

**THE 2000 TAX RETURN FILING SEASON AND THE
IRS BUDGET FOR FISCAL YEAR 2001**

HEARING
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
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**THE 2000 TAX RETURN FILING SEASON AND
THE IRS BUDGET FOR FISCAL YEAR 2001**

TUESDAY, MARCH 28, 2000

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to call, at 2:03 p.m. in room 1100, Longworth House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) Presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE

Contact: (202) 225-7601

March 20, 2000

No. OV-17

Houghton Announces Hearing on the 2000 Tax Return Filing Season and the IRS Budget for Fiscal Year 2001

Congressman Amo Houghton (R-NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the 2000 tax return filing season and the Administration's budget request for the Internal Revenue Service (IRS) for fiscal year 2001. **The hearing will take place on Tuesday, March 28, 2000, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include IRS Commissioner Charles O. Rossotti, representatives from the U.S. General Accounting Office, and professional tax practitioner groups. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The 2000 tax return filing season refers to the period of time between January 1st and April 15th when Americans will file over 215 million primary tax returns. During this period, the IRS is expected to issue over 95 million tax refunds and answer 118 million telephone calls from taxpayers asking for assistance.

The Administration's budget requests \$8.9 billion to fund the IRS for fiscal year 2001. This level of funding will support 100,133 employees who will collect about \$1.9 trillion in taxes, according to Administration estimates. (Note: These figures include the \$145 million and 2,082 employees, technically outside the spending caps for the IRS, devoted to administering the earned income tax credit.) The fiscal year 2001 budget request represents an increase of \$769 million (or 9 percent) over the fiscal year 2000 operating level, as well as an increase of 2,528 employees (technically referred to as full-time equivalents or FTEs) over fiscal year 2000 staffing levels.

Beyond supporting the traditional activities of the filing season, the fiscal year 2001 budget request also addresses several additional activities. First, the budget seeks to reverse the decline in the IRS workforce by proposing to increase IRS staffing levels by 2,835 FTEs over two fiscal years, 2000 and 2001. Described by the acronym STABLE (Staffing Tax Administration for Balance and Equity), the proposal would assign about half of the new employees to work in the customer service area, while the other half would be assigned to examination and collection activities. Second, the budget requests \$42 million to continue the Organizational Modernization program which would reorganize the IRS into four operating divisions correlated to the needs of taxpayers. The new operating divisions will be:

(1) wage and investment income, (2) small business and self employed, (3) large and mid-size businesses, and (4) tax-exempt organizations and governmental enti-

ties. Third, the IRS budget request includes \$119 million for its Investment Technology Account to support the project to upgrade the IRS' computer system.

In announcing the hearing, Chairman Houghton stated: "The IRS is seeking significantly higher funding and significantly more employees for next year. The Subcommittee should review this request carefully. We need to give the IRS the resources it needs to operate effectively, but why is it asking for such a large increase? It seems to go against the trend of government downsizing which the President and Congress began several years ago. What would the increases mean for the IRS, and more importantly, what would they mean for the taxpayers?"

FOCUS OF THE HEARING:

The Subcommittee will review the 2000 tax filing season and explore how the IRS intends to allocate its fiscal year 2001 budget resources. It will examine the Administration's justification for the significant increase in both funding and staffing proposed for the IRS. It also will review the progress of the program to modernize the IRS' organizational structure, and the progress of its information systems program.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, with their name, address, and hearing date noted on a label, by the *close of business*, Tuesday, April 11, 2000, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, typed in single space and may not exceed a total of 10 pages including attachments. **Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.**

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at "<http://waysandmeans.house.gov>".

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman HOUGHTON. Good afternoon and welcome to our hearing.

Today the Subcommittee will examine the current tax return filing season and the budget request for the Internal Revenue Service for fiscal year 2001.

First of all, I am pleased to note that the current tax return filing season has been going smoothly and with no major problems. That is a relief for both the Commissioner and for us in Congress.

Processing tax returns and sending out timely refunds are the primary activities by which the public judges the IRS. This year the IRS will send out 8 billion pages of tax forms and instructions. This paperwork avalanche will be augmented by 100 million W-two forms from employers and about 1 billion 1099 forms from financial institutions. The net result is that about 300,000 trees will be sacrificed in order to carry out the current filing system. That ought to be a cause of alarm for the environmentalists.

Fortunately, more people than expected are filing their tax returns electronically. The figures for electronic filing are up about 12 percent so far this year. This means less paperwork for taxpayers to fill out, fewer paper forms for the IRS to struggle with and less harm to our forests.

For several years, the IRS has had a fairly flat budget and a declining work force. This was part of a larger pattern of government downsizing which the President and Congress both supported. It supported the theme advanced by the Vice President's campaign on "Reinventing government."

For fiscal year 2001, the administration has proposed an IRS budget increase of \$769 million which is about 9 percent higher than its operating level for the current fiscal year. The increased budget funding would be used in part to hire over 2,500 new IRS employees. Why are so many new employees needed? What will they be doing? Does the fiscal year 2001 budget request mean that the era of IRS downsizing has ended?

The IRS currently is in the midst of a major internal reorganization. It is transforming itself into four operating divisions. The IRS has fostered the expectation that its new operation divisions would result in better taxpayer service, but a new organizational structure is not enough to improve that taxpayer service.

As the IRS' own budget material states, it requires a combination of improved management, business practices, and technology. So while the IRS reorganization may take 12 to 18 months to complete, what is the timetable for implementing new business practices and for providing the operating divisions with the new technology tools they will need in order to make better taxpayer service a reality.

If we have the new operating divisions functioning with the old business practices and the old computer systems, then clearly it is difficult to see how the IRS will be able to meet the expectations of improved taxpayer service.

It is not the role of the Oversight Subcommittee to explore all the narrow, technical details of the IRS budget request. A budget is more than just numbers. A budget is a policy statement. We want to know what the trends are and what this budget signifies for the IRS. What are the long term goals which this budget is trying to achieve; are the proportions of this budget request the best ones for achieving the overall, long term goal?

The IRS has a difficult job to do, and I believe that Congress should give the IRS the resources it needs to do that job, but we also should require that the IRS provide a strong justification for any increases which it requests and hold it accountable for producing the results which it promises.

I look forward to working with and hearing the Commissioner and our other witnesses.

I would like to now recognize the Ranking Democrat, Mr. Coyne, for his opening statement.

Mr. COYNE. Thank you, Mr. Chairman.

I would like to join Chairman Houghton in welcoming today's witnesses. I look forward to discussing with the IRS Commissioner the progress of the current tax filing season and the IRS' fiscal year 2001 budget request.

The President's proposed budget for the IRS contains a small increase in IRS funding and staffing levels. This will help the IRS handle the many new requirements imposed by the Reform and Restructuring Act of 1998 and allow the IRS to address the increasing number and complexity of tax returns to be filed this year.

The Congress must support full funding for IRS' fiscal year 2001 budget as requested by the President. The IRS needs the resources to provide improved customer service and to make sure each American pays their fair share. Proper funding is a critical step to a successful restructuring and reform of the IRS. Support for the fiscal year 2001 budget request would signal our support for the hard working men and women who enforce the Nation's tax laws.

I would like to commend Commissioner Rossotti on what has been an extremely successful 2000 filing season thus far.

I look forward to working with my colleagues on both sides of the aisle to continue supporting the IRS' efforts to restructure and reform our tax collection agency. Our annual hearing on the IRS is an important oversight responsibility of this Subcommittee and I commend the Chairman, Mr. Houghton, for his commitment to a better IRS.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you, Mr. Coyne.

Mr. Portman, have you got a statement?

Mr. PORTMAN. No, sir. Just eager to hear.

Chairman HOUGHTON. Ms. Dunn?

Ms. DUNN. No.

Chairman HOUGHTON. Mr. Watkins?

Mr. WATKINS. No.

Chairman HOUGHTON. Mr. Hayworth?

Mr. HAYWORTH. No.
Chairman HOUGHTON. Commissioner, you are on.

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

Commissioner ROSSOTTI. Thank you, Mr. Chairman and distinguished Members of the Committee.

The IRS is delivering a very successful filing season while we are also working to fulfill the many mandates that we were given under the Restructuring Act. Under the direction of the Act, we are making some of the most significant changes in 50 years to the IRS organization, technology and most importantly, the way we serve taxpayers.

In the current filing season, we expect to receive a total of 127 million individual returns. Electronic filing is up 16 percent, so we expect to receive between 34 and 35 million returns electronically this season.

In terms of our telephone service, we are delivering about a 65 percent level of service, meaning about 65 percent of the calls get through which obviously is still way too low, but it is up substantially compared to the 50 percent of last year.

Our current success was possible in large part, due to the completion of the enormous program of \$1.3 billion to fix all of our Y2K problems. I am pleased to say that has been accomplished almost flawlessly.

For the whole year, we expect to collect \$1.67 trillion and turn over that amount to the Treasury.

While the IRS is showing important signs of progress, I cannot say today the IRS meets the legitimate expectations of our compliant taxpayers. Furthermore, the number of exam and collection cases is declining substantially.

As you know, many of the basic accounting and other systems we use to manage the \$1.8 trillion in tax revenue are inherently deficient. These problems are severe and if they are not addressed, over time they will certainly undermine the fairness, viability and integrity of the whole tax system.

However, these problems are not newly identified and I do not believe they are impossible for us to solve. In fact, I think we now have in place at the top level at least all the plans we need that will allow us to address them.

The President's budget for the IRS for 2001 requests the resources I think we need to implement these plans. So far, we have implemented many RRA, Restructuring and Reform Act, taxpayer rights provisions; we have completed the first phase of our new system of balanced performance measures; our reorganization to increase customer focus and management accountability is progressing rapidly and all of our top management teams are now in place.

We are beginning the long term program of re-engineering our business practices and technology which is ultimately what will really allow us to deliver on our mandates for improved service and taxpayer compliance. As streamlined management and new technology becomes effective, we will also improve our efficiency and be able to maintain a stable work force even while the economy grows.

To do all this, we must have adequate budget resources in 2001 to address our critical operational needs for the short term and to invest in new technology for the longer term.

This chart illustrates how the rapidly expanding economy increases our workload every year, not only because of the number of returns increasing but the complexity. For example, the number of individual returns with over \$100,000 reported income, which tend to be the more complex returns, have increased by 63 percent in the last 5 years. In the meantime, during that period of time, our staff has dropped by 17,000.

In addition to these general trends which have been long standing, some of the specific provisions of the RRA 1998 have added significantly to our workload in the short term. As you can see on the chart, some specific provisions have required about 4,500 additional staff just to administer these provisions.

Our compliance personnel, those that do the case work, are the largest component of the budget. In addition to compliance, they are the staff required to administer the provisions of RRA 1998. Therefore, when you look at the net effect on the number of front-line workers actually in the compliance functions, it has declined quite significantly.

In addition to the staffing factors, the red line which is the net effect on our frontline compliance staff, we have also had a great deal and very pervasive change in the way the work force is required to work because of all the changes in RRA. This undoubtedly has caused a certain amount of confusion and relearning for many of our employees. These changes have had an effect on the number of compliance activities we have been able to address.

To address these operational requirements, we are requesting a staffing increase in the 2001 budget which we call STABLE. With this staffing level, we expect that in 2001, the IRS will be able to stabilize the level of collection and exam activity while also implementing those provisions that were noted in RRA 1998, and also continue to gradually improve our service levels.

Additional staff will enable us to meet our pressing operational requirements while we implement our longer term solution which is our technology. As this Committee knows, our IRS systems are fundamentally deficient and really need to be replaced.

This is a big program and it has risk, but I think the success we had in the Y2K program, which was also a huge program, is a good harbinger of the future. We have in place many activities to manage these programs and manage this risk which I would be glad to go through in more detail if the Committee would like.

I think we are making real progress toward our goals and mandates of RRA. If Congress can continue to provide us the support we need for modernization, including our fiscal year 2001 budget request, we will be able to produce the visible and tangible improvements in service, compliance and efficiency which I think are the three things that America's taxpayers expect from the IRS.

Thank you, Mr. Chairman.

[The prepared statement follows:]

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

Mr. Chairman and Distinguished Members of the Subcommittee, I am pleased to discuss the IRS' 2000 tax filing season, our FY 2001 budget request and some of the initiatives we are undertaking on behalf of America's taxpayers.

INTRODUCTION

The IRS is delivering on a very successful filing season as it also works to fulfill the mandates that Congress set forth in the landmark IRS Restructuring and Reform Act of 1998 (RRA 98). During this time, the IRS also completed an enormous, yet almost flawless, Y2K conversion program to ensure that IRS computer systems continued to operate after the century date change.

Following RRA 98's clear directions, the IRS is planning and implementing the most significant changes to its organization, technology and the way it serves taxpayers in almost a half-century. However, in spite of some recent tangible improvements in service, many years of hard work lie ahead to make this modernization of the agency a reality, and FY 2000 and FY 2001 represent critical junctures in our efforts.

Mr. Chairman, neither Congress nor the IRS could have anticipated all the implications, including resources, needed to implement the full scope of RRA 98 which covers 71 new taxpayer rights and organizational and technological modernization. However, in the 20 months since this bill was enacted we have learned a great deal, and at this point I am convinced we can succeed through the combination of a limited increase in staff resources and investments in technology and organization.

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

Projected net collections for FY 2000 are \$1.767 trillion. During FY 2000, we also project to receive 213.1 million returns, including over 127.3 million individual returns, and expect to issue over 93 million individual refunds. As of March 10, 2000 refunds are up over 10 percent over last year, and the average refund is \$1,731. On-line filing is running 96 percent ahead of last year's pace and has already exceeded last year's total volume of 2.5 million.

Y2K CONVERSION

Mr. Chairman, the IRS experienced a smooth Y2K "roll-over weekend" between December 29 and January 3 with fewer glitches than we experience in a normal year. There were also no problems associated with the leap year on February 29, 2000. We have now enjoyed almost three full months of successful operations following the century date change. Although we do not anticipate any future problems, we will remain vigilant during the remaining few weeks of high-volume tax-filing season.

Our success to date was hard won and can be directly attributed to our comprehensive planning and preparations over the past three and a half years. Mr. Chairman, we are also most grateful for the guidance, assistance and support that you and the Ranking Minority Member provided throughout this effort.

I would like to briefly recap our Y2K efforts. The scope of the Y2K problem at the IRS was enormous. The IRS employs more than 100,000 individuals in over 700 locations across the United States. Making the IRS' Y2K problem even more challenging is the sheer number of affected information technology systems.

There were over 800,000 information technology (IT) items in our inventory that were assessed for compliance; renovated, replaced or retired; tested; and placed back into production. The technology ranged from custom applications programs to main-frame computers to commercial software products as well as thousands of non-IT items found in elevators and office equipment.

Without the significant investment in resources to plan and prepare for Y2K, there was a tremendous potential for significant disruptions to ongoing IRS operations. Simply put, the tax system would have ground to a halt causing a massive disruption affecting almost every taxpayer. Fortunately, that investment was made.

The IRS also gained some valuable residual benefits from the Y2K conversion project that will be of great value as we now proceed to our even more challenging business systems modernization program.

First is replacement of obsolete hardware and systems software products. As a result of the Y2K program, most of this hardware has been replaced and software releases have been brought up to date. This is a prerequisite for supporting our technology modernization program and it is imperative that we have adequate annual replacements of hardware and regular routine upgrades of software releases.

Second is improved program management practices. The Y2K program has been successful, largely because effective program management practices were implemented and improved over the last three years. This experience will be extremely valuable as we now move forward with our major technology modernization program. However, the modernization program imposes greater challenges because it involves major business changes as well as new technology.

Third is standardization of products. The IRS installed base of hardware and software was not only obsolete, it was heterogeneous in the extreme. The Y2K program has allowed us to set up and largely implement standard products. Because of our reorganization under the leadership of our CIO Paul Cosgrave we now have the management structure and delegated authority in place to make design and procurement decisions to maintain standardization of technology.

Fourth is improved inventory management. GAO criticized the IRS for the poor condition of its IT inventory, but because of Y2K, we were forced to examine our inventory as never before. The condition of our inventory is now greatly improved although much work remains to be done.

Mr. Chairman, I must stress that these benefits will only be realized if we actively continue the practices established during Y2K, including regular replacement and upgrades of hardware and software.

ELECTRONIC TAX ADMINISTRATION

Meeting the Challenge

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

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

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

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

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

The 2000 Filing Season

2000 filing season is turning out to be another growth year for ETA as more taxpayers than ever before are enjoying the benefits of filing taxes electronically. Through March 10, 2000, over 25 million individual taxpayers filed using one of the three e-file options; a 16 percent increase over the same period last year.

- Nearly 18.4 million taxpayers e-filed their tax returns electronically through an IRS-authorized Electronic Return Originator (ERO); a 16.1 percent increase over the same period last year.

- Approximately 2.8 million taxpayers file their tax returns on-line via their home computer through a third party transmitter. On-line filing is running 95.7 percent

ahead of last year's pace and as of March 10 has already exceeded last year's total volume of 2.5 million.

- Almost 3.9 million taxpayers filed their returns over the telephone using the award winning TeleFile system. For the first time, taxpayers in Indiana and Kentucky were able to file both their federal and state returns in a single telephone call during the pilot of the first Federal/State TeleFile option.

- Overall, 8.5 million taxpayers have chosen to file both their federal and state tax returns simultaneously in a single electronic transmission. This year, 35 states and the District of Columbia are participating in the program.

In addition, many of the volunteer sites under the IRS-sponsored Volunteer Income Tax Assistance (VITA) or Tax Counseling for the Elderly (TCE) programs offer free e-filing to those seeking help. Taxpayers can locate the nearest volunteer site by calling the IRS at 1-800-829-1040. As described in the following section, the IRS is undertaking several initiatives to further expand the program this year. Individuals, businesses and practitioners are also seeing many improvements in 2000 and will see even more in future filing seasons.

New in 2000 for Individual Taxpayers:

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

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

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

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

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

New in 2000 for Business Taxpayers:

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

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

New in 2000 for Practitioners:

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

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

Presidential Budget Initiatives

The President's FY 2001 budget request contains two provisions that are intended to make electronic filing of income tax returns more attractive to taxpayers. These provisions would provide taxpayers with:

- A temporary, refundable tax credit for the electronic filing of individual income tax returns. The credit would be for tax years 2002 through 2006—\$10 for each electronically filed return other than TeleFile returns for which the credit would be \$5; and
- One or more no-cost options for preparing and filing individual income tax returns over the Internet beginning no later than tax year 2002.

If enacted, the IRS intends to work closely with the private sector to implement the free Internet filing provision. It states that no later than tax year 2002, the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer. If the IRS offered such options through contract arrangements with Authorized IRS e-file Providers, it would be with the assurance that the taxpayer's tax return information would not be used by the Provider without the taxpayer's permission for any purpose other than submission to the IRS.

This proposal does not mean that the IRS will be entering the tax software business. Currently, there are several dozen commercial providers of tax preparation software for individual returns who provide software and customer support. The IRS does not currently provide tax preparation software and is not equipped to enter this business, nor does it plan to do so. However, the proposal would require the IRS to build on the trends that already exist in the industry, which are to offer very low cost, or even no cost tax services over the Web. The IRS could implement this option by issuing a Request for Proposal (RFP) to the industry.

PROVIDING INFORMATION AND SERVICE TO TAXPAYERS

From web-based technology to 24 hours-a-day/7-days-a-week phone service to sitting down face-to-face with a taxpayer with a problem, the IRS continues to work to provide the easiest and most efficient ways for taxpayers to get the information and assistance they need not only during filing season, but throughout the year.

Web Site

An increasing number of taxpayers are discovering that the IRS site on the World Wide Web (the "Digital Daily") is an excellent and convenient source for tax forms and tax information. In preparation for the 2000 filing season, the IRS also has a shorter and easier to remember Web site address—*www.irs.gov*. Since coming on line in January 1996, taxpayers have downloaded over 201 million forms, publications and products. Through February 2000, there have been over 51.5 million downloads as compared to 24.3 million for the same period in 1999—an increase of almost 112 percent.

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

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

Web Site and Innocent Spouse

The IRS Web site has become an important tool in the IRS' efforts to educate and inform taxpayers of their rights under the new RRA 98 innocent spouse provisions and to help them to make correct and accurate claims. To this end, we developed an interactive application on our Web site that provides taxpayers a general explanation of eligibility for spousal relief. This application has also been distributed to 50,000 tax practitioners nationwide and assists taxpayers in understanding the information IRS needs in order to evaluate innocent spouse claims.

The interactive application includes not only innocent spouse provisions, such as separation of liability and equitable relief, but it also takes taxpayers through injured spouse and community property issues as well. Moreover, the interactive application will give taxpayers direct access to forms and publications so they can apply for any of the applicable relief options. We have shared this interactive Inter-

net application with 11 Internet sites associated with spousal issues, including the Oprah Winfrey Television Show Web site.

Web Site and Installment Agreements

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

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

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

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

Web Site Alerts

This filing season, the IRS continues a Web site alert for taxpayers and practitioners about problems that could affect them. Similar to a product recall notice, the "Index of Problem Alerts," found under the "What's Hot" section describes the problem, its scope (the number of people likely to be affected), where they are located, and most importantly, what the IRS is doing to fix the problem, and what, if anything the taxpayer needs to do about it. In most cases, taxpayers do not have to take any action. However, if they want more information, taxpayers can call our toll-free, 24 hour-a-day/7-day-a-week phone number 1-800-829-1040. Thankfully, this filing season there were few problems to report.

Web Site Small Business Corner

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

Expanded Web Site Tax Professional Corner

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

Web-based Customer Service

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

Notice Information on the Web

This new application answers the most frequently asked questions about the IRS' highest volume notices. It shows taxpayers how to determine which notice they have, what they should do next and who to contact if they disagree. Information is provided on the following notices:

CP Number	Notice Title
CP 12	Math Error—Overpayment of \$1 or more
CP 14	Balance Due, No Math Error
CP 49	Overpaid Tax Applied to Other Taxes You Owe
CP 161	No Math Error, Balance Due
CP 515	First Notice—Return Delinquency
CP 518	Final Notice of Overdue Tax Return
CP 523	Notice of Default on Installment Agreement
CP2000	Notice of Proposed Adjustment for Underpayment/Overpayment

Expanded Web Site Orders

In FY 1998, the IRS introduced “Forms & Publications by U.S. Mail.” This allowed taxpayers to request forms by conventional mail rather than downloading. In January 2000, approximately 82,000 orders were placed distributing 283,000 products. In FY 1999, we added the “Practitioner Order Program.” For FY 2000, the Digital Daily expanded the electronic order capability to add a Tax Practitioner Order Program and added a Tax Package Request service and an Employer Order Program.

The Tax Practitioner Order Program is used by tax professionals to order their copies of Package X. In an effort to save both paper and IRS costs, the IRS issued a “postcard” rather than a tax package to individuals who filed an electronic return in the previous year. Some portion of those individuals may still want to receive a tax package. The postcards the IRS issues provide the vehicle to request a tax package, but now taxpayers have yet another option. Those individuals can order their Tax Package via the Web using our new Online Tax Package Request.

For FY 2000, tax professionals are able to correct their mailing addresses with IRS via the Internet. The IRS is expanding these ordering services to Post Offices, libraries, and other tax products distribution partners. In addition, we are looking to add VITA and TCE order capability on the net.

This on-line ordering program will provide an online capability for employers to order quantities of Forms 1099 and a variety of other employer forms. In the past, employers had to request a copy of “Package 1099” in order to get a copy of the paper-based order form. More than 750,000 electronic orders were filled last year, before these many enhancements.

CD-ROMs

The Federal Tax Forms CD-ROM contains more than 600 tax forms and instructions for the current tax year, and an archive of forms and instructions dating back to 1992, and some 3,000 pages of topic-oriented tax information. Users can electronically search, view-on-screen, or print any of the items contained on the CD on their own printers. The two-issue subscription is conveniently available through the Digital Daily for \$21. If ordered by fax, mail, or telephone, the cost is \$28. As of March 20, 2000, over 40,500 subscriptions were sold.

In conjunction with the Small Business Administration, the IRS also recently produced the joint small business CD-ROM, “Small Business Resource Guide: What You Need to Know About Taxes and Other Topics.” Last year’s prototype CD-ROM received highly favorable reviews from small businesses and external stakeholders. As a result, the Year 2000 version of the CD-ROM is being made available free of charge, one-per-customer, by calling our toll-free number at 1-800-TAX-FORM. It can also be ordered on the IRS Web site.

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

We are working with the SBA, the Association of Small Business Development Centers and the Service Corps of Retired Executives (SCORE) to help publicize and

distribute the new CD-ROM so that we can get it to the people it will help most. Combined, these organizations have over 1,500 locations and the IRS is sending each site 100 free copies of the CD-ROM to share with their small business clients. Each Member of Congress will soon receive two copies as well.

EITC CD-ROM

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

New TAXi Module Debuts/TAXi CD-ROM Nears Completion

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

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

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

Braintaxer Tax Game Show

"Braintaxer" is a new fun and Web-based interactive game to test knowledge of a specific IRS or tax-related topic. A game show host introduces the taxpayer to the game and the contestants. The taxpayer selects the contestant of his or her choice and answers tax questions related to that contestant. Choosing a small business owner profile means the taxpayer receives small business tax questions. The taxpayer is then presented with three questions and multiple-choice answers. The "Results" page shows which questions were answered correctly and provides links to a more complete explanation of the tax issues. Finally, the taxpayer can display and print a certificate.

IRS Local News Net

IRS Local News Net is a list server that supplements the Web site's Digital Dispatch (there are over 70,000 Digital Dispatch subscribers) by providing localized, targeted and immediate information for tax professionals. It is a system capable of reliable and efficient delivery of information to the tax professional community across the nation.

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

TELEPHONE ASSISTANCE

24/7 Phone Service and Access

One of the hallmarks of the IRS' commitment to providing top quality service to taxpayers is 24 hours-a-day/7 days-a-week toll-free telephone service (1-800-829-1040). So-called "24/7" phone service became a permanent IRS service feature on January 4, 1999, and we offer it throughout the filing season. After April 17, we will continue to offer around-the-clock service for refund and account callers, and service will be available for tax law assistance Monday through Saturday from 7:00 AM until 11 PM. As of March 11, 2000, more than 26 million taxpayers have been served in FY 2000, compared to almost 29.9 million over the same period last year.

As the Subcommittee is aware, the expansion to 24 /7 service last year, combined with increased training demands to implement the new tax law requirements, caused the effective level of service to decline, especially during the beginning of the filing season. However, we believe we have turned a corner this filing season. The

upward trends across the board in phone service are most encouraging and show that our investments in training, management and technology are beginning to pay dividends. For this filing season as a whole, our level of service is 65 percent so far compared to our target of 58 percent. In the last four weeks, the level of service averaged 70 percent.

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

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

For access, we have begun to measure the percentage of calls in which the taxpayer receives actual service, in relation to the percentage of time the taxpayer simply gains access to our system.

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

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

Referral Mail

R-Mail (or Referral Mail) is a system that facilitates the referral of tax law questions on specific categories to Compliance employees.

Up until the 2000 filing season, Customer Service employees transcribed these phone message recordings to paper and faxed or delivered them to Compliance employees. Compliance employees made two attempts to call taxpayers and if no contact was made on the second attempt, the message was discarded or filed. This system was time consuming and inefficient. Its deficiencies included poor workload controls and lack of management information.

The R-mail system rolled out nationwide for the 2000 filing season addresses these problems. It provides a more effective method for moving this referral workload to Compliance staff than the previous cumbersome "message offloads" from recordings and unreliable distribution of paper.

Calls on the topics identified for Compliance referral are routed to screeners through our routing scripts. CSRs type a brief message into a template on the R-mail system and add each question to the centralized database. Revenue Agents and Tax Auditors from all over the country who are assigned to do the callbacks are immediately able to access the questions from their computers using a Web browser and call taxpayers back with answers.

Other than obvious workload distribution advantages, this system also provides not only better service to taxpayers, but easily quantifiable management information, improved controls, and the elimination of clerical time associated with logging and filing of paper referrals.

Forms By Fax

Taxpayers can receive more than 150 frequently used tax forms 7 days a week, 24-hours-a-day from IRS TaxFax. Taxpayers can request up to three items per call. Taxpayers use the voice unit of their fax machine to dial the service at 703-368-9694. The only cost to the taxpayer is the cost of the call.

Recorded Tax Information

TeleTax has 148 topics available 24 hours-a-day using a Touch-tone phone. Taxpayers can call (toll-free) 1-800-829-4477 to hear recorded information on tax subjects such as earned income credit, child care/elderly credit, and dependents or other topics, such as electronic filing, which form to use, or what to do if you cannot pay your taxes. Nearly 11.5 million taxpayers used TeleTax last year for recorded tax information; as of March 11, 2000, over 3.3 million have taken advantage of the service so far this fiscal year.

Automated Refund Information

In FY 1999, more than 34 million taxpayers used the Automated Refund Information system on TeleTax to check on the issuance of their refund checks. As of March 11, 2000, the number stands at over 14 million. Taxpayers may call 1-800-829-4477 to check on their refund status Monday through Friday from 7 a.m. to 11:00 p.m. if using a touch-tone phone, or 7:30 a.m. to 5:30 p.m. for rotary or pulse service.

TAXPAYER ASSISTANCE CENTERS

Saturday Service

Delivering on our promise to supply even more reliable and helpful taxpayer assistance, the Internal Revenue Service is providing Saturday service for the entire 2000 filing season at 275 locations nationwide, and for the first time, Sunday service on April 16th. As of February 29, 2000, we served 62,496 taxpayers on weekends. So far this filing season, we have served over 2.8 million taxpayers at all Taxpayer Assistance Centers—a nine-percent decrease from last year.

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

On each of the Saturday Service Days, IRS employees provided taxpayers with the following services: (1) distribution of forms and publications; (2) answers to account and tax law inquiries; (3) verification of Individual Taxpayer Identification Number documentation; (4) processing of alien clearances; (5) acceptance of payments; and (6) return preparation.

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

Problem Solving Days

Problem Solving Days continue to be a great success story on the problem resolution front. Last year, nearly 32,000 people took advantage of this program. According to the National Taxpayer Advocate's 1999 Annual Report to Congress, the IRS handled 57,450 cases during the program's first two years. More than half the cases revolved around seven issues raised by taxpayers: audit reconsiderations (6,667 cases), Offer in Compromise issues (6,330), requests for technical/procedural explanations (4,124), Installment Agreements (4,083), account and notice inquiries (3,393), various penalty issues (3,247) and inability to pay issues (2,561). Since the report was issued, an additional 5,700 taxpayers have been served during Problem Solving Days.

There were a number of lessons learned from handling these cases: (1) Most taxpayers prefer a telephone solution to their problem, although some still want the option of a face-to-face meeting; (2) taxpayers want their issue resolved with one contact; (3) an increasing percentage of cases at Problem Solving Days involve routine issues, and systemic long-standing problems cases are becoming the exception; (4) most of these routine cases could have been resolved either by phone or in person at our current Taxpayer Assistance Centers; and (5) cross-functional coordination is an essential ingredient to effective problem solving.

In July 1999, the IRS transferred responsibility for Problem Solving Days from the Office of the National Taxpayer Advocate to the IRS Chief Operations Officer. The Chief Operations Officer created a task force to study ways to institutionalize Problem Solving Days into every day operations and presented its recommendations earlier this year.

A project office is now operational in Customer Service. One of the key recommendations is to move key features and best practices that have evolved from Problem Solving Days and incorporate them into a plan for implementing the Taxpayer Assistance Centers. However, during this transition, we continue to hold the annual National Problem Solving Day and local Problem Solving Days. A total of 74 Problem Solving Day events were scheduled across the country from January through March 2000. Taxpayers can get schedules for these special days from the IRS Web site or by calling their local IRS office.

Volunteer Programs

Through February of the 2000 filing season, over 112,000 taxpayers were assisted by IRS Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly

(TCE) volunteers at more than 4,400 sites. During all of FY 1999, over 3.4 million taxpayers were assisted by more than 71 thousand VITA and TCE volunteers.

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

In addition to this type of volunteer assistance, our outreach program targeted expanding EITC education and assistance. We identified EITC coordinators in our offices who are responsible for the full complement of EITC outreach activities. While no data is available yet for FY 2000, during FY 1999, this program reached 174,067 EITC taxpayers through social workers, community organizations, homeless shelters and faith based organizations.

Our challenge for the 2000 filing season was to provide volunteers with the necessary tools to assist taxpayers and reduce the burden on internal resources. To this end we loaned 5,300 computers and 3,400 printers and provided software (TAXWISE) to volunteer sites. We are also identifying communities that would benefit from EITC programs and recruiting volunteers through the Internet.

The IRS Corporate Partnership Program

The IRS Corporate Partnership Program has expanded dramatically. While our initial goal was to partner with 500 companies that had 600,000 employees, there are now more than 2,366 companies with more than 15.5 million potential employees in the program. Employees of these firms can get forms through the corporations' Intranet site or local LAN."font-family: Arial">

Tax Package Innovations

In recent years, the IRS has worked with private contractors to improve forms, instructions, and publications by making it as simple as possible for taxpayers to understand and fulfill their tax obligations. The contractors have brought a wide range of expertise, including behavioral science and learning theory, to bear on the challenge. Application of these principles has enabled us to simplify language and use graphic and other cues to aid taxpayers.

Specific areas targeted included the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC) forms, worksheets, and instructions. The joint team effort used behavioral science principles to evaluate the effectiveness of the existing EITC and CTC materials, and to make improvements. While we do not yet have data from this filing season, the reworked forms and instructions received favorable reviews in focus group sessions, showing a dramatic decrease in the error rate. The redesigned EITC instructions refer taxpayers with very complex situations to Publication 596, Earned Income Credit. Removing consideration of these special situations from the instructions simplified filing for 90 percent of taxpayers claiming the EITC. Five publications have also been rewritten working with contractors using these same principles.

For the 2000 filing season, most taxpayers whose only capital gains are from mutual fund distributions will not need to file Schedule D (Form 1040), Capital Gains and Losses. Rather than having to complete the 54-line schedule, these taxpayers can use a 15-line worksheet. This represents a dramatic burden reduction for approximately six million taxpayers. For the 2001 filing season, a line will be added to Form 1040A for reporting capital gain distributions from mutual funds, thus allowing the Service to send the simpler Form 1040A package to the approximately 2.5 million taxpayers who in the past had to file Form 1040 to report those distributions.

Simplification Initiatives

The IRS released a new version of Form 8857, Request for Innocent Spouse Relief, that makes it easier for taxpayers to use the form. Using the revised form, filers are guided through the various types of relief available (innocent spouse, separation of liability, and equitable relief) through the use of simple-to-answer questions with Yes/No checkboxes. The instructions were revised to clarify key points and definitions such as the difference between understatement of tax and underpayment of tax. The revisions reflect feedback from various sources, including focus groups held at the IRS' Austin Development Center.

In an effort to streamline the amount of information with which small businesses must contend to meet their requirement to file information returns, the IRS also developed the following new products for 2000, while continuing to provide a booklet for payers who need all of the Form 1099 information. The new products should

help the majority of small businesses that are required to file only one or two of the various information returns:

- A separate new booklet containing only general instructions (16 pages) for use by all filers who need only certain form instructions; and
- Fourteen new separate form instructions for payers who need only the information pertaining to the forms they file (some form instructions have been combined based on forms used by certain filers).

The Form 5500 series for 1999 used for reporting employee plan information was also substantially revised and improved. The prior Forms 5500 and 5500-C/R were replaced with one Form 5500. The revised form will streamline reporting, filing, and processing.

In addition, we removed two lines from Schedule AI, Part II of Form 2210. Part II of Schedule AI is completed by self-employed taxpayers to figure their self-employment tax when computing any estimated tax penalty. Each line had four entry spaces, one for each payment period. Thus, these taxpayers now have two fewer lines to complete and eight fewer calculations to make.

For the longer-term, the IRS' Tax Forms and Publications Division entered into a multi-year contract with The Gallup Organization to help determine the degree of customer satisfaction with tax forms and publications. The contractor will work with the division in gathering data through surveys, focus groups, and other methods to measure customer satisfaction, reduce both processing and taxpayer errors, and identify other possible improvements to division products.

In addition, the Tax Forms and Publications Division is working with the Indiana District Office Research and Analysis (DORA) in the Simplifying Filing Research Strategy. This initiative will identify opportunities to migrate taxpayers to simpler returns, improve tax forms and instructions through detailed analyses of where errors are being made on current forms, and minimize the number of taxpayers affected by proposed changes to tax forms and instructions. This strategy initially focused on individual taxpayers, but has been expanded to include forms used by small business taxpayers.

Finally, the IRS established several vehicles for conducting focus group interviews with Service employees to test new and redesigned products. These include use of the Development Centers in the Austin and Ogden Service Centers, and establishment of a cadre of IRS employee volunteers. Use of these resources enables us to conduct focus group interviews on short notice and at minimal cost. Also, we have found that in addition to doing an excellent job of providing input from a taxpayer's perspective, these employees also provide us with valuable insight into how the revised products will impact the IRS.

Tax Packages

For most taxpayers, the 2000 filing season tax packages contain forms that look very much like last year's. There are different dollar amounts associated with some tax benefits, such as the higher \$500 per child limit for the child tax credit, but the structure of the forms is very similar. There were very few tax law changes for 1999, and these are reflected in the forms and instructions.

When the IRS finalized the content of the tax packages in October, it included a cautionary note about pending legislation. After Congress extended various expiring provisions, the IRS was able to replace the caution—or add an insert to ignore it—in all but about eight million of the 26 million forms packages. Taxpayers receiving these packages also received a postcard telling them that the forms and instructions were all right to use.

The one thing entirely new to the tax packages is not tax-related. Photos of missing children appear on otherwise blank pages of the tax instructions and other publications. The IRS is working with the National Center for Missing and Exploited Children to expand the distribution of photos of lost, abducted or runaway children.

Newspaper Supplement Program

The Newspaper Supplement Program promotes distribution of IRS forms in selected areas that do not currently have sufficient outlets for tax products. There are currently six newspapers enrolled in the program with a circulation of 1.1million readers. Each newspaper distributes six pre-selected tax items (Forms 1040, 1040EZ, 4868, Schedules EITC, A&B, and Publication 2053, Quick and Easy Access to IRS Tax Help and Forms) in one of their upcoming Sunday editions. The IRS will supply the newspapers with enough forms to satisfy one Sunday circulation. All participating newspapers distribute in one or more of the counties identified as needing additional tax form outlets.

TAXPAYER RIGHTS IMPLEMENTATION

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 FY 1999, for example, we had briefings and training on 55 RRA 98 provisions and provided a total of two million hours of training. We estimate that nearly 4,560 full time equivalent personnel were required for the specific administrative provisions of RRA 98.

We are at the stage where we have implemented the RRA legal provisions. However, we have several years of work ahead to make them work more efficiently and with higher quality. Our immediate challenges are primarily training and management. We are continuing a high level of training in FY 2000.

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

New Taxpayer Advocate Organization

The Taxpayer Advocate Service (TAS) is in the process of implementing a modernized structure as called for in RRA 98. The new organization officially "stood up" on March 12, 2000. TAS is competitively hiring over 2,300 individuals to work full time in the Taxpayer Advocate Service. All Taxpayer Advocates will report to the National Taxpayer Advocate rather than to an IRS District or Center director. 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. Because of the restructuring, TAS will be better positioned, better trained and more focused to address the more difficult problems facing taxpayers.

The expanded hardship criteria as called for in RRA 98 also changed the way TAS classified cases. This change allows more taxpayers to qualify to be considered for Taxpayer Assistance Orders (TAOs). Compared to FY 1998, nearly three times as many taxpayers qualified for consideration for a Taxpayer Assistance Order. The expansion of the hardship criteria was so dramatic that TAS no longer found it necessary to maintain the separate problem resolution criteria. By adopting a single unified criteria governing TA cases, the TAS was able to make it easier for taxpayers and the IRS staff to understand the types of cases that qualify to come to the Taxpayer Advocate for assistance.

Between FY 1998 and FY 1999 the number of regular cases worked in the Taxpayer Advocate Service decreased by 29 percent, or by 81,704 cases. At the same time, the number of cases that met the rules for Application for Taxpayer Assistance Order increased by 281 percent, or by 59,869 cases. Once again, this shift in casework is explained by the expanded rules for Application for Taxpayer Assistance Order criteria defined in RRA 98. Overall, the number of cases worked in the Taxpayer Advocate Service decreased by 7 percent, or by 21,835 cases.

Citizen Advocacy Panels

The Citizen Advocacy Panels achieved several major successes during the first year of operation. In addition to the South Florida panel, three additional Citizen Advocacy Panels were established in Brooklyn, Pacific-Northwest and Midwest Districts. Although independent, the panels came together in late June for a national conference. The meeting provided members with an opportunity to discuss their roles, share ideas and experiences. As a result, coordination and teamwork among panel members has increased.

Included in the accomplishments of the past year, the Pacific-Northwest panel worked with their local districts' small business lab unit to develop software that analyzes questions posed to the IRS through the Services' Web site, the "Digital Daily." The result should be improved categories of responses—more closely meeting the needs of taxpayers.

The South Florida panel also forwarded two recommendations to the Department of the Treasury: (1) the inclusion of a limited power of attorney on federal tax returns; and (2) changes to the Earned Income Tax Credit (EITC) to redefine qualifying child, household, and age requirements. The Brooklyn Panel is working with IRS to clarify wording and make recommendations for improvement to Publication 596, Earned Income Credit and the 1040 Schedule for EITC. In addition, the Midwest Citizen Advocacy Panel continues to work with the Taxpayer Education office to solicit input not only from individual taxpayers, but also from members of the Bar Associations and various tax practitioner groups.

1999 REVENUE PROTECTION STRATEGY

During the 2000 filing season, validation of Social Security Numbers (SSNs) and other tax identification numbers will continue to be a very visible portion of our overclaim prevention efforts for the Earned Income Tax Credit (EITC).

We have expanded the validation of SSNs/TINs to virtually all forms and schedules requiring identification numbers. We will identify dependent SSNs claimed on more than one return along with the improper claiming of children for the dependency exemption and/or EITC. Taxpayers with incomplete returns, invalid or duplicate SSNs, or returns demonstrating patterns consistent with profiles of invalid EITC claims can expect to have their refunds delayed or disallowed through "math error" procedures or examinations.

Beginning this filing season, we will test the Dependent Database that includes records from the Social Security Administration and the Office of Child Support Enforcement at Health and Human Services. These records contain data linking the names and SSNs of dependent children with the names of their parents and their parents' SSNs, along with information on custody and child support obligations. IRS is testing this data to identify the appropriate tax return for examination and eliminating unnecessary contacts with taxpayers who appear to be eligible for EITC, the Child Tax Credit and the dependency exemption.

We have expanded the EITC Communications Strategy in FY 2000 by initiating an integrated compliance strategy with the paid return preparer community. It consisted in part of

- **Outreach/Education:** Over 9,000 return preparers who prepared over 100 EITC returns were contacted and offered an opportunity to meet one-on-one with an IRS Revenue Agent and receive guidance on EITC and their due diligence responsibilities. Acceptance of the visits was voluntary and nearly 8,000 return preparers participated and were provided with materials and an overview of EITC specifically developed for tax return preparers. Additionally, we worked closely with the major tax return preparation services to provide information and training material as well as providing presentations at their tax year planning conferences.

- **A telephone survey** to determine the level of customer satisfaction achieved by these outreach visits was conducted by the Gallup Organization for the IRS and the results of that survey indicated that 83 percent of the contacted preparers were very satisfied with the education/outreach visits. Similarly, high scores were given for the clarity and completeness of the information provided to the preparers.

- **Due Diligence:** Approximately 1,100 preparers of EITC returns were examined to determine if they were complying with the due diligence requirements including the requirement that practitioners exercise due diligence in determining whether a taxpayer meets the eligibility requirements of the EITC. Penalties were asserted against 149 preparers.

For the fiscal year ending September 30, 1999, IRS examination resulted in approximately 605,000 cases closed with protected or collected revenue of \$740 million and math error corrections/adjustments of \$383 million total of \$1.123 billion.

FY 2001 BUDGET REQUEST

To deliver on the RRA 98 mandates for improved service and taxpayer treatment while also increasing compliance effectiveness, IRS requires increased funding in FY 2001. With improved management and technology enabling the delivery of improved service and increased compliance effectiveness, the IRS will be positioned to succeed with limited resources in future years. As the streamlined management and new technology become effective, the IRS can also improve efficiency and maintain a stable workforce in relation to the economy. However, we face a major budget challenge in FY 2000 and FY 2001, which, unless addressed, will threaten not only the IRS reform and restructuring program, but the entire tax system.

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

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

MAINTAINING CURRENT OPERATIONS

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

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

In part because of these changes and increased workload demands, the number of examination and collection cases handled declined by half since 1997. This illustrates the need to balance the continued improvements in customer service with funding adequate to maintain enforcement activity to collect unpaid taxes and address areas of potential under-reporting of income.

Current Services Level

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

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

It is vital to note that the long-term decline in the IRS workforce due to funding constraints has led to a situation where virtually no hiring has been done since 1995 in critical front-line skilled positions. For example, in a revenue agent workforce

that was over 15,000 in 1995 and hovers at 12,000 today, the IRS has only hired 75 revenue agents since 1995. Funding of our current services request, together with the STABLE initiative discussed next, will allow us to begin the process of meeting the need for critical skilled positions.

Stabilizing the Workforce (STABLE)

The IRS is requesting \$144 million and 1,633 FTE to stabilize and strengthen tax compliance and customer service programs in FY 2001 and \$39.8 million and 301 FTE for a FY 2000 proposed supplemental. This request is collectively known as the **STABLE** (Staffing Tax Administration for BaLance and Equity) Initiative.

Efforts have been made to improve toll-free service, improve access to new web-based products and information, and expand electronic filing/payment options. However, staffing resources devoted to critical compliance and enforcement programs have declined by more than 20 percent over the last five years.

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

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

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

Electronic Tax Administration (ETA)

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

Contract Management

In FY 2001, we are requesting an increase of \$44 million to fund necessary contracts that support general operations, mandatory contractual arrangements and necessary outside expertise. In prior year budgets, we funded these contracts—which were absolutely necessary to conduct business—by reducing funding available for staffing. This is in contrast to our FY 2001 request that simply requests the necessary funding. Mr. Chairman, I would like to stress that contractual support is critical to maintaining operations and implementing RRA 98 and the Modernization program. Our contractual support is in three categories: mandatory, operational and expertise contracts. I would like to describe for you the type of contracts and provide examples:

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

MODERNIZATION

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

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

Organizational Modernization

In FY 2001, an additional \$42 million is being requested to cover IRS reorganization expenses. These costs will peak in FY 2001, decline in FY 2002, and end in FY 2003. The IRS organizational modernization involves the first complete reorganization of the IRS since 1952. Essentially all management positions above the first line are being redefined; district and regional offices are being eliminated; and some new front-line positions are being created. This massive change is being done with the objective of minimizing physical relocation and associated costs. However, some relocation of personnel and a great deal of reassigning and retraining are required. In addition, some managerial and administrative positions are being eliminated and it is necessary to assist the incumbents in these positions either to find new positions in the IRS or to retire.

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

Business Reengineering and Technology Investments

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

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

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

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

Business Line Investments

Most of the largest scale and most complex systems' improvements will be accomplished through the agency-wide Core Business Systems program that is funded by the ITIA and is discussed below. However, there are dozens of smaller and more

focused high-priority needs to support and improve operations. They are either too specific to be included in the Core Business Systems program, or, if they were included, would not be delivered for many years. The IRS has gone through a prioritization process for these business line investments and requests funding for \$40 million in FY 2001 for only the highest priority of such projects.

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

(1) The Taxpayer Advocate's ability to identify problems and recommend changes to the business process by redesigning and consolidating multiple, stand-alone systems into one management and control system;

(2) The management and reporting of taxpayer and employee complaints by designing a new system;

(3) The new Tax Exempt/Government Entities organization's ability to process determination requests, contacts with requestors and track the deposits of fees;

(4) The notices sent to taxpayers, including clarity and reduction of the need for multiple contacts with taxpayers;

(5) The Chief Counsel Case Management activities, including modernizing many business rules and updating the system to save costly manual work and improve Counsel's ability to timely deal with the Courts, taxpayers and IRS' needs; and

(6) The walk-in sites' efficiency and service to taxpayers by providing automated management tools of tax information to about 125 walk-in sites.

ITIA Funded Core Business Systems

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

The first, relatively small projects to be delivered will provide for improved telephone service during FY 2001 and provide improved tax computation capabilities to examiners. Further enhancements to taxpayer service over the Internet and increased electronic tax administration services will follow. Two critically important projects will be planned in detail in FY 2000 and are expected to proceed to development stages in FY 2001. They will replace incrementally and over time the archaic tape-based system that maintains all taxpayer records and improve our financial management systems. Other critical projects to improve service and compliance programs, including correspondence, collection and exam are in the early states of design and further plans will depend on results of the design efforts.

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

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

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

CONCLUSION

Mr. Chairman, I believe we are making real progress not only to provide better service during the filing season, but also on the goals and mandates set forth by the Restructuring Act to bring meaningful, positive changes to the IRS and America's taxpayers. It is true that no one fully understood everything that would be required to implement this far-reaching Act. However, if Congress can provide continued and assured support for IRS modernization, such as that contained in our FY 2001 budget request, we will be able to produce the visible, tangible changes in service, compliance and productivity that America's taxpayers expect and deserve now and in the future. Thank you.

Chairman HOUGHTON. Thank you, Commissioner.
Mr. Coyne?

Mr. COYNE. Commissioner, you stressed the importance of the fiscal year 2001 as a pivotal year in the agency's restructuring. What will be the consequences to the tax system if the IRS receives less than the administration's requested budget of \$8.8 billion?

Commissioner ROSSOTTI. I think that we would be taking some real serious risks. In fact, we already have some serious risks but I think we would be increasing them more than we should if we are not able to get this funding. In the short term, the RRA 1998 has created an expectation among taxpayers that they will be treated right and that they will get reasonable service. While we are doing our best with our resources, we are still not anywhere near the 100 percent level.

In the meantime, it is a fundamental tenet of our tax system that the vast majority of people, the honest taxpayers, are complying voluntarily because they have a confidence that their neighbors or their competitors are also paying the bill. If we continue to have the kind of declines that we have currently in enforcement activities, I think we risk that fundamental tenet of the tax system.

Finally, the only solution in the long term, unless we really want to reverse the entire trend of efficiency in government, is to invest in technology. It takes some time to realize those benefits but we have to operate today while we invest in technology for tomorrow and that is why we need our budget request fulfilled.

I believe we already have a significant amount of risk because of the massive changes that we have been asked to comply with and the past resource reductions. I really do not think it is wise to risk our \$1.8 trillion tax system any further than we already have.

Mr. COYNE. I understand that you are working on an EITC compliance study currently under review. Is compliance better relative to EITC?

Commissioner ROSSOTTI. I really don't have that answer yet until we get the study completed. I can only say that with the funding the Congress gave us beginning in 1997, we have taken steps to deal with compliance issues, both by doing the traditional kind of compliance such as auditing many of the returns before the refunds are out and some after the refunds are out, but also through a very innovative program that we instituted last year.

We did a study of the tax preparers. Many of the EITC returns are done by tax preparers. We found that many tax preparers do make errors in these returns. These can be legitimate errors be-

cause of complexity or they could be just because of lack of due diligence by the preparers.

We did a study of where these errors were occurring and we had a program last fall for having 10,000 preparers visited by revenue agents to point out to them what some of the key due diligence requirements are for preparing EITC returns, the kinds of errors being made in the past. We are hopeful this will contribute to a reduced error rate in this filing season which we will not know until we get the study.

We felt some preparers were not performing their due diligence adequately, so we did more serious visits with them, where we audited their previous activities and potentially took enforcement action if necessary.

We have this program in place. We will get some additional data to see how effective it has been hopefully later this year.

Mr. COYNE. Do you have any sense of when the study will be completed?

Commissioner ROSSOTTI. I can only say I hope we will have it later this year.

Mr. COYNE. Later this year. Does the study or investigation give you any hint as to whether most of the errors that occur are problems of fraud or are they innocent mistakes?

Commissioner ROSSOTTI. It is really very hard to tell. There are purely innocent errors, there are careless errors and there are deliberate errors. It is extremely hard to separate those. I will tell you that we have some returns that are actually prepared by experienced IRS employees where we assist some people at our walk-in sites. We have looked at the error rate—those are some EITC returns—and even those returns sometimes have errors in them because of basic misunderstandings of what the taxpayer has said about their personal situation.

So you have a spectrum of errors from purely mechanical or straightforward errors to carelessness all the way up. We are trying to address the whole spectrum of them.

Mr. COYNE. Can the IRS identify, for instance, the number of people who are eligible for EITC say within the geographical area of the congressional district?

Commissioner ROSSOTTI. Can we identify the number that actually claimed it or would theoretically be eligible?

Mr. COYNE. That would be eligible?

Commissioner ROSSOTTI. I don't think we have that information because it really requires knowing some fairly specific details about the family situation. You can't just tell it from income levels. You have to know all the things that go into what a qualifying child is. To my knowledge, we don't have that but I will get back to you and see if we have some information on that.

Mr. COYNE. But you do have the knowledge and could provide how many take advantage of the ITC within a geographic district?

Commissioner ROSSOTTI. Yes, we do. We have that and we can give it to you but what we may not know is how many might not be claiming the credit that could. We just don't have any way of knowing that, that I am aware of.

Mr. COYNE. Thank you.

Chairman HOUGHTON. Mr. Portman?

Mr. PORTMAN. Thank you, Mr. Chairman.

On the ITC a couple of years ago, we had a hearing of this Subcommittee and the best consensus guess of Treasury, GAO and the IRS was there was about \$6 billion a year in missed payments under EITC. I am eager to see that report as well. I think it would be an appropriate area for the Subcommittee to delve into.

You know that I am very concerned about the complexity analysis that was mandated under the RRA. The Subcommittee was eager to see that report on March 1 when it was due. I know it continues to be in process. My concern is I have heard reports that this delay of getting the complexity analysis to us is not due to the IRS but due to the Treasury Department reviewing the IRS' work which was not the intent of this Congress.

I would refer you to the Code section itself which asks for Congress to hear straight from the IRS as to the sources of complexity and administrative problems. This came from the Commission's work where the Commission said it would recommend Congress hear "an uncensored view" of the administrability of all tax legislative proposals and makes the point that the tax legislative process is driven by revenue neutrality and progressivity estimates but rarely takes into account the IRS' ability to administer the tax law and taxpayers' ability to comply with it.

That is the background and I think you would be the first to agree with the need for more focus on that aspect of our job as legislators. I would hope you could give us an answer today as to when the complexity report is due and give us some assurance this will be an IRS report that is unfiltered and represents your best estimate as to what the sources of complexity are and not a tax policy document.

Commissioner ROSSOTTI. I am very sorry that I can't be here on time with this report. I take these deadlines very seriously. I have to say what we have been doing. We have been working very hard on this but we have been soliciting the input from technical experts in Treasury as well as counsel in other places in order to make sure this first report is as technically accurate as possible because that is important. That is taking some time. That is not an excuse but it is taking some time.

We haven't tried to tackle the whole Tax Code but we have three areas we have focused which I think are important. Those are the filing status and dependent qualification issue, the alternative minimum tax and the quarterly payments issue.

We are certainly intending and I believe we will come out with a report which will provide some useful analysis of what causes the complexity in these three important areas, what information we have and some possibilities as to what could be done to deal with the complexity aspect.

As you noted, it will not be a tax policy document, it will not deal with all of the issues you would need to think about in order to determine the best way to fix the Tax Code because there are issues about revenue and distribution which we will not deal with in our report.

Insofar as the report deals with what causes complexity and some of the things that might be done to deal with the complexity aspect, I am optimistic that we will get this out. I can't give you

a specific date but I think we are getting close to the point where we can submit this to you.

Mr. PORTMAN. We need it as soon as possible because we are once again in the process of legislating on tax matters and we have a short year in front of us. I think it would be possible even this year to make some changes based on your recommendations.

I would hope you could give this Subcommittee further assurance that these recommendations will be IRS recommendations and that they will reflect the best thinking of the IRS. Is that accurate?

Mr. PORTMAN. That is our intent.

There are so many other questions I would love to get into but I guess my major one would be in the area of the budget, we see your need for increased personnel and increased funding for technology. I have a concern that post-Y2K now that there are some resources that have been freed up, perhaps the IRS has decided to slow down a bit the pace of modernization and that there may be some delay in some of your projects including electronic services until 2002.

My question would be why would we want to slow down the modernization effort because it seems to me that although there may be a need for additional staff on the compliance side through this year's budget, the ultimate answer here is technology as you have said in other sessions, that technology will lead to not only better taxpayer service but more efficient delivery of service and fewer personnel over time.

I wonder if you could comment on that. Are we delaying and if so, why is the IRS doing that?

Commissioner ROSSOTTI. First, let me say I doubt you could find a greater supporter of the idea of using technology to improve the productivity and effectiveness of the IRS than I am. That is the only real solution that I think exists.

The limiting factor is really how fast we can manage this program successfully. We are going to move ahead at the fastest practical speed. The difficulty is that these are large, complex programs and there is a lot of risk attached to them. As you know, there were some not successful initiatives in the past at the IRS. The limiting factor we are dealing with is simply how fast we can manage these improvements, with reasonable and acceptable risk.

With respect to the e-filing part of our technology modernization program, we did, in an earlier, preliminary plan, have some objectives we thought we could reach for the 2001 filing season for Internet access for certain constituencies. We did have to make a decision to delay that past that season.

It was simply because upon further examination, we simply could not be confident—in fact, we were confident we would not have acceptable security infrastructure in place to manage that in the 2001 filing season. We just were not far enough along in solving some very difficult problems there. We just did not have the solutions to be able to go forward on that kind of an accelerated schedule. We have not in any way backed off from the priority. We have only tried to be realistic about what is necessary to be successful.

Mr. PORTMAN. I appreciate the fact that you have not backed off.

My time is up and I would just make one other statement. That is that under the RRA, we provided you with a public-private over-

sight board that has now been through the first process which was after a year late, the President finally made his nominations. Now the Senate has gone through its practice of confirmation and we need to move that on the Senate floor. I understand there is one Senator holding those nominees. I assume you are pleased they will soon be on board to help you with your strategic plan?

Commissioner ROSSOTTI. I am waiting.

Mr. PORTMAN. Thank you, Mr. Commissioner.

Chairman HOUGHTON. Ms. Dunn?

Ms. DUNN. I want to follow up, Commissioner, on the technology questions of Mr. Portman.

You have a prime contractor now for the computer blueprint, the modernization blueprint. I am wondering what benchmarks you believe we should be using to make sure that is proceeding at an acceptable pace?

Commissioner ROSSOTTI. I think the best benchmark is to look at the plans we have submitted to the Congress and have actually published. Because the way this appropriation works, even though money has been appropriated in previous years, in order to get it released to us, we have to submit some very specific programs that show exactly what projects we are going to do. A couple of weeks ago, we submitted our request for the remainder of this fiscal year to the Appropriations Committees. The GAO and others have those. I would be glad to supply you with a copy of that.

Our request lays out in some detail what the objectives are for various timeframes. There are a significant number of projects. To summarize them quickly, we have some shorter term projects which are aimed at delivering some improved service during the 2001 filing season, mainly for customer service for phone traffic and people that call in. That is an immediate project.

We then have a series of other projects underway including the overall blueprint which would be aimed at the next year, adding some additional electronic services for an array of taxpayers and then also the financial management systems to support the financial management improvement.

Finally, a very critical one and one in which we have made real breakthroughs is the most critical system of all, the one that keeps the basic taxpayer accounting records, the basic records of every taxpayer in America. This is the most fundamental problem that we have. We have a 35-year-old tape-based sequential system that is updated once a week. As long as that is there, no matter what else we do, we are not going to be successful.

We have now come up with what I think is the first practical way for gradually getting out from under this terrible burden. This is one of our critical projects. There are some others that are longer term. So there is a whole sequence of things that we hope are laid out step by step to deliver improved technology and improved business practices over the coming years.

Mrs. DUNN. I would like to have a copy of that.

Commissioner ROSSOTTI. I will get that to you.

Ms. DUNN. Let me ask a question about one of the areas that we spent some time on as we were reviewing and reforming the IRS, the innocent spouse provisions.

Right now I understand there is a backlog of about 45,000 of these cases waiting to be considered. I am wondering if this is the result of changes, did we make it too complicated, are there more cases than you expected, are we behind because we don't have enough FTEs looking at them? What is the problem here and what are we doing to try to get a hold on this?

Commissioner ROSSOTTI. That is a matter I have been very focused on. As a matter of fact, I ran into Mr. Portman in Cincinnati airport last night because I was returning from being all day in Cincinnati which is where we have our center of innocent spouse processing. I was out there for that exact reason.

Your question had a number of premises and I think the answer is all of them are part of it. It is a rather complex law. There are actually three new provisions plus a fourth provision and to judge each claim, as it turns out, you really have to look at each one of those. For example, if the requesting spouse doesn't qualify under one of the provisions, you then have to look at the equitable relief to see if they might get relief under that.

Learning how to comply with the provisions and getting the appropriate guidance out and the appropriate explanations to our own employees about how to adjudicate these claims correctly has been our number one problem and our number one effort.

I am pleased to say I believe we have really come up the learning curve quite significantly. It did take us longer than I wish it had but my conclusion was that it was most important to get these right. Remember, there are always two spouses involved in most of these claims, we couldn't just process them like a bunch of numbers, we had to be very careful. Until we learned how to get some experience with this, we were not able to process them very quickly.

Now, I think we have come up with that learning curve. We have gotten some guidance and training and are very well organized in the Cincinnati customer service site. We have already seen that the rate of conclusion of determinations, as they are called, to these claims has picked up. I believe over the remainder of this calendar year, we will see a substantial improvement in the rate of progress. I have stressed to our employees that the first and most important thing is to do them correctly because we really don't want to go wrong on this.

In reference to your question regarding the complexity of the law, I don't believe it is too complicated. I might not have said that 6 months ago because there was a time when some of us just couldn't figure it out, but we have now learned a lot about how to complement this provision. I think we have, through that experience, come up with some practical ways to make these decisions. I don't think the law is wrong, I believe that Congress was appropriately careful to say how this should be done. We are trying to be just as careful in our implementation.

I can honestly say that if I come back here next year for this hearing that we will be in a lot better shape on these claims than we are now.

Chairman HOUGHTON. I just have two questions. The first ought to be rather fast.

1,769 on the basis of 8 billion is roughly 8 or 9 percent, something like that, but what would that average out to over the past 5 years in terms of increase?

Commissioner ROSSOTTI. I think we would be talking about somewhere in the 2 or 3 percent range. I didn't bring the other chart with me but I do have a chart which I can supply to you which goes back over the last three or 4 years.

Chairman HOUGHTON. Anyway, in that range?

Commissioner ROSSOTTI. Yes, and you would see that it hasn't kept up even with the inflation rate.

Chairman HOUGHTON. I would like that information.

Commissioner ROSSOTTI. I will get it for you, Mr. Chairman.

Chairman HOUGHTON. The last question has to do with security. In the GAO report, there was a quote here about deficiency in computer security controls that "may allow unauthorized individuals to access or alter the propriety IRS information." This has been with us for several years.

Commissioner ROSSOTTI. Yes.

Chairman HOUGHTON. I am not only interested in what you feel the security problems are and the resolution of those but also how this affects the Internet age which we are moving into?

Commissioner ROSSOTTI. It just happens I do have the chart with me and I am distributing the chart you asked for. For once I am well prepared and have the data.

On the security issue, the IRS was way behind frankly, as acknowledged by itself as well as GAO, in a whole variety of areas, ranging from very simple things like physical security like fences around the building to more intangible things such as detecting unauthorized accesses.

Before I ever got there, I have to say there was an important initiative underway to try to deal with these over a long term plan. I think as GAO acknowledged in its report, there has been very significant progress made in that area over the last 3 years. Yet, there is still a significant amount to be done.

We are taking two paths to accomplish this goal. First, is we are attempting to deal with the problems that we can with our current security system. There is no reason we can't deal with physical security; there is no reason we can't do background checks even on our temporary employees. Those kinds of things can be done and we are doing them. I think in the short term, the next year or two, we will have that part of the problem licked.

We are also doing what we can within the confines of our old computer systems. On the computer system side, as I answered Mr. Portman's question, the real critical thing is to build the appropriate security mechanisms into the new systems that we build. In our new architecture, we are including our security standards as one of the paramount principles that we have to build into all these new systems.

In terms of going to the Internet, this slows us down. It needs to slow us down because if we were to go to the Internet without appropriate security, you would have a terrible backlash from the public and everyone if there was a potential security problem.

I would say in terms of using the Internet, this whole security issue is the paramount problem; it is the limiting factor in terms

of our ability to move forward. It is a problem even in the private sector. Many of the problems aren't so much having the technology as the question of how to administer and implement technology.

Chairman HOUGHTON. Any other questions?

Mr. PORTMAN. I just want to follow up on your Internet point and Mr. Houghton's question about how we prepare for the Internet age.

A month or so ago you issued a statement regarding the IRS' interest in providing free access, electronic filing through the Internet. Reading your testimony today, I noticed you say again the IRS does not intend to get into the tax software business. I see this as a potential conflict for us going forward.

There are companies now selling software for \$9.95 so people can file their taxes through the Internet. There are also companies providing web-based tax preparation for free. This is becoming more widespread and it is something that is providing a great benefit to the IRS because it is part of our 16-percent increase in electronic filing this year.

I just wonder how you, given your background in the private sector and your familiarity with this technology and its potential benefits are going to deal with the concern that you have the IRS making what I view to be an appropriate general statement that we want to bring down the barriers to access for Internet filing and we don't want to get into the tax software business and yet the IRS going to be moving toward what the private sector is currently providing and really intervening in the marketplace to a certain extent. I don't think even the most efficient IRS can keep up with what is going on in the outside world in terms of the latest software technology.

How are you going to deal with this issue and what are your personal thoughts on it?

Commissioner ROSSOTTI. That is an important question and there is a note in the President's budget in that regard. I appreciate the opportunity to clarify it.

Let me first make it clear what I don't think we should do. There is no possibility I can think of where the IRS could effectively compete in offering tax preparation software which is a consumer product, pretty complex, needs to be user friendly and up to date with what the private sector offers. There are quite a few excellent providers and there are more coming out all the time. As you note, they are going onto the Web and I believe this whole thing is going in this direction very soon.

There is also a section in the Restructure and Reform Act that deals with the electronic filing which actually addresses this issue and encourages the IRS to something like "stimulate robust competition in the private sector in order to drive down the cost" and that is really the strategy that I think we are going to try to follow.

We want to try to use whatever techniques we can and we will work with ETAC and our industry groups on how to stimulate competition and provide incentives of whatever kind we can for the private sector to provide ultimately what we hope will be no cost to the taxpayer electronic preparation and filing over the Web. It would not be our intention that we would provide this in any form ourselves.

We would like to find some ways of stimulating and driving the trend. It is already happening, as you noted, where basically any individual taxpayer would be able to go onto a Web site, prepare their taxes, send them to the IRS without any direct, out-of-pocket costs to the taxpayer. That is our goal.

Mr. PORTMAN. Again, I think there is a potential issue here as the IRS begins to develop that technology. There will be I think private sector options that may be displaced and maybe some more innovative solutions that the IRS might not look to in the future. I hope you never leave the IRS but perhaps the next Commissioner won't be as interested or as knowledgeable about some of these products. That is my concern, that we don't want to displace that.

Commissioner ROSSOTTI. It is not our intention to offer any products ourselves. I want to make that clear. I don't think we need to do that and I don't think that would be a wise thing to do for the very reasons you are giving.

I think we can build on the trend that is already happening to stimulate competition among the private sector providers. We may have to provide some incentives to them and this was also provided in the Restructure and Reform Act, but the idea is not that we would provide the software or have direct interchange with the taxpayer ourselves, but rather that we would stimulate various private sector providers to do this. That is the intent.

I think it is fully consistent with the direction we were given in the RRA 1998 Act which actually explicitly said that was what we were supposed to do.

Mr. PORTMAN. The simpler filings including telefile, I think the IRS has a good story to tell as well. Your telefiles are up again this year?

Commissioner ROSSOTTI. Actually, telefile is down a little because the people are filing more from home on their computers. Computer filing has almost doubled, so it has displaced a little bit of the telefile. Nevertheless, it is a good product.

As you noted, there are many who offer filing over the Web. Most of those are about \$9.95 and some of them are for free. We want to drive them down even further.

Mr. PORTMAN. Thank you, Mr. Chairman.

Chairman HOUGHTON. Ms. Dunn?

Ms. DUNN. No.

Chairman HOUGHTON. In giving us the information about the average cost increase, if you could give us your assumptions on inflation in that also, I would appreciate it.

Commissioner ROSSOTTI. Sure.

Chairman HOUGHTON. Thank you very much. We appreciate your testimony.

Chairman HOUGHTON. I would like to now call Mr. James R. White, Director of Tax Policy and Administration Issues, GAO. We are delighted to have you here. You may proceed.

STATEMENT OF JAMES R. WHITE, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY RANDY HITE, ASSOCIATE DIRECTOR, GOVERNMENTWIDE AND DEFENSE INFORMATION SYSTEMS, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION AND DAVE ATTIANESE, ASSISTANT DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION

Mr. WHITE. Thank you, Mr. Chairman.

I am accompanied by Randy Hite on my right and Dave Attianese on my left, also from GAO.

Mr. Chairman and Members of the Subcommittee, I am pleased to be here today to discuss the current tax filing season and IRS' fiscal year 2001 budget request.

With respect to the ongoing 2000 filing season, I want to make three points. First, despite the potential for complications due to Y2K and other systems changes, IRS' tax processing systems have operated without any significant disruptions of IRS' ability to process tax returns and issue refunds. In fact, data from various sources indicate that these systems are actually performing better than in 1999.

Second, the use of electronic filing with its potential for faster refunds and fewer errors continues to grow. So far this year out of about 53 million returns filed, almost half have been electronic. The continued growth is due in part to IRS' initiatives to make electronic filing truly paperless through the use of personal identification numbers and electronic payments and IRS efforts to better promote the program.

Third, compared to last year when IRS experienced a significant decline in the quality of its telephone service, service this year has improved. However, it is still not back to the level achieved in 1998. Telephone service is important because of the number of taxpayers that call IRS. From January 1 to March 4 of this year, for example, there were 21 million calls attempted to IRS.

IRS officials we talked to cited two factors that have played a part in keeping service below 1998 levels—a drop in productivity and fewer staff dedicated to answering calls.

I want to switch gears and discuss IRS' budget request for almost \$9 billion which includes a 9-percent increase over fiscal year 2000's proposed operating plan. IRS is also requesting a supplemental appropriation of \$40 million for fiscal year 2000 and an advance appropriation of \$375 million for fiscal year 2002 for its capital account. I want to make four points about that request.

First, we have concerns related to parts of IRS' initiative to increase full-time equivalent staff in tax compliance and customer service programs (known as STABLE). Because many of the new staff associated with STABLE will work only part of fiscal year 2001, IRS may have to ask Congress for additional funding in 2002 when these staff will work a full year. Moreover, IRS has a history of being unable to fill enforcement positions that were funded by Congress.

In addition, although we agree that IRS needs to improve its toll free telephone service, we do not believe that IRS has provided adequate justification for increasing the number of FTEs devoted to

that service. The level of service during the current season, while still not at 1998 levels, has improved significantly even though IRS reduced staffing this year. Based on these results, IRS does not need additional staff to achieve the 2001 performance goal of a 60 percent level of service it set in its budget request.

Accordingly, we believe Congress should consider withholding approval of this part of the STABLE request until IRS provides a revised estimate of the level of telephone service it can expect to provide in fiscal year 2001 with increased staffing.

Second, the \$119 million requested for IRS' capital account funding for 2001 and the \$375 million requested for 2002 are not justified. We believe Congress should consider denying these requests and directing IRS to develop a credible request based on defined modernization requirements and formal estimating methods. Such congressional action should not affect the continuity of IRS' systems modernization efforts because IRS' own plans leave \$211 million in the capital account to cover funding needs in 2001.

Third, IRS' reorganization costs will peak at \$182 million in fiscal year 2001 and end in fiscal year 2003. However, other costs associated with IRS' ongoing modernization such as training and systems investments will continue well past 2003.

Fourth, and last, as I alluded in my discussion of telephone service, IRS' budget request does not provide clear links between the resources being requested and expected results. We recognize that establishing such links is difficult and other Federal agencies are struggling with this issue. We believe nevertheless that as IRS proceeds with reorganization and development of new performance measures, it has an opportunity make future budget requests more useful to Congress.

Mr. Chairman, that concludes my statement. I would be happy to answer any questions.

[The prepared statement follows:]

**Statement of James R. White, Director, Tax Policy and Administration
Issues, General Government Division, U.S. General Accounting Office**

Mr. Chairman and Members of the Subcommittee:

We are pleased to participate in the Subcommittee's inquiry into the status of the 2000 tax filing season and the fiscal year 2001 budget request for the Internal Revenue Service (IRS).

Our statement is based on (1) the preliminary results of our review of the 2000 tax filing season; (2) our review of IRS' fiscal year 2001 budget request and supporting documentation; and (3) past and ongoing reviews of various IRS activities, including those related to information systems and IRS' reorganization. Much of our analysis is based on data provided by IRS that we did not verify. However, those data generally came from management information systems that we have used in the past to assess IRS operations.

With respect to the 2000 filing season, our statement makes the following points:

- IRS made several important changes to its tax processing systems before the 2000 filing season, and those systems have operated without significant problems. Various data sources indicate that the systems are actually performing better than in 1999.
- The use of electronic filing continues to grow, which is partly attributable to various IRS initiatives to make electronic filing paperless and to better promote the program.
- Compared to last year, when IRS experienced serious problems, telephone service has improved, but it has yet to reach the level of service achieved in 1998. IRS officials cited two factors that have likely played a part in keeping the level of service below the 1998 level—a drop in productivity compared to 1998 and fewer staff dedicated to answer telephone calls.

IRS is requesting about \$8.986 billion for fiscal year 2001, an increase of about \$729.8 million, or 9 percent, over IRS' proposed operating level for fiscal year 2000. IRS is also requesting (1) a supplemental appropriation of \$39.8 million for fiscal year 2000, which is included in the proposed operating level for that year, and (2) an advance appropriation for fiscal year 2002 for its multiyear capital account. With respect to those requests, our statement makes the following points:

The supplemental appropriation and a significant part of the increase for fiscal year 2001 is for an initiative that would increase staffing levels in several of IRS' program areas and which has budget implications for future years. While many aspects of the initiative seem appropriate, we are most concerned about (1) IRS' ability to implement the initiative given its past history of being unable to fill enforcement positions funded by Congress and (2) that part of the initiative that would increase staffing for IRS' toll-free telephone assistance program. Congress should consider withholding approval of the requested increase for telephone service until IRS provides a more realistic estimate of the level of service it can expect to provide in fiscal year 2001.

IRS' request includes \$1.58 billion for its Information Systems appropriation and \$494 million for its multiyear capital account, \$375 million of which would be an advance appropriation for fiscal year 2002. Because the \$494 million request is not adequately justified, Congress should consider denying the request and directing IRS to develop a credible and verifiable fiscal year 2001 budget request for the capital account that it can use in seeking, if necessary, a supplemental appropriation.

- IRS' includes \$182 million to cover expenses associated with its reorganization. Over the past year, IRS has developed detailed designs, selected management officials, and put in place management structures for several of its new operating units. IRS plans indicate that reorganization costs will peak in fiscal year 2001 and end in fiscal year 2003. Other costs associated with IRS' modernization, such as the costs of training and systems modernization, should continue well past 2003.

- IRS' budget request does not provide clear links between the resources being requested and expected results. We recognize that establishing such links is difficult and that agencies throughout the federal government are struggling with the same issue. As IRS proceeds with its reorganization and its efforts to develop new performance measures, it has an opportunity to make future budget requests more useful to Congress.

PRELIMINARY DATA ON THE 2000 FILING SEASON

At the Subcommittee's request, we are reviewing IRS' performance during the 2000 tax filing season. Our testimony focuses on three specific issues—the performance of IRS' processing systems and IRS' efforts to increase electronic filing and improve telephone service. Our preliminary results show that (1) computer systems for processing returns and remittances appear to be working well; (2) the number of individual income tax returns filed electronically has continued to increase; and (3) taxpayers have been better able to reach IRS by telephone than they were last year, although service has not yet reached the level IRS attained in 1998.

Tax Processing Systems Have Operated Without Significant Problems

Despite the potential for complications due to the replacement of critical equipment, consolidation of operations, and other Year 2000-related changes, IRS' tax processing systems have operated without any significant disruption of IRS' ability to process returns and issue refunds. In fact, various IRS performance measures and comments from IRS officials and a representative of the largest tax return preparation company indicate that IRS' tax processing systems have been performing better this year than in 1999. For example, as of March 10, 2000, the processing time for paper returns was at least 14 percent faster than at the same time last year. Also, according to IRS data as of that same date, IRS had experienced fewer system problems that caused work stoppages than in 1999 and was able to resolve these types of problems in less time than it took in 1999. According to the Commissioner of Internal Revenue, IRS' "smooth transition to Year 2000 can be directly attributed to our thorough planning and preparation."

In the last few years, IRS has been involved in three major system-related efforts that affect the processing of returns and remittances: (1) replacing service center return and remittance processing equipment, (2) consolidating the tax processing computer operations of IRS' 10 service centers to 2 computing centers, and (3) rewriting applications software to make systems Year 2000 compliant. The equipment replacement project was completed before the start of the 2000 filing season. The consolidation project is ongoing—five centers were consolidated before the start of the 2000 filing season, and the other five are scheduled for consolidation by the end of this

year. IRS' efforts to make its computer systems Year 2000 compliant were also substantially completed before the start of the 2000 filing season.

For the past several years, IRS has been processing returns and remittances without any significant problems. However, considering the volume of tax returns and remittances that IRS has to process during a filing season and the need for IRS to annually reprogram its systems to accommodate tax law changes, some "glitches" are to be expected. In that regard, IRS has experienced some relatively minor problems this filing season. According to IRS, those problems affected a relatively small number of taxpayers, and prompt action was taken to address the problems once they were identified. For example:

- IRS reported that in the first week of January 2000, it issued about 440 balance due notices with erroneous due dates. The notices were sent to taxpayers owing more than \$100,000 and account for less than 1 percent of the balance due notices issued during that week. According to IRS, it contacted all affected taxpayers and provided the correct payment dates.

- IRS' electronic filing system improperly rejected about 40,000 individual returns that claimed a child care credit or reported dependent care benefits from an employer. According to IRS officials, the problem began in mid-January and was corrected by February 10, 2000. According to a representative of the largest national tax return preparation company, most taxpayers filing through his company opted to resubmit their electronic return after IRS corrected the problem rather than submit a paper return. According to the representative, the problem resulted in only minor delays in taxpayers receiving their refunds.

- IRS' systems could not identify taxpayer accounts that were affected by a power of attorney designation. As a result, a few hundred refunds that should have been mailed to the third party were mailed directly to the taxpayer, and at least 81,000 notices or letters were delayed in being sent to third party representatives. In the event the notices related to unpaid tax liabilities and those tax liabilities are not paid on time, IRS may need to abate certain penalties and interest because of the error. According to IRS, it has corrected the system-related errors to avoid further problems.

Use of Electronic Filing Continues an Upward Trend

Pursuant to a provision in the IRS Restructuring and Reform Act of 1998 (RRA98), IRS has as its goal that 80 percent of all tax and information returns be filed electronically by 2007. Electronic filing has several advantages for taxpayers and IRS. For example, IRS acknowledges receipt of an electronic return, electronic filers receive their refunds faster, up-front checks in the electronic filing system help to ensure more accurate returns and thus reduce the number of taxpayer errors that IRS has to correct, and returns filed electronically bypass the error-prone manual procedures that IRS uses to process paper returns.

For the past several years, we have been tracking IRS' progress in getting individual income tax returns filed electronically. As noted in our report on the 1999 filing season, the number of electronically-filed individual income tax returns increased substantially between 1997 and 1999.¹ As shown in table 1, that upward trend is continuing.

Efforts to Increase Electronic Filing

To encourage taxpayers to file electronically this filing season, IRS has, among other things, (1) expanded tests aimed at making electronic filing paperless, (2) allocated \$7 million to promote electronic filing, and (3) increased the types of forms that can be filed electronically.

Table 1: Individual Income Tax Returns Received by IRS

[In Thousands]

Filing type	1/1/98 to 3/13/98	1/1/99 to 3/12/99	Percent change: 1998 to 1999	1/1/00 to 3/10/00	Percent change: 1999 to 2000
Paper	31,936	30,168	- 5.5	27,817	- 7.8
Electronic					

¹ *Tax Administration: IRS' 1999 Tax Filing Season* (GAO/GGD-00-37, Dec. 15, 1999).

Table 1: Individual Income Tax Returns Received by IRS—Continued

[In Thousands]

Filing type	1/1/98 to 3/13/98	1/1/99 to 3/12/99	Percent change: 1998 to 1999	1/1/00 to 3/10/00	Percent change: 1999 to 2000
Traditional ^a	13,649	15,853	16.1	18,404	16.1
On-line ^b	550	1,431	160.2	2,800	95.7
TeleFile ^c	4,598	4,353	-5.3	3,911	-10.2
Subtotal	18,797	21,637	15.1	25,115	16.1
Total	50,733	51,805	2.1	52,932	2.2

^aTraditional electronic filing involves the transmission of returns over communication lines through a third party, such as a tax return preparer or electronic return transmitter, to an IRS service center.

^bOn-line returns are prepared and transmitted by the taxpayer through an on-line intermediary using a personal computer and commercial software.

^cUnder TeleFile, certain taxpayers who are eligible to file a Form 1040EZ are allowed to file using a toll-free number on touch-tone telephones. Officials in IRS' Office of Electronic Tax Administration suggested that TeleFile use is down over the last 2 years because taxpayers who could have used TeleFile might have switched to on-line filing.

Source: IRS' Management Information System for Top Level Executives.

A major criticism of the electronic filing program has been that it is not paperless—electronic filers had to send IRS a paper signature document (Form 8453) and, if they owed money, a check and payment voucher. According to IRS, feedback from the tax practitioner community indicated that making electronic filing paperless would significantly increase taxpayers' and tax preparers' willingness to file electronically.

IRS, in 1999, implemented two tests that provide alternatives to paper signature documents and two tests that provide electronic payment alternatives for taxpayers who owe money. For the 2000 filing season, IRS expanded each of those tests.

The two alternative signature tests waive the need for participating taxpayers to submit paper signature documents and copies of their Wage and Tax Statements (Forms W-2).² The first test allows certain tax practitioners' clients who choose to file electronically to use a self-selected personal identification number instead of completing a signature document. IRS data show that about 500,000 taxpayers used this option in 1999. IRS increased the number of practitioners allowed to participate in the test from 8,100 in 1999 to 18,000 this year. IRS data show that about 3.95 million taxpayers had already used this option as of March 9, 2000—a significant increase over last year.

The second alternative signature test involves taxpayers who used tax preparation software to prepare their previous year's tax return. Instead of sending those taxpayers a paper tax package, IRS sends them a postcard with a unique customer number that they can use in lieu of mailing in a signature document, if they decide to again file through their computer. About 660,000 taxpayers used this option in 1999. IRS increased the number of taxpayers who could participate in the test from about 12 million in 1999 to about 16 million this year. According to IRS, about 778,000 taxpayers had used this option as of March 9, 2000.

IRS also expanded two tests involving alternative payment methods for taxpayers who owe money, both of which eliminate the need for taxpayers to send checks and payment vouchers. One test, involving the use of credit cards, was expanded to taxpayers who file Estimated Tax Payments (Form 1040ES) or an Extension of Time to File (Form 4868). IRS also did more to publicize this option's availability to paper filers. The other test, involving payments via direct debit, was expanded to include TeleFile users. As of March 10, 2000, according to IRS, 28,200 taxpayers had used one of these two payment alternatives, compared to 7,286 at the same time last year. Of those 28,200 taxpayers, 20,697 were electronic filers who paid by direct debit (including 6,367 TeleFile users) and 7,503 were an unknown combination of electronic and paper filers who used credit cards.

Another effort to increase electronic filing this year involved additional marketing of the electronic filing program. IRS allocated \$7 million to market individual electronic filing for the 2000 filing season, compared to \$5 million for 1999. This year's marketing effort includes expanded television and radio advertising, advertising in several magazines and newspapers, and the use of outdoor billboards. IRS officials

²These tests are consistent with a provision in RRA98, which required that IRS "develop procedures for the acceptance of signatures in digital or other electronic form" and that further authorized IRS to waive the requirement of a signature or provide for alternative methods of signing until such time as such procedures are in place. According to a cognizant IRS official, IRS can waive the submission of W-2s because there is no statutory requirement that these forms be attached to tax returns.

from a regional office we visited told us that many more taxpayers have been coming into IRS walk-in sites to have their returns filed electronically, which the officials attributed, at least in part, to the increased marketing.

IRS also added five forms to the list of forms that can be filed electronically this year. Practitioner feedback to IRS indicated that providing the ability to electronically file additional forms, such as those used for averaging farm income or reporting passive activity gains, would allow practitioners to file more electronic returns because they had clients who were required to file those forms with their returns. IRS estimated that about 250,000 of these types of forms would be filed electronically in the 2000 filing season. As of March 16, 2000, about 9,800 had been filed.

Telephone Service Shows Some Improvement But Is Still Below 1998 Performance Level

An important indicator of how well the filing season is going is the ease with which taxpayers can reach IRS over the telephone to ask questions about the tax law or respond to a notice they received.³ In the few years before 1999, there had been a steady improvement in this indicator. That trend ended in 1999, when IRS experienced problems that significantly reduced taxpayers' ability to reach IRS by telephone. IRS addressed some of the problems that contributed to the service problems in 1999 and, as shown in table 2, service has improved this year. However, the level of service as of March 7, 2000, was still below the level achieved in 1998 partly because, according to IRS officials, the productivity of telephone assistants has declined compared to 1998 and fewer staff years have been dedicated to answering the telephone in 2000.

Table 2: Toll-Free Telephone Level of Service for the First 2 Months of the 2000, 1999, and 1998 Filing Seasons
[in Millions]

Telephone service	1/1/00 to 3/4/00	1/1/99 to 3/6/99	1/1/98 to 3/7/98
(a) Calls answered	13.4	14.7	16.3
(b) Calls abandoned	3.9	4.6	3.8
(c) Subtotal—calls that got into IRS' system	17.4	19.3	20.2
(d) Busy signals	4.1	14.8	2.2
(e) Total call attempts	21.4	34.1	22.3
Level of service ^a	63%	43%	73%
Percentage of calls that received busy signals ^b	19%	44%	10%
Percentage of calls that got into IRS' system but were abandoned ^c	23%	24%	19%

Note 1: This table combines data on three of IRS' toll-free telephone lines—tax law assistance, account inquiry, and refund.

Note 2: Totals may not add and percentages may not compute due to rounding.

^aLevel of service is the number of calls answered divided by the total call attempts—computed in this table by dividing row (a) by row (e).

^bComputed in this table by dividing row (d) by row (e).

^cComputed in this table by dividing row (b) by row (e).

Source: GAO analysis of data in IRS' Weekly Customer Service Report.

The 63-percent level of service IRS had achieved as of March 4, 2000, was a significant increase compared to the 43-percent level of service achieved as of the same time last year. According to a cognizant IRS official, unlike last year when IRS faced many problems that affected access, there has been only one major problem this year that had a significant impact on the telephone system. In late January 2000, contract delays resulted in the bulk of over 1 million notices being mailed out over a 2-week period instead of being staggered over 7 weeks as intended. As taxpayers received the notices, there was an unexpected increase in the number of telephone calls that IRS was unprepared to answer. According to the official, the level of service decreased over about a 3-week period as a result of this unexpected demand, but then increased back to levels achieved before the erroneous mailing. In that regard, according to IRS data, the level of service was 67 percent for the week ended January 22, dropped to 44 and 48 percent the following 2 weeks, then rose to 66 percent the week ended February 12. For the most recent week for which data were avail-

³An equally important indicator is the quality of the response taxpayers get to their questions once they reach IRS. We had not done enough work at the time this statement was prepared to comment on IRS' performance in that respect.

able when we prepared this statement (the week ended March 4, 2000), the level of service had risen to 72 percent.⁴

IRS Addressed Some of the Problems That Contributed to Poor Telephone Service in 1999

As noted in our report on the 1999 filing season, despite several changes IRS made to improve its toll-free telephone operations, service actually declined in 1999.⁵ For the 2000 filing season, IRS has addressed some of the problems that contributed to that decrease; however, issues surrounding declining productivity and optimal staffing levels have not yet been resolved.

Before 1999, IRS used a messaging system to handle calls from taxpayers with questions on certain complex topics that were known to usually require long conversations. Taxpayers were asked to leave their name and telephone number with the expectation that someone in IRS would return their call within 2 to 3 days. Because of an expected increase in the productivity of its telephone assistors in 1999, IRS believed that it could answer all calls, even the more complex ones, as they came in. Thus, at the start of the 1999 filing season, IRS discontinued use of the messaging system. IRS subsequently reinstated the system when it realized that its expectations of increased productivity had not materialized and that the system's discontinuance had a negative effect on telephone access.

IRS is continuing to use a messaging system this filing season. However, it modified the messaging procedure to improve management of the message workload. Now, instead of being routed to a voice messaging system, calls involving certain complex topics are routed to an assistor who adds the taxpayer's name, phone number, and question to a centralized database. IRS compliance staff nationwide can then access the database and return the taxpayer's call to answer the question.

Inadequate staffing plans and work schedules for IRS' 24 call sites also contributed to the reduced level of telephone service in 1999. Those plans and schedules were created using faulty productivity assumptions and demand data and were not completed until just before the start of the 1999 filing season. According to cognizant officials, IRS improved the timeliness and accuracy of its work schedules this year, allowing them more time for planning and providing the ability to better match staffing at sites with call volumes.

Because it assumed that it would have adequate staffing for the 1999 filing season, IRS initially decided not to use a feature of the telephone system, known as selected expanded access (SEA), that gives taxpayers access to automated services when they would have otherwise received a busy signal because of high call volume. If the service the taxpayer desires is not available through automation, the only option is to hang up and call back later. In response to high levels of busy signals and resulting low accessibility in the early part of the 1999 filing season, IRS began using SEA in early February 1999. This year, IRS has used SEA from the start of the filing season. IRS' use of SEA is most likely reflected in the reduction of about 10.7 million busy signals during the first 2 months of the 2000 filing season compared to the same period in 1999. What is not clear is to what extent the automated information satisfactorily answers the taxpayer's question. We will be following up on taxpayer use of SEA as we continue our review of the filing season.

Decline in Productivity and Fewer Staff May Be Keeping Telephone Service Below 1998 Levels

Although the 63-percent level of service as of March 4, 2000, was a significant increase over the 43-percent rate achieved as of the same time last filing season, it was still about 10 percentage points lower than in 1998. IRS officials cited two factors that have likely played a part in keeping the level of service below the 1998 level—a drop in productivity compared to 1998 and fewer staff dedicated to answer telephone calls.

According to IRS officials, productivity—the rate at which assistors answer telephone calls—is down considerably from 1998. Although they speculate that some of the decline may be due to their emphasis on assistors taking as long as necessary to fully resolve a taxpayer's question or problem, IRS does not conclusively know what factors have contributed to the productivity decline and whether this has resulted in better or worse service. IRS has undertaken two studies to determine the reasons for declining productivity and what, if any, corrective action should be taken. We will monitor the results of those two studies as we continue our review.

⁴According to IRS, at the "best in class" private sector companies, 85 percent of callers are connected to an assistor within 30 seconds.

⁵GAO/GGD-00-37.

Another factor that may be keeping level of service during this filing season from reaching the level achieved in 1998 is the decision to reduce the staff dedicated to providing toll-free telephone assistance. For fiscal year 2000, IRS allocated fewer positions to provide telephone service and shifted the remaining positions to non-telephone work, such as responding to taxpayer correspondence and contacting taxpayers who owe taxes. Cognizant officials said that when a disproportionate number of staff are diverted to any one type of service, the other services suffer with large and aged inventories. They added that the resources and demand for telephone and correspondence assistance are highly interrelated because taxpayers who have not received a timely response to their correspondence call IRS, thus increasing telephone demand.

IRS' FISCAL YEAR 2001 BUDGET REQUEST

For fiscal year 2001, IRS is requesting \$8.986 billion and 100,133 full-time equivalent (FTE) positions, including \$145 million and 2,082 FTEs to be funded outside the discretionary spending caps for the Earned Income Tax Credit compliance initiative.⁶ As shown in appendixes I and II, that request is about 9 percent more than IRS' proposed operating level for fiscal year 2000 (\$8.256 billion) and is the net result of several increases and decreases, including increases for (1) an initiative called "Staffing Tax Administration for Balance and Equity" (STABLE), (2) information systems and technology investments, and (3) organizational modernization.⁷

In analyzing the request for STABLE, it became apparent that several portions of IRS' request do not contain clear links between the resources being requested and expected results. Given IRS' ongoing reorganization and its efforts to develop new or revised performance measures, we believe that IRS has an opportunity to make future budget requests more useful to Congress.

IRS Requests Funds to Stabilize Its Workforce

IRS is requesting \$144 million and 1,633 additional FTEs to stabilize and strengthen tax compliance and customer service programs in fiscal year 2001. IRS has also proposed a supplemental fiscal year 2000 appropriation of \$39.8 million for this initiative, collectively known as STABLE, to allow it to hire some of the new staff in fiscal year 2000. According to IRS, approval of the supplemental appropriation would allow IRS to train those new hires in fiscal year 2000, thus maximizing their impact in fiscal year 2001.

As shown in table 3, the STABLE initiative includes staffing increases for several IRS program areas.

Table 3.—FTEs Requested for STABLE Initiative

Budget activity	Fiscal year 2000 supplemental	Fiscal year 2001 annualization	Fiscal year 2001 initiative	Total
Submission Processing	50	150	208	408
Telephone and Correspondence				
Toll Free	63	189	248	500
Automated Collection System	75	225	150	450
Document Matching				
Underreporter	40	120	40	200
Combined Annual Wage				
Reporting	10	30	64	104
Examination	11	33	778	822
Collection				
Field Collection	0	0	50	50
Walk-In	48	142	43	233
Tax Exempt and Government				
Entities	4	12	52	68

⁶ Fiscal year 2001 will be the fourth year of funding for this 5-year initiative.

⁷ In our report on IRS' fiscal year 1999 financial statements, *Financial Audit: IRS' Fiscal Year 1999 Financial Statements* (GAO/AIMD-00-76, Feb. 29, 2000), we discussed certain issues related to IRS' budget, such as concerns about IRS's ability to ensure compliance with the laws governing its use of budget authority and IRS' controls over property and equipment. We are not discussing those issues in this testimony.

Table 3.—FTEs Requested for STABLE Initiative—Continued

Budget activity	Fiscal year 2000 supplemental	Fiscal year 2001 annualization	Fiscal year 2001 initiative	Total
Total FTEs	301	901	1,633	2,835

Note: The FTEs shown in the column headed “Fiscal year 2000 supplemental” reflect IRS’ assumption that the persons hired under the supplemental appropriation will be coming on board around July 1, 2000, and thus will be working for only 3 months of the fiscal year. Thus, for example, the 50 FTEs for Submission Processing in that column represent 200 persons working for 3 months in fiscal year 2000. Because those 200 persons would be expected to work a full year in 2001, the number of FTEs needed that year would be 200—or 150 more than provided for in the fiscal year 2000 supplemental. That 150 increase is reflected in the column headed “Fiscal year 2001 annualization.” The same rationale applies to the other numbers in that column.
Source: IRS’ Fiscal Year 2001 Congressional Justification.

Before discussing specific parts of this initiative, we have two overall comments.

- Because IRS’ request for fiscal year 2001 assumes that many of the new staff will not be brought on board until April 1, 2001, the number of FTEs associated with STABLE in fiscal year 2001 reflects the fact that many of the new staff will not be working the entire fiscal year. Because they will be working full time the following year, the number of FTEs associated with STABLE will increase to 4,003 in fiscal year 2002, according to IRS. Thus, if Congress funds the initiative and IRS implements it as intended, IRS can be expected to seek a further increase in fiscal year 2002 to fund the additional staffing costs associated with this growth in FTEs.
- However, there is ample precedent to question whether IRS will be able to implement STABLE as intended. Many times in the past, IRS has not filled enforcement positions that were funded by Congress because shortfalls in other areas caused IRS to use those funds elsewhere. In that regard, IRS’ budget justification says that, for fiscal year 2000, it has had to “adjust projected spending on personnel, operational support, and other support costs,” which “required that we not fill 2,339 FTE devoted to tax law enforcement in the [fiscal year] 2000 President’s Budget.”

In responding to our second overall comment, IRS’ Budget Office said the following:

“We agree that for the past few years we have had to divert labor resources to fund unfunded mandatory items such as telecommunications and contracts, as well as reduce the number of FTE due to an unfunded labor shortfall. This could happen again if we do not receive our full [fiscal year] 2001 budget request. However, as currently submitted, our [fiscal year] 2001 budget is balanced and will allow us to fund all requested FTE. If fully funded we expect to be able to recruit and fill all of the requested positions.”

The rest of our discussion of STABLE focuses on those elements related to (1) telephone service, (2) submission processing (3) examination, (4) collection, and (5) the underreporter program.

Telephone Service

STABLE includes 500 additional FTEs for IRS’ toll-free telephone service. With the additional staffing, according to the budget request, IRS plans to provide a 60-percent level of service for toll-free assistance in fiscal year 2001 and reduce its dependence on revenue agent detailees from Examination.

Of the 500 FTEs being requested for toll-free telephone service, 200 will be used to free Examination staff from having to support customer service activities. In effect, IRS will be hiring Customer Service staff to replace Examination staff who have been detailed to answer the phone. Since the net effect of those 200 FTEs is not to increase the resources available to answer the telephone but rather to increase the resources available to do examinations, we will discuss that part of the request in the next section. The other 300 FTEs would actually increase the number of resources devoted to answering the telephone.

Although we asked IRS for documentation further justifying this proposed staffing increase, IRS did not provide sufficient detail on how it determined the size of the staff increase or how such an increase would affect service. In addition, IRS cannot project the level of service it can expect from its current staffing, much less the level of service it can expect from more staff. In that regard, IRS has shown that it may be able to provide better service with even fewer staff than before. As we discussed earlier, the level of service during the current filing season has improved significantly over last year—63 percent as of March 4, 2000, compared to 43 percent at the same time in 1999—even though IRS allocated fewer staff to toll-free service this year.

Although we agree that IRS needs to improve its toll-free telephone service, we do not believe that IRS has provided adequate justification for increasing the num-

ber of FTEs devoted to that service. Although IRS' stated goal (a 60-percent level of service) may have seemed reasonable at the time the fiscal year 2001 budget was prepared, it appears clear, based on the preliminary results of this year's filing season, that IRS does not need additional staff to achieve that level of service.

Matter for Consideration by Congress

We believe that Congress should consider withholding approval of this part of the STABLE request until IRS provides a revised estimate of the level of telephone service it can expect to provide in fiscal year 2001 with the increased staffing and clearly demonstrates that the revised estimate considers (1) the service level achieved this filing season, (2) reasonable expectations for further improvements in management and processes, and (3) any planned technological changes.

Submission processing

The STABLE initiative includes 408 additional FTEs that IRS says will be used to transcribe data from 18 million Schedules K filed on paper.⁸ According to IRS, these paper schedules, together with those filed electronically, represent in excess of \$500 billion in total income. IRS says that processing of these documents will allow IRS, as part of its document matching program, to reconcile K data with information reported on individual tax returns.

IRS' plan is consistent with a recommendation we made in 1995—namely that IRS devise ways to enter all Schedules K onto the computer so they can be used in the document matching program and for other compliance programs.⁹ We presented cost/benefit information in the report and said that IRS could reduce the cost of transcribing this information if it could encourage more partnerships to file the schedules electronically. At that time, only 1.7 million of the total 17.3 million Ks were filed electronically. IRS has made progress in that regard—about 4 million are now processed electronically and IRS is projecting about 11 million by 2001.

It should be noted that the transcription of K data starting in fiscal year 2001 could significantly increase IRS' document matching workload starting in fiscal year 2002. It remains to be seen what IRS is able to do with that increased workload since, as discussed later, IRS is currently unable to investigate many of the discrepancies identified by its document matching program. Thus, the increased matching workload resulting from the processing of K data could affect IRS' budget request for fiscal year 2002.

Examination

STABLE would increase Examination staffing in two ways. First, as discussed earlier, the telephone service portion of STABLE includes 200 FTEs to free up Examination staff who have been detailed in the past to help the Customer Service function answer taxpayers' questions. Second, the Examination portion of STABLE includes 822 FTEs, which would allow IRS to hire additional staff for the Examination function. IRS says that the staffing increase will lead to an increase in audit coverage for high-income individuals (those with taxable income of more than \$100,000) from 0.76 percent to 1.10 percent. We have no way of knowing what an appropriate level of audit coverage would be. Assuming 1.10 percent is a reasonable goal, the question becomes whether IRS needs additional staff to achieve that goal or whether it can be achieved by using existing resources more efficiently.

Because there was insufficient information in IRS' budget justification to address that question, we obtained additional data from IRS. The data we received showed that

- the number of revenue agent FTEs has declined by about 17 percent between fiscal year 1995 and fiscal year 1999, with a further decline of 4 percent expected in fiscal year 2000;
- between fiscal years 1995 and 1999, the number of returns filed by high-income individuals and corporations (the type of returns generally audited by revenue agents) increased by about 36 percent;
- primarily because of an increase in the amount of FTEs spent in training and helping Customer Service, the percent of revenue agent FTEs spent doing examinations (known as direct examination time) decreased from 53.9 percent in fiscal year 1997 to 45.2 percent in fiscal year 1999; and
- time spent per examination case has increased due to such factors as (1) changes in the mix of work; (2) the learning curve associated with new laptop com-

⁸Schedules K provide information on income (or losses) distributed by business entities to individual partners, beneficiaries, and shareholders.

⁹*Tax Administration: IRS' Partnership Compliance Activities* (GAO/GGD-9551, June 16, 1995).

puters; (3) the stops and starts associated with details to Customer Service; and (4) various new documentation, taxpayer notification, and other requirements associated with implementation of RRA98.

Although direct examination time and time per case could improve as details to Customer Service become less necessary and staff become more familiar with the provisions of RRA98 and although other increases in efficiency are surely possible, we find it hard to argue against increasing Examination staff in light of the 21-percent decline in revenue agent staffing since fiscal year 1995 while the number of filed returns in categories audited by revenue agents has been increasing at an even greater rate.

Collection

STABLE includes 283 additional FTEs for IRS' Collection activity—50 for the Field Collection function and 233 for the walk-in program. According to IRS, much of this initiative is designed to address (1) declining staffing levels among revenue officers, (2) a downward trend in collection case closures, and (3) substantial increases in the time required per case due to provisions of RRA98.

IRS' budget request did not contain details on the downward trends in revenue officer staffing and case closures or the upward trend in case times. We pursued those issues with IRS and obtained the following information:

- Revenue officer FTEs declined from about 8,130 in fiscal year 1995 to about 6,480 in fiscal year 1999—a drop of 20 percent—and have continued to decline this year.

- The number of tax delinquent accounts and tax delinquency investigations closed by the Field Collection function decreased by 30 percent and 49 percent, respectively, between fiscal years 1997 and 1999.

- The Collection function is expected to spend about 1,400 FTEs in fiscal year 2001 administering various provisions of RRA98, which, according to IRS, more than offsets the productivity gains associated with the recently completed national roll-out of the Integrated Collection System.

In addition to the decline in overall staffing levels, some revenue officer FTEs have been used to provide assistance at IRS walk-in sites. According to data obtained from IRS, the number of revenue officer FTEs devoted to that effort increased from 289 in fiscal year 1998 to 542 in fiscal year 1999. According to IRS, of the 233 FTEs being requested for the walk-in program under STABLE, 200 are intended to allow IRS to reduce this reliance on revenue officer help. We agree in principle with the desirability of replacing revenue officer detailees with persons hired and trained specifically to provide customer service. Doing so should not only allow the revenue officers to concentrate on collection case work but also improve customer service. A person who has been hired and trained for a customer service position should be able to better assist taxpayers than a person who has been hired and trained to collect taxes.

Unlike the 200 FTEs discussed above, which would increase the staffing devoted to collecting taxes, the other 33 FTEs being requested for the walk-in program would increase the number of FTEs devoted to providing walk-in assistance. IRS' budget request provides little information that can help Congress evaluate the need for additional walk-in staff. IRS says that funding of its request will "increase the level of customer service." However, although IRS has efforts underway to measure such service indicators as wait time and quality, its budget currently includes no such measure. In fact, one measure in IRS' budget request (customer satisfaction with walk-in assistance) indicates that service might already be at an acceptable level. According to that measure, customers gave the walk-in program a satisfaction rating of 6.4 on a scale of 1 to 7, with 7 meaning "very satisfied." That rating is the highest of all the customer satisfaction ratings reported in IRS' budget request.

Information we received from IRS' Budget Office indicated that the additional walk-in staff would allow IRS to enhance the accessibility of its walk-in assistance by expanding the hours of service at walk-in offices and expanding efforts to help taxpayers (through such nontraditional outlets as shopping malls and taxmobiles) who cannot easily reach a walk-in office. However, the budget request does not reflect any impact from that expanded service. In fact, the request shows that IRS expects 10.0 million walk-in contacts in fiscal year 2001—the same number as in 1999 and 2000.

Underreporter Program

STABLE also includes 200 FTEs for additional document matching within IRS' Underreporter Program. IRS' budget justification contains no performance measures related to the Underreporter Program that can be used to help assess the reason-

ableness of this request. In our report on IRS' fiscal year 1999 financial statements, however, we presented the following information on IRS' performance in this area.¹⁰

"For tax year 1996 [the most recent year for which substantially complete matching program results were available], IRS' matching program for individual taxpayers screened about 155 million individual income tax returns and found that about 12 million (8 percent) had potential underreported taxes due totaling at least \$15 billion. However, IRS investigated only about 3.1 million (26 percent) of these returns, accounting for estimated underreported taxes due of about \$5.2 billion (35 percent). . . . According to IRS, resource constraints precluded them from investigating more of these discrepancies and the related estimated underreported taxes due."

Fiscal Year 2001 Information Technology Budget Request: Observations and Suggestions

Beginning in 1995, we reported on serious and pervasive information technology (IT) management and technical weaknesses at IRS and made recommendations for correcting them.¹¹ To minimize the risk of IRS investing in systems before the recommendations were fully implemented, we suggested in 1996 that Congress limit IRS' IT spending to cost effective activities that (1) support ongoing operations and maintenance; (2) correct pervasive management and technical weaknesses, such as a lack of requisite systems life cycle discipline; (3) are small, represent low technical risk, and can be delivered in a relatively short time frame; or (4) involve deploying already developed systems that have been fully tested, are not premature given the lack of a complete systems architecture, and produce a proven, verifiable business value.¹² Since 1996, we have reported on IRS' progress in implementing our recommendations and reviewed IRS' annual budget requests to ensure their consistency with IRS' IT management capability and these spending categories.¹³ While IRS has made progress over the last 4 years in addressing our recommendations, it has yet to fully implement them, and thus they remain operative in assessing IRS' fiscal year 2001 IT budget request.

For fiscal year 2001, IRS' Information Systems appropriation request is \$1.58 billion and includes 7,531 FTEs. Of the \$1.58 billion, \$1.54 billion is to fund the operation and maintenance of existing systems. The remaining \$40 million is for what IRS terms "Business Line Investments." The investments are intended to add new capabilities to five operational systems and develop three new systems that, according to IRS officials, address business needs that are unique to some of IRS' newly formed operating divisions and are not related to, or dependent upon, IRS' core business systems modernization program.

In addition to the \$1.58 billion, IRS is requesting \$119 million for fiscal year 2001—and an advance appropriation of \$375 million for fiscal year 2002—for IRS' multiyear capital account that is intended to fund contractor costs associated with IRS' core business systems modernization program. This account, referred to as the Information Technology Investments Account (ITIA), currently contains \$438 million in appropriated, but unobligated, funds.¹⁴

Pursuant to legislation,¹⁵ funds from the ITIA are not available to IRS for obligation until IRS and Treasury submit to Congress for approval an expenditure plan that (1) implements the IRS Modernization Blueprint; (2) meets Office of Management and Budget (OMB) investment guidelines; (3) is reviewed and approved by IRS' Investment Review Board,¹⁶ OMB, and Treasury's IRS Management Board and is reviewed by us; (4) meets requirements of IRS' life cycle program; and (5) is in compliance with acquisition rules, requirements, guidelines, and systems acquisition

¹⁰GAO/AIMD-00-76.

¹¹*Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is to Succeed* (GAO/AIMD-9556, July 26, 1995).

¹²*Tax Systems Modernization: Actions Underway But IRS Has Not Yet Corrected Management and Technical Weaknesses* (GAO/AIMD-9606, June 7, 1996).

¹³*Tax Administration: IRS' Fiscal Year 2000 Budget Request and 1999 Tax Filing Season* (GAO/T-GGD/AIMD-9940, Apr. 13, 1999); *Tax Administration: IRS' Fiscal Year 1999 Budget Request and Fiscal Year 1998 Filing Season* (GAO/T-GGD/AIMD-9814, Mar. 31, 1998); *Tax Administration: IRS' Fiscal Year 1997 Spending, 1997 Filing Season, and Fiscal Year 1998 Budget Request* (GAO/T-GGD/AIMD-97-66, Mar. 18, 1997); *Tax Administration: IRS' Fiscal Year 1996 and 1997 Budget Issues and the 1996 Filing Season* (GAO/T-GGD-96-99, Mar. 28, 1996).

¹⁴Of the \$438 million, \$227 million is to expire on September 30, 2000, and the remaining \$211 million is to expire on September 30, 2002.

¹⁵The fiscal year 1998 Treasury and General Government Appropriations Act (P.L. 105-61) and the fiscal year 1999 Omnibus Consolidated and Emergency Supplemental Appropriations Act (P.L. 105-277).

¹⁶According to IRS, the Investment Review Board has been replaced by the Core Business Systems Executive Steering Committee, which is chaired by the Commissioner of Internal Revenue.

management practices of the federal government. In May 1999, IRS submitted its first expenditure plan, seeking to spend about \$35 million for modernization initiatives through October 31, 1999. We reported to Congress that the plan was an appropriate first step toward successful modernization, but that the key to success for IRS would be to effectively implement the plan.¹⁷ Subsequently, the relevant appropriations subcommittees agreed to IRS' obligation of \$35 million from the ITIA.

IRS was unable to finalize its second expenditure plan before the original \$35 million was obligated and on December 14, 1999, it requested approval to obligate \$33 million from the ITIA as a "stopgap" measure until the next expenditure plan was submitted. In briefings to the relevant appropriations subcommittees and IRS, we reported our concerns about IRS' lack of progress in completing and implementing an enterprise systems architecture and system development life cycle and the risks associated with IRS' plans to develop selected systems without these critical management controls in place. In approving IRS' \$33 million request, the appropriation subcommittees directed IRS to, among other things, (1) expedite completion and implementation of the architecture and system life cycle methodology and (2) explain in future expenditure plans how IRS plans to manage the risk of performing detailed design or development work if the architecture is not completed or the life cycle is not implemented.

In response to these and other concerns raised by the appropriations committees, OMB, and us, IRS has reassessed its plans and is in the process of restructuring its modernization program to scale-back its new system development efforts until it first puts in place the requisite modernization management capability, including developing its enterprise architecture and implementing its system life cycle methodology. In early March 2000, IRS submitted its second expenditure plan to Congress seeking approval to obligate \$176 million of the \$438 million currently in the ITIA.

Fiscal Year 2001 Information Systems Budget Request Appears Consistent With Established Spending Categories

The vast majority (97 percent) of IRS' fiscal year 2001 request of \$1.58 billion for its Information Systems appropriation appears in line with the aforementioned spending categories. Specifically, \$1.54 billion is being requested to operate and maintain existing information systems that support day-to-day tax administration functions and activities. The remaining 3 percent, or \$40 million, is for eight relatively small "Business Line Investments" that are to enhance existing operational systems and develop new ones. Specifically, five investments, estimated at about \$13 million, are to add capabilities to operational systems, such as the Integrated Case Processing System and the Chief Counsel Case Management System. The other three investments, estimated at about \$27 million, are to develop new systems for some of IRS' new operating divisions.

For example, one of these investments—referred to by IRS as the Near Term Electronic Filing and Electronic Fraud Detection System project—is for the Wage and Investment Income Division and the Small Business and Self Employed Division. This system is to provide the capability to accept additional tax forms and schedules that IRS is currently not capable of receiving electronically. According to IRS, the system will support IRS' goal of enabling more taxpayers to file their tax forms and schedules electronically.

Fiscal Years 2001 and 2002 ITIA Requests Are Not Adequately Justified

Key provisions of the Clinger-Cohen Act, the Government Performance and Results Act, and OMB Circular No. A1 and supporting memoranda, require that, before requesting multiyear funding for capital asset acquisitions, agencies develop accurate, complete cost data and perform thorough analyses to justify the business need for the investments. For example, agencies must show that needed investments (1) support a critical agency mission; (2) are justified by life cycle cost-benefit analysis (i.e., business case); and (3) have cost, schedule, and performance goals.

IRS' Chief Information Officer (CIO) acknowledged that IRS has not yet performed the above-cited analyses to justify its fiscal year 2001 investment account request of \$119 million and its fiscal year 2002 advance request of \$375 million. Instead, IRS officials told us that the funding requests for both years were based on a \$300 million average annual rate of spending, which, according to the CIO, was derived 6 months ago based on full contractor staffing of the maximum number of projects that IRS assumed its human capital capacity would allow it to manage effectively at one time. However, the reliability of this estimate is questionable be-

¹⁷ *Tax Systems Modernization: Results of Review of IRS' Initial Expenditure Plan* (GAO/AIMD/ GGD-99-206, June 15, 1999).

cause we were not provided any verifiable documentation supporting the above-described estimating approach, and the estimate is not based on a complete definition of what IRS' fiscal year 2001 and 2002 investments will be. Moreover, even using the above-described rationale for how the 2001 and 2002 funding requests were derived, the estimate is likely overstated for two reasons. First, IRS has recently reassessed its human capital capacity to manage projects and has determined that the number of projects it can effectively oversee needed to be scaled back, which in turn has reduced contractor staffing needs. Second, the \$300 million estimate represented the upper bound of IRS' funding requirements for a given year, according to the CIO.

Matter for Consideration by Congress

We suggest that Congress consider denying the \$119 million requested for fiscal year 2001 and the \$375 million requested for fiscal year 2002, and that it direct IRS to develop a credible and verifiable fiscal year 2001 ITIA budget request (i.e., a request that is based on defined modernization requirements and formal estimating methods) and to seek, if necessary, a supplemental appropriation for this amount in time to meet its fiscal year 2001 needs. Neither of these congressional actions should affect continuity of the modernization because (1) IRS' own plans for obligating available ITIA funds will leave \$51 million in the account for the remainder of fiscal year 2000,¹⁸ and \$211 million to cover funding needs in fiscal year 2001, even if IRS does not receive a supplemental, and (2) IRS can still request funding for fiscal year 2002 in its fiscal year 2002 budget submission, when it should be in a better position to reliably estimate its funding needs.

IRS' Reorganization Effort Is Continuing

IRS has requested \$182 million to cover reorganization expenses—\$140 million in base funding from the fiscal year 2000 budget plus an additional \$42 million requested for fiscal year 2001. According to IRS, reorganization costs will peak in fiscal year 2001, decline in 2002, and end in 2003. This funding pattern is consistent with IRS' plan for implementing the reorganization, which shows a significant amount of activity in fiscal year 2001 with lesser amounts continuing into 2003. Other costs associated with IRS' modernization, such as the costs associated with training staff and upgrading IRS' computer systems, should continue well past 2003.

Over the past year, IRS has made progress in shifting to the new organizational structure. IRS has selected the Commissioners and Deputy Commissioners for each of the four operating divisions and has put in place management structures for several new units, including the Taxpayer Advocate Service and the Tax Exempt and Government Entities Division. The two largest operating divisions, those serving individual taxpayers and small businesses, are expected to become operational this fall, but key aspects of the organizational designs are to be phased in over the following 2 years. Plans for the Wage and Investment Income Division, for example, include new compliance approaches that IRS plans to implement or pilot test in fiscal year 2002.

In our testimony on IRS' fiscal year 2000 budget request, we commented that IRS did not separately identify an amount for the Office of the Taxpayer Advocate, but instead included it within the Telephone and Correspondence budget activity in the Processing, Assistance, and Management appropriation.¹⁹ We suggested that congressional oversight of the Advocate's Office and IRS' efforts to solve taxpayer problems would be further enhanced and any concerns about the Advocate Office's independence would be further mitigated if funding for that Office was separately identified in IRS' budget. IRS created a separate budget activity for the Taxpayer Advocate Service in fiscal year 2000, which it has included in its fiscal year 2001 budget request.

In that same testimony, we discussed how IRS' budget request commingles resources for enforcement and assistance. The Telephone and Correspondence budget activity, for example, includes resources for several forms of assistance, such as answering telephone calls and correspondence, as well as several enforcement activities, such as audits handled through correspondence and attempts to collect overdue taxes via the telephone. When we raised the same issue in our report on IRS' fiscal year 1999 financial statements, IRS said that it would be addressing the issue in its new organizational structure.²⁰

Fiscal Year 2001 Budget Request Not Clearly Linked to Performance

¹⁸This \$51 million, if not obligated by September 30, 2000, will expire.

¹⁹GAO/T-GGD/AIMD-9940.

²⁰GAO/AIMD-00-76.

As noted in our earlier discussion of STABLE, several portions of IRS' budget request do not contain a clear link between the resources being requested and expected results. As we have noted in the past, the Government Performance and Results Act of 1993 aims for a closer and clearer link between the process of allocating resources and the expected results to be achieved with those resources.²¹ We further noted that an agency's performance goals are of little value to congressional appropriation decisions without a connection to the resources that an agency is requesting.²²

While we recognize that it is not easy to clearly link budget levels and performance results, we believe that IRS could do a better job of making that connection. For example, IRS' request does not clearly link the various budgetary inputs that affect toll-free level of service with IRS' goal in that area. What the budget shows is a request for about \$1 billion for the Telephone and Correspondence activity and a performance goal of 60-percent level of service associated with that budget activity. What is unclear from the budget is (1) that much of the Telephone and Correspondence request is not for toll-free telephone service; (2) that some of the resources requested for other activities, such as Examination and Information Systems, are for toll-free telephone service; and (3) the projected level of service IRS can expect from its current staffing.

IRS is in the process of implementing a major reorganization. That reorganization and any related budget restructuring, along with IRS' ongoing efforts to develop new or revised performance measures, could provide an opportunity to make future budget requests more useful to Congress by more clearly linking requested resource levels with the achievement of performance goals.

That concludes my statement. We welcome any questions that you may have.

APPENDIX I

IRS' Fiscal Year 2001 Budget Request Compared with Proposed Fiscal Year 2000 Operating Level

[Dollars in thousands]

Budget activity	FY 2000		FY 2001		Percent change	
	Dollars	FTEs	Dollars	FTEs	In dollars	In FTEs
Submission Processing	\$930,325	15,682	\$1,036,818	16,040	11.45	2.28
Telephone and Correspondence	932,190	20,480	1,026,742	21,291	10.14	3.96
Taxpayer Advocate Service	133,145	2,294	141,095	2,294	5.97	0.00
Document Matching	59,036	1,437	73,023	1,690	23.69	17.61
Management Services	609,771	6,694	686,155	6,694	12.53	0.00
Rent and Utilities	695,579	67	735,666	67	5.76	0.00
Subtotal: Processing, Assistance, and Management Appropriation	\$3,360,046	46,654	3,699,499	48,076	10.10	3.05
Criminal Investigation	384,549	3,750	399,065	3,750	3.77	0.00
Examination	1,772,371	22,089	1,885,882	22,900	6.40	3.67
Collection	676,676	10,548	721,547	10,785	6.63	2.25
Tax Exempt/Government Entities	156,600	2,102	168,654	2,166	7.70	3.04
Statistics of Income	28,390	471	29,696	471	4.60	0.00
Chief Counsel	225,059	2,378	234,176	2,372	4.05	-0.25
Subtotal: Tax Law Enforcement Appropriation	\$3,243,645	41,338	3,439,020	42,444	6.02	2.68
Operations and Maintenance	1,258,155	7,292	1,543,565	7,531	22.68	3.28
Year 2000	250,426	239	0	0	NA	NA
Investments	0	0	40,000	0	NA	NA
Subtotal: Information Systems Appropriation	\$1,508,581	7,531	1,583,565	7,531	4.97	0.00
Information Technology Investments	0	0	119,000	0	NA	NA
Earned Income Credit (outside caps)	\$144,000	2,082	\$145,000	2,082	0.69	0.00
Total	\$8,256,272	97,605	\$8,986,084	100,133	8.84	2.59

Source: IRS' Fiscal Year 2001 Congressional Justification.

²¹ *Performance Budgeting: Fiscal Year 2000 Progress in Linking Plans With Budgets* (GAO/AIMD-99-239R, July 30, 1999).

²² *Performance Budgeting: Initial Agency Experiences Provide a Foundation to Assess Future Directions* (GAO/T-AIMD/GGD-99-216, July 1, 1999).

APPENDIX II

Comparison of IRS' Fiscal Year 2000 Proposed Operating Level and Fiscal Year 2001 Budget Request

[Dollars in thousands]

	Subtotal	Total
Fiscal year 2000 proposed operating level (includes Earned Income Tax Credit appropriation)		\$8,256,272
Decreases for fiscal year 2001		
Information Systems (non-recur)	(\$ 50,897)	
Transfer of resources to Treasury Inspector General for Tax Administration	(732)	
Subtotal-decreases	(\$51,629)	
Increases for fiscal year 2001		
Adjustments necessary to maintain current levels	347,596	
Program annualization	40,736	
Staffing Tax Administration for Balance and Equity	144,071	
Electronic Tax Administration	3,000	
Operational support contracts	43,631	
Organizational modernization	42,407	
Business line investments	40,000	
Information Technology Investment Account	119,000	
Earned Income Tax Credit compliance initiative	1,000	
Subtotal-increases	781,441	
Fiscal year 2001 budget request		\$8,986,084
Difference between fiscal year 2000 operating level and fiscal year 2001 budget request		\$729,812

Source: IRS' Fiscal Year 2001 Congressional Justification.

Chairman HOUGHTON. Thank you, Mr. White.

Mr. Coyne?

Mr. COYNE. Thank you, Mr. Chairman.

You have reported that while only about 1 million returns were audited in 1997, 10 million additional returns were subject to other forms of IRS reviews. How does the IRS review tax returns beyond full fledged audits?

Mr. WHITE. You are referring to non-audit contacts and you are correct, those are the overwhelming majority of audit type contacts. The contacts in this category, include math errors contacts, reviews of Social Security numbers to make sure the taxpayer is using a valid number, the document matching program and various items IRS refers to as soft notices which are in effect an advance warning to taxpayers about potential problems.

Mr. COYNE. What are the current audit rates for individual, small business and corporate taxpayers?

Mr. WHITE. I don't have all of those numbers but the rate for high income individual taxpayers that is expected for fiscal year 2000 would be .76 percent. The numbers I have for fiscal year 1999, are 1.03 percent for high income individuals and 1.51 percent for corporate returns.

Mr. COYNE. There has been an improvement this year relative to telephone service that fell sharply last year. I guess it is up by about 30 percent this year. To what do you attribute that?

Mr. WHITE. Last year, IRS switched to 7 day a week, 24-hour a day telephone service. As they did that, they experienced a pretty severe decline in productivity. This year productivity appears to be

up, although staffing this year is actually down somewhat. In fact, they have actually achieved the goal this year with less staffing than they set for themselves next year if they got the additional staffing they requested as part of the STABLE request.

Mr. COYNE. In your review, have you been able to find out what types of telephone calls are being answered and which are not?

Mr. WHITE. They are doing some things differently.

Mr. ATTIANESE. Last year, IRS did away with a process where they would take complex calls and route them to a messaging system and the taxpayer would leave a name and number and somebody that knew about that issue would call back and give them an answer.

At the beginning of last year, IRS decided not to use that process because they thought they would have enough people to answer all the calls as they came in. That was one of the reasons they had a problem last year because they didn't have enough people to answer the calls.

Those kinds of complex calls this year are getting routed to a system whereby the taxpayer leaves a message and somebody, generally a revenue agent who knows that issue, will call the taxpayer back in a couple of days and give an answer to the question. So those complex calls are actually getting answered better this year than they were last year because of that messaging system.

Mr. COYNE. Does your review enable you to determine how long a taxpayer waits to talk to an IRS assisted, someone to respond to them, what the average telephone wait is?

Mr. WHITE. We don't have that information for this filing season. We have some work ongoing that was actually requested by the Subcommittee, so later this year, we hope we will be able to report on that.

Mr. COYNE. Thank you.

Chairman HOUGHTON. I have three questions. One is the use of the additional 2,500 people for the IRS. I would like your comments on that. Second is an updating on the 1997 modernization plan. How is it going? Third, I would like to ask about some of your comments in the audit on page seven.

Mr. WHITE. With respect to the staffing, a couple of points to make. One is that most of the staffing would go to enforcement and compliance activities. With respect to the part going to customer service, there is about 300 FTEs.

Chairman HOUGHTON. I don't mean the allocation. Do you feel it is an effective use of people and increased funds?

Mr. WHITE. With the exception of the 300 FTEs going to telephone service. We don't think right now that part of the request is adequately justified because they have already met their goal with their current staffing level.

With respect to modernization, a couple of points there. First of all, the reorganization that I mentioned in my oral statement and that the Commissioner talked about is well underway but that is only one part of the overall modernization efforts at IRS. There are other key parts to the overall modernization.

In addition to reorganizing IRS into four operating divisions by taxpayers, the other key parts of the modernization effort include systems modernization, development of a balanced set of perform-

ance measures and the development of new business processes, new ways of interacting with taxpayers.

Before we see significant results from modernization at IRS, we are going to have to see significant parts of modernization enacted.

Chairman HOUGHTON. How do we get a handle on that? You talk about systems and performance measures and the business processes. In the next 12 months, how do we get a handle on those?

Mr. WHITE. I think partly it requires recognizing this is going to take time. IRS is well into the reorganization part of this but systems modernization, because of the age of IRS' systems and the complexity of those systems, the number of taxpayers involved, and the size of the investment, it is going to take time to do that right.

The reorganization and the fact that executives have been named to manage the new operating units is designed now to allow those newly named executives to begin to think about redesigning business processes. That is how those units would actually interact with taxpayers. Those people are just getting into place, so that kind of thought and planning is just beginning.

Randy, do you want to expand on the systems part?

Mr. HITE. You asked the question with regard to the 1997 modernization blueprint. That blueprint included a number of things: An enterprise architecture which would define in both business and technical terms the environment IRS wants to get to; some high level business requirements that would be used as a basis for developing new systems; and a systems life cycle which would be the cradle to grave set of processes and procedures for managing those systems.

We reviewed that back in 1997 and said that was a good first step but it wasn't complete and more needed to be done in order for it to be the basis for modernizing. The Commissioner agreed. As of today, we are still waiting for an update to the enterprise architecture and the blueprint. We are still waiting for implementation of the system life cycle methodology.

I believe it was about 9 months ago when they requested and received a first draw down from the investment account for modernization. During that time, they have been working to put these things in place. I think it is fair to say they have gone through some growing pains in getting to the point where they have these type of program management and technical controls in place to guide the modernization.

Chairman HOUGHTON. This Committee has to keep an eye on this. We have to have some milestones, so what are the milestones we have to have in order to understand and our job responsibly?

Mr. HITE. When Mr. Rossotti responded to that question he mentioned these expenditure plans that are required under the 1998 and 1999 Appropriation Acts. They submitted the first plan in May of last year. We reported on that in June. We concluded that was a reasonable first step, a reasonable plan for launching the modernization effort. The key to it would have been implementation of the plan.

He also mentioned they submitted the second expenditure plan about a month ago. We are reviewing that now and we are under obligation to report to the Appropriations Committees in a few days

on the results of that. We would be happy to brief your staff on the results of that also.

Those plans include the details on the projects in terms of what is going to be accomplished by when and it makes commitments in terms of deliverables. That is what you should hold them to.

Chairman HOUGHTON. Thank you. On page seven of the report put out in February, you mention "The key issues IRS faces include the following." The Commissioner has said that some of these things are management receptive. In others words, you can change them. The other things have to wait until better equipment, better computers are involved. Do you agree with that?

Mr. WHITE. Yes, we do. To do this right is going to take some time, to redesign IRS' business processes and to develop the kinds of systems that will support those processes given the place they are starting from, it is going take time.

Chairman HOUGHTON. Mr. White, gentlemen, thank you very much for being with us. It has been very helpful. I hope we can keep in touch with you.

Chairman HOUGHTON. Now we have another panel. Our panel is Mr. Gregory Steinbis, Enrolled Agent, Immediate Past President, National Association of Enrolled Agents from California; Bryan Gates, Enrolled Agent, National Society of Accountants from Florida; and Deborah Pflieger, Chairman, American Institute of Certified Public Accountants Relations Internal Revenue Service Committee. Thank you for being with us.

Ms. Pflieger.

STATEMENT OF DEBORAH PFLIEGER, CHAIR, RELATIONS WITH THE IRS COMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Ms. PFLIEGER. Mr. Chairman, Mr. Coyne, thank you for inviting the AICPA to testify before you today. I am Debbie Pflieger, Chair of the AICPA Relations with the IRS Committee.

The AICPA's members provide tax services to all types and sizes of taxpayers and it is from this broad base of experience that we offer our comments today.

The AICPA has been a long-time advocate for adequate funding of the IRS. Providing sufficient funding is particularly important now as the IRS strives to perform its tax administration duties, implement the numerous taxpayer rights provisions recently enacted by Congress and at the same time reorganize its structure and modernize its technology.

The IRS has had its share of problems in the past and in RRA 1998, Congress directed the Service to change. We believe the change process is well underway and that this movement is in the right direction. We look forward to seeing the final results but those results will not occur without adequate funding.

The Administration has proposed a fairly significant increase in the IRS' budget. While the specific dollar amounts and allocations are beyond the scope of our review, given the day-to-day, practical experiences of our members, we offer the following general views and insights on the subject.

Included in the administration's proposed budget increase is funding for the STABLE initiative. We welcome this new initiative

as a means to achieve a balance between taxpayer service and enforcement since both are critical for effective tax administration.

News reports about the extremely low audit levels and lack of collection activity by the IRS are widespread. Commissioner Rossotti discussed them here again today. The AICPA believes strongly that it is vital to our voluntary tax system that this lack of audit and collection activity be reversed immediately and that the increase in enforcement be widely publicized.

When the IRS is or appears to be unable or unwilling to actively administer and enforce the tax laws, serious damage to our tax system results. Those who normally flaunt the law will continue to do so at no risk. Those who have reluctantly complied in the past only because of a fear of enforcement may become noncompliant and the normally compliant taxpayers will lose all faith in the system.

For the voluntary tax compliance system to operate effectively, taxpayers must perceive that everyone pays their fair share and that, if they do not do so voluntarily, the IRS will force them to do so.

The current lack of enforcement is a matter of great concern to our members who see on a day-to-day basis its impact on the attitudes of taxpayers. This is a problem that must be addressed quickly. We fear that any damage to the voluntary nature of our tax system will be difficult to reverse. Therefore, we urge Congress to provide the Service with funds for additional personnel as well as for the proper training of its staff.

Through recent legislation, Congress has taken much needed and much heralded steps to improve the IRS and our Nation's tax system. Commissioner Rossotti has assumed responsibility for leading the IRS in making the comprehensive changes to its structure, manner of operation and technology that you mandated. He has made impressive strides in doing so.

It is crucial that Congress follow through on the reforms it started by providing the IRS with the necessary funds to accomplish its goals. At this point, a failure to support the continuing implementation of these reforms through adequate funding will cause havoc not only on the reforms but to our entire tax system.

We were also asked to discuss the status of the current filing season. However, at this time, we have heard little from our members regarding this filing season, probably because as we sit here today, they are totally immersed in it.

Related to filing season issues, however, is the matter of electronic filing. We are completely supportive of the expansion of the electronic filing program. However, we have concerns about the inability to electronically transmit all forms and all schedules, including white-paper schedules, elections and related compliance disclosures. We see this inability as the greatest barrier to widespread use of electronic filing by our members, who tend to prepare more complex returns.

Given that effective disclosure is central to our current tax reporting system, it is unrealistic to believe that electronic filing can be used for complex returns until all forms and all schedules can be filed electronically.

In conclusion, the AICPA is encouraged by the progress the IRS has made in becoming more responsive to taxpayer needs. Al-

though we are concerned about the decline in audit and collection activity, we regard the administration's budget proposal as indicative of the Service's attempt to correct that decline. Therefore, we urge Congress to continue to support Commissioner Rossotti and the IRS in those efforts by providing them with adequate funding.

Congress instituted the massive and much needed reforms now going on within the IRS. It is crucial that you now support appropriate appropriations for their implementation.

Thank you.

[The prepared statement follows:]

**Statement of Deborah Pflieger, Chair, Relations with the IRS Committee,
American Institute of Certified Public Accountants**

Mr. Chairman and members of this distinguished Subcommittee:

Thank you for inviting the American Institute of Certified Public Accountants to testify before you today. I am Deborah Pflieger, Chair of the AICPA Relations with the IRS Committee. The AICPA is the national, professional organization of certified public accountants comprised of more than 330,000 members. Our members advise clients on Federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, small and medium-size businesses, as well as America's largest businesses. It is from this broad base of experience that we offer our comments today.

IRS BUDGET

The AICPA has long advocated that funding for the IRS must be sufficient for the Service to efficiently and effectively administer the tax laws and collect tax. Providing adequate funding is particularly important currently as the IRS both performs its tax administration duties, including implementing numerous new taxpayer rights provisions enacted by Congress, and, at the same time, is reorganizing its structure and modernizing its technology.

The IRS has had more than its share of problems in past years and, in the *Internal Revenue Service Restructuring and Reform Act of 1998* (RRA98), Congress directed the Service to change. We believe the change process is well under way, and the movement is in the right direction. We look forward to seeing the final results. But, those results will not occur without adequate funding.

The Administration has proposed an increase in the IRS's FY 2001 funding by \$769 million more than the FY 2000 budget; the majority of this amount would be for "current" day-to-day operations and the balance would be for the reorganization of the IRS's structure and the modernization of its technology. The merits of the specific dollar amounts and allocations in the budget proposal require knowledge of facts and an analysis beyond the scope of our review; however, given the insights gained by the day-to-day practical experiences that our members have working with the IRS, we offer the following general views on the subject.

"Current" Operations

Included in the Administration's proposed budget increase for IRS's "current" operations is funding for additional employees to strengthen the tax compliance and customer service functions of the IRS; FY 2001 and supplemental FY 2000 funding is requested for this purpose. This initiative to increase IRS staffing, aptly called STABLE (Staffing Tax Administration for BaLance and Equity), is a welcome measure. We applaud the IRS for recognizing its weaknesses and commencing numerous taxpayer service initiatives since the passage of RRA98. We also applaud the STABLE initiative as a means to achieve a balance between taxpayer service and enforcement. Both are necessary for effective tax administration.

Reports about the extremely low audit rates and lack of collection activity by the IRS are widespread. In his recent testimony before the House and Senate Appropriations Subcommittees, Commissioner Rossotti indicated that, because of a reduction in staff, an increase in return filings, and additional workload created by RRA98, there has been a "steady erosion" in audit coverage, enforcement, and case closures.

It is vital to our voluntary compliance tax system that this lack of audit and collection activity be reversed immediately and that the increase in enforcement be widely publicized. When the IRS is, or appears to be, unable or unwilling to actively

administer and enforce the tax law, serious damage to the effectiveness of our tax system results. Those who normally flaunt the law will continue to do so at no risk; those who in the past have reluctantly complied only because of a fear of enforcement may become noncompliant; and, the normally compliant taxpayers will lose faith in the system and may be tempted to become noncompliant as well. For the voluntary tax compliance system to operate effectively, taxpayers must perceive that everyone pays their fair share and that, if they do not do so voluntarily, they will be forced to do so by the IRS.

The current lack of enforcement is a matter of great concern to our members who see on a day-to-day basis the impact it is having on the attitudes of taxpayers. It is a problem that needs to be addressed—and addressed quickly, for we fear that the damage to the voluntary nature of our tax system will be difficult to reverse. We support the IRS in its decision to add additional personnel to its staff to strengthen its enforcement activities.

Furthermore, emphasis should be placed on the training and knowledge of IRS personnel. Well trained, well paid, and knowledgeable enforcement personnel would be welcome. Some of the most frustrating experiences for taxpayers and tax practitioners in dealing with the IRS occur because of the lack of training and knowledge of the IRS employees. It is a lot easier to work out a solution that is fair to both the tax system and the taxpayer if the individuals dealing with the issues are knowledgeable of the subject matter.

We urge Congress to provide the Service with funds for additional personnel and for the proper training for its entire enforcement staff.

Restructuring of Organization and Modernization of Technology

By the enactment of RRA98, Congress took much-needed, and much-heralded, steps to improve the IRS and our nation's tax system. In the year and a half since Congress directed it to do so in that legislation, the IRS has initiated plans for comprehensive changes to its structure, manner of operation, and technology. Commissioner Rossotti has assumed responsibility for leading the IRS in making those changes and has made impressive strides in doing so. It is crucial that Congress follow through on the reforms it started, by providing the IRS with the necessary funds to accomplish its agenda. At this point, a failure to support the continuing implementation of these reforms through adequate funding would wreak havoc not only to the reforms but also to our entire tax system.

The American taxpaying public is beginning to get the Internal Revenue Service that Congress looked for when it passed the IRS restructuring legislation. It is critical that Congress facilitate moving the reform process ahead without delay by providing the necessary funding.

2000 FILING SEASON

Having heard little from our members regarding the current filing season (as we meet today, they are totally enmired in it), it appears that the filing season is progressing without major problems. It is the experience of our members, however, that many of the more complex returns are yet to be filed at this point in a filing season. Also, since historically we have not solicited input from our members regarding the positives and negatives of a filing season until after the season has ended, it is not unusual for us to have had little feedback at this time unless there is a major systemic problem. If in the future we become aware of any items of significance regarding the current filing season, we will provide you with that information.

Related to filing season issues is the matter of the electronic filing program. We are completely supportive of the expansion of electronic filing. However, we do have some concerns about, and accordingly express our disappointment in, the inability of the electronic filing program to accept all forms and all schedules. This inability to accept all forms and all schedules, including white paper schedules, elections and related compliance disclosures, is the greatest barrier to widespread use of electronic filing by AICPA's members (who tend to work with the more complex returns). Given that effective disclosure is key to the modern tax reporting system, it is unrealistic to believe that electronic filing can be used for complex returns until all forms and all schedules, including white paper schedules, elections and compliance disclosures, can be filed electronically.

At the present time, many CPA tax return preparers cannot be certain that the returns they will prepare in the current filing season can be filed electronically. Given that uncertainty, the vast majority of these preparers have not elected to use the electronic filing system; to do so would require the establishment and operation of two separate filing procedures in their offices, which would result in a needless increase in workload and costs. Only when it is clear that all forms and all sched-

ules can be accurately filed electronically can preparers be expected to begin the natural migration from filing paper returns to filing electronic returns.

We all have heard the reports about the marked increase in the use of electronic filing and we hope that the trend continues. Nonetheless, we would expect that the vast majority of taxes continue to be assessed on paper returns. Electronic returns are only available for the less complex scenarios in which most taxpayers are being charged only relatively modest amounts of tax. While the exact statistics are not available to us, a key question that should be asked and answered is: What percentage of the personal income tax is assessed on paper returns versus electronic returns? Evidence of a successful electronic filing system should at least be partially based on the amount of tax ultimately collected through the electronic return submission process.

CONCLUSION

The AICPA is encouraged by the progress the IRS has made in becoming more responsive to taxpayers. Although we are concerned about the decline in audit and collection activity by the IRS, we regard the STABLE initiative as indicative of the Service's acknowledgment of the problem and attempt to correct it. We are optimistic that, under Commissioner Rossotti's leadership, the IRS soon will attain an appropriate balance between taxpayer service and enforcement.

We urge Congress to continue to support Commissioner Rossotti and the IRS in those efforts by providing adequate funding for the IRS's day-to-day operations as well as its organizational restructuring and technology modernization. Congress instituted the massive and much-needed reforms in the IRS; it is crucial that it now support their implementation.

We appreciate this opportunity to offer our comments to you and would be happy to discuss any of these matters in further detail with you or members of your staff if you so desire.

Chairman HOUGHTON. Thank you, Ms. Pflieger.
Mr. Gates.

STATEMENT OF BRYAN E. GATES, ENROLLED AGENT, AND MEMBER, FEDERAL TAXATION COMMITTEE, NATIONAL SO- CIETY OF ACCOUNTANTS, ALEXANDRIA, VIRGINIA

Mr. GATES. I represent the National Society of Accountants which is much smaller than the American Institute of CPAs and generally represents very small business.

We circulated the request regarding the filing season to our members throughout the United States and heard specifically from about seven or eight States and felt we had made a pretty good inquiry.

The report was what everyone is saying here now. This filing season is beyond anything in anybody's recent memory as going well. The glitches that the newspapers have picked up are of no interest to our members. They don't engage in those activities, they don't know about them. The electronic machinery is operating just fine. The only thing they would like to see is it operate better.

The electronic filing contemplates an intermediary. The Internal Revenue website is so wonderful that I wish I could take my entire time to explain to you what that is doing to practice out there. Practitioners now are communicating with the Internal Revenue Service daily through its website. In fact, it wasn't mentioned by the individual from GAO who talked about the phone service, but we can see the phone service disappearing very quickly.

It is not widely known but the Service will answer a question on the web now. They give an e-mail answer within about 24 hours,

a written answer. It is very beautiful. I am afraid if word got out to the public right now, IRS would be totally overwhelmed by e-mail requests for information.

I have asked personally very difficult questions just to test the ability of the system to work and in fact have gotten correct answers in writing, in e-mail within 24 hours. If the Service could ever get to the point where every taxpayer who has a question could simply go to the web, type in the question and get an e-mail answer, they will have done it. That would be tax administration at its highest.

Specifically, the only things that were really mentioned a problems were the ones you are well aware of. The earned income tax credit is a nightmare for practitioners, return preparers. They never know, we don't know, whether our clients are telling us the truth when they give us information about the earned income tax credit and their eligibility. If they have the misfortune to live in a family with multiple members in the household, the complexity becomes absolutely unbelievable.

The original idea of the earned income credit was to give back money to people who need it, the earning people. Once they get in a controversy with the Internal Revenue Service over the credit they were supposed to get, it is unending. Specifically, one member said, what am I going to do filing the 1999 return when I am still arguing over whether they were eligible for the 1997 credit they took. It is a nonending thing.

We find people who don't even know where the United States Tax Court is being handed petitions and told you can work it out by petitioning the United States Tax Court. This is a person who is eligible for their earned income credit. Absolutely unbelievable.

It was suggested to one of the IRS citizens advisory panels, that the Internal Revenue set up, that perhaps it is time for Congress to reconsider whether the Internal Revenue Service should even be administering this form of return of earnings to the American citizen. There might be a better way to do it.

Chairman HOUGHTON. I am not going to interrupt now but I wish you would explain that later on in the questioning.

Mr. GATES. Yes, sir.

The increasing incidence of the alternative minimum tax is hitting more and more people as a result of inflation and also to the extent that some of their credits are phasing out. It is beginning to grate on taxpayers our members don't believe it was ever intended to affect. They are not high income people; they are medium income people. They are finding that the alternative minimum tax requires them to pay more tax than they would otherwise have to pay.

One other thing brought to our attention was the difficulty of the Service to stay up with changes in our lives. The web now permits trading, day trading, and our members are having to fill out Schedule D's designed years ago to put hundreds and hundreds of gains and losses involving pennies. How the Service can ever keep up with the rapid change of this nature, I think they will need all the help they can possibly get.

Last, with my time gone, we are still are having and our members can never stop talking about the difficulty of getting just the

signup number, their Federal Employer Identification Number. Some day when the Service is able to change this technology so it is as easy to get a Federal ID number as it is a library card, our members and their clients will have a new faith.

They can't open bank accounts without those numbers, the Service says they need the personnel to answer the telephone. They need more staff to serve these people who are complying.

I would love to tell you how wonderful Commissioner Rossotti is doing but I think you already know it. Our members were skeptical at first but we think this is the greatest experiment ever done in Federal taxation. If he is successful in teaching people what is expected of them, how to do it and then making it easy and convenient for them to do it, we think he is going to revolutionize the way this country collects tax.

The few people that are talked about and not audited enough and so forth, as many former commissioners can tell you, you tighten up the screws a little bit, you can audit so many people in this country that the hissing would be heard for miles around. The Federal tax lien stays in place for 10 years anyhow. I hope the press will leave him alone a little bit and you will trust him with the budget he needs so we can see if his experiment is going to work.

I am sorry I ran over.

[The prepared statement follows:]

Statement of Bryan E. Gates, Enrolled Agent and Member, Federal Taxation Committee, National Society of Accountants, Alexandria, Virginia

INTRODUCTION

The National Society of Accountants appreciates the opportunity to testify before the Ways and Means Subcommittee on Oversight and offers this statement concerning the 2000 tax filing season, the Fiscal Year 2001 Budget for the Internal Revenue Service, and IRS Restructuring and Reform.

Through our national organization, and affiliates in 54 jurisdictions, the National Society of Accountants represents the interests of approximately 30,000 practicing accountants and tax practitioners. Generally, our members are sole practitioners or partners in small to medium-sized accounting firms. They provide accounting, tax preparations, representation before the Internal Revenue Service, tax planning, financial planning and managerial advisory services to approximately nineteen million individuals and small businesses. The members of NSA are pledged to a strict code of professional ethics and rules of professional conduct.

I am Bryan E. Gates, a federally authorized tax practitioner (Enrolled Agent), who has represented taxpayers before the IRS for over twenty-five years. I offer this testimony in my capacity as a member of the National Society of Accountants' Federal Taxation Committee. NSA has been given the privilege of testifying before this Committee on several other occasions, and, as always, we greatly appreciate the invitation.

Our statement is based on (1) our reaction to the 2000 tax filing season to date; (2) our thoughts on the administration's fiscal year 2001 budget request for IRS; and (3) our view on the IRS restructuring effort.

YEAR 2000 FILING SEASON

NSA keeps in touch throughout filing season with its members. Through our on-line communications and surveys, we gain insight from front-line practitioners who are seeing taxpayers. NSA also maintains a tax research hotline for its members which gives us a basis on which to comment on some of the filing issues our Tax Manager, Bernie Phillips, has received so far this season. In addition, after we were invited to testify, we requested information from NSA members in all fifty states as to any problems or concerns they may have had with the filing season to date. We are able to report that there were few complaints or concerns expressed by our members this year. We heard from members who practice in Hawaii, Florida, Wisconsin, California, and more. Typical of their comments were, "a relatively calm fil-

ing season” to “filing season 2000 involves, so far, fewer problems than in recent years.” The lack of problems may be the result of the increasing ability of the IRS to process return information electronically and the increasing expertise of our members in submitting electronic data. In terms of IRS processing operations, there are several issues our members would like to bring to your attention. Our members have told us that the following specific issues are of greatest concern:

The first issue is information returns. Our members realize that every financial institution cannot become adept in handling the intricacies of the Internal Revenue Code. But, they believe the Service should demand greater compliance with information reporting requirements. Incomplete and inaccurately completed forms in the IRS 1099 series cause unbelievable problems for taxpayers, practitioners and IRS personnel during filing season. This is particularly true with respect to the returns required of mutual securities funds. Our members report a neverending struggle to separate combined reporting of dividends and short-term gains. Other members report continuing difficulties with Roth versus regular IRA reporting, Roth conversions and re-characterizations, and brokerage reports. These are practitioners who are familiar with and who have read IRS publications 590 devoted to the matter. NSA believes the Service should make special education outreach efforts to the entities who are required to prepare these information reports.

The second issue surrounds the Earned Income Tax Credit. Many taxpayers and practitioners alike remain confused by the eligibility requirements. They are particularly concerned in light of specific due diligence requirements and the repercussions of making a mistake. For example, multiple family households present a myriad of questions having little to do with the credit. Moreover, there are many types of income which must be considered to determine if they apply for purposes of the Earned Income Tax Credit. In our view, the rules are unacceptably difficult for the taxpayer, the tax practitioner, and the IRS: those who believe this program should be administered under another section of the United States Code may be correct.

The third issue is the Alternative Minimum Tax (AMT). More and more of our members’ clients are being subjected to the AMT and we are beginning to hear complaints about the increasing incidence of this tax. Since the AMT was designed to prevent circumstances in which high-income taxpayers enjoyed little or no tax liability it is particularly unwelcome when it strikes taxpayers who do not enjoy a high income in the real sense. We feel strongly that Congress needs to address the dramatic growth in the numbers of taxpayers becoming subject to the AMT as it was never intended to have such a broad application.

The fourth issue concerns the effect of “day trading” on tax reporting responsibilities. Our members realize that this phenomenon is relatively new to the world of tax practice but are finding the impact on clients to be overwhelming. Following the existing reporting requirement that each transaction be listed in detail is overly burdensome in many cases. Some NSA members report the frustration of pages and pages of details concerning tiny individual gains and losses. We are confident that IRS personnel are hearing these concerns and changing the reporting requirements to reflect the reality of current financial markets.

The fifth issue is logistical in nature. Since the IRS mailed postcards instead of return packages, many taxpayers had difficulty obtaining forms and instructions. Taxpayers appeared at practitioner offices in search of forms saying that their requests for forms had not been answered by the Service and that they were unable to obtain forms in banks, post offices, or libraries. NSA’s President, Jeffrey Adelstone in Tucson, Arizona, among others, reported a considerable number of taxpayers unable to obtain needed forms without a visit to IRS offices. NSA believes taxpayers should have to go no further than the closest bank to get the instructions and forms they need to prepare a simple tax return.

An issue which will go unnumbered since it does not involve the year 2000 filing season was mentioned repeatedly by our members. Members are unable to obtain Federal Employer Identification Numbers for their new clients in a prompt and convenient manner. This complaint is continuous and widespread. It goes without saying that a new businessman’s introduction to the world of employment tax should not include difficulty in obtaining an account number which will prove necessary to deposit, report and pay tax withheld from employee wages. NSA strongly urges that an end be put to this systemic failure. Employer identification numbers should be easier to obtain than telephone numbers. Immediate assignment of numbers is a crucial enhancement to the prospects for voluntary compliance.

Lastly, Electronic Tax Administration remains an NSA concern. The IRS is requesting \$3 million for ETA to continue progress toward the Congressional goal that 80 percent of all tax and information returns be filed electronically by 2007. In RRA 98, Congress established the interim goal that all returns prepared electronically, but filed on paper, be filed electronically by 2003. Increasing taxpayers’ awareness

and understanding of IRS e-file services and benefits will require expanded marketing efforts that communicate the benefits of IRS e-file to both taxpayers and practitioners. The IRS should not only advertise the benefits of electronic filing but also, at the same time, the benefits of web access. As the public becomes more comfortable with the web and security available on the web, taxpayers will be less hesitant to trust e-filing for tax transactions. Since more than 50% of all tax returns are prepared by a professional tax preparer or accountant, IRS must also make the process of electronic filing more advantageous and less complicated for the practitioner. Continual dialogue between the IRS and organizations such as NSA are essential to the ultimate realization of Congressional objectives. Ongoing refinements and improvements can happen if both practitioners and the IRS explore in partnership the underlying reasons for the unwillingness of many taxpayers and practitioners to file their returns electronically. NSA, for its part, is eager to continue discussions on this matter with members of Congress and IRS personnel.

ADMINISTRATION'S FISCAL YEAR 2001 BUDGET REQUEST FOR IRS

Congress sought by means of the IRS Restructuring and Reform Act to provide a more balanced environment in which IRS would focus on both compliance and taxpayer service. The Act directed IRS to revise its mission statement to achieve this balance. In addition, the Act directed the IRS to reorganize its structure by moving away from a geographical, region and district organization toward a structure that focuses on groups of similar taxpayers with unique needs. This directive essentially ended a way of doing business which had existed for nearly fifty years. Since the IRS performs an essential government function, however, it could not be closed down while it was being restructured but must, instead, maintain operational activity at acceptable levels. Some have likened this directive to the task of rebuilding an airliner while it is still flying.

The National Society of Accountants foresees a new era when Commissioner Rossotti has fully implemented the '98 Act and accomplished tangible and visible changes in service, compliance and productivity that taxpayers expect and deserve. Commissioner Rossotti has testified before other committees saying that the IRS will be able to perform all aspects of its new mission more effectively and efficiently, and in line with the best private and public sector practices, by reengineering IRS business practices and IRS technology, which will require only a limited staff increase. NSA believes that Commissioner Rossotti has made excellent progress and that he should be trusted with the additional funding he is requesting. He has assembled an impressive group of top executives to make the four planned customer type/unique need operating divisions a reality. Although some are saying the IRS is now in a position where it is not yet meeting the legitimate service expectations of compliant taxpayers who voluntarily pay their taxes and is letting compliance activity, such as examination coverage and collection enforcement activity, drop rapidly NSA believes it is too early to judge.

Commissioner Rossotti's idea that increased, pre-filing taxpayer education will reduce the need for post-filing examination has not yet been tested. His critics who point to a declining percentage of tax returns examined do not consider that deterrence may not be tomorrow's answer to voluntary compliance. Commissioner Rossotti's idea that increased alternatives for paying taxes will reduce the need for enforced collection measures has not been tested yet. His critics who point to declining IRS seizure statistics ignore the fact that the federal tax lien created by Congress remains in effect against the income and assets of taxpayers who do not pay for ten years. They also ignore Commissioner Rossotti's business-like theories that effective collection practice in the future consists of rapid problem solving intervention with taxpayers before taxes become past due.

Restructuring of necessity involves retraining IRS personnel. NSA understands that some two million hours of training were necessary to acquaint IRS employees with RRA-98's specific administrative provisions. Training will continue to be an expensive challenge in FY 2001 to insure that business practices and strategies are actually changed and that new information technology is instituted. NSA believes Commissioner Rossotti's commitment to continue a high level of training necessary to implement every taxpayer rights provision and make them work as intended while still collecting taxes that are due should be funded fully.

NSA believes that full implementation of the Act's legislative intent will require years of dedicated effort and may require continued appropriation of additional funds to the Service to support Congress's long overdue reform efforts. Oversight by your Subcommittee, other committees who share oversight responsibility, the tax-paying public, and professional organizations such as NSA must, of course continue as to whether additional funds are actually needed and whether the funds are being

used appropriately to accomplish the reforms. While NSA is not prepared to suggest specific dollar amounts which might achieve the continuing reforms, NSA urges this Subcommittee to advocate sufficient resources to support the IRS continuing efforts to carry out its Congressional mandate. NSA believes the increases will mean the 88,000 remaining IRS employees will turn the corner with Commissioner Rossotti and finish re-engineering the IRS. NSA believes the increases will result, for the taxpayers, in an IRS which views the majority of taxpayers as customers whose willingness to pay their fair share deserves quality help and assistance. NSA is confident that the re-engineered IRS providing top quality service to the majority of American taxpayers will also be able to deal decisively with the few taxpayers who do not pay unless forced to do so and the even smaller number of taxpayers who attempt to evade tax by violating the criminal statutes.

IRS RESTRUCTURING

In recent NSA/IRS meetings with Commissioner Rossotti, we experienced a new degree of IRS openness and a new spirit of cooperation. Commissioner Rossotti and his senior management team are open to new partnerships with professional associations such as ours who work for the wellbeing of the American taxpayer. The partnerships they are forging recognize that our members individually and collectively can help, not hinder, them in helping taxpayers comply voluntarily and willingly with our tax laws. It is our view that Commissioner Rossotti and his new staff are working diligently to create the IRS that the American people want and deserve.

Our only concerns with the IRS restructuring and reform program are beyond the control of IRS personnel. Our first concern is that Congress will become impatient prematurely as headline-seeking reporters focus on temporary shortcomings and urge us to return to the overly intrusive tactics of imprudent enforcement. Secondly, NSA is concerned that the delay in confirming members to the oversight board for the IRS is sending mixed signals to IRS employees, tax law practitioners, and the American people. Congress intended the board to help the IRS set and maintain its objectives, including such important matters as its annual budget and modernization program. Further delay or use of the nominees as political footballs will not contribute to accomplishment of the Congressional mandate or create the IRS taxpayers deserve.

NSA is particularly pleased with the progress the IRS has made in implementing a transition from the office of Taxpayer Advocate into the Congressionally mandated National Taxpayer Advocate and the Taxpayer Advocate Service. The change in title accompanied by increased authority and new independence is already being administered effectively.

The Taxpayer Advocate Service has implemented a modernized structure as called for in RRA '98. It is now an independent, modernized organization ready to deliver service to each taxpayer through individual casework and to every taxpayer through systemic analysis. Taxpayer Advocate managers are now in place and the managers are selecting the remaining staff. The new organization establishes a career for Taxpayer Advocate caseworkers to begin working on routine cases. Based upon their skill level, caseworkers can now earn promotions to technical advisors, advocacy analysts, or even Taxpayer Advocates. NSA understands that more than 8,000 IRS employees applied for positions in the new Taxpayer Advocate Service. We applaud this indication of new interest by IRS employees in taxpayer service. The new and dedicated employees of the Taxpayer Advocate Service appear to have taken the new TAS Mission Statement, "We help taxpayers solve problems with the IRS and recommend changes that will prevent the problem" to heart. NSA members report that TAS personnel are enthusiastic in their efforts to assist taxpayers who need help. For many years, the former PRO program fixed problems and made the system better. Personnel with the new Taxpayer Advocate Service appear poised to do even more. For example, the National Taxpayer Advocate recently identified, reported to Congress and made recommendations on the top 20 problems affecting taxpayers. Addressing and managing the changes needed to reduce or eliminate these problems may require significant IRS management attention and may require additional resources.

Finally, NSA would like to join the chorus of praise for the IRS website. The IRS has greatly expanded its web site and continues to provide vast amounts of information to both taxpayers and tax practitioners. IRS forms, instructions and publications are easily accessed. Official forms can be filled-in on line and printed or downloaded blank. The site includes searching features and interactive calculation whereby taxpayers and practitioners can determine acceptable installment payment terms. Another assistance feature is a tax law research site: taxpayers can enter their query in a question box and e-mail it for a prompt IRS reply. For profes-

sionals, the site provides each issue of the Internal Revenue Bulletin and even some portions of the once secret Internal Revenue Manual. There is more information now on the IRS website for a taxpayer who wants to know than there was at one time in an entire IRS office. Experienced NSA members contrast this to the time when "two" was the limit on IRS publications, the comprehensive Publication 17 cost 50 cents, and IRS employees threw out more information at the end of a filing season than they gave out during the filing season.

CONCLUSION

I would like to conclude by thanking the Committee and Chairman Houghton for their leadership and attention to the issues which, when adequately addressed, help the IRS and taxpayer representatives achieve a more effective, efficient, and progressive tax collection system under the law. NSA, for its part, plans to remain an active part of the process and continue helping the IRS achieve its modernization and reform objectives. We are greatly encouraged by the achievements made thus far. Thank you.

Chairman HOUGHTON. Thank you, Mr. Gates.
Mr. Steinbis.

**STATEMENT OF GREGORY H. STEINBIS, ENROLLED AGENT,
AND CERTIFIED PUBLIC ACCOUNTANT, MORGAN HILL, CALI-
FORNIA; AND IMMEDIATE PAST PRESIDENT, NATIONAL AS-
SOCIATION OF ENROLLED AGENTS, GAITHERSBURG, MARY-
LAND**

Mr. STEINBIS. Thank you, Mr. Chairman.

My name is Greg Steinbis. I am from Morgan Hill, California, a suburb of San Jose which is the heart of Silicon Valley.

On behalf of my fellow Enrolled Agents, I would like to thank you and express their appreciation to the Oversight Subcommittee for your annual review and evaluation of the filing season and the IRS budget request.

Over this past tax filing season, you have heard there has not been too much. We have heard that customer service has finally arrived at the IRS. It has a home there. IRS personnel are exceptionally professional now. They volunteer to give their name and their ID number immediately; they are going that extra mile to answer questions and solve problems.

The electronic filing administration continues to receive accolades from the practitioners. Taxpayers are getting their refund checks in much quicker time if it is direct deposit, well within the tolerances posted by the IRS.

There has been a cost for this great success at the IRS and that is because all employees of the IRS, including auditors and highly trained staff, are sitting at the front desks, at the walk-in offices handing out forms and answering tax questions.

What is falling apart, you heard, is that the innocent spouse relief is not being resolved, offers and compromises are being held up, abusive trusts are not being looked at. In fact, there seems to be a new animal out there called LLC where people are putting their houses into the LLC to then write off that house as if it was a rental property just like it was in the old abusive trust.

Our members are voicing concern that the lack of resources will lead to greater noncompliance. As you have heard from the press as well as from my fellow member sitting here, there have been

fewer audits which can only translate into lower compliance, with more taxpayers willing to play the audit roulette, the lottery you don't want to win.

This year, the glitches are few but the IRS has responded quickly and professionally.

What we would like to see is all forms capable of being e-filed. Our members too are starting to fill out those complex returns. By not being able to e-file all forms, there is more paper being filed to the IRS, especially if the IRS is going to meet its 2007 goal of 80 percent of tax returns being filed electronically.

We would also like to see elimination of the two signatures on the 8453. When someone sits home with the telephone and can do a telefile and not have to submit a form, why can't taxpayers who come to my office not have to submit a form? Generally, I only have one taxpayer, either the spouse or the husband there, so the administration in my office of that form becomes very complex.

We need to standardize the 1099. The 1099 dividends are starting to look like W-2s a few years ago. They are not standard. Even though they have the same box numbers, the paper comes in different sizes, the 1099 interest comes in different sizes and the 1099 dividends are being attached to the 1099(b) for brokerage statements. Our tax clients are not sure what they are supposed to bring to their appointment, so we have to send them back home and can't complete the returns in a timely manner.

The IRS budget it very important. Even though the request is more than it was last year, NAEA believes the IRS is in a very critical position during the next several years to respond to some extraordinary challenges that lay ahead. We feel the full budget needs to be there.

What are those challenges—to continue to transform itself into a customer service agency base; to respond to those changes you mandated in RRA 1998; and modernization. Most of us in our practices change our computers every 2 years. Our software requires us to keep on changing our computers.

You wouldn't want a policeman chasing you in a car that was built in 1970 and we don't want the IRS chasing us with a computer built in 1970. So the investment in modernization of computers will eliminate some of the problems you heard about like staffing. The more computers, the more efficient you are and you can balance the people that are needed.

We believe that the budget request of the IRS is a reasonable budget to continue the work you set out for them. It meets the three challenges I described. As professional tax practitioners, we see the results firsthand.

Thank you very much for your time.

[The prepared statement follows:]

Statement of Gregory H. Steinbis, Enrolled Agent, and Certified Public Accountant, Morgan Hill, California; and Immediate Past President, National Association of Enrolled Agents, Gaithersburg, Maryland

Mr. Chairman, Members, staff and guests, my name is Gregory Steinbis and I am an Enrolled Agent and CPA engaged in private practice in Morgan Hill, California, near San Jose. In my practice I work primarily with individual and small business taxpayers.

As Immediate Past President of the National Association of Enrolled Agents, I am very pleased to have this opportunity to present testimony on behalf of my fellow

Enrolled Agents. As you know, Enrolled Agents are licensed by the U.S. Department of the Treasury to represent taxpayers before the Internal Revenue Service. Enrolled Agents, along with attorneys and CPAs, are governed by Treasury Circular 230 in our practice before the IRS. Enrolled Agents were created by legislation signed into law by President Chester Arthur in 1884 to remedy problems arising from claims brought to the Treasury after the Civil War. Today, we represent taxpayers at all administrative levels of the IRS and provide tax preparation assistance as well, thereby affording us a front-line perspective on the administration of our nation's tax laws. There are approximately 35,000 Enrolled Agents, more than 10,000 of whom are members of NAEA. Each year our members work with more than 5 million individual and small business taxpayers.

On behalf of my Enrolled Agent colleagues, I would like to express appreciation to the Oversight Subcommittee Chair, to the Members and staff for your annual review and evaluation of filing season and the IRS budget and operations. We believe you are making an invaluable contribution to improving our system of tax administration by regularly scheduling these hearings. They offer an opportunity for the practitioner community to share its views and an occasion for the IRS to provide information on its needs. This hearing is an annual benchmark against which we can measure accomplishments, highlight problems and seek remedies.

Mr. Chairman, you are to be commended for taking a fiduciary interest in the management of the IRS. In the advisory announcing this hearing, you asked the questions: Why does the IRS need such a large increase in resources? What does this increase mean for the IRS and what will be its impact on the American taxpayer? From the perspective of front line tax practitioners, we hope to respond to your questions in our testimony.

2000 FILING SEASON REPORT CARD: AN OVERVIEW

As we have done in the past, NAEA has kept in touch throughout filing season with our members. Through our online communications and surveys, we have gained insight as to what Enrolled Agents, as front line practitioners are seeing. Our members have told us that this has been an extremely smooth filing season so far as IRS operations are concerned. The glitches—the few that have occurred—have been minor.

In terms of IRS operations, there are several successes we would like to bring to your attention. Customer service seems to have found a home at IRS. IRS personnel have been exceptionally professional in their demeanor over the telephone this filing season. Members report that IRS employees automatically provide their name and an identification number. They ask how they may help sincerely and enthusiastically and go the extra mile to answer questions or solve a problem. The following two statements are typical of the scores of messages we received commenting very positively on IRS personnel this filing season:

“Aside from filing season, there is one thing I would like to get out. And that is the Tax Practitioner Hotlines and especially ours in Jacksonville, Florida. This is one of the best actions from my perspective that IRS has ever taken. The people in our office are all very knowledgeable, most helpful and eager to be helpful. I really enjoy working with them. The other day I had reason to speak to the Hotline in Ogden, UT. The gentleman there was just like our group in Jacksonville, very helpful and knowledgeable. I hope that the Hotlines continue.”

“[The] Northern California Practitioner Hotline has been very helpful in getting us information on a new corporation. The response would have taken 2–3 weeks in the old days. We had our response in 2 hours with a critical filing deadline approaching.”

NAEA members are increasingly comfortable with the modern technology IRS is using and would like to see it available in more applications. For example, requests to NAEA for copies of federal and state tax forms have declined markedly as our members shift to using the IRS CD-ROM which is sold for less than \$20 through the Commerce Department's NTIS or to the IRS web site where forms and publications can be downloaded easily 24 hours a day, 7 days a week.

Our members also find useful the IRS *Help with Tax Law Questions* site which enables practitioners and taxpayers to send the IRS questions by e-mail and receive a reply by e-mail, often within a day or two. This year the replies include the name and identification number of the researcher, along with a 1–800 telephone number. Very customer friendly.

The IRS Electronic Tax Administration (ETA), responsible for advances in e-filing, continues to receive accolades from practitioners for the smoothness of this year's e-filing operation. Members report that clients are receiving their refunds well with-

in the tolerance posted by IRS. Practitioners like having access to error codes to figure out what went wrong on an e-filed return.

A typical, enthusiastic reply to the success of e-filing this season: "I got a call this morning from a client who asked if a \$1,000 deposit to her checking account could be her federal tax refund. I checked the file and the figure she had was the same as her tax refund. I e-filed her return on March 8. It was in her account on March 16. That is fantastic!"

From a Maryland practitioner, "Electronic filing is stunningly successful. People are suddenly more interested. I appreciate the efforts of the Service to further shorten the delay between e-filing and the direct deposit of the refund."

Last season, we told you that the Treasury Offset Program for non-tax debts such as child support and student loans was poorly handled, disorganized and dysfunctional. This filing season we are hearing that it is providing quick, courteous service.

This year, more taxpayers than ever have turned to paid preparers to assist them in the completion of their tax returns. Our members report business up anywhere from 10% to 20%. Many report working 14 hours a day and 7 days a week. Some advised that by March 15 they were considering putting clients on extension because they knew they wouldn't make the April 15 deadline given the volume of work.

Our members report that, where there have been declines in business, it is because taxpayers are using software to do their own returns. Clients who used to do their returns at home and then bring them in to be checked and e-filed are now skipping that process and e-filing them directly themselves. Where taxpayers do bring their returns in to be checked our members find that they may not take all the deductions or credits to which they are entitled because they are not as familiar with the tax code as someone who is a tax professional. More often, our members find they are handling the more complex tax returns. The easy ones are being done at home.

Our members tell us that while the tax season has been remarkably smooth, it is because IRS is using every available employee to get the filing season work handled in timely fashion. Auditors and other highly trained staff are sitting at front desks in walk-in offices, handing out forms and answering taxpayer questions.

However, these improvements in filing season operations come at a price. As one exasperated California EA put it, "What is wrong with the IRS? I have three offers in compromise that have taken over a year to work. . . no word from San Jose district about them except when I call. I find they have been reassigned and a new Form 656 must be filed. They are overwhelmed with the numbers of OICs coming in. They can't work them. Needless to say, this is putting the clients in a precarious position."

A Massachusetts EA writes, "I've got two requests working for Innocent Spouse relief. Each time I follow up on them I'm told that 'we're swamped and have a huge backlog.'" The EA continues, "Is this true?" Unfortunately, it is. More than 46,000 innocent spouse cases wait to be worked.

An Oregon EA writes, "A problem I've encountered this filing season involves the collections department. I have a corporate client that owes over \$300,000 in payroll taxes to the IRS. We are in the process of obtaining financing and needed subordination. The tax collection officer assigned to our case was also required to spend most of his time at the downtown office of the IRS—handing out forms and assisting taxpayers with their filing questions. This meant he was only in his own office one morning a week. I estimate this delayed our financing by approximately three weeks. This is a highly skilled officer whose expertise was essential to the process of keeping my client in operation. I question the use of his time in this way."

From Washington State: "It still takes too long to get an Offer in Compromise through. I have one OIC that wasn't even assigned to an OIC specialist until 5 months after I was notified that the package was processable."

A Florida Enrolled Agent comments, "IRS needs well trained personnel in sufficient quantities to do the job and that requires adequate funding. As we can all attest, it takes years to become really conversant with the [tax] Code and able to handle inquiries quickly and correctly. As long as Congress wants to use the Code to handle social problems such as stimulating the economy, helping the poor, promoting education, etc., they must be willing to provide the resources to handle that complex task."

Finally, some of our members are voicing concern about the lack of resources leading to greater noncompliance. As a Texas Enrolled Agent wrote, "The public is becoming aware that there have been very few audits. This can only translate into lower compliance. The audit rate needs to increase back up to [a respectable level]."

Ours is a tax system based on voluntary assessment. If we are to maintain compliance, taxpayers in every income bracket must have confidence in the integrity of the system.

THE GLITCHES

This year, the glitches are very few. We have heard about sporadic telephone overloads and occasional problems with e-filing when too many returns were submitted. Members whose clients are turning from paper returns to e-filing are having to contend with the inevitable glitches—names that don't correspond precisely to what the Social Security Administration has on file, taxpayers who have failed to provide SSA with a name change when they married, and so forth. Inevitably, these problems would have to be resolved anyway. Our members advise their clients that it is better to do so now rather than wait until retirement, death or disability.

Empty boxes

Every year there is a new glitch. This year, we have had reports of problems where clients had a Form W-2 with nothing in box 1 but sick leave pay, which was stated, in box 13. Due to box 1 being empty, the electronically filed return was rejected. Paper returns were filed instead.

Form 5500EZ

Coordination between federal agencies can be difficult. Last year practitioners experienced difficulty with the Treasury Offset Program. This year, it's coordination between the Department of Labor and IRS involving Form 5500EZ, which provides reporting of certain types of pension plans. While technically not a filing season problem, it has increasingly been handled during filing season.

Since 1994 tax practitioners have had to alert their small business clients to the requirement to file Form 5500-EZ for their one-participant (Keogh) plans that held more than \$100,000 at year-end. The \$25 per day penalty (up to \$15,000) is an attention-getting incentive to motivate them to file, even though the filing requirement itself is not well publicized. The return isn't due until the end of July for calendar year taxpayers, however many practitioners have trained their clients to include the information in their tax prep folders so that it can be addressed routinely as they prepare their tax returns.

The 5500EZ has never been an easy form to integrate into a regular practice since many software vendors did not support it. This year it appeared to be almost mission impossible, yet even more sole-proprietor, small businesses need to file it because of the asset growth in the stock market. Since it was not included in the tax pros' super forms disk, one of our Members accessed the IRS web site and quickly discovered why. "Form 5500-EZ has been revised to take advantage of a new computerized system that will process the form ("EFAST"). The new form is printed on special paper with green dropout ink. Filers were advised that they should not substitute a reproduction of these machine-readable pages. A copy of the hand-printed form is available in Package 5500-EZ. The instructions refer taxpayers to the IRS web site, "How to Get Forms and Publications" where they would discover they could not download the form for use anyway.

We are pleased to report that once alerted to the problem, the IRS Office of Public Liaison responded quickly. Through e-mail messages to practitioner groups, they advised that the forms had been revised, that Package 5500 and Package 5500 EZ had been mailed to all filers of record beginning the last week of February 2000 and that these packages contained the necessary computer-scannable forms and schedules. They also advised where the green ink forms could be obtained 24 hours a day, 7 days a week, by calling 1-800-TAX-FORM (1-800-829-3676).

It is our hope that this marks the end of the Form 5500EZ debacle. However, without the outreach to practitioner groups done by IRS in recent years, the word could not have gotten out and the problem could not have been resolved. Technology and personnel made the difference.

THE WISH LIST: IMPROVEMENTS FOR NEXT FILING SEASON

All Forms Can Be E-filed

For the fourth year in a row, we bring to your attention the dilemma of tax practitioners who would be willing to convert their operations completely to e-filing but who are still finding too many forms which cannot be filed electronically. NAEA understands the priority the IRS gave to ensuring its computer systems were Y2K compliant. With that problem behind us, it's now time to focus on bringing all forms online. It is particularly important if IRS is to meet the goal of 80% of tax returns

filed electronically by 2007. If this is to happen, IRS must pick up a very substantial portion of tax returns done by paid preparers.

Eliminate the Requirement of Two Signatures on Form 8453

There is a disconnect between reaching a goal of 80% of returns e-filed and requiring original signatures on Form 8453 before a return is e-filed. We are pleased that through pilot programs this year IRS is attempting to resolve this issue. They include a PIN pilot under which taxpayers use a PIN instead of a signature to verify their tax return. While practitioners and taxpayers appear ready to embrace the technology, this is still a cumbersome approach.

Standardize the Form 1099

Practitioners need the IRS to require a standardized Form 1099. Our members tell us that the proliferation of 1099s is very confusing to taxpayers and contributes to stress for practitioners during filing season. As an EA from New York observed, "Two forms—1099-DIV and 1099-B—appear on standard size pages, legal size pages, 12 by 12 inch pages. The information is late. The information is less correct this year than in prior years." In an era of computer generated forms, there is no excuse for nonstandardization. We will leave aside, for now, the issue of accuracy which the Commission on Restructuring the IRS considered. Among the solution, extending filing season for another few weeks.

Simplify the Earned Income Credit

EIC remains a morass of complexity burdened further by fine distinctions that only King Solomon could reconcile. The personal nature of the questions practitioners may be required to ask EIC clients to avoid penalty are off-putting, to say the least. We are hearing of more and more practitioners who are simply turning away EIC clients.

Incentive Stock Option Publication

The taxpaying public and tax practitioners would benefit from one clear publication on how the IRS wants incentive stock options treated, particularly when the alternative minimum tax applies as well as when it does not.

Complete Tax Legislation Early

While it may seem frivolous to mention it, delayed Congressional action on pending tax legislation creates enormous problems for the IRS, for software vendors who provide the software used in tax preparation, and for practitioners and taxpayers who need forms and instructions in order to complete the tax preparation process. We would respectfully request that every effort be made to complete legislative action over the summer so that adequate time and attention can be given to these important functions in order to ensure a smooth filing season.

THE IRS BUDGET

Congress has done much in the last several years to transform the IRS into a modern, customer-focused agency. The National Commission on Restructuring the IRS, and the subsequent legislation, the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), both addressed this vision for the IRS and put the IRS on a path towards achieving this vision. Our members in the field tell us that progress is being made, but clearly much more needs to be done.

Even though the requested FY 2001 budget of \$8.9 billion is \$795 million than the FY2000 budget, NAEA believes that the IRS is in a very critical position during the next several years as it responds to some extraordinary challenges, and the full budget is needed to meet these challenges. The first challenge is to transform itself in an agency that has a customer-service focus. The IRS has worked to achieve this transformation through a massive reorganization into four customer-oriented operating units. This reorganization has been thoroughly planned and is now being implemented. IRS needs the funding to carry it through to completion.

The second challenge facing IRS is to respond to the legislative mandates of the RRA 98. Congress is to be commended for passing such sweeping legislation that provides taxpayers with more rights. However, the IRS needs funding to be able to implement the new provisions into its operating procedures and systems. Without this funding, the new provisions will not deliver the benefits to the taxpayer that Congress expected.

The third challenge facing the IRS is modernizing its antiquated computer systems. Much attention has been focused in the media recently on the decreasing IRS resources dedicated to compliance. The proposed Staffing Tax Administration for

Balance and Equity (STABLE) program will resolve some of these issues by increasing IRS staffing levels by 2,835 Full Time Equivalent (FTE) personnel, half of which would be assigned to customer service and half to compliance. Until the IRS computer systems are modernized, however, the IRS will face the constant dilemma of balancing resources between customer service and compliance. The investment in modernized computer systems will eliminate the need for this balancing act by providing IRS workers the data they need when they need it. Particularly with the successful passage into the new millennium and eradication of the Year 2000 (Y2K) computer problem, now is the time to move forward aggressively on modernization. Your support is needed to fund both the business systems modernization program, which provides the necessary long-term technology solution to customer service and compliance problems, and the STABLE program, the immediate remedy to these problems.

The NAEA believes the request for fiscal year 2001 is a responsible budget for continuing the work the IRS has begun. NAEA has testified to both the National Commission on Restructuring the IRS and Congress on the necessity for modernizing the IRS, and believes strongly that the three challenges described must be met. As professional tax practitioners, we see the results first hand. For example, cuts in compliance programs delay resolution of tax cases, and cost taxpayers more in interest and penalties. The challenges the IRS must resolve are serious, so serious that failure to meet them will undermine the entire tax collection system. Cutting the budget at this time makes it more difficult for IRS to succeed.

CONCLUSION

In our view, the management team now in place at IRS, led by Commissioner Rossotti, has demonstrated its ability to get the job done. We believe IRS is making significant progress. We are getting results—whether it is the smooth filing season, the emergence of customer service programs such as Problem Solving Days, or a new appreciation for the taxpayer as customer. Our members and their clients are pleased with the changes they are seeing in the restructuring. However, as the reorganization continues, we respectfully urge you to give IRS the support it needs to conclude this endeavor.

Chairman HOUGHTON. Thank you, Mr. Steinbis.

Mr. Coyne.

Mr. COYNE. I would like to ask this generally of the panel. The IRS has spent a lot of its resources in an outreach program to practitioners. I was wondering if you could comment on how this has helped or has not helped your members?

Mr. GATES. It has helped tremendously. Twenty-five years ago, the Internal Revenue Service would not talk to practitioners. We were the enemy, we represented the taxpayer, we were adversaries, so why give away any secrets. It took a Supreme Court case to get the Internal Revenue Manual away from the Internal Revenue. They didn't want anybody to see it. Practitioners could not understand what their internal workings were like, they only had access to the Code but didn't have any internal operating procedure knowledge.

The IRM was wrested away by a Supreme Court case. As a result, the Service got much more free, now that they had to, with their inner workings. They began publishing more pubs, they began sharing portions of the Internal Revenue Manual and handing it out.

That made it easier for us to do our job and they finally realized maybe we weren't the enemy, that we were active players in the tax administration system and contributing to the greater good.

As they began to think that was true, they became more and more generous. I think Commissioner Rossotti realized the truth of

what I am saying because he has accelerated all of that. There are not going to be districts anymore, but the people who are going to become the area and territory managers are getting clear instructions that they are not only to send out publications, instruction sheets and share materials, but are to actively conduct classes, briefings, anything necessary to get the practitioner up to absolute full speed so that we can help do the job. So they have done an outstanding job in that area.

Mr. COYNE. I wonder if your positive response to the general idea outreach by the IRS extends to the EITC educational outreach activities on EITC?

Mr. GATES. That is a very, very difficult one because of necessity. An earned income tax recipient is not the best client in the world, so a lot of people take a lot of pride in saying I don't have to know anything about the earned income tax credit because none of my clients are eligible for it. So, since it is of necessity for low earnings people, the quality of people that are trying to help them with their tax returns is not necessarily as high. When it is not as high, the probing to see if they are really qualified for it can stop pretty early.

In addition, in certain parts of the country, certain areas, a practitioner knows the truth is being withheld, that only enough information is being given to appear eligible. Once getting around those two shortcomings, then you have the unbelievable complexity, if it is not straightforward.

A straightforward, eligibility case is very easy but if they are in a multiple household where there are three families living, perhaps one is unmarried with children and one is a bachelor with high income, trying to sort through the complexity to find out whether they are eligible or not can be mindboggling.

With the Service reacting to the lack of diligence in this area, the preparer will then, on top of this, it is so difficult and so complicated, think, if I mess it up, I am going to have a due diligence charge against me, so there is a tendency then to back off and say I don't want anything to do with this because it can be a nightmare.

The poor people who are questioned come in and don't understand what the IRS revenue agent is asking for. You want statements from my principal where he goes to school, he wants this, he wants that. The laundry list of what you have to do to substantiate a questioned earned income tax claim is unbelievable.

The Service only has so much time, they dispose of these cases relatively rapidly with a determination that, no, you are not eligible, or worse, you did not bring in all the substantiation that is required in the time we have to give you. Then this puts them in a situation where they are told they can go to appeals. This level of people do not know the IRS appeals procedures. So they use up their time. They only have 30 days to decide whether they want to take advantage of their appeal rights or not. They lose their time, they get discouraged, they don't respond and the Service does the only thing it can do, it issues a notice of deficiency which now requires the taxpayer to submit a petition to the United States Tax Court before they can be given any further consideration.

Even though this only costs \$65 and the Court is very generous in that they will take a petition literally prepared on toilet paper, they don't hold the people back, but imagine the formidable idea of a United States court trial over this matter. The number of people who go on from there even if they could fill out a petition, never go to trial.

The revenue officers get the collection cases and then the Service is left to deal with this tax liability that they shouldn't have to pay.

Mr. COYNE. Thank you.

Chairman HOUGHTON. If I understand what you are saying, Commissioner Rossotti is doing a great job, probably the best job that has been done around there for a long, long time. The procedures are good, the attitudes have changed, there are suggestions to be made, and you think the increase in the budget is right. Yet I would like to ask some questions.

Ms. Pflieger, this is something we have worried about here. You said on page two of your testimony, "The current lack of enforcement is of grave concern to our members who see on a day to day basis the impact it has on the attitude of taxpayers." Do you want to elaborate on that a little bit?

Ms. PFLIEGER. Yes. An example would be someone who says: "I read in the papers that audit rates are at an all-time low and there is a real good chance I am not going to be audited with respect to this return, so, instead of claiming the \$600 of charitable contributions that I would be entitled to, I am going to put down \$1,800. I am never going to get caught." That is the type of concern that we certainly have when low audit rates are so well publicized.

Likewise on the collection side, when it is so well known that the IRS is not going to come in and levy or place liens on certain pieces of property, a taxpayer might say: "Well, yes, I owe the IRS money but who cares, it is not going to do anything to collect that tax."

Again, I think the real concern is not just that we are losing the specific tax dollars attributable to those taxpayers but rather that, that attitude will spread across the American tax paying public and undermine our voluntary tax system.

Chairman HOUGHTON. Our counsel has indicated that half of the 2,500 new people would be on the enforcement side. Do you think that will be sufficient now? Once you get that attitude eroded, it is very hard to get it back.

Ms. PFLIEGER. I think it depends on how well publicized that increase is. I am not here saying I want to go back to a mean, nasty IRS. I think the Commissioner has come a long way in making the IRS, if not kinder and friendlier, certainly a fairer and more interested organization, but I think if the enforcement mechanisms are put there and are publicized, then yes.

It would be wonderful if we could give the Commissioner billions of dollars, but we cannot. So I would hope that with increased support and appropriate publicity, he could do what he needs to do.

Chairman HOUGHTON. Mr. Gates, you remember I interrupted you during your testimony about whether the IRS should be involved in certain dollar returns and things like that? Do you want to elaborate on that a bit?

Mr. GATES. The interesting thing, the earned income tax credit, when Congress passed it, some people even said is this not a form

of welfare because it is actually distributing money in the form of a tax credit which, to a certain extent, might be the same thing as giving money and questioned whether or not the Internal Revenue Service should even administer a program like that since they have been a collecting agency.

The Service in early examinations of earned income tax credit eligibility, many agents said I don't know why I am even involved in this but it is my job and I am going to do it. They are trained to apply a very stringent Internal Revenue Code to the facts.

People who get earned income tax credit don't generally have lives that can stand that kind of precise scrutiny. So we revisited that question with a member of one of the IRS citizens advisory panels that has been convened pursuant to the administration's response to the restructuring effort, particularly the one in New York. The chairman of that Committee talked about what they do their problem solving days and invite people from the community to talk to them and so forth. He talked about the tremendously high percentage of earned income tax difficulties that people from Manhattan and the low income of Brooklyn and so forth bring to them and the frustration they feel in being unable to even come up with a way of changing the law, changing the rules, changing anything else because it is so difficult for that segment to understand complex law.

Chairman HOUGHTON. So it is just a matter of questioning the ability of the IRS to handle something like this?

Mr. GATES. Indeed. I found it interesting that this fellow who is on the citizens advisory panel because he represents some multiple of 60,000 to 70,000 people in New York who are trying to raise the standard of housing in the boroughs of New York, represents the very people that quite frequently are eligible for this.

When he considered the concept of maybe this is being administered by the wrong agency, it was like a light bulb went off, and he began to wonder if that wasn't right, if there wasn't a better way to accomplish the objective than to have the Internal Revenue Service administer it like a tax law.

We came to the conclusion if this Committee wanted to hear that and give it any thought, it might do so.

Chairman HOUGHTON. Mr. Steinbis, I have one final question. You and your members are on the frontlines in the effort to comply with the tax law. Based on the experience of your members, what do you believe should be done to simplify the tax law? Have you any general comments you would like to make on that?

Mr. STEINBIS. A lot of people would like to get rid of it but the easiest one would be to standardize all the limitations. You have the different cutoffs for standard deductions, the AGI limitation on standard deductions is different than the AGI limitation on IRAs or regular IRAs. There are 18 different cutoffs. Standardize those if you are going to continue to use the Tax Code in the manner it is being used. At least standardize those.

Chairman HOUGHTON. Anything else? It is the cancer of the tax system.

Mr. STEINBIS. AMT, the alternative minimum tax, has to be modified in some way. We had a press conference today to show the

complexity of AMT. Like Bryan said earlier, it is picking up more people into the system.

All of a sudden a gentleman has this phantom income, didn't receive any money but he owes \$50,000 in tax. What does he do? He has to sell it now to pay some of that tax. Some of that tax will be carried over into the future when he starts to sell in the future. So AMT needs to be adjusted and the limits need to be raised. That would be another one to make it simple.

Chairman HOUGHTON. Thank you very much. We certainly appreciate your input. If there is anything else, you can send it to us in writing. If we have other questions, we will ask them of you.

Thank you so much for being with us today.

The hearing is concluded.

[Whereupon, at 3:36 p.m., the hearing was adjourned.]

