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OVERSIGHT OF THE INTERNAL REVENUE SERVICE: THE COMMISSIONER REPORTS

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

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OVERSIGHT OF THE INTERNAL REVENUE SERVICE: THE COMMISSIONER REPORTS

MONDAY, APRIL 10, 2000

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn, Walden, and Turner.

Staff present: J. Russell George, staff director and chief counsel; Louise DiBenedetto, GAO detailee; Bonnie Heald, director of communications and professional staff member; Bryan Sisk, clerk; Ryan McKee, staff assistant; Michael Soon, intern; Trey Henderson, minority counsel; and Jean Gosa, minority assistant clerk.

Mr. HORN. A quorum being present, the Subcommittee on Government Management, Information, and Technology will come to order.

The only contact that most taxpayers have with the Internal Revenue Service is when they file their annual income tax return. Now, 1 week before the deadline, many taxpayers are frantically focused on gathering the year's worth of documents and receipts needed to verify the accuracy of their own tax return.

Taxpayers should expect prompt, quality service from their Government, especially from the agency that collects their money, but over the years critics have bitterly complained about the agency's rude service or lack of any service at all, and I believe times have changed quite a bit now.

The IRS has come under fire for everything from its failure to assist taxpayers in preparing and filing their tax forms to ensuring that all taxpayers pay their tax obligations. The IRS had, indeed, become the Federal agency that everyone loved to hate.

The public told the tax agency that it expects better services, and on July 22, 1998, Congress passed and the President signed the Internal Revenue Service Restructuring and Reform Act. Their message to the Internal Revenue Service was clear: there must be a fundamental change in the way it conducts business. The Internal Revenue Service must not only collect taxes; it must provide quality service to the people who pay those taxes.

The law demanded that the Internal Revenue Service shift from its self-defined role as an enforcement agency toward a role that more resembles a financial service organization.

Internal Revenue Service Commissioner Charles Rossotti has taken that message seriously. He is responsible for planning and implementing the most fundamental changes in the IRS in nearly half a century.

A few weeks ago, the commissioner testified before another House subcommittee stating that the IRS is "wholly committed to implementing each and every taxpayer's rights provision and making them work as intended, while still fulfilling the mandate to collect taxes that are due."

Some people are now concerned that the agency has become so user friendly that it isn't collecting enough of the tax money that is owed. In a recent hearing before this subcommittee, we learned that taxpayers owe the people and the Treasury $231 billion in overdue taxes and penalties. We recognize that this is an enormous undertaking filled with both short-term and long-term challenges.

We welcome each of our witnesses today and look forward to discussing the agency's progress and challenges and how they are affecting the American people and the Internal Revenue Service workers.

I might say, Commissioner, I'm very pleased with the willingness of the IRS workers to come to our District office to set up phones, to have hundreds of constituents go there and electronically file for the first time, in most cases, to those constituents. We hope down the line that we will all be sensitive to filing in time, and that would help get the refund, if they had one, and it would also be simpler than most people now have to go to.

[The prepared statement of Hon. Stephen Horn follows:]

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"Oversight of the Internal Revenue Service:
The Commissioner Reports"
CHAIRMAN STEPHEN HORN (R-CA)
OPENING STATEMENT
April 10, 2000

A quorum being present, the Subcommittee on Government Management, Information, and Technology will come to order.

The only contact most taxpayers have with the Internal Revenue Service is when they file their annual income tax return. Now, one week before the deadline, many taxpayers are frantically focused on gathering the year's worth of documents and receipts needed to verify the accuracy of their tax return.

Taxpayers should expect prompt, quality service from their government, especially from the agency that collects their money. But over the years, critics have bitterly complained about the agency's rude service, or lack of any service at all. The IRS has come under fire for everything from its failure to assist taxpayers in preparing and filing their tax forms to ensuring that all taxpayers pay their tax obligations. The IRS had, indeed, become the federal agency that everyone loved to hate.

The public told the tax agency that it expects better service. And on July 22nd, 1998, Congress passed and the President signed the IRS Restructuring and Reform Act. Their message to the IRS was clear: There must be a fundamental change in the way it conducts business. The IRS must not only collect taxes; it must provide quality service to the people who pay those taxes. The law demanded that the IRS shift from its self-defined role as an enforcement agency toward a role that more resembles a financial service organization.

IRS Commissioner Charles Rossotti has taken that message seriously. He is responsible for planning and implementing the most fundamental changes in the IRS in nearly a half century. A few weeks ago, the Commissioner, testified before another House subcommittee, stating that the IRS is "wholly committed to implementing each and every taxpayer rights provision and making them work as intended, while still fulfilling the mandate to collect taxes that are due."

Some people are now concerned that the agency has become so user friendly that it isn't collecting enough of the tax money it is owed. In a recent hearing before this subcommittee, we learned that taxpayers owe $231 billion in overdue taxes and penalties.

We recognize that this is an enormous undertaking, filled with both short-term and long-term challenges. We welcome each of our witnesses today and look forward to discussing the agency's progress and challenges, and how they are affecting the American people and IRS workers.

We welcome our witnesses, and look forward to their testimony.

Mr. HORN. So I now yield an opening statement to the ranking member, Mr. Turner, the gentleman from Texas.

Mr. Turner.

Mr. TURNER. Thank you, Mr. Chairman.

After having worked on my tax return yesterday, I hope I am in a good mood here to visit with the commissioner.

We do appreciate the commissioner being here this morning. As we all know, your agency is responsible for the very difficult task of administering and enforcing the internal revenue laws and related statutes.

Your mission is to collect the proper amount of tax at the least cost to the public and in a manner that warrants the highest degree of confidence in the Service's integrity, efficiency, and fairness.

We know the IRS has been subject to many studies and congressional inquiries and much criticism. Congress and others have identified a long list of problems, including inadequate technology, poor services to taxpayers, violation of taxpayers' rights, failure to follow established procedures, and lack of adequate employee training and resources.

This concern led the Congress to pass the IRS Restructuring and Reform Act of 1998. This law included many provisions to enhance taxpayer rights and to fundamentally reform the IRS.

To achieve these goals, the IRS plans to make fundamental changes on virtually every front. The IRS has referred to this process as "modernization," because it involves building on the essential components that have made the IRS successful in the past, while bringing them up to date in a way designed to achieve the new mission.

We are here today to assess the progress the IRS has made in implementing its modernization changes. This subcommittee wants to ensure that all Federal managers are given the necessary tools and incentives to perform effectively and to be held accountable for their job.

We welcome the commissioner this morning and I commend you, Commissioner Rossotti, on your leadership. I commend the employees of the IRS in your efforts to become a better agency. When I came to Congress 3 years ago, the IRS had an image that was less than desirable. Since that time, with the new legislation and the efforts you have made, I am confident there has been significant progress toward the goal of providing the type of high-quality service that the taxpayers of this country expect and deserve.

I appreciate the leadership you have brought to the position, and I look forward to hearing your testimony this morning.

Thank you.

Mr. HORN. As you know, Commissioner, and the others that follow you, we swear in all witnesses before this committee, so if you would raise your right hand we will swear you in.

[Witness sworn.]

Mr. HORN. Thank you. Also, as I think you know since you are a regular here, your full statement goes in the record right now, so we would appreciate it if you could summarize it and then we will have more chance for dialog.

Thank you.

STATEMENT OF CHARLES O. ROSSOTTI, COMMISSIONER, INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY

Mr. ROSSOTTI. Mr. Chairman and Mr. Turner, we think the IRS is following the clear direction of the Congress in the IRS Restructuring and Reform Act. As both of you noted in your opening statements, this involves some of the most significant changes in organization, technology, and, most importantly, the way we serve taxpayers.

We are already witnessing some positive results. These include the implementation of the 71 taxpayer rights that were in the act, improved hours and improved phone service, and more electronic filing in this current season.

Just to note some statistics, we expect to receive 127 million individual returns this season, and electronic filing is up 16 percent over last year, so we will get about 34 to 35 million returns electronically.

Our level of telephone service overall is about 63 percent this year, which is still way too low, but is up a lot from the 50 percent or so from last year.

And for the whole year, we expect to collect $1.67 trillion in net receipts for the Treasury.

Of course, all of this has been done after the completion of the enormous program to fix the Y2K program, which I am pleased to say was accomplished almost flawlessly.

Just going back for a moment to Y2K, I think that this success was achieved due to comprehensive planning and preparations over a significant period of time. Mr. Chairman, we are most grateful for your guidance and assistance which you provided over that entire period. We think your leadership was a critical component of our success.

Mr. HORN. Thank you very much.

Mr. ROSSOTTI. Despite some of these signs of progress, Mr. Chairman, we have to say honestly that today the IRS does not meet all the legitimate service expectations of the vast majority of compliant taxpayers, and at the same time our compliance activities, such as exam and collections, continues to drop.

Further, as GAO has pointed out, many of the systems we use to manage and account for the $1.67 trillion in tax revenue are inherently deficient.

These are severe problems, and if they are not addressed they will certainly, over time, undermine the fairness and perhaps even the viability of the Federal tax system. But these problems are not newly identified, nor do I believe that they are impossible to solve. In fact, I believe we now have employees at the top level plans that will allow us to address them.

We have implemented the taxpayer rights provisions of RRA. We have completed a new system of balance performance measures, and our reorganization, which is aimed at increasing customer focus and management accountability, is progressing rapidly and we have a new top management team in place.

Building on this foundation, we are now beginning the longer-term program of re-engineering all of our business practices and technology so that we will be able to deliver on the RRA's man-

dates for improved service and taxpayer treatment, while also increasing fairness and compliance effectiveness.

As these new management and technology practices become established, we can also improve efficiency. However, to succeed in this enormous program, we do need adequate budget resources in fiscal year 2001 to address critical operational needs in the short run and to invest in new technology for the long run.

The rapidly expanding economy continues to increase the IRS's workload. For example, since 1993, the number of individual tax returns of over $100,000, which are generally the more-complex returns, have increased by 63 percent, but, because of budget constraints, the IRS staff has dropped by 17,000 personnel, which, as shown on the chart at your left, shows the workload going up, the staff going down.

On top of these general trends, as shown on the second chart which is going to be put up there, certain specific provisions of RRA, alone, have required about 4,500 additional personnel to administer. Those are just listed by code section there, an estimate of personnel.

Now, since our compliance personnel, those that do exams and collections, represent the largest component of the IRS budget, they are also the ones that administer these RRA provisions. Our net front line compliance staffing has declined quite rapidly, which is shown here in this red line on the third chart. So I think we can see that, as a result of these resource declines and the pervasive change in the way the business has done, there has been not only resource declines but some uncertainty, confusion, and a great deal of relearning among our employees and managers, and this, combined, is the reason that, overall, the number of exam and collection cases we have been able to complete has declined about half since 1997.

To address these operational problems, we have requested an increase in staffing in the 2001 budget which would provide for about 2,800 FTEs and would allow us to rectify some of the shortages that have developed over the last 2 years, and that would be one component of the budget.

This staffing increase increment will allow us to meet some critical short-term needs while we transition to the more-efficient structure and re-engineered technology, which is the second key needed in our fiscal year 2001 budget and, as you have pointed out many times, Mr. Chairman, is really the long-term solution that we need to get to.

Clearly, we depend on our computer systems to administer the tax system and to properly collect and account for our $1.8 trillion of tax revenues.

We have submitted our plan for re-engineering our systems in some detail, and they are included in my written testimony and in the funding request that we have made to the Appropriations Committees.

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

These include a single, centrally managed information systems organization, a very active top-level governance process, adherence to architectural, technological, and methodological standards, use of the prime contract to manage development and integration activities, and, most importantly, an unwavering commitment to an open process that includes outside oversight agencies such as GAO and OMB.

Now, although we have put in place most of the necessary elements, I do want to stress, Mr. Chairman, that it will take time and practical experience executing projects for our management process to mature.

I would like to call the subcommittee's attention to a fourth chart, which is about to be put up on the screens, which shows what I would consider the normal pattern by which we would expect our management process to mature over time if we are successful.

Based on my experience in the industry, if we were to achieve the kind of growth rate depicted on this chart, it would actually be a quite rapid rate of growth in maturity of our management process, and within 1 to 2 years I think it would put IRS in a top category of institutions managing large technology programs.

Since this maturity process necessarily depends on practical experience, one of our most important responsibilities as top managers is to adjust the level of activity we are managing to that which is appropriate to the level of management capacity we have at any point in time. We have already seen this process in action as we have unhesitatingly revised some initial proposals to slow down some projects and rearrange others to ensure that management and architectural issues were adequately addressed.

On the other hand, I also have to stress that there is no way to achieve maturity in the management process without practical experience actually executing projects.

So, Mr. Chairman, I believe we are making real progress in the goals and mandates of the Restructuring Act. I believe, if Congress will continue to provide us the support for IRS modernization, which includes acting favorably on our budget request, we will be able to produce the most visible, tangible changes in service, compliance, and productivity that America's taxpayers expect and deserve.

Thank you.

Mr. HORN. Thank you.

[The prepared statement of Mr. Rossotti follows:]

April 10, 2000

Statement of

IRS Filing Season

Charles O. Rossotti

IRS Restructuring Act

Commissioner
Internal Revenue Service

Before the

IRS Budget

House Committee on Government Reform
Subcommittee on
Government Management,
Information and Technology

IRS
Department of the Treasury
Internal Revenue Service
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TESTIMONY OF
COMMISSIONER OF INTERNAL REVENUE
CHARLES O. ROSSOTTI
BEFORE THE
HOUSE COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON
GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY
HEARING ON IRS FILING SEASON, IRS RESTRUCTURING ACT AND BUDGET
APRIL 10, 2000

Mr. Chairman and distinguished Members of the Committee, the IRS is delivering 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 continues to plan and implement the most significant changes to its organization, technology, and the way it serves taxpayers in almost a half-century.

We have implemented the 71 new RRA 98 taxpayer rights provisions. We have completed the first phase of a new system of balanced measures of performance. Our reorganization to increase customer focus and management accountability is progressing rapidly and we have a new top management team in place.

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

However, neither Congress nor the IRS could have anticipated all the implications, including resources, needed to implement the full scope of RRA 98. Yet, in the 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 critical investments in new technology and organization.

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

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

We have already seen this process in action as we have unhesitatingly revised some initial proposals to slow down certain projects that were not ready to proceed at the desired pace, and to rearrange certain other activities to ensure that architectural and methodological concerns were adequately addressed.

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

Y2K CONVERSION

Mr. Chairman, as I testified before the Subcommittee in January, 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 more than 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 time 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 provided throughout this effort. Your leadership was a critical component of our success.

I would like to recap briefly our Y2K efforts. The scope of the Y2K problem at the IRS was enormous. Making the IRS' Y2K problem even more challenging was 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 mainframe 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 again 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.

THE FILING SEASON

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

Projected net collections for FY 2000 are $1.767 trillion. During FY 2000, we also project to receive 213.1 million returns, including over 127.3 million individual returns, and expect to issue over 93 million individual refunds. As of March 31, 2000, the number of refunds is up 6.6 percent over last year, and the average refund is $1,685 up 13 percent over the same period last year. 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.

Electronic Tax Administration

Meeting the Challenge

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

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

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

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

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

The 2000 Filing Season

The 2000 filing season is turning out to be another growth year for ETA as more taxpayers than ever before are enjoying the benefits of filing taxes electronically. Through March 31, 2000, almost 28 million individual taxpayers filed using one of the three *e-file* options; a 16 percent increase over the same period last year.

- Over 20.5 million taxpayers *e-filed* their tax returns electronically through an IRS-authorized Electronic Return Originator (ERO); a 16.8 percent increase over the same period last year.

- Approximately 3.3 million taxpayers have filed their tax returns on-line via their home computer through third party transmitters. On-line filing is running 95.7 percent ahead of last year's pace and as of March 31, has already exceeded last year's total volume of 2.5 million.

- Almost 4.2 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 or Tax Counseling for the Elderly programs offer free *e*-filing to those seeking help. Taxpayers can locate the nearest volunteer site by calling the IRS at 1-800-829-1040. As described in the following section, the IRS is undertaking several initiatives to further expand the program this year. Individuals, businesses and practitioners are also seeing many improvements in 2000 and will see even more in future filing seasons.

New in 2000 for Individual Taxpayers

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

Expansion of Electronic Payments: More electronic payment options (credit card and ACH debit payment) have been made available to taxpayers this year, such as accepting debit payments through TeleFile and accepting credit cards for Forms 1040ES, estimated tax

payments, and Forms 4868, extensions of time to file. Last year, over 53,000 tax payments were made by credit card and approximately 75,000 payments were made by ACH Debit.

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

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

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

New in 2000 for Business Taxpayers

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

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

New in 2000 for Practitioners

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

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

Providing Information And Service

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

Web Site

An increasing number of taxpayers are discovering that the IRS site on the 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 Tax"; all TeleTax topics; answers to the most frequently asked tax questions; a library of tax regulations; and the weekly Internal Revenue Bulletin, which contains all the latest revenue rulings, revenue procedures, notices, announcements, proposed regulations and final regulations.

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

Web Site and Innocent Spouse

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

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

Web Site and Installment Agreements

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

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

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

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

Web Site Small Business Corner

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

Expanded Web Site Tax Professional Corner

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

Web-based Customer Service

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

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. So far in FY 2000, approximately 308,000 orders were placed distributing over one million 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 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 31, 2000, over 104,520 subscriptions were sold through all venues.

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

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

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

EITC CD-ROM

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

New TAXi Module Debuts/TAXi CD-ROM Nears Completion

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

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

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

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 31, 2000, more than 31 million taxpayers have been served on all product lines in FY 2001, compared to almost 36 million over the same period last year.

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

service is 63 percent so far compared to our target of 58 percent. In the last four weeks, the level of service averaged 66 percent.

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

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

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

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

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

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 25, 2000, over 22 million have taken advantage of the service so far this fiscal year.

Automated Refund Information

In FY 1999, more than 34 million taxpayers used the Automated Refund Information system on TeleTax to check on the issuance of their refund checks. As of March 31, 2000, the number stands at over 18 million. Taxpayers may call 1-800-829-4477 to check on their refund status Monday through Friday from 7 a.m. to 11:00 p.m. if using a touch-tone phone, or 7:30 a.m to 5:30 p.m. for rotary or pulse service.

Taxpayer Assistance Centers

Saturday Service

Delivering on our promise to supply even more reliable and helpful taxpayer assistance, the Internal Revenue Service is providing Saturday service for the entire 2000 filing season at 275 locations nationwide, and for the first time, Sunday service on April 16th. Through the end

of March, we served 70,258 taxpayers on weekends. So far this filing season, we have served over 4.4 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.

FINANCIAL AUDIT

Mr. Chairman, as you know, I am precluded from playing any role in the financial audit process. However, I would like to recap what IRS Chief Financial Officer Larry Rogers said at the Subcommittee's February 29th hearing.

Due to the combined IRS and GAO efforts, GAO once again was able to render an "unqualified" or clean opinion on the IRS' Statement of Custodial Activity, which represents the $1.9 trillion that the IRS collected in tax revenues last year. That being said, the IRS is obviously disappointed that it was unable to achieve an unqualified opinion for its Administrative accounts. However, over the past year, the IRS staff made great strides and remedied a large number of deficiencies.

In its report, GAO expresses concern about IRS' use of labor intensive compensating workarounds. However, as Mr. Rogers stated, until the IRS is able to replace the archaic legacy data systems, it must continue to use these procedures. However, with the improvements made during the past year, we believe that we can sustain our progress while seeking more fundamental system improvements. There is a basis, in fact, for a positive outlook in this matter.

Mr. Rogers outlined a number of improvements this year. For example, the IRS overcame the loss of CFO managers that occurred two years ago; our new team of supervisors is now in place. On the Custodial side, the IRS improved its data extract process, and in 1999, was able to assume responsibility for analysis of the financial classifications for accounts receivable. The IRS was also able to perform "collectability" analyses of receivables – work that the GAO teams performed until IRS staff was capable of taking over the duties.

On the Administrative side, the fund balance was reconciled with Treasury at the end of FY 1999, and monthly reconciliations have now occurred for October and November of Fiscal 2000. A new permanent team is now charged on a recurring basis with the duty. IRS cleaned up the suspense account to a reasonable level, and the appropriate entries were made to record the clean out of the account.

Under Mr. Rogers leadership, the IRS is also working to provide a subsidiary ledger to our accounts, which will enable us in the future to give the GAO "cleaner" extracts for audit purposes. In addition, the IRS put into effect procedures that it will follow to ensure sustainability of our property valuation figure from the end of FY 1999. This process will remain in place until a more permanent solution can be achieved.

Mr. Rogers also discussed an item of great interest to GAO and the Subcommittee. Over the past year, the IRS continued to improve on an aggressive security management program, which focuses on identifying, managing and mitigating security weaknesses. In addition, the IRS established the Financial and Management Controls Executive Steering Committee to strategically manage improvement initiatives and ensure that appropriate controls are an integral component of all IRS programs.

As Mr. Rogers concluded, the IRS views these steps, and numerous others as necessary investments by IRS to meet the statutory and policy requirements for good financial data that fairly presents the status of IRS finances to all interested parties. The IRS did this to the best of its ability in FY 1999, and will continue to do so from here on.

Mr. Chairman, in the long-term, the inadequacies in, and solutions to, our financial reporting systems must be addressed through the broader efforts to modernize both the systems, technology and organization of the IRS as mandated by the Restructuring Act, and I want to thank you Mr. Chairman, for your leadership and support in this critical area.

This is a vast, complex and risky undertaking that will require many years to accomplish. The IRS must replace nearly its entire inventory of computer applications and convert its data on every taxpayer to new systems. It must be accomplished in conjunction with redesigned business practices as part of our overall modernization program, while continuing to provide service to taxpayers and to respond to ongoing tax law and other changes.

In the interim, we intend to develop the best financial data possible, while continuing to concentrate on the more complete reform of the data systems. I can assure you that we will sustain each of this year's improvements. We will simultaneously work toward a financial management system that fulfills the requirements of the various acts and also provides IRS managers with the data they need to operate the agency effectively and efficiently.

RRA 98 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.

FY 2001 BUDGET REQUEST:
CARRYING OUT RRA '98 AND MODERNIZATION

To deliver on the RRA 98 mandates for improved service and taxpayer treatment while also increasing compliance effectiveness, IRS requires increased funding in FY 2001. With

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

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

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

Maintaining Current Operations

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

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

In part because of these changes and increased workload demands, the number of examination and collection cases handled declined by half. This illustrates the need to balance the continued improvements in customer service with funding adequate to maintain

enforcement activity to collect unpaid taxes and address areas of potential under-reporting of income.

Current Services Level

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

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

It is vital to note that the long-term decline in the IRS workforce due to funding constraints has led to a situation where virtually no hiring has been done since 1995 in critical front-line skilled positions. 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** (**S**taffing **T**ax **A**dministration for **BaL**ance and **E**quity) 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 4,561 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 across the board, we need to reengineer the entire way the agency does business.

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

Organizational Modernization

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

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

Office. These resources cover all aspects of organizational change that will complement the IRS' systems modernization efforts and implement the RRA 98 reorganization mandate.

Business Reengineering and Technology Investments

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

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

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

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

Business Line Investments

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

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

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

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

ITIA Funded Core Business Systems

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

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

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

The Congress through the specified ITIA wisely planned the funding for this core business systems program. This account represents a practical means of funding a long-term program such as the IRS technology modernization program. Under ITIA, Congress

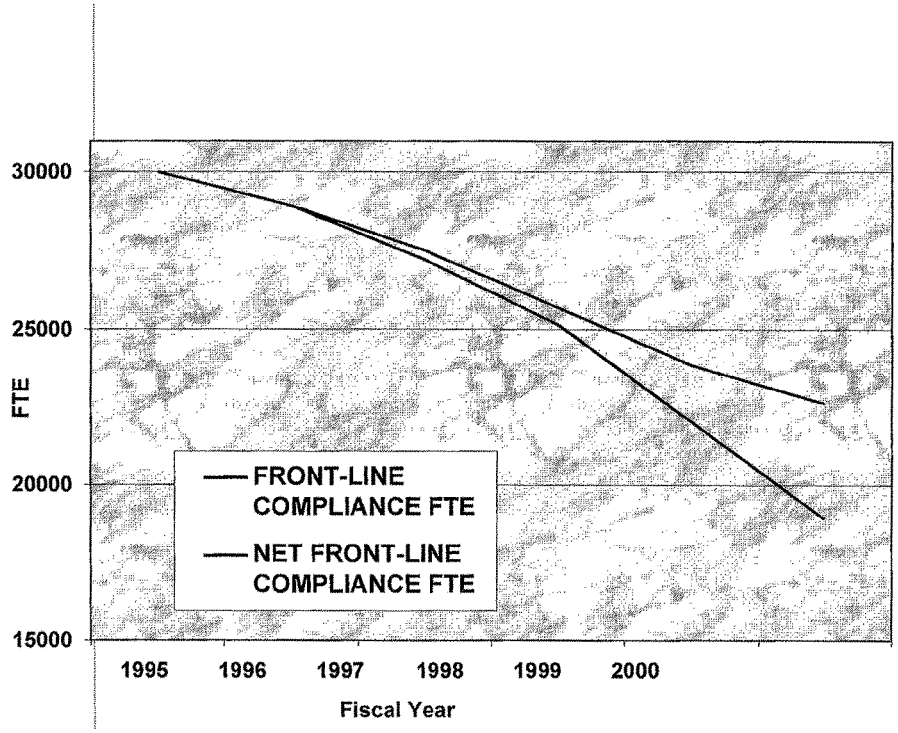
appropriates the funds for the program as a whole and the IRS is allowed to plan for continuity of the program subject to stringent reviews and safeguards. No funds are released from the ITIA until the IRS prepares a plan for specific increments of funding and is reviewed and approved by the Treasury, OMB, GAO and the two Appropriations Subcommittees. This approval, however, still only provides the IRS authority to proceed up to a certain funding level. No funds are actually obligated except through a rigorous internal process within the IRS, which is managed by the IRS Executive Steering Committee chaired by the Commissioner.

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

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 can succeed.

FY 1995 - FY 2000 FRONT-LINE FTE COMPARISON

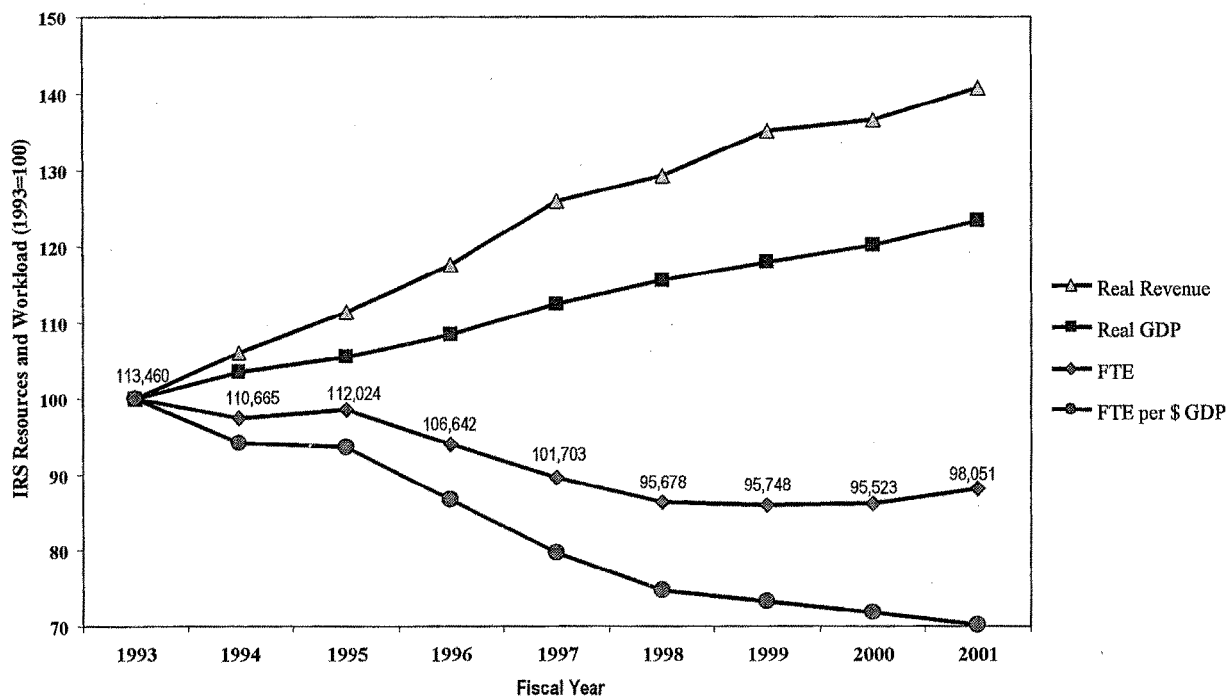


FY 2000 Mandatory FTE Increases from RRA '98

FTE by PROGRAM

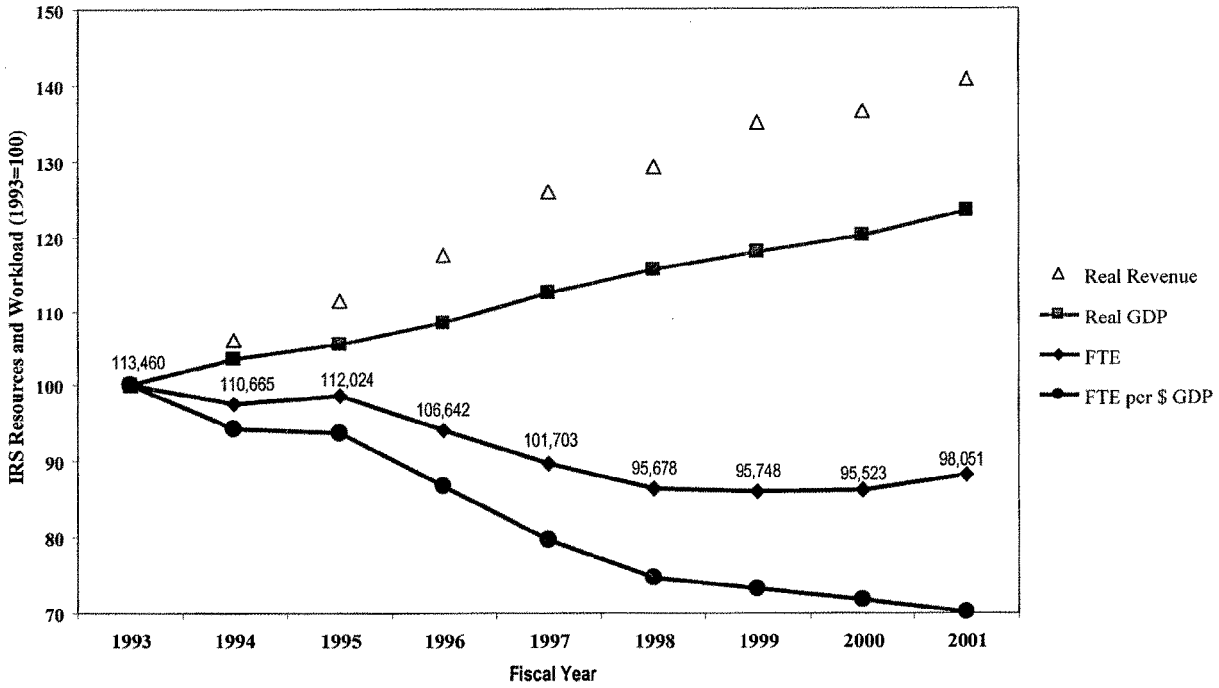
Code Section		Total FTE
1203	Termination of Employment for Misconduct; Incl 1203 Training	126
1205	Employee Training Program	368
3001	Burden of Proof	5
3201	Innocent Spouse Case Processing & Adjudication	731
3301	Global Interest Netting	103
3401	Due Process in Collections	356
3417	Third Party Notices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

IRS SHRINKS AS A FRACTION OF THE ECONOMY



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

IRS SHRINKS AS A FRACTION OF THE ECONOMY



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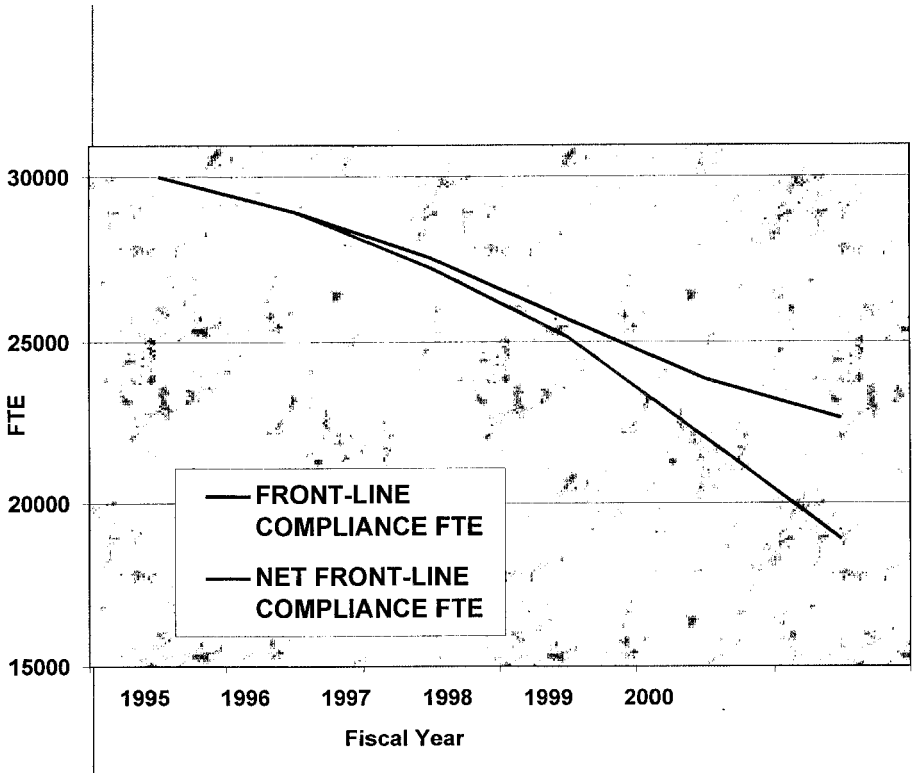
FY 1995 - FY 2000 FRONT-LINE FTE COMPARISON



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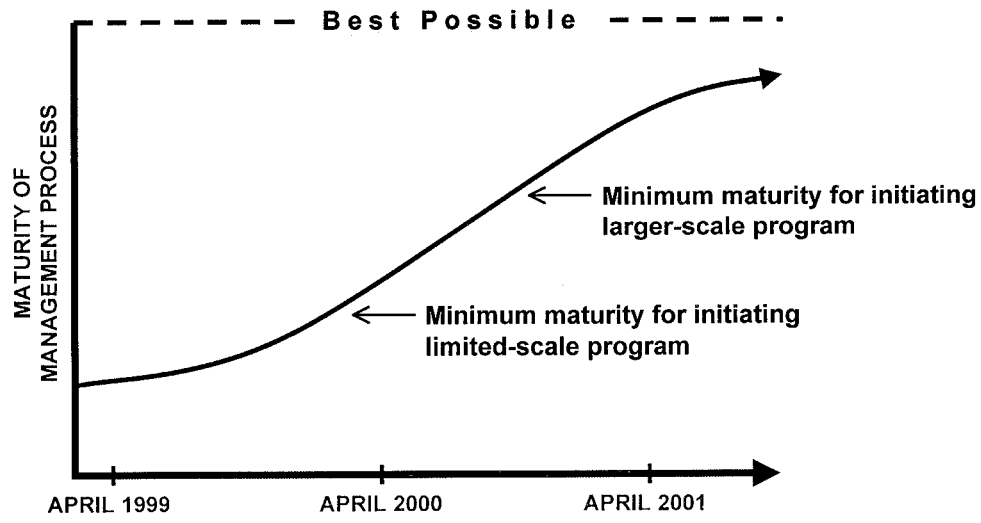
IRS TECHNOLOGY MODERNIZATION PROCESS



ELEMENTS OF MATURE MANAGEMENT PROCESS:

- Program Management
- Enterprise Life Cycle
- Acquisition Management
- Change Management
- Architecture and Standards Management
- Technology Infrastructure

Mr. HORN. We have a few questions for you, and we will be alternating between Mr. Turner and myself 5 minutes at a time.

Let me first start. There are a lot of different groups, including OMB, the IG—Inspector General—that give you recommendations. Tell me how you go about prioritizing which is which, and particularly the Inspector General's.

Mr. ROSSOTTI. Well, you are right, Mr. Chairman. We get hundreds of recommendations every year from many different audits that are done by the IG, as well as GAO, and, of course, many other things that come in from congressional sources and from our stakeholders, such as the practitioner groups and taxpayer groups. There are hundreds of them.

What we have put in place over the last 2 years is a management process which we call "taxpayer treatment and service improvement," by which we have a small program staff that reviews all of these and lists all of these recommendations, tries to apply criteria to them, and then comes before a top management group, which I chair, to basically determine which ones we can manage in which timeframes.

We are going through a new phase of this process in the next year as we establish our new organization. We are folding this process into an even more systematic strategic planning and budgeting process where we will include this kind of prioritization as part of our planning and budgeting and we, as a matter of fact, have already started that for fiscal year 2002, as well as 2001, which is, of course, the budget that is before Congress.

So we made, I think, an important step in prioritizing and managing these recommendations, and now we are going even further with strategic planning.

I think the, of course, crux of this is that we have more demands on our capacity than we can implement. In other words, we have more things that we would like to do and that others would like us to do than we have capacity to manage, so we simply have to make choices along the way.

Mr. HORN. How much, if any, do you get from that Advisory Committee that was put together to sort of guide the commissioner under the Restructuring and Reform Act of IRS? Now, who is on and who isn't? Have all the appointees been nominated?

Mr. ROSSOTTI. Yes. I think you're referring to the Oversight Board, as it is termed in the act.

Mr. HORN. That's right.

Mr. ROSSOTTI. And they were nominated, they were acted upon by the Senate Finance Committee favorably in—I believe it was February, and it is now on the Senate floor waiting for action to go through the Senate floor. That would be the last step before they would become active.

There are seven private sector members, as well as the commissioner and the Secretary of the Treasury. So there have been no meetings yet because they have not been finally confirmed, but we have had some informal discussions when they were preparing for their confirmation hearings actually at some length.

I think that these—in fact, I know that these members are all very qualified people who are quite fired up, as a matter of fact, about the idea of participating in this, and so I am looking forward

to having them—and, of course, one of their statutory responsibilities is precisely the point that you were noting in your question, is participating in the strategic planning process to help us make the right choices for how we deploy our resources and what initiatives we undertake.

Mr. HORN. The law took effect when?

Mr. ROSSOTTI. Well, the law took effect July 1998. It requested the President——

Mr. HORN. So we have lost almost 2 years from that particular committee?

Mr. ROSSOTTI. Well, yes.

Mr. HORN. That wasn't your fault. That was the President's fault. He didn't like the system. So is that going to work? I mean, they've now got them, you say, before the Senate. Hopefully they will be confirmed one way or the other.

Mr. ROSSOTTI. Yes. Well, I was somewhat involved, tangentially involved. It is quite a process to find seven private sector qualified people and get them through all the clearances. That certainly took longer than expected.

But I think that, without question, at this point there is strong support now for, I think, all quarters for making this Oversight Board work. You know, I've met quite a few times with the Secretary of the Treasury about this, and he is committed to it. He has met with them and, you know, we have a plan to get them oriented. So I think as soon as they are confirmed by the Senate we will be ready to really gear up.

I really anticipate that they will be a very constructive force in helping us have the continuity to make this whole process work.

Mr. HORN. My last question on this round is the computing situation. You went through Y2K. That caused you to look at various systems—should you merge some, should you get rid of some.

We've asked the General Accounting Office to look across the whole executive branch to look at the hardware and the software.

I wonder—you're an expert in this area—what are your plans?

Mr. ROSSOTTI. Well, I think you are quite right. One of the residual benefits of Y2K is that we did standardize and consolidate quite a few different systems, I mean, and water also, I think importantly, and probably one of the most important things is that we centralized all of the information systems resources under one management. I mean, previously we had about 15 different information—roughly 15 different information systems organizations. We now have one, and they control almost essentially all the resources. We have consolidated our mainframes. By the end of this year we will have them all into 3 centers instead of 12. And we've eliminated, you know, thousands of one-off type vendor products that were on desktops, for example.

So that was an important benefit of Y2K. We still have more work to do in that regard, but I think that is one of the foundational elements that gives us a foundation to start going up this "S" curve that we need to get to to manage in a more-effective way.

Mr. HORN. Thank you.

The gentleman from Texas, Mr. Turner, 5 minutes.

Mr. TURNER. Thank you, Mr. Chairman.

Commissioner, the growth in electronic filing seems to be impressive, but I gather that most of the electronic filing that takes place under current law has to go through some third party in order to accomplish it, rather than electronically filing directly with the IRS.

Why is that the case? And is there anything we could or should do about that?

Mr. ROSSOTTI. Well, as a matter of fact, that is one of the issues that we are addressing in the whole strategic plan for electronic filing.

I think one thing that is important to understand is that preparing a return electronically is a prerequisite for filing electronically. Those two processes are very closely linked. I mean, you can't file something electronically until you've prepared it. In order to prepare it, you have to have tax preparation software, and I think, if you've ever used any of this software, you know that there are quite a few software products out there on the market that are very sophisticated and really quite effective consumer software products.

So the route that the IRS has taken is to essentially try to—and this was actually a provision in the Restructuring Act encouraged us to do this—was to partner with the private sector to encourage competition in the private sector to bring down the cost and make it easier to file electronically by taking advantage of the capabilities that are offered in the private sector.

We don't see it as the right strategy to try to separate these two parts of the equation, if you will—the preparation and the filing. Instead, what we are working on—and there is a provision, actually, in the President's budget for this that was just submitted earlier this year which requests or requires the IRS, by 2002, to be able to, working with private industry, find a way to allow every taxpayer to file—both prepare and file their taxes on the Web at no cost to the taxpayer. I think that's really what taxpayers want.

As a matter of fact, even in this season that's possible on a limited basis, because there are a number of providers that provide software on the Web that allow you to prepare your tax return and send it to the IRS. Many of them charge a fee of $9.95. Some of them charge no fee, however, and this is because of competition driving down the prices.

What we have been requested in the President's budget to do and will continue to do is to work with the industry to provide ways—and this may require us to provide some incentive to the industry—to basically drive that price down to zero so that every taxpayer would be able to sign on to the Web, use that in a secure way to prepare their tax return, which is, I think, the thing that people get the most benefit out of, just being able to use the question and answer format to prepare their tax return, and then just push a button and file it up through us.

Mr. TURNER. Is there any statutory inhibition to doing that now? Isn't there a problem with the signature and the way it works now? Doesn't the taxpayer get something back in hard copy by mail and they sign it and send it back?

Mr. ROSSOTTI. Right. There's a second issue. Even if you do file, you now have to send in a separate—in most cases, you have to

send in a separate signature document. We have some pilot projects this year where we've sent out specific identification numbers that avoid the need to send in the paper document, and one of our highest priorities is to figure out how we can extend those pilots basically to everyone, or almost everyone, so that they would not have to send in that paper jurad, as it is called.

We do not, at this moment, think we need special additional legislative authority. We think that it is more a matter of administrative action to ensure ourselves that we have adequate authentication of the return that the taxpayer has filed.

Mr. TURNER. How, then, do you get a signature on that return so that the signature line, which is the taxpayers attestation that they are providing the correct information under penalty of law, how do you get that electronically?

Mr. ROSSOTTI. What we're doing now in our pilot projects is using PINs, as we call them—personal identification numbers. Many taxpayers received—I don't remember the exact number. I could get it for you. But we sent out letters to quite a few millions of taxpayers prior to this season giving them personal identification numbers which they could then enter in in lieu of a signature, in lieu of a hand signature as the authentication that it was a valid tax return.

Mr. TURNER. Thank you.

Mr. HORN. I think we had the staff furnish you an appeal from a particular constituent in Colorado, and his point is very interesting. This is Kenny Knapp of Steamboat Springs, CO. He received a reply to his appeal from the district director, Deborah Decker, and he felt that the proper authority to write him on that was the Secretary of Treasury. I wonder if you have had a chance to look at that? And do you feel that the district director, Deborah Decker, has that authority from the Treasury or not?

Mr. ROSSOTTI. First of all, as you know, I can't specifically comment on a particular taxpayer matter, but I think that it has been well established that the Secretary designates and delegates certain authority to take certain actions to the commissioner, and the commissioner, in turn, can re-delegate them to other authorized individuals. That's the way the tax system has worked for many, many years, and it really has to, because you have to be able to delegate authority for people to act or you couldn't really function at the scale that we function.

Mr. HORN. Well, is there a delegation from the Secretary of the Treasury? And what is the source of that? Is it a regulation of the Secretary?

Mr. ROSSOTTI. There are delegation orders in effect, as they're called, that delegate, generally speaking. I can give you more technical answers in a written response, but basically the way it works is that the law frequently authorizes the Secretary to do certain things, and then the Secretary has standing delegation orders that delegate to certain officials—usually the commissioner—to take action. And then, within the agency, we have official delegation orders that delegate certain other officials to take certain other kinds of action.

Mr. TURNER. That was really in relation to a deficiency notice. So you feel that you have sufficient authority from the Secretary of the Treasury?

Mr. ROSSOTTI. Yes.

Mr. TURNER. Because often Congress, over the years, and not just in IRS, has taken the authority away from the President, taken it away from Cabinet officers, and vested it in the person that really is responsible for the operation. So you don't feel a loss of authority there?

Mr. ROSSOTTI. I don't. And I'd be glad to give you a more-specific answer in writing, but generally——

Mr. HORN. Without objection, we'll put it in the record in this place.

[The information referred to follows:]

Please insert the following on page 25 line 530 in replace of the text currently there. (This is pursuant to the request of Chairman Horn located on line 551 on page 25.)

Under S. 6212 (a) of the Code, "If the Secretary determines that there is a deficiency..., he is authorized to send notice of such deficiency to the taxpayer..." The term "Secretary" means the Secretary of the Treasury or his delegate (section 7701 (a) (11) of the Code). The Secretary may delegate his authority to send deficiency notices.

The Secretary has delegated his authority to send deficiency notices via Treasury Order No. 150-10, which provides that the Commissioner shall be responsible for the administration and enforcement of the Internal Revenue laws.

The delegation of authority of IRS' personnel to issue deficiency notices has specifically been set forth in:

- 26 Code of Federal Regulations (C.F.R.) section 301.6212-1, which states in pertinent part:

  "(a) General rule. If a district director or director of a service center (or regional director of appeals), determines that there is a deficiency in respect of income, estate or gift tax imposed by subtitle A or B, or excise tax imposed by chapter 41,42, or 44 of the [Internal Revenue] Code, such official is authorized to notify the taxpayer of the deficiency.." (Also, 26 C.F.R. 301.6861-1 (c) recognizes the delegation of authority regarding deficiency notices within the context of jeopardy assessments.)

- Commissioner's Delegation Order No. 77, whereby the authority to issue (or execute an agreement to rescind) notices of deficiency has been redelegated to, among others, Directors of Customer Service Centers.

In dismissing a meritless challenge to the validity of a tax deficiency notice, the Ninth Circuit has noted, "To the extent [the taxpayer] seeks to challenge the District Director's authority to issue a notice of deficiency, this argument fails." *Urban v. Commissioner,* 964 F. 2d 888, 890 (9th Cir. 1992).

Mr. HORN. Now, on the modernization efforts, and when they might be made, I'd like to give you a little time. You've mentioned it, but just give us an idea of where some of this modernization is going besides the electronic aspect. What else is there?

Mr. ROSSOTTI. Well, there is an entire program of what we call our major business systems modernization, which is really aimed at replacing all of the basic systems that are deficient in the IRS that support basic tax administration processing, as well as, I might add, financial management systems, which I know in your committee you've had a great deal of concern about, because that is really at the root of a lot of our problems.

These go to basic systems that keep all the taxpayer records, for example. That's the most fundamental system. We still keep all of our taxpayer accounts on tape files in a system that was designed in the 1960's. It is hard to believe that. Sometimes when I say this people think I'm exaggerating, but it really is true. Really, every single taxpayer's records, business and individual, is on tape files that are only updated once a week. This is the heart of our entire system.

Then there are about 130 other systems that do everything from collecting money to accounting for money to helping to support auditing of taxpayers, and then, of course, the actual customer assistance. If somebody wants to call up and wants to find out where their refund is or there's a mistake on their account, to fix that is quite a laborious process.

All of these are what we call our "basic tax administration systems." Frankly, Mr. Chairman, I think I have testified before, this agency is very, very deep in the hole in this matter. This is not a matter of—you know, most businesses today are going forward with their basic—you know, like, for your bank the demand deposit system is there. OK. They know how many debits and credits there are in somebody's bank account. What they're working on is putting it on the Web and making it easier for people to do banking over the Web.

We're going back to foundations and rebuilding, you know, if you will, the equivalent of our basic checking account system, which I can't stress too much is really an essential thing for this country.

Every day we see examples of really horrible problems that we have in just administering the tax laws because of the limits of these systems. Unfortunately, we're so far behind that this is not an easy process to fix.

We have in place now, over the last year and over the last several years, put together the outlines of a plan of how to do this, and we are now beginning to launch this process. In fact, we've just, within the last several months, submitted the first large request to our Appropriations Committees to get money released from the fund that has been established to provide this.

At the same time what we're doing is we're building, as is shown on this curb, the management process that we need in place.

This is a very complex, large-scale program, and, as GAO and many others have observed, the IRS in the past has not had in place the management process to do this.

We are putting that process in place. To actually make it work takes some time and some experience, and so it is not an instanta-

neous process and it can't be done just by reading textbooks and by going to training classes. I mean, we can't build a world-class football team by just, you know, reading—watching videotapes of football games.

So we have to proceed in a measured pace, and I think one of the most important responsibilities that I feel I have—and my top management team is working on this—and you've met Mr. Cosgrave and some others—is to try to really manage this process so the level of activity we undertake, in terms of making actual projects go forward, initiating projects, is managed in relation to the capacity we have to manage them. That's sort of an ever-changing process.

However, just to put the bottom line as to what I expect to happen, if we get the release approval we expect from the committees to release funds, we will be launching the first real significant development projects which will deliver some initial capabilities next year in 2001. These will be mainly in the area of customer service and customer communications.

Then, basically every year for the next, you know, as far as we can plan at this point, at least 5 years, every year, at least once and possibly twice a year, we will be delivering additional new capacity into the system, and this will include not only the electronic services, the e-filing, and customer communications, but I think one of the most important of all these is the taxpayer accounts data base, because, again, we need to get rid of that 35-year-old tape file before we can do anything else.

I think we finally have a plan as to how to do that in a sort of way that has acceptable risk.

One other area I'll mention that I know has been important to you, Mr. Chairman, as well as Mr. Turner, is the whole area of debt collection. We talked about this. We now have, I think, the outline at least of a plan to replace the technology that we need and to basically completely re-engineer this process. I don't have time to go through it this morning, but I think when we get to that we will have something that will basically have the effect of allowing us to act much more quickly on overdue accounts, which right now is not one of our forefronts. We're very slow—to act much more quickly on potential or actual overdue accounts, and also use our resources more efficiently to do collection the right way. If all it takes is a phone call, we'll only make a phone call. If it really takes a collection officer to go out there, we can do that.

This, in turn, might provide us some broader opportunities, such as the ones I know you are interested in, to use other resources, perhaps outside resources to supplement our own, because basically we will have in process with this collection system what we really need to manage our collection process, but this is not going to happen in a year, this is going to take a couple years.

Mr. HORN. You mentioned in this answer that you have two committees. Now, that's Senate Finance and House Ways and Means? Or are you also including the Appropriations Subcommittee?

Mr. ROSSOTTI. Well, on this matter it is the Appropriations Committees actually that we have to work with to get the money released.

Mr. HORN. So this would be Mr. Kolbe's subcommittee?

Mr. ROSSOTTI. Yes, sir.

Mr. HORN. And on the Senate side the same?

Mr. ROSSOTTI. Senator Campbell.

Mr. HORN. Senator Campbell?

Mr. ROSSOTTI. Yes.

Mr. HORN. I now yield to the gentleman from Texas, Mr. Turner.

Mr. TURNER. Commissioner, you mentioned your efforts to try to improve debt collection. As you know and your staff is aware, I introduced a bill, H.R. 4181, last week, joined by Chairman Horn, as well as Chairman Burton and Ranking Member Waxman, and, as I recall, most of the members of our subcommittee, to try to help on your debt collection problem.

As you know, the law has provided for some time under the Debt Collection Act that if a person owes a non-tax debt to the Government they can go out and get Federal contracts and get Federal loans and other Government benefits, and so we wanted to close that loophole by providing that tax debt is now subject to those same rules, so that if you owe tax debt you can't get an SBA loan until you make arrangements to pay your tax debt, or you can't enter into a contract to sell the Government some equipment or services if you owe taxes, unless you make arrangement to pay those taxes.

I know your staff has been kind to take a look at the bill, and I wanted to ask you just three questions. One is: do you feel the concept is good with regard to it? And then I wanted you to comment on whether you thought you could administratively handle this task and whether you felt good about the efforts we've made to address the privacy concerns with the provision that we have in there that says the taxpayer is the one that will sign the consent form to release the information as to whether or not they owe any taxes, and that form would be promulgated by your office, but it would go to you and then you would respond back to the agency.

Mr. ROSSOTTI. Let me just talk about the administrative one first, because that's the one that most directly affects us. I think that we could administer that, provided, in the short term, if the volume of transactions was relatively limited. The only limitation there is because of our computer systems. A lot of this kind of stuff has to be handled semi-manually right now, so as long as it wasn't too large a volume of transactions, which I don't think it would be if it was Federal contracts, we could manage that. In the longer term, we'd be able to manage a larger volume, you know, we modernize our computer systems, but in the short term that would be the only issue administratively is just how large the volume of transactions would be.

As far as the privacy issue, I think that certainly requiring a disclosure of consent by the taxpayer would be an appropriate step, would be the right and necessary step to conform to the requirements of disclosure. We need that under our 6103, which is the section of the tax code which deals with taxpayer privacy.

I think that, on the broader issue of privacy, there is, I guess, a longstanding and probably never-ending debate over the broader question of whether it is the right policy decision to use tax information for other legitimate Government purposes. That's more of

a broader policy issue. The Treasury probably takes the lead on that, rather than the IRS.

The Joint Committee has issued a report just recently on this very subject which dealt with disclosures of tax records, even with consent of taxpayers, to other Federal agencies for various other purposes, and what they simply said was that they felt that it should be done only if there is a "compelling case" made by the part of the other agency. Whether it is a compelling case or not is a question.

But I think that, from the point of view of helping us to collect tax debt, to the extent that we had additional, you know, incentives, if you will, built into the taxpayers to actually pay those taxes, that can only help us.

Mr. TURNER. Thank you. I want to thank your staff for helping us on the bill.

We are going to have a hearing on May 9th, as I recall, Mr. Chairman, that you've set, and I welcome any of your staff's input between now and then——

Mr. ROSSOTTI. Sure.

Mr. TURNER [continuing]. Or at the hearing to be sure that we do this right.

Mr. ROSSOTTI. Sure.

Mr. TURNER. The objective clearly is to enhance collection of taxes, but to do it in a way that is appropriate.

Mr. ROSSOTTI. Yes.

Mr. TURNER. So any help that your staff can give us is welcome on this.

Mr. ROSSOTTI. We'll be happy to.

Mr. TURNER. Thank you very much.

Mr. ROSSOTTI. We'll be pleased to do that.

Mr. HORN. I thank the gentleman.

It is on May 9th, a Tuesday, 10 a.m., right here. And so we look forward for future action.

Let me ask you about the General Accounting Office testimony before this subcommittee. They said the IRS chief financial officer is not appropriately placed in the organization to address its serious financial and operational problems. What action is being taken by you and your management team to address this particular problem, because we had a real concern over the lack of internal methods for looking at the financial statements.

Mr. ROSSOTTI. Mr. Chairman, it is always a pleasure to be here and to be able to give a clear, simple, straightforward answer that we fixed that problem. In this case, I can honestly do that because we have successfully recruited and appointed Mr. Rogers as the chief financial officer, and he now reports, as of about 2 weeks ago, directly to the Office of the Commissioner. That includes myself and the deputy commissioner.

The reason it is stated that way is there are certain matters that I am recused from with respect to financial systems, but the deputy commissioner, Mr. Winzel, who is here with me today, will take my place in those cases.

But the important point is Mr. Rogers is now, No. 1, appointed on a permanent basis. He was previously acting. Second, he is reporting up directly through the Office of the Commissioner. We've

also made certain other realignments to give him some more authority and staff.

And so I believe that I can honestly say at this point that we fixed whatever concerns there might have been in that regard. They have been definitively addressed.

Mr. HORN. So you are very happy with it?

Mr. ROSSOTTI. On that particular point we have. I have to say that we still have a tremendous amount of work to do to address many of the issues in financial systems—not just financial systems, but our whole accounting process. Some of them Mr. Rogers and his team, with the support of Mr. Winzel, I believe will be able to address this year in a very, you know, active way. They relate to such things as reconciling balances with the Treasury and hopefully working on our property management.

Others, of course, as GAO, itself, have noted, are really longer-term issues related to technology modernization. They have to do with fixing the basic accounting systems. Those will not be fixed this year, obviously, but we will be working on the plans that will allow us to replace those systems longer term.

Mr. HORN. The senior counselor of the National Taxpayers Union, Mr. David Keating, noted in his testimony, which is about to come, that Treasury Secretary Summers said many times that the Board of Oversight is unnecessary and unwise, and "the long delay in submitting the nominations raises the question of whether the Administration is seeking to revamp the IRS on its own without the oversight and input of the legally required IRS Oversight Board. It also suggests to taxpayers the IRS reform is a low priority issue for the Administration."

Then he says, "We were also disappointed that none of the nominees appear to have, as required by law, professional experience and expertise in the needs and concerns of taxpayers."

Do you want to make some comments on that? I realize they aren't your nominees.

Mr. ROSSOTTI. Yes. Well, first of all, as far as the issue, though, of whether the Treasury Department supports this whole concept, I mean, it is a fair statement that in the early stages, when the bill was being debated, that there was a great debate about this and exactly what the powers of the Board should be, but I think that threshold was passed long ago, frankly, and I worked very closely with the Secretary.

I can tell you the Secretary was probably, especially toward the end of last year, as frustrated as anybody else at various things that caused us not to get these nominations up there.

I can tell you just one thing is that going through the clearance process to get a private sector person who has never been in the Government before into this, because they go through the same thing that you would go if you were a full-time employee, is really quite an interesting process. And it's not only lengthy, but in some cases it caused people to drop out.

So it was very difficult. I do not believe, from my observation, that the delay was caused by the Treasury Department not wanting this to happen.

It's true in the early stages they were against it, but once they changed they did get behind it, and I think that they absolutely—the Secretary does want this to work.

Now we've had the nominees and they are in the Senate, so it's just a matter of the Senate acting, and we'll get them there.

As far as the nominees, themselves, I can only say that we have a wide range of nominees that cover such things as, you know, for example, Mr. Colby—that's not Congressman Kolbe, but the nominee Mr. Colby—who actually is one of Senator Grassley's constituents, and he's a cattle rancher from Iowa, small business person. The other side, we have people like Mr. Farr, who ran American Express and had a lot of experience at the big business side, and we have, you know, Mr. Levitan, who is very much of an expert in large-scale technology programs.

So it is a wide-ranging board. I don't know whether one can prove that it touches every base of all the things that were listed in the legislation, but I think it is a wide-ranging board, and they are certainly interested in the task that has been assigned to them, from what I've seen from talking to them.

Mr. HORN. Well, my last question—I certainly agree with you, by the way, on it's a wonder we get anybody to serve in the executive branch of the Federal Government in terms of the forms, the ethics, the financial filings, and all the rest. So these do take time, and I understand that.

My last question is that you've testified you've implemented the various taxpayer rights legal provisions; however, you stated you are several years away from making them work more efficiently and at higher quality, so I'd like you to elaborate on what you mean by that and what are you doing to address that situation.

Mr. ROSSOTTI. Well, what I mean by it is that the taxpayer rights provisions were very pervasive in their impact in a way that almost every employee or a large percentage of our employees works. And many of them were quite complex.

An example of what I mean, the innocent spouse provision. This was a very important provision, very high profile, and I think a very necessary change in the law.

What happened at the time that the law was passed is that, whereas there was one provision in the law that in very limited circumstances allowed for relief of liability on a joint tax return, there are now four provisions, including the one that was there before, and they are really quite finely tuned, as is appropriate, to try to determine, you know—because here you are talking about taking basically a married couple that filed a joint tax return and now has split up, and you're trying to figure out who knew what about their tax return at the time they filed it. I mean, that's not a simple thing to do.

Then it adds to it an additional consideration, which the IRS has not really been required to do in the past, to my knowledge, which is deal with equity. In the past it was strictly, you know, who owed the money. On this particular provision, as well as some others, there is now what is called "equitable relief." Well, you know, figuring out what is appropriate to give equitable relief to one spouse in a marriage on a tax liability is something that takes some time to learn.

So we went forward and got out forms and we let people file claims, because they were—as was required, and we began to adjudicate those claims, but learning how to do it correctly and learning how to do it in a reasonable amount of time has been quite a challenge.

I think we have made some big progress. Again, it's a curve like that. It's a learning curve. You just don't do it overnight.

I think at this point, just taking that provision, we now have gotten out lots of guidance. We've learned how to adjudicate some cases. We've taken advantage of that experience to revamp the training materials. We've done a whole bunch of things which I won't go into here. So now we are at a point where I think we are starting to do them in a timely manner, and, second, do them correctly, with higher assurance that they are being done correctly. That's an example.

And there are 71 different provisions. I could give you a story like that on each one.

Mr. HORN. Does the gentleman from Texas have any further questions?

Mr. Rossotti, the commissioner, will stay through the next panel and is prepared to answer questions that are raised by panel two.

Mr. TURNER. I wanted to give you an opportunity to make this point again about your need for funding for your modernization effort. I know you intend to go to the appropriate committees and seek some movement of funds within your agency, but the overall modernization effort seems to me to be one that may very well and could detract from enforcement, and I don't think any of us would want that to occur.

I want to be sure that you have been able to make your case clearly for why you need additional funding for modernization.

Mr. ROSSOTTI. Mr. Turner, I think that, you know, what we have to do in the budget is to both do the modernization but also keep enforcing the tax laws at the same time. I mean, that's the two things that we have to do.

I think if you look at some of the previous charts that were up there—I don't know whether, Floyd, you can keep the previous one up—what has happened over the last—and this really is even before the Restructuring Act, but the budget was very constrained, and a majority of the money is for the case work, for going out and auditing and collecting money.

What has happened is you can see in the green line that the number—since 1995, the number of front-line people—this is in compliance. These are people that actually audit taxpayers, collect money—the green line is what was happening just to the staffing because of the budget. The red line shows that the gap between those two, with the additional requirements of the Restructuring and Reform Act, just required more time.

So if you look the that red line, you can see that we're down in 2000 well below where we were 4 years ago. And then there are even some intangible factors on top of that.

The net effect is we have half the number of audits that we were doing 4 years ago. Nobody knows exactly what the right number is, but I don't think that kind of a line is where we—you know, we're really risking the tax system if we keep that line.

So what we've proposed in the 2001 budget is two things, basically. One is stabilize that. OK? That's what we call it, stable. Give us enough staff to basically keep that from continuing to go down, keep it steady so we will no longer go down in terms of our compliance enforcement activities, and then, the other piece of the money is for the modernization for the technology, which is really how we are going to fix this.

I mean, we know that we can collect money more efficiently. I mean, I feel very confident of that. It does require some people, but we can leverage those people with more procedures and better technology, but it is going to take a few years to get to that point.

Mr. TURNER. In my last comment, I want to—for those of us that are struggling to get our tax return in, April 15th is on Saturday this year. Does that mean we have to have it in the Post Office? Can we get it postmarked by April 15th on a Saturday?

Mr. ROSSOTTI. Well, I think that it has actually come to the 17th as the day that it has to be done.

Mr. TURNER. OK. So you can actually deposit your tax return in the Post Office on Monday and still be in compliance with the law?

Mr. ROSSOTTI. Yes, sir.

Mr. TURNER. And I also wanted to mention, for those who may be interested in a phone number, 1–800–829–1040 is where you can get information, among—there are several other options available, as well, for taxpayers, but that is the 24-hour, 7-day-a-week, toll-free phone number, is it not?

Mr. ROSSOTTI. Yes.

Mr. TURNER. The 1–800–829–1040?

Mr. ROSSOTTI. Yes, sir.

Mr. TURNER. Well, for those who are struggling, as I am, to meet the deadline, I urge them to take advantage of that number.

And I noticed that your website is becoming much more popular in the past. I believe you had twice as many hits this year as you did last year, and that IRS.GOV is another place where taxpayers can get help.

Mr. ROSSOTTI. Yes, sir. Absolutely. As a matter of fact, I can tell you that this calendar year, through the end of March, we had 658 million hits on that Website, so it is really quite a popular one and one of our best products.

Mr. TURNER. Thank you.

Thank you, Mr. Chairman.

Mr. HORN. We thank you. That's good information for the average citizen.

Well, Commissioner, I'm done asking questions of you and I'll go to the next panel. And I must say you are a brave commissioner to stay here and when your critics are there. Most of the other people just run.

Mr. ROSSOTTI. We're happy to stay. We consider them very constructive critics.

Mr. HORN. Well, I know you are, and that's why you've got good relations on Capitol Hill.

So we will now have panel two: Margaret Wrightson of the General Accounting Office; Colleen Kelley of the Treasury Employees Union; Mr. Oveson, National Taxpayer Advocate; and David Keating, National Taxpayers Union.

If you will stand and raise your right hands, and if there is anybody going to assist you on the answers have them stand, also.

We have four at the witness table, three in back, for a total of seven.

[Witnesses sworn.]

Mr. HORN. The three helpers and the four witnesses are certified and noted to the clerk.

We will now start with Margaret Wrightson, the Associate Director, Tax Policy and Administration Issues of the U.S. General Accounting Office, the programmatic arm of the legislative branch.

STATEMENTS OF MARGARET T. WRIGHTSON, ASSOCIATE DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, U.S. GENERAL ACCOUNTING OFFICE; COLLEEN M. KELLEY, NATIONAL PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION; W. VAL OVESON, NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE; AND DAVID L. KEATING, SENIOR COUNSELOR, NATIONAL TAXPAYERS UNION

Ms. WRIGHTSON. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, Mr. Turner, thank you very much for inviting me here this morning to discuss IRS' progress on key elements of its modernization efforts.

Let me begin with my three bottom-line conclusions. In each case, it is important to say at the outset that there is substantial agreement between GAO and IRS on the issues and actions IRS must take.

First, before taxpayers will see any appreciable benefits from modernization, IRS needs to make breakthrough changes in its business practices and become more customer friendly.

Second, if IRS is to better balance the value it historically has placed on compliance with the value it now wishes to place on customer service, it needs to revamp its performance management system.

Finally, modernization will not succeed unless IRS follows through on important tasks for information systems modernization—most notably, complete its enterprise system architecture and systems development life cycle.

With regard to business practice changes, IRS has already completed a number of developmental steps that will help it redefine the way it does business, including establishing an organizational structure built around customer-focused operating divisions. Reorganization is going reasonably well, but the agency must also reengineer business practices. Breakthrough changes are needed because IRS' current processes are not well-suited to taxpayers' needs.

IRS has a number of re-engineering efforts underway, and the commissioner has mentioned a few. I'd like to highlight three this morning.

The first one is something that we're going to call "creating one-stop shopping at IRS walk-in centers." Taxpayers, as you know, have long been frustrated in trying to reach the right person at IRS. In large part, their frustration came from IRS' old structure that was kind of a transactional assembly line for addressing tax-

payer inquiries, clarifying and correcting tax returns, and collecting unpaid taxes.

Because of this stovepipe structure, IRS really couldn't take care of taxpayers on an end-to-end basis. To help solve the problem, IRS has established a new position that can handle a much larger range of taxpayer problems. It is called the tax resolution representative [TRR]. TRRs will still perform traditional duties like answering taxpayer questions and helping prepare returns, but they also will be able to do compliance work, like installment agreements, lien and levy releases, account adjustments, and simple audits. IRS intends to have about 2,000 TRRs on staff by fall, 2001.

Now, implementing the TRR concept is, of course, going to require substantial investments in people and systems. Probably the greatest human capital challenge for IRS will be the cross-training that is going to be needed, but TRRs are also going to need enhanced IT so they can have access to complete and up-to-date account information or they won't be able to be successful at this new role.

The second example I want to mention is one that has been mentioned previously, which is electronic filing. During the filing season, we all see commercials of tired and frazzled taxpayers. This year, my personal favorite saga is a taxpayer who is on day 20 of trying to paper file his family's return. The commercial is pretty funny. I mean, the taxpayer has got hands full of pencils, his hair is uncombed, his shirt tail is hanging out. But the fact is that paper filing a tax return is really no laughing matter.

Electronic filing, or e-filing, is not going to make the tax code any simpler, but it can reduce the wear on taxpayers from filing itself.

E-filing also reduces the calculation and transcription errors that later trigger IRS notices, and that's all to the good, as well.

But e-filing will benefit IRS. I don't know how many of you have been to an IRS service center, but I think it is fair to say that IRS is drowning in paper.

The returns are literally piled to the ceiling in the halls at IRS service centers. These returns must be opened and sorted and reviewed, transcribed, shipped, and stored. And then later, if IRS employees need additional information, they have to get them shipped from where they are stored so they can have access to that paper return again.

Although electronic filing promises to be win/win, however, IRS is having difficulty making it sufficiently appealing. A major criticism is that e-filing is not yet paperless. IRS has been testing eliminating W–2s and signature documents and allowing people to pay balances using credit cards. The commissioner mentioned that in his testimony.

However, before electronic filing can fully replace paper, IRS must enhance its technology to allow the full range of returns to be filed and also develop new marketing strategies for additional market segments.

The last example that I want to point to of business process reengineering is something called risk-based examination. Here, I'm going to start with a personal story, because I think, while taxpayer benefits from one-stop shopping and e-filing are pretty obvi-

ous to all of us, I'm not sure it is so obvious why IRS building a better mousetrap for auditing is going to benefit taxpayers. So let me use an example.

When I was about 10 years old, I remember standing on the porch with my dad, and the postman walked up—that was in the days when they, in fact, did walk up—he talked to my dad and handed him the mail. And, after thanking the postman, my dad started sifting through that mail until he stopped and he stared at a very official-looking document. You're right. Actually, in retrospect, that was a notice from the IRS.

I'm never going to forget, as a 10-year-old, looking at my dad and seeing this big guy and the panic on his face when he looked at that envelope. And I'm also not going to forget that he waited until my mom came home before he opened it up. I think he needed her moral support.

What's striking about my own little example is that it is not unusual. No taxpayer wants to get a letter from the IRS in his or her mailbox—unless, of course, it is a refund from the Treasury Department. But they certainly don't want to be audited when they are compliant, nor, when audited, do taxpayers prefer anything other than for their audits to be efficient and targeted only to the questionable return items.

Our past work has identified weaknesses in how IRS determines which taxpayers to audit. When IRS picks the wrong person or approaches an audit like a fishing expedition, everybody loses. Taxpayers are burdened unnecessarily, and IRS wastes valuable resources.

To improve the situation, IRS hopes to deploy something called "risk-based examination," a model that will target audits more accurately and help determine which compliance strategies are actually going to be the most efficient and effective.

If IRS' approach is successful, taxpayers and IRS will both benefit, but, as was true with my first two examples, training, new technology, and more data about taxpayers are going to be critical if that business process is going to be re-engineered effectively.

OK. The second part of my testimony looks at IRS' efforts to revamp its performance management system. Before Congress enacted the Restructuring Act, there was an uneasy feeling on the Hill and elsewhere that IRS employees were so intent on assessing and collecting taxes that they did not give due regard to taxpayer needs and rights.

The Restructuring Act mandated changes to IRS' performance management system, including a new mission statement to place greater emphasis on taxpayer needs. IRS now has that new mission statement and is in the process of revamping its performance management system. However, for the system to work, IRS employees will need to understand that customer service and compliance are intended to be complimentary and not competing values and activities. Our work suggests that this relationship may not be well understood at IRS at this point.

The commissioner does not view compliance and customer service as competing. Indeed, he has said that improvements in customer service will increase compliance among taxpayers who do not un-

derstand the applicable tax law requirements or find IRS' processes too daunting to deal with.

Understanding that customer service and compliance activities are meant to work together will take time at IRS and an ample amount of communication and clear training, which I think is going to be mentioned by some of our subsequent witnesses.

At the same time, however, it will be very important to ensure that IRS employees also understand that they can and should use the full range of IRS' enforcement tools to collect taxes owed by those who willfully fail to comply with the tax laws.

Our second concern about performance management involves IRS' new system of balanced performance measures. Although IRS is on the right track with these measures and may well be regarded as a leader in the Federal Government in this area, it still does not yet have a key measure of performance.

Mr. Chairman, that measure is a measure of voluntary compliance. For over 30 years, until the early 1990's, IRS had measures of voluntary compliance that were developed by periodically auditing random samples of taxpayers' returns.

In 1995, IRS formally canceled plans to continue the random audits because of concerns that it was overly costly and overly intrusive on compliant taxpayers.

The commissioner has said that, in the absence of such measures, informed decisions on strategies to improve voluntary compliance will be impossible.

At this point, you might be wondering: why not just use data from audits that IRS does conduct to measure voluntary compliance? The answer is that that data would not capture the extent of voluntary compliance among all taxpayers. Using only audit results is actually akin to using information about speeding tickets to measure how many drivers are driving safely. As anyone who has ever ventured onto the Washington Beltway knows, just because a driver doesn't get ticketed doesn't mean he or she is driving 55.

Similarly, the results of IRS' audits tell you something about the population of taxpayers who are audited, but they tell you nothing about the population of taxpayers who are not.

IRS is beginning to tackle the problem of how to measure voluntary compliance, but the solution likely will involve auditing some—and I say some—randomly selected returns, and IRS may have difficulty going forward without the support of key outside stakeholders.

GAO believes that, in moving forward on this, IRS should work diligently to minimize intrusion and burden on compliant taxpayers; however, we also believe in the principle of random selection when necessary to ensure the accuracy and integrity of IRS' results.

The last part of my statement is on a topic that I know, Chairman Horn, you are very familiar with, which focuses on IRS systems modernization challenges, which is a perennial problem at IRS.

Although IRS' past track record in this area is dismal, Congress has supported IRS' most recent efforts to modernize its systems

through the 1998 and 1999 Appropriations Acts and the establishment of the new technology account.

In light of concerns about giving IRS free reign, however, Congress set certain conditions on spending, including requiring spending plans to ensure that IRS had the management and technical discipline to successfully design major software-intensive systems. It is this issue that the commissioner is referring to with his "S" curve, I believe.

Thus far, IRS has obligated about $68 million from its technology account and submitted plans in March asking for approval to spend an additional $176 million; however, based on our review of IRS' most recent plan and reported progress, we have concluded that IRS is still not ready to build major software-intensive systems.

As I noted earlier in my statement, IRS has not yet completed its enterprise systems architecture and systems development life cycle. Until we are convinced that IRS is ready, we will continue to designate its systems modernization efforts as high risk.

Thank you, Mr. Chairman. I can answer questions now or wait until you complete the rest of the panel.

[The prepared statement of Ms. Wrightson follows:]

United States General Accounting Office

GAO

Testimony

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IRS MODERNIZATION

Business Practice, Performance Management, and Information Technology Challenges

Statement of Margaret T. Wrightson
Associate Director, Tax Policy and Administration Issues
General Government Division

GAO/T-GGD/AIMD-00-144

Statement

IRS Modernization: Business Practice, Performance Management, and Information Technology Challenges

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss key elements of the Internal Revenue Service's (IRS) modernization efforts aimed at fundamentally changing the way it does business. As IRS acknowledges, it is an agency fraught with long-standing and significant management problems and a history of ineffective attempts to correct them.

Building on the direction set forth in the IRS Restructuring and Reform Act of 1998 (Restructuring Act),[1] IRS hopes that many of these long-standing issues will ultimately be addressed through the current modernization effort. To that end, Commissioner Rossotti has revised IRS' mission statement to more fully embrace customer service and fairness to taxpayers as core organizational values. He has also articulated a supporting modernization strategy that encompasses major changes in IRS' organizational structure, business practices, human capital and performance management systems, and information systems.

As we said before this Subcommittee last year, the magnitude of this modernization effort makes it a high-risk venture that will take years to fully implement.[2] IRS has taken some important steps over the last year; however, some of its most important and difficult work lies ahead.

My statement discusses the business practice, performance management and information technology challenges IRS faces. It is based on our past work on IRS management challenges and our ongoing monitoring of IRS' modernization efforts. Specifically, my statement makes the following three points.

- IRS acknowledges that it will need to do more than make marginal improvements in the efficiency and effectiveness of its current business practices. Accordingly, IRS is planning to implement breakthrough changes to those practices. Only when these changes are implemented will taxpayers see any appreciable benefits from IRS' multiyear modernization. IRS has some initiatives of this type under way, but they, and other business practice changes, will not be easy to implement. This type of reengineering requires not only a new way of thinking, but also investments in human capital, data collection, and technology.

[1] P.L. 105-206, July 22, 1998.

[2] IRS Management: Business and Systems Modernization Pose Challenges (GAO/T-GGD/AIMD-99-138, Apr. 15, 1999).

- No matter what organizational structure or business practices IRS establishes, successful modernization ultimately depends on whether the employees who are to lead, manage, and carry out agency programs and services can deliver IRS' new mission of top-quality customer service and improved overall compliance. Historically, IRS' performance management system emphasized revenue production at the expense of customer service. IRS is developing a new system and has taken the important first step of developing a balanced set of performance measures that is to capture both the customer service and compliance aspects of its new mission. Given the difficulties that attend so substantial an effort, it is not surprising that we have identified problems. At a fundamental level, it is not clear to us that IRS employees fully understand that customer service and compliance can be mutually supporting. Such an understanding would be fostered by a coherent set of performance measures, but IRS does not yet have a key measure for voluntary compliance. Not only is such a measure important in its own right to track performance on a key aspect of IRS' mission, but it would also provide important data for designing the kinds of products and services taxpayers need and for targeting compliance activities. IRS is working to develop this measure. Eventually, once a complete set of balance measures is developed, IRS should be able to assess whether improved customer service contributes to an increase in voluntary compliance. IRS acknowledges that it will need to address these issues as it continues to develop its new system.

- Revamping its time-worn tax processing systems is a critical aspect of modernization. However, IRS must overcome several serious management challenges in its current systems modernization effort before it will be ready to build modernized systems. In particular, IRS must (1) complete, enforce, and maintain an enterprise systems architecture,[3] (2) establish and implement sound investment management processes to ensure only incremental, cost-effective system investments are made, and (3) impose software acquisition and life cycle management[4] discipline on each system investment it undertakes.

[3]A systems architecture defines the critical attributes of an agency's collection of information systems in both business/functional and technical/physical terms.

[4]A systems life cycle defines the policies, processes, and products for managing information technology investments from conception, development, and deployment through maintenance and support.

With Reorganization Under Way, Revamped Business Practices Tailored to Taxpayer Needs Is a Next Critical Step

IRS has already completed a number of elemental steps in redefining the way it does business. It has clarified its mission and articulated strategic goals to support the mission. It has identified its customer segments and key processes that are to define IRS' primary interactions with each segment—prefiling, filing, and postfiling. IRS is institutionalizing its focus on customer segments through its new organizational structure built around four operating divisions, each with end-to-end responsibility for serving a group of taxpayers with similar needs and interests.[5]

The reorganization is an important piece of the modernization process. IRS is phasing in its new organizational structure, and our monitoring work indicates that the reorganization is proceeding reasonably well. The new operating divisions should provide IRS with the management structure and customer focus needed to facilitate the breakthrough business practices that taxpayers need and deserve. Although employees in the new operating divisions will, for the most part, be initially constrained by old ways of doing business, IRS has under way a number of initiatives to revamp business practices. My statement today highlights three such initiatives:

- providing cross-functional customer service,
- advancing the use of electronic filing, and
- developing a new risk-based return examination process.

None of these, or other business practice changes, will be easy to implement; success will hinge on investments in human capital, data collection, and technology.

Cross-Functional Customer Service

Taxpayers have long been frustrated by the circuitous routes they often must follow to find an IRS employee who can address their concerns or questions. In large part, this was because IRS' old structure had separate functions for answering taxpayer inquiries, clarifying and correcting tax returns, and collecting unpaid taxes. Each of these functional areas maintained separate taxpayer databases, and thus, taxpayers who contacted IRS were often referred to offices other than those they had initially contacted. As IRS learned from its recent Problem Solving Days initiative, a single point of contact for resolving issues is, from the

[5]The operating divisions and their target start-up dates are (1) Tax Exempt and Government Entities, serving pension plans, exempt organizations, and governments (operational since December 1999); (2) Large and Mid-Size Business, serving businesses with assets over $5 million (June 2000); (3) Wage and Investment Income, serving individual taxpayers (October 2000); and (4) Small Business and Self-Employed, serving fully or partially self-employed individuals and small businesses with assets under $5 million (October 2000).

taxpayer's perspective, a far better way of doing business, and IRS is using this lesson to define a new cross-functional approach to frontline customer service.

In November 1997, shortly after a series of Senate Finance Committee oversight hearings that highlighted taxpayers' problems in dealing with IRS, the agency began holding monthly Problem Solving Days at field offices across the country. During a Problem Solving Day, IRS brought together employees from various functional groups, such as Examination and Collection, to provide a range of expertise to discuss and resolve taxpayers' problems in a face-to-face meeting. In our review of Problem Solving Days, we found that both taxpayers and IRS staff found the concept to be a good idea.[6]

Based on the apparent success of this initiative, IRS intends to institutionalize the concept of Problem Solving Days through a new Tax Resolution Representative (TRR) position. TRRs are to provide prefiling assistance and education and postfiling compliance support to taxpayers at IRS walk-in sites and other locations convenient to taxpayers. Staff at IRS' walk-in sites, some of whom are employees on detail from other functions, currently answer tax law questions, distribute tax forms and publications, help taxpayers prepare their returns, and resolve some account issues. TRRs are to be permanent staff who perform traditional walk-in service duties as well as a variety of compliance actions, including installment agreements, lien and levy release, account adjustments, and simple audits. IRS intends to begin the process of filling about 1,300 TRR positions early in 2001 and, if funding is available, plans to have about 2,000 TRRs on staff by October 2001.

The concept of cross-functional service embodied in the TRR position is compelling and fits neatly with IRS' goal to improve service to each taxpayer. As with other business practice changes, though, implementing the TRR concept will require investments in human capital and information systems. Probably the greatest human capital challenge will be training. The initial cross-functional training needs will be significant because the TRR position combines elements from several current positions, and ongoing training to keep such a broad array of skills up-to-date will be a continuing challenge. We also expect that this position will require strong interpersonal skills. In addition to training, TRRs will also need enhanced information system support to do their jobs effectively. For example, providing high-quality service to taxpayers will be difficult

[6] Tax Administration: IRS' Problem-Solving Days (GAO/GGD-99-1, Oct. 16, 1998).

without access to a modern information system that contains accurate and up-to-date information on taxpayer accounts, something IRS plans to deliver as part of its information systems modernization effort.

Electronic Filing

According to IRS customer satisfaction surveys as well as one done by the President's Management Council, taxpayers report high satisfaction with their electronic filing experiences. IRS also benefits from electronic filing through efficiency and accuracy gains. While electronic filing is a breakthrough process that is clearly more efficient for IRS and satisfies some taxpayers, the process still includes barriers that make it unappealing to certain groups of taxpayers. The Restructuring Act mandates that by 2007, IRS is to receive 80 percent of tax and information returns (i.e., information provided to IRS by third parties, such as employers and payors of interest and dividends) electronically, something that may be difficult to achieve.[7] According to IRS' November 1999 projections, 46 percent of individual taxpayers, at most, will file electronically by 2007. IRS notes that these projections are not based on complete information about the impact of future initiatives. Thus, the projections could increase.

Maximizing electronic filing is important to IRS because the agency is currently drowning in paper. Returns that are filed electronically do not have to move through IRS' labor-intensive paper return processing operations. Paper returns need to be opened, sorted, reviewed, transcribed, shipped, and stored. Later, returns must be physically retrieved if IRS employees need data from the returns that were not keypunched into computer records. Moreover, electronic filing prevents common taxpayer errors, such as computational mistakes and erroneous Social Security Numbers, from entering IRS' tax return processing system. As a result, electronic filing reduces the need for contacts with taxpayers regarding those errors.

Although taxpayers do receive benefits from electronic filing, such as faster refunds and notification that IRS has, in fact, received their returns, IRS has had difficulty inducing taxpayers who file individual returns to do so electronically. In 1993 and 1995, we made recommendations regarding IRS' need to develop strategies to broaden the use of electronic filing and to remove operational barriers that made electronic filing less appealing to

[7]IRS has interpreted the goal to mean 80 percent of all tax returns and 80 percent of all information returns as opposed to 80 percent of the combined total.

certain taxpayers.[8] For example, a major criticism of electronic filing is that the process is not yet truly paperless because of the need to submit wage and tax statements (form W-2s), a signature document, and payment information if a balance is owed.

IRS is continuing to grapple with this issue and, since 1996, has been conducting various tests to determine how best to eliminate the paper associated with electronic returns. In the 2000 filing season, IRS has expanded on the tests that were done in the 1999 filing season. These tests focus on eliminating W-2s and signature documents for taxpayers that use practitioners or file on-line from a personal computer and allowing taxpayers to use paperless payment options, such as credit cards.

Responding to recommendations that IRS needed a strategic business plan for advancing electronic filing, in December 1998, IRS issued a strategic plan that, among other things, identifies several challenges or barriers that must be overcome to advance electronic tax administration.[9] IRS acknowledges that it will need to enhance its technology to allow the filing of a full range of returns; resolve security issues to eliminate the requirements for submitting paper signature documents; and develop marketing strategies for different sets of taxpayers, including those that submit payments. IRS also plans to use some of its systems modernization funds for various electronic tax administration initiatives that it expects to implement in 2002. According to an IRS official responsible for these initiatives, they have not been finalized, in part because IRS is considering how best to meet the needs of the new operating divisions.

Risk-Based Return Examination Process

Taxpayers do not want to be audited if they have complied with the tax law, and if they have not, they want the audit to be efficient and targeted only at the questionable return items. Our past work has identified some weaknesses in how IRS determines which taxpayers it should audit and the audit approach it should use.[10] These weaknesses include relying on outdated information to identify potential noncompliance and selecting returns for audit based on manual review and judgment. As part of IRS' strategy to change the way it deals with taxpayers that may have

[8]Tax Administration: Opportunities to Increase the Use of Electronic Filing (GAO/GGD-93-40, Jan. 22, 1993) and Tax Administration: Electronic Filing Falling Short of Expectations (GAO/GGD-96-12, Oct. 31, 1995).

[9]IRS issued a revised strategic plan in November 1999. See Electronic Tax Administration: A Strategy for Growth (IRS Publication 3187, Nov. 1999).

[10]IRS Audits: Weaknesses in Selecting and Conducting Correspondence Audits (GAO/GGD-99-48, Mar. 31, 1999) and Tax Administration: IRS' Return Selection Process (GAO/GGD-99-30, Feb. 22, 1999).

compliance problems, IRS is developing a risk-based examination model that is to centrally and systematically identify which returns to audit as well as the most efficient and effective way to audit them. If successful, taxpayers and IRS should both benefit.

The risk-based examination model includes a number of elements, such as (1) a statistically-based model, similar to IRS' current scoring system, to assign a risk score indicating the probability of noncompliance; (2) decision support software to be used by operating divisions to centrally select returns for audit; and (3) the selection of an audit method—such as telephone contact, correspondence examination, or face-to-face audit—based on multiple factors, including projected risk, likelihood that taxes due can be collected, overall compliance objectives, and workload considerations.

As envisioned, the risk-based examination approach is data-driven; thus, the quality of the process is inherently dependent upon the quality of the data used. At the outset, the lack of a comprehensive, up-to-date taxpayer account database will hinder IRS' efforts to compile the data needed to build the model. As a result, IRS will need to rely on its fragmented information systems. Eventually, it will need accurate data on taxpayers' past compliance histories and reasons for noncompliance—data that are not currently available. Recognizing that it has much preparatory work to do, IRS does not expect to pilot its risk-based examination model for 2 to 3 years.

A New Performance Management System With Comprehensive Measures That Employees Understand Will Be Critical for Long-Term Success

No matter what new business practices IRS establishes, its successful modernization ultimately rests on whether the employees who must lead, manage, and carry out agency programs and services can deliver IRS' new mission. As we have said, an organization's human capital policies, including the performance management system it uses to manage and motivate its people, must be aligned to support its mission and expectations of itself.[11]

Historically, IRS' performance management system emphasized revenue production at the expense of customer service. IRS is developing a new system and has taken the important first step of developing a balanced set of performance measures that captures both the customer service and compliance aspects of its new mission. Given the difficulties that attend so

[11] Human Capital: A Self Assessment Checklist for Agency Leaders (GAO/GGD-99-179, Sept. 1999) and Human Capital: Key Principles From Nine Private Sector Organizations (GAO/GGD-00-28, Jan. 31, 2000).

substantial an effort, it is not surprising that we have identified problems. At a fundamental level, it is not clear to us that IRS employees fully understand that customer service and compliance can be mutually supportive. Such an understanding would be fostered by a coherent set of performance measures. However, IRS does not yet have a key measure for voluntary compliance, though it is working to develop one. Not only is such a measure important in its own right, but it would also provide important data for designing the kinds of products and services taxpayers need and for targeting compliance activities. IRS acknowledges that it will need to address these issues as it continues to develop its new system.

A Well-Understood Mission Statement Is the Foundation of a Successful Performance Management System

In broad terms, a performance management system can be viewed as a strategy for continuous improvement. Ideally, under such a system, performance measures are developed to operationalize the organization's goals and mission. These measures can be used to assess and improve the performance of organizational units and employees. Over time, the measures may be refined on the basis of feedback about how well they are working to meet current organizational goals as well as future needs. When an organization's mission is accurately captured in its performance measures, the mission and measures understood by employees, and the measures aligned with the organization's operations, agency leaders have a powerful tool for encouraging managers and employees to achieve their common goals.

Before Congress enacted the Restructuring Act, there was an uneasy feeling that IRS employees were so intent on assessing and collecting taxes, which was emphasized in IRS' old mission statement, they did not give due regard to taxpayer needs and rights. As a result, the Restructuring Act mandated several changes to IRS' performance management system, including requiring IRS to develop a new mission statement that placed a greater emphasis on meeting taxpayers' needs. Accordingly, IRS developed a new mission—to "provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all."

If IRS is to fulfill its commitment to high-quality customer service and ensuring taxpayer compliance, employees must understand the relationship between the two, as well as the performance measures that IRS plans to use to assess progress toward those goals. Given IRS' history and culture, this will not be easy. Our monitoring work suggests that the relationship between customer service and compliance may not yet be well understood by IRS frontline employees. One source of confusion may be whether the value IRS now wishes to place on customer service must

compete with the value it historically has placed on compliance. The Commissioner has attempted to clarify this confusion by stating that the Restructuring Act asked IRS to do three things: (1) respect taxpayer rights and provide high-quality service, (2) ensure that taxes that are due are paid, and (3) do its work efficiently and in a quality manner. The Commissioner has said that he does not envision moving an imaginary pendulum toward any one of three things—all are important to improving IRS' overall performance.

The Commissioner has said he believes that there is a cause-and-effect relationship between improvements in customer service and increased compliance for taxpayers who do not understand the applicable tax law requirements or find IRS' processes too daunting. For example, IRS' efforts to help taxpayers understand the eligibility requirements for the Earned Income Credit would be expected to increase voluntary compliance by reducing the number of inappropriate claims taxpayers might unwittingly file.

At the same time, however, IRS should not hesitate to use the enforcement tools at its disposal to collect taxes owed by those who willfully fail to comply with the tax laws. Understanding that customer service and compliance are not competing, but complementary, values will take time and an ample amount of clear communication and training.

Balanced Measures Are Key to Achieving IRS' Mission

To better balance the goals of providing high-quality customer service and ensuring compliance, IRS has turned to a system of "balanced measures." Our work on leading private organizations shows that developing and using a coherent set of performance measures is one key factor in an organization's ability to achieve its mission. Properly used, balanced performance measures help organizations assess progress toward achieving strategic goals and improving operations. When aligned with an employee evaluation system, the measures can serve as a powerful tool for encouraging employees at all levels to work together toward a common end.

The concept of balanced measures originated in the private sector among industry leaders seeking to strengthen their companies' long-term financial performance. The companies recognized that placing too much emphasis on short-term financial objectives actually could be detrimental to success if organizational units and employees neglected other factors, such as customer satisfaction, that drive financial success over the long term. By developing and using a more comprehensive set of measures, including measures of key aspects of products and services (e.g., convenience and

quality) that their customers valued, the companies hoped to earn the kind of customer satisfaction and loyalty necessary for lasting success.

Under the balanced measures approach, organizations develop and use a comprehensive suite of measures to address strategic objectives in four basic areas: financial impacts, customer needs and service, internal processes, and employee development and growth. The underlying premise is not only that companies need to perform well in each of these areas, but also that these areas are interrelated and mutually supportive. For example, providing better training to employees should lead to improved customer service and ultimately have a positive impact on the financial bottom line.

IRS has recognized that a system of balanced measures might work well to help achieve its new mission, and it has become one of the leaders in adapting the concept to the federal sector. Like the aforementioned private sector companies, IRS had been focusing heavily on indicators related to revenue production, and it took steps so that its performance management system supported this emphasis. To revise its performance management system to better reflect its new mission, IRS is developing a new suite of measures to address three strategic goals: service to each taxpayer, service to all taxpayers, and productivity through a quality work environment. For each strategic goal, IRS is developing a discrete corresponding measure–customer satisfaction, business results, and employee satisfaction, respectively.

IRS Lacks a Key Measure for Voluntary Compliance

While IRS has made some progress in developing the measures, it does not yet have a complete set of balanced measures. A complete set should help foster a full understanding that customer service and compliance can be mutually supportive. However, IRS does not have a key business results measure for voluntary compliance, but is working to develop one. Although it will be difficult to develop and may take several years, such a measure is essential for a number of reasons. Regularly measuring progress in voluntary compliance is important to gauge whether IRS is accomplishing a key aspect of its mission. Also, the information about taxpayers to be generated as part of measuring voluntary compliance should help IRS identify the characteristics of taxpayers who have difficulty understanding and meeting their tax responsibilities. IRS must better understand the problems of noncompliant taxpayers and the sources of their problems so that it can develop better products and services to meet the needs of those taxpayers. Finally, the data IRS would develop as part of any voluntary compliance measurement effort should allow IRS to better direct its enforcement resources to those taxpayers

that willfully flaunt the tax laws. Eventually, once a complete set of balanced measures is developed, IRS should be able to assess whether improved customer service contributes to an increase in voluntary compliance.

IRS recognizes that it needs reliable and meaningful measures of voluntary compliance. In fact, for over 30 years—until the early 1990s—IRS had measures of voluntary compliance that were developed by periodically auditing random samples of taxpayers' returns. In 1995, IRS formally canceled its plans to continue the random audits because of concerns that it was costly and overly intrusive on compliant taxpayers. The Commissioner has said that in the absence of measures of voluntary compliance, informed decisions on strategies to encourage voluntary compliance would be impossible, and the tendency to fall back on enforcement revenue as a measure of performance might reoccur. Using data from the audits that it does conduct could provide IRS with some compliance data, but because these returns are not randomly selected, the audit results would not provide IRS with the data it needs to determine whether its customer service and compliance activities are supporting its mission.

IRS' Office of Program Evaluation and Risk Analyses is working with a contractor to determine how to measure compliance and develop a compliance strategy. However, that effort is still in its early stages. We plan to continue to monitor IRS' efforts in this regard as part of our ongoing work on IRS' balanced performance measures.

IRS Continues to Face Formidable Systems Modernization Challenges

Revamping its time-worn tax processing systems is a critical aspect of modernization. However, IRS must overcome several serious management challenges in its current systems modernization effort before it will be ready to build modernized systems. In particular, IRS must (1) complete, enforce, and maintain an enterprise systems architecture,[12] (2) establish and implement sound investment management processes to ensure only incremental, cost-effective system investments are made, and (3) impose software acquisition and life cycle management[13] discipline on each system investment it undertakes.

[12]A systems architecture defines the critical attributes of an agency's collection of information systems in both business/functional and technical/physical terms.

[13]A systems life cycle defines the policies, processes, and products for managing information technology investments from conception, development, and deployment through maintenance and support.

The challenges that IRS faces today are generally the same ones we reported on in 1995, when we identified pervasive management and technical weaknesses with what was then known as Tax Systems Modernization and made specific recommendations to correct them.[14] Since then, we have reviewed and reported on IRS' actions to address our recommendations and strengthen its modernization capability, such as issuing its May 1997 Modernization Blueprint.[15] We have also made additional recommendations in light of IRS' actions.[16]

IRS awarded its Prime Systems Integration Services (PRIME) contract for systems modernization in late 1998. In mid-1999, IRS submitted its first expenditure plan,[17] seeking to spend about $35 million from its Information Technology Investments Account[18] for modernization initiatives through October 31, 1999. We reported that the plan was an appropriate first step and was consistent with congressional direction and our past recommendations.[19] We also said that the key to success was implementing it effectively.

IRS was unable to finalize its second expenditure plan before the original $35 million was obligated, and in December 1999, it requested approval to obligate $33 million as a "stopgap" funding measure until the next expenditure plan was submitted. In briefings to the relevant appropriations subcommittees and IRS on our review of the "stopgap" request, we reported our concerns about (1) the lack of progress in completing and implementing its enterprise systems architecture and systems life cycle and (2) the risks associated with IRS' plans to develop selected systems without these critical management controls in place. In

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

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

[16] For example, see Tax Systems Modernization: Actions Underway But IRS Has Not Yet Corrected Management and Technical Weaknesses (GAO/AIMD-96-106, June 7, 1996) and GAO/AIMD/GGD-98-54.

[17] Pursuant to the fiscal year 1998 Treasury and General Government Appropriations Act (P.L. 105-61) and the fiscal year 1999 Omnibus Consolidated and Emergency Supplemental Appropriations Act (P.L. 105-277), IRS and the Department of the Treasury are required to submit to the Congress for approval, an expenditure plan that meets certain conditions (e.g., implements IRS' Modernization Blueprint, meets IRS system life cycle management program requirements) before IRS can obligate funds from the Service's Information Technology Investments Account (ITIA).

[18] Established in IRS' fiscal year 1998 appropriations act, this multiyear capital account is to fund IRS systems modernization initiatives.

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

approving IRS' $33 million plan, the appropriation subcommittees directed IRS to, among other things, (1) expedite completion and implementation of the enterprise 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, the Office of Management and Budget, and GAO, IRS reassessed and restructured its modernization program. It scaled back its new system development efforts, recognizing that it must first put in place the requisite modernization management capability, including developing its enterprise architecture and implementing its life cycle methodology, which IRS refers to as its Enterprise Life Cycle.

In early March 2000, IRS submitted to Congress its second expenditure plan that (1) sought approval to obligate an additional $176 million, and (2) reported on its progress in implementing the first plan. With respect to IRS' progress, we briefed the relevant appropriation subcommittee staffs that IRS' performance on the modernization over the last 9 months fell far short of the commitments that IRS had made. We concluded that IRS had not corrected its longstanding management and technical weaknesses and was still not ready build major, software-intensive systems. In the March plan, IRS included initiatives intended to address these longstanding weaknesses. For example, by September 30, 2000, IRS plans to issue an update to its Modernization Blueprint to reflect changes in light of technology advances and IRS' reorganization. In addition, IRS plans to have its Enterprise Life Cycle implemented by June 30, 2000.

We will continue to designate IRS' systems modernization as a high-risk and "challenged" federal program until IRS has corrected its management and technical weaknesses, thus establishing effective controls for building modernized systems.

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

Contact and Acknowledgments

For future contacts regarding this testimony, please contact Margaret T. Wrightson, at 202-512-9110. Ralph Block, Jonda VanPelt, Sherrie Russ, Deborah Junod, Gary Mountjoy, Agnes Spruill, and Tim Hopkins made key contributions to this testimony.

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Mr. HORN. We're going to have everybody else finish. Each are going to summarize for 5 minutes each. That's 15 minutes. And then we'll still have a chance for questions and the commissioner some answers to the questions.

So we will now go to Ms. Colleen M. Kelley, national president of the National Treasury Employees Union.

Ms. KELLEY. Thank you, Chairman Horn, Ranking Member Turner, and members of the subcommittee.

I am the president of the National Treasury Employees Union [NTEU] which represents more than 155,000 Federal employees across the country, including the employees who work at the Internal Revenue Service.

The IRS interacts with more citizens than any other Government agency or private sector business. Twice as many people pay taxes as vote, yet many Americans take for granted the outstanding work done by IRS employees.

Following enactment of the IRS Restructuring and Reform Act of 1998, Commissioner Rossotti set in motion a process to restore the public's confidence in the IRS. The commissioner recognized that any meaningful reform had to include the active participation of his chief assets, his employees, and employees have been involved in the reorganization work being done as we speak and going back to the enactment of RRA 1998.

I believe that modernization will succeed, with the support of Congress and the dedicated work of IRS employees, and I believe Commissioner Rossotti would agree with me that, although the modernization of the IRS will require several more years of effort and commitment, the results so far have been positive.

Communication between IRS management and the employees who make the IRS work has been crucial and will continue to be essential in improving customer service and increasing productivity at the IRS.

I was pleased that Congress, too, recognized the importance of ensuring that the employees' voice in reforming the IRS be heard by insisting on an employee representative on the IRS Oversight Board, which was established through RRA 1998.

Congress recognized that an employee representative was necessary, not in spite of, but because of the important role of IRS employees in reform. NTEU takes great pride in the fact that we have had a cooperative relationship with the IRS dating back more than a decade. Our partnership efforts and employee efforts are constantly being tested, reworked, and revised in the face of budget restrictions and funding limitations and changes in the tax law.

One particular area where NTEU and the IRS have worked together and where we feel we have made great strides has been in improving customer service. This has included not just providing longer office hours, but hours that meet customers' needs.

Without the commitment of the IRS rank and file employees, these well-documented customer service improvements could not have been accomplished in the short timeframe in which they occurred.

We are at a critical point in our restructuring efforts at the IRS. First, technology improvements and investments must continue to

give the IRS and employees the tools that they need to do the work that America's taxpayers need and want done.

Next, since 1993, staffing levels at the IRS have been reduced by 17,000 FTEs; yet, during this period IRS' toll-free phone services and Web-based services for taxpayers have improved and taxpayers have more options for filing their tax returns.

Our employees have made great strides in customer service at the IRS, while continuing to perform the necessary functions of ensuring that the taxes that are due to the Treasury are paid.

Additionally, Congress has made hundreds of changes to the tax code in the past 3 years. In fact, the Taxpayer Relief Act of 1997, alone, made 801 tax law changes.

Next, continued record economic growth in this country has led to an increased number of tax returns and more complexities in taxpayer and business filings. The bottom line is the IRS work force is being asked to do considerably more work with fewer resources. And, while I applaud advances in the use of technology at the IRS and I commend this subcommittee's commitment to these improvements, technology, alone, cannot possibly manage the increasing workload at the IRS.

For this reason, I wish to express NTEU's strong support for increased funding for staff training and the new IRS initiative, STABLE. This initiative will support the hiring of approximately 2,800 new employees at the IRS. The number of IRS revenue agents has declined by roughly 17 percent since 1995, and it will continue to decrease another 4 percent in this fiscal year. We need to reverse the severe cuts in IRS staffing levels and approve this STABLE request.

One last thing I would like to mention is that IRS employees continue to work in fear in section 1203 of the Revenue Restructuring Act. As you know, section 1203 lists 10 infractions, known as the "10 deadly sins," for which IRS employees face mandatory dismissal. The broad scope and vague nature of these 10 deadly sins have created anxiety and confusion in the workplace.

Just last week, the House Ways and Means Committee approved legislation which would waive penalties for taxpayers who do not pay their taxes on time; yet, if IRS employees are as little as 1 day late in paying their taxes, they are subject to mandatory dismissal.

NTEU vigorously opposed section 1203 and continues to believe that this section of the Restructuring Act should be repealed. I am hopeful that this subcommittee will work with NTEU and Commissioner Rossotti to address this issue.

In summary, since 1992 the IRS work force has declined by more than 16 percent. In the meantime, demands on IRS employees have increased significantly. Unless Congress gives the IRS the staffing and the resources for technology necessary to do the job, our entire tax system will be threatened and we will not be able to meet the challenges of the 21st century.

Thank you, again, for the opportunity to appear today.

Mr. HORN. Thank you very much.

[The prepared statement of Ms. Kelley follows:]

TESTIMONY

OF

COLLEEN M. KELLEY

NATIONAL PRESIDENT
NATIONAL TREASURY EMPLOYEES UNION

"IRS RESTRUCTURING AND REFORM ACT"
APRIL 10, 2000

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY
HOUSE COMMITTEE ON GOVERNMENT REFORM

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Chairman Horn, Ranking Member Turner, and Members of the Subcommittee, my name is Colleen Kelley and I am the President of the National Treasury Employees Union. As you know, NTEU represents more than 155,000 federal employees across the federal government, including the employees who work at the Internal Revenue Service. I want to thank you for holding this important hearing today and for giving me the opportunity to present testimony on behalf of the dedicated men and women who work at the IRS.

The IRS interacts with more citizens than any other government agency or private sector business. Twice as many people pay taxes as vote. Yet, many Americans take for granted the outstanding work done by IRS employees and they fail to realize how this work helps the world's premier democracy continue to flourish. However, we know that without the IRS, we would not be able to have the funds to maintain the world's strongest military force, a fair judicial system, or a robust transportation infrastructure. Therefore, it is incumbent on this subcommittee to carefully consider the effects of any changes at the IRS because they not only directly affect the lives of IRS employees, they impact the livelihoods of every American.

Following enactment of the IRS Restructuring and Reform Act of 1998 (RRA), Commissioner Rossotti set in motion a process to restore the public's confidence in the IRS. The Commissioner recognized that any meaningful reform had to include the active participation of his chief asset - his employees. NTEU has long argued for meaningful input for employees, not only at the IRS, but in every federal agency.

the IRS will require several more years of effort and commitment, the results so far have been positive. It is heartening for both the Commissioner and I to hear from Members of Congress, the taxpaying public and those that practice before the IRS that we are on the right road. It wasn't too long ago that nary a positive word was heard about the IRS - either in Congress or among the taxpaying public. Communication between IRS management and the employees who make the IRS work has been crucial to this positive turn of events and will continue to be essential as we continue our important work together to improve customer service and increase productivity at the IRS.

I was pleased that Congress, too, recognized the importance of insuring that the employees' voice in reforming the IRS be heard by insisting on an employee representative on the IRS oversight board which was established through RRA. Congress insured that employees' views would be received as the IRS began its reform efforts. Congress recognized that an employee representative was necessary, not in spite of, but ***because*** of the important role of IRS employees in reform.

I believe we are in agreement that the most valuable resource at the IRS and throughout the federal government is the employees. As has been shown time and again, when federal agencies make a conscious decision to involve rank and file employees in the decision making process, everyone wins: the agency, the employees, and most of all, the agency's customers - the American taxpayers.

There is a direct link between employee job satisfaction and satisfied customers. Research has shown that the quality of service delivery depends on the situation created by the organization. Soliciting and using customer feedback, providing adequate staffing and training programs that emphasize service quality, considerate supervision and career development opportunities are all key to creating an atmosphere in which the employee is motivated to deliver the best possible level of service. As a result of NTEU involvement in the restructuring and modernization of the IRS, the IRS is successfully implementing the new mandates imposed by Congress in RRA.

NTEU takes great pride in the fact that we have had a cooperative relationship with the IRS dating back more than a decade, well before RRA. Over the years, we have honed our relationship, building on ideas that get results and tossing out those that do not lead to success. While our partnership has not always been perfect, we have learned from each other and continue to learn and build on our relationship as new and challenging situations arise. Our partnership efforts are constantly being tested, reworked and revised in the face of budget restrictions and funding limitations and changes in tax law. Each tax law change requires the IRS to reprogram computers, retrain employees, update forms and redouble customer service efforts designed to explain these changes to taxpayers. There is often a temptation to blame IRS employees for the complexity of the tax law. This fact makes it all the more important that IRS and NTEU work together to insure that employees have the tools they need to perform their jobs. While some of our partnership efforts with IRS need some improvement, others have worked well.

For example, last year, the North Central District of the IRS (North and South Dakota and Minnesota) and NTEU Chapters 2, 8 and 29 received the 1999 John N. Sturdivant National Partnership Award. The North Central District Partnership Council received this award for its accomplishments and its team approach to resolving difficulties. Its successes include development of a joint mandatory training program on new work procedures which has increased training effectiveness and dramatically reduced training time and costs, and expansion of the IRS's conflict management initiative to include cooperative dispute resolution. IRS employees in the North Central District are proud of their accomplishments and the fact that they have been able to help improve the IRS's organizational performance. Again, this is an excellent example of what can be accomplished by providing a voice to front line employees.

IRS employees are competent, hardworking and motivated individuals who want to deliver a high quality product to the American taxpayer. Commissioner Rossotti knows this and his efforts to empower employees have reaped rewards. We, NTEU and the IRS, have worked collaboratively and we have tried, and continue to try, new and different approaches to solving problems.

One particular area where NTEU and IRS have worked together and where we feel we have made great strides, has been in improving customer service. This has included providing not just longer office hours, but hours that meet customer's needs, taking our services to more customer-friendly environments like libraries and shopping malls and using the latest technology to provide our services. The dramatic results attained have resulted from improvements in the

efficiency of IRS employees and operations, proving again that including front line employees early in the decision making process has a positive effect on the bottom line. Without the commitment of IRS rank and file employees, these well documented customer service improvements could not have been accomplished in the short time frame in which they have occurred.

An excellent example of the steps we are taking to improve customer service was the establishment of Problem Solving Days. This nationwide effort to provide taxpayers with direct, one-on-one assistance with tax questions and problems proved to be an unqualified success. Surveys following these problem solving days have shown that both taxpayers, ***and employees***, believed these efforts were successful. Following the first series of Problem Solving Days, taxpayers rated employees on their service, courtesy, competence and fairness of treatment, effort put forth toward solving problems, and convenience of office hours. Using a scale of between one (1) and seven (7), the overall rating was 6.46 – ***6.46 out of a possible 7***. Employee courtesy ranked highest at 6.77. This experience showed beyond a doubt that given a clear goal, and adequate time and resources, IRS employees can deliver a level of service that in many cases actually exceeds that expected by taxpayers.

Yet as we stand here today in the Spring of 2000, the dawn of the 21st century, we are at a critical point in our restructuring efforts at the IRS. While the close of the last century brought measurable improvements in customer service at the IRS, the agency is lacking the staffing and resources necessary to build on this progress, and to ensure that revenues due to the Treasury

continue to be collected and our tax laws are followed.

Since 1993, staffing levels at the IRS have been reduced by 17,000 FTEs. Yet, during this period, IRS toll free phone services and web-based services for taxpayers have improved, taxpayers can visit IRS officials at more convenient locations during longer hours of operation, and taxpayers have more options for filing their returns. Meanwhile, it is projected that the IRS will collect $1.767 trillion in revenues for FY 2000, will receive 213.1 million returns, and will issue over 93 million individual refunds.

Our employees have made great strides in improving customer service at the IRS while continuing to perform the necessary functions of ensuring that the taxes that are due to the Treasury are paid. Yet the 71 new taxpayer rights established in RRA 98 have created new procedures in handling cases, which has led to some confusion among IRS employees and has increased the time it takes to close current cases. Additionally, Congress has made hundreds of changes to the tax code in the past three years: in fact the Taxpayer Relief Act of 1997 alone made 801 tax law changes. Next, continued record economic growth in this country has led to an increased number of tax returns and more complexities in taxpayer and business filings. For example, IRS Commissioner Charles Rossotti pointed out in testimony presented to the Congress this year that since 1993, the number of individual tax returns with over $100,000 in reported income, which are generally more complex returns, has increased by 63 percent. These and other demands being put on IRS employees have contributed to a significantly increased workload at the IRS. Plain and simple, the IRS workforce is being asked to do considerably more work with

fewer resources. And while I applaud advances in the use of technology at the IRS, and I commend this subcommittee's commitment to these improvements, technology alone cannot possibly manage the increasing workload at the IRS.

For this reason, I wish to express NTEU's strong support for increased funding for staff training and for the new IRS initiative, "Staffing Tax Administration for Balance and Equity" (STABLE). With regard to training, we at NTEU very much want the taxpayers to be guaranteed the rights they are entitled to. We want the RRA 98 provisions to work for the taxpayers and for the IRS. And we want the taxpayers to be able to take full advantage of the recent changes in the tax code. Our employees are up to these challenges, but if taxpayers and the IRS are to reap the benefits of these improvements, then we need to dedicate more resources to training our employees about these complex changes.

The STABLE initiative will support the hiring of approximately 2,800 new employees at the IRS. Specifically, the budget requests an increase in funding for Fiscal Year 2001, which would allow for the hiring of 2,534 new employees at the IRS beginning October 1, 2000. The President has also requested a supplemental appropriation of $39.8 million to allow the IRS to hire 301 new staff in the current fiscal year, so that they will be trained and ready for fiscal year 2001.

The number of IRS revenue agents has declined by roughly seventeen percent since 1995, and will decrease an additional four percent during the current fiscal year. And as a result

of RRA 98, many IRS examination staff, revenue agents, compliance officers, auditors and others have been detailed to help improve customer service, answer taxpayers' questions, and provide walk-in assistance to the taxpayers. I strongly believe that the IRS should continue to expand the hours of service and convenience of the walk-in service, which in turn will lead to reduced waiting times and further improved quality of service for the taxpayers. However, increased emphasis on customer service should not come at the expense of collecting unpaid taxes and ensuring that taxpayers are complying with our tax laws when it comes to reporting the correct amount of income received.

In order to continue to make improvements in the level of customer service while simultaneously processing a growing number of tax returns and stabilizing collections and examinations of cases, we need to reverse the severe cuts in IRS staffing levels, and approve the STABLE request. The President's request for additional staffing is a modest increase over current levels and if fully implemented would still mean fewer IRS employees than the agency employed in 1997.

The last, but by no means least important, issue I wish to discuss, which is seriously undermining IRS efforts to carry out its mission, is that IRS employees continue to work in fear of section 1203 of the RRA. As you know Section 1203 lists ten infractions, known as the "10 Deadly Sins," for which IRS employees face mandatory dismissal. The broad scope and vague nature of the "10 Deadly Sins" have created anxiety and confusion in the workplace. These infractions, which range from IRS employees not paying their taxes on time, to harassing

taxpayers, to violating the civil rights of taxpayers, have always subjected employees to discipline, including dismissal, and rightly so. However, RRA's requirement for ***mandatory*** dismissal of employees who violate these infractions, is having a chilling effect on collections and morale at the IRS.

Furthermore NTEU is concerned about double standards in this area. We do not believe that those enforcing our nation's tax laws should be treated more harshly than other federal employees. No other government employee in the executive branch, judicial branch, or legislative branch – and in fact no other American taxpayer – can be fired solely on the basis of paying their taxes one day late. Moreover, just last week, the House Ways and Means Committee approved legislation which would waive penalties for taxpayers who do not pay their taxes on time. Yet, if IRS employees are as little as one day late in paying their taxes, they are subject to mandatory dismissal.

While I am not suggesting that Section 1203 be expanded, I want to point out the double standard here for those who work at the IRS. It seems incredibly unfair to single out for mandatory termination the men and women who enforce our tax laws and collect the revenues to pay the salaries of every federal employee.

NTEU vigorously opposed Section 1203 and continues to believe that this section of the Restructuring Act should be repealed. IRS employees have justifiably expressed reservations that they could inadvertently break one of the rules and face termination. In order to relieve the

anxiety most IRS employees feel and create the trust necessary to continue to move toward a modernized IRS, Congress needs to work with the IRS and NTEU to repeal or modify this section of the law. I am hopeful that this subcommittee will work with NTEU and Commissioner Rossotti to address this issue.

In summary, since 1992, the IRS workforce has declined by more that 16%. In the meantime, demands on IRS employees have increased significantly. IRS employees want to deliver first rate programs and services to the American taxpayers. But, unless Congress gives the IRS the staffing and resources necessary to do the job, our entire tax system will be threatened and we will not be able to meet the challenges of the 21st century. I am hopeful that IRS employees, and the American taxpayers, can count on this subcommittee to provide the oversight, the staffing, and the resources the IRS needs to carry out its mission.

I would like to thank the Subcommittee again for the opportunity for our Union to present its views on the implementation of the IRS Restructuring and Reform Act. As you continue your subcommittee's deliberations, I hope you will give special consideration to the hard work and dedicated service the men and women at the IRS provide our nation. I would be happy to answer any questions.

Mr. HORN. Our next presenter is W. Val Oveson, National Taxpayer Advocate, Internal Revenue Service.

Mr. OVESON. Thank you, Mr. Chairman and distinguished members of the subcommittee. I appreciate the opportunity to be here with you today and to talk a little bit about the role of the Taxpayer Advocate—the "Taxpayer Advocate Service" is the name we have adopted internally—in helping taxpayers to resolve their problems with the IRS.

I have now been the National Taxpayer Advocate for 18 months, and during that 18 months we've implemented the provisions or RRA 1998 within the Taxpayer Advocate Service, or in the process of implementing them. Many of them, as Commissioner Rossotti mentioned, will take some time to actually play themselves out.

The restructuring provided opportunities for the Taxpayer Advocates across this country to be better positioned, better trained, and more focused to address the problems that the taxpayers are facing.

I am pleased to report to you that the new Taxpayer Advocate Service officially transitioned as a modernized organization on March 12, 2000.

Every State now has at least one local Taxpayer Advocate who works to resolve problems that individual taxpayers have with the IRS. Many States have multiples, depending on the population and other factors. They also address taxpayer problems within the IRS, policy and procedural failures, and recommend solutions to improve those problems.

Between October 1, 1999 and March 31, 2000, the Taxpayer Advocates across this country closed 114,000 cases. During fiscal year 1999, Taxpayer Advocates worked on more than 292,000 taxpayer cases to help resolve their problems with the IRS, and almost 93,000 of those cases met the expanded hardship criteria defined in RRA 1998.

RRA 1998 expanded the authority to issue taxpayer assistance orders when taxpayers are suffering or about to suffer a significant hardship.

We work with front-line IRS employees in an effort to resolve taxpayer problems, and knowing that we have the authority to issue the taxpayer assistance order is usually enough to convince the functional IRS employees to work with the taxpayer to resolve the issue.

So far this fiscal year we have issued three taxpayer assistance orders. During fiscal year 1999, we issued five.

We also identify and monitor the progress of procedural and systemic changes designed to benefit taxpayers. For example, we worked with IRS operations to delay the implementation of some of the procedural changes related to secondary Social Security number matching. By negotiating a change to the implementation date, we prevented refund delays and communications frustrations for thousands of taxpayers.

In addition, we worked with a variety of stakeholders to identify legislative changes. In the fiscal year 1999 report, I included several recommendations related to penalty and interest administration, and a proposal that would allow the IRS to correct its own er-

rors—amazing as that sounds, that's something that needs to be corrected.

I am pleased that several of these provisions are included in the proposed Taxpayer Bill of Rights 2000.

My annual report to Congress includes a ranked list of the top 20 most serious problems facing taxpayers. Today I'd like to focus on four of those.

The complexity of the tax code remains the most serious problem facing taxpayers. I believe that the single most complicating factor of tax administration is the frequency and number of changes to the tax law. I encourage you to reduce the complexity of the existing laws, or at least to slow down the frequency of change.

No. 2, the IRS must be able to communicate with taxpayers regarding account activity and computer-generated compliance notices. This means the toll-free telephone service must be improved, and I say that recognizing that some tremendous improvements have been made over the last year, but they're still not enough.

The IRS must ensure that taxpayers can get in to an individual who can help them with their problems and who can answer the phone.

It is equally important that Congress fund this critical activity.

RRA 1998 provisions expanded the innocent spouse relief available to taxpayers, and they are filing in large numbers. The sheer volume of cases stretches the ability of the system to deal with these cases.

The IRS must reduce the processing time, increase the training, and ensure that all levels of the agency have internalized the new requirements of this law in order to get it right in the future.

Offer and compromise is another area of RRA 1998 that I'd like to talk about for a moment. This provided the authority to resolve collections issues that the IRS now has the authority to compromise based on the effective tax administration criteria. The training needs are tremendous. The volumes are much greater than anticipated. And the IRS must speed up the process so that taxpayers can get timely decisions to these critical issues.

The changes being made as a result of the modernization are placing the service in a better position to understand the problems, the frustrations, and the needs of taxpayers. The new operating divisions will be a catalyst to improving service to the IRS and to make progress in eliminating problems that are on my top 20 list.

In conclusion, thank you very much for inviting me here today. The Taxpayer Advocates mission statement is to help taxpayers resolve problems that taxpayers are having with the IRS, and with your continued support and the support of the Treasury Department and all of the IRS employees, we can continue to make progress toward that goal.

Thank you very much.

Mr. HORN. Thank you very much.

[The prepared statement of Mr. Oveson follows:]

Statement of
W. Val Oveson
National Taxpayer Advocate
Internal Revenue Service

Before the
Subcommittee on Government Management, Information and Technology
House Committee on Government Reform

April 10, 2000

Mr. Chairman and distinguished members of the Subcommittee:

Thank you for inviting me to testify before the Subcommittee regarding the role of the Taxpayer Advocate Service in helping taxpayers resolve problems with the Internal Revenue Service.

I have now served as the National Taxpayer Advocate for 18 months and have issued two annual reports to Congress. As I reported in December 1999, the last year has been a year of incredible change for the Taxpayer Advocate Service. Implementing the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA '98) was a major challenge and the process of modernizing the Taxpayer Advocate Service energized us and exhausted us. However, the restructuring provided opportunities for Taxpayer Advocates across the country to be better positioned, better trained and more focused to address the problems facing taxpayers. The new Operating Divisions within the IRS have started the modernization process and they will experience the turmoil involved in restructuring a major business. However, I firmly believe that taxpayers will only realize the improvements you intended in RRA '98 if the modernization is allowed to continue over the long term.

I. Role of the Taxpayer Advocate

I am pleased to report that the new Taxpayer Advocate Service officially transitioned as a modernized organization on March 12, 2000. We developed a modernized organization to deliver service to each taxpayer through our casework, and to every taxpayer through outreach, systemic analysis, and advocacy.

Every state now has at least one Local Taxpayer Advocate. Local Taxpayer Advocates work to resolve problems that individual taxpayers have with the Internal Revenue Service. They also address taxpayer problems when an IRS system, policy or procedure fails. Separate addresses, telephone and fax numbers for Taxpayer Advocates are included on notices of deficiency and are being published as the telephone directories are updated.

We hired the Operating Division Taxpayer Advocate and several Advocacy Analysts for the Wage and Investment Operating Division. Advocacy Analysts identify and monitor the progress of procedural, systemic and legislative changes designed to benefit taxpayers. They also solicit feedback from taxpayers and key stakeholders about IRS problems. We will hire an Operating Division Taxpayer Advocate for the Small Business/Self Employed Operating Division and additional Advocacy Analysts as the new IRS Operating Divisions become operational later this year.

II. Casework

Between October 1, 1999 and March 31, 2000 Taxpayer Advocates closed 113,976 cases. During fiscal year 1999, Taxpayer Advocates worked on 292,843 cases of which 92,852 met the expanded hardship criteria defined in RRA '98 Section 1102, (amending Section 7811 of the Internal Revenue Code). We also worked on 199,991

other cases where taxpayers were seeking assistance. The expanded hardship criteria caused us to change the way we classify cases and resulted in nearly a threefold increase in hardship criteria cases and a decrease in the old Problem Resolution cases of 81,704 from the previous fiscal year. The expansion of the hardship criteria was so dramatic, that we collapsed the traditional problem resolution criteria into the statutorily based, hardship criteria. This made it easier for the taxpayers and the IRS staff to understand the types of cases that qualify for Taxpayer Advocate assistance.

RRA '98 expanded the authority of the National Taxpayer Advocate to issue Taxpayer Assistance Orders when the taxpayer is suffering or is about to suffer a significant hardship as a result of the manner in which the tax laws are being administered. We work with front-line IRS employees in an effort to resolve taxpayer problems, and knowing that the Taxpayer Advocate has the authority to issue a Taxpayer Assistance Order is usually enough to convince a functional IRS employee to work with the taxpayer to resolve the issue. The functions can appeal a Taxpayer Assistance Order, and we encourage them to do so, if they are convinced that the action they proposed appropriately balanced the interests of the Government with the rights of the taxpayer. So far this fiscal year, we have issued three Taxpayer Assistance Orders. During Fiscal Year 1999, we issued five.

III. Advocacy

Taxpayer Advocates analyze the major issues reported on cases and look for systemic problems. As a result of this analysis, they identify proposals to improve service and reduce taxpayer burden. Many of these proposals result in changes to

processes and procedures. For example, we worked with IRS Operations to delay the implementation of some of the processing changes related to secondary social security numbers. If the name reported to IRS did not match the name reported to the Social Security Administration, refunds would be delayed. Most frequently, this mismatch occurs when a married taxpayer does not report a name change to both IRS and Social Security. By negotiating a change to the implementation date, we prevented refund delays and communications frustrations for thousands of taxpayers.

In addition, Taxpayer Advocates and a variety of internal and external stakeholders routinely identify situations where current law may prevent the resolution of taxpayer problems. We carefully evaluate all suggestions and include legislative proposals in the annual report that are designed to reduce complexity for taxpayers or to increase the ability of IRS to provide relief. In the Fiscal Year 1999 report, I included several recommendations related to penalty and interest provisions that provided clarification on interest accrual, provided IRS more ability to abate interest or waive penalties, and simplified penalty administration. I also submitted a proposal that would allow IRS to correct its errors in taxpayer cases and thus provide relief to taxpayers that is now prevented by law in many cases. I am pleased to report that several of these provisions are included in the proposed Taxpayer Bill of Rights 2000.

IV. 20 Most Serious Problems Facing Taxpayers

The National Taxpayer Advocate's Annual Report to Congress includes a ranked list of the 20 most serious problems facing taxpayers. As illustrated in the following table, the ranking may have changed between fiscal years 1998 and 1999, but the problems remained the same.

The changes being made as a result of the modernization are placing the Service in a better position to understand the problems, frustrations, and needs of taxpayers. The new Operating Divisions, which have been designed around customer bases, will also be a catalyst to improve service to taxpayers and make progress in eliminating problem areas from the top 20 list.

THE TOP 20 PROBLEMS FACING TAXPAYERS		
Ranking for 1999	**Name of Problem**	**Ranking for 1998**
#1	Complexity of the Tax Law	#1
#2	Clarity and Tone of IRS Communications	#2
#3	Administration of the Earned Income Tax Credit	#3
#4	Lack of One-Stop Service	#4
#5	Penalty Administration	#5
#6	Inability to Access the Toll-Free Number	#12
#7	Lack of Acknowledgment of Correspondence and Payments	#6
#8	Divorced and Separated Taxpayers	#7
#9	Offer-In-Compromise Program Issues	#8
#10	Misapplied Payments	#10
#11	Delays in Compliance Contacts	#13
#12	Audit Reconsiderations	#19
#13	Maintaining Taxpayers' Current Addresses	#9
#14	Separate Mail Out of Math Error Notices and Refund Checks	#11
#15	Compliance Burden on Small Business	#16
#16	Lack of Concern for Taxpayer Problems and Issues	#15
#17	Substitute for Return Issues	#20
#18	Understanding Federal Tax Deposit Problems	#14
#19	Cost to Taxpayers of Electronic Filing	#17
#20	Automated Collection System Levy Releases	#18

IV.a. Complexity of the Tax Law

Complexity remains the most serious problem taxpayers face. I believe that the single most complicating factor in tax administration is the frequency and number of changes to the tax law. I encourage you to reduce the complexity of the existing laws or at least to slow down the frequency of the changes.

IV.b. Inability to Access the Toll Free Number

The Service must be able to communicate with taxpayers regarding account activity and computer generated compliance notices. This means the toll-free telephone service must be improved. The Service instituted major improvements in the technology and infrastructure for this service. Many taxpayers report that if they get through and can talk to a customer service representative, they are being helped. However, many are not getting through. To meet customer service objectives, the Service must ensure that taxpayers can get in by assigning the staff and resources necessary to answer the telephones. It is equally important that Congress provide the funding required to support this critical component of IRS customer service.

IV.c. Divorced and Separated Taxpayers

RRA '98 provisions expanded the innocent spouse relief available to taxpayers, who are filing claims in large numbers. The sheer volume of cases stretches the ability of the system. The IRS faces a major challenge ahead in reducing processing times, increasing training in a complex area of the law and ensuring that all levels of the agency internalize the requirements of the new law.

IV.d. Offer in Compromise Program Issues

RRA '98 gave the Service new authority to resolve collection cases. Now in addition to the doubt as to collectibility and the doubt as to liability, the Service has the authority to compromise when it will promote effective tax administration. This additional basis for compromise allows the Service to consider equitable factors in compromising cases. Again, the training needs are tremendous because of the changes, and the volumes are much greater than anticipated. The management task will be to find a way to speed up the process so that the taxpayers can get timely decisions.

V. Challenges Ahead

The Service will face many challenges this year. Implementing the modernization is one of the biggest for the IRS and the Taxpayer Advocate Service. In the past, I stated that Congress liberated the IRS from maximizing revenue, which was oftentimes epitomized by the phrase, "protecting the interests of the government." I asserted that the new mission of the IRS should be to balance the interests of the government with the interests of the taxpayer. I also commented that to balance these interests, it would require the IRS to back away from positions and issues that they had pursued in the past. If this new philosophy is to take root and grow to its full potential, the IRS modernization efforts must have the sustained support of the Congress, the Treasury, and the American people. It is imperative that we stay the course and see the changes through. If the IRS is going to provide the level of service demanded by the

public, then enforcement levels of the past cannot be achieved with the existing organization and resources.

VI. Conclusion

Thank you for giving me this opportunity to report to you on the Taxpayer Advocate Service. The dedicated employees of the Taxpayer Advocate Service have internalized our Mission Statement *"We help taxpayers resolve problems with the IRS and recommend changes that will prevent the problems."* They are going the extra mile to assist taxpayers who need our help. I have talked to scores of taxpayers and practitioners who rave about the service they have received. For twenty years, this program has been fixing problems and making the system better. But, even with a solid record of success, we must to do more to implement the new statutes and meet your expectations, and the expectations of the public. I am confident that with the sustained commitment of Congress, Treasury, the Commissioner and IRS employees, we can meet the challenge and provide better service and greater equity to America's taxpayers.

Mr. HORN. We now have Mr. David L. Keating, the senior counselor, National Taxpayers Union.

Mr. Keating.

Mr. KEATING. Mr. Chairman, Mr. Turner, members of the subcommittee, I thank you for the invitation this morning to testify on the IRS, and I appreciate your continued interest in how the IRS is operating.

A historic step was taken 2 years ago when the Congress passed and the President signed into law the Internal Revenue Service Restructuring and Reform Act. As a member of the Commission on Restructuring the IRS, I was both proud and pleased to see that Congress not only agreed to the far-reaching reforms that we recommended, but went a few more steps beyond.

While a promising start has been made by the IRS, I think it is still far too early to conclude whether reform efforts will succeed or fail. If reform is successful, it will take many years before the average taxpayer will notice substantial improvements in the day-to-day operations of the IRS, especially in the audit and collection area.

The risk of failure is still high, due to the tax laws' growing complexity, the agency's culture that still resists change, criticism, and independent advocacy for taxpayers, and—I think this is equally important—the possibility that elected officials will pressure the IRS to increase enforcement at the expense of fairness.

There are both hopeful signs and discouraging signs. I'm hopeful the agency will improve because Congress continues to show genuine interest in how it operates. This is something that we had not seen in years before the Commission was established to review the IRS. Congress also passed much-needed taxpayers' rights provisions.

We're also very much impressed with the work of the commissioner and the caliber of several of the people he has hired to help him improve the IRS. We believe he brings the right background and attitude to the job, and we have had the pleasure to meet with him.

He has proven, I think, beyond a doubt, that a commissioner does not have to be a tax lawyer or accountant. In fact, a good case can be made that we may be better off with commissioners who are not tax lawyers or accountants.

I do want to say a few things about the IRS Oversight Board. My testimony was quoted earlier, but I really do think it was important for the administration to meet the legal deadline. It was over a year late, and we're still waiting, unfortunately, for the nominees to be confirmed, due to an unrelated controversy in the Senate.

I call on the administration today to encourage the unnamed democratic Senator, who has placed a hold on at least one of these nominees and prevented the Senate from considering all of them, to release that hold and let's get these nominees confirmed and get them to work. They should have been on the job quite some time ago, and I think it is unconscionable that we are holding up confirmation of these nominees for some issue unrelated to the issue of tax administration and the IRS.

The IRS touches essentially every American citizen, directly or indirectly, and the unrelated controversy that is being talked about

in the Senate, my understanding is, concerns some ambassador to some country that probably isn't even that large, certainly not compared to the population of taxpayers. The administration should work with its party colleagues in the Senate and get that hold released to get these nominees confirmed.

Also, I do want to say a few words about IRS culture. It is very important that the agency's culture be changed, and they are working very diligently to do that. This, too, requires ongoing commitment by the Congress. For far too long in the past, the IRS emphasized tax collection as opposed to faithful interpretation of the law and respect for taxpayers' rights. Much of that attitude, I think, developed over the years from the 1970's and 1980's. In that time pressure was placed on the agency to increase revenues so that Congress would not have to increase tax rates to close the deficit.

As a result, the IRS developed internal statistic that tracked enforcement actions, while neglecting agency compliance with laws, regulations, and its own Internal Revenue Manual.

Recent news accounts indicate some Members of Congress and candidates have raised concerns about the IRS' level of enforcement actions in the previous fiscal year. While we can understand these concerns, we think they are misplaced at this time. The IRS is in the middle of a massive restructuring and retraining program. In our view, the recent collection statistics are almost meaningless.

Those who expressed a concern about the enforcement statistics seem unconcerned by recent reports from the Inspector General for Tax Administration that show the IRS failed to follow the law, regulations, or internal guidelines in roughly one of three enforcement actions reviewed by the Inspector General. We think this error rate is also completely unacceptable.

We do note that the IRS is moving ahead with balanced measurement statistics. I am very optimistic that these will help ensure fair collection and fair treatment of taxpayers in the future.

My statement also explains that the IRS may soon administratively define the power of the National Taxpayer Advocate to issue a taxpayer assistance order. We think the law is rather clear, and we are rather puzzled at the need to perhaps administratively define, and we fear limit, that power, which we think power is quite clear.

The advocate can order the IRS to take any action the IRS could take on its own. I have spoken with the commissioner on this, and I know they are working on it diligently, but the same IRS that doesn't think that it can post taxpayers who are due refunds on the Internet because they are allowed to send press releases out to every newspaper in the country but they can't take the same press release and put it on the Internet, shows an IRS that tries to adhere to the law to its letter. Yet, I think the law regarding the Taxpayer Advocate is equally clear and the advocate's power should be duly recognized in any administrative action.

One final point I would like to make here—two final points, if I might—while we applaud the IRS' efforts to publish photos of missing children on pages of tax form instruction booklets, we wonder why the IRS is not doing more to reunite millions of parents with their missing part of their tax refunds.

The Inspector General noted that the IRS is not bringing to the attention of perhaps—I think it is 1.7 million taxpayers who appear to have forgotten to claim the child tax credit last year, and presumably they will make the same error this year.

We found the agency's response to the Inspector General's report unsatisfactory and unacceptable, and we think if there are 1.7 million taxpayers who may have forgotten a tax credit, the IRS should tell them that they may have forgotten it.

The final point I'd like to make is the issue of simplification. As Val Oveson has stated, and many of us have stated, the tax law is so complicated nobody understands it. Yet we expect the IRS to enforce and administer this law.

One of the recommendations not taken up by the Congress from the National Commission was some sort of procedure to establish a quadrennial simplification process or provide additional simplification incentives beyond a simple report by the Joint Tax Committee on pending legislation.

I would like to bring to the committee's attention and the public's attention the interest in simplification was recently demonstrated by an unprecedented joint initiative of the American Bar Association, the American Institute of Certified Public Accountants, and the Tax Executives Institute that recommended 10 ways to simplify the law. Many of these recommendations were quite good, and we commend them to the Congress.

We see no reason, for example, why there has to be multiple definitions of a child under the tax law to claim various tax breaks such as tax credit, and earned income credit and personal exemption. It's ridiculous. It makes things complicated for the taxpayer as well as the IRS.

Again, thank you very much, Mr. Chairman, Mr. Turner, members of the committee, for holding this hearing and for your continued interest in the IRS.

Mr. HORN. Thank you.

[The prepared statement of Mr. Keating follows:]

Statement of
David L. Keating
Senior Counselor,
National Taxpayers Union

before the

Subcommittee on Government Management, Information and Technology
Committee on Government Reform
U.S. House of Representatives

on the

Progress of IRS Reform

April 10, 2000

Mr. Chairman and Members of the Committee, thank you for inviting me to testify on the progress of efforts to reform and restructure the Internal Revenue Service.

The Internal Revenue Service contacts millions of Americans each year. For many of us, it is the only agency we deal with so regularly. It's important that Congress continue its work to improve the IRS.

A historic positive step was taken when Congress passed and the President signed into law the Internal Revenue Service Restructuring and Reform Act of 1998. As a member of the National Commission on Restructuring the IRS, I was both proud and pleased that Congress agreed to enact the far-reaching reforms that we recommended.

While a promising start has been made, the agency is in the middle of a massive reorganization and transition. Many problems have yet to be solved, and taxpayers still do not receive the service they deserve.

It is far too early to conclude whether IRS reform will succeed or fail. If reform is successful, it will take many years before the average taxpayer will notice substantial improvements in the operations of the IRS.

The risk of failure is still high due to the tax law's growing complexity, the agency's culture that still resists change, criticism and independent advocacy for taxpayers, and the possibility that elected officials will pressure the IRS to increase enforcement at the expense of fairness to taxpayers.

There are both hopeful signs and discouraging signs. I am hopeful that the agency will improve because the Congress has shown genuine interest in the topic of IRS reform. It also passed much-needed taxpayers rights provisions.

We are also impressed with much of the work of Commissioner Charles Rossotti and the caliber of several of the people he has hired. We believe he brings the right background and attitude to the job. He has proven beyond a doubt that a Commissioner does not have to be a tax lawyer or accountant.

Instead of dividing the country into regional districts, the Commissioner is reorganizing the agency into divisions that will serve types of taxpayers (i.e., self-employed and small businesses, wage and salary earners, large corporations, and non-profit organizations). We fully support this approach and believe it holds much promise to increase service to taxpayers.

We are pleased that the districts will soon disappear in part because many of the worst abuses and inequities came about because local managers too often interpreted the law in a way that was inconsistent with national IRS policies.

We can also be grateful that the IRS did manage to prepare its computers for the year 2000, and the filing season to date appears to be progressing smoothly.

Yet there are still many discouraging signs, and the rest of my statement will review some of the problems that remain and make recommendations.

IRS Oversight Board

One of the National Commission's key recommendations was that "overall responsibility for executive branch governance of the IRS should be placed with a new Board of Directors, accountable to the President and the American people, to provide the expertise and continuity to ensure that the IRS achieves its mission."

The Administration opposed our recommendation, but agreed to a compromise in structuring such a board, which was reflected in legislation adopted by the House of Representatives on November 5, 1997. After the House vote, there was little doubt that the bill would become law. The only question was how soon.

The reforms signed into law on July 22, 1998 say in part that "The President shall submit the initial nominations [to the Internal Revenue Service Oversight Board] . . . to the Senate not later than 6 months after the date of the enactment of this Act."

Unfortunately, the nominations took over 18 months to reach the Senate, and we are still waiting for Senate confirmation of the nominations because of a controversy unrelated to the nominees.

Why is it that the Treasury Department and IRS expect taxpayers to understand a highly complex tax law and file their tax returns on time, but that this simple and clear provision in the law intended to improve the IRS was flouted?

During the Commission and the Congressional deliberations on IRS restructuring and reform, Treasury Secretary Lawrence Summers said many times that a Board was unnecessary and unwise. The long delay in submitting the nominations raises the question of whether the Administration is seeking to revamp the IRS on its own without the oversight and input of the legally-required IRS Oversight Board. It also suggests to taxpayers that IRS reform is a low-priority issue for the Administration.

We were also disappointed that none of the nominees appear to have, as required by law, "professional experience and expertise in . . . [t]he needs and concerns of taxpayers."

IRS Culture

IRS reform will fail unless the agency's culture can be changed. This requires ongoing commitment by the Congress. For far too long, the IRS emphasized tax collection as opposed to a faithful interpretation of the law. We have heard too many times the old mantra of "protecting the interests of the government," which as National Taxpayer Advocate Val Oveson has noted meant "maximizing revenue."

Much of that attitude developed over the years due to pressure placed on the agency by previous Congresses to increase revenues so that Congress would not have to increase tax rates. As a result, the IRS developed internal statistics that tracked enforcement actions while neglecting agency compliance with the laws, regulations, and the Internal Revenue Manual.

Recent news accounts and some Members of Congress have raised concerns about the IRS's level of enforcement actions in the previous year. While we can understand these concerns, they are misplaced. The IRS is in the middle of a massive restructuring and retraining program. In our view, the recent statistics are meaningless.

It would be a mistake for Congress, the President, or candidates for public office to criticize the agency for the recent enforcement statistics. The new law is quite clear. Congress rightly desired that taxes be collected fairly and according to taxpayers' rights provisions in federal laws.

Those who expressed concern about the latest enforcement statistics seem unconcerned by recent reports from the Inspector General for Tax Administration that show the IRS failed to follow the law, regulations, or internal guidelines in roughly one third of enforcement actions he reviewed. This error rate is completely unacceptable.

We are pleased that the IRS is moving ahead with new and better-balanced measures of employee performance that take into account a range of important aspects of each employee's job, including taxpayer satisfaction with the service. This was long

overdue, and was clearly prompted by the new legislation as well as the new Commissioner. These methods of evaluating employees are absolutely essential to ensuring that taxpayers are treated fairly and courteously. We hope that Congress will carefully review whether these employee measures are implemented successfully.

There are two issues regarding the National Taxpayer Advocate that show the agency has not accepted the idea of change to the old ways of doing business.

Taxpayer Assistance Orders

Recent news accounts indicate that the IRS may soon administratively define the power of the National Taxpayer Advocate to issue a Taxpayer Assistance Order (TAO).

This upcoming decision is critically important to the independence and effectiveness of the Office of the National Taxpayer Advocate. We also view it as a key test of whether the IRS culture will accept the reforms mandated by the Congress in 1996 and 1998.

As reported in the December 15, 1999 *Tax Analysts Tax Wire:*

> Five of the IRS's top officials are debating the scope of authority that can be exercised by the National Taxpayer Advocate in issuing a Taxpayer Assistance Order or a Taxpayer Advocate Directive, Tax Analysts has learned.
>
> The officials are addressing whether the National Taxpayer Advocate's tools encompass procedural or also substantive matters. For example, can the National Taxpayer Advocate issue an order requiring the IRS Office of Chief Counsel to change a revenue procedure? Or can the National Taxpayer Advocate order the IRS to concede an issue to a taxpayer?

While we can understand a need for procedures regarding TAOs, such procedures must reflect the law's broad grant of authority to the Advocate. The clear meaning of this law is that the National Taxpayer Advocate can order the IRS to take any action that the IRS could take on its own.

Section 7811 defines the terms of a TAO:

> (b) Terms of a Taxpayer Assistance Order
> **The terms of a Taxpayer Assistance Order may require the Secretary within a specified time period** -
> (1) to release property of the taxpayer levied upon, or
> (2) **to** cease any action, **take any action as permitted by law**, or refrain from taking any action, with respect to the taxpayer **under** -
> (A) chapter 64 (relating to collection),
> (B) subchapter B of chapter 70 (relating to bankruptcy and receiverships),

(C) chapter 78 (relating to discovery of liability and enforcement of title), or
(D) **any other provision of law which is specifically described by the National Taxpayer Advocate in such order.** (Emphasis added.)

The Advocate may first order the IRS to reconsider an action for various reasons. Or he may order the IRS to consider a new procedure. Yet if the IRS refuses to reconsider, then the Advocate must have the power to force action. That is precisely what the National Taxpayer Advocate is supposed to do.

A TAO is not final because it can be rescinded. However, rescission only occurs with the agreement of the Commissioner, Deputy Commissioner, or National Taxpayer Advocate.

Because TAOs are so rare, there is no need to limit the number of TAOs that can be issued.

Time after time, Members of Congress have supported greatly increasing both the clout and independence of the National Taxpayer Advocate. The IRS has no authority to "interpret" this clear law so as to limit the authority and independence of the National Taxpayer Advocate.

The National Taxpayer Advocate should be encouraged to help resolve any problem in any branch of the IRS on behalf of taxpayers. That is his job.

The law and common sense already ensures that the National Taxpayer Advocate will issue TAOs only when appropriate:

1. The National Taxpayer Advocate serves at the pleasure of the IRS Commissioner. This obviously would ensure that the National Taxpayer Advocate would not take any ill-considered actions.

2. The National Taxpayer Advocate has limited resources and is unlikely to increase the office's workload except in unusual cases where the IRS is off track in a particular case or has failed to treat a class of taxpayers properly.

3. The law itself allows the IRS to rescind a TAO. So even if a mistake is made, the National Taxpayer Advocate, Commissioner, or Deputy Commissioner can rescind it. Furthermore, a record of the TAO and any rescission is kept for review by the Congress. Such a record would allow Congress to spot issues concerning fairness to taxpayers in any aspect of IRS operations.

Section 7803 of the Code says:

It shall be the function of the Office of the Taxpayer Advocate to -
(i) assist taxpayers in resolving problems with the Internal Revenue Service;

(ii) identify areas in which taxpayers have problems in dealings with the Internal Revenue Service;
(iii) to the extent possible, propose changes in the administrative practices of the Internal Revenue Service to mitigate problems identified under clause (ii); and
(iv) identify potential legislative changes which may be appropriate to mitigate such problems.

The National Taxpayer Advocate can only fulfill the legal function of his office if he has the power to issue TAOs for any aspect of IRS operations that may be causing a problem for a taxpayer.

Taxpayer Advocate Counsel

The Senate version of the 1998 IRS reform legislation proposed a provision establishing a counsel in the office of the National Taxpayer Advocate. While this provision was dropped in conference, the conferees wrote that they "intend that the National Taxpayer Advocate be able to hire and consult counsel as appropriate."

The National Taxpayer Advocate has not been given the authority to hire his own counsel. Fortunately, a very competent counsel has been assigned to assist the National Taxpayer Advocate. While this arrangement seems to be working well at present, it is not in keeping with the intention of the Conference Report language and has set up a difficult precedent that undermines the independence of the office.

IRS Fails to Notify Taxpayers of Overlooked Tax Credit

While we applaud the efforts of the Internal Revenue Service to publish photos of missing children on pages of tax instruction booklets that would otherwise be blank, we wonder why the IRS cannot also do more to reunite millions of parents with the missing part of their tax refund.

If the Child Tax Credit is overlooked by as many American families this tax season as apparently failed to claim it last year, the IRS will over-collect perhaps $7 million just from returns that are filed today, while we talk about their performance. Multiply that by every day of the 1999 and 2000 tax filing seasons, and this may well be a billion-dollar secret that takes money out of the pockets of parents.

The IRS appears to be ignoring a recent Inspector General for Tax Administration's recommendation regarding the Child Tax Credit. Here is an excerpt from the report's recommendation on this subject:

> The Assistant Commissioner (Customer Service) should request a computer routine to identify taxpayers who may qualify for the Child Tax Credit but did not claim it on their 1998 income tax return. These taxpayers should be sent an informational notice similar to the notice which has been used to inform taxpayers that they may qualify for the EITC.
>
> Management's Response: IRS Management expressed continued concern that taxpayers receiving such a notice would lower their withholding in response to the notice but find when they completed their subsequent tax returns that they were not eligible for the credit. The IRS will continue to communicate with taxpayers regarding this credit through outreach programs.
>
> Office of Audit Comment: Based on an analysis of the IRS' Individual Masterfile near the end of the 1999 filing season, we estimate there could be as many as 1.7 million taxpayers who qualified for the Child Tax Credit in Tax Year 1998 but did not claim or receive the credit. In our opinion, the IRS should notify these taxpayers that they may be eligible for the credit and advise them of the steps they need to take to amend their 1998 tax returns if necessary. Concerns regarding whether these taxpayers will subsequently reduce their withholding should not deter the IRS from performing this customer service.

The IRS response is completely unacceptable. The apparent failure of 1.7 million people to claim a tax credit is a serious issue and the IRS should act.

Unlike the Earned Income Credit, for which the IRS continues to send many taxpayers letters (and checks) claiming that they are eligible when they are not, eligibility rules for the Child Tax Credit are relatively simple. The child just has to be a dependent, under age 17, a citizen or resident alien, and a child, grandchild, or foster child of the taxpayer. The parent's Adjusted Gross Income has to be under a certain amount. There is just no excuse for not handling it as a "math error," or something very similar. If the IRS is concerned about citizenship or relationship status, it should at least send a questionnaire to the taxpayer, asking for it to be verified before a refund is issued.

We have also noticed that the National Taxpayer Advocate is not on the distribution list for the Inspector General's reports. We have written Inspector General David Williams and requested that Advocate Val Oveson be added to the distribution list for his reports. If Mr. Oveson agrees with the recommendation and the IRS has refused to act, then Mr. Oveson has the power to order the IRS to act.

Congress and the National Taxpayer Advocate

Congress must support the National Taxpayer Advocate. If there are issues where the Advocate needs assistance, then Congress should remind the IRS that it expects the agency to give the Advocate the clout, independence, and ability the office needs to help taxpayers.

Congress should carefully review and adopt more of the recommendations of the Advocate. We are disappointed that the Administration and the Congress are ignoring many of these proposals.

Simplification

Complexity is the number one problem faced by taxpayers, according to the new report of the National Taxpayer Advocate. Unfortunately, too little is being done in this area by the Congress or the Treasury Department.

The Tax Code is so convoluted that no one inside or outside the IRS understands it. *Money* magazine's most recent test of tax preparers brought another sad result. Nearly four dozen tested tax professionals got a different answer, and no one had the correct tax on a hypothetical tax return.

The National Commission suggested that Congress consider a quadrennial simplification process, and we hope that Congress and the President will quickly implement such a process either through legislation or by executive order. The Commission found that many members of the private sector tax community were willing to volunteer substantial time to make suggestions for simplification.

A quadrennial simplification commission would harness this volunteer activity and give a broad group of people much more incentive to work for the adoption of simplification rules. This quadrennial commission would also give the Joint Committee on Taxation and the Treasury Department more incentive to suggest simplification of the law.

This interest in such efforts was recently demonstrated by an unprecedented joint initiative of the American Bar Association Section of Taxation, the American Institute of Certified Public Accountants Tax Division, and the Tax Executives Institute that recommended ten ways to simplify the tax law. There were many excellent recommendations in this package, and we hope Congress will study and pass them as soon as possible.

Innocent Spouses

The 1998 reform legislation finally brought real relief to innocent spouses. The IRS appears to be interpreting these new provisions correctly and has halted enforcement actions while it reviews petitions for relief. However, we are disappointed with the

progress of processing these applications for relief. There is a huge backlog to be resolved, and the IRS is aware of the delays and the need to reduce them.

Telephone Service and Communications

Another problem area last year was the number of taxpayers who could not reach the IRS through the national toll-free number. As noted by the Inspector General, "the cost to provide toll-free telephone service during the 1999 filing season increased while productivity decreased. About 19.5 million calls resulted in busy signals and the level of service provided declined from 73 percent for the 1998 filing season to 51 percent for the 1999 filing season."

IRS computer notices remain confusing too. This problem has been highlighted by both the Inspector General and the National Taxpayer Advocate.

A New Approach to Taxes Is Needed

While beyond the scope of this Committee's jurisdiction, a complete overhaul of our tax system remains a critically-important goal. As I have stressed, a fundamental problem for taxpayers and the IRS is the complexity of our tax law. Every detail of a taxpayer's private financial life is open for government inspection. IRS employees can make extraordinary demands on taxpayers, and can take extraordinary actions against them. Mixing such broad powers with a vague and complex law is a recipe for a civil liberty catastrophe.

Until we change how we tax income, we will continue to have an intrusive agency with broad powers. It doesn't have to be that way. Our economy as well as our civil liberties would be better off with fundamental tax reform. A tax return could fit on a postcard if Rep. Dick Armey's flat tax were to become law. Under the FairTax proposed by Reps. John Linder and Collin Peterson, we wouldn't even need an income tax. The government would still need some form of tax collection mechanism, but it could be far smaller than the current IRS workforce, and it would not need to interact with virtually every adult American, as it does today

Mr. HORN. I would thank all of you, because each of you has raised some very interesting points, and we hope to now pursue them. We'll start with Mr. Walden, the Representative from Oregon, to begin the questioning.

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

Mr. Rossotti, I thank you for being here today and for the work you are doing to improve the situation at the IRS.

I'm curious as to what you believe are the major obstacles in developing a measure of voluntary compliance.

Mr. ROSSOTTI. Well, the difficulty is finding a way to do that measurement without being overly intrusive or burdensome on otherwise compliant taxpayers. I think Ms. Wrightson gave one of the better expositions that I've ever heard of what is involved in doing this and why it is necessary.

So what we are working on is a plan or a proposal for how to get the necessary information that we need to measure voluntary compliance and figure out how to target our audit resources where they really are needed and not where they are not needed. That's the reason we do it.

We're working on a plan to figure out how to do that with the least burden on the taxpayers. It will never be reduced to zero, because it is in some ways like jury duty. I mean, you have to have some people that go to a jury to basically make the justice system fair, and it is certainly burdensome on the people that do it while they do it, so there's going to be some burden to do this measurement process.

But what we are working on is trying to figure out a way that we would basically do two things to reduce the burden. One is to reduce the number of taxpayers that need to be surveyed, and, second, reduce the amount of time it will take for them to be part of this process.

We have not yet completed that. We have been working on it. As a matter of fact, this is one of the first things that amazed me, frankly, when I got to the IRS, because I always heard that there were these numbers like 87 percent of the people comply and all that, so where did that number come from? Well, it turns out it came from some very old studies that are no longer valid and I realized that we had to do something about this.

So we have been working on it, and I think we are reasonably close to having what I consider an acceptable proposal, but we're not quite there yet.

Mr. WALDEN. I think I read in somebody's testimony, perhaps yours, that there is $231 billion in uncollected taxes out there. Is that——

Mr. ROSSOTTI. Well, on the books there is something like $220 or $220 billion of, you know, a whole variety of numbers that represent assessments, and we're required to keep them for 10 years, as well as the interest and penalties. That is, frankly, not a valid number as to what could be—a lot of that is bankrupt corporations from years ago that are still kept on the books, just because they are there for 10 years.

According to the GAO audit of our 1999 financial statements, on the balance sheet there was, if my number is right, I think it was $21 billion.

Ms. WRIGHTSON. I'm not the financial person, but I think that's right.

Mr. ROSSOTTI. It was either $21 or $20 billion. Somewhere in that range is the number that was viewed as actually collectible amounts that we should be able to collect, which actually went down slightly from the preceding year.

There's another array of money in that $20 billion that could possibly be collected that represents what are called compliance assessments. These are assessments where we have proposed, an adjustment to your tax bill, but you, as a taxpayer, have not accepted it, so it is still in, a disputed category, and some of that may turn out to be money.

So there is a significant amount of money that is out there, but it's not $221 billion.

Mr. WALDEN. You weren't referring to my taxes, personally, were you?

Mr. ROSSOTTI. No, sir.

Mr. WALDEN. Good.

Mr. ROSSOTTI. I meant "you" generically. Pardon me for using that. I just meant generically, you, as a taxpayer.

Ms. WRIGHTSON. It is 21.

Mr. WALDEN. Twenty-one?

Ms. WRIGHTSON. Right.

Mr. WALDEN. Billion?

Ms. WRIGHTSON. Right.

Mr. WALDEN. OK. What about putting out some of that to private collection process? I know Department of Education and elsewhere has worked pretty effectively trying to recapture overdue student loans using the private sector in a responsibility way.

Mr. ROSSOTTI. Yes. This is a matter that I know the chairman has a great interest in, and something that I, personally, in my previous life, have actually worked on and done successfully.

I think that possibility exists, but I believe, very honestly, where we are right now is that our whole tax collection process—and I brought a chart for one of these hearings that showed what it is because of our computer systems, our internal rules, and the recently passed restructuring account. It is so complicated and our data systems are so poor that it is really hard to figure out how you could ever extract a portion of that and turn it over to anybody very effectively in today's world.

I think, as we re-engineer it, those possibilities may well exist. As I said in my earlier testimony, that's one of the major initiatives of our re-engineering is re-engineering the collection process.

Mr. WALDEN. Mr. Chairman, I'll yield back.

Mr. HORN. OK. The gentleman from Texas, Mr. Turner.

Mr. TURNER. Ms. Wrightson, you were talking about voluntary compliance. Is it correct that there is no random audit system at the IRS any longer?

Ms. WRIGHTSON. Well, there is no—hopefully there is no random audit system at the IRS because one shouldn't audit at random. What we're really talking about here is the random selection of returns to audit, so that—and, in fact, today there is no random selection process.

IRS had a process in place. I think the last one was probably 10 to 12 years ago, maybe even 13. It abandoned that process because it was viewed as too onerous to compliant taxpayers and politically sensitive, so there is not one now.

We believe, like the commissioner, that, as they go forward, and they're going to have to do some measure, probably, of randomly selected returns; however, no one knows right now how much that will be required.

For example, IRS could use more information that it already has about taxpayers. It could audit much smaller numbers. It could do it on a continuous basis. But it doesn't have it now and it probably will need some measure of that in the future in order to get accurate, reliable indicators of voluntary compliance.

Mr. TURNER. And did I read somewhere that the IRS is working on that, but it's about 2 or 3 years off before they may be able to do it?

Ms. WRIGHTSON. As the commissioner has said, they are working on something called the "national compliance survey." Do I have that right, NCS? They have been holding it fairly close, I think for obvious reasons. It is going to be politically sensitive. We have not had access to look at what they're doing. I think we enjoy a fairly good, close communication with the commissioner. I know our Comptroller General and he meet every 6 months or so to talk and this issue came up. So I expect we'll be looking at that in the future and provide to them again our feedback as to whether the strategy that they're using is the one with the least burden, but also providing reliable results.

Mr. TURNER. Thank you.

Ms. Kelley, you were critical of section 1203, and I understand your concerns. I am curious as to how many employees have been dismissed under the new section 1203, to give me some feel for the actual impact upon IRS employees.

Ms. KELLEY. To date the numbers are actually probably just in the double digits. It is less than 100. Commissioner Rossotti probably knows the exact numbers, as there are reports issued every quarter on these.

Part of the problem and the fear that it has created among employees is that even if, in the end, there is not the ultimate termination, the process that employees go through during that period of time puts them in a position where they are just afraid to do much of anything.

There are already processes in place in the IRS that require, under the rules of conduct, that employees file tax returns, of course, and pay their taxes, and there has always been a process in place to deal with employees who don't do that as required under law, and it is a process that has worked. So those parts of 1203 just haven't, in our opinion, been necessary and have led to unnecessary fears and investigations. It also has led to, in some cases, managers being afraid of making a wrong decision because of this overview of 1203. And that is just one example of 1203. There are, of course, 10, and the one that I cited was about paying taxes late.

Mr. TURNER. Commissioner, what's your impression of section 1203 and how it has worked.

Mr. ROSSOTTI. Well, first let me just give the number. There have been 17 employees actually finished through the termination process. There were a few others that resigned without actually being terminated. I have to say that most of those employees, as Ms. Kelley said, probably would have been, if not terminated, at least severely disciplined even without 1203, because they really were serious cases.

I have to say that this provision has turned out to be one of the most difficult provisions to administer properly of any of the provisions of the Restructuring and Reform Act, simply because of the practical difficulty of learning how to apply it, and the psychological problems of, on the one hand, trying to follow through on the intent of Congress that serious misconduct be disciplined and people be terminated, which we have done, and, on the other hand, trying to reassure employees what I believe is true and have said right from the beginning—that this was not intended, was never intended, and as long as we are here administering it, it will never be administered in such a way as to provide a penalty or a termination penalty, especially, for an employee who simply, for example, makes a mistake in the normal course of their job. That is not the intent.

The difficulty is that, although I think we have made some progress in getting that point across, there is still this fear out there that, even if an employee is not ultimately terminated, I'm going to go through a long and very unpleasant process potentially of being investigated and have this threat hanging over me. That is a fact that does exist out there.

So what we are trying to do, since this law is on the books and it is there, is to administer it in a very fair and very transparent way so that people know what we're actually doing.

I mean, one of the—probably the most important thing that we've done, one of the most important things that we've done, as Ms. Kelley said, is to actually publish on a regular basis all the actions that are taken—by the way, not just under 1203, but all the disciplinary actions, a very mysterious area in the past. Nobody actually knew, you know, what kind of actions were taken, and there were all kind of rumors that spread.

So we've taken to—actually, I must say, with great cooperation from NTEU—it was really their idea to do this—to publish on a regular basis, without identifying specifically named employees, of course, but, nevertheless, to identify, not only on a statistical basis, a complete list of all the disciplinary actions that are taken and at what levels they are taken so that people will actually know how this process is really being administered.

I believe that in practice we can administer it so that we will not terminate employees that shouldn't be, but, whether we can convince people to be more comfortable with the fact that this process exists. This is where we are going to have the most difficulty.

Mr. TURNER. Thank you.

Mr. HORN. Any other questions? The gentleman from Oregon? The gentleman from Texas?

Mr. TURNER. I just want to followup with Mr. Rossotti. What is your assessment of the morale of the IRS employees currently? They've gone through quite a bit of stress because of restructuring

legislation, and now we hear this specific problem on 1203. Give us an assessment from your point of view. Ms. Kelley says it is not too good. I just want to hear from your point of view.

Mr. ROSSOTTI. I would concur with that. We do a regular survey of all IRS employees, and then we do other samples, and more than that. I, personally, travel almost all the time talking to people.

It is varied by different segments of the 100,000-person work force. I would say that the field compliance employees, especially the collection employees and the exam employees, are the ones that had the most pervasive changes as a result of the Restructuring Act and were the ones that took some of the criticisms most personally, I think that there is where we have our most significant morale problems.

They're learning how to implement these new provisions. They're learning what it means to—again, I have to say Ms. Wrightson was very articulate in saying that our goal is to provide good service and provide taxpayer rights to all taxpayers, but also to enforce the law for the people that are not willing to comply. Doing both of those things—it's harder to learn how to do two things at the same time than one thing at the same time. Those are all things that are learning process.

So I think if you look at the field compliance employees, where they've had the biggest change, certainly I would not describe the morale there as good. I think we've gotten by some of the really serious fears about 1203 to some degree. We've started to put the balanced measurement system in place. We've certainly done a lot of training. I could go on and on and talk about all the things that we've done, but I think that we are still at a fair low point.

Now, I will say that—violating my own rule that it is OK to make predictions, as long as they're not about the future, I'll go off on a limb and predict that this fiscal year, in terms of the field compliance, will be sort of that we will hit the bottom in terms of both morale and some of the statistics, and that in 2001, especially if we get the budget request approved, we will see a material turnaround, because we will have a new organization structure in place, we'll have the balanced measurement system in place for a longer period of time, we will have gotten a lot of the training issues resolved, at least to a certain level, and I do believe that we will see, in several tangible measures of both morale and operational effectiveness, some improvements during 2001 in the area where we have the greatest weakness today.

Mr. HORN. Let me ask you about the level of supervisorial training. Do you have enough funds there and enough people to——

Mr. ROSSOTTI. Yes.

Mr. HORN. I know when I was at your swearing-in you said, "This is going to take me a few years," and there's no question——

Mr. ROSSOTTI. Well, it's a very, very important——

Mr. HORN [continuing]. We all knew that, but training is key, our human resources.

Mr. ROSSOTTI. It is important, and you mentioned specifically the supervisory training. I think that the answer to your question is the Congress did provide that particular funding, so I can't use that as an excuse, if you will. I mean, the funding for the training has improved significantly.

What we have is, though, a job where, you know, training is one thing and learning is something else. OK? I mean, we have a learning process, and this "S" curve that I put up could be used for a lot of things that we're learning at the IRS.

In the case of the first-line supervisors, especially in exam and collection, the big learning process is how do we manage, in a world where it is not just one thing that we're measuring, but it is two things we're measuring—we want to provide taxpayer service and taxpayer rights. We also want to collect the money. That is a learning process that many businesses have gone through. You know, every business has to do the same thing.

It is starting to get there. We did one thing recently that was never done before. We brought all of the first-line managers for our field collection organization, which is about 550—these are the first line, the first level of management, the group supervisors that supervise the collection employees. We brought them all together in one place, about 550 of them, for a 3-day training session, and all of our top executives were there for almost the entire time, and they were some of the employees that—some of the managers that I'd say, first of all, are the most critical, in terms of turning this whole thing where we want it to go, and, second of all, you know, probably had some of the more significant morale problems.

You know, General Eisenhower said one time that when he hears his generals say that there is a morale problem, he thinks that they're the ones that may have the morale problem. Well, I think that, in the case of our managers, they were talking about the employees' morale problem, they're the ones that had morale problems for very legitimate, understandable reasons.

I think in that meeting we made a significant turn-around, because we began to get down to very concrete details about what we really expect in the collection area for people to do and what we don't expect them to do, and, most importantly, just created an atmosphere of support for what we did. And we acknowledged very openly that there is a long list of things that we, as the top management, have to explain better or resolve in how we're going to go about reconciling these competing objectives, which was a good thing for them to hear.

So that's a step, I mean, but there are many steps.

My bottom-line conclusion is I think that we will—that this year we will sort of hit bottom, if you will, and I really do believe that, with some luck, and especially if we can get a little bit of resource to meet some of these stop-gap staffing problems, that next year, meaning fiscal year 2001, we will see, you know, some noticeable indicators of improvement in the field area.

In the customer service area and the phones, and so forth, we've already had some noticeable improvement, but I'm talking about in the area where we have the most problems still.

Mr. HORN. Well, as you said, dear to my heart is the Debt Collection Act of 1996, and we put that on the books through using the omnibus appropriations bill, which nobody could veto it that way, and Mrs. Maloney, the ranking democrat then, was very helpful with that.

Could you give me an idea of what do we do, in terms of someone that has a debt to IRS, in terms of the number of letters they go

from IRS, the telephones they go, and to, if any degree, you have a revenue officer knock on their door.

Mr. ROSSOTTI. Well, I think that this is the chart that I think that I showed you that you took back to your office last time. Unfortunately, we still have that long process.

Mr. HORN. We've got a broader audience today.

Mr. ROSSOTTI. Well, it really is—I mean, here's a simple way to understand it. If you look at the main resources we have in debt collection, which are our phones and revenue officers, about 90 percent of their time is spent on accounts that are more than 6 months old, and if you look at the revenue officer inventories, many of those would be a couple of years old.

That's not because they are doing the wrong thing as employees, it's just the process—some of it is defined in regulations, some of it is defined in just procedures. All of it is embedded in our computer systems. A lot of it is related to the fragmentation of our collection organizations.

You know, it's just not a very easy thing to fix, but we are moving one step at a time. Now, one step will be in place by the end of this year, a very important step, which is we will have consolidated the organization, so we will have collection processes, you know, managed in a more integrated way.

We are making some smaller steps that we can do within our existing technology later this summer on our phone collection operations to accelerate some things.

And then the really big opportunity is through this re-engineering process, which will basically replace the technology underpinnings but also the business practices. Then, at that point, we can be more effective in using various kinds of resources to do debt collection.

Mr. HORN. Your predecessor, when I discussed the matter with her, they had, as I looked at your financials—this is back in 1994 and 1995—that it was roughly $100 billion to $110 billion that had been sort of written off with the bankruptcies, as you said, with small business and this kind of thing, and they had another pile that was roughly $60 billion they thought they could collect.

I raised the obvious question: besides your own revenue people, what about putting that out for debt collectors that know their business? And then I was told, "Oh, no, there are privacy problems." Look, you just give them the address, you give them the amount. No privacy problem as to the details of their tax form. And if they have a gripe about what IRS is doing to them, then you put them in to the revenue officers that are authorized to deal with that particular situation.

Now, have you thought about going to your authorizing committees—Ways and Means in the House, Finance in the Senate—and get that authority for the private collectors, or do you feel you already have it?

Mr. ROSSOTTI. I think that actually the way it works is that we could—it's a little more complicated because you can't give out any information, even names and addresses, under current law, but I think, on the other hand, if we were to treat some people as contractors we could get them to agree to certain—under even existing law, we probably could overcome—I say "probably," because any-

thing that deals with these legal issues really requires research. We could probably overcome the privacy issues, and basically I think we could solve that particular part of the problem.

The more serious problem right now is just the process that we have that is just—it's really not in a shape right now, very honestly, to pull a piece of this out and give it to somebody. If we did that, we would end up just having them fail, probably, and give a bad name to the whole thing.

I'm not saying that it can't be done in the future, but I think there's some work we have to do to get the data in shape and get the process simplified to at least a level where we could realistically turn over to it.

One opportunity that might exist longer-term is that, as we get to a newly re-engineered process, one of our challenges will be what we do with the old inventory, because we will have to take our existing resources of revenue officers and others and apply them to more-current work, so then we would have this base of old work, and that might be an opportunity in the future. But we are probably, realistically, a couple years away from that.

Mr. HORN. Well, I would also hope that the Treasury and IRS would look at the people that have claimed bankruptcy, and when they pop up again and there is a pattern and practice of where they are milking the taxpayers, very frankly—and, since those of us that pay our taxes aren't too happy when we see them getting away with murder. I would hope that the Treasury and the IRS would figure out a way to follow them through their business career and try to get some of the money back that are owed to the taxpayers of the country.

Mr. ROSSOTTI. Incidentally, the biggest obstacle in that area is our data systems, because, you know, part of our problem is that the basic records don't allow us to point and make these relationships between one taxpayer and another. It's all one taxpayer number.

It's like the way that the old phone systems used to be. You know, the telephone companies used to bill everything off the phone number because they thought everybody had one phone number, and that was one of the problems that they ran into that I used to work on in my old days, you know, when people started to get five phone numbers. How do you point them and make them one customer? The issue that we have is how do you track, as you say, a small business person or principal through multiple entities that they may have, either at one time over time. Right now our data systems don't really provide very good support for that.

Mr. HORN. One of the things that I have found when I'm looking at the IRS claims that go through our District office—and you have some very good people at Laguna Niguel that we can talk to there, and I'm really interested in the degree to which the Taxpayer Advocate with—are you now handling those that come from District offices? There's 435 District offices on the House side—there may be 40 with the territories—and you've got 100 on the Senate side. So when we've got these cases of people that say, "I've got a problem with the IRS," or others are obviously Social Security, Medicare, Immigration, the whole works, when I look at the ones on IRS, the ones I've found over the years that bother me is one part

of the IRS has put a lien on the person and they can't pay what the other part of the IRS is. Have we solved that problem? And the right hand didn't seem to know what the left hand was doing, by the way.

Mr. OVESON. There are still challenges in those communications that you've mentioned, but Connie Adams is the Taxpayer Advocate in Laguna Niguel, and she reports now directly to me, rather than the district director. We are handling the congressional cases that you've mentioned, and hopefully doing an excellent job of that.

Mr. HORN. Well, we have great praise for the people that are helping us solve this, and that's why I wanted to know, are we still going to the district directors, or do we strictly go to the Taxpayer Advocate?

Mr. OVESON. Again, the congressional correspondence and the individual casework is being handled now by the Taxpayer Advocate.

With the modernization program, that is being solidified and standardized throughout the country, and hopefully it will continue to work well.

Mr. HORN. Now, when you say you have taxpayer assistance orders, five in fiscal year 1999 and three in fiscal year 2000 so far, is that then across the whole IRS system as to a generic issue, or is this one case?

Mr. OVESON. No. That's across the whole IRS. And I mentioned in my annual report right up front that I felt those numbers were too small, but you need to understand that this year there were nearly 90,000 applications for taxpayer assistance orders, and the need to actually implement the taxpayer assistance order in the end was only used five times last year, three times so far this year.

Most of those situations are resolved by the Taxpayer Advocate visiting with and talking with the individual that has the case in either exam or collections and working out an arrangement that is acceptable. But my No. 1 goal for this year is to get the taxpayer assistance order process into a situation that is more meaningful and more representative and that we have more experience with the taxpayer assistance orders as per the intent of Congress, I believe.

Mr. HORN. Mr. Keating made a very interesting point in his testimony that the IRS is over-collecting millions of dollars every year because they are not informing taxpayers of their right to the child tax credit, and I wonder, Mr. Keating, how significant do you believe this problem is, and what do you believe should be done about it?

Mr. KEATING. Well, I think it is especially interesting, given the comparison to the way the IRS has acted in the past regarding the earned income credit. There have been examples in the past where the IRS sent checks out to people who didn't even quality for the earned income credit. Then there was no chance of ever getting the money back from these people, almost by definition. They had probably gone out and spent it, and these are people of modest means, by and large.

I think what should be done is what the Inspector General recommended, which is to at least send a notice to the taxpayer flagging a potential error on the return that may have resulted in an overpayment by the taxpayer.

The IRS management response was that they were worried that taxpayers receiving such a notice would lower their withholding in response to the notice, then find out when they completed the subsequent tax returns they were not eligible for the credit.

I think there is a very, very small chance of that happening. First of all, three-quarters, roughly, of all taxpayers receive refunds. A very smaller number go and adjust their withholding in the middle of the year in response to an IRS letter such as this.

We are not calling on the IRS to automatically send a refund check. We think the notice should flag it and send a questionnaire to the taxpayer to go through the steps needed to ensure the taxpayer may actually be due the additional refund. So we think it can be done, and we hope that it will be done.

I don't know how many other areas of the law are like this. I suspect this is one that might be a problem because it is a new item in the tax code it started. I believe, in the last tax filing season, and there are some taxpayers that haven't figured it out yet.

Mr. HORN. Well, we thank you for those suggestions, and we have a few questions the staff on both sides would like to send you, and we'll put them at this place in the record, if you don't mind.

Let me just ask, as one more point, as many Americans work toward meeting the filing deadline, is there anything you wish to say to them, Commissioner?

Mr. ROSSOTTI. I just want to say that I hope that every taxpayer will have an increased level of confidence in the IRS interest in basically helping taxpayers get the right—pay the right tax, no more, no less.

I do agree with Mr. Keating that it is our obligation to inform taxpayers of where they have credits due. As a matter of fact, we had a public service commercial that was, I think, pretty effective on the child tax credit.

So if they call us, I really hope that we are making some progress in getting taxpayers to have increased confidence that we are not there as the enemy, we are not there as an adversary, we are there as a resource to basically help people get it right.

Of course, we are also there—if there is that small group of taxpayers that wants to burden everybody else by not paying, we are also there to make the system fair, and we are looking out for those that are not willing to pay. But the majority are, and I hope they will recognize that that's what our interest is, is in helping to make the system fair and having them pay what they owe, no more, no less.

Mr. HORN. Well, I thank you and I thank all of your colleagues here that have made excellent suggestions, and I want to thank the staff that prepared this hearing: J. Russell George, the staff director and chief counsel of the Subcommittee on Government Management back there against the wall; and to my left and your right, Louise DeBenedetto, who is the professional staff person on this issue and a detailee from the General Accounting Office; Bonnie Heald, director of communications, professional staff member, on the wall in the back there; Bryan Sisk, clerk; and Ryan McKee, staff assistant; and Michael Soon, a valued intern; and, on the minority side, counsel to Mr. Turner as the ranking Member is Trey

Henderson; and Jean Gosa, the minority clerk; and we thank Mel Jones for being the court reporter today.

With that, we are adjourned.

[Whereupon, at 12 noon, the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

Statement of the Honorable Jim Turner
GMIT Hearing "Oversight of the Internal Revenue Service:
The Commissioner Reports"
4/10/00

The IRS is responsible for administering and enforcing the internal revenue laws and related statutes. The IRS's mission is to collect the proper amount of tax revenue at the least cost to the public, and in a manner that warrants the highest degree of public confidence in the Service's integrity, efficiency, and fairness. However, during the last several years, we know that the IRS has been the subject of many studies, congressional inquiries, and much criticism.

Congress and others have identified a long list of problems, including inadequate technology, poor services to taxpayers, violation of taxpayer rights, failure to follow established procedures, and lack of adequate employee training and resources. Public concern over the IRS's behavior led Congress to act. On July 22, 1998, the IRS Restructuring and Reform Act of 1998 was signed into law by President Clinton. This law included many provisions to enhance taxpayer rights and fundamentally reform the organizational aspects of the IRS.

To achieve these goals, the IRS intends to make fundamental changes on virtually every front: redefine business practices, rebuild the organization structure, establish management roles with clear responsibility, employ a balanced set of performance measures, and build technology to support these changes. The IRS refers to this process of change as "modernization," because it involves building on the essential components that made the IRS successful in the past while bringing them up to date in a way designed to achieve the new mission.

We are hear today to assess what progress the IRS is making in implementing its "modernization" changes. This subcommittee wants to ensure that all federal managers are given the necessary tools and incentives to perform effectively and be held accountable for their job.

I want to welcome Commissioner Rossotti here this morning, and commend him and all IRS employees on the efforts they have made to become a better agency. When I first came to Congress 3 years ago, the IRS was at all time low in terms of its public image. Since that time, I believe we have made significant progress toward our goal of providing the type of high-quality service that taxpayers expect and deserve. I believe this is due in large part to Commissioner Rossotti's strong leadership. I thank the Chairman for his focus on this issue and look forward to the witnesses testimony.

Dibenedetto, Louise

From: Michanczyk Amanda A [Amanda.A.Michanczyk@irs.gov]
Sent: Wednesday, April 26, 2000 5:00 PM
To: Dibenedetto, Louise
Cc: Williams Floyd
Subject: Delegation Orders

6212notice.wpd

Louise,

Attached is our response to Chairman Horn's question about the delegation order regarding deficiency notices. This issue came up during the April 10th hearing and Commissioner Rossotti promised to provide

Chairman Horn with this information.

Please call me at 202-622-6759 if you have any questions.

Thanks,
Amanda Michanczyk
Legislative Affairs Division

<<6212notice.wpd>>

This responds to your request for assistance in responding to a taxpayer's inquiry regarding the authority of Deborah Decker, Director, Ogden Customer Service Center, to issue a notice of deficiency pursuant to I.R.C. § 6212.

As the taxpayer has noted, "If the Secretary determines that there is a deficiency. . ., he is authorized to send notice of such deficiency to the taxpayer. . ." I.R.C. § 6212(a). The term "Secretary" means the Secretary of the Treasury or his delegate. I.R.C. § 7701(a)(11). Clearly, therefore, the Secretary may delegate his authority to send deficiency notices.

The Secretary has delegated his authority to send deficiency notices via Treasury Order No. 150-10, which provides that the Commissioner "shall be responsible for the administration and enforcement of the Internal Revenue laws."

The delegation of authority of Service personnel to issue deficiency notices has specifically been set forth in:

- 26 C.F.R. § 301.6212-1, which states in pertinent part:

  (a) General rule. If a district director or director of a service center or (or regional director of appeals), determines that there is a deficiency in respect of income, estate or gift tax imposed by subtitle A or B, or excise tax imposed by chapter 41, 42, or 44 of the [Internal Revenue] Code, such official is authorized to notify the taxpayer of the deficiency. . ."[1]

- Commissioner's Delegation Order No. 77, whereby the authority to issue (or execute an agreement to rescind) notices of deficiency has been redelegated to, *inter alia*, Directors of Customer Service Centers.

In dismissing a meritless challenge to the validity of a tax deficiency notice, the Ninth Circuit has noted, "To the extent [the taxpayer] seeks to challenge the District Director's authority to issue a notice of deficiency, this argument fails." *Urban v. Commissioner*, 964 F.2d 888, 890 (9th Cir. 1992).

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[1] *See also* 26 C.F.R. § 301.6861-1(c), recognizing the delegation of authority regarding deficiency notices within the context of jeopardy assessments.

I.R.C. § 6213, about which the taxpayer also inquired, is implemented by 26 C.F.R. § 301.6213-1.

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INDEPENDENT

April 17, 2000

Ms. Margaret T. Wrightson
Associate Director
Tax Policy and Administration Issues
U.S. General Accounting Office
Washington, DC 20548

Dear Ms. Wrightson:

I would like to thank you for testifying at the April 10, 2000, hearing on the Internal Revenue Service (IRS) conducted by the Subcommittee on Government Management, Information, and Technology. As a follow-up to the hearing, the Subcommittee is requesting that you respond to the following questions:

1. In your testimony, you noted that the IRS must overcome several serious management challenges in its current systems modernization efforts. How serious are these challenges, and does the GAO feel that they are being adequately addressed?

2. You testified that the IRS lacks a measure of voluntary compliance—how important is this to a system of "balanced measures"? What are GAO's observations about other measures the IRS is developing?

Please send your responses to the Subcommittee at B-373 Rayburn House Office Building, Washington, DC 20515, no later than Friday, April 28, 2000. Thank you for your continued participation on this matter, if you have any questions contact Louise DiBenedetto at (202) 225-5147.

Sincerely yours,

Stephen Horn

Stephen Horn, Chairman,
Subcommittee on Government Management,
Information, and Technology

SH:ld

Committee Question: You testified that the IRS lacks a measure of voluntary compliance—how important is this to a system of "balanced measures"? What are GAO's observations about the other measures that IRS is developing?

GAO Response:

Voluntary compliance measure

We believe that a measure of voluntary compliance is absolutely vital for IRS and the Congress to monitor whether IRS is achieving a key aspect of its mission. Moreover, once IRS' balanced measures are fully developed, a voluntary compliance measure, coupled with a reliable measure for customer service, should help IRS assess whether improvements in customer service cause an increase in voluntary compliance. For example, the Commissioner believes it is more efficient for IRS to prevent problems by providing better customer service during the pre-filing and filing stages than to address problems through the post-filing activities of Examination and Collection. If IRS makes a significant commitment to this philosophy, it will be imperative for both Congress and IRS to know how well the strategy is working and what, if any, modifications or improvements might be needed. In addition, other benefits will accrue from a reliable measure of voluntary compliance.

While we recognize there are concerns regarding taxpayer burden, we believe it is critical that IRS obtain data for this measure from something other than the audits it ordinarily conducts on noncompliant taxpayers. This is because the data obtained from audits are only for the subset of taxpayers that IRS believes have the highest probability of noncompliance and would not be representative of the entire population--i.e., those that IRS believes to be compliant and those it does not. Because of this, any measures of voluntary compliance IRS would develop from such data would be biased. Some modified version of the random audits that IRS used in the past might be an appropriate vehicle for obtaining data for a voluntary compliance measure. Random sampling would ensure that the data are representative of all taxpayers. Burden on compliant taxpayers could be reduced in a number of ways—for example, by emphasizing smaller samples, continuous sampling, and/or supplementing the data obtained through the audits with data IRS already has on hand for the taxpayers whose returns were selected.

Observations on other measures

Currently, IRS is developing corresponding measures for each of its strategic goals—service to each, service to all, and productivity through a quality work environment, respectively. The corresponding measures for each of the goals are customer satisfaction, business results, and employee satisfaction. For IRS' goal of service to each, or its customer service goal, IRS is using a measure of customer satisfaction. For most people, the phrase "customer service" conjures up the retail sector – in other words, did we make the customer happy and was the customer satisfied with our service? For example, Nordstrom's employees are famous for providing top quality customer service and going out of their way to meet customer needs.

However, for an enforcement agency like IRS customer service is important but has a different meaning than in the retail industry. IRS' primary focus cannot be on making the customer happy because, in accomplishing its primary function of collecting taxes, IRS is naturally going to make some taxpayers unhappy.

Basically, customer service for IRS has two components. The first is the quality of IRS employees' interactions with taxpayers. Are the employees courteous, are they professional, do they listen to taxpayers and answer their questions? The second component, which the Commissioner acknowledges, has to do with how well IRS handles taxpayers' problems within the context of the tax law. Do employees correctly interpret the tax law, do they explain to taxpayers why they are not compliant and how to avoid non-compliance in the future, do they follow IRS procedures and legislative requirements?

Because the concept of customer service involves more than simply making taxpayers happy, there should be no inherent conflict between customer service and compliance. In fact, the Commissioner believes that customer service will enhance compliance, as IRS makes more effort to insure taxpayers understand how to comply with tax laws and, in the event of non-compliance, contact taxpayers promptly to minimize the extent to which tax liabilities are compounded by costly interest fees and penalties.

Committee Question: In your testimony, you noted that the IRS must overcome several serious management challenges in its current systems modernization efforts. How serious are these challenges, and does the GAO feel they are being adequately addressed?

GAO Response:

As we have reported over the past few years, these challenges are serious and must be adequately addressed before IRS is ready to build major modernized systems. The management challenges confronting IRS include (1) completing, enforcing, and maintaining its enterprise architecture, (2) establishing and implementing a sound investment management process to ensure only incremental, cost-effective system investments are made, (3) imposing software acquisition and life cycle discipline to effectively govern cradle-to-grave management of its system investments, (4) clearly defining and applying IRS and contractor roles and responsibilities, (5) making operational the systems modernization program office, including such important government acquisition functions as quality assurance, risk management, and configuration management, (6) filling the program office 's manager position, (7) confirming the readiness of all modernization projects, and (8) implementing the use of performance-based contractor task orders. Implementing these management and technical controls will provide IRS the requisite modernization management capability needed to effectively build modernized systems.

IRS has acknowledged the importance of these challenges, and its March 7, 2000, expenditure plan submitted to the Congress details steps recently initiated and its planned steps to address each challenge. For example, IRS recently reassessed and restructured its systems modernization program and as a result, scaled back its system development

efforts, recognizing that it must first develop and implement modernization management capability and controls before it can build systems. In addition, IRS plans to issue, by September 30, 2000, an update to its Modernization Blueprint to reflect changes in light of technology advances and IRS' reorganization. IRS also plans to have its systems life cycle methodology—which IRS refers to as the Enterprise Life Cycle—implemented by June 30, 2000.

IRS' March 7, 2000, plan, if implemented properly, coupled with the restructured modernization program provide the potential for IRS to overcome its system modernization challenges. However, until IRS does, it will continue to lack the modernization management capability and controls needed to effectively build modernized systems.

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INDEPENDENT

April 17, 2000

The Honorable Charles O. Rossotti
Commissioner
Internal Revenue Service
Washington, DC 20224

Dear Mr. Rossotti:

I would like to thank you for testifying at the April 10, 2000 oversight hearing on the Internal Revenue Service conducted by the Subcommittee on Government Management, Information, and Technology. As a follow-up to the hearing, the Subcommittee is requesting that you respond to the attached questions.

Please send your responses to the Subcommittee at B-373 Rayburn House Office Building, Washington, DC 20515, by Friday, April 28, 2000. If you have any questions concerning this request please contact Louise DiBenedetto at (202) 225-5147.

Thank you for your continued participation on this matter.

Sincerely yours,

Steve Horn

Stephen Horn, Chairman,
Subcommittee on Government Management,
Information, and Technology

SH:ld

Enclosure

Follow-up Questions on the April 10, 2000 Hearing

1. In your testimony, you noted that the IRS faces a major budget challenge in fiscal year 2000 and 2001 that unless addressed, will threaten not only the IRS reform and restructuring program, but the entire tax system. Please explain what you meant by that?

2. The GAO has expressed concern that the system modernization roles and responsibilities of IRS and its contractors still have not been adequately defined. How can the systems modernization efforts be efficient and effective when these roles and responsibilities are not yet defined? What do you intend to do about this?

3. The Internal Revenue Service Restructuring and Reform Act of 1998 mandated that by 2007 at least 80 percent of all tax returns are to be filed electronically. You also noted an interim goal that by 2003 all returns that are prepared electronically are to be filed electronically. What are some of the challenges in meeting these goals? Do you feel that these goals will be met?

4. How much of your requested nearly ten percent budget increase for fiscal year 2001 do you anticipate spending on contractors and consultants? For what types of services?

Answers to questions submitted to IRS in reference to the April 10, 2000 hearing conducted by the Subcommittee on Government Management, Information and Technology.

1. **In your testimony, you noted that the IRS faces a major budget challenge in fiscal year 2000 and 2001 that unless addressed, will threaten not only the IRS reform and restructuring program, but the entire tax system. Please explain what you meant by that?**

   As you know, a major tenet of our tax system is voluntary compliance. In fact roughly 98 per cent of the taxes collected are paid without active intervention by the IRS. I believe this compliance in large measure is due to taxpayers' confidence that their neighbors, competitors, etc., are also paying their fair share of the tax bill.

   Unfortunately, reduction in IRS staffing levels, annual growth in return filings, and additional workload from the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998) have contributed to a steady erosion of enforcement presence, audit coverage, and case closures in front-line compliance programs. I am concerned that knowledge of this decline could over time undermine the taxpayer's confidence that the IRS can adequately enforce the tax law.

   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 STABLE (**S**taffing **T**ax **A**dministration for **BaL**ance and **E**quity) Initiative. With this staffing level, we expect that in 2001, the IRS will be able to increase levels of service slightly and stabilize the level of exam and collection activity while complying with the taxpayer rights provisions of RRA 98.

2. **The GAO has expressed concern that the system modernization roles and responsibilities of IRS and its contractors still have not been adequately defined. How can the systems modernization efforts be efficient and effective when these roles and responsibilities are not yet defined? What do you intend to do about this?**

   IRS and PRIME have recognized the lack of a well-grounded partnering process. This risk, if unmanaged, would result in continued confusion over who is responsible for specific deliverables, roles, responsibilities and accountabilities. The risk has been identified and is being managed by the Business Systems Modernization Office (BSMO). Our risk management plan currently reflects joint IRS/PRIME activities towards the establishment of shared operating disciplines between the two organizations to be completed in June 2000.

   It is important to note the partnership concept was never intended to influence the way IRS is managing and controlling the PRIME contract. IRS is currently

maintaining and will continue to maintain a formal government/contractor relationship in terms of managing the contract, including all negotiations, to ensure that the government's interest is protected.

Also, the IRS is restructuring the PRIME task orders to reflect clarified roles and responsibilities between PRIME and IRS. These revised task orders will be reorganized to parallel the major initiative Program Offices in the BSMO. This will allow for enhanced monitoring and accountability. As part of this effort, a standard Statement of Work will be promulgated. This standard will require the acquisition teams to articulate more clearly their requirements, to specify deliverables and to outline more effectively acceptance criteria. Improvement of the acquisition management process and products resulting from this restructuring will evolve to performance-based contracting of ITIA-funded projects.

3. **The Internal Revenue Service Restructuring and Reform Act of 1998 mandated that by 2007 at least 80 percent of all tax returns are to be filed electronically. You also noted an interim goal that by 2003 all returns that are prepared electronically are to be filed electronically. What are some of the challenges in meeting these goals? Do you feel that these goals will be met?**

The IRS is aggressively addressing several challenges that must be met if significant progress is to be made toward meeting these goals. These include the ability to accept all forms, schedules, and preparer notes electronically; eliminating the paper signature jurat; enhancing taxpayer awareness and acceptance of electronic payment options; reducing the cost of electronic filing for taxpayers; upgrading our technical infrastructure; and ensuring the security of our electronic systems and the confidentiality of taxpayer information.

The IRS realizes that these are formidable goals and that reaching the 2003 milestone--receiving electronically all returns that are prepared electronically (approximately 60 percent of all individual income tax returns or 80 million)--will be especially difficult. IRS' most recent projections for 2003 call for an IRS e-file volume of approximately 44-49 million returns (33-37 percent of all individual tax returns) which will fall short of the goal established by Congress.

Included in the published Strategic Plan for Electronic Tax Administration are IRS' official projections of electronically filed returns developed by the professional forecasters under the Assistant Commissioner (Research and Statistics of Income). These projections indicate that between 55-64 million returns will be received electronically in 2007, or 40-46 percent of all individual income tax returns, which would also fall short of the 80 percent goal. However, it is important to note that these projections represent baseline extrapolations of current trends, existing marketing approaches, enacted legislation, and confirmed (or reasonably certain) IRS program changes. They do not reflect the full impact of all of the initiatives contained in the Strategic Plan for Electronic Tax Administration. At this time, the IRS does not have sufficient information to make reasonable projections for many of

the future initiatives. As the IRS gains more experience with the impact of the enhancements reflected in the Strategic Plan, increases to the current projections are expected.

4. **How much of your requested nearly ten percent budget increase for fiscal year 2001 do you anticipate spending on contractors and consultants? For what types of services?**

A total of $180.6 million: $119 million for the Information Technology Investment Account (ITIA) Core Business Systems, $43.6 million for operational support contracts, $15 million for contracts to support the IRS' modernization effort, and $3 million for contracts related to Electronic Tax Administration.

The $119 million for the Information Technology Investment Account (ITIA) Core Business Systems is requested for "other services" contracts related to Service-wide business systems enhancements. This includes processes, hardware, and software.

Operational support contracts are categorized as mandatory, operational, and expertise as follows:

- Mandatory contracts 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 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 are required to obtain expertise outside the IRS. Some of these activities include developing and administering customer satisfaction surveys and rewriting of IRS forms and Publications into "plain English."

We anticipate that some part of the $40 million initiative for Business Line Investments will be used for contracts and/or consultants, but at this time IRS is still finalizing the portfolio of projects to be funded. Until this project list is finalized, we cannot accurately determine the portion of the $40 million that will fund contacts and/or consultants.

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April 17, 2000

Mr. W. Val Oveson
National Taxpayer Advocate
Internal Revenue Service
Washington, DC 20224

Dear Mr. Oveson:

I would like to thank you for testifying at the April 10, 2000 oversight hearing on the Internal Revenue Service conducted by the Subcommittee on Government Management, Information, and Technology. As a follow-up to the hearing, the Subcommittee is requesting that you respond to the following question:

In Mr. David L. Keating's testimony, he raised a concern that the National Taxpayer Advocate's authority and independence is limited and not in compliance with the intent of the Internal Revenue Service Restructuring and Reform Act of 1998. Do you feel that your authority and independence is limited and not in compliance with the intent of the 1998 Act?

Please send your response to the Subcommittee at B-373 Rayburn House Office Building, Washington, D.C. 20515, no later than Friday, April 28, 2000. If you have any questions please contact Louise DiBenedetto at (202) 225-5147.

Thank you for your continued participation on this matter.

Sincerely yours,

Stephen Horn

Stephen Horn, Chairman,
Subcommittee on Government Management,
Information, and Technology

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NATIONAL
TAXPAYER ADVOCATE

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

April 28, 2000

The Honorable Stephen Horn
Chairman, Subcommittee on Government Management,
Information, and Technology
2157 Rayburn House Office Building
Washington, D.C. 20515-6143

Dear Mr. Chairman:

It was a pleasure to testify before your Subcommittee on April 10, 2000. Thank you for inviting me to be there with you.

In response to your letter of April 17, 2000, I feel that I have the authority and the independence I need to fulfill the intent of the IRS Restructuring and Reform Act of 1998. Commissioner Rossotti, to whom I report, is very supportive of my function and has not interfered with my ability to appropriately assist taxpayers to resolve their problems with the functional units of the IRS.

We have had internal discussions about Taxpayer Assistance Orders and how such an order could be appealed through the organization. The statutes are clear that only the Commissioner, the Deputy Commissioner or the National Taxpayer Advocate have the authority to modify or rescind a Taxpayer Assistance Order issued in the field by a local Taxpayer Advocate. We have had a high-level task force working on this and related issues. I do not feel the results of this effort will infringe on my ability to assist taxpayers.

I appreciate your interest in the Taxpayer Advocate Service and am happy to respond to this request or others that you may have.

Sincerely,

W. Val Oveson

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