

IRS Oversight Board
FY2010 IRS Budget Recommendation
Special Report

June 2009

**IRS Oversight Board
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Executive Summary

The Internal Revenue Service (IRS) Oversight Board recommends an FY2010 IRS budget of \$12.489 billion, an increase of \$966 million over the enacted FY2009 amount of \$11.523 billion. This recommendation is \$363 million above the President's request of \$12.126 billion.

As the Board stated in its 2008 *Annual Report to Congress*, our tax administration system has two serious weaknesses, the \$290 billion tax gap and the archaic nature of IRS information systems. As a result, the Board recommends that strengthening the system be a national priority.

Addressing those weaknesses is critical and urgent. The Board is fully supportive of the Administration's boost in enforcement funding. However, the Board recommends greater funding in the areas of Business Systems Modernization (BSM) and Operations Support than the President's budget requests. While the Oversight Board and the Administration's budgets agree in many ways, the Board feels that these key additional investments are needed sooner—not later—to strengthen our tax administration system.

The effort required to correct the two weaknesses identified above is not to be taken lightly. Although the tax gap can never realistically be eliminated, it is equally as foolish to suggest that nothing can be done to reduce it. As the Board has opined on numerous occasions, there is not a single solution to reducing the tax gap. Rather, a comprehensive, multi-faceted, multi-year, approach is needed that provides for excellent taxpayer service combined with vigorous enforcement, along with a long-term investment in IRS information technology and infrastructure. It is generally recognized that the IRS "cannot audit its way out of the tax gap." Balance between immediate expansion of personnel combined with long term investments in information technology and infrastructure are needed.

The second weakness, modernizing the IRS' archaic information technology systems, is equally daunting—yet it must be done. As noted in the Board's 2008 *Annual Report to Congress*, the IRS' system modernization program has been on the Government Accountability Office's (GAO's) high risk list since 1995. The GAO placed this program on its high risk list because it believed that the IRS relied on obsolete automated systems for key operational and financial management functions. The Board believes that it is unacceptable for this program to remain a high risk.

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The Board believes strongly that the IRS' BSM program should be in a position to move forward in FY2010 and FY2011 so that program milestones scheduled for 2011 can be achieved. Because the President's budget provides little additional funding for the Customer Account Data Engine in FY2010, it puts the FY2011 milestones at great risk. In addition, the Board believes additional funding is needed to refresh and update the IRS' aging infrastructure. In total, of the \$363 million difference in the two budgets, about \$332 million is for investments in critical information technology and infrastructure.

The Board would also increase funding for several key initiatives to improve taxpayer service. These initiatives are all designed to help the IRS plan and implement better taxpayer service in the future.

The Board's FY2010 IRS budget recommendations are summarized below by account.

Board Fully Supports Increased Enforcement Funding

The Board's recommendation for the enforcement account, which at \$5.5 billion is close to half of the IRS total budget, is identical to the President's budget. Both the President's and Oversight Board's budgets add \$332 million for additional enforcement. This increase constitutes a 7.6 percent boost in enforcement funding, and includes additional funding to strengthen criminal investigations programs, increase examinations and collections, and support a variety of regulatory matters.

This increase in enforcement resources pays for itself; in some cases many times over—a consideration that should not be ignored in the budget process. In addition, it helps to reduce the tax gap, which deprives the nation, and hence its citizens, of \$290 billion annually it is legally owed. The tax gap is an affront to honest taxpayers and efforts must be made to reduce it.

The President's request for enforcement funding includes a multi-year investment of \$128 million, starting in FY2010, to deal more effectively with increasing international tax activities of individual and business taxpayers. The Board is pleased with this initiative, as the effects of globalization on tax administration are significant and must be addressed.

The Board also strongly supports additional funding to improve compliance among "high-risk" taxpayer segments. Estimates show that much of the tax gap is due to underreporting of income by businesses, mostly run by individuals. It is imperative that the IRS not only ensure that all individuals understand their tax obligations, but that they report their income and pay their taxes.

Taxpayer Service Increase Recommended

For the taxpayer service account, the Oversight Board's and President's budgets are within 0.2 percent of one another. The President's budget request for taxpayer service benefits from congressional action taken during consideration of the FY2009 budget. By adding additional funding

to the IRS taxpayer service budget in FY2009, Congress raised the base amount for taxpayer service in FY2010, giving the IRS additional resources to serve taxpayers in an increasingly more complex economic environment.

The need for taxpayer service is especially acute during periods of economic hardship, as taxpayers may find themselves facing challenging financial situations. In addition, taxpayers need additional help to understand new tax provisions and programs designed to help them during difficult times. Every change in the tax code causes the tax administration system to become more complex, with more taxpayers in need of help to understand and meet their obligations. It is especially important during this recession that the IRS be able to follow through on its strategic goal to “make voluntary compliance easier.”

Despite a higher funding base for taxpayer service, there are several areas where the Board recommends additional funding. In 2005, Congress asked the IRS, National Taxpayer Advocate, and the IRS Oversight Board to develop a five-year plan to improve taxpayer service. The result was the Taxpayer Assistance Blueprint (TAB), which was completed in April 2007. In the Board’s opinion, the IRS needs additional resources to more fully carry out the TAB by expanding its on-line capabilities. Additional funding is also needed to optimize the use of Taxpayer Assistance Centers, also known as walk-in sites, which traditionally serve lower income taxpayers who depend more on walk-in services. Overall, the Board recommends an additional \$31.6 million be appropriated for taxpayer service, all of which will be focused on improving taxpayer service in the future.

Strategic Funding Needed for BSM

The IRS’ archaic computer systems are a serious challenge facing the IRS. The Board is dismayed by the long-term under-funding of the BSM program, forcing the IRS to stretch out its efforts at a painfully slow pace, to the detriment of taxpayers.

The Board is pleased that the IRS has revised its BSM approach to put more focus on completing the program, and considers it a critical foundation of service and enforcement in the future. IRS Commissioner Douglas H. Shulman told the House Appropriations Committee on May 19, 2009, that, “The integrated strategy includes a particular focus on enhanced information technology security practices and robust accounting and financial management controls.”

However, the Board questions whether the President’s budget will allow for substantive progress in the coming years. The Board has opined in past years that the BSM account is fundamentally under-funded, and despite the additional \$7.3 million added by Congress in FY2009 and the President’s FY2010 requested increase of \$22.6 million, the FY2010 request for BSM continues to be far too low. Progress will come slowly should that trend continue. The Customer Account Data Engine project, in particular, has funding needs that go far beyond what was requested in FY2010, and those needs will only grow in FY2011.

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The Board's recommended BSM budget of \$400 million is 58 percent higher than the President's BSM budget of \$253.7 million. At \$253.7 million, the President's BSM budget consumes 2.1 percent of the IRS total budget of \$12.126 billion. This compares to the Board's recommendation of a \$400 million BSM budget, which consumes 3.2 percent of its total \$12.489 billion budget. Although the difference is quite small when viewed as a portion of the total budget, the vision presented by these two BSM budgets is quite different. The Board believes that funding decisions for the IRS must look beyond consideration of short term benefits and immediate return on investment. Serious consideration must also be given to the long term benefits to taxpayers and the tax administration system that will result from a modernized information technology system. These investments will result in fundamental changes to tax administration that will benefit both taxpayers and tax administrators alike.

The Board recommends that a total of \$400 million be appropriated for the BSM program so that the pace of progress is increased, allowing the IRS to achieve key milestones in FY2011 that are an important part of its revised approach, such as the deployment of a daily Individual Master File processing capability and a Customer Account Data Engine relational database.

More Funding for Operations Support

Another important aspect of the IRS' performance is the state of its legacy infrastructure: the technology and tools used by IRS employees to do their work. IRS laptops, software, the telecommunications systems, and the buildings themselves are aging and must be updated and maintained. In addition, the IRS must protect its hardware and data infrastructure from threat, whether it comes from bad weather or cyber-attack.

The Administration's FY2010 budget calls for \$108.1 million in program increases to address information technology security and material weaknesses, and to strengthen the Electronic Fraud Detection System. The Board supports this funding, as both can help ensure the integrity of the tax system and maintain taxpayer confidence that returns remain private and safe from security risks.

However, more needs to be done. The Board recommends a total of \$292 million in infrastructure program increases, compared to the \$108 million requested by the President's IRS budget. The Board recommends an additional \$164 million in technology initiatives and a \$20 million initiative related to workforce development. This funding is needed to refresh and maintain the IRS' infrastructure, strengthen its ability to protect the personal information of taxpayers, increase the productivity of its workforce by leveraging information technology, and upgrade its financial services accounting system that uses a software application product that is so old the vendor will no longer support the program in 2013.

In addition, workforce development cannot be ignored, especially during a period when the IRS is losing experienced employees to

retirement and is hiring a significant number of new employees. Frontline supervision plays a key role in employee satisfaction, quality, and productivity, and the IRS lacks funding to properly train frontline managers in a timely fashion. Approximately \$15 million of the workforce initiative is for frontline management training, with the remaining \$5 million for succession planning and executive development.

Long-Term Investment Key to IRS Strength

Although the magnitude of the Board's IRS budget recommendations are not vastly different from the President's budget request in amount, they do focus more on the IRS' strategic goals and call for investments that are needed today for a stronger tax administration system in the future. The Oversight Board believes that its approach represents a meaningful long-term investment to benefit our nation in the decades to come.

I. Introduction and Scope

The IRS Oversight Board's responsibilities include overseeing the IRS in its administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws. The Board is also responsible for ensuring that the IRS' organization and operations allow the agency to carry out its mission. To this end, the Board was given specific responsibilities for reviewing and approving strategic plans and annual budgets, including performance budgets.

Specifically, the Board is required by 26 U.S.C. § 7802(d) to review and approve the IRS-prepared annual budget request submitted to the Department of the Treasury, and to ensure that the approved budget supports the annual and long-range strategic plans of the IRS. The President is required to submit the Board's budget recommendation, without revision, to Congress along with the Administration's request. Additionally, the Government Performance and Results Act (GPRA) outlines the agency's responsibilities for linking agency strategic plans, budget plans, performance plans and performance reporting to a comprehensive strategic process needed to measure agency performance.

In meeting this duty, the Board must ensure that the IRS' budget and related performance expectations contained in the performance budget: (1) support the IRS' annual and long-range plans; (2) support the IRS' mission; (3) are consistent with the IRS' goals, objectives and strategies; and (4) ensure the proper alignment of IRS strategies and plans.

In this special report, the Oversight Board presents its recommended budget of \$12.489 billion for the IRS—a \$966 million increase over the enacted FY2009 level. It also examines the President's FY2010 IRS budget request of approximately \$12.126 billion and compares this request with the Board's recommendations.

In developing these recommendations, the Board has applied its own judgment but has also drawn on the collective wisdom of others in the tax administration community, including the IRS, the Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA), the National Taxpayer Advocate (NTA), and Congress.

II. FY2010 Strategic Assessment: Challenges Facing the IRS

One of the IRS Oversight Board's most important statutory responsibilities is to ensure that the IRS' budget request supports the agency's annual and long-term strategic plans. A budget request is more than a mechanism for appropriating funding; it's also a plan, a commitment, and a performance management tool. Not only does a proposed budget request funding, it also describes the activities the IRS will perform, how those activities align with the long-range strategic plan, and identifies measures to evaluate the expected results.

As noted in the Board's 2008 *Annual Report to Congress*, the Board believes the tax administration system has two serious systemic weaknesses that must be addressed: the tax gap and IRS' archaic information technology systems. Failure to do so will create long-term performance issues for the tax administration system. With tax administration so critical to the nation's economic health, the Board recommends that strengthening the country's tax administration system be a national priority.

The IRS has developed an update to its strategic plan, *IRS Strategic Plan 2009–2013*, that presents a plan to guide the IRS' efforts to address these serious weaknesses. This plan, approved by the IRS Oversight Board, also contains measures that the Board, and other oversight organizations, will use to evaluate the IRS' performance, not only in addressing these weaknesses, but to evaluate how well the IRS is serving the American public. The plan established the following goals and strategic foundations for the IRS:

- **Goal 1:** Improve service to make voluntary compliance easier
- **Goal 2:** Enforce the law to ensure everyone meets their obligations to pay taxes
- **Strategic Foundations:** Invest for high performance

The Board takes very seriously the charter imposed on it by 26 U.S.C. § 7802(d) to review and approve the IRS-prepared annual budget request submitted to the Department of the Treasury, and to ensure that the approved budget supports the annual and long-range strategic plans of the IRS. It is this legal responsibility that requires the Board to recommend to Congress its own recommendations for the IRS budget, one that will allow the IRS to achieve the strategic goals and strategic foundations identified in the *IRS Strategic Plan 2009–2013*, which will address the two serious tax administration weaknesses of the tax gap and archaic information systems. However, to deliver the performance

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mandated by the plan will require an appropriate investment, and the Board believes that the budget recommendations documented in this report are needed to support those goals.

The effort required to correct the two weaknesses identified above is not to be taken lightly. Although the tax gap can never realistically be eliminated, it is equally as foolish to suggest that nothing can be done to reduce it. As the Board has opined on numerous occasions, there is not a single solution to reducing the tax gap. Rather, a comprehensive, multi-faceted, multi-year approach is needed that provides for excellent taxpayer service combined with vigorous enforcement, along with a long-term investment in IRS information technology and infrastructure. It is generally recognized that the IRS “cannot audit its way out of the tax gap.” Balance between immediate expansion of personnel combined with long term investments in information technology and infrastructure is needed.

The second weakness, modernizing the IRS’ archaic information technology systems, is equally daunting—yet it must be done. As noted in the Board’s *2008 Annual Report to Congress*, the IRS’ systems modernization program has been on the Government Accountability Office’s (GAO) high risk list since 1995. The Board believes that treating this situation as the normal way of doing business is unacceptable. The Board also observes that one consequence of under-funding the IRS can be to shift costs to taxpayers. The burdens imposed on taxpayers, in terms of what it costs them to comply with the law, and what it costs them in terms of the tax gap, far exceed the funds appropriated for the IRS. These costs are as real as the direct taxes paid to the federal government and should be considered in the broad context of tax administration in order to understand the burden imposed on taxpayers for underfunding the IRS.

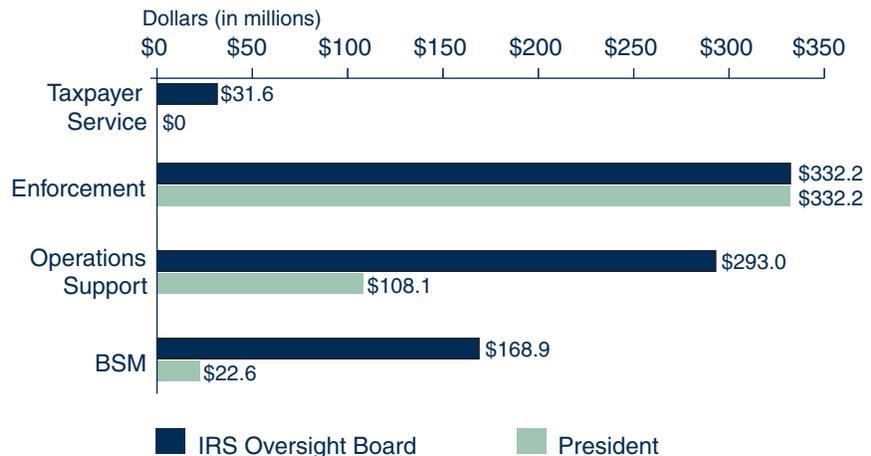
This report presents the Oversight Board’s budget recommendations in support of the *IRS Strategic Plan 2009–2013*, and explains why additional investments are required in some key strategic areas, so burdens and tax gap costs imposed on taxpayers can decrease, not increase, in the future.

III. Oversight Board Recommended IRS FY2010 Budget

The IRS Oversight Board recommends an FY2010 IRS budget of \$12.489 billion, an increase of \$966 million over the enacted FY2009 amount of \$11.523 billion, as shown in Table 1. This recommendation is \$363 million above the President’s request of \$12.126 billion. To facilitate the direct comparison of the Board’s and President’s FY2010 IRS budgets, Table 2 displays the Board’s recommended budget by appropriation account.

Despite the \$363 million difference, there are many points of agreement between the Oversight Board’s recommendations and the President’s budget request. However, the Oversight Board supports increased funding for BSM and Operations Support, along with a smaller boost in taxpayer service (see Figure 1). The IRS’ fifth account, Health Insurance Tax Credit Administration (HITCA), will not be further addressed in this report because of its small size and lack of budget initiatives.

Figure 1. Comparison of Program Increases Contained in the President’s and Oversight Board’s FY2010 IRS Budgets



Addressing the two weaknesses in the tax administration system is critical and urgent. The Board is fully supportive of the Administration’s boost in enforcement funding. However, the Board recommends greater funding in the areas of BSM and Operations Support than the President’s budget requests. While the Oversight Board’s and the Administration’s budgets agree in many ways, the Board feels that these key additional investments are needed sooner—not later—to strengthen our future tax administration system.

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For significant parts of the IRS FY2010 budget, the President's and Oversight Board's budgets are consistent. In fact, for the enforcement account, which at \$5.5 billion is almost half of the IRS total budget, the President's and Oversight Board's budgets are identical. In the area of taxpayer service, they are within 0.2 percent of one another.

Table 1. IRS Oversight Board Recommended FY2010 IRS Budget
(dollars in thousands)

FY2009 Enacted	\$11,522,598
Changes to Base:	
Maintaining Current Levels	\$256,329
Efficiencies/Savings	(\$118,125)
Reinvestment	\$2,331
Subtotal Changes to Base	\$140,535
Total FY2010 Base - Current Services	\$11,663,133
Program Increases	
<i>Taxpayer Service Initiatives</i>	
TAB Technology Enhancements	\$6,000
Optimize TAC Footprint	\$17,880
Research and Analysis to Improve Taxpayer Service	\$7,750
Subtotal, Taxpayer Service Initiatives	\$31,630
Program Increases:	
<i>Enforcement Initiatives</i>	
Reduce the Tax Gap Attributable to International Activities	\$128,064
Improve Reporting Compliance of SB/SE Taxpayers	\$94,215
Expand Document Matching for Business Taxpayers	\$26,237
Address Nonfiling/Underpayment and Collection Coverage	\$83,644
Subtotal, Enforcement Initiatives	\$332,160
<i>Infrastructure Initiatives</i>	
Address IT Security and Material Weakness	\$90,000
Implement Return Review Program	\$18,100
Refresh/Sustain Infrastructure	\$75,000
Training and Certifying Project Managers	\$5,000
Enhance Privacy, Information Protection and Data Security	\$9,154
Technology Investments to Enhance Operations	\$35,000
Upgrade Integrated Financial System (IFS)	\$40,700
Leadership Training and Development	\$20,000
Subtotal, Infrastructure Initiatives	\$292,954
BSM Initiative	
Fund BSM to Accelerate Taxpayer Benefits	\$168,933
Subtotal, BSM	\$168,933
Subtotal FY2010 Program Changes	\$825,677
Total FY2010 Request	\$12,488,810
FY2010 President's Request for IRS	\$12,126,000
Increase Over President's Request	\$362,810

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Table 2. Summary of IRS Oversight Board Recommended IRS FY2010 Budget by Account
(dollars in thousands)

	Taxpayer Service	Enforcement	Ops Support	BSM	HITCA	Total
FY2009 Enacted Budget	\$2,293,000	\$5,117,267	\$3,867,011	\$229,914	\$15,406	\$11,522,598
Changes to Base:						
Maintaining Current Levels Adjustment	\$60,195	\$133,815	\$61,060	\$1,153	\$106	\$256,329
Efficiencies/Savings	(\$90,918)	\$0	(\$27,207)	\$0	\$0	(\$118,125)
Reinvestment	\$2,025	\$0	\$306	\$0	\$0	\$2,331
Subtotal Changes to Base	(\$28,698)	\$133,815	\$34,159	\$1,153	\$106	\$140,535
Total FY2010 Base - Current Services	\$2,264,302	\$5,251,082	\$3,901,170	\$231,067	\$15,512	\$11,663,133
Program Increases						
<i>Taxpayer Service Initiatives</i>						
TAB Technology Enhancements	\$592		\$5,408			\$6,000
Optimize TAC Footprint	\$4,238		\$13,642			\$17,880
Research and Analysis to Improve Service			\$7,750			\$7,750
Subtotal, Taxpayer Service Initiatives	\$4,830	\$0	\$26,800	\$0	\$0	\$31,630
<i>Enforcement Initiatives</i>						
Reduce the Tax Gap Attributable to International Activities	\$3,124	\$104,113	\$20,827			\$128,064
Improve Reporting Compliance of SB/SE Taxpayers	\$267	\$75,114	\$18,834			\$94,215
Expand Document Matching for Business Taxpayers	\$1,425	\$17,955	\$6,857			\$26,237
Address Nonfiling/Underpayment and Collection Coverage	\$712	\$55,736	\$27,196			\$83,644
Subtotal, Enforcement Initiatives	\$5,528	\$252,918	\$73,714	\$0	\$0	\$332,160
<i>Infrastructure Initiatives</i>						
Address IT Security and Material Weakness			\$90,000			\$90,000
Implement Return Review Program (RRP)			\$18,100			\$18,100
Refresh/Sustain Infrastructure			\$75,000			\$75,000
Training and Certifying Project Managers			\$5,000			\$5,000
Enhance Privacy, Information Protection and Data Security			\$9,154			\$9,154
Technology Investments to Enhance Operations			\$35,000			\$35,000
Upgrade Integrated Financial System (IFS)			\$40,700			\$40,700
Leadership Training and Development			\$20,000			\$20,000
Subtotal, Infrastructure Initiatives	\$0	\$0	\$292,954	\$0	\$0	\$292,954
<i>Business Systems Modernization Initiative</i>						
Fund BSM to Accelerate Taxpayer Benefits				\$168,933		\$168,933
Subtotal, BSM Initiatives	\$0	\$0	\$0	\$168,933	\$0	\$168,933
Subtotal FY2010 Program Changes	\$10,358	\$252,918	\$393,468	\$168,933	\$0	\$825,677
Total FY2010 Board Recommendation	\$2,274,660	\$5,504,000	\$4,294,638	\$400,000	\$15,512	\$12,488,810
FY2009 Enacted	\$2,293,000	\$5,117,267	\$3,867,011	\$229,914	\$15,406	\$11,522,598
FY2010 President's Request for IRS	\$2,269,830	\$5,504,000	\$4,082,984	\$253,674	\$15,512	\$12,126,000
Increase Over President's Request	\$4,830	\$0	\$211,654	\$146,326	\$0	\$362,810
Percent Increase Over President's Request	0.2%	0.0%	5.2%	57.7%	0.0%	3.0%

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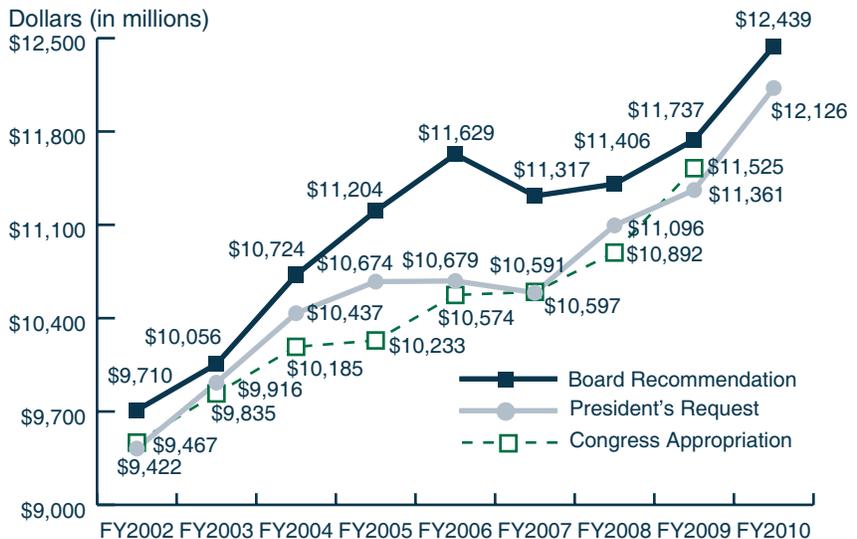
However, there are significant differences in the BSM and Operations Support accounts. For the BSM program, which the Board has viewed as historically under-funded, the Board's recommended budget of \$400 million is 58 percent higher than the President's BSM budget of \$253.7 million. At \$253.7 million out of a total budget of \$12.126 billion, the President's BSM budget consumes 2.1 percent of total funding. This compares to the Board's recommendation of a \$400 million BSM budget, which consumes 3.2 percent of the total \$12.489 billion budget. Although the difference is quite small when viewed as a portion of the total budget, the vision presented by these two BSM budgets is quite different. The Board believes that funding for the IRS must grow beyond simply viewing the IRS budget through the lens of short term benefits, and consider as well the long term benefits to taxpayers and the IRS that will result from a modernized information technology system.

In the Operations Support account, there are also real differences in vision. The President's budget has proposed program increases for Operations Support of \$108.1 million compared to the Board's proposed program increases of \$293 million. The Board believes additional funding is needed to refresh and update the IRS' aging infrastructure.

The IRS Oversight Board and the President's budgets are relatively close with respect to overall funding, as shown in Figure 2, but contain divergent views on the need to fund information technology and infrastructure.

In total, of the \$363 million difference in the two budgets, about \$331 million is for investments in critical information technology and infrastructure. The balance would fund several key initiatives to improve taxpayer service.

Figure 2. IRS Funding History FY2002-2010



The next section describes how the Board's budget recommendations support the achievement of the *IRS Strategic Plan, 2009–2013*. It contains sub-sections that address each strategic goal and the strategic foundations.

IV. Meeting Strategic Goals

Achieving the strategic goals and establishing the strategic foundations identified in the *IRS Strategic Plan 2009–2013* will require the IRS to address the two serious tax administration weaknesses: the tax gap and the IRS’ archaic information systems. However, to deliver the performance mandated by the plan will require appropriate investments.

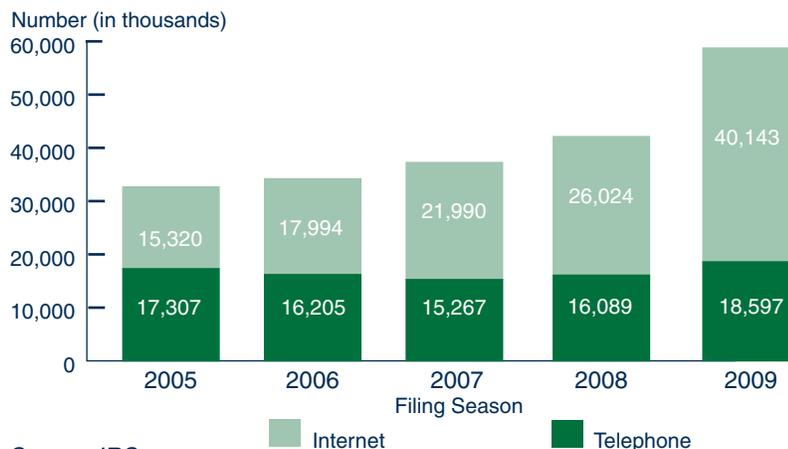
The IRS Oversight Board’s budget was developed with these strategic goals in mind.

Goal 1: Improve Service to Make Voluntary Compliance Easier

The IRS has responded admirably to taxpayers’ need for help with innovation, developing such web applications as “Where’s My Refund?” and “Where’s My Stimulus Payment?” as well as automated call systems capable of handling millions of phone calls. Nonetheless, every new tax credit creates additional burden and questions among taxpayers struggling to fill out their returns. Whether calling a toll-free number, visiting the IRS web site, or getting help at a tax clinic, more Americans need help understanding their tax obligations.

While the American Recovery and Reinvestment Act (ARRA) will benefit millions, it demonstrates the burden we place on our already-stretched tax administration system and the importance of providing the resources needed to provide taxpayers with the service they need. During the 2009 tax filing season, the IRS web site was visited 160.9 million times, up nearly 20 percent from the previous year. As illustrated in Figure 3, more than 40 million inquiries were sent to the “Where’s my Refund?” application, up from 26.024 million in 2008.

Figure 3. Automated IRS Service on Taxpayer Refund Inquiries During Filing Season, 2005-2009



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For that reason, the Board was pleased to see that the FY2009 Omnibus Appropriations Act increased the base funding for taxpayers services that now yields a stronger FY2010 request. However, more is needed to ensure that IRS delivers quality service in FY2010 and beyond. Specifically, the Board recommends three specific program initiatives, for a total of \$31.6 million, to improve taxpayer service.

Implement the Taxpayer Assistance Blueprint - \$6.0 million

In 2005, Congress asked the IRS, National Taxpayer Advocate, and the IRS Oversight Board to develop a five-year plan to improve taxpayer service. The result was the Taxpayer Assistance Blueprint (TAB). This plan was completed in April 2007 and includes:

- A comprehensive portfolio of service improvement recommendations
- A sound implementation strategy to ensure that taxpayer service remains a key consideration in IRS budget and strategic planning processes
- A recommended set of future research studies to further enhance understanding of taxpayer and partner service needs, preferences, and behaviors

The TAB identified five areas for improvement of IRS service delivery to increase value to all taxpayers. The Blueprint's goals included aligning delivery channels with the most effective and efficient methods of delivery possible and strengthening performance by improving first contact resolution. A second goal promised promptness of service and accuracy of information. Two additional goals coupled reduction of burden and improvement of service delivery awareness for taxpayers. A fifth goal called for the migration of services to electronic channels for efficient, effective, and promptly delivered information.

However, much of the Blueprint remains to be implemented, and is more important than ever. Based on research and analysis, the TAB identifies what kind of services taxpayers want and need and how best those services are provided. This knowledge can allow the IRS to make wise resource decisions based on the unique needs of particular taxpayer segments and to build a solid foundation of service for taxpayers in a timely basis. One size does not fit all when it comes to taxpayer service. By providing the right service at the right place at the right time, the IRS is investing its funding wisely.

Cost is an important factor for the IRS to consider as it makes service delivery decisions. Taxpayers who cannot obtain the information they need to comply with federal tax laws or to resolve their issue on the first attempt can generate additional costs for the IRS and additional burden for themselves. There could be considerable value in the IRS designing its service delivery to focus on preventing and minimizing taxpayer noncompliance, and assisting taxpayers in correcting errors to reduce taxpayer burden. Therefore, it is important that the IRS move forward to implement several key initiatives from the TAB.

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By enhancing the IRS web site so that it becomes the first choice for more taxpayers for obtaining information and service, the IRS would be keeping pace with current technology and taxpayer expectations. Funding would also allow the IRS to expand capabilities to make www.irs.gov readily accessible to persons with disabilities.

Therefore, the Board recommends an additional \$6 million to implement TAB technology enhancements. This initiative will encourage taxpayer use of www.irs.gov by advancing the electronic initiatives outlined in the 2007 TAB Phase 2 Report. This includes funding for seven web projects that integrate the on-line capabilities of the IRS such as adding audio and video formats to further taxpayer education and increasing accessibility and functionality to meet taxpayer needs.

Optimize Taxpayer Assistance Center Footprint - \$17.88 million

The Board recommends an additional \$17.88 million to optimize the Taxpayer Assistance Center "Footprint." Some taxpayers are underserved and have a difficult time getting the kind of help needed to understand their tax obligations. The TAB, citing research of the IRS Oversight Board, suggests that about one-third of the population, including those with problems filing or paying their taxes, do not live within 30 minutes of an IRS Taxpayer Assistance Center (TAC).

Table 3: Taxpayer Assistance Center Coverage Rates

Taxpayer Segment	Percent of Taxpayer Segment Within 30 Minutes of IRS TAC
Low Income (annual income under \$30,000)	60.2%
High Frequency of Late Filing or Late Paying	63.2%

Source: Taxpayer Assistance Blueprint Phase 2 Report

The TAB analyzed and provided recommendations for TACs based on research findings about the needs, preferences, and behaviors of those taxpayers who contact the IRS for assistance. The research indicated taxpayers' preference for receiving interactive services through face-to-face channels and with receiving direct personal assistance to resolve tax issues during their first contact with the IRS. An IRS strategy of migrating some taxpayers to use electronic channels for certain services would free TAC assistors to focus on those interactive activities and services that taxpayers tend to prefer to receive in person. The IRS can also gain efficiencies in the TAC geographic footprint by evaluating TAC effectiveness and initiating improvements that respond to taxpayer needs and preferences and deliver quality service through the channels that taxpayers prefer. This initiative will provide funds to reach underserved taxpayers in areas addressed in the TAB Geographic Footprint and to expand space in current locations where customer demand has outgrown the current available space.

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Research and Analysis to Improve Taxpayer Service – \$7.75 million

The third service initiative recommended by the Board is an additional \$7.75 million for research and analysis to improve taxpayer service. The TAB developed a multi-year research portfolio that acknowledges the Treasury Department’s tax gap strategy and called for studies to better understand the impact of service on compliance. Examples of recommended studies for the portfolio include taxpayer preferences and behaviors; taxpayer burden; inadvertent, unintentional noncompliance; facilitated self-assistance model; channel migration strategies; and alternative approaches to contacting taxpayers.

Understanding taxpayer behavior is critical to designing service programs to help taxpayers comply with the least cost to taxpayers and the IRS. The additional \$7.75 million for research and analysis to improve taxpayer service would enhance the quantity, complexity, and reliability of research information in the areas of service channels to reduce taxpayer burden and tax complexity. It will provide resources to fund multi-year programs to understand the relationship among complexity, burden, and compliance.

Goal 2: Enforce the Law to Ensure Everyone Meets Their Obligation to Pay Taxes

The Board fully supports the Administration’s recommendation to strengthen IRS’ enforcement efforts with an additional \$332.16 million in new investment. Increased enforcement produces direct tax revenue and also encourages voluntary compliance that produces additional, albeit immeasurable, indirect revenue. Moreover, enforcement investments ultimately pay for themselves many times over—an aspect that should not be overlooked during the budget process. Table 4 shows the IRS’ estimates for the return on invest (ROI) for direct revenue only produced by each of the four enforcement-related program increases the President’s budget is requesting.

Table 4: Return on Investment on FY2010 Enforcement Initiatives, FY2010–FY2012 (dollars in millions)

Enforcement Investment	First Year (FY2010)			Full Performance (FY2012)		
	Cost	Revenue	ROI	Cost	Revenue	ROI
Reduce the Tax Gap Attributable to International Activities	\$128.1	\$93.8	0.7	\$103.4	\$736.6	7.1
Improve Reporting Compliance of Small Business/Self-Employed Taxpayers	\$94.2	\$159.6	1.7	\$72.6	\$567.2	7.8
Expand Document Matching for Business Taxpayers	\$26.2	\$191.8	7.3	\$22.8	\$386.5	17.0
Address Nonfiling/ Underpayment and Collection Coverage	\$83.6	\$165.9	2.0	\$64.0	\$359.4	5.6
Direct Revenue Producing Initiatives, Total	\$332.1	\$611.1	1.8	\$262.8	\$2,049.7	7.8

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As shown in Table 4, the President's FY2010 request for enforcement funding, if enacted, will generate \$2.0 billion in additional revenue annually once the new hires reach full potential in FY2012.

Further, the Board fully appreciates the Administration's budget request for enforcement investments in FY2010 because it takes a long-term view on enormous changes in the world. The IRS must respond to the tax implications of globalization and the opportunities it can create for tax evasion. The time is now to build a solid foundation on international tax administration.

In the past few years, the IRS has observed the following trends:

- The number of multinational enterprises increased by twenty-fold, from 3,000 in 1990 to well over 63,000 in 2007
- The number of filings of Form 1120, U.S. Corporation Income Tax Return, containing international features, has increased by 87 percent from 2002 to 2007
- Technology is making it easier for small and mid-sized businesses to compete across borders

The Administration's budget would invest \$128 million on a multi-year basis, starting in FY2010, to deal more effectively with increasingly complex international tax activities of individual and business taxpayers. Specifically, the IRS must improve its identification and coverage of international issues on returns of domestic taxpayers and increase examination coverage of all international tax returns. To accomplish this, the IRS must enhance its international technical expertise, hire additional economists and international finance experts, and focus on complex issues, such as transfer pricing, foreign tax credit generators, and abusive transactions involving hybrid instruments.

The Oversight Board does not recommend additional enforcement resources over and above the President's request at this time. Given the number of new hires the IRS will be making in FY2009, to fill both new positions and replace employees who retire or voluntarily leave the IRS, the Board believes that steady, stable growth, as reflected in the President's budget request, is the best path for the IRS to follow. Such a recommendation is consistent with the advice received from outside experts at the Board's February 2009 public meeting. A summary of this discussion can be found at the Board's web site at www.irsoversightboard.treas.gov.

Strategic Foundations: Invest for High Performance

In its recently published *IRS Strategic Plan 2009–2013*, IRS Commissioner Douglas H. Shulman stated, "We need to excel at both service and enforcement to meet our mission: it isn't an either/or proposition. To succeed, we will support these goals by investing in two strategic foundations—our people and our technology. We will strive to make the IRS the best place to work in government. We will give our people the technology that they need to improve efficiency, ensure privacy and security of data, and target the highest-risk areas of tax abuse and fraud."

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The Oversight Board agrees, and believes that investing in a well-trained, empowered, and satisfied workforce and modern information technology systems that serve taxpayers on a par with private sector financial institutions, is critical to delivering a sound and strong tax administration system.

In reviewing the Administration's budget, the Board finds much to support. However, it also finds a budget that delays key investments that would improve tax administration greatly in the future. The Board believes strongly that the IRS' BSM program should be in a position to move forward in FY2010 and FY2011; this budget will not allow that to happen. As a result, the Board continues to advocate additional funding to strengthen the IRS infrastructure.

The strategic foundations in which the IRS must invest for it to deliver top quality service and more robust enforcement encompass both the BSM and Operations Support budget accounts. The following sections describe the Board's budget recommendations for both accounts.

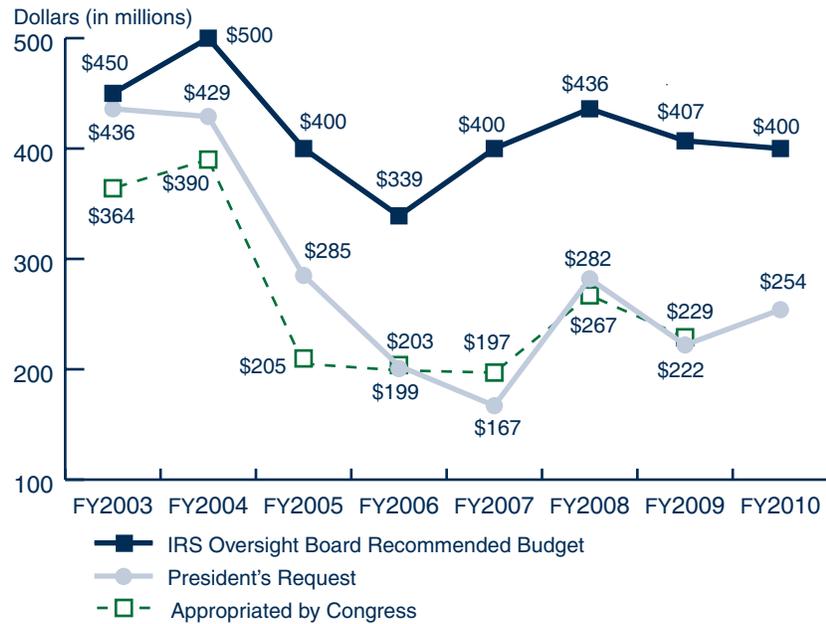
Business Systems Modernization: Boost Funding in FY2010

As noted in the Board's *2008 Annual Report to Congress*, the second serious challenge facing tax administration is modernizing the IRS' computer systems. The Board is dismayed by the long term under-funding of this most important program, forcing the IRS to stretch out its efforts at a painfully slow pace, to the detriment of better service to taxpayers.

The Board does not believe the President's budget will allow for substantive progress in the coming years. The Board has opined in past years that the BSM account is fundamentally under-funded, and despite the additional \$7.3 million added by Congress in FY2009 and the President's FY2010 requested increase of \$22.6 million, the FY2010 request for BSM continues to be under-funded. Figure 4 illustrates the funding history of the BSM program from FY2003 through FY2010, and the wide gap that exists between the Oversight Board's funding recommendations, those of the President, and the funds appropriated. Progress will come slowly should that trend continue, much to the detriment of taxpayers. The Customer Account Data Engine (CADE) project, in particular, has funding needs that go far beyond what was requested in the President's FY2010 budget, and those needs will only grow in FY2011 as the IRS implements its revised approach to completing CADE.

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Figure 4. BSM Funding FY2003 to FY2010



The IRS' revised approach for completing CADE, as described in the Government Accountability Office report, *Review of the Fiscal Year 2010 Budget Request* (GAO-09-754), is to:

- establish a relational database for taxpayer accounts,
- populate it with data available from the current Individual Master File (IMF) and CADE,
- move from IMF weekly processing to a daily cycle,
- modify downstream business applications,
- better address financial management and security weaknesses, and
- define a target end state solution.

These tasks will require increased funding in FY2010 and FY2011. The Board sees a need for higher funding in both fiscal years so the IRS can achieve major milestones in FY2011, such as the establishment of a relational database. In the opinion of the Board, it is far too risky to achieve these milestones in FY2011 if FY2011 is the first year that development funding is increased significantly. A gradual buildup of the IRS team, starting in FY2010, is far less risky and will help the IRS make reasonable progress on what is arguably the most important initiative for the future. Maintaining BSM funding at approximately current levels, even with a ten percent increase, will prevent real progress in implementing its revised CADE approach and ultimately result in higher costs by delaying program completion.

One fundamental handicap to CADE development has been the growing amount of funding from the BSM account that must be spent on operations and maintenance (O&M) of the CADE system completed to date, including the costs of annual updates to reflect new tax provisions.

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O&M costs for CADE are estimated to be approximately \$40 million in FY2009, which directly decrease the amount that can be spent for CADE development, and which threaten future development at a critical time. Therefore, the Board recommends that \$40 million be added to BSM funding to recognize the costs of CADE O&M, which is sufficiently large that they warrant additional visibility.

Secondly, the Board recommends that development costs should be \$110 million in FY2010. This level of development funding will give the IRS an early start on critical work that must be accomplished by the end of FY2011. This action increases development funding by approximately 240 percent, from \$46 million in FY2009 to \$150 million in FY2010, and permits the IRS to make the necessary progress that must be made to achieve the planned FY2011 milestones noted above. In addition, the Board recommends that BSM labor costs be increased to \$70 million to account for the additional IRS labor associated with its new strategy.

As an illustration of the negative consequences to taxpayers from underfunding BSM over the years, consider the slow pace of IRS' progress in establishing the capability to process tax returns on a daily basis. Daily processing of returns, instead of the weekly basis imposed by IRS' legacy computing system, enables the IRS to issue refunds to taxpayers much more quickly and reduces the taxpayer demand for refund anticipation loans (RALs) and the exorbitant costs associated with them. The initial release of the CADE project in filing year 2005 enabled the IRS to process returns on a daily basis for the first time, but only for the simplest of tax returns. That year, CADE handled around 1.4 million individual tax returns. For filing year 2009, four years later and following the development and implementation of subsequent releases, CADE will provide daily return processing for about 40 million filers. While this growth between 2005 and 2009 in the number of returns processed daily reflects tangible benefits to the taxpayers affected, the IRS estimates that around 141 million individual income tax returns will be filed in total during calendar year 2009. A pace in which over two-thirds of individual taxpayers are still locked into weekly tax return processing five years into the corresponding modernization effort is one the Board finds too slow. It is time to devote more budget resources to get the job done.

The Board also recommends that Core Infrastructure and Architecture, Integration, & Management (AIM) funds be increased so that the IRS can begin to build out the infrastructure for the production and test environment that would enable CADE application redesign and database construction to start earlier. These increases are necessary to support the increased CADE development.

Table 5 reflects the recommendations made by the Board. It provides a total BSM budget of \$400 million, a \$146.3 million increase over the President's request of \$253.7 million. Funding for the Modernized e-File (MeF) program and management reserve is as recommended in the President's budget.

FY2010 IRS Budget Recommendations

Table 5. Recommended Oversight Board's BSM FY2010 Budget vs. President's Budget
(dollars in millions)

Project	IRS Oversight Board's Recommended FY2010 BSM Budget	President's FY2010 BSM Budget	Difference
Customer Account Data Engine (CADE)	\$150.0	\$85.7	\$64.3
CADE O&M	\$40.0	\$0.0	\$40.0
Modernized e-File (MeF)	\$50.0	\$50.0	\$0.0
Core Infrastructure	\$43.0	\$32.0	\$11.0
Architecture, Integration, & Management	\$42.0	\$35.0	\$7.0
Management Reserve	\$5.0	\$5.0	\$0.0
Subtotal Capital Investments	\$330.0	\$207.7	\$122.3
Total BSM Labor	\$70.0	\$46.0	\$24.0
Total	\$400.0	\$253.7	\$146.3

Operations Support: Upgrading Aging Equipment

Another important aspect of the IRS' performance is the state of its infrastructure: the actual tools used by IRS employees to do their work. IRS laptops, software, the telecommunications systems, and the buildings themselves are aging. In addition, the IRS must protect its infrastructure and the data it contains from threat, whether it comes from bad weather or cyber-attack.

The Administration's FY2010 budget calls for a \$90 million program initiative to address information technology security and material weaknesses and an additional \$18.1 million initiative to strengthen the Electronic Fraud Detection System. The Board supports these program initiatives as both can help ensure the integrity of the tax system and maintain taxpayer confidence that returns remain private and safe from security risks.

However, more needs to be done. Most notably, funding is needed to refresh and sustain infrastructure. The Board recommends five additional program initiatives under the Operations Support budget account. Four of the recommended initiatives are for information technology and one is for leadership training and workforce development. Table 6 contains the two initiatives recommended by the President plus the additional five initiatives recommended by the Oversight Board. Table 7 provides a description of the recommended initiatives and the benefits that the recommended initiatives will produce.

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Table 6. Operations Support Budgets: IRS Oversight Board's vs. President's Budget
(dollars in millions)

Project	IRS Oversight Board's Recommended FY2010 Operations Support Budget	President's FY2010 Operations Support Budget	Difference
Address IT Security and Material Weaknesses	\$90.0	\$90.0	\$0
Return Review Program	\$18.1	\$18.1	\$0
Refresh/Sustain Infrastructure	\$75.0	\$0	\$75.0
Upgrade Integrated Financial System (IFS)	\$40.7	\$0	\$40.7
Technology Investments to Enhance Operations	\$35.0	\$0	\$35.0
Training and Certifying Project Managers	\$5.0	\$0	\$5.0
Enhance Privacy, Information Protection, and Data Security	\$9.15	\$0	\$9.15
Leadership Training and Development	\$20.0	\$0	\$20.0
Total	\$292.95	\$108.1	\$184.85

FY2010 IRS Budget Recommendations

Table 7. Additional Operations Support Program Increases Recommended by the Oversight Board

Description	Benefit
Refresh/Sustain Infrastructure - \$75 million	
<p>This initiative for \$75 million will upgrade the backlog of aged and outdated information technology (IT) and telecommunications equipment currently in use at the IRS to be in line with current business standards. It will ensure the IRS continues to meet its core taxpayer service and tax law enforcement responsibilities efficiently and effectively, and enable the IRS to improve its productivity. IRS officials view the need to refresh the agency's worn and obsolete technology infrastructure as a high priority.</p>	<p>This initiative:</p> <ul style="list-style-type: none"> • enables the IRS to meet both its current taxpayer service and enforcement responsibilities and improve the productivity of service and enforcement staff in the future; • avoids increased maintenance costs for obsolete equipment; and • reduces the risks of disruptions to tax processing systems, security breaches, and substandard equipment.
Upgrade Integrated Financial System (IFS) - \$40.7 million	
<p>This initiative for \$40.7 million is the first part of a two-year program to upgrade the IRS internal, enterprise-wide financial management system and migrate it to a shared service provider in compliance with OMB requirements. The current version of the IFS software used by the IRS is eight years old, and the software vendor will not update it to accommodate changes to federal accounting requirements. This initiative will ensure continued IRS compliance with federal financial management standards and sustain GAO's "clean audit opinion" of IRS' financial management practices. This migration to software based on federal accounting practices would eliminate the current work-around processes the IRS must employ each year to complete its required annual financial statement; work-around processes that reflect shortcomings in current IRS financial management practices and that are regularly cited as significant weaknesses in GAO's annual audits of IRS' financial statements.</p>	<p>This initiative:</p> <ul style="list-style-type: none"> • improves the IRS project management capabilities relative to costs and assets; • reduces costly and labor-intensive work-around processes the IRS must use now to produce its annual financial statement; • addresses the IRS' need to replace specialized financial accounting software that is rapidly nearing obsolescence; • helps IRS comply with an OMB mandate; and • addresses a long-standing IRS material weakness identified by the GAO.
Technology Investments to Enhance Operations - \$35 million	
<p>This initiative for \$35 million will allow the IRS to leverage specific IT products and redesign systems to increase the productivity of particular IRS tax processing and service delivery operations. These productivity improvements include providing taxpayers with on-line resource tools to answer their tax law questions; improving the quality of taxpayer interactions with IRS through the use of contact recording; accepting lien filing fees electronically and automatically depositing that revenue into the Treasury System; redesigning the IRS revenue accounting system to address related material weaknesses in financial reporting identified by the GAO; and improving the case management and information reporting systems for major IRS compliance programs.</p>	<p>This initiative:</p> <ul style="list-style-type: none"> • provides more Internet-based self assistance tools to taxpayers; • improves the quality of IRS service provided to taxpayers contacting the IRS; and • increases the productivity of IRS compliance operations.

Table 7 continues on next page.

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Training and Certifying Project Managers - \$5 million	
<p>This initiative for \$5.0 million is to ensure that the IRS has a sufficient cadre of properly trained and certified IT project managers with the prerequisite skills to effectively manage the IRS' many complex technology-centered projects. Both the GAO and TIGTA have emphasized for many years the critical role that IRS IT project management plays in delivering successful BSM projects that meet requirements within cost and schedule. While the GAO and TIGTA have recognized IRS improvement in this area over the years, both oversight organizations still emphasize that the success of BSM efforts requires IRS to continue to devote significant attention to improving its IT project management capabilities.</p>	<p>This initiative:</p> <ul style="list-style-type: none"> provides the IRS with the necessary supply of trained IT project managers who are a prerequisite to successful delivery of IRS' business systems modernization efforts.
Enhance Privacy, Information Protection, and Data Security - \$9.15 million	
<p>This initiative for \$9.15 million will enable the IRS to be more proactive in reducing the risks to taxpayers posed by online fraud and identity theft. The additional resources will enable the IRS to develop better monitoring and response capabilities to fight online fraud and identity theft, and promote other security steps to protect taxpayer privacy, information, and data.</p>	<p>This initiative:</p> <ul style="list-style-type: none"> provides the IRS with a more aggressive capacity to fight online fraud and identity theft; and protects taxpayer privacy.
Leadership Training and Development - \$20 million	
<p>The Board is concerned that the IRS is not providing frontline supervisors with leadership training in a timely way. In FY2009, through the second quarter, only 69 percent of IRS frontline supervisors had received timely leadership training. The next several years are likely to produce high attrition, especially among manager ranks as the workforce ages. The Board considers timely frontline supervisor training as essential to good taxpayer service and effective tax law enforcement, so it recommends a program initiative of \$15 million to restore leadership training capabilities to previous levels. In addition, another \$5 million for the purpose of expanded succession planning, such as expanding the Executive Development program and other development programs for senior managers, is also recommended in light of the high number of senior managers and executives who are expected to retire in the next several years.</p>	<p>This initiative:</p> <ul style="list-style-type: none"> provides for greater capacity for frontline manager training to correct current under-capacity to perform this essential training. Research has demonstrated that frontline supervision is a key factor in promoting high levels of employee engagement, which in turn leads to high levels of customer satisfaction.

V. Conclusion

The IRS Oversight Board and the President's budgets are relatively close with respect to overall funding, but contain divergent views on the need to fund information technology and infrastructure. Although this may appear at first glance to be about people versus things, another view would be the divergence is based more on valuing short term gains over long term benefits.

Program initiatives in enforcement and service result in the hiring of additional IRS personnel. Although there is a time lag due to hiring, assimilating, and training new employees, the additional resources can be applied quickly, and the results are measurable in terms of output, such as more cases worked or additional telephone calls answered.

Additional investments in information and technology often take longer for benefits to be realized, because of the delay to develop, test, and implement new systems, which is relatively time-consuming compared to the time it takes to hire and train new employees. Moreover, many of the IRS' information technology systems were designed in the 1960s. The IRS needs both more employees and better tools. Most taxpayers would prefer not to bank using the systems of the 1970s or even the 1980s. The IRS needs modern tools and refreshed infrastructure. Handicapping IRS employees with old tools by not appropriating funds for technology is not actually saving taxpayers' money. It is costing them in terms of burdens and delays that are placed on taxpayers and taxes that go uncollected.

IRS Oversight Board

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