TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Office of Inspections and Evaluations

The Internal Revenue Service Restructuring and Reform Act of 1998 Was Substantially Implemented but Challenges Remain

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

March 1, 2010

MEMORANDUM FOR COMMISSIONER SHULMAN

FROM: R. David Holmgren
Deputy Inspector General for Inspections and Evaluations

SUBJECT: Evaluation Report – The Internal Revenue Service Restructuring and Reform Act of 1998 Was Substantially Implemented but Challenges Remain (Project # 200810IE010)

This evaluation represents the results of our review to determine whether the goals of the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)[1] have been substantially achieved by the IRS.

Impact on the Taxpayer

The RRA 98 required the IRS to change its organizational culture, restructure, modernize, and improve taxpayer protections and rights. With a new mission focused on taxpayer service, the IRS shifted its emphasis from an enforcement first culture to a more customer service-oriented culture, made progress in modernizing its business processes and computer systems, and provided taxpayers with greater protections and rights. As a result, taxpayers receive more professional and courteous services to assist them in complying with the tax law.

Synopsis

The RRA 98 was broadly scoped legislation with the goal to transform the IRS into a modern financial services organization. The transformation into a modern financial institution was to be

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[1] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app, 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

accomplished by providing taxpayers customer service similar to private sector financial institutions, including electronic access to their accounts.

The IRS transformation was a massive undertaking that required changes to virtually every aspect of the organization. First, the IRS reorganized from a geographically based organization to a customer-based organization structure with four operating divisions.[2] Second, a new mission statement focusing on taxpayer service was developed. To align with the new mission, organizational performance measures were changed to the three equally weighted measures of business results, customer satisfaction, and employee satisfaction. In addition, the IRS implemented safeguards to ensure enforcement statistics are no longer used as a basis for employee evaluations.

Third, efforts to modernize computer systems and business processes were also undertaken. With technology changes, the IRS made return filing easier by offering expanded electronic filing, created an extensive Web site (www.IRS.gov) with a broad range of information, and installed a state-of-the-art telephone routing system to more effectively and efficiently answer taxpayer calls. In addition, 71 taxpayer protections and rights required by the RRA 98 were engineered into operational processes and procedures. Finally, the IRS emphasized employee engagement throughout the change process. There was a consistent upward trend in employee job satisfaction survey results that indicates that the IRS is providing a quality work environment. Employees satisfied with training to perform their jobs increased by 25 percent from Calendar Years 2002 to 2008.

While the IRS has made significant strides in transforming into a modern financial services organization, major challenges remain. The Business Systems Modernization effort remains a work in progress. In addition, there are human capital management challenges for issues such as replacing an aging workforce, developing a comprehensive employee skills gap assessment, measuring the effectiveness of training, and implementing a performance-based pay system. Finally, in the compliance arena, estimating noncompliance and effectively addressing repeat offenders are continuing challenges.

In recent years, there has been considerable discussion about the tax gap.[3] For Tax Year 2001, the tax gap was estimated to be $345 billion. The IRS has provided many testimonies to Congress on actions that can be taken to reduce the tax gap and developed, with the Department of the Treasury, a tax gap reduction plan.[4] The tax gap reduction strategy is predicated on being successful in several of the improvement areas identified in the RRA 98 and the IRS Restructuring Commission Report.

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[2] The Wage and Investment, Small Business and Self-Employed, Large and Mid-Size Business, and Tax Exempt and Government Entities Divisions.
[3] The tax gap is the difference between taxes that are legally owed and taxes that are paid on time.
[4] *Reducing the Federal Tax Gap, A Report on Improving Voluntary Compliance, August 2, 2007.*

Recommendation

We are making no recommendations in this report concerning implementation of the RRA 98.

Response

Management had no comments on the draft report.

Please contact me at (202) 927-7048 if you have questions or Philip Shropshire, Director, at (215) 794-1542.

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Abbreviations

ACSI	American Customer Service Index
CDP	Collection Due Process
CY	Calendar Year
FY	Fiscal Year
GAO	Government Accountability Office
IA	Installment Agreement
IRS	Internal Revenue Service
MIRSA	My IRS Account
NTA	National Taxpayer Advocate
OIC	Offer in Compromise
RRA 98	Restructuring and Reform Act of 1998
SB/SE	Small Business and Self-Employed
TAS	Taxpayer Advocate Service
TBOR	Taxpayer Bill of Rights
TIGTA	Treasury Inspector General for Tax Administration
W&I	Wage and Investment

Background

In the early and mid-1990s, "reinventing government" efforts were underway across the Federal Government. The Government Performance and Results Act of 1993[1] required agencies to develop strategic plans and annual performance measures. One of the tenets of reinventing government was the emphasis on customer service. While the Internal Revenue Service (IRS) took actions to improve customer service, it also measured and emphasized compliance and enforcement actions. Prior to the IRS Restructuring and Reform Act of 1998 (hereafter referred to as the RRA 98),[2] Congress had received taxpayer complaints about how the IRS was overly aggressive in enforcing the tax laws. At the same time, IRS customer services like the toll-free telephone system were often unreachable to millions of taxpayers seeking assistance. In addition to these issues, the IRS had undertaken several unsuccessful attempts to modernize its computer systems.

Congress established the National Commission on Restructuring the IRS (hereinafter referred to as the Commission) to examine the IRS organization structure, expedite the implementation of modernization, and improve service to taxpayers. In June 1997, the Commission issued a report[3] and provided recommendations on improving the IRS. The main recommendations focused on improving the governance, management, and oversight of the IRS; addressing problems identified with the workforce and the culture; improving customer service and compliance; achieving efficiencies; modernizing core computer systems; converting returns processing into an electronic environment; simplifying the tax code; and protecting taxpayer rights. The RRA 98 codified many of the recommendations made by the Commission; thereby, causing the largest overhaul of the IRS since the 1950s.

The objective of the RRA 98 was to transform the IRS into a modern financial services organization. The broadly scoped legislation changed the IRS mission, organization structure, and business focus while targeting change in the organizational culture. Congress envisioned the reform provisions to help transform IRS culture by introducing new innovation and management practices, and restricting older practices that were considered abusive. Congress intended to transform the IRS from

The RRA 98 changed the IRS mission, organization structure, and business focus while targeting change in the organizational culture.

[1] Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).
[2] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app, 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).
[3] *Report of the National Commission on Restructuring the Internal Revenue Service – A Vision for a New IRS* (June 25, 1997).

an enforcement first culture to a culture that valued taxpayer service to help taxpayers comply with their responsibilities.

This review was performed in Washington, D.C., during the period April 2009 through September 2009. The review was performed in accordance with the Council of the Inspectors General for Integrity and Efficiency Quality Standards for Inspections. The scope of the evaluation did not include an evaluation of every provision in the RRA 98. The decision to include or exclude a provision was based on materiality and judgment. In addition, while the RRA 98 legislation differed from the Commission's report in some areas, we often referred to the Commission's report to better understand the purposes of the legislation. In some areas, the legislation did not specifically address concerns expressed by the Commission; however, we have included an assessment of selected topics expressed in the Commission's report to provide a broader assessment of IRS modernization efforts.

The objective of this evaluation was to determine whether the IRS has substantially achieved the goals of the RRA 98. The term "substantially," as used in this evaluation, is defined as fundamentally or with a considerable amount. In other words, substantial does not infer completely achieved but, rather, essentially achieved. When appropriate, we identify areas where additional improvements can be realized. Detailed information on our objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

The purpose of the RRA 98 legislation was to change the IRS into a modern financial services organization. The RRA 98 legislation touched virtually every aspect of the IRS and tax administration. The significant challenge of changing the governance and organizational structure, transforming the workforce and culture, improving customer service and compliance, achieving efficiencies, modernizing core computer systems, converting to electronic returns filing, and protecting taxpayer rights required the IRS to virtually reinvent itself while still administering the tax system.

The IRS has made significant strides in transforming into a modern financial services organization but major challenges remain. The Business Systems Modernization effort remains a work in progress. In addition, there are human capital management challenges for issues such as replacing an aging workforce, developing a comprehensive employee skills gap assessment, measuring the effectiveness of training, and implementing a performance-based pay system. Finally, in the compliance arena, estimating noncompliance and effectively addressing repeat offenders are continuing challenges. The major actions for each of these areas are as follows.

I. Governance and Organizational Structure Changes Were Implemented

The term "governance" when used with public institutions and government agencies has various definitions. In the context of the Commission's report on the IRS in 1997, the term referred to both the external and internal governance frameworks. The purpose of the changes in governance was to provide the IRS with more stable oversight, create greater transparency for taxpayers, and provide taxpayers with forums to express their viewpoints to the IRS. The governance elements of the RRA 98:

Created the IRS Oversight Board **–** The Oversight Board is a nine-member independent body charged to oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws, and to provide experience, independence, and stability to the IRS so that it may move forward in a focused direction. The IRS Oversight Board has express authority to approve IRS budgets and strategies and provides an annual report on the Board's responsibilities and another report on the progress of electronic filing to Congress.

Appointed the IRS Commissioner to 5-Year Term **–** The IRS Commissioner is nominated by the President and confirmed by the Senate to a five-year term. The Commissioner is eligible to be reappointed for more than one five-year term. Among other qualifications, the Commissioner is required to have demonstrated management experience. The Commissioner's duties and powers are prescribed by the Secretary of the Treasury. Unless otherwise specified by the Secretary, the duties and powers include the power to administer, manage, conduct, direct, and supervise the execution and application of the internal revenue laws. The Commissioner also exercises the IRS's final authority concerning the substantive interpretation of the tax laws.

Established the National Taxpayer Advocate (NTA) - The NTA is appointed by the Secretary of the Treasury after consultation with the IRS Commissioner and the IRS Oversight Board. The individual appointed is required to have a background in customer service as well as tax law and experience in representing individual taxpayers. The NTA reports directly to the IRS Commissioner. By December 31 of each year, the NTA provides Congress an annual report which, among other mandatory items, includes a summary of at least 20 of the most serious problems encountered by taxpayers with corresponding recommendations for administrative and legislative actions.

Established the Treasury Inspector General for Tax Administration (TIGTA) **–** The TIGTA is an independent Inspector General office in the Department of the Treasury devoted to oversight of the IRS. The TIGTA is charged with conducting audits, investigations, and evaluations of IRS programs and operations (including the IRS Oversight Board) to promote the economic, efficient, and effective administration of the nation's tax laws and to detect and deter fraud and abuse in IRS programs and operations. In this regard, the TIGTA specifically is directed to evaluate the adequacy and security of IRS technology on an ongoing basis. In addition, the TIGTA is responsible for protecting the IRS against external attempts to corrupt or threaten its employees.

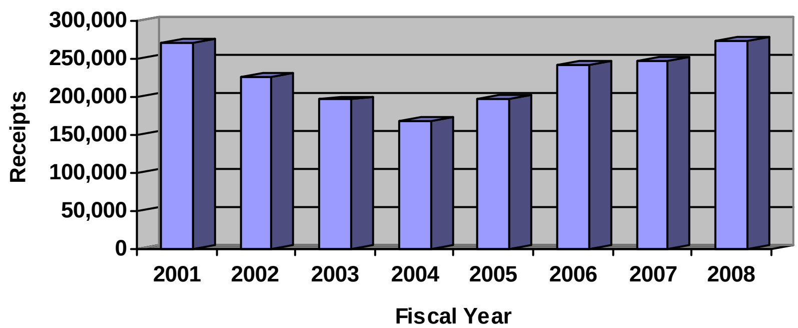
The governance changes have resulted in significant changes in strategic focus. After the initial RRA 98 changes, there was a substantial drop in IRS compliance program results. There were several contributing factors that caused the compliance drop but a major factor was compliance resources were used to improve customer service. However, that has changed to a much more balanced approach articulated in the equation "Service Plus Enforcement Equals Compliance." There has also been greater oversight and transparency. Since September 2001, the IRS Oversight Board has issued 31 reports on various topics confronting tax administration from the progress of electronic filing to taxpayer attitude survey results. The Oversight Board Chairperson has also testified before Congress 16 times since May 2001.

From a different oversight perspective, as of March 31, 2009, the TIGTA issued more than 1,600 final audit reports and made more than 4,000 recommendations to improve tax administration, 3,500 of which the IRS has taken action; identified more than $192 million in questioned costs and more than $25 billion in funds that could have been put to better use; processed over 91,000 complaints; opened over 44,000 investigative cases and successfully closed more than 99 percent of those cases; and provided testimony to Congress on 36 occasions.

The NTA has provided a forum for taxpayers to voice their opinions and get problems solved. Between April 2003 and October 2008, the NTA testified before Congress 30 times on issues spanning the spectrum of tax administration issues and has provided an annual report as required. To directly listen to taxpayers' views, the Taxpayer Advocacy Panel was created in October 2002 with the expansion of the former Citizen Advocacy Panel, first established in 1998. The Taxpayer Advocacy Panel reports to the Secretary of the Treasury, the IRS Commissioner, and the NTA. The Panel offers an opportunity for citizens to participate in the improvement of both the tax administration system and the organization of the IRS. Panel members from every State provide input on the IRS's strategic initiatives as well as provide a venue for raising issues identified by citizens.

The NTA resolves tax problems for taxpayers that are having difficulty in obtaining resolution and closure of their tax issues. Figure 1 shows the Taxpayer Advocate Service (TAS) case receipts for Fiscal Years (FY) 2001 through 2008 averaged approximately 228,000 per year.

Figure 1: TAS Case Receipts by FY



Source: NTA Annual Reports to Congress for FYs 2001 through 2008.

IRS Reorganization and Management

Prior to the RRA 98, the IRS was organized in a three-tier geographic structure with a National Office, four regional offices, and 33 district offices. There was a Regional Commissioner, a Regional Counsel, and a Regional Director of Appeals for each region. The compliance functions, such as Examination and Collection were operated separately in each region. There were also ten processing service centers and two computing centers. Each region, district, and service center served all the taxpayers that were in their geographic area. The tiered geographic structure had been in effect since the 1950s.

In early 1998, the IRS Commissioner announced a plan to replace the geographic structure with a customer-based structure by having divisions devoted to serve taxpayer groups with similar needs. The key operational units are four operating divisions: Wage and Investment (W&I), Small Business and Self-Employed (SB/SE), Large and Mid-Size Business, and Tax Exempt and Government Entities. Under this structure, each operating division was charged with complete responsibility (e.g., taxpayer education, customer service, audit, and collection) for serving taxpayers with similar needs.

The four operating divisions are supported by two service organizations: Modernization and Information Technology Services and Agency-Wide Shared Services (providing common services such as facilities management and procurement services). Appeals and the TAS are nationwide organizations that provide separate specialized independent channels for taxpayers. The Criminal Investigation Division has sole responsibility for investigation of criminal violations of the tax law and, for the first time, operated as a line function within the IRS. The National Headquarters organizations assumed the role of setting broad policy, reviewing plans and goals of the operating units, and developing major improvement initiatives. By changing from the geographically based to a customer-based structure and eliminating the middle regional management tier, the IRS centralized its organizational structure.

Evaluation and Conclusion

The governance requirements of the RRA 98 were implemented in accordance with the legislation. The changes have resulted in increased oversight, greater transparency, and a greater taxpayer voice in tax administration. The IRS restructuring has resulted in divisions devoted to serving taxpayers with similar taxation characteristics. In this regard, the RRA 98 governance and restructuring requirements have been achieved.

II. Workforce and Culture Changes Were Implemented; However, Human Capital Issues Remain as a Challenge

The Commission identified several issues with the IRS workforce and culture. Some of these were attributed to budget and salary structure constraints outside of the control of the IRS. Other issues identified included employees sometimes lacking basic tools like office equipment, having research materials available, and receiving training. The Commission also identified issues with the IRS's ability to recruit and attract skilled employees, a risk adverse culture, and stovepipe operations.[4] Finally, the Commission identified employee frustration with the internal measures and the criteria for performance evaluations. In summary, virtually all aspects of human capital management required change.

Human Capital and Culture

The Government Accountability Office (GAO) defines human capital simply as meaning people.[5] The GAO further states that there are two key principles that are central to the human

[4] In a stovepipe operation, functional units such as taxpayer services, exam, collection, appeals, and counsel implement their own priorities and objectives, which often are disconnected from the other functions and organization as a whole.
[5] *Human Capital: A Self Assessment Checklist for Agency Leaders* (GAO/OCG-00-14G, dated September 2000).

capital idea. First, people are assets whose value can be enhanced through investment. As the value of people increases, so does the performance capacity of the organization, and therefore its value to clients and other stakeholders. Second, an organization's human capital policies must be aligned to support the organization's mission, vision, core values, goals and objectives, and strategies. All human capital policies and practices should be designed, implemented, and assessed by the standard of how well they help the organization pursue its shared vision.

The RRA 98 was designed by Congress to transform the IRS's organizational culture from an enforcement first focus to a modernized one that values taxpayer service by helping taxpayers comply with their tax responsibilities. Congress intended that the reform provisions, such as the change in the mission statement, new personnel flexibilities, and performance measures, would transform the IRS's culture by introducing new innovation and management practices, and restricting older practices that were considered abusive.

Changing the culture of an organization requires substantial efforts and is considered a long-term process that can take years. In February 1992, the GAO[6] reported what several experts had identified as being essential to changing an organizational culture. Figure 2 shows the techniques considered essential to achieve a cultural change and the corresponding actions the IRS took to change its organizational culture.

[6] *Organizational Culture: Techniques Companies Use to Perpetuate or Change Beliefs and Values* (GAO/NSIAD-92-105, dated February 1992).

Figure 2: Culture Change

Degree of Importance	Culture Change Techniques	What the IRS Has Substantially Implemented/Achieved
Very Great	Top Management Support	Displayed top management commitment and support for a new and improved IRS through a series of actions such as a new mission statement, organizational blueprint, strategic plan, and performance measures.
	Training	Trained employees to develop customer service and technical skills.
Great	A Statement of Values and Beliefs	Developed a new mission statement emphasizing customer service and guiding principles. Identified values that complemented the IRS mission.
	Communicating Desired Values and Beliefs	Used internal publications, newsletters, Web site, town hall meetings, and internal video broadcasts to communicate mission statement, objectives, values, and beliefs of the IRS.
	Management Style	Since 2005, the employee satisfaction survey program has grown to encompass more than a once-a-year survey event and is now charged with integrating employee engagement into daily IRS operations. Employee engagement is the degree of employees' motivation, commitment, and involvement in the IRS mission. It is a year-round effort incumbent on all employees, at all organizational levels, to openly communicate challenges, suggestions, and successes regarding their work, among other issues. Engaged employees use their discretionary energy and talents to excel in performing their job tasks and to further the organization's interests. In Calendar Year (CY) 2008, 47 percent of employees responding to the survey question indicated that they felt empowered with respect to their work process.
	Rewards, Incentives, and Promotions	Evaluated employees on the fair and equitable treatment of taxpayers.
	Organizational Gatherings	Held community day events throughout the organization to bring employees from different functions and business units together.
	Organizational Structure	Restructured the organization into four operating divisions that meet the needs of particular taxpayer groups.
	Systems, Procedures, and Processes	Developed systems, procedures, and processes compatible with the new structure. Compliance procedures emphasize customer service and taxpayer rights.

Degree of Importance	Culture Change Techniques	What the IRS Has Substantially Implemented/Achieved
Moderate	Staff Changes	Replaced or changed responsibilities of management and employees to support desired values and beliefs. Filled key positions such as the Chief Information Officer; National Taxpayer Advocate; and the Commissioners, Large and Mid-Size Business, and SB/SE Divisions with outside expertise using streamlined critical pay authority. Employed personnel flexibilities authority to be more competitive with private companies and hire talented front-line professionals for special agent, revenue agent, revenue officer, and newly established tax specialist occupations. Performed a comprehensive workforce strategy to match employee skills with new positions and ensure productive employment for all employees.
	Stories, Legends, and Myths	Used stories in "IRS Today" and newsletters like "W&I Offline" to convey values and beliefs on customer service and highlight employee innovations. Newsletters report awards and achievements.
	Company Heroes and Heroines	Highlighted IRS employees volunteering in their community through newsletters.
Some	Hiring the Right People	Improved hiring process is addressed through the Workforce of Tomorrow Taskforce.
	Slogans	Used the "One-stop Service" and "One-IRS" slogans, which consider customer service from the taxpayer's prospective. Also, used the "Services Plus Enforcement Equals Compliance" slogan as a guiding principle.
	Assigning a Culture Manager	The IRS Commissioner chartered the IRS Services Committee as the governance body for IRS service investment decisions. The committee is responsible for overseeing, prioritizing, and approving an integrated portfolio of IRS services.

Source: TIGTA Analysis of IRS Actions found on IRS Intranet Site.

When compared to the cultural change model developed by the GAO, the IRS took many actions to affect cultural change. Still, audits and evaluations in several human capital areas show that while many actions have been taken, challenges remain.

Training

Within the first year of the passage of the RRA 98, about 50,000 IRS employees received customer service training.[7] Since then, the IRS has continued providing training with a focus on customer service and tax law. The IRS integrated training into modernization plans as part of the IRS Strategic Plan 2005-2009. However, aspects of employee training remain a challenge. The overall IRS training budget is approximately one percent of the annual budget or about $100 million. Both the GAO and the TIGTA reported that the effectiveness of training has not been adequately evaluated.[8] The Federal Workforce Flexibility Act of 2004[9] requires agencies to regularly assess their training efforts to determine whether their training is contributing to the successful completion of the agencies' missions. The lack of training course assessments limits the IRS's ability to determine whether employees are getting the right training to effectively perform their jobs.

There are indications that training has improved with the RRA 98. From CYs 2002 to 2008, the IRS employee satisfaction survey showed that the number of employees satisfied or very satisfied with training to perform their jobs increased by 25 percent. Customer satisfaction surveys indicate that responding taxpayers' satisfaction with SB/SE auditors' tax law knowledge increased by 15 percent from the quarter ending in June 30, 2002, to the year ending March 31, 2008. Large and Mid-Size Business saw less change from FY 2003 to FY 2008, with the percentage of taxpayers satisfied with industry's auditors'[10] and Coordinated Industry's Audit Team Coordinators' knowledge of tax law within three percentage points for the two years. Ninety-five percent of taxpayers that responded to surveys about their experience with the Toll-free functions in W&I[11] and Tax Exempt and Government Entities in FY 2008, were satisfied with the knowledge of the representatives.

Modernizing to a Performance-Based Pay System

The IRS implemented a new Payband System for managers that combines pay scale ranges from the traditional government pay system and groups them together, thus allowing a broader pay range to reward high performance. However, the Payband System has encountered some problems. First, the IRS did not use its RRA 98 authority to improve the existing manager classification system, which was considered to be especially problematic. Instead, the IRS simply removed the incremental pay steps that existed under the traditional pay system. Next,

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7 *IRS Management: Formidable Challenges Confront IRS as It Attempts to Modernize* (GAO/T-GGD/AIMD-99-255, dated July 1999).
8 *Tax Administration: IRS Needs Better Strategic Planning and Evaluation of Taxpayer Assistance Training* (GAO-05-782, dated July 2005) and *The IRS Does Not Adequately Assess the Effectiveness of Its Training* (Reference Number 2005-10-149, dated September 19, 2005).
9 Pub. L. 108-411, 118 Stat. 2305 (2004).
10 Measured from the first half of FY 2003 ending March 2003.
11 W&I also includes Toll-free for SB/SE.

the IRS did not establish pay policies and procedures to ensure managers were paid comparably to their traditional pay system counterparts and commensurate with their individual performance. Finally, the Payband System operating concepts were not adequately communicated to the managers before it was implemented, causing opposition and decreasing morale. As a result, the IRS risks reducing rather than improving its ability to recruit, retain, and motivate highly skilled leaders.[12]

Workforce Planning

Workforce issues remain a primary concern of the new IRS Commissioner[13] who convened the Workforce of Tomorrow Task Force to address human capital issues. The Task Force issued its report in August 2009 and developed 58 recommendations in six focus areas.

1. **Planning a Dynamic People Strategy.** Create a sustainable and flexible workforce planning strategy that is responsive to both environmental trends and to evolving IRS plans and initiatives in a method that informs senior leaders' key decision making.

2. **Attracting the Best.** Create an organization-wide recruiting strategy that supports and balances all division needs, includes consistent corporate messages and enables local ownership and execution.

3. **Streamlining Hiring.** Redesign the hiring process to reduce the time necessary to hire by 50 percent, making it more efficient and responsive to both candidates and managers, and improving the quality and fit of new hires for all positions.

4. **Enhancing the Role of Managers.** Reset the expectations of and for managers to make the role more attractive and to reinforce a culture of leadership at the IRS.

5. **Growing Future Leaders**. Enhance leadership development at all levels to ensure that the best leaders are identified, developed, and placed in the right positions throughout their careers.

6. **Valuing and Retaining Our People.** Create a culture in which every employee is valued and empowered to contribute to both personal and organizational success.

In February through May 2009, the TIGTA performed an assessment of the IRS human capital challenge[14] and determined that the IRS took significant actions to address workforce issues. These actions included creating the IRS Commissioner's Workforce of Tomorrow Task Force, establishing the Centralized Recruiting Office, and incorporating human capital strategies and

[12] *The IRS Pay-for-Performance System May Not Support Initiatives to Recruit, Retain, and Motivate Future Leaders* (Reference Number 2007-10-106, dated July 3, 2007).
[13] Douglas Shulman began his tenure as IRS Commissioner on March 24, 2008.
[14] *To Address Its Human Capital Challenge, the Internal Revenue Service Needs to Focus on Four Key Areas* (Reference Number 2009-10-118, dated August 19, 2009).

high-level measures in the IRS Strategic Plan 2009-2013. Still, the IRS will need to address four key areas to make progress in addressing its human capital challenge. Namely, IRS executive management will need to 1) lead the agency to act as "one IRS" to strategically address its human capital issues, 2) balance the need for a more strategic focus on human capital issues with the need to continue addressing day-to-day issues that affect the IRS workforce, 3) evaluate the success of human capital initiatives and make adjustments as necessary, and 4) build upon the momentum gained through the IRS's recent emphasis on human capital issues.

Development of New Performance Measures

A final workforce and culture issue identified by the Commission was the IRS performance measures. Historically, the IRS used enforcement revenue as a key measure of success. IRS employees and managers perceived pressure to produce tangible enforcement results. A 1997 to 1998 GAO survey[15] of a statistically representative sample of Examination and Collection function employees showed a widespread perception that managers considered enforcement results when preparing annual performance evaluations. The GAO estimated that 75 percent of front-line compliance employees (revenue agents, tax auditors, and revenue officers) and 81 percent of first-line managers perceived that tax enforcement results affected their then most recent performance evaluation.

As a result of the RRA 98, the IRS took actions to change the measurement focus. First, to align with the new mission statement, the organizational performance measures were changed to the three equally weighted measures of business results, customer satisfaction, and employee satisfaction. Strategic measures apply to the organization as a whole and to each of the major operating and functional divisions. At the operational management level, balanced measures are used to assess the effectiveness of program and service delivery.

Next, the IRS revamped employee critical job elements to remove an emphasis on enforcement results and include customer service elements. Finally, the IRS also began surveying taxpayers receiving various services. These surveys provide the basis for identifying areas for improvement.

Over the past decade, IRS measures for employee satisfaction and taxpayer satisfaction have shown steady improvement. Figure 3 shows that overall IRS employee job satisfaction increased by 41 percent between CYs 2001 and 2008 just as the American Customer Satisfaction Indexes[16]

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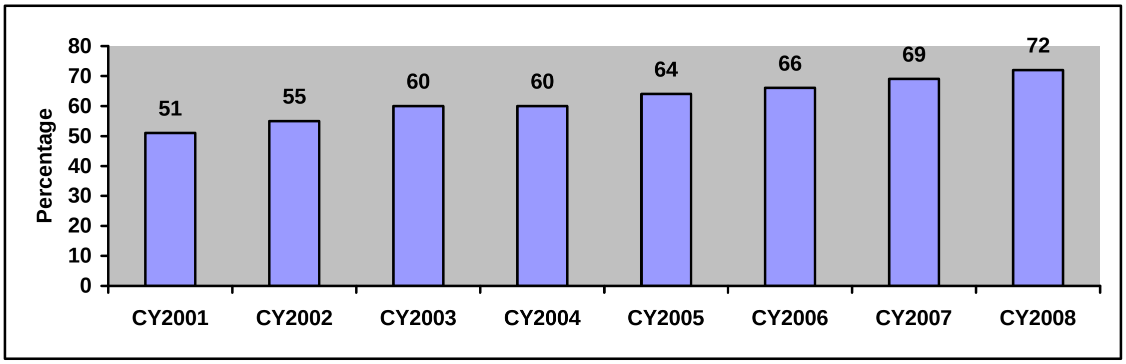
[15] *IRS Personnel Administration: Use of Enforcement Statistics in Employee Evaluations* (GAO/GGD-99-11, dated November 1998).

[16] The American Customer Satisfaction Index (ACSI) is a national indicator of customer satisfaction with the quality of products and services available to household consumers in the United States. Each December the ACSI issues a report on satisfaction of recipients of services from the Federal Government. Agency participation is voluntary - linking customer expectations and perceptions of quality and value to satisfaction. In 1999, the Federal Government selected the ACSI to be a standard metric for measuring citizen satisfaction.

show that individual taxpayer satisfaction increased by 13 percent between FY 2001 and FY 2008 as shown in Figure 4.

Figure 3: Employee Engagement/Job Satisfaction for CYs 2001 - 2008

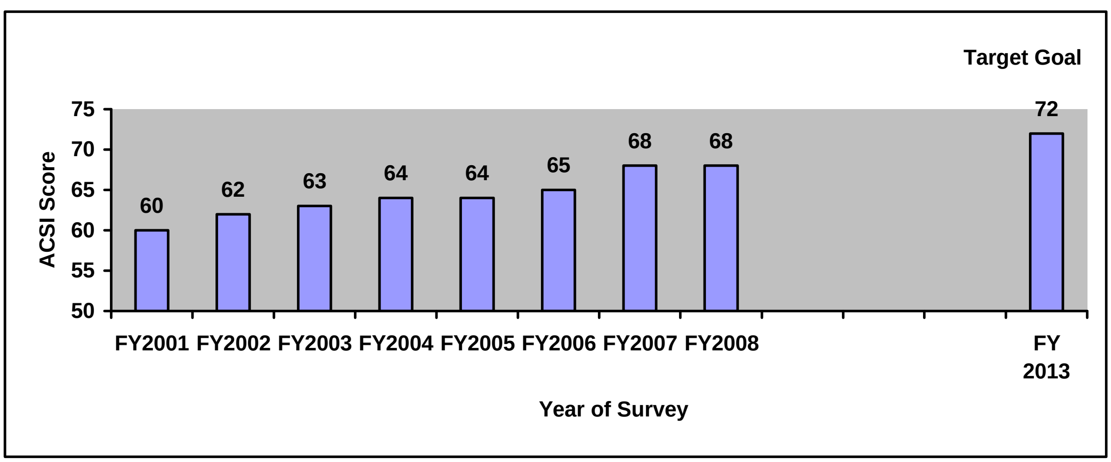
Response to question: Considering everything, how satisfied are you with your job?[17]



Source: *IRS Employee Engagement: Engage for Results*, 2008 Employee Survey Results (November 2008).

Figure 4: American Customer Satisfaction Index (ACSI)

All Individual Tax Filers



Source: FY 2001 though FY 2008 scores from the 2008 ACSI .reports produced by the National Quality Research Center at the University of Michigan Business School, the CFI Group and the Federal Consulting Group.

[17] In FY 2008, 46,767 (72 percent) of the 66,105 employees who responded to the survey question responded with a 4 or 5, Satisfied or Very Satisfied, to the question: *"Considering everything, how satisfied are you with your job*?"

Evaluation and Conclusion

The workforce and cultural changes required by the RRA 98 have been substantially addressed. The IRS has expended significant organizational resources to transform the culture from an enforcement first focus to one that better balances enforcement with customer service. The major requirements needed for a cultural change were implemented. While there are many positives in these accomplishments, major human capital challenges remain. The Workforce of Tomorrow Task Force recommendations have not yet been implemented completely. As the IRS workforce transition continues, human capital management remains a major management challenge and is critical to the IRS achieving its business modernization and tax gap reduction goals.

III. The Internal Revenue Service Strategic Objectives of Customer Service, Compliance, and Efficiency Gains Were Substantially Addressed, and Further Improvements Are Planned

In evaluating how the IRS should approach its three strategic objectives of improving customer service, increasing voluntary compliance, and finding efficiency gains, the Commission adopted two guiding principles:

- The IRS should only initiate contact with a taxpayer if the IRS is prepared to devote the resources necessary for a proper and timely resolution of the matter.
- Customer satisfaction must be a goal in every interaction the IRS has with taxpayers, including enforcement actions. Taxpayers expect quality service in all interactions with the IRS, including taxpayer assistance, filing tax returns, paying taxes, and examination and collection actions.

The Commission report stated that the American public expects timely, accurate, and respectful service from the IRS, but surveys rated the IRS low in customer satisfaction when compared with other service organizations. The Commission believed that good customer service and taxpayer education leads to increased compliance. Further, the Commission believed that the public compared the IRS to private sector financial services organizations. This comparison led to expectations for the IRS.

The Commission further stated that two initiatives that the IRS employed in the 1990s — Compliance 2000 and the compliance research approach — embody IRS efforts to turn away from high-cost enforcement solutions to noncompliance to lower-cost solutions without enforcement. This approach was contrasted with the traditional enforcement approach to compliance of one-by-one enforcement through examination of individual taxpayers. The Commission stated that this approach is expensive and did not identify patterns of noncompliance.

Customer Service

The RRA 98 provided requirements for customer service training for IRS employees. While the RRA 98 did not provide specific requirements for many aspects of customer service and compliance, the governance and restructuring requirements suggest that customer service and compliance improvements were the expected outcome. The Commission identified several areas where the IRS needed to improve its service to taxpayers. These areas included communicating through notices and correspondence,[18] telephone calls, electronic communications, using information strategically, and increasing the commitment to training and education.

Subsequent to the RRA 98, Congress requested that the IRS provide detailed plans for customer service.[19] The IRS developed the Taxpayer Assistance Blueprint which is a five-year plan that defines the IRS vision for improving taxpayer service. The Taxpayer Assistance Blueprint envisions a much broader use of the Internet for electronic interactions between taxpayers, practitioners, and the IRS. The Taxpayer Assistance Blueprint envisioned the IRS as an interactive and fully integrated, online tax administration agency with the potential for any exchange or transaction that currently occurs face-to-face, over the phone, or in writing to be completed electronically. This is similar to what customers of large financial institutions could already do. Taxpayers generally prefer the Internet for self-assisted services most often for tasks like getting a form, but prefer assisted services, such as those available through telephones or Taxpayer Assistance Centers,[20] most often for more complex tasks like responding to a notice. Therefore, it is important that notices are clear to reduce taxpayers' need for further communication, but for those that do, it is important to ensure that service channels meet taxpayers' needs and expectations.

Notices and Correspondence

The Commission identified the IRS notices as an area requiring improvements. Notice clarity has long been an issue with many attempts being made for improvement over the years.[21] The RRA 98 required that notices be used to inform taxpayers in new ways, causing an increase in the volume and cost of IRS notices.

- The IRS must notify the taxpayer in writing within five business days of the filing of a Notice of Federal Tax Lien and at least 30 calendar days prior to levying his/her property, and if the notice is not delivered to the person or their dwelling, it must be sent by certified or registered mail. This increases postage costs.

[18] In general, notices are automatically computer generated and correspondence is manually initiated by IRS employees.
[19] Congressional mandate for the Taxpayer Assistance Blueprint.
[20] An IRS office with employees who answer questions, provide assistance, and resolve account-related issues for taxpayers face to face.
[21] *Tax Administration: IRS Notices Can Be Improved* (GAO/GGD-95-6, dated December 1994).

- The IRS is required, wherever practicable, to send any notice relating to a joint return separately to each individual.
- The IRS must provide each taxpayer that has an Installment Agreement (IA),[22] an annual statement of the initial balance, payments, and ending balance for the year.
- The IRS notices sent to individual taxpayers must include the title section and the computation for any notice that includes interest and/or penalty.
- The IRS must periodically or upon request provide a taxpayer a record of persons contacted during the time period used to determine or collect a tax liability of that taxpayer.
- The IRS must provide an IRS contact person, title, and telephone number on manually generated correspondence. On automatic notices, a contact number must be provided.

Approximately 120 million notices and correspondence (letters) were issued in FY 2008. The Office of the Notice Gatekeeper has responsibility for these taxpayer communications. The Notice Gatekeeper staff works with other IRS offices for initiatives involving notices and letters. It also maintains the Servicewide Notice Information Program, an internal electronic tool that provides notice and letter content information and telephone response rates.

In FY 2007, the IRS conducted a Notice Summit to assess the current state of the notice process, update the notice vision and strategy, and develop a plan of action for improvements. One of the conclusions reached at the Summit was that the IRS needs a centralized business authority to oversee and guide all IRS outbound correspondence.

In FY 2008, the Media and Publications function planned to establish a Notice Governance structure to provide oversight for notice delivery services. The Notice Governance structure would provide the building blocks to create an IRS-wide review function ensuring that notices are developed and issued in the most cost-efficient manner and adhere to IRS standards. Most importantly, a new system, the Notice Management Information System, would capture issuance costs and taxpayer behavioral information.

Also in FY 2008, the IRS Commissioner chartered the Taxpayer Communications Task Group to study and improve the clarity, accuracy, and effectiveness of written communications to taxpayers. The goals of the task group were to:

- Improve taxpayer understanding by simplifying and clarifying language.
- Increase customer satisfaction by reducing erroneous correspondence.
- Reduce unnecessary burden by streamlining and improving business processes.

[22] Satisfaction of a liability through scheduled periodic payments.

- Reduce costs by eliminating unnecessary correspondence.
- Institute effective measures.

While the IRS has made many efforts to improve the notice process with a focus on notice clarity, managing taxpayer notices and IRS correspondence remains a challenge. The GAO is completing a review of IRS notices and the report is scheduled to be issued early in FY 2010.

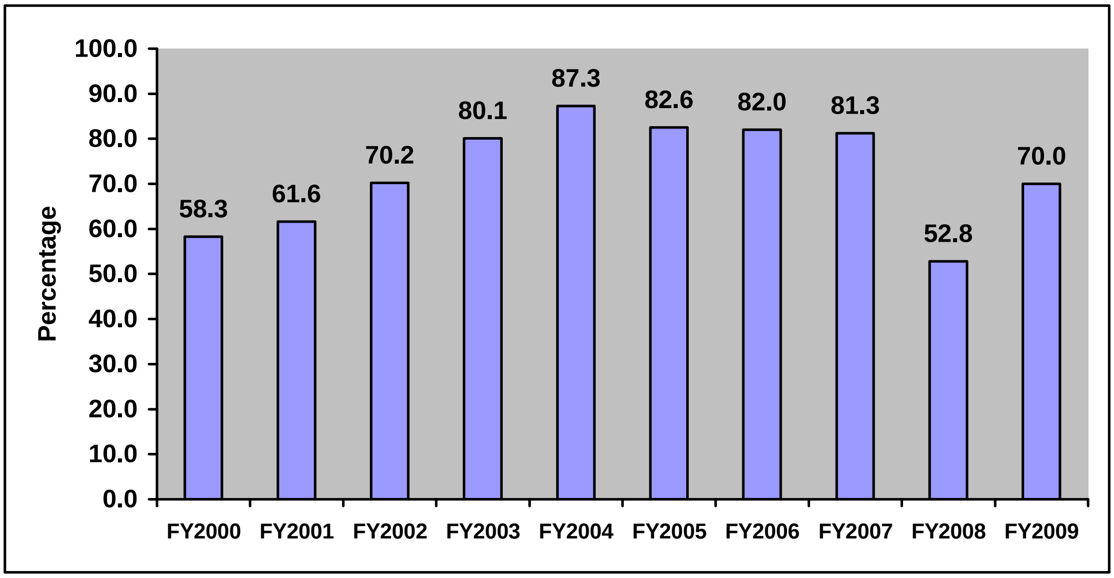
Telephones

In the 1990s, taxpayers had extreme difficulty accessing the IRS by telephone. The IRS operated a geographic telephone network that in simple terms limited a taxpayer call to a specific geographic location. If that call site was busy, the taxpayer would have to wait until an employee at that location became available. At other times, taxpayers received busy signals. In fact, in FY 1994, taxpayers received busy signals 73 percent of the time. When the calling queue got too large, the IRS would contact the network provider and "move" incoming calls to another geographic location. Between October 1995 and September 1996, the IRS answered 21 percent of all calls.

In FY 1997, the IRS began piloting an intelligent call routing system. Intelligent call routing links all the call sites together to function as one call center that routes calls to the next available agent. The RRA 98 and the Commission emphasized that the IRS must provide better telephone access to taxpayers since in most instances, telephones are the taxpayer's contact method of choice. The IRS set a goal to be a world-class call center operation and made technological modernization improvements such as using state-of the-art workload scheduling, dynamic call routing, and establishing a call management center.

In the years since the enactment of the RRA 98, the IRS has substantially improved its telephone assistance to taxpayers. Figure 5 shows that the level of service improved 39 percent from FY 2000 through FY 2007.

Figure 5: Toll-Free Assistor Level of Service[23]

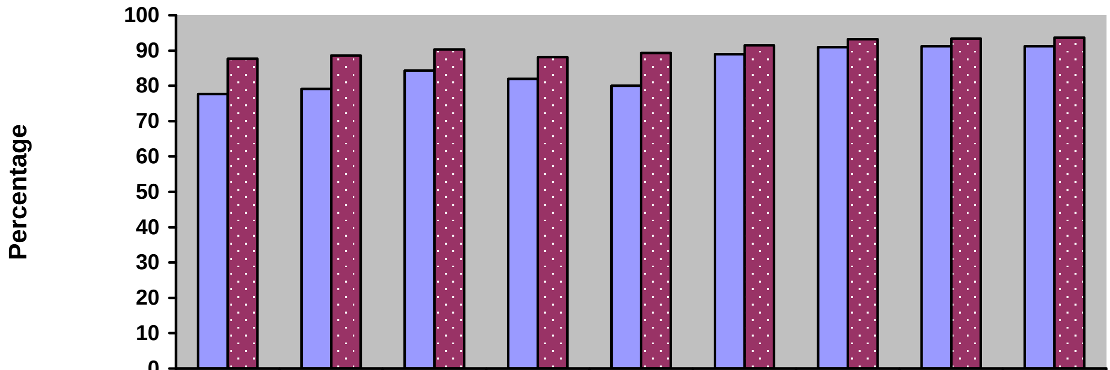


Source: IRS Enterprise Telephone Data Warehouse Snapshot Reports, Toll-free Combined FY 2000-FY 2002 and Customer Accounts Services FY 2001-FY 2008.

Likewise, the answer quality has improved over a similar time period. The IRS developed probe and response guides for customer service representatives to improve accuracy. Likewise, quality call monitoring is used to accurately measure the technical accuracy and professionalism of responses. In order to further improve operations, calls are now recorded so that quality monitoring can be accomplished outside of real time and customer service representatives can learn by hearing themselves interact with taxpayers. In fact, Figure 6 shows that the accuracy rate for tax law questions improved 17 percent from FY 2000 to FY 2006.

[23] The dramatic decline in FY 2008 was due to the unexpected volumes of calls regarding the Economic Stimulus package.

Figure 6: Quality of Toll-Free Assistance — Correct Response Rate



	2000	2001	2002	2003	2004	2005	2006	2007	2008
Tax Law	78	79	84	82	80	89	91	91	91
Accounts	88	89	90	88	89	91	93	93	94

Fiscal Year

Source: IRS Enterprise Telephone Data Warehouse Snapshot Reports for FY 2000-FY 2004 and Centralized Quality Review System for FY 2005 – FY 2008.

Communicating Electronically

Both the Commission and the RRA 98 focused on the IRS becoming more like a large financial services business that provides electronic account services. The Commission report and the RRA 98 legislation sought to have the IRS provide taxpayers with direct Internet access to their account and the ability to conduct any transaction that is now provided by telephone, correspondence, or face to face.

Direct taxpayer Internet access to their account is not yet available. In September 2009, the TIGTA reported that the IRS initiated the My IRS Account (MIRSA) project (initially called the Internet Customer Account Services project)[24] in April 2006.[25] The first release of the MIRSA project, which would allow taxpayers to view their tax account information online, was developed and near deployment when the IRS decided to terminate the project. The IRS Strategic Plan 2009-2013 was presented at the same time the MIRSA project was being readied for deployment, and IRS executives decided to reexamine the project for its ability to fully meet both taxpayer and IRS strategic needs. As a result, to ensure that a long-term strategy was in

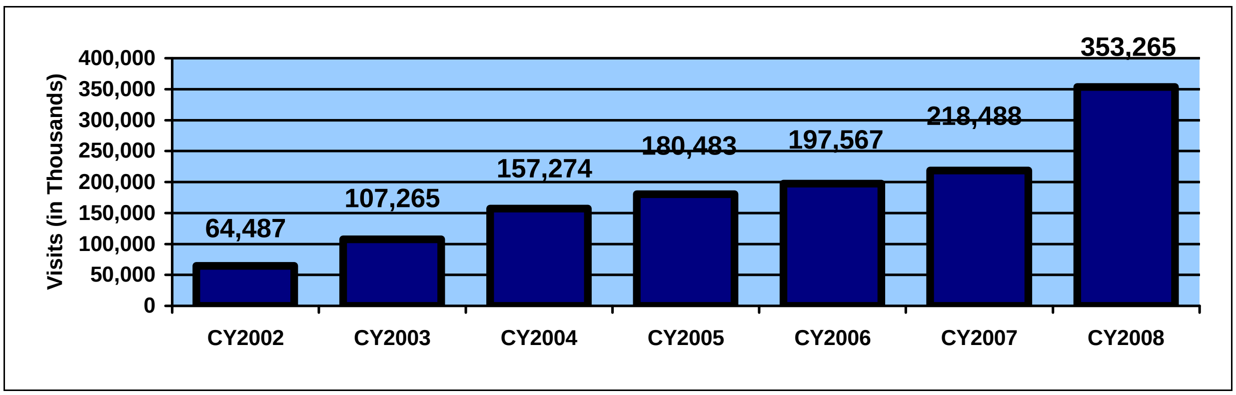
[24] On June 24, 2008, the Customer Service Executive Steering Committee voting members approved the name change of the Internet Customer Account Services project to the MIRSA project for all releases.
[25] *Changing Strategies Led to the Termination of the My IRS Account Project* (Reference Number 2009-20-102, dated August 12, 2009).

place before proceeding with the MIRSA project or other online projects, the IRS approved the termination of the MIRSA project in December 2008.

While the MIRSA project termination adversely affected individual taxpayer access to account information, there has been other progress in expanding Internet-based access. Since FY 2004, the IRS has provided access to various electronic services through e-Services. The e-Services are a suite of Web-based products that allows tax professionals and payers[26] to conduct business with the IRS electronically. Registration must be completed before using any of the e-Services products such as Disclosure Authorization, Transcript Delivery Service, Electronic Account Resolution or Taxpayer Identification Number (TIN) Matching. In Calendar Year (CY) 2008, there were approximately 3.8 million page views[27] in e-Services.

The IRS also provides services on the IRS Web site (www.IRS.gov). Taxpayers and practitioners can obtain general information, view and/or download copies of forms and publications, and determine the status of their refund from the Web site. Figure 7 shows that the number of visits has grown at least three-fold from CY 2003 to CY 2008[28] to more than 350 million visits in a year.

Figure 7: Annual Internet Visits



Source: Monthly IRS.gov Usage Report: December 2008.

Using information strategically

The Commission reported that IRS employees needed access to timely and accurate taxpayer information to improve customer service and compliance. The Commission pointed out that the IRS relied on stovepipe legacy systems and that modernized information systems as envisioned

[26] A payer is an entity that provides the IRS third-party information reporting.
[27] This Web metric is also known as a page impression. It is a measurement of the number of times that a Web page is viewed from a Web server.
[28] The total number of visits for January 2002 is not available. Hence, the total number of visits for CY 2002 includes only February through December.

would allow the IRS to better service taxpayers. An analysis of the IRS computer modernization efforts are provided in a separate section of this report.

Training and Education

The Commission reported that a well-trained workforce is a fundamental component of providing quality customer service. The Commission also believed that the IRS needed to increase its commitment to training and education. The IRS has increased its commitment as the following two examples illustrate. First, the IRS provides online access to over 2,000 SkillSoft Web-based courses. These courses cover a wide variety of subjects in the information technology and business skills arenas. The SkillSoft curricula includes instruction in accounting and finance, personal computer software applications, customer service, project management, management, leadership, communications, human resources, team building, and other relevant topics.

Second, the IRS is also addressing the need to have experienced technical personnel involved in training. There is a high cost for taking experienced personnel off-line to develop training courses and instruct trainees. In general, overall productivity is reduced. Compounding the problem, many experienced employees are eligible to retire and, because of legal restrictions, do not financially benefit by becoming a rehired annuitant.[29] As a result, the IRS is contracting for technical training instructors and course developers. The IRS has a Request for Proposal[30] out for bid with an expected contract award date in October 2009. This contract will allow current IRS revenue agents, revenue officers, and several other occupations to focus on core work, while the contractor's employees instruct classes and develop training materials.

Public-Private Partnership

The Commission stated that an important aspect of customer service is understanding what is necessary to achieve customer satisfaction. The Commission added that public-private partnerships, which can be institutionalized as formal advisory groups, can help the IRS achieve that understanding. The IRS used several such groups to advise the IRS Commissioner on various issues, including information reporting and art valuation. The Commission recommended that the IRS should continue to partner with the private sector and State tax administrators to improve its operations, particularly with respect to information reporting,

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[29] In most cases retirees keep the full retirement annuity; however, the new Federal salary is reduced by the amount of the annuity for most retirees. It is important to note that Federal retirees can work in the private sector without any impact on their Federal annuity. Therefore, if a contractor pays the retiree rather than the Federal Government, the retiree receives both a full annuity and a full salary. Pub. L. No. 111-84, enacted on October 28, 2009, authorizes Federal agencies to reemploy Federal annuitants under certain limited conditions without a dual compensation reduction.

[30] A Request for Proposal is an invitation to suppliers, often through a bidding process, to submit a proposal on a specific commodity or service.

training and education, customer service and compliance, electronic commerce, and financial management.

The IRS has made several successful efforts to partner with the private sector and other public entities since the RRA 98. First, since January 2003, the majority of taxpayers are eligible for free online tax preparation and free electronic filing through a partnership agreement between the IRS and the Free File Alliance, LLC, a private-sector consortium of tax software companies. Each Free File Alliance member sets taxpayer eligibility requirements for its program. The requirements differ from company to company. Generally, eligibility is based on factors such as age, adjusted gross income, State residency, military status, and eligibility to file an Income Tax Return for Single and Joint Filers With No Dependents (Form 1040EZ) or for the Earned Income Tax Credit.[31]

Next, the IRS also has cooperative partnerships on several levels with State and local revenue agencies. For example, beginning in 2003, the IRS and several States signed a Memorandum of Understanding to share information concerning Abusive Tax Avoidance Transactions.[32] The information sharing and cooperation has expanded to include:

1. State Reverse Filing Match Initiative (SRFMI) — The IRS and State revenue agencies exchange taxpayer data for tax administration under the Governmental Liaison Data Exchange Program (GLDEP). In CY 2006, the IRS created the State Reverse Filing Match Initiative pilot program to expand data sharing by obtaining more data from the States. States match IRS's return-filing information received through the existing Governmental Liaison Data Exchange Program data-sharing arrangement against State tax data to identify individuals and businesses that filed a State return but did not file a Federal return or reported income to the State but not to the IRS. The pilot takes steps to validate or put State data into a format usable for compliance activities.
2. Title 31 Money Servicing Businesses Memorandum of Understanding — The IRS and State agencies agreed to share Bank Secrecy Act information and leverage their resources to ensure that money service businesses (non-bank financial institutions like currency exchangers and check cashers) are complying with their Federal and State responsibilities to register with the government and report cash transactions and suspicious activities. This initiative was the result of the partnership efforts of the IRS, the Financial Crimes Enforcement Network, and State regulatory agencies.
3. Federal State Internet Employer Identification Number — Taxpayers are able to obtain an Employee Identification Number from the IRS and a registration number for sales tax

[31] The Earned Income Tax Credit is a refundable credit used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment rather than welfare.
[32] Abusive Tax Avoidance Transactions are transactions promoted for the promise of tax benefits with no meaningful change in the taxpayer's economic position. These transactions typically have no economic purpose other than reducing taxes.

and/or income tax from their home State. This one-stop approach would reduce paperwork and save time. Thus far, three States are participating.

4. Questionable Employment Tax Program — The IRS shares Miscellaneous Income (Form 1099-MISC)[33] extract data with the State workforce agencies, and the State workforce agencies investigate whether the people on the IRS's list are employees or independent contractors.

Finally, in another example of partnering with State and local tax agencies, the IRS has a training program for external Federal, State, and city partner agencies. The IRS offers classroom training opportunities at no cost when space is available in scheduled training classes. Similarly, in another cooperative training initiative, the New York University School of Law and the IRS Office of Chief Counsel jointly deliver the Internal Revenue Service/New York University Continuing Professional Education Program for Office of Chief Counsel employees. Employees from other Federal agencies and State/city tax authorities may also participate in the courses. Finally, the IRS provides State tax agencies with electronic training course materials.

At the Federal level, the IRS has partnered with other agencies on several projects of mutual concern. The IRS established the Federal Intergovernmental Partnering Program that held a two-day summit in March 2009. In past years, there have been examples of IRS cooperation with other Federal agencies.

- In February 2006, the IRS partnered with the Department of Housing and Urban Development to provide outreach to businesses located in empowerment zones and renewal communities and to practitioners catering to renewal communities/empowerment zone interests. The agencies jointly developed products to inform economic development professionals and stakeholders about the $11 billion empowerment zone/renewal communities tax incentive package, culminating in an October 2007 Department of Housing and Urban Development Webcast on an overview of tax incentives for empowerment zone and renewal communities, and updates on changes to these incentives.

- Enforcement officers and special agents at the National Oceanic and Atmospheric Administration were granted specific authority to administer over 37 statutes related to commercial fishing as well as numerous treaties with ties to the Internal Revenue Code.

- The Federal Intergovernmental Partnering Program formed an IRS/Social Security Administration team that meets quarterly to discuss issues common to the two agencies. This team has resolved more than 50 major issues to provide better services to shared customers. Based on that success, the Social Security Administration has asked the IRS

[33] Form 1099-MISC is used to report payments of $600 or more for services performed for a trade or business by a nonemployee, including independent contractors.

to help develop a new Social Security Administration wage reporting system to secure more data for effective tax administration.

- The IRS worked with the Department of Energy to promote a system of energy star ratings of residential water heaters and tax credits for residential energy efficiency upgrades effective January 1, 2009.

Increasing Compliance

In recent years, there has been considerable discussion about the tax gap.[34] For Tax Year 2001, the tax gap was estimated to be $345 billion. The IRS has provided many testimonies to Congress on actions that can be taken to reduce the tax gap and developed, with the Department of the Treasury, a tax gap reduction plan.[35] The tax gap reduction strategy is predicated on being successful in several of the improvement areas identified in the RRA 98 and the IRS Restructuring Commission Report.

The Commission reported that the IRS struggles to ensure taxpayer compliance because it relies heavily on examination and collection processes. While these methods are necessary, they are expensive and do not identify patterns of noncompliance. The Commission identified several areas that it believed showed promise for increasing compliance. These are integrating research and enforcement, training and resources, taxpayer education and outreach, estimating noncompliance, and targeting repeat offenders. While the RRA 98 did not specifically address the IRS methods to increase voluntary compliance, there are clear indications that increasing compliance was a desired outcome.[36]

Integrating Research and Enforcement

The Commission referred to the IRS research model in effect at the time of their study. The Commission reported that non-enforcement methods could be used to address noncompliance and analytic tools could be used to increase efficiencies and the effectiveness of examination efforts.

As part of the overall IRS restructuring, embedded research staffs were established in each operating division, the Criminal Investigation Division, and in the Office of the Taxpayer Advocate. These staffs generally focus efforts on issues related to their customer base. Customers for these research projects, studies, and tests typically include the operating division managers and executives. In July 2009, the TIGTA reported that the IRS does not have a systemic process to measure research outcomes to show whether the research projects

[34] The tax gap is the difference between taxes that are legally owed and taxes that are paid on time.
[35] *Additional Actions Are Needed to Effectively Address the Tax Gap* (Reference Number 2008-30-094, dated April 23, 2008).
[36] RRA 98 Section 3803 required report on noncompliance.

contributed to the research programs' mission of providing information to support data-driven decisions by IRS management.[37]

A successful example of using analytics to increase efficiencies and effectiveness has been the "voluntary disclosure" approach. After a compliance problem has been identified, the IRS offers taxpayers the opportunity to voluntarily disclose noncompliance and correct it. Different voluntary disclosure initiatives have differing offers, but usually offer the taxpayer the opportunity to avoid criminal penalties and the potential of prison. The voluntary disclosure approach allows the IRS to save resources by having taxpayers come forward rather than the IRS having to expend resources on identifying the taxpayer, performing the examination, processing a potential appeal, or going to court. The voluntary disclosure approach has been used for compliance issues such as the Son of BOSS (Bond and Options Sales Strategy) and the recent Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1) disclosure initiative. For the Son of BOSS, the IRS estimated that approximately $3.2 billion in tax, interest, and penalties were paid by approximately 1,100 taxpayers.

Training and Resources

The Commission reported that research staff members interviewed by the Commission expressed the need for more training in methods and data analysis. Likewise, the research community in the IRS requires access to computer systems that are properly maintained. The National Headquarters Office of Research Analysis and Statistics now provides internal training for IRS research personnel. These include courses in using Structured Query Language and Hyperion Intelligence. There are also recommended external training classes for using Statistical Analysis Software. The compliance research is performed using the resources of the Compliance Data Warehouse that has IRS compliance and return databases available for research purposes. The effectiveness of the training for the research organizations has not been recently evaluated by the TIGTA or the GAO.

Taxpayer Education and Outreach

The Commission believed that taxpayer education is core to voluntary compliance. The Commission stated that there are many facets to taxpayer education, including outreach programs, post office and library programs, small business education programs, programs at post and secondary educational institutions, practitioner education, pro bono tax clinics, emergency assistance, media information programs, volunteer tax assistance, and the distribution of tax forms and publications.

As part of the IRS restructuring, taxpayer education and outreach organizations were established. These included stand-alone organizations in the two divisions focused on individual taxpayers

[37] *An Improved Project Management Process Is Needed to Measure the Impact of Research Efforts on Tax Administration* (Reference Number 2009-10-095, dated July 21, 2009).

and small business taxpayers. From the time of the Commission's report, technology has changed and the IRS has evolved education and outreach activities to coincide with those changes. For example, the IRS Web site is a significant distribution point for forms and publications. In CY 2008, there were more than 183 million downloads from the Web site. There is also a Small Business Resource Guide Web site that provides information for small businesses on tax related issues from pre-startup to post-filing issues.

The IRS also uses many of the education and outreach techniques described by the Commission. For example, evidence shows that the IRS provides extensive services for presidentially declared disasters. For tax practitioners, the IRS conducts annual tax forums to provide information on e-services, income tax law changes, and other areas of interest. There are usually about six forums a year held in cities across the country.

Besides these services, the W&I Division has approximately 600 employees devoted to using a leveraged approach to taxpayer assistance. That is, it emphasizes partner involvement and introduces relationship management as a key element in its operations. Organizations of all types—corporate, faith-based, non-profit, educational, financial, and government have joined the IRS in community-based coalitions that help lower-income people in their own neighborhoods. Community coalition members work together. They have greater access to taxpayers, higher potential for expanded resources, and own the important intangibles of credibility and trust.

For small businesses, the SB/SE Division offers streaming video of IRS Small Business Workshops. The online video stream allows small business owners to take this course at any time, day or night, seven days a week. An online ordering capability for the Small Business educational products is also available. The Web site lists local events, seminars, and workshops that are geared toward the small business owner.

The IRS also provides speakers for industry group meetings including the American Bar Association, the American Institute of Certified Public Accountants, the National Association of Enrolled Agents, the Tax Executives Institute, and many other organizations.

Estimating Noncompliance

The Commission reported that one of the most significant criticisms of the IRS compliance research was the lack of current, reliable data on noncompliance. Subsequent to the RRA 98, the IRS did revamp the Taxpayer Compliance Measurement Program that had been dormant for more than ten years because of concerns that the program was too intrusive. The Taxpayer Compliance Measurement Program was replaced by the National Research Program. National Research Program data are used to develop algorithms to better identify tax returns for examination. By selecting returns with a higher likelihood of change, the IRS is able to use resources more effectively and not burden compliant taxpayers.

The TIGTA reported[38] that when compared to earlier Discriminant Index Function[39] initiated examinations, SB/SE Division statistics showed that examination productivity continued favorable trends since the updated Discriminant Index Function formulas were introduced. The combined revenue agent and tax compliance officer results show Discriminant Index Function-initiated examinations are yielding higher recommended additional taxes, both on an hourly and return basis, and are generating higher examination agreement rates. Statistics also show that the percentage of no-change examinations has decreased since the updated Discriminant Index Function formulas were introduced.

The National Research Program recently completed a Subchapter S Corporation project and is starting an employment tax project. In addition, the Tax Year 2001 individual taxpayer information is being updated. These research projects are used to project the tax gap which is defined as the difference between what taxpayers are supposed to timely pay and what is actually paid. For Tax Year 2001, the IRS estimated that the tax gap was $345 billion. Several of the tax gap components were outdated and the TIGTA reported that it is doubtful that the tax gap estimate includes international tax issues such as hidden offshore income.[40] While the IRS has made considerable efforts to update the estimate of noncompliance, developing methods to keep the data current remains a challenge.

Targeting Repeat Offenders

The Commission reported that there is a significant difference between taxpayers finding themselves in unexpected financial difficulties trying to meet their tax obligations and taxpayers who continuously or frequently fail to meet their tax obligations. The Commission also stated that various information systems and audit programs intended to allow the IRS to manage its non-filer inventory, track recidivism, and monitor Federal tax deposits have not been successful.

The Commission determined that to address these problems, the IRS must use technology to tailor compliance programs that target repeat offenders and allow the IRS to stop compliance problems earlier in the cycle. Only by continuously improving collections programs and procedures, including payment procedures that reflect taxpayers' circumstances, will the IRS be able to improve voluntary compliance, reduce burden on taxpayers who have made honest mistakes, and focus enforcement resources on the small number of repeat offenders.

The IRS has significant challenges in addressing the concerns expressed by the Commission. In July 2008, the GAO reported[41] that as of September 30, 2007, IRS records showed more than 1.6 million businesses owed more than $58 billion in unpaid Federal payroll taxes, including

[38] *Potential Opportunities Exist to Enhance the Favorable Productivity Trends for Audits Initiated by the Updated Return Selection Formulas* (Reference Number 2009-30-105, dated August 5, 2009).
[39] Discriminant Index Function formulas are used to select noncompliant returns for examination.
[40] *A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap* (Reference Number 2009-IE-R001, dated January 27, 2009).
[41] *Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes* (GAO-08-1034T, dated July 2008).

interest and penalties. Some of these businesses took advantage of the existing tax enforcement and administration system to avoid fulfilling or paying Federal tax obligations—thus abusing the Federal tax system. More than a quarter of payroll taxes were owed by businesses with more than three years (12 tax quarters) of unpaid payroll taxes. Some of these business owners repeatedly accumulated tax debt from multiple businesses. For example, the IRS found more than 1,500 individuals to be responsible for nonpayment of payroll taxes at three or more businesses, and 18 were responsible for not remitting payroll taxes for a dozen different businesses. The IRS agreed to the GAO recommendations to address the problems identified in the report and provided documentation for policy and procedural changes, research areas, and management reports. The GAO will perform a follow-up review in FY 2010.

Likewise, individual repeat non-filers remain as a challenge. During Tax Years 1996 through 2005, 47 percent of the 38.9 million individual non-filers identified by the IRS for the time period failed to file timely for two or more years. The High Income Repeat Non-Filer (defined as a taxpayer with third-party information documents reporting income of $100,000 or more) category is especially troubling. Between Tax Years 2002 and 2005, these taxpayers accounted for only between four percent and six percent of identified non-filers. Yet, this group of taxpayers accounted for between 59 percent and 66 percent of the projected balance due from non-filers.[42]

The TIGTA issued a report[43] that stated the IRS needed a coordinated Service-wide Non-filer Strategy in order to increase voluntary compliance, reduce the tax gap, and ensure that resources were being used effectively to bring non-filers into the tax system. IRS management accepted the report's recommendations and agreed to develop a Service-wide Non-filer Strategy to coordinate and track all efforts taken to plan, control, and improve efficiency in identifying and working non-filer cases. The goal of this strategy is to ensure that IRS resources are used effectively to bring non-filers into the tax system, ensure future compliance, and reduce the portion of the tax gap attributable to non-filers.

The TIGTA followed up on this audit in FY 2008[44] and identified that the Service-wide Non-filer Strategy required additional steps to be completed if the Strategy is to be fully implemented within the time period originally planned. The TIGTA found that Service-wide Non-filer Strategy outcome and performance measures were not yet approved and adopted. In addition, there was no systemic method in place to track and monitor cases that are worked as part of Service-wide Non-filer Strategy Initiatives. Without such a tracking system, results cannot be captured and used for future planning, and cost benefit analyses cannot be performed.

[42] FY 2009-2010 Strategic Assessment Small Business/Self-Employed Operating Division, dated February 2008.
[43] *The Internal Revenue Service Needs a Coordinated National Strategy to Better Address an Estimated $30 Billion Tax Gap Due to Non-filers* (Reference Number 2006-30-006, dated November 22, 2005).
[44] *Additional Steps Need to Be Completed to Ensure the Success of the Service-wide Non-filer Strategy* (Reference Number 2008-30-165, dated September 22, 2008).

The IRS has implemented new processes to associate business non-filer cases to identify repeaters. The new processes and procedures were implemented in 2009 and will be baselined for 2009 results. The IRS also planned actions to address the issue of repeat individual return non-filers.

Efficiency Gains

The Commission identified several potential cost savings approaches the IRS should carefully consider, as appropriate, to motivate managers and employees to embrace continuous improvements and cost savings. The Commission recommended private sector partnering and outsourcing, managed competition, enterprise management, and performance management. These approaches seek to cut costs and increase quality and production by maximizing competition, exploiting efficiency in the marketplace, and motivating employees through awards and recognition.

The Commission stated that private sector partnering and outsourcing are approaches that public organizations use to cut their costs and increase their quality. Subsequent to the RRA 98, the IRS outsourced several activities including a small portion of collection cases. The IRS began contracts with private debt collection contractors in FY 2006 and the contracts were terminated in March 2009. For its duration, approximately $80 million was collected through the effort; however, there was significant debate over whether IRS debt collection should be handled by the private sector. The IRS did use other competitive sourcing options for activities such as managing IRS records filing and area distribution centers.[45]

In an effort to achieve greater efficiencies, the IRS embraced the Lean Six Sigma methodology. Lean is a time and valued-based process improvement approach designed to ensure continuous flow and eliminate waste and nonvalue added activities. Six Sigma is a business process improvement method that uses data and facts to produce measurable results through reduction in process variation. The IRS created the Lean Six Sigma organization to effectively administer the Lean Six Sigma program and projects.[46]

A specific application of the Lean Six Sigma projects includes the Correspondence Inventory project. In 2008, the Lean Six Sigma organization partnered with the Accounts Management

[45] Area distribution centers mail forms and publications to taxpayers and practitioners.

[46] The Lean Six Sigma organization delivered an executive overview of the W&I Division Lean Six Sigma program to approximately 75 participants across the IRS. These participants were comprised of executives and senior leaders from the Modernization and Information Technology Services organization; Human Capital Office; Large and Mid-Size Business, SB/SE, and Tax Exempt and Government Entities Divisions; Research, Analysis and Statistics function; Office of Professional Responsibility; and Services and Enforcement. Also, a representative from the IRS Oversight Board attended. As a result of these sessions, Memorandums of Understanding have been signed with the Human Capital Office, Modernization and Information Technology Services organization, and SB/SE Division to expand the Lean Six Sigma program into these areas. Offers have been extended to 8 external candidates to fill these Lean Six Sigma black belt positions, which will bring a total of 17 quality specialist black belts in the Lean Six Sigma organization.

function to stratify and define the population of correspondence inventory. The team analyzed a sample of the more than 2.5 million pieces of correspondence received from taxpayers during CY 2007. The team identified the volume peaks for each of the seven identified categories of work which now enables the Accounts Management function to anticipate training needs and resource requirements.

In addition, a Kaizen Event[47] was conducted in the Kansas City, Missouri campus in January 2009 to reduce the percentage of correspondence misrouted to the Accounts Management function by the Submission Processing function. As a result of the Kaizen Event, the IRS reported that misrouted correspondence has decreased from a baseline of 37.1 percent to 18.7 percent as of March 7, 2009.

The effectiveness of IRS's focused improvement process such as Lean Six Sigma has not been evaluated by the TIGTA or the GAO.

Evaluation and Conclusion

The IRS has made substantial progress in addressing many of the concerns expressed by the Commission and included in the RRA 98 legislation. There are successful initiatives in customer service such as the vast improvement in telephone services. Likewise, the IRS is making substantial progress in measuring noncompliance and has started to employ structured methods to improve efficiencies and effectiveness. The results that have been achieved demonstrate the IRS efforts to modernize its practices and better balance services with enforcement while achieving efficiencies. At the same time, there are many opportunities to improve as evidenced by the continuing challenges with repeat offenders. In summary, the result of these efforts will determine whether the IRS is able to efficiently and effectively improve voluntary compliance and reduce the tax gap.

IV. Electronic Filing Goals and Computer Modernization Remain a Challenge

The RRA 98 placed an 80 percent electronic filing goal for tax returns and information documents[48] by 2007.[49] Besides this goal,[50] the RRA 98 made changes to the due dates of

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[47] Kaizen Event is a team approach short-term effort, normally five business days, which focuses on the Value Stream and Flow action.

[48] Mitre Corporation: *Advancing E-file Study Phase 1 Report – Executive Summary - Achieving the 80% E-file Goal Requires Partnering with Stakeholders on New Approaches to Motivate Paper Filers* (Case Number 08-1063, dated September 2008) stated in 2006, the combined electronic file rate of information returns and tax returns (for individuals and businesses) was 88 percent. However, the IRS interpretation of the 80 percent electronic file goal is defined as the electronic filing of Federal individual income tax returns using U.S. Individual Income Tax Return (Form 1040, 1040A, or 1040EZ) and their related schedules.

information document submissions,[51] required elimination of the paper signature documents, directed the study of the feasibility of return free filing,[52] and required the IRS to provide Internet-based account services for individual taxpayers.[53]

Beyond the RRA 98 requirements, the Commission report delved into the broader difficulties encountered with IRS computer systems modernization. The Commission placed great emphasis on the importance of the IRS having a strategic business focus and using technology as an enabler to achieve the business vision and not using technology as the strategic driver. The report stated that the previous IRS efforts to modernize its core business systems had failed because:

> *The IRS has experienced great difficulty managing technology. The technology deficiencies are an outgrowth of management and governance problems and the agency's inability to pursue a long-term strategic vision in its business operations. Absent a strategic vision, no quantity or quality of technological modernization can be truly effective.*

Further, the Commission Report identified strategic, tactical, and technical reasons why the previous IRS Tax Systems Modernization effort failed:

> *The IRS Tax Systems Modernization (TSM) project failed because the IRS did not have a consistent, long-term strategic vision to guide the project. The IRS modernization deficiencies, as documented by GAO and the National Research Council (NRC), show both a lack of business technology integration and a failure to use best practices:*
>
> - *The IRS did not possess the technical management resources necessary to manage a program as complex as TSM. Senior technical leaders were noticeably absent.*
> - *The systems architecture within the IRS, including its functions, data, and technology building blocks, was insufficient.*

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[49] In its Electronic Filing 2007 Annual Report to Congress, the IRS Oversight Board approved a new goal that calls for a combined electronic filing rate of 80 percent by the year 2012 for all major tax returns filed by individuals, businesses, and tax exempt organizations.

[50] The Year 2000 century date change was also of concern. The IRS received approximately $1 billion to address the issue and there were no problems encountered.

[51] Forms provided by payers for interest, dividends, and like payments.

[52] RRA 98 Section 2004 required the Secretary of the Treasury or the Secretary's delegate to develop procedures for the implementation of a return-free tax system for appropriate individuals by 2007. In December 2003, the Department of the Treasury provided the *Report to The Congress: Return-Free Tax Systems: Tax Simplification Is a Prerequisite*.

[53] As stated previously, the first release of the MIRSA project, which would allow taxpayers to view their tax account information online, was developed and near deployment when the IRS decided to terminate the project in December 2008 to reexamine the project for its ability to fully meet both taxpayer and IRS strategic needs.

- *Enterprise wide technical security had not been developed.*
- *The IRS lacked a cost effective strategy for reducing paper tax return submissions.*
- *The process for selecting, prioritizing, controlling, and evaluating the progress and performance of major information systems investments was ineffective.*
- *The IRS failed to develop fully and put in place the requisite management, software development and technical infrastructures necessary to implement successfully an ambitious world-class modernization effort.*
- *The IRS had inconsistent and poorly controlled software development processes.*
- *Organizational structure with the accountability and authority needed to manage modernization efforts was lacking below the Commissioner's office.*

While the RRA 98 legislation explicitly addressed electronic filing goals and electronic interactions, the Commission Report addressed the importance of the need to integrate the business vision with technological capabilities. To accomplish this goal, the Modernization Vision and Strategy Program[54] was developed to implement a fundamentally different approach to the IRS modernization effort and to provide guidance in the development of an integrated portfolio of information technology investments. Developed in October 2006, the Modernization Vision and Strategy Plan is an annually updated five-year plan for the governance and planning process of IRS information technology decisions. This approach leverages the IRS strategic plan and associated business plans to drive information technology decisions. The Modernization Vision and Strategy Program will guide the investment priorities of the Business Systems Modernization program for FY 2007 through FY 2011.

The 80 percent electronic filing goal was not met in 2007 and the time period to achieve the goal has been extended to 2012. In CY 2008, the IRS received approximately 58 percent of the individual tax returns electronically and approximately 20 percent of other major returns electronically. Even if the 80 percent goal is not absolutely achieved, the IRS has made substantial progress in receiving electronically filed returns.

Figure 8 shows the IRS resources for processing individual tax returns per Full-Time Equivalent[55] improved by almost 80 percent from FY 2003 to FY 2008.

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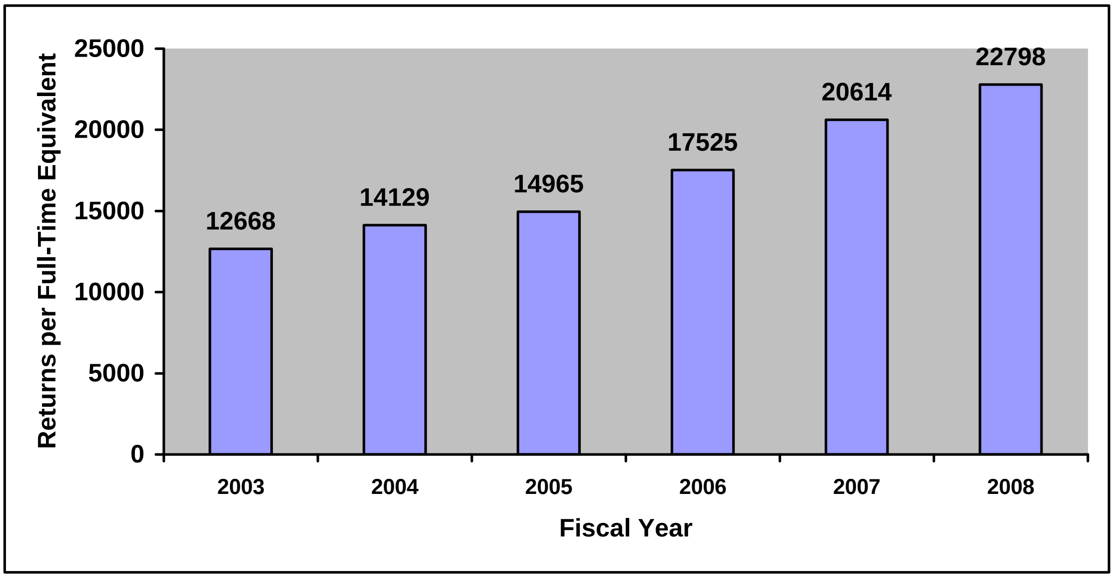
[54] *The Modernization Vision and Strategy Program Is Achieving Desired Results, but Risks Remain* (Reference Number 2009-20-008, dated October 31, 2008).

[55] A Full-Time Equivalent is a human resources measurement equal to one staff person working full-time for one year.

Figure 8: Individual Returns Processed Per Full-Time Equivalent



Source: ExpectMore.gov.

In September 2009, the TIGTA summarized[56] the IRS modernization program, in part, as follows:

> *In December 1998, the IRS hired the Computer Sciences Corporation as its PRIME contractor[57] for the Modernization Program. The IRS originally relied on the PRIME contractor to act as a systems integrator to find and manage the best expertise and technical resources to achieve its organizational goals. In January 2005, due to budget reductions and concerns about the adequacy of the PRIME contractor's performance, the IRS began transitioning many activities from the PRIME contractor and taking over the primary role as the systems integrator for all projects.*
>
> *The IRS originally estimated the Modernization Program effort would last up to 15 years and incur contractor costs of about $8 billion. The Program is in its 11th year and has received approximately $2.71 billion for contractor services, plus an additional $353 million for internal IRS costs.*

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[56] *Annual Assessment of the Business Systems Modernization Program* (Reference Number 2009-20-136, dated September 14, 2009).

[57] The PRIME contract was used to design and develop an information system that would allow the IRS to effectively and efficiently process tax information, provide customer service, and maintain accurate financial records. The PRIME contract was an Indefinite Delivery Indefinite Quantity contract, which permits flexibility in both quantities and delivery scheduling and limits the government's obligation to a minimum quantity. Under this Indefinite Delivery Indefinite Quantity contract, cost reimbursable, fixed price, time and materials, and performance-based task orders may be issued.

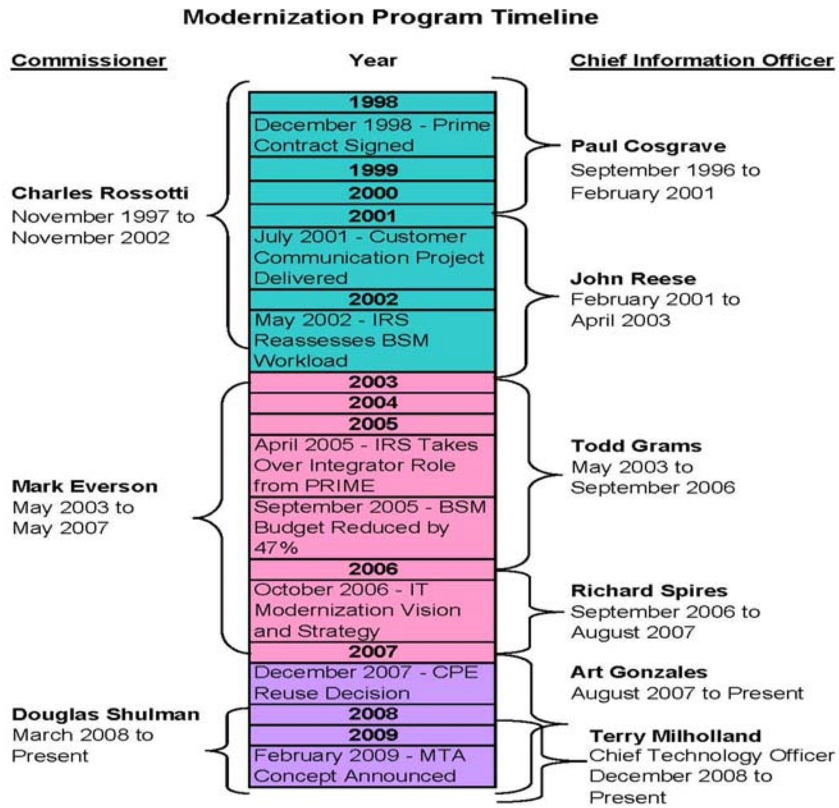
> *The IRS has recognized that, in addition to the accomplishments achieved in the Modernization Program, it faces significant challenges in meeting the requirements of the next phase of project development and systems integration. The immediate challenge is the future of the Customer Account Data Engine,[58] the acknowledged centerpiece throughout the life of the Modernization Program. The IRS Program Integration Office is considering using elements from the Individual Master File[59] and the current Customer Account Data Engine to significantly reengineer the IRS tax account management process. The continued improvement to managing individual taxpayer accounts will be curtailed until the use of the reengineered database is implemented and made available for integration with other systems and applications. Further, the challenge in modernizing the management of business taxpayer accounts has yet to be considered.*

The TIGTA report also provides the details of an issue that was of a major congressional concern in establishing the Restructuring Commission. That is, the stability of the IRS governance structure to provide the strategic focus to modernize the information systems. Through the RRA 98, the IRS Commissioner position has been stabilized with five-year terms. However, as Figure 9 from the TIGTA report illustrates, the tenures of the modernization executives are shorter and changes to modernization plans continue.

[58] The foundation for managing taxpayer accounts in the IRS modernization plan. It will consist of databases and related applications that will replace the existing IRS Master File processing systems and will include applications for daily posting, settlement, maintenance, refund processing, and issue detection for taxpayer tax account and return data.

[59] The IRS database that maintains transactions or records of individual tax accounts.

Figure 9: Tenure of IRS Modernization Executives



BSM	Business Systems Modernization
IT	Information Technology
CPE	Current Production Environment (systems)
MTA	Modernized Tax Account[60]

Source: Annual Assessment of *the Business Systems Modernization Program* (Reference Number 2009-20-136, dated September 14, 2009).

Both the RRA 98 and the Commission believed that governance with stability in leadership was critical to the IRS in maintaining focus to achieve its goals. With three Commissioners, five Computer Information Officers, and a Computer Technology Officer, the frequent changes in

[60] The Modernized Tax Account (MTA) Concept is the next phase of project development for Individual Master File and Customer Account Data Engine systems integration.

Business Systems Modernization leadership, and the less than full achievement of the modernization goals, suggests that stability in leadership could be a contributing factor.

Evaluation and Conclusion

The IRS has made significant progress in increasing the number of electronically filed returns and has expanded the opportunities for businesses to file electronically. The IRS has also expanded electronic services through Internet-based applications. However, the overall Business Systems Modernization program remains a major management challenge.

V. Taxpayer Protection and Rights Improved With Taxpayer Bill of Rights Legislation and Were Further Strengthened by the Restructuring and Reform Act of 1998

The Commission believed that a significant part of improving taxpayer service and changing the culture of the IRS involves ensuring that taxpayers are treated fairly and impartially, are able to seek redress or review of IRS actions by the courts, and are able to resolve conflicts creatively and expeditiously with IRS cooperation.

The Commission found that the passage of the Omnibus Taxpayer Bill of Rights (TBOR)[61] and TBOR 2[62] had an important effect on changing the IRS culture. The IRS spent significant resources educating personnel to treat taxpayers fairly, and the Commission found very few examples of IRS personnel abusing power. The Commission concluded that with the complexity of the tax law and an agency of its size with powers to audit and collect from taxpayers, there likely will continue to be the few unfortunate examples of abuse; however, the many additional safeguards against abusive actions enacted with the TBOR legislation prior to the RRA 98 were helping people deal with these systemic problems.

The RRA 98 expanded and added to the TBOR legislation several major safeguards for taxpayers. These included strengthening the role of the NTA,[63] expanding several pre-RRA 98 taxpayer rights such as Innocent Spouse Relief and Offers in Compromise (OIC);[64] adding new rights such as those related to liens, levies and seizures; and changing organization structures,

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[61] Pub. L. No. 100-647, 102 Stat. 3730 (1988) (codified as amended in scattered sections of 5 U.S.C. and 26 U.S.C.).

[62] Pub. L. No. 104-168, 110 Stat. 1452 (1996) (codified as amended in scattered sections of 26 U.S.C.).

[63] The Office of the Ombudsman, created by the IRS in 1979 to serve as the primary advocate, was codified by the TBOR, which authorized Tax Assistance Orders for taxpayers experiencing significant hardship. TBOR 2 changed the title to the Taxpayer Advocate enhancing authority to advocate changes that benefit taxpayers. The RRA 98 renamed the title to NTA significantly changing the appointment from an appointee of the IRS Commissioner to an appointee of the Secretary of the Treasury, after consulting with the IRS Commissioner and the IRS Oversight Board.

[64] An OIC involves acceptance of less than the full amount of tax, penalty, and interest owed.

policies and procedures, human capital practices, and customer service practices. In total, 71 taxpayer protections and rights required by the RRA 98 were engineered into operational processes and procedures. As a result, taxpayers receive more professional and courteous services to assist them in complying with the tax law.

Independence of the TAS Was Strengthened

The Commission believed that the Office of the Taxpayer Advocate (TA) required strengthening by addressing several issues related to independence. First, the Commission believed that a TA must be accessible to taxpayers, have the authority and accountability necessary to speak for and take actions on behalf of taxpayers, and must be viewed, both in perception and reality, as an independent voice for the taxpayer within the IRS. Second, the Commission also questioned the independence of the local TAs because they were under the supervision of operational executives often with conflicting goals. Next, the Commission found that the local TA program was not visible enough for most taxpayers. Finally, prior to the RRA 98, the TA's recommendations for systemic improvement merely tended to highlight ongoing corrective actions.

The RRA 98 strengthened the Office of the NTA. Under RRA 98, the Secretary of the Treasury appoints the NTA.[65] To ensure independence and objectivity, all employees in the TAS report directly to the NTA or his or her delegate. To increase visibility, TAS numbers are listed in local telephone directories, the IRS Web site, and many IRS publications. To further independence, the NTA provides Congress an annual report which among other mandatory items includes a summary of at least 20 of the most serious problems encountered by taxpayers with corresponding recommendations for administrative and legislative actions.

Low-Income Taxpayer Clinics

The RRA 98 created a grant program to protect low-income taxpayers who would otherwise be disadvantaged when they encounter tax problems. The purpose of tax clinics is twofold 1) to provide representation for low-income taxpayers, and 2) perform outreach to certain populations. Congress believed that the provision of tax services by accredited nominal fee clinics to low-income individuals and those for whom English is a second language would improve compliance with the Federal tax laws and should be encouraged. Today, the TAS oversees matching grants to low-income tax clinics authorized by the RRA 98. The IRS awarded almost $9.5 million in Federal Government matching grants to 162 tax clinics for the 2009 grant cycle.[66]

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[65] Although the Treasury Secretary consults with the Commissioner and the Oversight Board, the NTA does not need to be selected from candidates chosen by the IRS Oversight Board.
[66] January 31, 2009, through December 31, 2009.

The IRS Implemented Additional Taxpayer Rights in Contacts

Congress believed that taxpayers needed greater understanding and strengthening of their rights for contacts with the IRS. These included understanding the legal implications of signing a joint tax return, having the right to representation, knowing the reasons for being selected for an examination, and possessing the right to have an assessment reviewed by the IRS Office of Appeals. Another taxpayer rights issue that required strengthening was protecting the confidentiality of communications between taxpayers and their accountants to make it similar to the common-law confidentiality afforded communications with attorneys.

Some provisions of the RRA 98 TBOR codified existing practices, while many provided taxpayers with additional rights. These include:

- Notifying taxpayers of their rights in each matter and verifying that they received Publication 1, *Rights as a Taxpayer*, to ensure taxpayers' rights are protected and observed.
- Providing publications to explain the examination and collection processes; Appeal rights; and why the IRS requests information, what is done with information, and the consequences if the information is not provided.
- Including a contact telephone number on notices and including IRS telephone numbers and local office addresses in local telephone directories.
- Maintaining practitioner-client privilege of confidentiality of tax advice by generally not requesting audit or tax accrual workpapers.
- Recording third-party contact information so taxpayers can be provided with records of persons contacted to determine or collect the taxpayers' tax liabilities.
- Advising taxpayers of their right to refuse to extend the statute of limitations or limit the extension to specific issues or time periods.

Existing Relief Programs Were Expanded

The Commission reported that the restoration of public confidence in the IRS must begin with Congress through legislation promoting fair and impartial tax administration which focuses on preventing problems before they occur. The Commission heard from many sources that it is sometimes difficult for taxpayers to obtain an OIC or IA. The Commission heard testimony that there was wide variance based on geography.

Congress believed that the ability to compromise tax liability and to make payments of tax liability by installment enhances taxpayer compliance. Therefore, the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Consequently, Congress believed the IRS should make it easier for taxpayers to enter into OICs or IAs and should do more to educate the public about the availability of such agreements.

Offer in Compromise

The OIC application requires taxpayers to provide extensive amounts of financial information to the IRS. Then IRS personnel evaluate the application to determine eligibility. A critical aspect of the evaluation is the criteria for expenses. The IRS had developed national standards for necessary living expenses and local standards for the cost of housing, utilities, and transportation. In the past, critics claimed that the IRS was inflexible with the standards, making middle-class Americans unable to compromise their taxes.

The RRA 98 required the IRS to develop and publish schedules of national and local expense standards. The provision also required the IRS to consider the facts and circumstances of an individual taxpayer's case in determining whether the national and local standards are adequate for that taxpayer. If the scheduled expense allowances would be inadequate under the circumstances, the taxpayer would not be limited by the allowances.

The RRA 98 also addressed other problems identified with OICs. First, the IRS must notify a taxpayer whose OIC was terminated due to the actions of a spouse or former spouse, that upon application, the OIC will be reinstated with the spouse or former spouse who remains in compliance. Next, the IRS can no longer reject an OIC based on doubt as to liability solely because it could not locate the taxpayer's return or return information.

The RRA 98 caused the IRS to change the organization's structure, develop information systems, and revamp procedures. The OIC program was reorganized by centralizing initial processing at two campus[67] locations. These sites complete the processing of OICs under $50,000 that meet certain criteria and forward more complex offers to revenue officers (OIC specialists).

The IRS also revamped procedures subsequent to the RRA 98 and continues efforts at process improvement. For example, after an OIC application is evaluated, an eligibility determination is made. If the decision is made to reject the application, an independent administrative review is performed to determine if the proposed rejection is reasonable based on the taxpayer's facts and circumstances. The IRS notifies taxpayers of their appeal rights on the OIC application and again in an offer rejection letter.

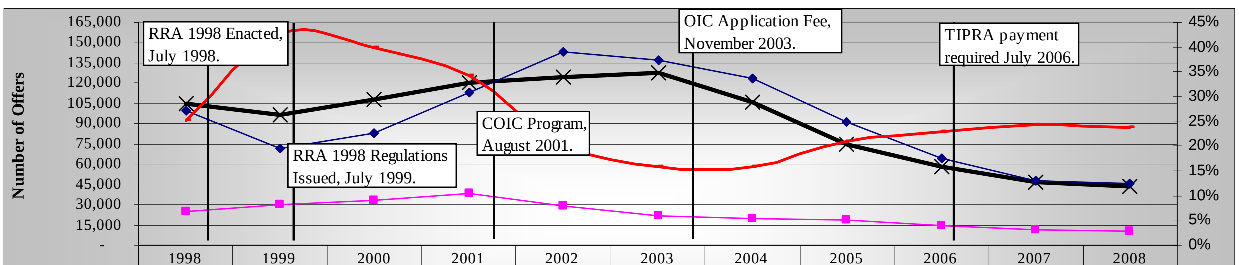
While there have been positive changes to the OIC program, challenges remain. Several changes after the RRA 98 have affected the volume of OIC applications. Beginning November 2003, the IRS instituted a $150 user fee[68] to reduce the number of inappropriate OICs and offset the cost of

[67] The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
[68] OMB Circular A-25 requires that Federal agencies charge user fees for activities that convey special benefits to recipients beyond those accruing to the general public. The user fee does not apply to low-income taxpayers.

the program. This reduced OIC receipts from 127,769 in FY 2003 to 74,311 in FY 2005. Then legislation enacted in May and December 2006[69] also reduced receipts in FY 2007 to 46,458. The legislation authorized the IRS to impose a $5,000 penalty for a frivolous offer, but also requires automatic acceptance of an OIC if a decision has not been reached within 24 months.

This large decline in receipts is a concern of the NTA. In the NTA's 2007 Annual Report to Congress, the OIC program was listed as one of the most serious problems facing taxpayers. Between FY 2001 and FY 2008, OIC applications receipts declined from 120,684 to 43,989 (64 percent), and the number of OICs accepted declined from 38,643 to 10,677 (72 percent). According to the report, customer perceptions are that the IRS is predisposed to rejecting OIC applications and is not realistic in considering taxpayers' circumstances. The IRS, in response, explained that it has repeatedly revised procedures to maximize the number of OIC cases that are actually investigated for a decision to accept or reject the offer. Figure 10 shows a historical perspective of OICs for FY 1998 through FY 2008.

Figure 10: Historical Perspective of OICs for FY 1998 through FY 2008



	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Receipts	104,942	95,998	108,113	120,684	124,033	127,769	106,025	74,311	58,586	46,458	43,989
Dispositions	99,154	71,393	83,208	113,209	143,102	136,822	123,970	91,343	64,169	47,719	45,163
Accepted	25,052	30,542	33,114	38,643	29,140	21,570	19,546	19,080	14,734	11,618	10,677
% Accepted	25%	43%	40%	34%	20%	16%	16%	21%	23%	24%	24%

Fiscal Year

COIC *Consolidated Offer in Compromise*
TIPRA *Tax Increase Prevention and Reconciliation Act of 2005*

Source: IRS Collection Activity Report No. 5000-108 (FY 1998 – FY 2008).

The IRS did identify a condition that may have affected the OIC application receipt volume. Prior to 1998, the IRS accepted partial payment IAs that could last 15 years and longer. In 1998, the IRS Chief Counsel determined that the IRS did not have the authority to enter into IAs that would not fully pay the liability within the ten-year statutory collection period plus five-year extension. According to IRS officials, more taxpayers turned to the OIC program as a result of this decision, but could not quantify the impact of the decision. The IRS proposed legislation to

[69] The Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. 109-222, 120 Stat. 345 (2006) and The Tax Relief and Health Care Act of 2006, Pub. L. 109-432, 120 Stat. 2958 (2006). These required an initial payment with an OIC and allowed the IRS to disregard offers made to delay collection.

allow partial payment IAs, and this option has been available since January 2005.[70] In FY 2008, the IRS accepted 22,555 partial payment IAs.

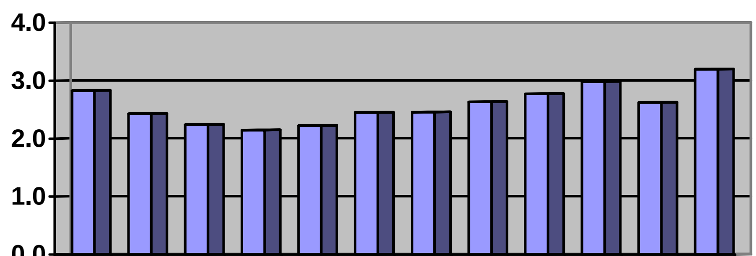
The NTA included priority attention to improving accessibility of the OIC program for appropriate taxpayers in the NTA's FY 2010 Objectives Report. According to the report, the IRS formed an OIC Project Team to take a closer look at the characteristics of applicants who submit acceptable OICs and to increase the number of qualifying applicants within the existing process. Also, one of the Department of the Treasury's revenue proposals in the FY 2010 budget would eliminate the nonrefundable payment required with initial OICs.

Installment Agreements

The RRA 98 requires guaranteed acceptance of IAs for individual taxpayers who owe $10,000 or less if the taxpayer filed all returns, paid all tax, and had not entered into any IA for the past five years. The taxpayer must pay the liability through scheduled periodic payments within three years and agree to remain compliant during that time. The IRS goes beyond what is legally required and grants guaranteed IAs even if taxpayers could fully pay. Beyond this, the IRS extended the authority to grant IAs to employees with taxpayer contact outside the Collection function.

If an IA request is rejected, a managerial and independent administrative review process is generally required. If the IA is still rejected, taxpayers must be notified of their appeal rights. Taxpayers can request a Collection Appeals Program hearing for rejected or terminated (or proposed termination) IAs. The RRA 98 also required that taxpayers be sent annual statements to report the amount of the beginning balance due, payments, penalties, interest, other changes, and the amount of the ending balance due. Each year, the IRS initiates approximately 2.5 million IAs. Figure 11 shows the IAs initiated from FY 1998 through FY 2009.

Figure 11: IAs Initiated



	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Volume In Millions	2.8	2.4	2.2	2.1	2.2	2.5	2.5	2.6	2.8	3.0	2.6	3.2

Fiscal Year

Source: IRS Cumulative Report CAR 5000-6 for September of each fiscal year, Line 1.1 New Entities to IA.

[70] Provided by the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

Joint and Several Liability — Innocent Spouse Relief

When a husband and wife file a joint tax return, each spouse is individually liable for the accuracy and completeness of the return and payment of the tax reported plus any additions. A spouse may be subject to joint liability for the omissions from income or erroneous deductions of the other spouse, even though they did not know about the understatement of tax when they signed the return.[71]

Congress was concerned that the Innocent Spouse Relief provisions were inadequate because relief was only available for substantial amounts. The RRA 98 expanded Innocent Spouse Relief to apply to any amount, established a separate liability election for joint returns of separated taxpayers, and allowed for equitable relief for the underpayment of tax. The IRS now issues separate notices to joint filers and requires employees to discuss joint and several liability, as well as the availability of Innocent Spouse Relief, with taxpayers that might qualify. The signature line of U.S. Individual Income Tax Return (Form 1040) also refers joint filers to an explanation of joint and several liability.

The IRS centralized Innocent Spouse Relief claim processing to ensure cases were consistently evaluated and to allow tax examiners to specialize. The tax examiners use a computer application designed to lead them to make more accurate and consistent determinations.

In May 2005, the TIGTA reported that examiners made accurate decisions in 100 percent of its sampled cases and generally provided taxpayers with timely preliminary and final determination letters.[72]

Interest and Penalties

The Commission heard from a number of sources that because of the high interest and penalties, it is very difficult for many taxpayers to resolve their tax disputes. They believed high penalties and interest payments are created to raise revenue, not to act as a deterrent to taxpayers. The penalties and interest are often a significant disincentive for many taxpayers to reach an agreement with the IRS. In addition, the penalties and interest payments (coupled at times with unreasonably low living allowances) are so heavy a burden that taxpayers will enter an agreement only to find later that they cannot meet the terms.

The Commission believed that the recommendations on penalties, interest, and IAs would help relieve the unnecessary burdens placed on taxpayers to come into compliance and pay their taxes. The recommendations would benefit taxpayers, should increase revenues in the long run, and improve voluntary compliance.

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[71] This is known as joint and several liability.
[72] *The Innocent Spouse Centralized Review Function Ensured Accurate Relief Determinations, but Improvements Could Increase Customer Service* (Reference Number 2005-40-075, dated May 2, 2005).

Many changes to interest and penalty administration were required by the RRA 98. First, the RRA 98 eliminated the differential between interest rates applicable to overpayments and underpayments of tax for noncorporate taxpayers, thus eliminating the necessity for and complexity of interest netting. Second, the Commission believed that taxpayers, who have entered into an IA to pay their tax liabilities including interest, should not continue to be penalized when the taxpayer is in compliance with the agreement. The RRA 98 reduced the Failure to Pay penalty from 0.50 percent to 0.25 percent per month after the taxpayer enters an IA.

Next, IRS notices to individual taxpayers now reference the Internal Revenue Code sections for interest and penalty along with the computation. Further, interest and certain penalties are suspended after 36 months[73] on assessments if the IRS fails to notify the individual taxpayer of the liability within that time period.

The RRA 98 required the Joint Committee on Taxation and the Department of the Treasury to conduct studies to determine whether the then current penalty and interest provisions encouraged voluntary compliance. The studies were to also consider whether the provisions operated fairly, whether they were effective deterrents to undesired behavior, and whether they were designed in a manner that promoted efficient and effective administration of the provisions by the IRS. The Joint Committee report was provided to Congress in July 1999 and the Department of the Treasury report in October 1999.

Additional Protections Were Implemented for Taxpayers Subject to Liens, Levies, and Seizures

Congress believed that taxpayers are entitled to similar protections from the IRS as from any other creditor. Accordingly, the IRS should afford taxpayers adequate notice of collection activity and a meaningful hearing before the IRS deprives them of their property. Due process in collections affords fairness to taxpayers.

The Fair Debt Collection Practices Act[74] did not apply to the Federal Government. The Fair Tax Collection provision of the RRA 98 applies certain restrictions relating to communication with taxpayers/debtors and the prohibitions on harassing or abusing a debtor. In July 2009, the TIGTA reported that there were no cases involving Fair Debt Collection Practices Act violations in CY 2008 for which an employee received disciplinary action, and there were no taxpayers awarded civil damages for a Fair Debt Collection Practices Act violation.[75]

[73] The period for suspending the penalty and interest was originally one year for tax years starting in 2004 and was subsequently extended to 36 months by the Small Business and Work Opportunity Tax Act of 2007, Pub. L. 110-28, 121 Stat. 190.
[74] Pub. L. 95-109, 91Stat. 874 (1977).
[75] The IRS does not routinely track all oral counseling or minor actions against its employees.

Collection Due Process - Right to Appeal

The Collection Due Process (CDP) ensures that taxpayers are aware of their rights regarding liens and levies. The IRS must notify the taxpayer of the lien or levy and the taxpayer's right to formally appeal the proposed collection action which can be further appealed to Tax Court. IRS Collection function personnel have to follow several procedures before using a levy. If the action is appealed, Appeals personnel must verify that procedures were followed. This change led to a significant case workload increase in the Appeals organization. Appeals receives about 30,000 CDP cases per year, comprising about 30 percent of its receipts. To better manage the workload, in March 2003, the IRS implemented the Collection Due Process Tracking System to better track CDP hearing requests and to provide management information to project workload.

The RRA 98 also changed the IRS process for filing liens and levies. The IRS must notify taxpayers within five business days of filing Notices of Federal Tax Lien. The IRS also implemented automated controls in database systems[76] to ensure that taxpayers are advised of their appeal rights at least 30 calendar days prior to issuance of a systemically generated levy. In June 2009, the TIGTA reported that it found no untimely mailed lien notices in its review; however, taxpayers' representatives were not always notified and undeliverable notices were not always timely researched for a different address.[77] In May 2009, the TIGTA reported that revenue officers and Automated Collection System customer service representatives properly informed taxpayers of their rights at least 30 calendar days prior to issuing levies in cases reviewed for the last several years.[78]

In September 2008, the TIGTA reported that Appeals has continued to improve its processing of CDP cases as a whole by generally classifying taxpayer requests properly, developing additional CDP procedures, and ensuring that the Collection Statute Expiration Dates for taxpayer accounts were correct. However, the TIGTA identified a few instances in which taxpayers were not provided with their right to a CDP hearing because Appeals employees did not make sufficient attempts to contact taxpayers before closing their cases.[79]

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[76] The Automated Collection System and the Integrated Collection System are systems that track collection action. The Automated Collection System is used in sites where employees make only telephone contact with taxpayers. Integrated Collection System is used in sites where employees who make face-to-face contact with taxpayers are located.

[77] *Additional Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process* (Reference Number 2009-30-089, dated June 16, 2009).

[78] *Fiscal Year 2009 Statutory Review of Compliance With Legal Guidelines When Issuing Levies* (Reference Number 2009-30-070, dated May 12, 2009).

[79] *The Office of Appeals Continues to Show Improvement in Processing Collection Due Process Cases* (Reference Number 2008-10-160, dated September 12, 2008).

Seizures

Seizures are usually the last option in the collection process. Prior to the RRA 98, there was no restriction on selling a personal residence to satisfy a small tax deficiency or seizing assets of a going business. The Internal Revenue Code did not prohibit sale of seized property for less than the minimum bid price, which is set to avoid selling property for substantially less than the forced sale value of the taxpayer's interest. The IRS was not required to inform taxpayers how the proceeds of sales were applied to their tax liabilities.

The RRA 98 codified existing guidelines for Collection function personnel that apply prior to a sale. Also, for fairness and the appearance of propriety, Collection function personnel attempting to collect tax are prohibited from participating in the sale of seized assets. Prior to sale of seized property, Collection function personnel must verify the taxpayer's liability and determine that there is enough equity in the property to yield proceeds after expenses. Collection function personnel must obtain approvals for seizures of personal residences and assets of the individual used in a trade or business.

A new position, the property appraisal liquidation specialist, takes possession of and stores property after seizure by Collection function personnel, verifies the fair market value, determines the minimum bid price, and sells seized property thorough public auction or public sale under sealed bids.

The RRA 98 had a tremendous effect on IRS seizures. In FY 1997, the IRS performed 10,090 seizures. In FY 2000, the seizure total was 74. After that initial drop, the number of seizures increased to 676 in FY 2007 and 610 in FY 2008. Each year the TIGTA performs an audit of IRS seizure activity. There have been no significant problems reported by these reviews.

Employee Misconduct

The RRA 98, Section 1203, defined ten specific acts of misconduct – covering taxpayer and employee rights and tax return filing requirements – for which an IRS employee may be terminated. In FY 2008, 320 Section 1203 allegations were substantiated. Of these, 311 were due to employees' failure to file a Federal tax return or understatement of their tax liability, and would not have affected taxpayers.

Evaluation and Conclusion

Implementing the RRA 98 was a tremendous task for the IRS, but as a result of numerous efforts to improve processes, program computers, and train employees, taxpayer rights are better protected today. Taxpayers are better positioned to challenge IRS assertions, even those taxpayers who cannot afford representation. Taxpayers are more educated about their rights and IRS processes. IRS employees are held accountable for their actions and evaluated on their treatment of taxpayers. The IRS is fairer and taxpayers who truly cannot pay what they owe have more options to settle their debt which is especially important in these difficult economic times. There are opportunities for improvement, as the NTA has stated, particularly for greater use of the OIC program.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of our evaluation was to determine whether the goals of the IRS RRA 98 have been substantially achieved by the IRS. The RRA 98 legislation was substantial legislation that included some tax provisions. Our evaluation was limited to the major provisions that affected the changes on organization structure, taxpayer rights and protections, modernizing the institution, and the culture.

To accomplish our objective, we:

I. Answered three questions (sub-objectives).

   A. Determined whether the IRS substantially changed the organizational culture from compliance/enforcement focused to a more balanced organization that serves taxpayers.

   B. Determined whether the IRS substantially modernized itself through organization structure, policies, processes and procedures, human capital practices, customer service, and technology improvements.

   C. Determined whether taxpayer rights are better protected through changed organization structure, policies, processes and procedures, human capital practices, and customer service.

II. To answer these questions, we:

   A. Determined the major provisions affecting changes to organizational culture, modernization, and taxpayer protection and rights.

   B. Obtained and reviewed prior TIGTA reports, GAO reports, NTA Annual Reports, and any other authoritative reports specific to the provisions and their implementation, or to the subject area of the provision.

   C. Reviewed relevant IRS Internal Revenue Manuals and the IRS Intranet Web site for guidance provided to employees that pertain to taxpayers' protection and rights and specific to the provisions.

   D. Researched current tax law and available information to determine whether laws enacted by the RRA 98 have been subsequently modified.

   E. Used a business model encompassing four factors: strategy/policy, processes/procedures, information technology, and employee/human capital. We reviewed each major provision in terms of how it satisfied one or more factors of the business model.

F. Assessed information gathered to determine whether the provisions were substantially implemented.

Appendix II

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Appendix III

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