increase the Telephone Level of Access Can Be Improved
199920063	August 1999	The General Controls Environment Over the Internal Revenue Service's Unisys 2200 Systems Can Be Improved
199910064	August 1999	The Internal Revenue Service Can Improve Its Process for Accurately and Timely Reporting Revenue Accounting Activities
093103	September 1999	Limitations of the Automated Non-Masterfile and the Impact on the Internal Revenue Service
094602	September 1999	Effectiveness of the Internal Revenue Service's Management of the Customer Service Call Router Pilot
199940060	September 1999	The Problem Solving Day Program in the Ohio District Has Been Generally Successful <i>Reliability of Management Information:</i> \$ 514,000 incorrectly classified
199940062	September 1999	The Internal Revenue Service Can Improve Its Electronic Return Preparer Fraud Activities
093506	September 1999	The Internal Revenue Service Needs Additional Emphasis On Computer Component Retirement Decisions to Be Ready for the Year 2000

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Appendix IV

TIGTA Audit Report Listing

Report Number	Issued	Report Title
094900	September 1999	An Evaluation of the Impact of Raising the Threshold Requirements for Making Estimated Tax Payments
199940065	September 1999	Improvements Can Be Made in Providing Assistance to Taxpayers <i>Taxpayer Burden:</i> 130,000 electronic mail inquiries
199910061	September 1999	Opportunities to Improve the Effectiveness of Internal Revenue Service Advocacy Efforts
199910072	September 1999	The Internal Revenue Service Needs to Improve Compliance with Legal and Internal Guidelines When Taking Taxpayers' Property for Unpaid Taxes <i>Taxpayer Rights and Entitlements:</i> 32 taxpayer accounts
199940057	September 1999	Controls Should Be Strengthened Over Business Taxpayer Accounts with Frozen Million Dollar Refunds <i>Protection of Resources:</i> \$ 17,500,000 at risk
199930069	September 1999	The New Jersey District Needs to Execute Levy Actions Consistent with Sound Tax Administration and Concern for Taxpayer Treatment <i>Taxpayer Rights and Entitlements:</i> 56,000 taxpayer accounts at risk
094505	September 1999	The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations
199920068	September 1999	The Service Center Mainframe Consolidation Project Has Made Significant Progress, But Project Execution and Administration Risks Remain <i>Funds Put to Better Use:</i> \$ 19,000,000 <i>Protection of Resources:</i> \$ 7,000,000 <i>Reliability of Management Information:</i> \$ 1,070,000
199910074	September 1999	The Internal Revenue Service Should Improve Its Federal Tax Lien Procedures <i>Taxpayer Rights and Entitlements:</i> 157 taxpayer accounts at risk
199910070	September 1999	The Internal Revenue Service Can Further Improve Its Complaint Processing Procedures and Systems
199920066	September 1999	The Internal Revenue Service Needs to Improve Information Systems Quality Assurance Efforts over Key Tax Law Changes for the 2000 Filing Season
199910073	September 1999	The Internal Revenue Service Should Continue Its Efforts to Achieve Full Compliance with Restrictions on the Use of Enforcement Statistics
199910071	September 1999	The Internal Revenue Service Has Not Fully Implemented Procedures to Notify Taxpayers Before Taking Their Funds for Payment of Tax <i>Taxpayer Rights and Entitlements:</i> 204 taxpayer accounts at risk
199910077	September 1999	The Internal Revenue Service's Procedures for Responding to Written Requests for Collection Activity From Joint Return Filers Vary From Statutory Requirements
199910076	September 1999	The Internal Revenue Service Needs to Enhance Guidance on and Monitoring of Compliance with Procedures for Directly Contacting Taxpayers and Their Representatives
199910080	September 1999	The Internal Revenue Service Is Addressing the Use of the Illegal Tax Protestor and Nonfiler Designations

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Appendix IV**TIGTA Audit Report Listing**

Report Number	Issued	Report Title
092104	September 1999	Further Improvements Are Needed to the Internal Revenue Service's Process for Admitting Preparers and Transmitters Into Its Electronic Filing Program

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Appendix VSection 1203 Standards

In general, the Commissioner of Internal Revenue shall terminate the employment of any employee of the IRS if there is a final administrative or judicial determination that such employee committed any act or omission described in the performance of the employee's official duties. Such termination shall be removal for cause on charges of misconduct.

Acts or omissions 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 IRS, the violation of –
 - any right under the Constitution of the United States, or
 - any civil right established under –
 - (i) Title VI or VII of the Civil Rights Act of 1964¹,
 - (ii) Title IX of the Education Amendments of 1972²,
 - (iii) The Age Discrimination in Employment Act of 1967³,
 - (iv) The Age Discrimination Act of 1975⁴,
 - (v) Section 501 or 504 of the Rehabilitation Act of 1973⁵, or
 - (vi) Title I of the Americans with Disabilities Act of 1990⁶;
- (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 IRS, but only if there is a criminal conviction, or a final judgment by a court in a civil case, with respect to the assault or battery;
- (6) violations of the Internal Revenue Code, Department of Treasury regulation, or policies of the IRS (including the Internal Revenue Manual) for the purpose of retaliating against, or harassing a taxpayer, taxpayer representative, or other employee of the IRS; –
- (7) willful misuse of the provisions of Section 6103 of the Internal Revenue Code for the purpose of concealing information from a Congressional inquiry;

¹ 42 U.S.C. § 2000e

² 20 U.S.C. §§ 1681-1688

³ 29 U.S.C. §§ 621-634

⁴ 42 U.S.C. §§ 6101-6107

⁵ 29 U.S.C. §§ 701 & 794

⁶ 42 U.S.C. §§ 12111 et seq.

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Appendix V**Section 1203 Standards**

- (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.

In general, the Commissioner of Internal Revenue may take a personnel action other than terminate for an act or omission above. The exercise of this authority shall be at the sole discretion of the Commissioner and may not be delegated to any other officer. The Commissioner in his sole discretion may establish a procedure which will be used to determine whether an individual should be referred to the Commissioner for a determination by the Commissioner. Any determination of the Commissioner in these matters may not be appealed in any administrative or judicial proceeding.

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Appendix VIStatutory TIGTA Reporting Requirements

Shortly after the July 22, 1998, passage of the legislation that created TIGTA, the former IRS Internal Audit staff began planning the audit work around the 11 statutory provisions. Sixteen final audit reports were issued in September 1999 that dealt with taxpayer protection and rights, and the adequacy and security of the technology of the IRS. Final reports for two statutory audits of taxpayer protection and rights were not issued as of September 30, 1999, but will be issued during the next reporting period.

Reference to Mandated Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
Restrictions on the Use of Enforcement Statistics I.R.C. § 7803(d)(1)(A)(i)	An evaluation of the compliance of the IRS with restrictions under § 1204 of RRA 98 on the use of enforcement statistics to evaluate IRS employees.	<i>Final report issued, Report No. 199910073</i> This report has been highlighted in this semiannual report and a synopsis of the report is listed in the Statutory Requirements section.
Restrictions on Directly Contacting Taxpayers I.R.C. § 7803(d)(1)(A)(ii)	An evaluation of the compliance of the IRS with restrictions under § 7521 of RRA 98 on directly contacting taxpayers who have indicated that they prefer their representatives be contacted.	<i>Final report issued, Report No. 199910076</i> The IRS has procedures that should enable it to protect taxpayers' rights during an interview with the taxpayer or when IRS employees appropriately bypass a representative and contact a taxpayer directly. However, the auditors could not determine whether IRS employees complied with the procedures or protected taxpayers' rights because the auditors could not identify or review cases. Current IRS management information systems do not separately record or monitor cases where taxpayers requested representation during an interview, and there is no requirement for the IRS to maintain separate records for these situations.
Filing of a Notice of Lien I.R.C. § 7803(d)(1)(A)(iii)	An evaluation of the compliance of the IRS with required procedures under I.R.C. § 6320 upon the filing of a notice of lien.	<i>Final report issued, Report No. 199910074</i> This report has been highlighted in this semiannual report and a synopsis of the report is listed in the Statutory Requirements section.

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Appendix VI

Statutory TIGTA Reporting Requirements

Reference to Mandated Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
Seizures and Levies I.R.C. § 7803(d)(1)(A)(iv)	An evaluation of the compliance of the IRS with required procedures under Subchapter D of Chapter 64 for seizure of property for collection of taxes, including required procedures under I.R.C. § 6330 regarding levies.	<i>Final report issued, Report No. 199910072 (Seizure) and Final Report No. 199910071 (Levy)</i> These reports have been highlighted in this semiannual report and a synopsis of each report is listed in the Statutory Requirements section.
Taxpayer Designations – Illegal Taxpayer Designation and Nonfiler Designation I.R.C. § 7803(d)(1)(A)(v)	An evaluation of the compliance of the IRS with restrictions under § 3707 of RRA 98 on designation of taxpayers.	<i>Final report issued, Report No. 199910080</i> The IRS has taken actions and is substantially in compliance with RRA 98 as it relates to no longer designating taxpayers as Illegal Tax Protestors (ITP), removing the ITP designation from the Individual Masterfile, and disregarding the ITP designation made on or before July 22, 1998, on other IRS computer and paper files.
Disclosure of Collection Activities with Respect to Joint Returns I.R.C. — § 7803(d)(1)(B) I.R.C. § 6103(e)(8)	Review and certify whether or not the IRS is complying with I.R.C. 6103(e)(8) to disclose information to an individual filing a joint return on collection activity involving the other individual filing the return.	<i>Final report issued, Report No. 199910077</i> To comply with statutory requirements, the IRS developed procedures for responding to taxpayers who file jointly and submit written requests for information on the IRS' collection activity. However, these procedures allow IRS employees to provide both oral and written responses to taxpayers. This is different from the statutory requirements, which require the IRS to provide written responses if taxpayers or their representatives send in a written request. The IRS controls general correspondence from taxpayers but is not required to maintain separate records of the joint filer requests. The IRS also does not have a process to ensure that employees are following procedures for responding to the joint filer requests. Therefore, the auditors could not determine if the IRS is complying with the statutory requirements and protecting taxpayer rights, because they could not readily identify any joint filer requests from taxpayers in the IRS' records or verify whether the IRS properly answered the joint filer requests.

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Appendix VIStatutory TIGTA Reporting Requirements

Reference to Mandated Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
<p>Complaints and Allegations of Employee Misconduct and Terminations and Mitigation for Certain Proven Violations Committed by IRS Employees</p> <p>I.R.C. § 7803(d)(1)(E) I.R.C. § 7803(d)(2)(A)</p>	<p>List any terminations or mitigation under § 1203 of RRA 98, § 1102(a).</p>	<p><i>Final report issued, Report No. 199910070</i></p> <p>The IRS currently does not have an integrated complaint processing system for identifying and reporting taxpayer complaints and allegations of employee misconduct. Instead, it uses various existing systems and procedures that were implemented prior to RRA 98. However, the IRS is taking significant actions to improve its complaint processing procedures and systems.</p>
<p>Administrative or Civil Actions with Respect to the Fair Debt Collection Practices Act of 1996¹</p> <p>I.R.C. § 7803(d)(1)(G)(i)(ii) I.R.C. § 6304 § 3466 of RRA 98</p>	<p>Include information regarding any administrative or civil actions with respect to violations of the fair debt collection provision of I.R.C. § 6304, including a summary of such actions, and any resulting judgments or awards granted.</p>	<p>A draft report was issued to IRS management and the final report will be issued during the next reporting period.</p> <p>Information provided by the Department of Justice's Tax Division showed that during the period July 22, 1998, to March 31, 1999, there were no civil actions resulting in money paid out to taxpayers as a result of Fair Debt Collection Practices Act (FDCPA) violations by IRS employees. However, through a review of the IRS' various management information systems, the auditors identified two FDCPA violations that resulted in employee administrative action for the period July 22, 1998, through March 18, 1999.</p>

¹ 15 U.S.C §§ 1601 & 1692 (1994)

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Appendix VI

Statutory TIGTA Reporting Requirements

Reference to Mandated Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
Denial of Requests for Information I.R.C. § 7803(d)(1)(F) I.R.C. § 7803(d)(3)(A)	Include information regarding improper denial of requests for information from the IRS, based on a statistically valid sample of the total number of determinations made by the IRS to deny written requests to disclose information to taxpayers on the basis of I.R.C. § 6103 or § 552(b)(7) of Title 5, U.S.C.	Audit work has been completed and a final report will be issued during the next reporting period. This first audit was broadened to include a review of all denied FOIA requests. In addition, we did not review I.R.C. § 6103 requests because we could not identify denied requests on IRS' computer systems. The auditors found that the IRS improperly withheld information that should have been provided to the requester for: <ul style="list-style-type: none"> • 12.4 percent of the denied or partially denied FOIA requests. • 8.8 percent of the denied or partially denied Privacy Act¹ requests that were processed as FOIA requests.
Adequacy and Security of the Technology of the IRS I.R.C. § 7803(d)(1)(D)	An evaluation of the adequacy and security of the technology of the IRS.	During this reporting period, the Office of Audit issued eight reports in this area. <i>Final Reports Issued:</i> <i>Report No. 199920068</i> <i>Report No. 199920063</i> <i>Report No. 199940062</i> <i>Report No. 094602</i> <i>Report No. 093103</i> <i>Report No. 093009</i> <i>Report No. 092903</i> <i>Report No. 092303</i>

¹ 5 U.S.C. § 552a (1994)

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Appendix VIStatutory TIGTA Reporting Requirements

Reference to Mandated Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
<p>Extensions of the Statute of Limitations for Assessment and Collection of Tax</p> <p>I.R.C. § 7803(d)(1)(C) I.R.C. § 6501</p>	<p>Include information regarding extensions of the statute of limitations for assessment and collection of tax under I.R.C. § 6501 and the provision of notice to taxpayers regarding requests for such extension.</p>	<p>The effective date for this provision is January 1, 2000. Therefore, the audit is scheduled to start in FY 2000.</p>

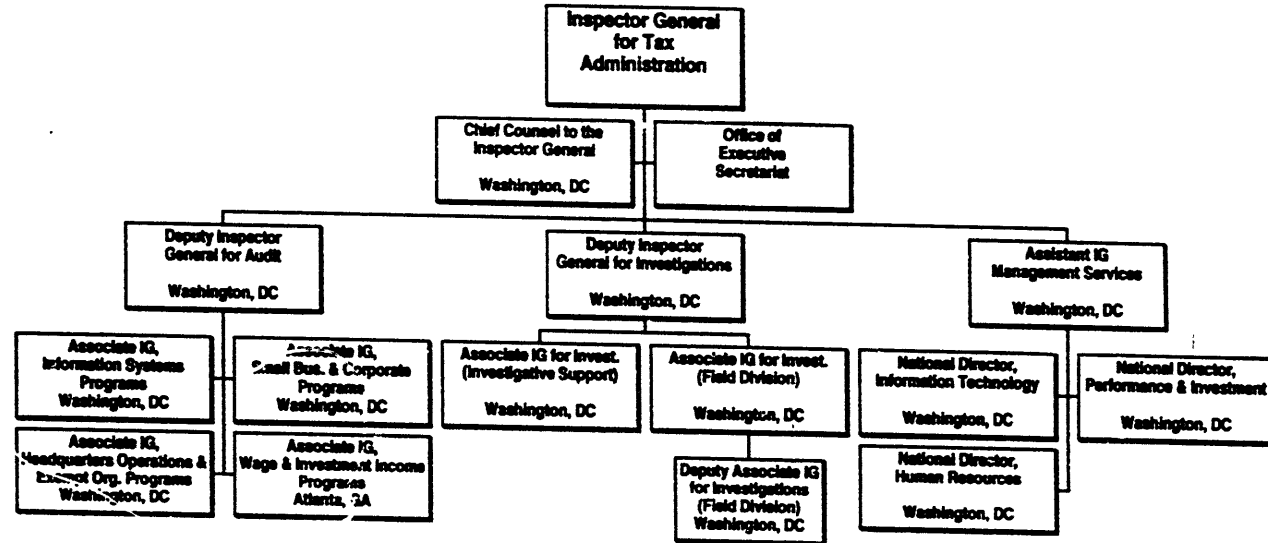
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Appendix VIIAcronyms

ANMF	Automated Non-Masterfile	I.R.C.	Internal Revenue Code
APR	Applications Program Registry	IRS	Internal Revenue Service
ATLAS	Audit Trail Lead Analysis System	ISC	Integration Support Contract
CDC	Century Date Change	ITIN	Individual Taxpayer Identification Number
CFS	Customer Feedback System	ITP	Illegal Tax Protestor
COTS	Commercial-Off-The-Shelf	MACS	Midwest Automated Compliance System
DIF	Discriminant Function	PMO	Project Management Office
DOL	Department of Labor	PRP	Problem Resolution Program
EFDS	Electronic Fraud Detection System	RCP	Regional Compliance Program
ERCS	Examination Returns Control System	RRA 98	Restructuring and Reform Act of 1998
ESC	Executive Steering Committee	SED	Strategic Enforcement Division
ETP	External Trading Partner	SSA	Social Security Administration
FAA	Federal Aviation Administration	TBOR2	Taxpayer Bill of Rights 2
FCL	Federal Computer Laboratory	TECS	Treasury Enforcement Communications System
FDCPA	Fair Debt Collection Practices Act	TFR	Trust Fund Recovery
FIRP	Foreign Information Returns Program	TFSD	Technical and Forensic Support Division
FOIA	Freedom of Information Act	TIGTA	Treasury Inspector General for Tax Administration
FSL	Forensic Science Laboratory	TIPSS	Treasury Information Processing Support Services
FTL	Federal Tax Lien	TRA 97	Taxpayer Relief Act of 1997
FY	Fiscal Year	UNAX	Unauthorized Access to Taxpayer Accounts
GAO	General Accounting Office	U.S.C.	United States Code
GPRA	Government Performance and Results Act of 1993	Y2K	Year 2000
IG	Inspector General		
IDRS	Integrated Data Retrieval System		
INOMS	Integrated Network and Operations Management System		
INS	Immigration and Naturalization Service		

Organization Chart



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