IRS BUDGET FOR FISCAL YEAR 1998 AND THE 1997 TAX RETURN FILING SEASON

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

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IRS BUDGET FOR FISCAL YEAR 1998 AND THE 1997 TAX RETURN FILING SEASON

TUESDAY, MARCH, 18, 1997

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

The Subcommittee met, pursuant to notice, at 10:04 a.m., in room B–318, Rayburn House Office Building, Hon. Nancy L. Johnson (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
March 10, 1997
No. OV–3

CONTACT: (202) 225–7601

Johnson Announces Hearing on IRS Budget for Fiscal Year 1998 and the 1997 Tax Return Filing Season

Congresswoman Nancy L. Johnson (R–CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the Administration's budget request for the Internal Revenue Service (IRS) for fiscal year (FY) 1998, and the 1997 tax return filing season. The hearing will take place on Tuesday, March 18, 1997, in room B–318 Rayburn House Office Building, beginning at 11:00 a.m.

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

BACKGROUND

The Administration's budget requests $7.37 billion to fund the IRS for FY 1998, plus an additional $500 million to establish a new account to fund future computer modernization. This level of funding will support about 102,000 employees who will collect an estimated $1.7 trillion in taxes, according to Administration estimates.

The 1997 tax return filing season refers to that period of time between January 1st and April 15th when Americans will file 200 million individual and business tax returns. During this period, the IRS is expected to issue over 85 million tax refunds and answer 111 million telephone calls from taxpayers asking for assistance. Beyond the traditional activities of the filing season, the FY 1998 budget will also fund, among other things: IRS examination activities, criminal tax law investigations, efforts to collect delinquent taxes, employee salaries, and maintenance of the operational status of the IRS's aging computer systems.

In announcing the hearing, Chairman Johnson stated: "Although the IRS has made progress in recent years to streamline its organizational structure and improve its financial accountability, clearly more remains to be accomplished in terms of downsizing, redirecting resources to front-line operations, eliminating unnecessary layers of management, reducing waste, and correcting deficiencies in its multibillion dollar Tax Systems Modernization program. The Subcommittee will examine the IRS's progress in these areas. At the same time, we must also make sure that the IRS is carrying out its responsibilities in a fair and courteous manner. American taxpayers must sacrifice a great deal to support the cost of operating the Federal Government. They deserve to receive quality service and fair treatment by the IRS."

FOCUS OF THE HEARING

The Subcommittee will explore how the IRS intends to allocate its FY 1998 budget resources, and what effect its funding level will have on the IRS's ability to fulfill its mission "to collect the proper amount of tax revenue at the least cost, and serve the public by continually improving the quality of its products and services . . . ." In particular, the Subcommittee will examine: what effect will the budget request have on the quality of IRS taxpayer services, the level of effort in the examination program, the level of effort in collecting delinquent taxes, and what the implications are of the FY 1998 budget request for the remaining five years of the budgeting window.

With respect to the current filing season, the Subcommittee will explore how effectively the IRS is responding to taxpayers requests for assistance, how efficiently it is processing taxpayers' refunds, and the effectiveness of IRS's actions to deter refund fraud.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement and a 3.5-inch diskette in WordPerfect or ASCII format, with their address and date of hearing noted, by the close of business, Tuesday, April 1, 1997, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS

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

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on a 3.5-inch diskette in WordPerfect or ASCII format.

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

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

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

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

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–225–1904 TTD/TTY in advance of the event (four business days notice is requested).

Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman JOHNSON. I'd like to call the hearing to order, and welcome the Chairman. I'm going to keep my opening comment very brief, Mr. Chairman, in recognition of your schedule.

But this is an important hearing to hear the administration's proposal for the budgets of not only next year, but the 4 or 5 years following, and we hope they will give us greater insight during this hearing as to how they expect the IRS to become, as Deputy Secretary Summers said, a different IRS in the future under both their budget scenario and under their plans.

So it's a pleasure to welcome you, Chairman Archer, to this Subcommittee hearing. I appreciate your willingness to testify on the important matter of the structure of the IRS, and the problems that we face at this time. And without further ado, unless my Ranking Member has comments——

Mr. COYNE. Well, thank you, Madam Chair, and I welcome the Chairman here to testify today. Today's hearing will focus on two of the most important issues currently facing the Internal Revenue Service: The 1998 tax return filing season, and the proposed fiscal year 1998 budget for the IRS.

The Oversight Subcommittee holds a hearing each year in the early spring to evaluate the IRS' efforts to assist taxpayers in filing their tax returns, and to review the administration's proposal for funding the various functions of the IRS.

It is important that the Congress have a full understanding of where the IRS stands in administering our voluntary tax system, assisting taxpayers in their filing of tax returns, and planning for the coming year.

Fortunately, the IRS will report to us that the agency has made great strides in improving taxpayers' ability to reach the IRS by telephone.

Also the GAO will report that by and large the 1997 filing season is going very well. We all should thank IRS employees nationwide for their hard work and a job well done.

Of concern to all of us, of course, continues to be the impact the IRS' downsizing and reorganization will have on our constituents, particularly their ability to comply with the tax laws and to obtain assistance from the IRS.

Clearly, the Congress must continue to evaluate the effect IRS restructuring efforts will have on taxpayers and particularly on IRS customer service offices and problem resolution cases.

The fiscal year 1997 appropriations bill requires the IRS to report to the Congress on these matters after March 1, 1997, before proceeding with its planned field reorganization.

I would hope that the Oversight Subcommittee would review the IRS' report upon its release, and allow us to provide comment before reductions in force are implemented.

Finally I want to welcome GAO and the panel of tax professionals for providing their insights into the operations of the IRS, and thank you, Madam Chair.

[The opening statement of Mr. Ramstad follows:]

Statement of Hon. Jim Ramstad, a Representative in Congress from the State of Minnesota

Madame Chairman, thank you for holding this important hearing on the IRS budget for FY 1998 and the 1997 tax return filing season.

Just as we have asked every area of government to do more with less and eliminate waste, the IRS must continue to streamline its operations and improve its financial accountability. At the same time, this agency has a long way to go in delivering fair and courteous service to American taxpayers, who foot the bill for our government.

I look forward to exploring IRS customer service and management issues in the context of our hearing today, especially in light of yesterday's statements by Deputy Treasury Secretary Larry Summers that the Treasury Department plans to increase its role and overhaul the IRS to focus on management.

Again, Madame Chairman, thank you for your leadership in convening this hearing.

Chairman JOHNSON. Mr. Chairman.

STATEMENT OF HON. BILL ARCHER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS; AND CHAIRMAN, WAYS AND MEANS COMMITTEE

Chairman ARCHER. Thank you, Madam Chair. I agree with you that this hearing is exceedingly important. The IRS has such an impact on each of our lives, often only psychologically, but at other times in an administrative way that encumbers us to a degree beyond what many of us would like to be encumbered.

And I join you this morning to say a few words about the tax system and the Internal Revenue Service and the role that it plays in the lives of American citizens. I'm sure that most would agree with me that our Nation's Federal income tax laws have grown extraordinarily complex in recent decades.

In some ways this is a natural outgrowth of the increasing complexity of the American economy. The financial affairs of American families are far more complicated today than in previous generations.

Ownership of both financial and nonfinancial assets is more widespread and varied. Families have a greater variety of income sources. Business transactions are more complicated.

In response, Congress has continually tried to refine the tax laws to match the rapid changes in our economy. The Tax Reform Act of 1986 added tremendous complexity to the Tax Code, while flying under the banner of simplicity, fairness and growth.

The Internal Revenue Service is the agency tasked by Congress with the responsibility of enforcing the tax laws and collecting the taxes that are legally owed. And that is an important responsibility to our society, because the very functioning of the Federal Government depends on the American people's willingness to voluntarily pay the taxes that they owe.

Now, that voluntary nature, of course, is enforced by some very tough rigid and potentially harsh sanctions.

However, it is very difficult for the IRS to discharge its responsibility, because the complicated structure of our current income tax system necessarily interjects the IRS into our private lives.

There is no question that the IRS has grown too powerful and too intrusive in recent years.

However, this has come in direct response to the complexity of our current income tax system, and the pressure that Congress annually places on the IRS to collect taxes. And we should never forget that.

The individual elements of the administration's five-point plan to restructure the IRS announced yesterday by Deputy Treasury Secretary Lawrence Summers are all sensible: Better customer service, less paperwork, greater oversight. Who could be against that?

We heard that in 1986. We hear it over and over again all the time. But it really is a figleaf on the problem. Yet a figleaf is better than no clothes at all, and we should consider it in that way.

But the plan's main shortcoming is it doesn't go far enough. Increased oversight by the Treasury Department of the IRS is only a part of the problem. The crux of the problem is the tax system itself. The IRS management failures which prompted the administration's five-point plan have to be viewed in the context of a Tax Code which has grown so horribly complex that a majority of Americans today must utilize the services of paid tax preparers to complete their tax returns.

Madam Chair, I am happy to tell you that I continue to do my own personal income tax, and it is because of that that my awareness of the complexity of this Code has been heightened. I have always been of the view that if all of the Members of Congress had to do their own tax returns, we'd have a very different Tax Code.

The Internal Revenue Code and regulations now come in at 1 million words, and 9,000 pages. On average, the Code is "reformed" once every 1.3 years. Just since the Tax Reform Act of 1986, several thousand sections have been added.

According to 1995 IRS estimates, businesses will spend about 3.4 billion hours, and individuals will spend about 1.7 billion hours embroiled in tax-related paperwork. That means nearly 3 million people—more than all those serving in the U.S. Armed Forces, work full time all year just to comply with the tax laws at a cost of some $200 billion a year. And I frankly believe that $200 billion is a conservative estimate.

This translates into a tremendous productivity loss for our Nation. I talked to the chief executive officer of one of our major corporations 2 weeks ago, and he said in their most recent audit that the paperwork stacked 200 feet high. For 1 year's audit, for one corporation.

The answer isn't just another IRS oversight organization. What we need is a tax system that is fundamentally fairer than the current income tax, that contains no loopholes or special treatment for favored interests, a tax system that is vastly simpler, a tax system that is capable of enforcement in a far less intrusive manner, both in terms of reducing the burdens placed on the American citizens to comply with the system, and eliminating the need for an intrusive agency to administer it.

A tax system that enhances, rather than impedes, savings and investment, economic growth, and advances U.S. living standards. A tax system which can respond more flexibly to rapid changes in

information technology. And a tax system that gets at the underground economy.

I'm convinced that there is no single, more important action that President Clinton can take in his second term to build a strong bridge into the 21st century than to join me in seeking a new tax system that is fairer, simpler, less intrusive and more conducive to economic growth.

I am committed to working with the administration on a bipartisan basis to achieve this goal.

Let me make one last point, and this is very important: As long as we have an income tax, we must have an IRS that has the resources and the tools to perform the mission that it has been given by the Congress. That means that the IRS must receive adequate funding.

I am glad that the administration has stepped up to the plate and indicated its commitment to bring discipline and accountability to the IRS and its Tax Systems Modernization effort.

As we all know, recently the IRS admitted that it had spent over $4 billion on a computer system that doesn't work.

In the short run, there is no more important action we can take in terms of improving the quality of the IRS' services to the Nation's taxpayers than a successful completion of the computer modernization system.

And I say successful, and it is going to be a daunting task to try to deal with administering this exceedingly arcane Tax Code.

I also agree in concept with the information technology investment account proposed in the IRS' fiscal year 1998 request to fund future computer projects.

However, I agree with my colleague, Jim Kolbe, the Chairman of the Appropriations Subcommittee, Treasury, Postal Service, and General Government, that Congress should not commit to spend any more funds on computer modernization until a plan for completing this effort has been approved and specific and viable projects have been identified.

Once those pieces are in place, capital budgeting for the IRS' long-term investments is a concept we should adopt. Again, however, the answer in the long run is not just better IRS oversight; we must fundamentally reform our tax laws to eliminate the incredible complexity which necessarily injects the IRS into each of our individual lives.

And I thank you for listening.

[The prepared statement follows:]

Statement of Hon. Bill Archer, a Representative in Congress from the State of Texas; and Chairman, Ways and Means Committee

I wanted to join you this morning to say a few words about our tax system and the Internal Revenue Service and the role it plays in the lives of American citizens. I'm sure all of you agree with me that our nation's federal income tax laws have grown extraordinarily complex in recent decades. In some ways, this is a natural outgrowth of the increasing complexity of the American economy.

The financial affairs of American families are far more complicated today than in previous generations. Ownership of both financial and nonfinancial assets is more widespread and varied. Families have a greater variety of income sources. Business transactions are much more complicated. In response, Congress has continually tried to refine the tax laws to match the rapid changes in our economy. The Tax Reform Act of 1986, in particular, added tremendous complexity to the tax code.

The Internal Revenue Service is the agency tasked by Congress with the responsibility of enforcing the tax laws and collecting the taxes that are legally owed. This is an important responsibility, because the very functioning of the federal government depends on the American people's willingness to voluntarily pay the taxes they owe. However, it is also a very difficult responsibility, because the complicated structure of our current income tax system necessarily interjects the IRS into our private lives.

There's no question that the IRS has grown too powerful and too intrusive in recent years. However, this has come in direct response to the complexity of our current income tax system and the pressure that Congress annually places on the IRS to collect revenues.

The ultimate answer to this problem is not increased oversight by the Treasury Department over the IRS. The individual elements of the Administration's five-point plan to restructure the IRS announced yesterday by Deputy Treasury Secretary Lawrence Summers are all sensible—better customer service, less paperwork, greater oversight—who could be against that? The plan's main shortcoming is that it does not go far enough.

The problem is the tax system itself. The IRS' management failures which prompted the Administration's five-point plan have to be viewed in the context of a tax code which has grown so horribly complex that a majority of Americans today must utilize the services of a paid tax preparer to complete their tax returns.

The Internal Revenue Code and regulations now come in at one million words and 9000 pages. On average, the code is "reformed" once every 1.3 years. Just since the Tax Reform Act of 1986, several thousand sections have been added. According to 1995 IRS estimates, businesses will spend about 3.4 billion hours and individuals will spend about 1.7 billion hours embroiled in tax-related paperwork. That means nearly three million people more than all those serving in the U.S. armed forces work full time all year just to comply with the tax laws, at a cost of some $200 billion a year. This translates into a tremendous productivity loss for our nation.

The answer isn't another IRS oversight organization. What we need is:

- a tax system that is fundamentally fairer than the current income tax, that contains no loopholes or special treatment for favored interests;
- a tax system that is vastly simpler;
- a tax system that is capable of enforcement in a far less intrusive manner, both in terms of the reducing the burdens placed on American citizens to comply with the system, and eliminating the need for an intrusive agency to administer it;
- a tax system that enhances, rather than impedes, savings and investment, economic growth and advances U.S. living standards;
- a tax system which can respond more flexibly to rapid changes in information technology.

I am convinced that there is no single more important action that President Clinton can take in his second term to build a strong bridge into the 21st Century that to join with me in seeking a new tax system that is fairer, simpler, less instrusive and more conducive to economic growth. I am committed to working with the Administration on a bipartisan basis to achieve this vital goal.

Let me make one last point and this is very important as long as we have an income tax, we must have an IRS that has the resources and the tools to perform the mission it has been given by Congress. That means that the IRS must receive adequate funding.

I'm glad that the Administration has stepped up to the plate and indicated its commitment to bring discipline and accountability to the IRS and its Tax Systems Modernization effort. In the short run, there's no more important action we can take in terms of improving the quality of the IRS's services to the nation's taxpayers than a successful completion of computer modernization.

I also agree in concept with the Information Technology Investment Account proposed in the IRS's FY 1998 to fund future computer projects. However, I agree with my colleague, Jim Kolbe, the chairman of the Treasury, Postal Appropriations Subcommittee, that Congress should not commit to spend any more funds on computer modernization until the plan for completing this effort has been approved and specific and viable projects have been identified. Once those pieces are in place, capital budgeting for IRS's long-term investments is a concept we should adopt.

Again, however, the answer in the long run is not better IRS oversight. We must fundamentally reform our tax laws to eliminate the incredible complexity which necessarily injects the IRS into our private lives.

Chairman JOHNSON. Mr. Chairman, I thank you for your testimony. I agree with it wholeheartedly. As you are aware, we have been holding hearings to follow up on the provisions of the Taxpayer Bill of Rights 2. And one of those provisions was to have the taxpayer advocates bring to this Subcommittee the problems they see on the frontline there with the ordinary person with an ordinary problem trying to get timely and accurate assistance from the IRS.

And while generically the hearing was a failure, because the leadership provided a list that we have seen since 1993, functionally it was a success, because for the first time we had advocates from around the country sitting at this table. And one of the things in spontaneous conversation that was brought up was the impossibility of implementing some of the complex proposals that we have passed here in the Congress recently, and changed repeatedly, like the EITC.

And to hear a taxpayer advocate sit there and say, Look, just take the money, and put it out through a program that's used to dealing with means testing, but don't try to ask us to implement this tax law that we can't do without a high level of fraud.

It was very revealing, and it puts face and voice behind what you're saying. And I hope that the Treasury will be far more forthcoming, and I appreciate your offer to work with them. But I hope they will be far more forthcoming with us and with the public in terms of their vision.

Because Deputy Secretary Summers did note in recent testimony before the Treasury, Postal Service, and General Government, Appropriations Subcommittee that it should be clear that a smaller IRS will not be able to do the work that needs to be done unless it is also a different IRS, and it could only be a different IRS if it is also a different Code.

And while I appreciate Secretary Summers' comments yesterday on reorganization, I'd have to say Where's the beef? I was truly disappointed that at this juncture, when we have a Restructuring Commission, when through the Taxpayer Bill of Rights we have asked for a lot of information that will help us really deal with restructuring issues, and when the administration did acknowledge the complete collapse and failure of the modernization systems, the Tax Systems Modernization Project, that they didn't come forward with a plan that had, frankly, more to it.

What they did do was to acknowledge the many changes that the current Commissioner, Commissioner Richardson, has put in place as a response to her very deep concern with the ability of the IRS to serve the people and to carry out its function. And she has done some very good things, and they are all important, and they are all steps, and they need to be recognized.

But they don't constitute a vision of a slimmer, trimmer, more efficient, more effective, more responsible to the ordinary person taxpayer IRS. And that's really where we are and where we have to start moving aggressively and deliberately.

And I thank you for your testimony because without that kind of insight we cannot do the job the Congress is called upon to do

with the IRS and preserve not only our voluntary system of revenue collection that funds our great and free society, but to do it in a way that is increasingly fairer and simpler and more intelligible so that all of us on the Ways and Means Committee can do our own taxes, never mind the ordinary American citizen out there.

I thank you for your comments.

Chairman ARCHER. It's a pleasure to be with you. Let me just cite one very, very small part of the Tax Code as evidence, anecdotally, of the tremendous complexities. Whether or not you are the head of a household is a pretty basic thing to many, many people in this country, because if you're the head of a household then you get a different tax treatment.

To determine whether you are the head of a household, an IRS agent must ask you 42 questions and get the answers to 42 questions before that agent can definitively tell you that you are the head of a household.

That's just one minor part of the Code to evidence the complexities. And so we're going to run aground if simply all we try to do is get a more efficient IRS until we get rid of this Tax Code.

And, of course, as you know, I want to abolish the income tax completely and totally, not simply try to make it better, because I think inherently income taxes are flawed.

Everybody's got a different definition of income. You talk from one economist to another and they don't agree on what income is. And you are forever trying to define income, and as you try to define it you inevitably get to the complexities that we have in the current Code today.

Chairman JOHNSON. Well, Mr. Chairman, it's a privilege for this Subcommittee to have you testify before us. We are the Oversight Subcommittee. I don't know how far we have to go back in history to find another Chairman of the Ways and Means Committee who does his own taxes. And your knowledge of the Code at this particular juncture in history is going to be of enormous importance, not only to the Ways and Means Committee, but to the American people. And I thank you for being with us here today.

Chairman ARCHER. Thank you, Madam Chair.

Chairman JOHNSON. Mr. Coyne.

Mr. COYNE. Thank you, Madam Chair. I, too, want to welcome the Chairman here today and welcome your spirit of bipartisanship in saying that you're committed to working with the administration on a bipartisan basis to achieve a fairer, simpler and less intrusive Tax Code, and also that you recognize the necessity to have a fully funded or an adequately funded IRS to do the job that needs to be done with the present Code as we know it.

And, of course, we all have concerns about the modernization problem. And I know that you're willing to work to achieve computer modernization and to get it done in the right way. Thank you.

Chairman ARCHER. Thank you, Mr. Coyne.

Chairman JOHNSON. Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair. And, Mr. Chairman, thank you for being here and for all you are doing to promote simplification and new thinking in our tax system. You've been a tire-

less advocate for it, and I want to personally thank you for the support you've given this Commission to Restructure the IRS.

I know it's not advocating the kind of consumption tax that you think is so necessary to pull the IRS out by its roots and truly transform our system into the next century. But nonetheless, you've been supportive of the effort and understand that short of fundamental tax reform that you advocate, and that I happen to support as well, we do need to make changes in the IRS.

And I want to thank you again for this morning extending your hand to work with us to come up with changes that really make sense, even in this imperfect world, to make the IRS work better.

I agree with many of your statements with regard to Treasury's proposal yesterday. Among other things, it was said in the proposal that fundamental tax reform would not necessarily simplify the Code, and would not necessarily make the IRS' job easier. I think that is difficult to defend.

I think it is absolutely true that we need fundamental tax reform in order to move the system in a more aggressive way to make it easier on the taxpayer.

But short of that, I do think there are things we can do, and really look forward to working with you on that. You and I have discussed several times the issue of simplification, even within our existing Code.

No one knows the Tax Code better than you in Congress in my view. I wonder if you would have any thoughts on whether short of, again, structural tax reform this year we might be able to move something forward to simplify our tax system.

Because, as you say, we are not going to be able to make the kind of progress we would all like to see at the Internal Revenue Service, I think, until we give the people lined up behind you better tools.

Do you have any thoughts on that?

Chairman ARCHER. Well, I think we should pursue trying to simplify the Code that we currently have, as we await that halcyon day of structural tax reform where we can throw out the income tax completely.

We have that responsibility to try to improve it, constructively. And with the work that you've been doing, and the analysis that you and others have been doing, our Subcommittee should consider that. We have the question of revenue loss, of course, and what becomes very, very difficult is that when you begin to simplify, generally you are looking at revenue losses.

But to the degree that we don't have any significant revenue loss, I would hope that we could pursue some type of effective simplification this year.

Mr. PORTMAN. We'd love to work with you on that through the Commission, through the Full Committee and this Subcommittee. Let me just make one final comment, and that is that after the last 9 months of analyzing the various challenges the IRS faces and problems at the IRS, I think it is fair to say that all 17 Commissioners, many of whom came at it, frankly, from a different perspective, now believe that if we do not address simplification, we will not have done our job.

Certainly there are other problems at the IRS that need addressing, some of which were discussed yesterday by the Deputy Secretary of the Treasury. We believe that some of those solutions make sense. Some of them don't go far enough.

But I think it's fair to say that all 17 members, and this includes a former Commissioner, as you know, a representative of taxpayer advocate groups, the head of the union for the Treasury Department, and a lot of experts from around the country, now truly are committed to the notion of simplification—really following along the lines of what you've been talking about for years.

And again, short of major structural tax reform, I would hope that we could move in that direction. Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Mr. Portman. Thank you for the good work that you've been doing in trying to lead us down the path toward a simpler income tax.

Chairman JOHNSON. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Madam Chair. Mr. Chairman, I, too, want to applaud your strong, outspoken and effective leadership in this area. It's accurate to say that no one in this Congress or this town has done more to highlight the need for major tax reform than you, and we all appreciate that.

And I also appreciate the comments of Mr. Coyne. We do need to work together in a bipartisan, pragmatic way to get this done. I saw this headline this morning, after running my 3 miles, and it set me back.

This is not about heading off the GOP. The headline reads, Clinton IRS Plan Seeks to Head Off GOP. This is not about politics as usual. It's not about us trying to preempt them or trying to outdo them politically. This is something that there is strong unanimity, certainly, among the American people that we do need major, structural tax reform, that the present system is neither simple nor fair—two requisite elements, as we all know, for any legitimate tax system.

So I truly hope that those at the other end of Pennsylvania Avenue understand, as well as those on this Subcommittee and in this Congress, that we do truly need to work together, because that's what the American people want, and that's what they deserve.

And I was encouraged. My question was the same as Mr. Portman's. I think most recognize that we probably will fall short of major structural reform this year—of a complete, sweeping, comprehensive overhaul of the system—but that we should enact simplification.

I was very encouraged by your response, as well as your testimony. So thank you, again, Mr. Chairman. Madam Chair, this is an important area. I don't think anything is more important to the American taxpayers than what we're talking about today. Thank you.

Chairman JOHNSON. Thank you very much, Mr. Ramstad, and I agree with you absolutely. It's not about one party beating another. It's about service to the American people, and whether or not a great and free Nation like America can keep in place a voluntary tax system. And we are really there now. We have to deal with this, and your comments are right on, as is the Chairman's testimony.

Mr. Watkins.

Mr. WATKINS. Madam Chair, with all respect, I just walked in. May I yield to my colleague from Missouri, and then I'll take the last shot?

Chairman JOHNSON. All right. I'll recognize Mr. Hulshof.

Mr. HULSHOF. Thank you, Madam Chair. Mr. Chairman, it's good to be here. I just learned that you and I have something else in common. I, too, do my own taxes. I took every tax law course that the University of Mississippi had to offer.

I noticed that during your testimony that some of the representatives from the IRS that are here in the room began to shake their heads in disagreement with some of the things you had to say. And my only comment would be when I'm chewing my pencil trying to muddle through the tax forms as I do my taxes, I'm very violently shaking my head in disagreement, and certainly applaud all your efforts, as we move toward a simpler tax system.

I also applaud, Madam Chair, that this is a dialog that I think the people of this country need to participate in. Any time we have some major reforms—and I look at certain reforms that have been attempted in the past, regarding health care, Medicare, when we don't bring in the American people it's difficult to make our case.

So I certainly appreciate, Mr. Chairman, your testimony as we begin to bring the American people into this dialog as to what sort of tax system they would prefer. And again, I appreciate your testimony here today.

Chairman JOHNSON. Thank you. Mr. Watkins.

Mr. WATKINS. Thank you, Madam Chair. Mr. Chairman, I think like all Americans I would like to have more simple tax—I don't do mine. I have to get a CPA to do it.

But my concern is something I think we share, and that's whatever changes we make, we try to make this an economic growth package, a package with changing tax structure that would allow us to see more economic growth.

And I keep pushing this, and I wanted to just make a little more record on it again, that it seems like the administration has settled for a low economic growth policy. And I think it shouldn't be dismissed by the Congress or the American people that with this type of policy, it's not meeting our present-day needs, and puts tremendous burden on trying to find the revenue to try to carry out the functions of government today.

But also it's selling the future of our children and our grandchildren down the drain here in America. I think we have got to try to change the tax structure that will enhance our economic growth in the United States. Because we're in a global, competitive world. We're not going to go back to an isolated country and we're going to lose our leadership in the economic world in the next decade or so if we don't make some changes today or in the days and months ahead.

So with whatever structure changes we make, if it's tax simplification, if it's a flat tax, a modified consumption tax, whatever, I think we've got to—I keep emphasizing, every group that comes into my office, I talk about it, every group back home I talk about it, that if we continue to settle for a low economic growth policy,

we are selling the future down the drain for our children and our grandchildren.

And I think it behooves, and I want to be there trying to do everything I can during my tenure here in Congress to try to change our tax structure to the extent that will allow us and enhance that opportunity.

And so as we go about trying to simplify, I hope we will always continue to try to put the economic growth out front, because we're going to need it. So I thank you.

Chairman ARCHER. Mr. Watkins, thank you for your comments, and although the focus, I know, of this hearing is primarily simplification and perhaps fairness, the gentleman from Oklahoma is absolutely correct.

We need a Tax Code that will give us an advantage, competitively, in the world marketplace, not a disadvantage.

And the current Income Tax Code disadvantages us in our ability to compete with our foreign competitors, and as a result of that, impact negatively on our ability to grow and create jobs for export, which are the best kind of jobs.

And the gentleman is absolutely correct. That should be a major factor in our consideration, when we do start talking about restructuring our entire tax system.

Chairman JOHNSON. Mr. Chairman, we thank you for your testimony and we look forward as a Subcommittee to working with the Full Committee on these issues. We are, as you know, represented on the Restructuring Commission, the Commission that will propose how we restructure the IRS to better accomplish its goals, by both Mr. Coyne and Mr. Portman.

And we will be coming to you with proposals. We will be holding hearings on those. But it is appropriate that at this budget hearing we find ourselves talking about restructuring as well as Tax Code reform.

In the current budget, the administration proposes putting more money into telephones and telephone access for customers. Well, that's, of course, important. It's one of the big problems that they have.

But they take the money from document matching and examination activities, which is the way we collect money that isn't voluntarily paid. And they anticipate that because of this diversion of resources we will collect $35 billion instead of $38 billion next year. So we're going to lose $3 billion in revenue because of the place from which we're going to take resources to be more responsive to the ordinary citizen who has an ordinary problem with the IRS.

Surely we can do better than robbing Peter to pay Paul. Surely it is time now to look at the budget, look at the Code, look at the agency structure and act. And I think your comments today have given us a very clear indication of what the principles are that ought to underlie our Tax Code and therefore direct our action, both as we look at Tax Code reform, and as we look at the agency structure that we need to have in place to implement that Tax Code.

So I thank you for your testimony here today. This is a moment in history of great importance.

Chairman ARCHER. Well, I welcome, and I will look forward to the recommendations of your Oversight Subcommittee, and again I applaud all of you in a bipartisan basis for what you're doing. Thank you.

Chairman JOHNSON. Thank you, Mr. Chairman.

I would like to call Mr. Dolan, the Deputy Commissioner of the IRS.

Mike, I'd like you to introduce everybody before you begin, and I hope in your testimony you will address the very significant challenge of the current budget, which is over the next 5 years to carry out the mission of the IRS with what will be effectively $1 billion less in resources by the year 2002, and with 541 fewer employees than in 1997.

We face an enormous challenge, and I hope your testimony on your budget will be not only about numbers but about structure and reform. Because if we don't talk about these things now, I think we set both the IRS and our form of government up for troubled waters and possible failure in the decade ahead.

I would like you to introduce your people, and I welcome your testimony.

STATEMENT OF HON. MICHAEL P. DOLAN, DEPUTY COMMISSIONER, INTERNAL REVENUE SERVICE; ACCOMPANIED BY TONY MUSICK, CHIEF FINANCIAL OFFICER; DAVE MADER, CHIEF, MANAGEMENT AND ADMINISTRATION; ARTHUR GROSS, ASSOCIATE COMMISSIONER AND CHIEF INFORMATION OFFICER; AND JIM DONELSON, CHIEF, TAXPAYER SERVICE, AND ACTING CHIEF, COMPLIANCE

Mr. DOLAN. Thank you, Madam Chair. It's a pleasure to be here with my colleagues today, and I'll start from my left. Tony Musick is our Chief Financial Officer. To my immediate left, Dave Mader, is our Chief of Management and Administration. To my immediate right is Art Gross, our Associate Commissioner and CIO. And to his right is Jim Donelson, who is the Chief of Taxpayer Service, and Acting Chief of Compliance.

And we very much appreciate the opportunity to accept your invitation and to focus chiefly on the budget and on the filing season. We've got, Madam Chair, a longer statement that hopefully goes into a little more detail on some of the subjects that you asked about.

Chairman JOHNSON. Certainly. That will be included in the record, Mr. Dolan.

Mr. DOLAN. I'd like to do an opening statement, and to the extent I don't meet your standard of what you'd like me to comment on, I'm certainly prepared to answer any questions.

I was going to start off by saying that it might be an understatement on my part to say that these are challenging days to be in tax administration. But I think that between Chairman Archer and the balance of the panel you sort of made that case.

I think that you, Madam Chair, and Chairman Archer pointed out some things that we confront every day, and not only with respect to the complexity of the Code. First, there is an expectation among our customers that they are entitled to and do receive first-class treatment.

Second, we are part of a mosaic that finds a total shrinking budget available to do what are "discretionary" things within the current budget structure. And finally, you, Madam Chair, talked about the structure.

We are in the midst of taking an organizational structure born when geographical segmentation and functional segmentation made more sense than it does today: When the underlying taxpayer population is more mobile; when what is going on in the economy has evolved much, as Chairman Archer said, from the days of sort of stand-alone financial life and big corporations to today where financial life is a lot different.

It's a lot more dynamic. It is a lot more interdependent, and it is not subject to neat little functional or geographical boxes. And that underlies some of the changes that we have set out to make in the last couple of years.

And last, one of the realities with which we operate today is that our technology infrastructure strains under the business problems that we try to solve day in and day out.

Some of those business problems are a function of the Tax Code. Some are a function of the size of our customer base. Some are a function of the expectations of our customers.

Some of them are functions of laws that require us—in the CFO Act or other places—to make our systems comply with standards that are enacted after the systems were in place.

So without question our technology systems today are strained, not only under the business problems they solve, but also under the century date problem, such that like any other major enterprise in America, we have a major, major challenge in making our systems compliant with the century date problem.

Significant work lies ahead of us on all those subjects, and I think the seriousness of that couldn't be any more amply documented than the work that the Restructuring Commission has done, or the work represented in yesterday's announcement by Deputy Secretary Summers. Both of those I think adequately and vigorously put a spotlight on the work that remains.

One of the things I'd like to not have lost in that process, though, is the fact that a fair amount of progress has been made, and I respect, Madam Chair, the comments you made at the outset about the Commissioner's devotion of her energies; it's not all about future victories.

A lot of points have been put on the board in recent years that don't represent the whole solution, but represent the kind of progress that I think all of us are committed to to make the system work as effectively as possible.

Some of those really back up against a basic vision that we've had for some time, and the vision has two or three pieces to it that aren't rocket science. The first piece of the vision is that we think it's now fundamentally easier for people to receive information from us, to file, to make payments to us, and to get payments back from us.

I mean, those are the kinds of key front-end transactions that the vast majority of Americans have with us, and thankfully they don't need to have another transaction after that. But that whole

process of focusing on how you make that easier in large part means how you can support it with more electronic commerce.

But that whole function of the interface with the customer is a key part of our vision. The next one would be our customer service capacity. We have got to have a capacity to perform the way people have come to understand and expect from the best of the retail industry.

And to do that means a couple of things. One thing it means is that we have to allow folks broad access to us, so that if they have a question, or they're trying to meet an obligation, they have an opportunity to get to us.

The other thing that we have to do, and I think we have made some progress in doing it, is when somebody has a problem, we've got to be able to resolve it—resolve it quickly and resolve it finally.

Another part of our vision anticipates change in the compliance arena. And you quite accurately refer to one aspect of our compliance program that will look different in 1998 than it has in the past. Overall, Madam Chair, we've got a vision of compliance that says yes, many of the tried and true elements of audits and accounts receivable have got to be a component of any compliance strategy.

But there's no way that you solve this compliance issue, or resolve this compliance gap, in only retail, after-the-fact transactions. We've got to find more and more effective up front ways of segmenting noncompliance, and dealing with the segments as more preventative as opposed to strictly the after-the-fact, retail kinds of things.

And I think we've done a number of things that have started us on that path.

And last, the key piece of the vision that we seek to deliver to the American public does indeed require us to modernize and modernize effectively our information technology. I think it is clear that we have to have a new corporate data capacity. We don't have to have one that's mandated and splintered and changed at the margin. But we have to have a capacity to collect what is probably the most important asset the current tax system has—which is the data that underlies our individual compliance patterns and our individual compliance needs.

And we've then got to have a way—within that corporate structure—to manage that data much more dynamically and robustly than we do today. And last, the data has to find its way easily into the hands of the customer service person, or the compliance person who is trying to do their job.

Those are the components, the vision. I think if we can create that kind of a technology infrastructure, it will, indeed, allow us to leverage the first three or four pieces of that system.

I think the filing season this year is evidence that some of this is already taking hold, as you pointed out in your opening remarks. And I think the GAO will come in behind us and say that by most conventional standards, this filing season is going well.

One thing that helps us, and always helps us, is if there is no major tax law change. And none of us counted what went on in the last Congress as major tax law change, although I know you know, Madam Chair, that there were still several hundred changes that

we ended up trying to embrace this year, either as a part of the immediate filing season, or the ones to follow.

But it helps us to be able to enter the filing season without a major set of tax changes.

In the notion of trying to improve that access, that front-end access, one thing that we're very proud of this year is that we have made some strides in the telephone access. We've made some tradeoffs, and I'd like to come back to maybe respond to both questions and more directly to your concern about whether they are the right tradeoffs, and whether they are robbing Peter to pay Paul.

But we've made some choices that basically said to us, based on our experience over the last 2 or 3 years, when we were answering the questions—and answering them well—about half of our customers were unable to get to us.

None of us are satisfied with operating in that environment. You can answer every question right, but if half of your customers can't get to you, it's a loser. And so that's a large part of what we have tried to do. We tried to gut our way through this year by taking that level of access to a point that we still haven't achieved, but we're answering in excess of 70 percent of the people who are trying to get to us now.

Our notion also is that we're going to learn some things this year. Some part of the volume that's been out there in the past years is going to be moderated if we can indeed answer people when they want to get to us in the first instance, and that doesn't create a repeat customer call.

The other thing we have done fairly effectively this year is to do more than just throw resources at telephone calls. Not for a moment have we wanted to play a pat hand or just meet the demand that's out there. We know we've got to try to affect the demand.

And one of the things that we've been very successful at this year has been going through our whole notice family and looking at our notices. Last year we sent about 100 million notices out. Many of those notices prompt people to ask us, "What is it you're really trying to say to me? What should I do as a result of this transaction?"

Some of the notices are written in governmentese rather than in English. So, we have been about a very deliberate process that at this point in time has let us take out of the system 12 notices and something in the neighborhood of 18 million actual mailouts to customers.

We've got a second wave that we talk about in more detail in my statement that will eliminate the next series of notices and maybe another 3 million issuances.

In addition to making a variety of access points available to taxpayers, we've done some significant work, as you know, Madam Chair, in terms of creating the flexibility for people to come in and talk to a live assister or to use a voice response unit, or to use our TeleTax system, which covers 148 questions.

And last year our telephone traffic was evenly split with 45 million calls to the nondirectly assisted system, and about 45 million to the directly assisted system. This year we hope to answer another 15 million of the directly assisted and to get another 2 to 3 million calls into the automated systems.

Additionally, this year, we've segmented out two other kinds of calls. We've segmented out the person who comes to us with a notice. Somebody who has a notice from us is trying to pay, trying to figure out what they have to do to satisfy their obligation. We've created an access point for that person that hopefully guarantees a much higher probability that that person is able to get through.

And the second type of call segmented was selected to take what is a pretty significant inventory of people who only want to know about their refund and segment those calls so that we aren't consuming the energy of an IRS employee who might be able to answer a more complex call with the kind of question that could be more easily and more quickly answered on just the status of a refund.

We've done something else that signals where we are trying to go. In the old days if you wanted a tax return, whether you wanted to file your tax return or you asked your accountant to do it, you typically either got the package from us in the mail, or you went to the bank, the post office, or the library.

Increasingly we've tried to create other ways for people to do that. Now, we give the practitioners—and we make widely available—a CD–ROM capability so that they don't have to have a storeroom full of forms, but can take the CD–ROM and have available to them the forms and schedules that they can print as needed.

We've had a very good experience in the fax forms arena. A taxpayer who has access to a fax and finds himself on April 14, or Sunday on the kitchen table, can dial through, 24 hours a day, identify from a menu the form or the schedule they need, and have us fax it to them.

And then last, I know we've bragged a lot about our Web site. And that has been a terrific success by most standards, private or public. Last year at this point we had 29 million hits. This year, so far, there are 82.9 million hits, and we know some of the hits are people downloading forms and publications. Over 1 million have been people who have got their forms or publications that way. A bunch of the rest of it is coming into our 148 most asked questions, and, again, hopefully bringing the demand down for the telephones.

As for easier filing methods, one of the things that we have said is we'd like to have electronic commerce or an electronic filing strategy that takes everybody's returns in electronically. We'd love to have that.

We know in some part the way to get there has to do with the way we effectively design and market electronic filing. And in part it has to do with what taxpayers or customers really want to do with their tax returns or their data.

But one of the things we've tried to do each year is make incremental progress with electronic filing. And the product that we first introduced nationwide last year, the TeleFile product, once again looks like it's going to meet with even better success.

At this point this year we've got 3.6 million TeleFile returns as contrasted with only 2.3 million last year, which is a 54-percent increase at this point in the year. We expect that product again to

find its way into the marketplace of 26 million people who are eligible for it.

Regular electronic filing is also up by 18 percent this year. Fed/State, which allows a person to have one transaction and to feed both the Federal and the State interest, is up by 34 percent this year.

And we're about to do something new, which I think is kind of a neat way to take the TeleFile product, which has worked well in the individual market, to the business market. With the quarter that will end in March, we will invite nearly 1 million taxpayers in the 14 Southeastern States to do their 941, their quarterly tax deposit, with a touch tone telephone, and make that transaction a TeleFile type transaction.

So, again, we are not where we would love to be overall in the final state, but these are steps toward the final vision that says it's got to be made easier for people to get in touch with us and to have a transaction with us.

We are due to go back to the management, the Treasury Modernization Board in May to talk about how to take the electronic tax administration strategy to the next level. We think that answer can only involve a very healthy partnership with the private sector.

We clearly know that there are issues in the commercial sector—whether it's the tax preparation, the financial services, the banks—the entire suite of folks involved in that sector are going to propose answers as to how they can assist the development of an electronic tax administration strategy. We very much look forward to that.

I am going to very quickly talk about the budget. I know you have—perhaps—some of your most significant questions there, and so I will try to anticipate a couple, but then be ready for others.

Last year, as I think you know, Madam Chair, we went through a pretty difficult transition from fiscal year 1995 to 1996. We found ourselves with the tick of the fiscal year clock having about 6,200 more people on the payroll than we had money to pay.

So we essentially spent all of 1996 wrestling with that problem. And it wasn't as if we had unlimited options, because there were some givens. You've got to run a filing season. You've got to anticipate the telephone demand. You've got to get refunds out on time.

So when you take those givens, that there are 6,300 people more or less that you can't pay for, but you know you've got some givens that must be paid for, we did about the only thing that was available to us: We took the dollars that weren't associated with permanent salaries, the dollars that are in our seasonal and WAE's and tried to line them up first to ensure that the returns got processed timely, then that the refunds were made timely, and then that we were able to answer as many calls as we possibly could.

That was not a pretty process. That was a process that had us taking staff years based more on the nature of the staff year, the fact that it was a temporary dollar that didn't have a body onboard, and using the available resource to plug what we thought were the most critical parts of our mission delivery.

Beyond that, we did some other things that didn't make a lot of sense. We cut training to an alltime low. We cut travel in a way that was not optimum. We made some choices about enforcement expenses: When we would file liens and when we'd bring expert

witnesses in on some transactions, as a result, not necessarily of any grand, strategic plan, but as a result of trying to use 1996 to transition from an environment that we thought was going to be a 5-year revenue initiative to one that turned out to be only a 1-year revenue initiative.

We hired, ramped up and were prepared for 5 years, and had to end after the first year.

The present year, 1997, will have us doing more of that transition. But we were able in 1996 to do a fair amount of transitioning, such that the 1997 problem isn't of the same dimension. The year 1997, as you well know, was a step down still further from 1996, so in absolute terms, we have fewer dollars in 1997 than in 1996.

But what I think you will want to talk about, perhaps, Madam Chair, is some of the choices we have made in 1997, and envision in 1998. In our 1998 budget, the administration has proposed essentially to fund us at the current level. And what that will allow us to do is take the human assets and compliance and customer service and essentially roll them over into the next year.

Our challenge is obviously to leverage them more highly so that the rollover doesn't get us only what last year's numbers do, but gets us a different, a more impactful involvement in both compliance and customer service.

I look forward to maybe going into more detail on that. I know I've gone through this reasonably quickly. But we have made a series of choices that we feel we can stand behind, and we would clearly like the input and the influence of this Subcommittee on whether or not those are choices that you think meet the expectations the Subcommittee has.

The other thing that I would comment on before asking Art to spend 1 minute on what he envisions for our 1998 information technology is the couple of things in compliance we really hope will continue to bear fruit.

You know, I think, that this year we have been able to install in nine districts, as of the end of February, a system called the Integrated Collection System. That system makes our revenue officers on average at least 30 percent more effective, because of the kind of information it puts in their hands and the ability to manage their inventories. They are not paperbound, deskbound, or officebound any more.

That's a system that will be a key information rollout for us in 1998. We are very much interested in having that get as wide a penetration as possible. That allows us to compensate for what has been the erosion in the actual revenue officer base.

In the revenue agent or examination side, we continue to look at strategies like our market segment strategy, where we hope through the publication of some 31 audit guides, and market guides, that we can shape an industrywide reaction to something and depend less on an audit-by-audit transaction.

We're going to continue our tip agreements, which, again, allow us to take a whole segment of taxpayers rather than spend time auditing onesies and twosies. Instead, we move an entire set of entities into a compliance mode.

You, I know, Madam Chair, were very involved last year in our classification settlement program, where we took the nettlesome

issue of the employee/independent contractor status that has been sort of a bugaboo for all of us for a long time. We took and put that concept into what maybe is not the perfect solution, but it's a solution that allows people to come in and get themselves set up prospectively. And it takes us out of the onesies and twosies audit process.

So that has helped as has the reliance on a concept that we have built in each of our district offices. We now have a district office research capacity, which we never had in the past. It was always a capacity that was funded centrally and managed centrally.

Now each of our 33 districts have the capacity to know more about the unique features of their taxpayer base. The southern California taxpayer is not like the Connecticut taxpayer. The Illinois taxpayer is not like the Mississippi taxpayer, and it doesn't make sense for us to devote resources or employ strategies as if all taxpayers are the same.

And that's another of the aspects that we hope will help us get more leverage out of that compliance resource.

Maybe what I ought to do is, since I've probably used enough of your time, let me ask Arthur to spend, with your indulgence, just a couple of minutes highlighting the things that we think will be key aspects on the technology side of our 1998 budget.

Chairman JOHNSON. We'd be happy to hear from Mr. Gross. We're pleased to have him at the table.

Mr. GROSS. Thank you, Madam Chair, and distinguished Members.

My tenure began on April 15, 1996. And in the 11 months since that time in which I inherited an organization that had lost 20 percent of its staffing over the previous 3 years, had a quality assurance function that had sunk to 30 percent of the minimum national standards for those kinds of functions, had a year 2000 project office that had three staff members and a $20 million total project budget, a demoralized work force, but nevertheless delivered a filing season this year.

From that base, over the last 11 months, we have focused on the following priorities, on a previous and go forward basis. Year 2000 is our single greatest priority. We have established a massive project office. We pulled together the best and the brightest of IRS to manage the program. We've partnered with contractors.

We've acquired resources from Congress in both 1997, and, plan to in 1998. I would say that we have command and control, reasonable command and control, over the core business systems with respect to century date conversion.

And what I mean by that is the systems that year in and year out process more than 200 million tax returns, issue more than 80 million refunds, process more than $1.4 trillion in tax payments; I would say we have reasonable command and control over that aspect of the century date conversion problem.

Nevertheless there are still many problems with the balance of our infrastructure. We have perhaps as many as 3,000 applications in the field for which we have not even identified a complete inventory. And I would say that our single greatest priority on a go forward basis in 1998 must be the century date conversion.

Along with that we are rebuilding our quality assurance function. And with respect to modernization, we are completing preparedness, and preparedness is some ways off.

Our commitment in the future is that we will not begin modernization until we are ready, and that readiness involves three critical elements: We need a significant partnership, and a unique partnership, a strategic partnership with the private sector; we need a disciplined set of processes and practices which we do not yet have in place; most importantly, we need a practical, disciplined and focused plan. And that plan would be built around creating corporate data bases, storing corporate data, and accessing corporate data efficiently for customer service and compliance.

Mr. DOLAN. Madam Chair, we'd be happy to take your questions. I guess as we do that, I would also like to make the observation that we very much appreciate the quality of the interaction that we have with the Subcommittee staff.

We frequently are working with tough issues, but we almost always find an ear and a receptivity that I think makes our mutual interests and our joint jobs more constructive. And we appreciate that.

[The prepared statement and attachment follow:]

Statement of Hon. Michael P. Dolan, Deputy Commissioner, Internal Revenue Service

Madame Chairman and Distinguished Members of the Subcommittee:

With me this morning are Arthur Gross, Associate Commissioner and Chief Information Officer; Jim Donelson, Chief Taxpayer Service and Acting Chief Compliance Officer; Tony Musick, Chief Financial Officer; and Dave Mader, Chief Management and Administration. We are pleased to be here this morning to discuss the IRS' 1997 filing season as well as the Service's FY 1998 budget request and its effect on taxpayer services, the Internal Revenue Service (IRS) compliance efforts, the IRS reorganization, and our continuing efforts to modernize.

I. INTRODUCTION

In today's testimony, I would like to highlight what the IRS has accomplished over the past several years with its appropriations and what we expect to accomplish with our FY 1998 appropriation. Many of the programs that IRS has initiated or improved take time before their results are fully reflected in performance indicators. However, the evidence is already clear that the IRS has made progress in making it easier for taxpayers to get information about their tax obligations, pay their taxes, file their returns, and obtain their refunds where appropriate.

An important responsibility for the IRS is to manage a successful filing season. We collect more than one trillion dollars annually (see Chart 1), process more than 200 million returns and 85 million refunds, and assist millions of taxpayers to comply with their obligations. Over the past few years, we have been trying to shift taxpayers, and the IRS, from some paper transactions. We have made more and more information available via the telephone, computer, fax services, and CD–ROM. We have published telephone numbers which are dedicated to refund information and we have established what amounts to an IRS answering machine so that taxpayers can call in and leave a brief description of their issue. We also have encouraged taxpayers to use alternatives to filing by paper.

The Service recognizes that it must continue to improve services, reduce costs, and provide an effective balance between assisting taxpayers, processing returns, issuing refunds and ensuring that all segments of the taxpaying public—wage earners, self-employed, and businesses—pay their proper amount of tax, at the least cost to the government and to them. Balancing these seemingly competing interests so that the IRS can continue to be the world leader in tax administration is not a simple task.

The FY 1998 budget is about making informed choices based upon the best information available to strike a balance and recognizing when those choices are made what the consequences are to customer service, taxpayer burden, fairness and effi-

ciency. The IRS and the Congress both share a common interest: to provide this country with a fair and effective tax administration system.

II. OPERATIONS

Background. The IRS, like many large businesses, has many functions—all dedicated to accomplishing its mission. The Service collects money, processes data, maintains customer accounts, and responds to taxpayers' questions. Customers expect the Service to do this accurately and efficiently while maintaining a high level of integrity and safeguarding their privacy.

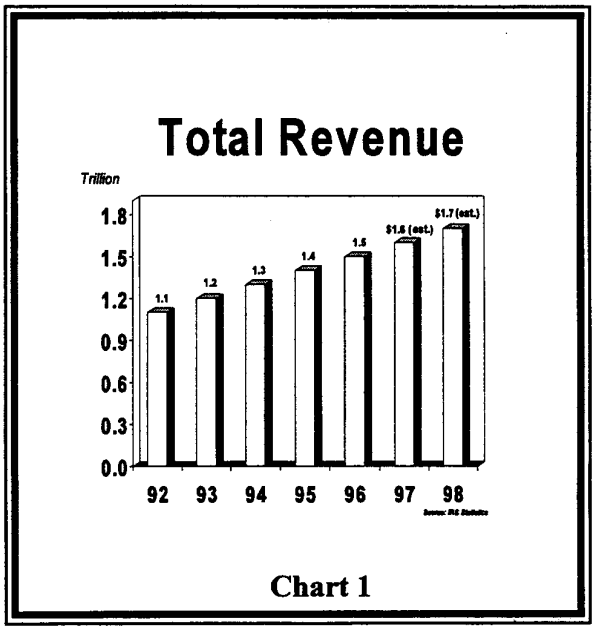

Chart 1

The Service is in the midst of a major transition that began several years ago and that will continue for many more years. As I discuss current operations and the FY 1998 budget request, I would like to focus on what the Service is doing to make it easier for taxpayers and how the IRS is doing its job more efficiently and effectively.

Serving Taxpayers Better

Making It Easier For Taxpayers. We understand that taxpayers get frustrated when they call the IRS and repeatedly get a busy signal. In the past four years, the IRS has answered more calls than ever before, but there are still taxpayers whose calls are not answered. There are also a growing number of taxpayers who visit or write. In 1993, the IRS heard from taxpayers by phone, visit, or letter 73 million times; last year, that number had increased to nearly 106 million taxpayers (see Chart 2). Access to the TeleTax recorded information line, which offers taped information on 148 topics all day, every day, and refund information 16 hours a day, Monday through Friday, has been expanded. Last year over 45 million TeleTax calls were answered and assistors answered another 45 million toll-free calls. The overall level of taxpayer access to telephone assistance increased from 39 percent to 46 percent. Our FY 1998 target for taxpayer level of access is approximately 60 percent. More taxpayers were served by increasing productivity, expanding hours of service, and installing call routing equipment that allows the ever growing telephone workload to be better managed. This technology allows the Service, among other things, to route calls to available assistors, who may be in the next county, next state, or across the country. As a result, account issues could be resolved with a single call over 80 percent of the time.

In FY 1997, assistors expect to answer 60 million toll-free calls. This represents an increase of 15 million over the 45 million answered last year. In addition, the TeleTax system should provide service to over 47 million taxpayers. During the 1997

filing season, the Service is using its resources differently to ensure more taxpayers are served. So that assistors can answer more tax law and account questions, the IRS added a new, toll-free number that will enable taxpayers to quickly determine the status of their refunds without having to speak to an assistor. Taxpayers who wish to call after hours or who do not want to be put on hold may leave their questions on recorded messages, and they will be contacted within two business days with an answer. In an effort to improve telephone service this year, the IRS is temporarily using some of its examination personnel to answer the telephones. In other words, compliance personnel are being used to perform traditional taxpayer service functions. Because of these efforts, we have significantly improved our toll-free telephone system, answering over 70 percent of callers. This is a 20 percentage point increase over last year.

Despite these improvements, not every taxpayer call is being answered and not all taxpayers who want to be served are being served. Resource constraints ultimately limit the number of calls that can be answered so the Service is looking for other ways to meet taxpayers' information needs. At the outset, that means making the information provided clear enough that taxpayers will not need to contact the Service.

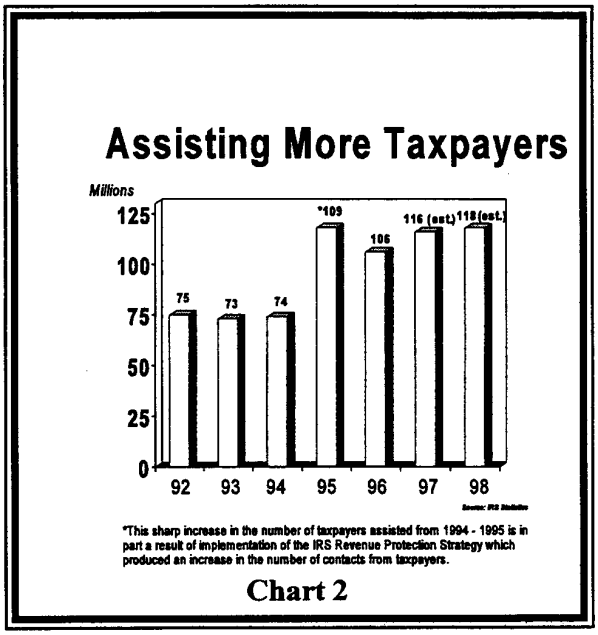

Chart 2

The notice reengineering efforts eliminated 12 different notices in FY 1996; this resulted in 18 million fewer notices being issued and mailed to taxpayers—potentially avoiding 18 million telephone calls or letters from taxpayers. We plan to eliminate another 20 notices and letters for FY 1997. This is good for taxpayers, who not only are relieved of the stress when an official looking letter from the IRS arrives in the mail, but who may not need to follow up with the Service. It also is good for the IRS; money is saved on printing and postage and subsequent questions are eliminated. The notices that will continue are being rewritten in clearer language so that fewer recipients will need to have any additional explanation.

The IRS also is conducting a test during this filing season to determine the optimal level of access, how the level of access affects repeat callers and the number of taxpayers who walk into IRS offices, and how it impacts the amount of correspondence received. With this information, the Service can better tailor its communications with taxpayers and make better decisions about the application of resources (the use of current technology) and the need for additional systemic support.

Technology has enabled entirely new ways for taxpayers to get forms and information from the Service while reducing IRS' postage and printing costs. Three years ago, taxpayers requesting a publication or form either had to call to have the material mailed or they had to drop by an IRS office, their local post office, or library.

Not today—at least for many taxpayers. Tax forms and publications now are available on CD–ROM, and, last year, the IRS instituted an innovative FAX-Forms service that processed over 79,000 requests for tax forms and instructions by fax during the filing season; so far this filing season, over 240,000 requests have been processed. This service has been expanded this year by doubling the number of forms and instructions available and advertising the FAX phone number in all 1040 series tax packages.

For the 1996 filing season, the Service also developed a world-class Web site that provides access to over 700 current and prior year tax forms and instructions, tax publications, regulations with plain English summaries, frequently asked questions, disaster relief assistance, newsletters, press releases, information on 148 tax topics, interactive applications that answer tax questions, and other information. This service is available world-wide, 24 hours a day, to anyone with access to a personal computer and the Internet. During 1996, over 100 million "hits" were logged and over three million files were downloaded. This year, the site is already averaging over one million "hits" a day and over 2.4 million files have been downloaded. This Web Site has received outstanding customer, media, and industry feedback and has been honored with over 40 awards for its design and ease of use from such sources as Netscape, PBS, *Wired* magazine, *USA Today*, *Tax World*, *Money* magazine, Microsoft, Harcourt Brace, *PC Computing Magazine*, and *Government Executive* magazine.

As a way of expanding the help available to taxpayers, the IRS also sponsors VITA, the Volunteer Income Tax Assistance program, and TCE, Tax Counseling for the Elderly. With these two programs, the IRS increased taxpayer assistance by giving taxpayers the opportunity to have direct contact at almost 20,000 sites with volunteers trained by IRS personnel. Last year, over 80,000 volunteers served almost 3.5 million taxpayers through both of these programs.

Easier Filing Methods. One of the Service's goals has been to make it easier for taxpayers to file their tax returns. Current data suggests progress is being made on this front. Almost 50 percent of individual filers now use the easiest tax forms and almost 75 percent take the standard deduction.

What could be easier than filing by telephone? This filing season, almost 26 million taxpayers are eligible to file their tax returns with a phone call that takes less than ten minutes. By making TeleFile available to married taxpayers and taxpayers wanting direct deposit of their refunds, three million more taxpayers can use TeleFile this year. Last year, the Service received 2.8 million TeleFile returns; as of March 14, 1997, over 3.6 million have been received for this year. Starting in FY 1994, taxpayers could file from their home computer through a third-party transmitter. In 1996, the IRS received over 158,000 returns that way, and as of March 14, 1997, 233,000 returns have been received. Also, last year, the IRS forwarded to 31 states 3.2 million returns filed through its joint Fed/State electronic filing program; this year the District of Columbia has been added. This represents a significant savings to taxpayers and to the states in this program.

Electronic filing is not just limited to individuals. It is also available to businesses. Employers nationwide can now file their "Employer's Quarterly Tax Return" (Form 941) electronically. Almost 363,000 of these returns were filed in this manner for 1996. A TeleFile option for the simpler Form 941 returns will be tested later this spring with nearly one million businesses in 14 states.

Electronic filing offers advantages for taxpayers and for the IRS. One advantage is that taxpayer refunds are received sooner—an average of 21 days as opposed to 40 days for paper returns. The advantage for the IRS is the receipt of more accurate information more quickly.

Electronic tax administration means more than just receiving returns electronically; it includes electronic payments as well. Most of the over 88 million taxpayers who will be entitled to refunds this year can have them directly deposited into their bank accounts. Taxpayers enjoy the safety and ease of direct deposit and the government saves the expense of printing and mailing checks. A change to the Form 1040 has made it even easier for taxpayers to request direct deposit this year. Last year, if a taxpayer wanted a refund deposited directly into a bank account, he or she had to submit a separate schedule. This year, a few extra lines on the Form 1040 will do it. As of March 14 in this filing season, we have had an increase of approximately 42 percent in the number of filers requesting direct deposit of their refunds.

The TaxLink/Electronic Funds Transfer Payment System (EFTPS), used by employers to pay employment and other depository taxes electronically, is faster, easier, and more accurate for tax collectors and taxpayers alike. In FY 1996, more than $380 billion were deposited electronically, an increase over the $232 billion deposited in FY 1995. As of March 15, 1997, over 928,000 enrollment forms had been received and approximately $42.6 billion had been collected through the new EFTPS.

The IRS has communicated extensively with banks, payroll companies, and practitioner groups—as well as with the taxpayers themselves—to enable a smooth July 1 implementation.

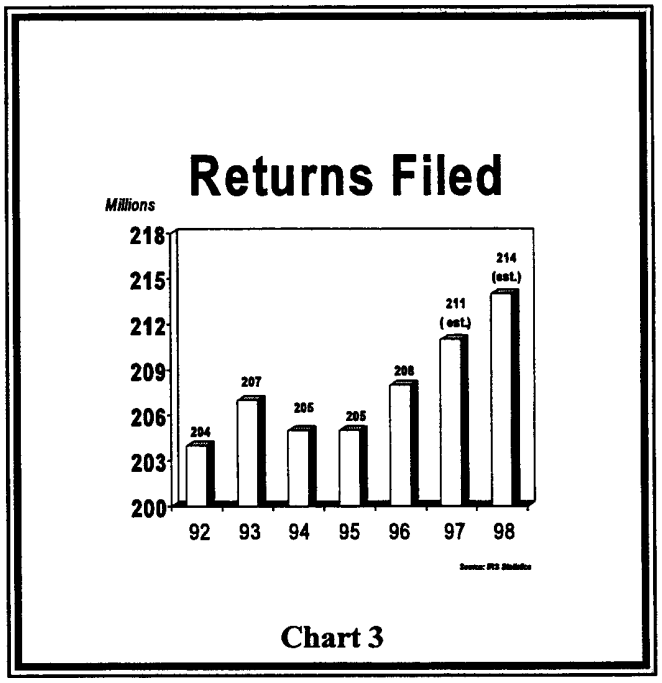

Chart 3

The IRS currently is working on ways to further expand electronic tax administration. The Service will soon present additional ideas for expanding electronic tax administration to the Treasury Modernization Management Board. At a minimum, it will include the following:

- full exploration of ways to make electronic filing more attractive to taxpayers;
- leveraging existing private and public sector infrastructure; and
- aggressively partnering with the private sector.

Despite new electronic options, the number of paper tax returns remains large: the IRS processes over 190 million paper returns and documents each year. To address the continuing volume of paper returns, the IRS is pursuing the potential for outsourcing the processing of paper returns as was outlined in our January report. Based upon this input, and assuming that there is commercial interest, a Request for Proposal would be issued to obtain contractor bids. Risks are inherent in turning such a critical system over to an outside processor. Thus, the IRS has already begun the ongoing process of identifying specific risks and potential mitigation strategies as well as identifying "inherently governmental" functions in that process. Based upon the experience of other agencies in large scale outsourcing initiatives, the IRS estimates that it could be as many as four years before it could be ready for a pilot project on outsourcing paper returns processing.

Fairness: Ensuring All Taxpayers Pay the Proper Amount

Along with responsibility for serving taxpayers and providing easier filing methods, the IRS is charged with enforcing the tax laws—both civil and criminal. In furtherance of its responsibility to enhance compliance, the Service has continued to improve its compliance operations.

The FY 1998 budget requests approximately the same number of employees in compliance as in the FY 1997 budget. Even so, the Service is committed to continuing to help taxpayers file and pay timely. For the past four years, the IRS has improved the compliance program through earlier identification of noncompliance patterns, innovative uses of compliance tools, and improved procedures—such as the

Market Segment Specialization Program, offers in compromise, and installment agreements.

Collection. For the past three years, the collection yield has steadily increased. In FY 1994, collection yield increased three percent; in FY 1995, it increased more than seven percent; and in FY 1996, it increased 19 percent. The 1995 and 1996 increases reflect in part the additional collection personnel hired as part of the 1995 Compliance Initiative. Beyond that the results reflect the continued emphasis on early involvement with delinquent taxpayers. As a result of improvements in the Compliance Program and the Compliance Initiative, the revenue collected from compliance increased from $31.4 billion in 1995 to $38 billion in 1996 (see Chart 4). We have consciously prioritized "front" collection operations—notice and telephone calls—to deal more quickly with the tax debt. We also have made significant improvements in the rate at which examination personnel secure collection of agreed tax assessments. In 1996, 70 percent of agreed tax assessments were collected at the earliest possible time—the close of the examination.

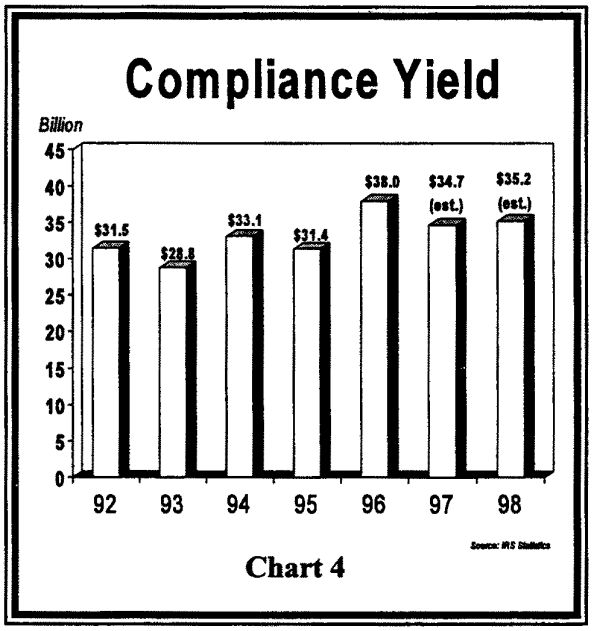

Chart 4

The Service has also expanded the use of an important tool—the installment agreement—to keep taxpayers in the system who cannot immediately pay all they owe. By increasing installment agreement authority, installment collections have increased from $2.28 billion in FY 1992 to $6 billion in FY 1996.

The improvements made in the collection process, which I described earlier, not only helped increase the collection yield over the last several years, but they are also helping the IRS manage the accounts receivable inventory. The IRS plans to continue increasing the collection yield through the use of technology in field collection operations. In FY 1995, the Integrated Collection System (ICS), which provides on-line access to current account information to revenue officers, was used in two districts. In these two districts, productivity increased more than 30 percent, translating directly to additional tax collections "in the bank." By February 18, 1997, ICS was operational in nine districts.

Examination. In 1996, the Service closed over 2.1 million examinations and audit coverage was 1.63 percent—maintaining the accomplishments achieved in FY 1995. Over 184,000 determination letters were issued for exempt organizations and employee plans.

The compliance program, however, is more than just delinquent accounts and traditional audits. The Service has continued to develop new compliance approaches. Through programs like Accelerated Issue Resolution and Advance Pricing Agreements, the IRS is stressing early resolution of issues—a practice that can save all of the parties time and money. With Accelerated Issue Resolution, the IRS can ac-

celerate the collection of the largest corporate assessments by resolving recurring issues and simply carrying the resolution forward to future years. Reducing the number of issues under examination can save costs both for taxpayers and the Service. Under this procedure, taxpayers have agreed to pay about $1.1 billion between FY 1993 and FY 1996.

The Advance Pricing Agreement program was developed as a new way to resolve intercompany pricing issues. As a cooperative process, both taxpayers and the government derive significant benefits. Taxpayers welcome certainty in a complex area and avoid a lengthy debate with the IRS. By the end of FY 1996, the Service had entered into 79 Advance Pricing Agreements. Currently, 146 Advance Pricing Agreements are in process.

To address the noncompliance with underreporting of tip income, the IRS, working with industry representatives, developed the Tip Rate Determination Agreement (TRDA) and the Tip Reporting Alternative Commitment (TRAC). These two initiatives benefit both employers and employees. Employers benefit from not having significant unplanned tax liabilities assessed against them. Employees benefit from increased social security benefits, unemployment benefits, retirement plan contributions, and worker's compensation benefits. As of December 31, 1996, the IRS had received over 3,100 TRAC agreements representing more than 21,000 establishments and more than 800 TRDA agreements with nearly 1,200 establishments. From tax year 1994 to 1995, tips reported have increased over $2 billion.

Working with private industry, the Service is responding to the increased sophistication of transactions in the financial world and specialization in the business community. The IRS has cooperatively developed Market Segment Specialization Program guidelines, focusing on the practical problems of examining a market segment and identifying particular issues of interest to the IRS. In turn, taxpayers are better informed about the noncompliance in that market and about the IRS' position. Through January 1997, the Service issued 31 Market Segment guidelines. These guides are available to the public through the Government Printing Office and also on the IRS Home Page on the Internet.

Last year, the IRS continued its efforts to address the problem of erroneous refund claims, one element of the filing fraud issue identified by GAO as an area of high risk for the IRS. The Service has contracted with the Los Alamos Labs for an anomaly detection program to help spot erroneous refund claims. The IRS also has continued and increased verifications, including increased checks of social security numbers. On the Electronic Return Filing System, there was a 25 percent reduction from FY 1995 to FY 1996 in the number of returns rejected because of missing, invalid, or duplicate uses of social security numbers. Similar validations were conducted on paper returns. In FY 1996, these efforts prevented over $900 million in erroneous or fraudulent refunds from being issued.

This filing season, the IRS has continued to refine the efforts to address refund fraud based on what was done last year. The Service is continuing to look carefully for suspicious returns and, under legislation enacted last year, a quicker, more efficient method to verify social security numbers can be used as returns are processed.

In addition to compliance activities in examination and collection, the IRS' Criminal Investigation (CI) Division investigates complex financial transactions of taxpayers, looking for criminal tax violations and money laundering. CI is also actively identifying and investigating new and emerging areas of tax fraud that affect the economy and prey on honest citizens. These areas include bankruptcy, health care, insurance, motor fuels excise taxes, non-traditional organized crime, and telemarketing. Last year, CI increased the number of investigations started in traditional criminal tax violations by 14 percent; money laundering investigations increased by eight percent; and bankruptcy investigations increased 58 percent.

The 1995 Compliance Initiative. In FY 1995, the Service received the first year of funding for a five-year plan to improve compliance with the dollars raised going directly to deficit reduction. The compliance accomplishments attributable to that initiative were impressive. An additional 676,000 examinations were closed and audit coverage increased from 1.08 percent to 1.63 percent in FY 1995. Furthermore, an additional $803 million directly attributed to the first year of the Compliance Initiative was collected, far exceeding the $331 million projected. Overall, with a five-year investment of $2 billion, the IRS had conservatively committed to raise $9.2 billion in additional revenue. As the Subcommittee is aware, the initiative was not funded beyond the first year.

Although the loss of the Compliance Initiative impacts federal revenues, an important point that may be overlooked is the corresponding loss in state revenues, because adjustments made during federal compliance efforts are used by the states to make corresponding adjustments without the need for a state audit.

III. Using the FY 1998 Budget to Achieve IRS' Strategic Goals

FY 1998 Increases. The FY 1998 IRS budget totals $7.369 billion and 102,385 FTE. It includes gross increases of $308 million and 195 FTE, amounts which are reduced by $143 million and 736 FTE. This produces a net increase of $165 million and a net reduction of 541 FTE from the FY 1997 operating level (See Charts 5 and 6). Also, an Information Technology Investment Account has been proposed to respond to the requirements of the Federal Acquisition Streamlining Act of 1994 and the Information Technology Management Reform Act of 1996.

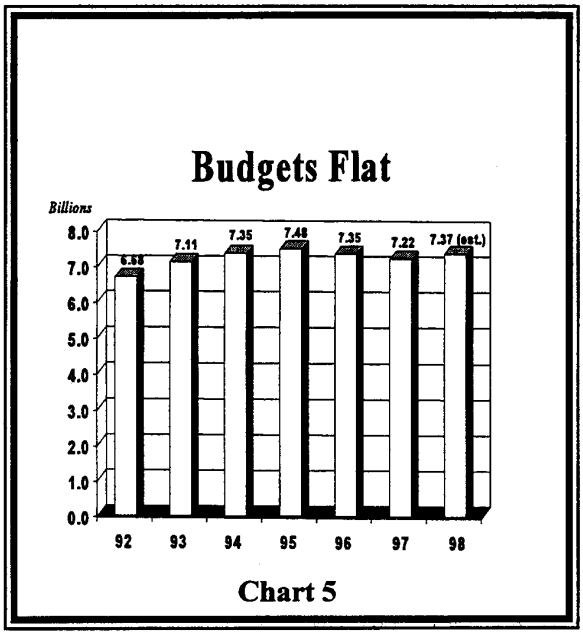

Chart 5

The $308 million increase has been requested to permit the Service to do the following: (1) maintain current service levels; (2) fund critical operational information systems needs; and (3) fund a very modest increase for Criminal Investigation to detect overseas money laundering. The $143 million in program reductions includes $113 million from Information Systems and $30 million from rent.

- Maintaining Current Service Levels. The Service needs a $214 million increase to fund mandatory pay increases and to maintain FY 1997 program levels in FY 1998. Without this increase, the Service would have to reduce programs and short-change funds for essential training, travel, and enforcement expenses.
- Funding Critical Operational Information Systems Needs. The Service is requesting a $93 million increase for Information Systems investments to finance immediate improvements in taxpayer services. Much of this increase will be used for Year 2000 Conversion efforts. However, a portion will be used to test programming changes for major information systems; to replace vital Service Center computers used to process remittances and input data from tax returns; and to replace some of the laptop computers used to examine individual and business returns.
- Deterring Money Laundering. The Service is requesting a $1 million increase to combat overseas money laundering. Many governments are considering, or have adopted, laws to criminalize money laundering and other financial crimes. The globalization of financial markets and the U.S. economy, and criminal organizations' increased sophistication at concealing illicit gains, have created an environment that requires the expertise of IRS special agents.

IV. Information Systems

Over the past several years, this Subcommittee, as well as other Congressional committees, have focused on IRS' efforts to develop, implement, and manage its

technology modernization projects—collectively referred to as Tax Systems Modernization.

Because technology modernization is so important to the business of tax administration now and in the future, the Service has been working closely with Congress for the past year on this issue. The IRS has made progress in addressing the concerns and criticisms of the technology modernization efforts. However, the Service recognizes that there is more work to be done to meet the challenges of updating technology to better serve the American taxpayers.

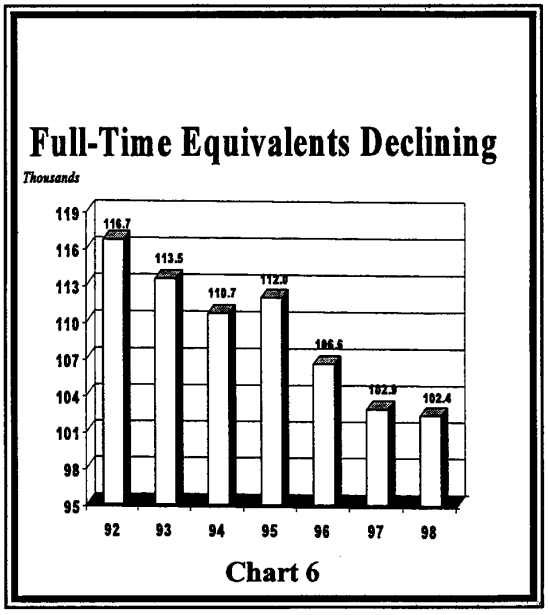

Chart 6

Efforts to improve the management of IRS' technology investments have benefitted from this oversight, and Tax Systems Modernization remains a high priority for the IRS. The Service has made progress in the past year within Information Systems on modernization efforts in developing an architecture for modernization and in establishing a process for making intelligent investment choices. The FY 1998 budget proposal is designed to let the IRS continue these efforts.

Maintaining the Legacy Systems. One accomplishment that often goes unheralded is the IRS' successful delivery of a tax filing season each year. A key factor in delivering a successful filing season is the group of conscientious employees in the Information Systems organization who continue to update the legacy systems, develop new computer programs to comply with legislative mandates, and manage a complex array of technologies. Early indicators are that the 1997 filing season will again be successful.

Year 2000 Conversion. The most immediate challenge is the massive century date conversion project—the Year 2000 conversion. This challenge is not unique to IRS and much has been recently reported in various media about the magnitude of this problem. Most legacy systems are programmed to display "00" in the year fields so that beginning on January 1, 2000, date-based calculations will be based unintentionally on an interpretation of the year field as 1900. Failure to identify, recode, and retest each of these date-based fields could result in the generation of erroneous tax notices, refunds, bills, interest calculations, taxpayer account adjustments, accounting transactions, and financial reporting errors. Put another way—such a failure could significantly burden the over 200 million taxpayers and IRS resources and jeopardize IRS' ability to carry out its mission. This conversion not only is vital to IRS but also to other organizations with which the IRS shares data, such as the Social Security Administration, Federal Reserve Banks, and most of the states.

To date, the Service has identified 62 million lines of computer code in the corporate systems which must be analyzed. The effort to make needed changes may exceed 2000 work years of effort on the part of both the IRS and its contractors to ensure these critical systems are century date compliant by January 1, 1999. The

IRS also is aggressively completing the inventory of field based applications, which may require the review of an additional 40 million lines of computer code. In addition, the IRS is actively reviewing all commercial off-the-shelf software and hardware to either replace or upgrade to ensure compliance.

With the support of Congress through a $45 million FY 1997 appropriation, the IRS has mounted a massive effort to ensure its systems become century date compliant. Given the broad scope of the Year 2000 Conversion, the Service also is diverting significant existing information systems resources to the project, deferring all but critical and legislatively mandated legacy systems changes during FY 1997.

In Fiscal Year 1998, the IRS is planning a further expansion of the project and, therefore, has requested a total of $84 million. The IRS' Chief Information Officer is currently leading an extensive effort to identify and cost the corrective actions that will need to be taken. If the resource requirements change upon completion of the field-based applications inventory, updated information will promptly be provided to the Subcommittee.

Management Processes and Practices. The Service has made significant progress towards improving the management processes and best practices that are requisite to managing the size and scope of IRS' modernization efforts. Specifically, the Service has focused FY 1997 resources on the development of the program infrastructure—systems architecture and systems life cycle—needed to undertake major modernization efforts. The IRS adopted a Systems Life Cycle that provides the policies and processes needed to manage systems development efforts. The Systems Life Cycle is consistent with industry practice, thereby underscoring the commitment to shift significant aspects of the technology modernization efforts to contractors. The Service is developing a modernization blueprint, including the architecture, which identifies critical business requirements and provides for a sequenced rollout of modernization projects based on prioritized business needs.

Advancing Modernization. The IRS has also put in place an investment review discipline to assess and prioritize information systems investments, monitor progress of spending against plans, and evaluate the results of those investments. The IRS Investment Review Board (IRB), chaired by the Deputy Commissioner, has reviewed all ongoing technology development projects. Projects that failed to demonstrate significant business value or comply with best practices for disciplined systems development have been suspended. To date, the IRB has suspended the Document Processing System, Corporate Accounts Processing System, Workload Management System, and Integrated Case Processing System, resulting in significant future cost avoidance. The IRB also is overseeing the reallocation of resources from these projects to higher priority investments, in accordance with the principles of the Information Technology Management Reform Act.

Last year, Art Gross was selected as the IRS Chief Information Officer. Art has significant technical management expertise and an excellent grasp of the tax "business." This year, the Service has continued to strengthen its information technology management capabilities with the appointment of the new Director of the Government Program Management Office (GPMO), who is an experienced systems development program management executive from the New York State Department of Taxation and Finance, and a new Director of the Systems Standards and Evaluation Office (SSE), who was formerly with the GAO and has extensive experience in the development of systems life cycle standards, policies and procedures, and information technology program evaluation and oversight.

The IRS recently initiated an aggressive, nationwide recruitment program for well-qualified individuals to fill approximately fifteen executive and senior management positions to enable the IRS to strengthen and improve its overall management of modernization efforts, including management of contractors.

One measure of the effectiveness of an information technology organization is the comprehensiveness of its product assurance program. Between 1992 and 1996, IRS' Information Systems organization downsized by over 2,000 positions, with a disproportionate reduction in the product assurance program. In the product assurance program, resource levels sank to less than 30 percent of the industry standard. Accordingly, in 1997, the IRS is undertaking a major rebuilding of this program to mitigate systems acceptance testing deficiencies that have prevented the thorough testing and certifying of principal IRS operating systems.

At the same time, the IRS continues to transfer significant aspects of the technology modernization program to the private sector. The December 1, 1996, report to Congress documents the modernization program resource allocation; 64 percent of it is provided by the private sector. The largest and most important initiative for FY 1997 was the contract recently awarded to develop, pilot, and implement the submissions processing manual data entry systems replacement. The IRS also is in the process of competitively acquiring a Systems Engineering and Technical Assist-

ance (SETA) contractor to provide technical, program, and project management guidance to the modernization effort. Pursuant to the FY 1997 Treasury appropriation, the Treasury Modernization Management Board is conducting the preparation of a Request for Proposal for a prime contractor to manage, integrate, test and implement the program.

The IRS is completing its strategic modernization plan, which integrates implementation schedules and establishes completion dates for each of the major components of the plan. The major components are (1) a Modernization Blueprint, which focuses on rebuilding the corporate data bases to enable customer service taxpayer account resolution and improved compliance; (2) a procurement strategy to shift primary responsibility for systems development and integration to the private sector; and (3) linkages among the short-term legacy and operational systems enhancements, the Year 2000 project, and the longer-term modernization sequencing plan. The modernization plan will be submitted to Congress in May 1997.

Downsizing. Significant progress is being made toward the Year 2000 Conversion and implementing the program infrastructure needed to undertake major modernization efforts. However, the IRS also needs to manage a nearly 10 percent downsizing of the Information Systems program staffing levels during FY 1997. The FY 1998 budget provides for a further downsizing of 736 FTEs. While this downsizing plan reflects the intention to shift additional elements of modernization to the private sector, this additional staff reduction must be carefully managed, given the number and the critical nature of initiatives that are underway in addition to modernization.

V. Implementing the Government Performance and Results Act (GPRA)

The IRS is one of the leaders among federal agencies that use an integrated Strategic Management Process, one in which planning, budgeting, investment, performance measurement, and program evaluation processes are interdependent. The IRS consulted with other public and private sector organizations and executives to develop its integrated Strategic Management Process.

The IRS and Treasury eagerly implemented the requirements of the Government Performance and Results Act of 1993 (GPRA). The long-term use of strategic management and participation as a GPRA pilot agency have enabled the IRS to implement many of GPRA's requirements ahead of schedule.

First, the IRS developed an integrated strategic plan and budget in the Spring of 1996, although GPRA does not require one until the Fall of 1997. This plan uses the IRS Mission and three Strategic Objectives to set priorities and program targets for business operations, set funding levels, and establish performance measures. The Service uses performance indicators to monitor progress during the year, to make mid-course adjustments to optimize performance, and to evaluate performance at the end of the year.

Second, in the FY 1997 budget request, the Service included outcome-oriented performance indicators rather than the traditional workload output measures. For FY 1998, the Service refined these performance measures and used them to evaluate its program choices. This allowed the Service to prioritize its program requirements and use that prioritization to drive its budget decisions. The Appendix to my testimony includes the overall performance indicators for FY 1998.

Third, the FY 1998 budget request includes a progress report on each program goal the Service proposed for FY 1996. If the performance goal was exceeded, that is noted, and if not, the report explains why not and what will be done about it.

Setting long-term goals and annual targets, managing activities to achieve those goals and targets, measuring performance annually, and holding people accountable will help improve tax administration. It will also help the IRS and Congress make more informed budget decisions about balancing resources across these objectives.

VI. GAO High Risk Areas

The General Accounting Office (GAO) issued its latest in a series of reports on federal programs considered high-risk "because of vulnerability to waste, fraud, and mismanagement." The latest report discusses four high-risk areas at the IRS: Tax Systems Modernization (TSM), financial management, tax accounts receivable, and tax filing fraud. While the report credits the IRS with making some progress in all four areas, it outlines significant challenges still ahead. The key points raised by the GAO and the IRS responses are summarized below.

TSM. Although the GAO recognizes that the IRS and Treasury have together taken several steps to implement their recommendations, much remains to be done. We agree with many of the concerns expressed by the GAO and have taken and are

continuing to take aggressive actions to address those concerns as illustrated in our February 27, 1997, report to Congress.

Financial Management. The GAO reported on financial management weaknesses that diminish the credibility of information available for assessing the results of IRS' financial operations and measuring its performance. The GAO did indicate, however, that the Service had made improvements in the areas of reporting and accounting, stating that the improvements in accounting were particularly notable. The revenue accounting system, which was designed prior to enactment of the Chief Financial Officers Act, was not designed to give data on financial position or give detailed transactions that auditors could go back and sample, as required by recent changes in the law. We agree with the GAO's recommendations and are making the short-and long-term changes needed to bring our systems up to those standards.

Tax Accounts Receivable. According to GAO, weaknesses hamper the IRS' ability to manage and collect its reported $216 billion inventory of tax debts effectively and efficiently. In FY 1996, IRS delinquency collections totaled $29.8 billion, the most ever collected by IRS—a 19 percent increase over FY 1995. Moreover, we continue to automate many of the processes carried out by collection field employees, resulting in substantial productivity improvements. Unlike private business, the IRS cannot determine credit-worthiness prior to a transaction, and the law requires that we keep accounts receivable on the books for 10 years. About 30 percent of the current inventory is accrued penalties and interest ($65 billion of the current $216 billion inventory); obviously, even if the principal remained static, the total would grow because of accrued interest and penalties.

Tax Filing Fraud. According to GAO, weaknesses hamper IRS' efforts to detect and prevent the filing of fraudulent tax returns. The IRS has taken several steps to prevent and deter tax return fraud, including substantial improvement to the Electronic Fraud Detection System. Criminal investigations and related prosecutions continue to demonstrate IRS enforcement presence. Moreover, we continue to develop and test various systemic and compliance alternatives to identify those that are most successful.

VII. Security of IRS Information

The IRS has long understood that protecting taxpayer information is essential to maintaining our country's self-assessment tax system. We also understand that although new technologies will help to streamline IRS operations and improve the delivery of services to taxpayers, these same technologies will also increase the risks to privacy associated with automation unless a strong program is in place to adequately mitigate these risks. Risk mitigation is of greater significance as IRS' reliance on paper decreases and its dependence on new technologies increases. In this regard, we are also aware that our security and privacy programs need to be strengthened, so that the Service has integrated and consistent safeguards in place to adequately ensure (1) the privacy and security of taxpayer account information; (2) continuity of its operations; and (3) security of the infrastructure for modernized systems.

In January 1997, IRS announced that centralized responsibility for security and privacy issues had been delegated to the Office of Systems Standards and Evaluation (SSE). Recognizing the critical need to enforce federal law and regulations on privacy and non-disclosure of confidential tax information, SSE was created to assume responsibility for establishing and enforcing standards and policies for all major security programs including, but not limited to, physical security, data security, and systems security. In this regard, SSE provides IRS with a proactive, independent security group that is directly responsible for the adequacy and consistency of security over all IRS operations.

One taxpayer security area of particular concern to this Subcommittee and to us is the unauthorized access to taxpayer data by IRS employees—or "browsing." The IRS does not tolerate browsing. We consistently stress both within and outside the IRS that unauthorized access of taxpayer accounts by IRS employees will not be tolerated. However, recent court cases, especially one in the First Circuit Court of Appeals (*United States v. Czubinski,* No. 9–1317, 1997 U.S.App. LEXIS 3077 (1st Cir. February 21, 1997), are very troubling to the IRS and make it more difficult for us to appropriately discipline employees who violate our policy against unauthorized access.

In the past several years, the IRS has taken a number of steps to ensure that unauthorized access of taxpayer information by IRS employees does not occur. For example, each time an employee logs onto the taxpayer account data base (the Integrated Data Retrieval System (IDRS)), a statement warns of possible prosecution for unauthorized use of the system. All new users receive training on privacy and secu-

rity of tax information before they are entitled to access the IDRS. The Service has also installed automated detection programs that monitor employees' actions and accesses to taxpayers' accounts, identify patterns of use, and alert managers to potential misuse. Employees are disciplined according to a Guide for Penalty Determinations that includes dismissal. In the recent First Circuit opinion, the court noted that "the IRS rules plainly stated that employees with passwords and access codes were not permitted to access files on IDRS outside the course of their official duties."

In addition to the internal actions, the IRS has recommended and supported legislative efforts to amend the Internal Revenue Code and Title 18 to clarify the criminal sanctions for unauthorized computer access to taxpayer information. A recent amendment to 18 U.S.C. 1030(a)(2)(B) provides criminal misdemeanor penalties for anyone who intentionally accesses a computer without authorization or who exceeds authorized access and thereby obtains information, including tax information, from any department or agency of the United States. Although the recent amendment to 18 U.S.C. will hopefully serve as a significant deterrent to unauthorized computer access of taxpayer information, this statute only applies to unauthorized access of computer records. It does not apply to unauthorized access or inspection of paper tax returns and related tax information. Legislation such as S.670, introduced in the 104th Congress, would achieve that result. By clarifying the criminal sanctions for unauthorized access or inspection of tax information in section 7213 of the Internal Revenue Code, whether that information is in computer or paper format, the confidentiality of tax information and related enforcement mechanisms would be appropriately found in the Internal Revenue Code.

VIII. Improvements in Financial Management

Despite inclusion in GAO's series of reports on areas at "high risk because of their vulnerability to waste, fraud, abuse and management," the IRS has significantly improved financial management over the last four years. Still, there is more to do. The Service has a detailed action plan, developed in cooperation with GAO, that addresses corrective actions and tracks the progress toward correcting deficiencies and implementing GAO recommendations.

The IRS was one of the pilot agencies under the Chief Financial Officers Act (CFO Act) of 1990 and, as such, was required to submit financial statements beginning with Fiscal Year 1992. Prior to this, the IRS was not required to prepare audited financial statements or to have financial audits. However, the fact that audits were not routinely done in the past does not mean that poor financial management existed. The IRS, like other agencies, was and is controlled by budgets that were appropriated by law and incorporated into our administrative financial system, and obligations and expenditures were monitored against those appropriations. Unlike many other agencies, the IRS also collected substantial amounts; our custodial financial systems were designed to account for those receipts and to ensure that they were promptly deposited into the Treasury. These requirements and controls still exist in addition to the new requirements introduced as part of the annual audit. Passage of the CFO Act and the introduction of annual financial statements and audits, however, added new rules. We are using the financial statement audit, and the discipline it imposes, as a blueprint for continued financial management improvements.

Financial Statement Audit—A Major Challenge. When the GAO began auditing our financial statements in 1992, we were not working with systems designed to provide data in accordance with the CFO Act. Our revenue and administrative accounting systems were designed with adequate controls but did not provide the information necessary to report on our financial position in accordance with Generally Accepted Accounting Principles. In addition, our size alone has made it difficult to obtain a clean opinion quickly. As the primary collector of the nation's revenues, we collect over $1 trillion annually and GAO has verified that this has been properly deposited in the Treasury. This is no small accomplishment for an organization that handles over one billion information documents per year, processes more than 200 million returns, issues 90 million refunds, and deals with over 12,000 financial institutions and 12 Federal Reserve Banks in over 600 locations. Any complex system will produce some errors. The IRS system does, but great efforts are made to detect errors and promptly correct them.

It is important to keep in mind that the Service has two separate financial processes to track funds: the administrative system that handles appropriated funds and the revenue system that tracks tax collections and is used to report on custodial statements. To understand GAO's audit findings, it is important to recognize the

distinction between these two systems and what is being done to improve both systems to comply with the CFO Act.

Improvements In Administrative Accounting. The IRS is proud of the improvements it has made in its administrative accounting system. Six years ago, the Service had eight separate systems that were not linked to each other. Now the IRS has a single corporate administrative financial system of record that it uses to monitor and control the more than $7 billion the IRS receives annually in appropriated funds. This system, known internally as the Automated Financial System, provides an integrated, auditable, comprehensive accounting and budgeting system that fully complies with the Joint Financial Management Improvement Program core requirements, including the U.S. Standard General Ledger, and other government-wide standards that apply to automated financial systems.

Even though IRS purchased an off-the-shelf commercial package, it was customized to meet the unique agency requirements, including developing interfaces. For example, the Service transferred payroll to the Department of Agriculture's National Finance Center (NFC) and operates an interface from NFC to provide payroll data to the corporate database. The Service also has integrated its procurement system and travel system so data is only entered once and is transmitted electronically.

Since the first audit in 1992, the Service has made significant improvements in administrative financial management, resulting in GAO's FY 1994 and FY 1995 audit reports focusing on just two remaining administrative accounting issues: (1) failure to reconcile IRS accounts with Treasury, and (2) the lack of receipt and acceptance documentation for some non-payroll payments to other federal agencies, such as rent payments to GSA and printing payments to the Government Printing Office (GPO).

Accounting for the Revenue the IRS Collects for the U.S. Treasury. The challenge with revenue accounting is to develop a financial management system that will provide the organization with the capabilities for (1) controlling financial transactions; (2) collecting and processing transaction-level data; (3) obtaining detailed information on financial position; and (4) providing complete financial information necessary to manage an organization.

While the IRS can, and does, reconcile gross amounts collected, it has been unable to give GAO auditors the information that they want to reconcile on a transaction-by-transaction basis with the Masterfile database. The challenge has been to augment the revenue accounting information to meet the requirements of the CFO Act.

For the FY 1995 and FY 1996 audits, in cooperation with the GAO, the IRS began extensive analysis and documentation of all revenue transaction flows and source documentation. Detailed flowcharts were prepared to document revenue flows between the Revenue Accounting and Control System (RACS) and supporting feeder systems. Site visits were made with the GAO to all service centers to validate these flowcharts and further document detailed transaction flows that were unique to a service center. Additionally, the IRS now uses its Masterfile to provide detailed transaction data to support its custodial financial statements. This data is reconciled to RACs and Treasury schedules.

Accounts Receivable. Another area that has caused concern is converting the IRS inventory of tax assessments to an accounting definition for accounts receivable. When taxpayers either do not file returns or file inaccurate returns, the IRS makes assessments based on the tax laws irrespective of collection potential. Since IRS assessments are unlike typical accounts receivable, the Service had to determine a way to derive and report the portion of the Accounts Receivable Dollar Inventory (ARDI) that meets more of a financial definition for accounts receivable.

To overcome the limitations associated with ARDI, the GAO and the IRS agreed on a systemic approach and definition of financial receivables. This approach relies on coding that is available in the Masterfile to identify the type of compliance action taken as of a certain date, and the major reason that the IRS made the assessment. Using this coding, the Service then segments the total ARDI into three categories: (1) financial receivables (amounts reported in the financial statements), (2) financial write offs, and (3) compliance assessments, (amounts disclosed as footnotes in the statements).

Progress in FY 1996 Toward Correcting the Five Major Findings. GAO listed five financial management problems as the major contributors to the disclaimer—two related to the administrative area and three to the revenue area.

1. Amounts reported as appropriations available for expenditure for operations cannot be reconciled fully with Treasury's central accounting records. IRS has worked with GAO to bring this issue to resolution. As of FY 1996, the reconciliations are current and there is an automated mechanism in place to ensure that these balances are reconciled monthly.

2. A significant portion of IRS' reported $3 billion in non-payroll operating expenses cannot be verified. The IRS can and does have acceptable and auditable records to verify commercial vendor payments. The $3 billion in non-payroll operating expenses could not be verified because of the interagency payments included in GAO's sample. Within this sample were interagency payments for which they questioned whether the IRS had support showing receipt and acceptance from other federal agencies, primarily GPO and the General Services Administration.

The interagency payment problem deals with a receipt and acceptance issue related to goods and services received from other federal agencies paid via the government's Online Payment and Collection system. Because they identified these transactions as exceptions, they concluded that their testing (review of supporting documentation) of the non-payroll expenditures could not be projected to the universe of $3 billion; therefore, they could not verify the non-payroll expenditures.

The IRS has been working closely with GAO to define the problem areas and to propose interim and long-term solutions to the receipt and acceptance issues.

3. The amounts of total revenue and tax refunds cannot be verified or reconciled to accounting records maintained for individual taxpayers. The IRS is now using individual taxpayer records to prepare financial statements and to ensure that the auditors can verify and reconcile the total revenue and tax refunds to the accounting records maintained for individual taxpayers. This is being done until such time as longer term systems solutions can be implemented.

4. Amounts reported for various types of taxes collected (social security, income, and excise tax, for example) cannot be substantiated. In preparing the FY 1995 and FY 1996 financial statements, the IRS made great progress in developing methods to substantiate the revenue collected. For Social Security, the IRS developed an extract that enables it to report and match assessment and collection information. As stated earlier, the IRS is also using the Masterfile to provide all detailed transactions to support income tax collected. In providing excise tax information, the IRS will continue to analyze monies assessed and collected to determine if there are significant differences. Additionally, the IRS is developing programming that will enable it to have detailed assessment and collection information as it does with Social Security.

5. The reliability of reported estimates for $113 billion in accounts receivable and $46 billion for collectible receivables cannot be determined. During the FY 1995 audit, initial testing by GAO resulted in its conclusion that the Service's program that classified receivables as financial receivables, financial write-offs, and compliance assessments was flawed. Based on a review of cases this year to determine the validity of our categorizations, GAO has indicated that the systemic process is accurately segmenting our portfolio of receivables. GAO's next step is to review the supporting source documentation for the selected cases to verify they are accurate. The Service is in the process of building the ARDI Expert System, a centralized data base that allows analyses to be performed on the entire inventory using all of the existing information.

Status of 59 Recommendations. The GAO has made 59 recommendations through their financial statement audits for the last four fiscal years. Of the 59 recommendations, the IRS and GAO agree that the IRS has implemented 17 of them. Of the remaining 42, the IRS believes it has met the requirements on an additional 27. The Service is working with GAO to get agreement before actually closing these items. Of the remaining 15, 11 are scheduled to be completed by the end of the fiscal year; and four have completion dates beyond FY 1997. The IRS is committed to working with GAO to resolve these recommendations and believes that through mutual cooperation and effort this goal will be achieved.

IX. REORGANIZATION

In 1993, details of a major IRS reorganization were announced and the Service has worked since then to streamline operations and reduce costs—a process that continues. This carefully considered effort, undertaken before IRS appropriations were reduced, was done in recognition that the IRS should place the maximum amount of its resources on meeting customer needs effectively and efficiently.

The National Office has been reduced in size, three regional offices have been closed and 63 district headquarters offices consolidated into 33, while 80 administrative support offices were consolidated into 24 and 70 customer service sites have been reduced to 30 and ultimately will go to 23. Taxpayer assistance levels and problem resolution services have been improved. Consolidating offices and operations reduces or avoids redundant infrastructure costs, such as space, telecommunications, toll-free call distribution systems, and management overhead. In FY 1997, IRS will eliminate a net of over 1,000 field office support positions plus

over 800 positions in the National Office, ensuring that the salary dollars can be spent instead on front line operations.

For almost three years, the IRS, working with the National Treasury Employees Union (NTEU), has used a variety of voluntary workforce transition tools to move employees into the new, streamlined organizational designs. Beginning in 1996, the total number of occupied IRS support positions not optimally located was approximately 3,390—less than five percent of the total IRS workforce at that time. However, there still are over 1400 employees occupying such positions who have not been placed in continuing positions despite the voluntary efforts and outplacement activities of the Service.

The IRS is making every effort to lessen the effects of the reorganization on employees. Working with the NTEU, the Service developed a Pre-Reduction in Force (RIF) Activities Agreement in October 1996. Voluntary activities, such as buyouts, early outs, paying moving expenses for employees, and a Career Transition Assistance Plan are all in place as methods to reduce the numbers that would be subject to a RIF.

As a result of Section 105 of the FY 1997 Treasury Appropriations Act, the Service has been unable to complete the final stages of the reorganization. This has caused an imbalance between workload and people. Upon delivering the report required by the Appropriations Act, the IRS will move forward to fill critical vacancies, move its workload, and finalize this phase of the IRS reorganization.

Buyout Update. Since Congress approved the IRS' voluntary incentive separation plan in December 1996, the IRS has implemented it aggressively. As of March 1, 1997, approximately 1300 employees have accepted buyout offers and have left the IRS employment rolls. Those who left were either in non-continuing positions or in positions that created a vacancy that would provide a placement opportunity for someone who could be subject to a RIF.

The IRS currently is placing employees in continuing positions and by mid-April should know how extensive a RIF, if any, would have to be. After that, the Service will move forward to separate employees when there is an agreement with NTEU either voluntarily arrived at or imposed by the Federal Service Impasses Panel. I know there is continuing interest in this matter by this Subcommittee and the IRS will continue to keep you informed about how it is proceeding.

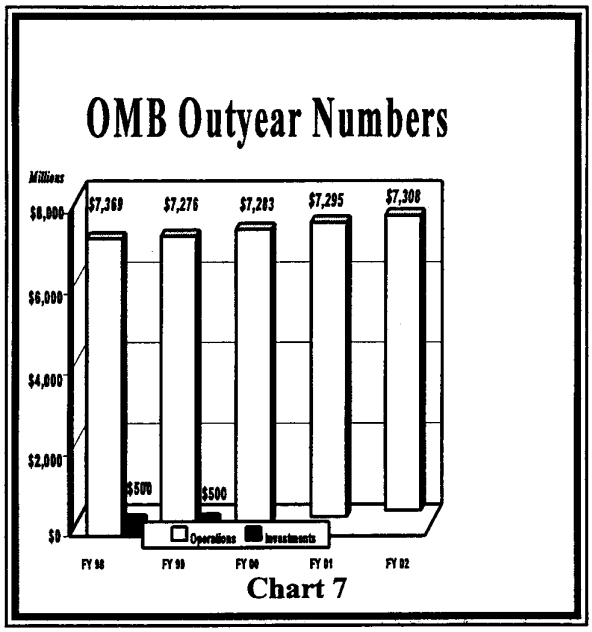

Chart 7

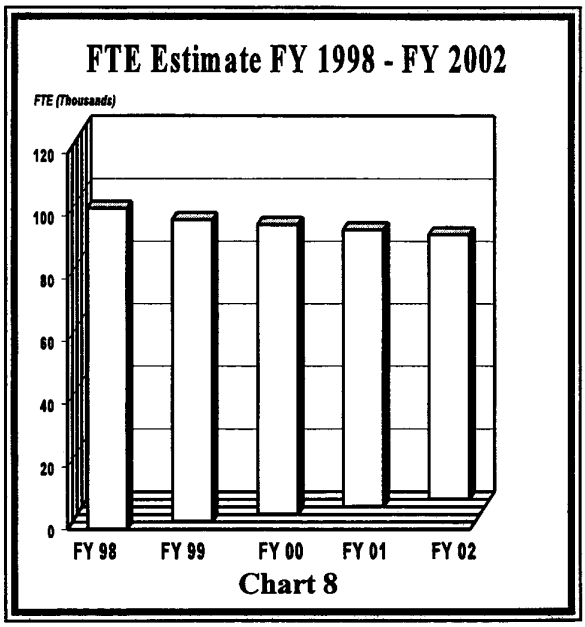

Chart 8

X. Conclusion

My colleagues and I appreciate the opportunity to present this testimony. The IRS is committed to achieving its mission in a way that provides the information and assistance required by our citizens and at the same time reinforce the overall fairness of the tax system by seeing to it that all of us pay our correct share of taxes. Under the most stable of circumstances this is a challenging responsibility. The testimony has highlighted some of the most important advances that we have made and also pointed out the many areas which still require improvement. The Service appreciates the consistent interest and support of this Subcommittee and its staff and we look forward to a continuing strong relationship.

APPENDIX

FY 1998 Performance Measures and Targets

Budget Level Measures	FY 98 Targets
Mission Level	
Mission Effectiveness Indicator: $\frac{\text{Total Net Revenue - (Budget +Burden)}}{\text{Total True Tax Liability}}$	79.9%
Objective - Increase Compliance (IC)	
Total Collection Percentage	87.3%
Total Net Revenue Collected (in trillions)	$1.57
Servicewide Enforcement Revenue Collected (in billions)	$35.2
Servicewide Enforcement Revenue Protected (in billions)	$7.5
Servicewide Audit Coverage	1.17%
Objective - Improve Customer Service (ICS)	
Taxpayer Burden Cost (in dollars) for IRS to Collect $100	$8.06
Initial Contact Resolution Rate	TBD
Objective - Increase Productivity (IP)	
Budget Cost to Collect $100	$0.47
Percent of Returns Filed Electronically	14.0%
Percent of Dollars Received Electronically	48.4%
Percent of Dollars Received Via Third Party Processors (Lockbox)	66.3%
Operations and Maintenance Appropriation	
Budget Activity Code (BAC) Measures	
Submission Processing BAC:	
Number of Primary Returns Processed (in thousands)	199,964
Total Number of Individual Refunds Issued (in millions)	85.5
Processing Accuracy Rate - Paper	95%
Processing Accuracy Rate - Electronic Filing	99%
Refund Timeliness--Paper (in days)	40
Refund Timeliness--ELF (in days)	21
Telephone and Correspondence BAC:	
Number of Calls Answered (in millions)	111.4
Taxpayer Service Level of Access	60.2%
Taxpayer Service Tax Law Accuracy Rate	92%
ACS Dollars Collected per FTE (in millions)	$1.4
Service Center (Examination) Dollars Recommended per FTE	$480,000
Problem Resolution Program Average Processing Time To Close Cases (District Office)	43.4
Problem Resolution Program Average Processing Time To Close Cases (Service Center)	32.3
Problem Resolution Program Quality Customer Service Rate - Districts	83.1%
Document Matching BAC:	
Document Matching Dollars Assessed (in billions)	$1.2

Budget Level Measures	FY 98 Targets
Inspection BAC:	
Number of Internal Audit Reports Issued	126
Number of Security Investigations Conducted	8,719
Management Services BAC:	
Support Services Performance Index	104.2
Support Budget Cost Per FTE	$11,718
Rent and Utilities BAC:	
Space Utilization Rate (sq. ft.)	167
Criminal Investigation BAC:	
Fraud Convictions	1,756
Narcotics Convictions	656
Examination BAC:	
Field Examination Dollars Recommended (in billions)	$22.83
Field Examination Dollars Recommended per FTE	$1,008,348
Appeals Non-docketed Cycle Time (days)	238
Appeals Staff Days per Disposal	2.14
Collection BAC:	
Field Collection Dollars Collected (in billions)	$4.92
Field Collection Dollars Collected per FTE	$476,000
Field Collection Average Cycles Per TDA/TDI Disposition	34.7
EP/EO BAC:	
EP Determination Letter Cycle Time (days)	170
EO Determination Letter Cycle Time (days)	87
Statistics of Income BAC:	
Percent of Statistics of Income Projects Delivered on Time	90%
Statistics of Income - Quality Customer Service Rate	90%
Chief Counsel BAC:	
Tax Administration Guidance per FTE	40
Counsel Litigation, Litigation Support, and Advice per FTE	139
Number of Private Letter Rulings per FTE	54
Advance Pricing Agreements per FTE	5
Operational Information Systems BAC:	
Integrated Data Retrieval System (IDRS) Real Time Availability	99.0%
Weekend Taxpayer Information File (TIF) Update Completion Times	85.6%
Corporate Files On-line (CFOL) Availability	99.0%
Developmental Information Systems BAC:	
None	NA

Chairman JOHNSON. Thank you, Mr. Dolan. I appreciate your comments about the chief of staff on both sides of this Subcommittee. We are blessed to have very bright and very capable women chiefs of staff on this Subcommittee.

I also appreciate your taking the time in your testimony to go through some of the accomplishments of the IRS in the last 2 years. And I would remind this Subcommittee and also the public that Commissioner Richardson was very forthright with this Subcommittee more than 2 years ago about the difficulty that the Fed-

eral Personnel Regulations posed for the agency to reach the level of expertise that you needed to help with the Tax Modernization Program.

And, indeed, after a long and very careful search you did bring Mr. Gross aboard. I think all parties are impressed with his expertise and abilities, and I think the vision that you lay out, Mr. Gross, of the kind of partnership that you are looking for, the kind of plan you think must precede action is music, at least, to the ears of this Member.

But, Mr. Dolan, while we have had great problems with the Tax Systems Modernization Program, the agency has not been idle. And I appreciate your going through the kinds of improvements that you have made in the last couple of years, in terms of enabling people to file by telephone, your Web site, access to forms, and schedules and information.

And I am pleased that this filing season seems to be going very well. I would also say that in part it is going well because in the last filing season you did a very good job of cracking down on some of the sources of, for example, fraud in the EITC Program, and I think that is paying off.

I think your willingness to sort of engage in the problem of the independent contractors does make it easier. I don't see how these kinds of approaches, as important as they are to the quality of tax administration, to customer service, and to a strong, fair IRS, I don't see how they can enable you over the next 5 years to live with basically a frozen budget, which means absorbing $1 billion in cuts.

And so while I don't want to belabor this at this hearing, because I don't think it's possible for you to respond, I would urge you to develop the resources or the focus, you know, in the coming months, to work with your regional research agencies—and I am very pleased to hear that, because it's absolutely true that you have different kinds of sectors predominant in different areas of the country, and therefore different compliance problems and enforcement problems and administration problems and taxpayer questions.

But we tried hard in the Taxpayer Bill of Rights to send the message that we have to know what actions of ours create the biggest administrative problems, because your administrative problems are people's fairness, equity, frustration problems.

And when we give you unadministerable law, or law that you cannot explain in a way that the ordinary person out there says, Oh, yeah, that's fair, then we do you a disservice, and we do the taxpayer disservice, and you do not do us a service in protecting us from that information.

So one of the things that is increasingly clear to me is that no amount of technology, and no amount of really thoughtful common sense, and a lot of what you've done in the last 2 years, the public doesn't realize quite how much you have done to improve access and improve service, and slim down and streamline the IRS. But no amount of that is going to work unless we can jointly focus on also some of the most complex and often unproductive in their complexity portions of the Tax Code.

So I would hope that as you plan, particularly your work for 1998, and preferably even in the next 6 months, that you really

press down hard on those issues. Because we have to make the philosophical decisions. But philosophical decisions are sometimes easier made, more easily made, if you know that one is not going to work, and that another one might.

So when I look at the budget challenge you face, it's meetable. And technology will matter, and you're going to have good plans and we're going to move ahead.

But we also have to be realistic, honest and very tough minded in terms of what constitutes administrable, enforceable, fair tax law. And I thought it was just really wonderful that one of your advocates spontaneously said, well, if you really want to help, repeal the EITC.

Now, politically that's a bomb. She wasn't talking to us politically. She was saying when I have to deal with people out there, and try to explain to them on the merit of simplicity and fairness this thing fails. It may meet the political standard of rhetoric, but it doesn't meet the real world standard when you're trying to help the very poorest people and they have to hire someone to explain the program to them.

So we need to talk more honestly about the Tax Code problems if we're going to back you in the changes you're going to make, and if you're going to succeed in creating the next generation of IRS bureaucracy, which is going to have to be different, more like the private sector in responsiveness, more like the private sector in number of management levels. It's going to have to be far more preventive.

We see that in controlling health care costs. We see that in productivity in the industrial sector. We have to really engage ourselves now on those issues. And prevention means Congress has to act in ways we haven't been willing to act before.

And the only hope of that is oversight. So if we don't get together and communicate about these things, and if you don't begin to structure your reports so that we don't get frankly the same kind of junk we used to get—now, we got it because we asked for it, and we liked it because it was easy to deal with.

But we're beyond that. So I have some other questions, but I am going on too long in this statement, so I am going to let my other colleagues go first, but I will come back.

Mr. DOLAN. I just wanted to respond directly to your invitation, as well as your suggestion that we might have done a better job with respect to the first report. I think everybody who came back from the last hearing realized that we need to and want to step up to your challenge of getting explicit and candid in the dialog about what are the impediments that we can do something about, and what are ones that only you can do something about.

And so we have heard you and we take your invitation seriously, and would very much look forward to that kind of relationship.

Chairman JOHNSON. Thank you. I would just say that a lot of our political rhetoric is outdated, and a lot of your bureaucratic mindset is outdated, and we really have to get real.

Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman. First of all, as a member of the Restructuring Commission of the IRS and a Member of this Subcommittee, I had written to Treasury Secretary Rubin

on March 11 specifically asking the administration to develop and release on an expedited basis its proposal to restructure the IRS.

I ask that the letter that I sent to Secretary Rubin on March 11, plus his five points that he's responded to relative to the restructuring in recent days, be included in the record.

Chairman JOHNSON. Mr. Coyne, I would be happy to do that. And I'd be happy to include his response as well. I'm particularly pleased to acknowledge that his response recognizes a lot of things that Commissioner Richardson and the IRS have accomplished and laid the groundwork to accomplish.

I appreciate those things. I do think as you see on the Restructuring Commission that the issues are larger and I think this issue of Tax Code complexity is fundamental. And I am pleased that this Subcommittee has such capable Members as Mr. Coyne and Mr. Portman on that Restructuring Committee, and I would be happy to include in the record both your letter to Secretary Rubin and this first response.

Mr. COYNE. Thank you, Madam Chair.

[The information follows:]

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March 11, 1997

The Honorable Robert E. Rubin
Secretary of the Treasury
U.S. Department of the Treasury
15th and Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Rubin:

I am writing to express my interest in working with you, and other Department of the Treasury officials, concerning possible approaches to reforming the structure and operation of the Internal Revenue Service. As a Member of the National Commission on Restructuring the Internal Revenue Service, I ask that the Department formally develop and transmit to the Commission its recommendations for reform at the IRS, on an expedited basis. Also, as the Ranking Democrat of the Ways and Means Oversight Subcommittee, I will need a clear understanding of Treasury's proposals with regard to the IRS, in order to prepare for the Subcommittee's hearing on the Commission's final report (tentatively planned for later this year).

The Commission "task force on governance" will be finalizing its findings by March 19th, and submitting its specific recommendations to the full Commission by May 1st. Thereafter, the Commission will review the various task forces's proposals and vote to approve a final report on June 5, 1997. Accordingly, it is essential that the views of the Department of the Treasury be available to me, and the other Commission Members, in a timely manner.

Honorable Robert E. Rubin
March 11, 1997
Page 2

To date, Treasury Counsel Ed Knight has been very helpful in clarifying the legal and policy implications of the various reform proposals offered during Commission hearings and meetings. Also, Deputy Secretary Larry Summers has provided general information about the Administration's views with regard to: how an oversight board within Treasury should be appropriately structured; how IRS funding mechanisms should be revised; factors that should be taken into account in selecting the next IRS Commissioner; and Treasury's plans to develop a tax law simplification package.

It would be very helpful to me, and I am sure helpful to the other Commission Members, if Treasury would outline its views, by letter or in other written form, by March 20th. This would allow me to more fully evaluate the issues surrounding proposed reform to IRS's management structure and Treasury's concerns.

I appreciate your assistance and support.

Sincerely,

William J. Coyne

William J. Coyne
Ranking Democrat

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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Toward an IRS for the Twenty-First Century
Lawrence Summers
Deputy Secretary of the Treasury
Tax Executives Institute, Inc.
Washington, DC
March 17, 1997

Good morning. Thank you for that kind introduction. It is an honor to be here among tax professionals to discuss the vital question of improving the way in which the IRS collects our nation's taxes.

Nobody likes to pay taxes, but, as Oliver Wendell Holmes once said, they are the price we pay for civilized society. They have been at the center of our nation's greatest debates from Revolutionary times to today. They fund our armed forces, our children's education, and our parents' health care, and they finance advances in science and technology that benefit us all.

Collecting taxes has always posed a difficult challenge. Because of the nature of the work they do, tax collectors will never win popularity contests. Recently, announcements we have made about continuing problems in computer systems have focused attention on the Internal Revenue Service. Continuing improvements in the service provided by banks, brokers, credit card companies, and other users of information technology bring ever more sharply into focus the IRS's problems with customer service. At Treasury and the IRS we recognize that the IRS could do much better at providing the kind of cost-effective, high quality service that the American people deserve.

We have, I believe, reached an important turning point. Over the last year, the Treasury Department has focused intense efforts on improving the IRS. The National Commission on Restructuring the IRS, led by Senator Bob Kerrey and Congressman Rob Portman, has already made a significant contribution to the ongoing discussion. A consensus has emerged among a wide group of stakeholders, from business executives to Members of Congress to leaders of the National Treasury Employees Union. The message is clear: it is time for change.

I believe that in the next year or so we have the opportunity and the obligation to bring about the RR-1556

Only if we confront problems directly – from protecting taxpayers' privacy to using technology to making sure the phones are answered – will we build an IRS for the 21st century.

The Five Point Plan
As we chart our new course, we will focus on five critical areas -- oversight, flexibility, budgeting, tax simplification, and leadership.

Let me address each of these in turn.

I. Institutionalize Oversight
First, we at the Treasury Department have strengthened and made proactive our oversight of the IRS, and we take responsibility for reforming the institution. We will devote the necessary resources, both managerial and financial, to do the job.

Oversight of the IRS by the Treasury department is the best way to ensure the IRS's accountability to the American people and to coordinate tax collection with tax policy. Through the Treasury, the IRS is able to bring concerns about the difficulty of administering tax changes to senior Administration officials; I raise these concerns frequently in tax policy discussions with policymakers in the White House and throughout the Administration. In addition, the IRS is able to draw upon Treasury resources for critical projects, as demonstrated by our current cooperation on the Year 2000 conversion.

Going forward, we will take two concrete steps to institutionalize oversight of the IRS. Over the last year, we have set up a Modernization Management Board comprised of senior officials from Treasury, the IRS, and other parts of the Administration. The Modernization Management Board is directed at overseeing the information technology programs and functions in many ways like a corporate board, approving major strategic decisions and investments. Based on its success, we will ask the President to issue an Executive Directive that will make this board permanent and extend its mandate to cover the broad range of strategic issues facing the IRS.

We will also establish a blue ribbon Advisory Committee, reporting directly to the Secretary of the Treasury, to bring private sector expertise to bear on the management of the IRS. This committee, composed of senior business executives, experts in information technology, small business advocates, tax professionals, and others, will meet regularly to make recommendations on major strategic decisions facing the IRS

II. Increase Flexibility
Second, we will enhance and strengthen the IRS's ability to manage its operations. The IRS faces a multitude of restrictions -- restrictions that would be unacceptable in the private sector – that hamper its ability to provide efficient service. For example:

- The Commissioner should not have to wait four months to hire the management team he

Over time, the Administration and Congress will have to give careful consideration to the appropriate size of the IRS budget. The budget has declined by more than nine percent in real terms over the last two years. On the one hand, efficiency improvements are surely possible through information technology, which should enable us to reduce the budget. On the other hand, more customer service requires more people serving customers, and experience demonstrates that investments in improving compliance have pay-offs in extra revenues that far exceed their costs.

IV. Simplify Taxes

Fourth, we will work to simplify the tax code.

There is no doubt that we can do a better job of administering the tax laws than we have. But our job, and yours, would be far easier if we, working with Congress, were able to streamline our 9,451-page tax code.

Our Administration has already taken several steps toward simplification. This audience knows first hand how our "check-the-box" regulations have simplified tax planning and compliance, particularly for small business. The President's current proposal to exclude up to $500,000 of capital gains from the sale of a home will dramatically simplify record keeping for more than 60 million families. The President's budget also states our intention to introduce new tax simplification legislation in this year's budget cycle.

There are some who, based on the complexity of the tax code and on problems at the IRS, argue for extreme measures such as a flat tax. I believe that such proposals would not only unfairly increase the tax burden on the middle class and hamper economic growth, they would not simplify the administration of the tax code.

V. Leadership

Ultimately, every business executive knows that leadership is crucial to performance. Leadership is particularly important when there is a need to change the culture of the organization.

Over the last four years, Commissioner Richardson has guided the IRS through difficult times and has made progress in many areas. Now, as we move forward, we are committed to appointing a new Commissioner who has experience with the challenges of organizational change, customer service improvement, and information technology management that the IRS faces. While technical excellence in tax matters must be maintained, the greatest challenges facing the IRS in the coming years are managerial.

We will charge the new Commissioner with developing a detailed strategic plan for change. And we will work to give the new Commissioner the flexibilities and tools he or she needs to effect change and to recruit a first-rate management team.

Mr. COYNE. To Mr. Dolan, in light of the continuing concerns about the quality assistance to taxpayers that we're all concerned about, and the taxpayer advocate's report to this Subcommittee concerning major problems facing the taxpayers in dealing with the IRS, I wonder if you could respond to the question that some of my constituents are asking me about to the justification for moving work out of the Pittsburgh office, when it was ranked 6th out of 65 districts in total efficiency, while the Philadelphia office was ranked 45th.

The Pittsburgh office got a good grade, ranking 6 out of 65 districts. Philadelphia was ranked 45th, yet we're moving work from Pittsburgh to Philadelphia.

Mr. DOLAN. I'll be happy to answer that question. I think perhaps the ranking that we're talking about is either in one of two areas, and I don't have it right in front of me. It's either a field office total performance index, or it has to do with the individual call site.

But in either event, let me answer the question hopefully in a way that would satisfy your constituents. As the Chair just said, one of the things that we have found is that our organizational structure was indeed a function of the fifties.

It remained relatively constant, in terms of its consumption of our dollars and resources. And one of the things we set out to do in 1992–93 was what most large corporations have done, in looking at the overhead structure and in satisfying ourselves that we made that overhead structure as efficient as possible.

That was before we entered the declining resources. Our objective at that point was to put every additional man or woman we could on the customer service frontlines, on the compliance frontlines.

It was not under the crush of the financial gun to our head. It was, we thought, a prudent way to run a business. And we did that. We looked at the seven region structures, and said, Well, some people have been able to do away with regions altogether. We looked at what kind of a business we were, the number of customers, and said we can't do that. But we did not need seven. So, we went from seven to four.

We did that, in part based on performance, but in part based on what were some geographical things that made sense.

Then we got to the harder question, the one that affected the Pittsburgh district. That is, we had 63 districts. In many cases the districts were aligned with a particular State, or a particular set of historical facts. They weren't always—it wasn't always the same rationale by which something became a district. And over time a few districts have been added, a few have been subtracted, but for the most part we ran in the middle sixties with the number of districts.

We looked at that and said There is an awful lot to be gained by having similarly sized offices, where we could concentrate some expertise. We didn't have to worry about the smaller districts that maybe had only 100 people, and we had a very hard time keeping engineer talent there, keeping international talent there, or even keeping talent on a particular part of the Tax Code that we wanted to give advice on.

And so a good part of what we did, we spent the better part of a year looking at the way we had our districts organized, and found what we thought would be the most highly leveraged combinations of 63. And we looked at whether it should be 20, 50, or 40. We ran data through various kinds of models, and at the end of the day what we did in Pittsburgh was let me say that Pittsburgh is an excellent work force. It has historically been an excellent work force. Its call site personnel are historically among the best we've had. And we did not for 1 second erode any of that operating base. But we looked at the State of Pennsylvania, and said wait 1 minute, do we need two entire district apparatus, district directors, division chiefs, branch chiefs, support activities.

And when we looked at that and we looked at the Philadelphia district being a significantly bigger district at that point, looked at the pluses and minuses of where would you locate the headquarters, that's kind of the way that decision got made, and it got made that same way across the other 30 districts that got consolidated.

At the end of the day, what we have taken out of Pittsburgh are only some of the compliance support activities, and some of the resource management support activities that can be done from a consolidated point. And we took the management overhead out.

So it was in no way a shot at the quality of the Pittsburgh office. As a matter of fact we continue to rely during this filing season very heavily on the Pittsburgh taxpayer service site.

Mr. COYNE. I will have additional questions on this matter. My time has expired here, but I'd like to be able to submit these questions to you to be able to get a response.

Mr. DOLAN. I'd be pleased to respond to them.

[The following was subsequently received:]

IRS Answers to Questions Submitted by Rep. William Coyne

Question: In light of the continuing concerns about quality assistance to taxpayers, and the Taxpayer Advocate's report to this Subcommittee concerning the major problems facing taxpayers in dealing with the IRS:

How can the IRS justify moving work from the Pittsburgh office when it was ranked sixth out of 65 districts in efficiency, while the Philadelphia office was ranked forty-fifth?

In May 1995, Internal Revenue Service (IRS) announced plans to consolidate its 63 district offices into 33 district offices. IRS' objectives in consolidating the district offices were to (1) foster an integrated and consistent approach to compliance over a wider geographic area, (2) decrease taxpayer burden by creating consistency across wider geographic areas, and (3) provide managers with greater flexibility to shift compliance staff within the district to respond to changing workload requirements.

Before the district office consolidation, Pennsylvania had two districts, one headquartered in Philadelphia and the other in Pittsburgh. As a result of the consolidation, the two districts were merged to form the Pennsylvania District, headquartered in Philadelphia. In deciding which districts to merge nationwide, IRS attempted to create districts that were more uniform in size than was the case under the structure of 63 districts. Accordingly, total staffing was a key criterion that IRS used to decide which district offices should retain a management structure and be designated as continuing districts. Generally, smaller districts were merged into larger ones, as was the case in Pennsylvania, where Pittsburgh was merged into Philadelphia.

To assess the interactions of the various functional reorganizations on district office responsibilities, the IRS convened a task force for each functional area affected by the consolidation. On the basis of input from these functional teams, the IRS developed an Organizational Impact Analysis report that outlined a standard approach for consolidation. One of the recommendations was that all district office compliance support functions be centralized in the continuing districts, unless a business case (cost benefit analysis) could be made for an exception.

As a result of a request for an exception, the IRS ultimately allowed the Pennsylvania District to centralize its collection support function in Pittsburgh. Of ninety-three positions that were granted exceptions nationwide, sixty-three were in Pittsburgh.

Question: How can the IRS justify RIFs in Pittsburgh and rehiring additional employees in Philadelphia when locality pay and rent per-square-foot are significantly lower in Pittsburgh?

In a Memorandum of Understanding (MOU) between IRS and National Treasury Employees Union (NTEU) dated October 9, 1997, the IRS agreed not to conduct a RIF. Consequently, employees will not be RIFed in Pittsburgh nor will additional employees be hired in Philadelphia.

Question: How can the IRS justify the loss of tax administration in the entire western half of Pennsylvania?

We do not believe tax administration in the western half of Pennsylvania will be affected by the restructuring. The restructuring efforts did not impact the size of the front-line compliance or customer service staffs in Pittsburgh. Positions eliminated as a result of the restructuring were entirely support and managerial positions.

Question: Considering these points, how can the IRS show that there is a cost benefit to the field reorganization concerning Pittsburgh?

As discussed previously, we believe there are solid business reasons for the restructuring efforts. The consolidation of support functions has resulted in the elimination of support positions both in Pittsburgh and Philadelphia. The elimination of these positions represents a savings in itself. With the MOU signed October 9, 1997, with NTEU, these positions will be redirected to front-line compliance and customer service positions. As a result we expect customer service and compliance to improve.

TAXPAYER SERVICES

Question: The IRS and others have conducted five "customer service surveys" evaluating the IRS's ability to provide efficient and satisfactory service to taxpayers. What conclusions can be reached from these surveys?

The surveys that have been conducted have generally been customer satisfaction surveys rather than customer service surveys, however, these surveys have provided clear indicators from taxpayers that they expect the same level of service from IRS that they can receive from the non government business community.

Question: To the extent specific IRS employees, or specific IRS offices, have provided below-acceptable service to taxpayers, what has the IRS done?

The surveys done by IRS were not structured to identify individual employees or specific offices. Rather the surveys were designed to measure customer satisfaction with the corporate delivery and quality of assistance related services and general level of customer satisfaction with compliance related contacts.

TAXPAYER ERRORS

Question: Again, for the 1997 tax return filing season, the "most common" errors taxpayers and tax preparers make in filling out tax returns relate to calculating and correctly claiming the earned income tax credit. This problem area continues to make the "top of the chart" every filing season.

What, exactly, has the IRS done for the 1997 filing season to reduce the number of innocent errors taxpayers and tax return preparers make in claiming the EITC? Should the EITC form and instructions be simplified to prevent unnecessary errors?

We made some editorial changes to the 1997 instructions to highlight who can claim the credit. However, before making extensive changes to the Schedule EIC and/or worksheets, we need more detailed information about the kinds of errors being made by taxpayers and preparers. We have tried to address the most common errors by including a section titled "How to Avoid Common Mistakes" in the tax forms instructions. We advise taxpayers to provide the correct SSN for dependents and to check their math, especially for the earned income credit.

We reorganized the 1997 Publication 596, Earned Income Credit, to eliminate duplicate information, streamline it and regroup qualifying information. Taxpayers will now find general rules explained first, then information for those with qualifying children and finally, information for those without qualifying children.

As part of the EITC initiative, the Service will be gathering information about taxpayers' filing behavior and what marketing techniques are appropriate for the target audience. We can use this data to decide what changes are necessary to forms, instructions and publications.

The EITC has complex qualifying rules and computations which involve both earned and unearned income. For 1998, we will be changing the instructions again to reflect the provisions in the Taxpayer Relief Act of 1997. In computing modified Adjusted Gross Income (MAGI), for purposes of the credit, taxpayers will have to add tax-exempt interest and nontaxable distributions from pensions, annuities and individual retirement arrangements. The Act also changed the percentage of business losses disregarded in the computation of modified AGI. For low-income taxpayers with little expertise in tax matters, trying to determine their correct credit with these complexities can cause errors.

FILING FRAUD

Question: The IRS continues to implement anti-fraud measures, including "computer fraud screens" and streamlined "math error procedures." How successful have the IRS's anti-fraud actions been to date?

The actions taken since the inception of the Revenue Protection Strategy several years ago have been impressive. Most recently, over 2 million returns with missing or invalid TINs were identified and processed using math error procedures. Taxpayers who do not have a valid TIN for themselves, certain dependents, children if claiming the earned income credit (EITC) cannot claim the exemption for these dependents or the EITC. In addition, the compliance functions continued to pursue questionable refund returns. In FY 1996, we continued our vigorous compliance efforts to identify and stop fraudulent refund schemes and to pursue questionable claims through pre-refund examinations. In FY 1996, we identified nearly 2,450 fraudulent refund schemes involving 24,000 returns and prevented the issuance of $46.8 million in refunds. We initiated 313 criminal investigations involving refund schemes. Prosecution recommendations were forwarded on 279 cases and indictments were obtained on 290 individuals and conviction in 304 cases. Through pre-refund examinations, we prevented the issuance of an additional $864 million in refunds. Thus, last fiscal year, our direct enforcement efforts prevented $932 million in erroneous or fraudulent refunds from being issued.

Question: What new anti-fraud controls are in place for the 1997 tax return filing season?

As in past years, the Service will not disclose detailed information concerning plans for fraud control and revenue protection. However, there are broad pieces of the revenue protection strategy that we will share to assist taxpayers and return preparers in filing accurate tax returns. Our main focus continues to be the validation of taxpayer identification numbers (TINs) on all tax forms and schedules requiring identification numbers, including:

- Security Numbers (SSNs) issued by SSA, Individual Tax Identification Numbers (ITINs) issued by IRS for non-citizens unable to obtain an SSN, Adoptive Tax Identification Numbers (ATINs) issued by IRS to families in the adoption process. (An SSN cannot be issued by SSA until the adoption is finalized.) Missing or invalid tax identification numbers will result in reduced refunds unless the appropriate information can be provided.
- Another segment of the strategy is to identify questionable refunds; refunds will only be issued after the taxpayer provides acceptable proof of eligibility for various credits and deductions claimed on the return.
- Other compliance/enforcement efforts will continue. We will proceed with criminal investigation and prosecution of fraudulent refund claims.

Although not necessarily new, the anti-fraud controls will again identify problematic returns. The additional resources recently approved will allow us to follow-up on a significantly larger portion of the returns identified.

1997 FILING SEASON

Question: The filing season appears to be going well. How long, on average, is it taking for the IRS to issue refunds for paper-file and for electronically-filed returns?

Refunds for paper filed returns average 39 days. For Electronically filed returns, however, the average turnaround for refunds is 14.5 days.

Question: Are all major tax forms and instructions available to taxpayers immediately upon request?

Generally, all forms and instructions are scheduled for development, production and delivery so that they are available (in paper) for individual taxpayers during the first week of January. Distribution of paper copies are made to IRS Posts of Duty, Area Distribution Centers, many post offices, and libraries.

In addition to these paper copies, products are also made available to the public electronically (IRS Bulletin Board, IRS Internet Web Site and by Fax), usually within 72 hours of the approval to print an item. This is obviously the most immediate source of IRS published products especially for those behind scheduled late legislation or technical development issues.

See attached copy of Publication 2053A "Quick and Easy Access to IRS Tax Help and Forms" for details of these alternative sources. (Attachment A)

Question: Are any forms or other materials currently on backlog?

There are generally items that are not "immediately" available throughout the year for various reasons. These items are tracked and reported on the "Backorder Status Report." Attached is a copy of the most current report as of October 18, 1997, showing items currently not yet available in paper versions, listing projected availability, and volume of orders on hand. (Attachment B)

Question: What are the major reasons taxpayers are calling the IRS?

Taxpayers call to obtain tax law information, in response to notices or bills and to inquire about the status of their refunds.

Question: What are the most common questions taxpayers ask when calling the IRS?

The most common question taxpayers ask is: "Where is my refund?" The five most common tax law topics (based on the frequency of tax topics selected in Tele-tax) are:

—Electronic filing;
—Dependents;
—Medical and dental expenses;
—Earned income tax credit;
—Filing requirements, filing status, and exemptions; or

Question: Have taxpayer walk-in services and open IRS office hours been expanded or reduced for this filing season?

During the FY 97 filing season our walk-in offices continued to provide the same national level of service as during the prior year. Walk-in offices also assisted individuals in the application process for the Individual Tax Identification (ITIN), beginning 7/1/96. The total number of walk-in offices open during this past filing season was 397. The hours of operation remained the same as FY 96 for most of our headquarters offices: Monday thru Friday—8:00 a.m.–4:30 p.m. Posts-of-duty days and hours of operations varied based on taxpayer demand and resources.

IRS TELEPHONE TAXPAYER ASSISTANCE

Question: IRS data for early March shows that the "level of access" for taxpayers calling the IRS is above 70%. This is an improvement from earlier filing seasons. However, even at the 70% level, over 7 million taxpayers have not been assisted. What level of access should taxpayers get when calling the IRS (i.e., is 70% good enough)?

From an IRS/Customer Service perspective, 70% is not good enough and we are moving toward a higher level of service for 1998.

Question: Does 70% level of service mean that 70% of the taxpayers calling actually talk to IRS employees on their first try?

The level of access means that 70% of the taxpayers who called had their questions answered by an IRS employee or an automated service. It does not address how many call attempts they made before they received an answer.

Question: The Fiscal Year 1998 budget contains $39 million to be used for the reprogramming of IRS computers to handle the century date. Where is the IRS in the conversion process?

The FY 1998 Appropriations provided $376.7 million ($289.7 million of current year funds and $87 million in FY 1996 and FY 1997 funds) for Century Date Change requirements, which includes $79 million for conversion and testing. The IRS expects to expend 580 full time equivalents (FTEs) or approximately $39 million for in-house conversion and testing activities. In addition, $40 million is needed for 313 contractor FTEs and discretionary expenses. Current estimates are that this funding is sufficient for the Service's FY 1998 conversion and testing efforts. If the IRS identifies other conversion requirements it will try to obtain Congressional approval to allocate some of the $42 million contingency funding to other conversion efforts.

- Status of Mission Critical Systems

—4 mission critical systems have already been converted.
—58 mission critical systems have been converted and will be implemented by January 1998.
—All 121 mission critical systems will be converted by January 1999.

Conversion Milestone	Status of Information Systems Owned Applications (As of 10/17/97)	Status of All IRS Applications (As of 10/17/97)
Assessment	Completed	Complete 9/30/97
Renovation	74%	53%
Testing	31%	22%
Implementation	4%	4%

In the first quarter of FY 1998, the IRS will complete the scheduling of the field and customer managed systems to be retained for conversion (expected to be in Phases 4 and 5). Conversion of telecommunications components will be conducted from January 1998 through February 1999 (Phases 4 and 5). A more detailed milestone schedule will be available by December 31, 1997.

Question: Will the various types of data received from the outside and critical to the IRS, such as Social Security wage information, also be reprogrammed in a timely and appropriate manner?

The IRS is trying to ensure that its trading partners can become Year 2000 compliant in a timely manner. The Century Date Project Office has spoken at public meetings, including the Information Returns Program Advisory Committee (IRPAC) and tax preparers' symposiums. It will work through established partnership organizations (e.g., CERCA, American Payroll Association) to reach a broader audience. The IRS also will provide Year 2000 conversion plans and date format standards required for exchanging data with its external trading partners on its Internet home page. The Project Office has included the external trading partner strategy in its Year 2000 Project Management Plan (version 3, September 12, 1997). There is awareness, concern, and strong support for the external trading partner efforts at the executive level within Information Systems. The IRS has appointed an executive, the National Director of Governmental Liaison and Disclosure, to lead the effort from the business side. There will be a "Communications Package" on this effort for field heads-of-office.

With the support of the Business owners, the IRS is building a data base to document agreements on schedule and Year 2000 compliance requirements between the IRS and all of its external trading partners, as well as to track the progress of these partners through the conversion process. The Project Office developed testing plans for external data exchanges which updated testing requirements in the Unit Test Procedures Handbook. External data exchanges will be tested as part of integration or "compatibility" testing at the IRS. The Project Office will track the progress of the testing with external trading partners.

By December 1997, the IRS will have a list of the key systems (e.g., Electronic Federal Tax Payment System) which exchange data with trading partners and their major trading partners (e.g., Social Security Administration) to address issues and focus its efforts. While the IRS will continue to specify its data requirements (e.g., through revenue procedures), and will document and test data formats for all external trading partners, it will also conduct an outreach program for the key trading partners which will entail site-visits and expanded tracking of their Year 2000 efforts and status. Further, the IRS will be doing additional verification of its most critical data exchange partners' plans to bring their systems into full year 2000 compliance. The external trading partners reviews are scheduled to be conducted from February 1998 through July 1998. The IRS has already begun discussions with the Social Security Administration on the data exchange requirements for wage information.

The IRS will incorporate contingency management measures (e.g. bridge software) in its plans which will be executed if any of its trading partners fail to become Year 2000 compliant as scheduled. The Project Office requested that the executive responsible for disaster recovery obtain certification that the Service's external disaster recovery site was Year 2000 ready.

(ATTACHMENT A)

Quick and Easy Access to IRS Tax Help and Forms

PERSONAL COMPUTER

Why not use a personal computer and modem to get the forms and information you need?

Here is a sample of what you will find when you visit the IRS's Internet Web Site at—http://www.irs.ustreas.gov

- Forms and Instructions
- Publications
- Educational Materials
- IRS Press Releases and Fact Sheets
- Tele-Tax Information on About 150 Tax Topics
- Answers to Frequently Asked Questions

You can also reach us using:

- File Transfer Protocol at **ftp.irs.ustreas.gov**
- Telnet at **iris.irs.ustreas.gov**
- Direct Dial (by modem) 703-321-8020.

PHONE

You can also get information and forms by phone.

Forms and Publications

You can order forms, instructions, and publications by phone. Just call 1-800-TAX-FORM (1-800-829-3676) between 7:30 a.m. and 5:30 p.m. on weekdays. The best time to call is before 9 a.m. or after 2 p.m. Thursdays and Fridays are the best days to call. (The hours are Pacific time in Alaska and Hawaii, Eastern time in Puerto Rico.) You should receive your order or notification of its status within 7 to 15 workdays.

Tele-Tax Topics

You can listen to pre-recorded messages covering about 150 tax topics by calling 1-800-829-4477.

WALK-IN

You can pick up certain forms, instructions, and publications at many post offices, libraries, and IRS offices. You can also photocopy, or print out from a CD-ROM or the Internet, many other products at participating libraries.

FAX

*Just call **703-487-4160** from the telephone connected to your fax machine to choose from over 100 forms and instructions or about 150 Tele-Tax topic.*

MAIL

You can order forms, instructions, and publications by sending a request to the IRS Distribution Center nearest you: (You should receive your order or notice of status within 7 to 15 workdays after we receive your request.)

Western part of the U.S.:	Western Area Distribution Center	Rancho Cordova, CA 95743-0001
Central part of the U.S.:	Central Area Distribution Center	P.O. Box 8903 Bloomington, IL 61702-8903
Eastern part of the U.S. and foreign addresses:	Eastern Area Distribution Center	P.O. Box 85074 Richmond, VA 23261-5074

CD-ROM

To order the CD-ROM, contact Supt.Docs. at 202-512-1800 (select Option #1), or by computer through GPO's Internet Web Site (http://www.access.gpo.gov/su_docs).

For small businesses, return preparers, or others who may frequently need tax forms or publications, a CD-ROM containing over 2,000 products can be purchased for $25 from the Government Printing Office (GPO), Superintendent of Documents (Supt.Docs.). Current tax year materials, and tax forms from 1991 and publications from 1994, are included on the disc.

The first release of the CD is available early January and the final release is available Mid-February. The following minimum configuration is required to use the CD:

- Windows 3.1 or later/Windows95
  - 386, 486, or Pentium-based personal computer;
  - 4 megabytes of RAM;
  - Windows-compatible printer with at least 1 Mb of user RAM.
- Macintosh
  - Macintosh 68020-68040: 2 megabytes of application RAM
  - Power Macintosh: 4.5 megabytes of application RAM
  - Apple System Software version 7.5 or later
  - CD-ROM drive capable of reading ISO 9660 format

Department of the Treasury
Internal Revenue Service
Publication 2053A (1-97)
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BACKORDER STATUS REPORT (ATTACHMENT B) **As of October 18, 1997**

Total Backorders

CENTER	100% BACKORDERS
EADC	10,064
CADC	12,859
WADC	5,736
TOTALS	28,659

Breakdown by Center and Product

CENTER	ITEM	VOLUME	CUM %
EADC	Publication 454	3,646	36.2%
	Publication 1518	2,761	27.4%
	Publication 587	1,020	10.1%
	TOTAL	7,427	73.8%
CADC	Publication 454	4,231	32.9%
	Publication 1518	3,915	30.4%
	Publication 1045	3,338	26.0%
	TOTAL	11,484	89.3%
WADC	Publication 454	1,813	31.6%
	Publication 1518	1,363	23.8%
	Publication 1045	1,360	23.7%
	TOTAL	4,536	79.1%

Cumulative ADC Backorders

ITEM	TITLE	COMMENTS	VOLUME	CUM. %
P 454	Your Business Tax Kit	Pub 454 should be in ADCs by Dec. 1. Pub 910 which is included in Pub. 454 will not be available until mid to late Nov.	9,690	33.8%
P 1518	Tax Tips – A Calendar for Small Businesses	Camera copy went to GPO 10/8/97 with projected ship date the second week of November.	8,039	28.1%
P 1045	Information for Tax Practitioners	Ship complete from contractor 10/10/97. Stock should be in all ADCs by 10/22/97.	4,698	16.4%
P 587	Business Use of Your Home	Stock is being transferred from CADC to EADC	1,020	3.6%
		TOTAL	23,447	81.8%

Bonnie Campbell, T:M:L, 202-622-6470 20-Oct-97

Mr. COYNE. And also, Madam Chairwoman, I have a letter from Commissioner Richardson relative to this subject and cutbacks that I would like to be able to insert in the record at this point.

Chairman JOHNSON. So ordered, Mr. Coyne.

[The information follows:]

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

March 14, 1997

The Honorable William J. Coyne
Ranking Democrat
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives
Washington, DC 20515-3814

Dear Mr. Coyne:

I am writing in follow-up to our March 5, 1997, meeting at which you expressed concern about reductions to the IRS workforce in Pittsburgh. Beginning in 1992, the IRS conducted a series of studies to fundamentally improve how it accomplished its mission. The studies resulted in decisions to make certain major realignments in the field office structure. These realignments were designed to reduce management and overhead positions and redirect those resources to front line customer service and compliance programs, consolidate and improve customer service telephone operations, and centralize administrative and support responsibilities as much as possible.

The realignments have reduced the number of IRS regional offices from seven to four, the number of districts from 63 to 33; customer service telephone sites will be reduced from 70 to 23. The realignments were planned to take place in stages. First, during FY94, the regional offices were consolidated. Executive and managerial personnel from the three discontinued regions were redeployed, and their responsibilities were assumed by the four remaining regions. The four region configuration was fully operational on November 1, 1995. Throughout FY95, the district offices designed and began to execute their transition plans in partnership with the National Treasury Employees Union (NTEU). On November 1, 1996, the Service began operating with 33 districts. The vast majority of the executive and senior management personnel from the 30 non-continuing districts either left through retirement or transferred to continuing management positions during FY95. In some cases, managers chose to assume technical positions. There was only minor redeployment impact on bargaining unit personnel, and these actions were governed by negotiated agreement.

Underlying these actions was an assumption that the resources saved through consolidation would be redirected and invested in customer service and compliance; there was no reduction of overall staffing levels planned. Congressional approval of a 5-year revenue initiative which funded more than 6,000 compliance FTEs supported this assumption. It allowed the IRS and NTEU to join in formulating a series of

redeployment strategies and transition plans designed to capitalize on the experience of our workforce and ensure employment security. The plans assumed a gradual transition which would allow for attrition and voluntary job movement to adjust necessary staffing levels between the continuing and non-continuing offices.

This crucial revenue initiative was discontinued after only one year. Not only did this strain already limited salary dollars but also the availability of positions over the longer term in which we could place employees displaced by the reorganization. The bottom line is that the IRS cannot afford to extend the completion of the field restructure over a long period of time as originally envisioned.

The field realignments are moving the Service forward in terms of both efficiency and effectiveness in accomplishing its mission. They must be completed expediently for both the Service and the taxpayer to realize the benefits.

In April 1996, the Internal Revenue Service initially announced the second phase of its Regional and District Management Consolidation. In the fall, you met with Dave Mader and expressed your concern at that time about the reduction in the workforce in Pittsburgh. In excess of 100 positions in the Pittsburgh metropolitan area were identified as non-continuing. These were primarily compliance support positions, management positions, overhead positions including personnel and training positions (Support Services), and information systems positions.

After the Pennsylvania District submitted a compelling business case which showed that significant revenue could be produced, and significant savings achieved, if some support positions were consolidated in Philadelphia, with others being consolidated in Pittsburgh, the number of non-continuing positions in Pittsburgh was reduced to fewer than 75. The additional revenue would be produced by redirecting revenue officers from support units in Philadelphia back to the field where the revenue potential is greater than in Pittsburgh.

Since that time, we have made significant progress in placing employees within the Pittsburgh metropolitan area.

- Two employees found positions outside the IRS through the voluntary outplacement services provided by Drake Beam Morin (DBM), a private contractor providing outplacement services, in almost 50 locations Servicewide. In addition, 16 employees who utilized the services of DBM have moved to other positions within the IRS.

The Honorable William J. Coyne

- Twenty-six employees accepted Voluntary Separation Incentive Payments (buyouts). Of this 26, 11 employees were employees in non-continuing positions, and the remainder were employees whose separation would create a placement opportunity for an employee in a non-continuing position.

- On March 3, 1997, we announced approximately 30 vacancies in Pittsburgh, primarily compliance support positions. It is our intent over the next several weeks to announce additional vacancies (e.g., attrition vacancies) after we have fully analyzed out ultimate staffing needs.

At this time, although we cannot fully assess the ultimate impact of our reorganization on the Pittsburgh metropolitan area, we are confident that through our voluntary processes we will reduce the number of occupied non-continuing positions to fewer than 30.

I know that you and your colleagues have been told that service to customers has been or will be adversely affected due to this reorganization. That is simply not the case either in the Pennsylvania District or throughout the United States. This year we made a concerted effort to improve our service to taxpayers, particularly the level of access on our toll-free assistance system.

I have asked Ms. Darlene Berthod, our newly selected Director of the Pennsylvania District, to provide me with the latest performance statistics. As you can see from the enclosed status report, dated March 13, 1997, taxpayers throughout Pennsylvania are receiving improved service this year.

I hope that this reassures you that our goals are the same – to improve customer service and improve efficiencies of tax administration. If you have any questions, please have your staff contact David Mader, Chief Management and Administration, at 202-622-4700, or you may contact me directly.

Sincerely,

Peggy Richardson

Margaret Milner Richardson

Enclosures

PENNSYLVANIA DISTRICT
March 13, 1997

Customer Service

Attached are comparisons between 1995, 1996, and 1997 for each of our customer service related activities. Where possible, the data is broken down between Philadelphia and Pittsburgh.

In addition, attached is a chart which reflects the totals for 1996 and 1997 broken down into weekly segments for our Walk-in Operation. The chart also compares the level of service for the current filing season versus last. Overall, the data reflects that we are servicing over 20% more taxpayers this year than we did at this point last year

The following should also be noted. More taxpayers have been directed to VITA sites for actual return preparation; therefore, while the number of returns actually prepared at Service locations has decreased, customer service levels have been maintained through taxpayer utilization of the VITA sites. Also noteworthy is the decreased number of account referrals. Account referrals reflect taxpayers whose inquiries cannot be fully addressed at the walk-in site, thus, necessitating a referral to another function. This year the walk-in sites have been given more authority and investigative abilities to resolve customer inquiries. A decrease in the number of account referrals actually reflects an increase in customer service (one-stop customer service).

PENNSYLVANIA DISTRICT
March 13, 1997

WALK-IN ACTIVITY (FILING SEASON)

	1995	1996	1996	1997
Form Distribution	156,284	132,359	72,680*	91,374**
Returns Prepared	25,274	23,313	11,470*	3,510**
Other Walk-In	144,708	102,771	53,532*	74,463**
Acct. Referrals	1,143	3,793	2,079*	631**
Totals	327,409	262,236	139,761*	169,978**

* As of March 9, 1996
** As of March 8, 1997

TELEFILE

	1996 (thru 4/19/96)	1997 (thru 3/7/97)
Philadelphia	88,746	128,920
Pittsburgh	57,539	90,515

PRACTITIONER ELF

	1995	1996	1997 (thru 3/7/97)
Philadelphia	247,805	249,674	214,287
Pittsburgh	164,738	168,925	135,846

VITA/ELF

	1995	1996	1997 (thru 3/7/97)
Philadelphia	315	1,696	1,055
Pittsburgh	128	244	51

WALK-IN ELF

	1995
Philadelphia	879
Pittsburgh	1,275

(NO ELF IN WALK-IN IN 1996 OR 1997 AS THEY ARE NOW BEING DONE IN VITA SITES)

VITA

	1995		1996		1997 (to date)	
	Phila.	Pitts.	Phila.	Pitts.	Phila.	Pitts.
Taxpayers Assisted	29,098	49,384	54,132	42,921	12,720*	11,960*
# of Sites	193	217	229	208	271*	218*
# Volunteers	865	810	993	770	1,020*	792*
# Returns Prepared						
Federal	19,086	24,003	39,610	31,569	9,896*	9,007*
State	9,987	11,898	11,045	13,231	1,908*	1,389*

* This data is through March 7, 1997. VITA statistics are historically not reported until the filing season has ended. These are very preliminary numbers.

PENNSYLVANIA DISTRICT
March 13, 1997

AARP/TCE

	1995		1996		1997
	Phila.	Pitts.	Phila.	Pitts.	
Taxpayers Assisted	41,123	40,054	52,521	46,374	AARP/TCE data for 1997 not available until April, 1997
# of Sites	221	217	241	216	
# Volunteers	954	886	978	987	
# Returns Prepared					
Federal	33,817	28,890	36,619	31,459	
State	25,620	23,786	24,001	21,987	

CALLS ANSWERED

	1995 (total)	1996 (total)
Philadelphia	1,425,295	1,155,582
Pittsburgh	1,514,995	1,593,343

	1995 (thru 3/11/95)	1996 (thru 3/9/96)	1997 (thru 3/9/97)***
Phila.	421,205	501,959	513,206
Pitts.	587,644	699,081	841,331

*** LEVEL OF ACCESS AS OF 2/22/97 WAS 63%. IN ADDITION, THE LEVEL OF DEMAND HAS BEEN LOWER THAN IN PREVIOUS YEARS DUE TO THE ADDITION OF THE SERVICE CENTER SITES FOR RECEIPT OF CALLS

QUALITY

	1995	1996	1997 (thru 3/1/97)
Philadelphia	84.6%	89.7%	88.4%
Pittsburgh	95.2%	97.5%	95.9%

Mr. COYNE. Thank you.

Chairman JOHNSON. Congresswoman Dunn.

Ms. DUNN. Thank you very much, Madam Chairman, and I apologize, Mr. Dolan for having missed almost all your testimony. I was in a joint leadership meeting and wasn't able to get here any earlier. And I am most interested in what you have to say, and have had a chance to read through your written comments.

Obviously the IRS is facing a very great workload with a flatline budget, and fewer employees. Can you tell me how this is going to be reflected in a couple of areas, the first being the audits? How many audits will be conducted, of what type, and how is this going to help you with your compliance responsibilities?

Mr. DOLAN. Well, just a tiny bit of background. I may have mentioned before you came in, but in 1996 and 1997 we have essentially been in a posture where we have done no new hiring of revenue agents or tax auditors. So essentially wherever the attrition has fallen, in 1996, and thus far into 1997, we've taken the loss. We have not backfilled any revenue agents.

And one outcome of that is that it isn't the most rational way to deliver an audit plan. So what we will do in anticipation of 1998 is again look for ways to create a presence or an involvement that may be less dependent on the classic one on one audit, because the

bottom line will be there will be fewer audits in 1998 than there were in 1995.

One of the things, when you look at our charts in our testimony, that we sometimes don't do a decent enough job of explaining is that we have included in the 1995 and 1996 bar charts what we call correspondence examinations. And that will make them look a little more stark.

The correspondence examinations were used specifically in the way that the Chair identified earlier as a part of this revenue protection strategy. When we first tried to cure the Social Security number problem, we went with all kinds of publicity. We then held up a number of those and put them through a correspondence examination.

With the help of this Subcommittee and Congress, this year we have something called a math error capability which doesn't require us to put one of those missing Social Security number cases through the entire examination process.

We do it in a much more summary process. So some of what will appear in the testimony as a fall off between 1996 audit rate and what we will do in 1997 and 1998 is a function of this kind of transaction no longer being required to be done through the classic examination process.

Ms. DUNN. What is the number of employees currently in the IRS?

Mr. DOLAN. It's 102,000 and something. And I would be happy to give you that as of the last pay period.

Ms. DUNN. That's fine.

[The following was subsequently received:]

The FTE count for fiscal year 1997 is 102,926.

Ms. DUNN. I wanted to ask you a question on electronic filing. When we first discussed that, it seemed like it would provide greater compliance, and would allow you to work on improving compliance without a lot of negative benefits to businesspeople.

Since then we have found that especially for small businesses it's tough for them to have to move to that sort of filing system. There is legislation out there that would allow a taxpayer to make a choice between the old system and electronic filing.

Tell me what your thoughts are on that, and how is it going to affect your ability to improve compliance?

Mr. DOLAN. I think we are very much still a believer that the electronic filing process does both things. It creates a tremendously more effective customer service environment, but it also can be a terrific asset in compliance.

Because what it will do over time is allow us to know more about the total population of filers, and be able to use on a realtime basis the attributes of a return to not waste the time of somebody on a return that fits within a particular pattern that today we have to take through a more manual process of pulling it out by a DIF score, putting it before a classifier's eyes, putting it in the examination process, and then finding out whether or not there really is the anomaly that there appeared to be.

So there will be a compliance benefit. The other compliance benefit, quite frankly, is to the extent that that data is electronic and we can react to anomalies earlier, we can react to somebody who is in trouble, someone who has a first quarter delinquency, and we can react to that in the first quarter of their delinquency, rather than three or four quarters later where their alternatives are they've got no way to get the money, they're confronted with a choice of do I go out of business or do I pay my tax.

And so tremendous, small "c" compliance benefits, I think, of moving more and more of the interfaces between—and the business community I think again—I may have mentioned this before you came in the room. We're doing something that's exciting to us. That's in the southeast part of the country we will take employers in 14 States and allow them to do their quarterly tax return on a touch tone phone, much like we do with the TeleFile.

Now, I think we want to develop some data to see whether they'll do it as quickly, but we think we probably will do it maybe even more quickly than the 8 to 10 minutes on average that it takes a 1040–EZ filer.

We think that kind of a system will have a whole lot more appeal to business than visions. Some businesses, I think, misunderstand the threshold investment, either of time or equipment. The other thing that you may have mentioned is our EFTPS Program, which is based on a very successful tax link program where we've had, I think, in the neighborhood of 72,000 to 75,000 people in this system voluntarily.

We now have something over 900,000 enrolled of the 1.2 million that are due to begin in July. And for the most part, people who get past the entry shock and get themselves enrolled, find out how tremendously simple it is. I mean, basically, access again to a telephone.

What we've been trying to do with the banks, the payroll houses, and all of the constituency groups is make sure that the businesses who see this—and might in the first instance be put off by it—understand how relatively simple it is, and how inexpensive and nonintrusive it is.

So in part we've been trying to do a better job of marketing and informing that group.

Ms. DUNN. I was just going to suggest, do you think you're getting the word out?

Mr. DOLAN. We could always do a better job.

Ms. DUNN. I continue to hear from my small business folks that they really would like to have the choice because they're fearful this would take a great deal more money and time. And compliance, as we all know, is very expensive right now.

Mr. DOLAN. We have worked very hard with the benefit of some private marketers as well. We've established linkages with the FMS and with the banking community. We've got a lot of people who have tried to help us carry the message.

And we are in the very late stages now. We will put in the hands of each of our district directors probably within the next 15 or 20 days the residual 200,000 whose obligations will accrue in July to make sure again that people aren't surprised by that, that they've heard from us, that we've done some direct outreach, so that as we

get close to July, people aren't again scared off by this impending government requirement.

Ms. DUNN. Thank you. Thank you, Madam Chair.

Chairman JOHNSON. Thank you. Mr. Dolan, Congresswoman Dunn raises a very, very important problem, because the next round of companies that have to comply are even harder to reach and educate. And a lot of us are very concerned about that, and that's really where that legislation comes from, and it is something we're going to have to buckle down and see whether we need to delay the date or whether we need to do something different to reach them.

But I appreciate the good work that you've done in this regard.

Mr. Hulshof.

Mr. HULSHOF. Thank you, Madam Chair. Mr. Dolan, and perhaps Mr. Gross, for you, each of you gentlemen was present as the Chairman gave testimony and made reference to the amount of resources we have committed to Tax Systems Modernization. And I want to ask, either one of you, a couple of questions about some budget requests.

It's my understanding that the Clinger-Cohen Act, as well as the Government Performance and Results Act, as well as memorandums from OMB require that information technology investments be supported by accurate cost data.

And I think, particularly, looking at the information systems request, you're asking for about $131 million for developmental information systems. And yet I'm not sure that your budget request includes plans of how this is going to be used, in that the architecture and system deployment plan have not yet been finalized. Is that true, Mr. Dolan?

Mr. DOLAN. Mr. Hulshof, you essentially have it right. And let me say, though, in saying that you have it right, to a certain extent we are—collectively we are the victims of the calendar year.

We are, as Art mentioned, very much on track doing the required first steps of getting the architecture, the plan, nailed down. He's got a timeline for that. The Modernization Board will receive our work on that in the summer.

The difficulty we have is until that work is actually complete, until some final choice is made, we would be guessing at the actual sequencing of the priorities.

It is very clear to us that there is going to be a critical mass of capital required for this architecture, for the sequenced investments. It was difficult for us, as we made the budget submission, to get ahead of the June/July timeframe; when we have finished these deliberations and made the choices, we will be much more sanguine.

And so, on the face of it, it is anomalous with the law that says before the train starts to move at all, you have to have taken certain steps. I think if you literally superimpose such requirements on where we are today, we'll lose some tremendous time during which we could leverage what we all fully hope and expect will be plans that we're able to look at this summer.

Mr. HULSHOF. I agree, Mr. Dolan, that before the train heads out of the station it needs to have a set of tracks for that train to run over. And yet I am concerned, as I was back in the district this

weekend, and this was a specific concern addressed to me by constituents.

And if we look back at the track record, 26 programs being eliminated, about $1 billion of our tax moneys that have been wasted—or that's the perception out in the real world regarding the systems modernization. Would your answer be essentially the same as far as the IRS' request for $1 billion for fiscal years 1998 and 1999 for yet to be specified developmental efforts regarding the investments account, or capital investments?

Mr. DOLAN. It would be a little different in this respect, Mr. Hulshof. I think that represents a recognition within the government budgeting process that something has to change when it comes to anticipating and accounting for capital investments.

And I think it represents as a part of the President's budget an effort to find a nonpartisan way of suggesting that no business in America does its capital thinking, capital investing, and capital planning out of a single year operating budget.

And so I think that represents, certainly with respect to the dialog within Treasury and OMB, an attempt to say there is a way of dealing with this problem within a capital budget so that if the plans aren't there, and the dollars can't be spent prudently, they won't be spent. They'll roll back into a subsequent fiscal year in a way that in today's single year budget environment is much more difficult to do.

Mr. HULSHOF. As a final matter, Mr. Gross, you indicated a partnership with the private sector was something that was online, and that you needed to have a focused plan.

And I think the second prong of your three prongs—I didn't get noted. What was that again?

Mr. GROSS. We need discipline, process and practice in place. Disciplined procedures for developing these investments.

Mr. HULSHOF. And are those in place?

Mr. GROSS. No, they are not, sir. Our commitment, and I think we have been asked this over these many months, "What will be different about this next round of modernization?" What will be different is the following: We will not move forward until we have those capabilities. We will not move forward until we have a partnership with the private sector.

And, most importantly, we will not move forward until we have a proven, practical, disciplined and focused plan.

Mr. HULSHOF. Thank you, Madam Chair.

Chairman JOHNSON. Ms. Thurman. Congresswoman Thurman. I'm sorry. I'm recognizing you out of order, Congresswoman. I didn't realize you'd come in.

Ms. THURMAN. That's OK. Thank you, Madam Chair. I appreciate it. Good afternoon. Thanks for being here.

After our last hearing in this Subcommittee from the taxpayer advocate group, I had an opportunity to meet with some of your folks who are actually the agents out there, the telephone operators, the people that are being complained about, at least from the taxpayer advocate's 20 suggestions.

I actually gave them a copy of the 20 most common questions and concerns with IRS, and I said to them, I said Have you ever seen this. And they said, No. And I said, But you all are the ones

that are being complained about, and you've not actually seen what is being complained about.

And they said, No. Actually, they are going to send me a written response to each one of the 20 complaints. My first question is this, Mr. Dolan: In the agency itself, particularly with the issues of trying to work from the bottom up, what are you doing to get the information down to those frontline people? Not just about the Tax Code, but the kinds of things that they're not being responsive to from the taxpayer? I'm interested to know how that system works from their situation.

Mr. DOLAN. Thank you. There are a couple of components to the problem resolution information that I think formed the basis for Mr. Monk's 20 points. In the past, I will tell you, we probably were more anecdotal about aggregating that information. By that I mean we would make regular surveys of our field personnel for them to essentially aggregate their experience and we'd compile it and put it in reports.

What we have done very recently—really, we're in the first full fiscal year of its availability to us—we've got a far more differentiating management information system in place today where I can tell you with great alacrity what exactly the issues are that are being confronted by a Jacksonville or by a Ft. Lauderdale.

I can tell you and I can look for the incidents with which there are anomalies, or a different pattern from one center to the other. And I can determine whether it is because people are more or less effective at recognizing when it is a problem resolution case.

So there is one body of data that helps me take what the frontline problem resolution results are, bring the data up into a management information construct that allows us to then turn it back around to the regional commissioners, the district directors and say, this is the data, this is what is broken, this is what is not satisfying taxpayers on a regular basis, and potentially—back to the Chair's comment—this is also what may need a legislative remedy.

Ms. THURMAN. But if they're not—if those frontline people are not getting that information how do they correct——

Mr. DOLAN. I'm being a little slow in getting to the second prong.

Ms. THURMAN. OK.

Mr. DOLAN. The second prong is essentially what we try to do every year when we prepare people for the opening of a filing season. We take them through very specific training on the new issues, the issues we know about, and where we've done well or not done well with respect to the quality of our answers.

And then throughout the filing season we also feed back information to people. Where are we getting it wrong? Where are people's needs not being met? Where are the bottlenecks in the system?

So those are essentially the two prongs. Jim may want to comment.

Ms. THURMAN. Where do they get their input, though? I mean, once you feed them that information, those folks who are trying to correct those issues, when do they get the input into the system? When do they get the opportunity to talk to those that might be making management decisions?

Mr. DOLAN. We probably do that more or less well. I would say, like any big organization, we should probably do that better.

Ms. THURMAN. I'll share my letter with you.

Mr. DOLAN. I would absolutely encourage you to do that. I think that individually we expect that of the district directors, the division chiefs. We expect our installation managers to do that.

I think, though, if you rely on the anecdotal or on somebody feeling strongly enough about an issue to float it up, in a big organization it doesn't always get to us—and that's why I'm hopeful this management information system allows us with starting point data.

Mr. DONELSON. Congresswoman, 2 of the last 4 years, we've run survey feedback action programs, called SFA, which really are to encourage our employees and managers to communicate about issues like you're talking about.

And I think that's one of the many vehicles we use. One of the other things I'd like to point out is the Ombudsman or the Taxpayer Advocate brought to the table and talked to this Subcommittee about issues such as telephone access, notices, the clarity of the notices, the lack of clarity of the notices.

And that's not about our people being bad people, not doing a good job. What that really is about is system problems. Things that we have recognized through the Advocate pointing it out to us, plus our own analysis, that you've got to fix that telephone system.

The employees out there answering the telephone that you talk to, they can't hire additional people to be there beside them to answer more phone calls, or they can't necessarily—because they're working on the phone—manipulate the telephone lines to be more efficient in the way we route calls.

They certainly can't, if they're dealing with the taxpayer on the telephone, on a notice, make changes to that notice. They can make recommendations, and we have suggestion programs to do that. But they are, if you will, the victims of the system as well.

And it's the job of all of us up here to change that system where possible. Some of those things listed on those items identified by the advocate are things that we've been working on with the help of our frontline employees, as well as the managers that are working with them.

Ms. THURMAN. Mr. Dolan, in your written testimony, you talked about, I think 26 million people possibly being eligible for some electronic, and those who would have direct deposit. And then you suggest in there, I think, that there are about 3.2 million people that may be taking advantage of that.

What I wasn't clear on is whether all 26 million people today tap into that system? Or are we limited? And then to carry along, with Ms. Dunn and Ms. Johnson's questions, maybe from a different standpoint, how much money do you spend in your budgets for marketing, or getting this kind of information out so that the taxpayer would know these issues are available? And just as importantly, what could we in Congress be doing to help you do that?

For example, I host a public affairs show called "Capitol Insights" once a month for my constituents. We did a whole series on the EITC, so our constituents would be informed. How else could we help you with educating people?

Considering that your budget is staying constant, it would seem to me, that if these new ways of filing are actually creating a sav-

ings, that that information ought to be shared with the taxpayers. If you do electronic filing, guess what, taxpayers, this is going to cost or save the government *x* amount of dollars.

I know that was a long question, Madam Chairman, but I'm sorry.

Chairman JOHNSON. It's a reasonable one, and we're all interested in the answer.

Mr. DOLAN. It's a great question, and it's also a kind of window into our soul. We have never historically had within the ranks of the IRS any particular marketing capacity.

We are tax administrators and not marketers. And that's to our peril, in some instances. What really has brought about our need for and use of marketers—and I don't want to mislead you that we've got huge contracts where we're spending lots of dollars—is the combination of the EFTPS and the other suite of electronic products. There is a marketplace of 26 million people, and you know that at least on the surface the characteristics of what you're inviting them to do ought to be fairly appealing.

But then you have to get beyond that, as we have tried to do, particularly the last 2 years, with the use of district office research capacity, which has allowed us to take that 26 million people and stratify that population.

We stratify the population because both the retired person who is within the dollar eligibility of that program and the college sophomore who is within that dollar eligibility are moved by two different brands of influence.

To wit, in your part of the country today, and all the rest of this week, we have people shadowing the MTV onsite studios. Apparently they're moving around Florida in some 20 different places during spring break week.

And so we have made a huge push this week and last week with college kids. Fifty of the biggest universities are giving us widespread publicity. We've got CBS' Web site—the one that gives the scores on the NCAA tournament—to run our banner across their site—and a lot of that is a function of the help we've gotten from marketers. They have given us ways of thinking about getting to that marketplace in ways that in the past, quite frankly, we would not have had the capacity or the creativity to do.

And so—I wouldn't want to tell you that we're as good as we're going to get. But we clearly have recognized that marketing is a skill, and when you take that plus the references Art made you see we are listening to an industry that is already out there in their business environment, day in and day out, dealing in this electronic commerce environment.

One of the major practitioners came to us and said, You know, I've got 6 million returns here that if I just flipped a switch I could send you electronically. But guess what, the people who file those returns with me aren't so sure they want you to get them electronically, because they're not sure what it means to have that data come to the IRS that way.

Those are some of the same people who for years haven't wanted to use our preprinted label because they were convinced that if they used the label that we sent with the package, that meant they were going to get audited.

We, for years, said no. What that means is we can enter a couple of key strokes instead of all the key strokes, because we've got that label on it. So there is a part of learning what the behavior sets are, what the motivations are, what it takes to track some of that marketplace. We clearly understand that we need help and we need other people's insights. And I think we're very much committed to using those kinds of skills.

Ms. THURMAN. Is there a significant savings?

Mr. DOLAN. There is a savings. What we're right now doing—in connection with something we've mentioned in the longer testimony, as we have indicated, and in response to this year's appropriations language—is look at outsourcing.

We propose to go to the marketplace with a request for information kind of dynamic, where we will ask people to bid on what they think they—the private marketplace—might want to do with the front end of sending us data and sending us information.

As a part of that, we're going through a study that Mr. Musick is now doing, to pin down not only the front-end costs, but a lot of the downstream benefits of electronic filing as well. Everything from the obvious, you don't have to store the paper, to the less obvious, I can call up 100 percent of the data on a screen for customer service. This means customer service will be a lot more effective than if I can only call up what's transcribed.

So we're right now trying to document that baseline in a way that I hope to give you a more precise answer in the future on that.

Ms. THURMAN. Thank you.

Chairman JOHNSON. Very briefly, Mr. Gross, you're supposed to report in May, are you not, in regard to your plan for the Tax Systems Modernization Proposal? Do you think by then you will have a plan and the disciplines governing it, as you've spoken about today?

Mr. GROSS. Our projection by May 15, 1997, is to submit to the Congress what's known as the modernization architecture. That is regrettably only one element of the program. It will take us longer to establish the disciplines, and to acquire the partnership with the private sector.

On the other hand, I would want to reinforce Mike Dolan's comments that given the nature of capital budgeting, it's essential for the government to plan in advance in anticipation that we will be prepared for modernization once those funds become available.

It's my understanding that the first of the two projected $500 million segments would first become available no earlier than July 1, 1998. And by that time, we aim to have both our capabilities and hopefully the contractor relationships, the requisite contractor relationships, together with the architecture and the practical implementation plan.

Chairman JOHNSON. So you need those funds to be available to you 1 year earlier?

Mr. GROSS. Our projection is that the availability of those funds, as set forth in the President's budget, is appropriate for the timing of our preparedness.

Chairman JOHNSON. Oh, is appropriate.

Mr. GROSS. Is appropriate, yes. Which I understand to be no earlier than July 1, 1998, with the first of the two $500 million increments.

Chairman JOHNSON. Thank you. And, Mr. Dolan, last, why did you make the decision to divert money from examination and document matching, that kind of program that has to do with enforcement, into customer service, telephone access, as important as those things are.

Was this the best place to take money, so that you end up not collecting $3 billion that last year we were able to collect?

Mr. DOLAN. Well, Madam Chair, it wasn't quite as clean a choice as that. I'll go back to the description that I was trying to give at the outset. For starters, in a perfect world, what I would have done if I was trying to leverage my compliance accounts to the maximum, I would have looked at perhaps people who were sitting in permanent revenue officer, revenue agent positions, and moved around along that spectrum of compliance, my assets.

And so I would have cut less deeply from the matching. The coincidence of employment categories happens to be that matching program is largely done with seasonals.

And so when I ended up in that predicament of 6,300 people that I couldn't pay for, and I looked for dollars that were otherwise fungible, that weren't tied to a person who was on the payroll getting paid every 2 weeks, the places I had to go were the seasonal hours, and, as I said, the training, the travel.

And my other alternative would have been to go through some general or some targeted furlough, and put permanent people at home for periods of time in order to create some cash savings for the payroll process.

I would like to tell you that I sat in some pristine way and made a true value choice to trade this dollar for this dollar. Last year, when we first made this transition, we did not invest in customer service as much as we'd like.

Even this year, we have moved very modest compliance resources from our office audit occupation over to support, phones. So we were very conscious about not savaging a compliance program in order to do exclusively customer service.

We've been trying——

Chairman JOHNSON. Of course, one of the challenges is to coordinate some of the other things you're doing. If you're doing market segmentation by region, and, I mean, all of that should enable you to use your compliance resources far more effectively.

Mr. DOLAN. But there is one thing that I really missed by not being more explicit about this. We're in this—we're kind of in this no man's land now of trying to complete our reorganization. One of the things that is at issue is—Mr. Coyne talked about it as it pertained to Pittsburgh—that we are in a position where we knew that what used to take 2,500 people to do in 63 districts could be done with 1,500 people in 33.

And we are sort of midstream trying to get that taken care of. And when we get that taken care of, it creates the flexibility of those thousand—essentially the dollars associated with those thousand staff years, that can be placed back in the right places.

We've got holes up and down the organization. It happens to show up graphically because of the outcome measure on the document matching. But we've got groups that are not supported clerically, and so we've got some revenue agents off doing that.

We've got lots of healing to do once we can accomplish this last phase of our reorganization. And I think that will go a long way toward rerighting some of those balances.

Chairman JOHNSON. Thank you very much. Are there any other questions or comments? Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairman. Mr. Dolan, Commissioner Richardson had asked some of us on the Subcommittee to consider introducing legislation that would make it a felony for an IRS employee to access tax information in an unauthorized manner.

I wonder if you could shed some light on the necessity for doing that?

Mr. DOLAN. Yes. The Commissioner, as I know this Subcommittee knows, has been passionate about the issue of unauthorized accesses, as have the rest of us. And we have identified over time a series of corrections, in what—as I think the Commissioner in her most recent correspondence was pointing out—was the need to supplement what's already on the books that deals with the unauthorized access to electronic records.

What is left open is the unauthorized access to paper records, and what she's asking for is some help in sort of applying to the paper world the same regime that the Congress helped us with on the electronic world.

So in a sort of thumbnail, that's what her request is, and it's an extension of our objective. You don't make this go away by criminal penalties, but you do create a deterrence by having the same brand of prohibition on the paper side as you do on the electronic side.

Mr. COYNE. Is it currently a felony relative to information that's accessed electronically?

Mr. DOLAN. Electronic. Yes, it is.

Mr. COYNE. And you want it extended to paperwork access?

Mr. DOLAN. That's correct.

Mr. COYNE. Thank you.

Chairman JOHNSON. We have been working with you and intend to be working with you on a bipartisan fashion to get this legislation right.

Mr. DOLAN. We very much appreciate it, too.

Chairman JOHNSON. There are lots of questions that could be asked, but we need to move on to the next panel, and I appreciate the quality of your testimony. And I would just suggest that if you have the information management capability that you were discussing, perhaps you could actually go back and pull up the three or four areas of complexity that are causing tax administration problems, and even frontline advocate problems.

Because we are going to have to move in that direction, and we can't wait until we have that hearing again next year. So I would appreciate it, understanding more clearly now what we need. Not a list of 20. But if you have that management capability you really ought to be able to give us some guidance as to what we ought to be looking at.

Because when I look at your budget, and the demands on you and the planning—I mean, just the transition, as you described that you can't get certain resources until you complete certain reforms, and then you can fill in some of the holes.

It's very important that as you do this, we begin to take our part of the responsibility to address some of the complexity issues. And I know how volatile they are. I know that they are AMT and they're EITC, and they are other things.

But we have to find a way to do some of those things, so that as you move toward a better system, you do it with a better law.

So thank you very much for being here today, and thanks to all your staff for their good work, and for their presence.

Mr. DOLAN. Thank you.

Mr. COYNE. Madam Chairwoman.

Chairman JOHNSON. Mr. Coyne.

Mr. COYNE. Several of my colleagues from Pennsylvania have asked that a letter that they sent to Commissioner Richardson be included in the record, relative to the reorganization of the IRS in Pennsylvania.

Chairman JOHNSON. I would be happy to do that.

I know that in my region they have worked very hard on this, and it has at this point seemed to serve the taxpayers of all the States involved very well. And I would be happy to include this letter on our behalf, Mr. Coyne.

[The following was subsequently received:]

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ENERGY AND ENVIRONMENT
BASIC RESEARCH

COMMITTEE ON
VETERANS' AFFAIRS
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DEMOCRATIC WHIP,
SOPHOMORE CLASS

Congress of the United States
House of Representatives

March 18, 1997

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Margaret Milner Richardson
Commissioner
Internal Revenue Service
11 Constitution Avenue, NE
Room 3244
Washington, D.C. 20002-5618

Dear Commissioner Richardson:

We would like to express our serious concerns over the Internal Revenue Service's plans to consolidate activities in the state of Pennsylvania. As we have stated before, we believe any field office reorganization should enhance taxpayers services and increase efficiency. However, it appears as if the proposed changes in Pennsylvania will not achieve either of these goals.

Under the current IRS reorganization proposal, the Examination and the Customer Service Divisions in Pennsylvania would be consolidated in Philadelphia, while collections activities would be concentrated in the Pittsburgh office. We believe that the removal of customer services from Pittsburgh will make it considerably more difficult for millions of taxpayers in Western Pennsylvania to get needed assistance.

In addition, the Pittsburgh district office has been rated as markedly more efficient than the Philadelphia district office. Recently, Pittsburgh was ranked the sixth most efficient district office in the nation, while Philadelphia was ranked forty-fifth. Specifically, the Customer Service and Examinations Divisions in Pittsburgh have consistently achieved higher efficiency ratings than their counterparts in Philadelphia. With these facts in mind, it appears likely that the consolidation of these divisions in the Philadelphia office would further deteriorate taxpayer services.

Finally, it is troubling that IRS activities under the reorganization could actually prove to be more costly than current operations. Costs for salary, rent, and travel are all higher in Philadelphia. In fact, it is estimated that annual operating expenses for a portion of the Examination Division would be nearly half a million dollars higher if the division were based in Philadelphia rather than in Pittsburgh. Clearly, this would be an unneccessary and chronic drain of resources.

Margaret Milner Richardson
March 18, 1997
Page 2

It is frustrating that a federal agency would implement, let alone consider, a reorganization plan that could result in diminished services and increased costs. Consequently, we respectfully request that you postpone the field office reorganization nationwide so that Congress may have time to review the forthcoming IRS report regarding the reorganization, which will be issued in accordance with Public Law 104-208. In addition, we ask that the IRS and the Treasury Department devise a new reorganization plan for Pennsylvania which is cost effective and insures consistent, if not improved, customer service throughout the Commonwealth.

We appreciate your prompt attention to this matter, and we look forward to receiving your response.

Sincerely,

Mike Doyle
Member of Congress

John Murtha
Member of Congress

Ron Klink
Member of Congress

Frank Mascara
Member of Congress

Ms. THURMAN. Madam Chairman.

Chairman JOHNSON. Yes, Congresswoman Thurman.

Ms. THURMAN. Could they also submit any of the educational pamphlets or whatever they do in targeting for businesses or seniors.

Chairman JOHNSON. I'm sure they can provide those to the Subcommittee, and we'll see that they get to you.

Ms. THURMAN. I'd like to see those just so we could have them. I think it might be helpful for us as well.

Chairman JOHNSON. I think if you just submit those, not as part of the record, but as part of the service to this Subcommittee, we'd appreciate it.

Mr. DOLAN. We will do that.

Chairman JOHNSON. Thank you.

Apologies to the GAO for the delay in your appearance. These are difficult issues, and it's important for the Subcommittee to understand them.

Lynda Willis, the Director of Tax Policy and Administration of the General Government Division of the GAO; and Rona Stillman, Chief Scientist, Accounting and Information Management Division of the GAO.

STATEMENT OF LYNDA D. WILLIS, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY RONA STILLMAN, PH.D., CHIEF SCIENTIST, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Ms. WILLIS. Good afternoon, Madam Chairman, and Members of the Subcommittee. One of the advantages or disadvantages of going second is that you have a lot of your prepared statement that's already been presented by the panelists before you.

With your permission I will submit my written statement for the record, and I will make a very brief overview of some of the key points that we make in the statement, and then open it up for any questions that the Members of the Subcommittee may have.

Chairman JOHNSON. Thank you.

Ms. WILLIS. This Subcommittee has asked us to look at three things basically for the Subcommittee today. First is IRS' actions to implement the fiscal year 1997 appropriation; second is the status of the 1997 filing season; and third is to comment on the administration's budget for fiscal year 1998, or the budget request.

Turning first to IRS' 1997 appropriation, in 1997 Congress was concerned about the lack of progress in implementing TSM and about the level of taxpayer service. In response to congressional concerns about TSM, IRS has realigned its 1997 information system spending plan.

IRS has canceled projects that were included in those plans that it had estimated would cost a total of $36 million in this fiscal year. According to IRS' Chief Information Officer, these projects were canceled because they did not have business case analyses that justified their continued development. I would note that several of those projects were discussed in reports that we prepared for this Subcommittee earlier this year.

The CIO also stated that IRS does not plan to start any new systems development projects, as he stated here this morning, until they have the internal capability to effectively develop systems. And that it would be 12 to 18 months before they could do that.

Therefore, we believe Congress should consider rescinding the $36 million that will not be spent on those canceled projects in fiscal year 1997.

Also in 1997, given congressional concerns about the level of taxpayer service and the low level of telephone accessibility, IRS decided this year, as it has stated, that one of its highest priorities would be to improve the ability of taxpayers to reach IRS by telephone.

IRS did allocate about 1,000 additional staff years to taxpayer service, and the increased staffing is having a positive effect.

Moving to the 1997 filing season, we're finding, as IRS indicated, that the filing season is going relatively smoothly this year. We have seen significant increases in two areas where we have criticized IRS' performance in the past—electronic filing and telephone accessibility.

As of March 7, the number of returns filed electronically was almost 25 percent more than at the same time last year. This increase is even more significant considering that the total number

of individual income tax returns filed as of that date was 1.5 percent less than at this time last year.

The largest percentage increase is in the number of returns filed using TeleFile. This increase may be due in large part to a change in the tax package IRS sent to eligible TeleFile users this year.

This year IRS eliminated the form 1040–EZ and related instructions from the package, hoping that more taxpayers would be inclined to use TeleFile if they only received the TeleFile materials, and from all indications it's worked.

And I would like to digress here a moment from my prepared statement to observe that this is exactly the sort of thing that IRS needs to do to better target its programs to the market they're trying to reach.

When we understand why people don't participate in electronic filing programs, or when we understand why people are concerned about the new EFTPS Program, we are then in a better position to either provide the educational assistance, the different types of systems or programs, or perhaps even different timing of delivery of those services to meet taxpayer needs.

And I think in this case, IRS' use of a different package of filing information for these taxpayers successfully enhanced IRS' ability to improve electronic filing.

The accessibility of IRS' telephone assistance has increased substantially. IRS has answered 52 percent of taxpayer call attempts during the first 2 months of the filing season, compared to 21 percent during the same period last year.

The number of taxpayers assisted was also up, with 71 percent of the callers getting through, compared to 52 percent last year. And I think we would agree that those are substantial improvements.

There are several factors that appear to have contributed to IRS' increased telephone service. One is an increase in the number of staff assigned to answer the phone, some of which was achieved by detailing staff from other IRS functions.

And I would note here that the last time we looked at the resources going into telephone assistance was in 1994, and at that time the IRS was only budgeting enough resources to answer 52 percent of the calls.

So based on the budgeted resources it was not surprising to us or the IRS that the accessibility was at the rate it was.

The second reason is an attempt to reduce the need for persons to call the IRS by eliminating certain notices that the IRS deemed to be unnecessary. And, finally, IRS revised its procedures for handling calls.

Turning finally to the 1998 budget request, included in that request is $131 million for developmental information systems, the same amount that was provided in 1997.

As a Member of the Subcommittee pointed out, the Clinger-Cohen Act, GPRA and OMB require that information technology investments be supported by accurate cost data and convincing cost/benefit analyses.

However, IRS' request does not include a credible, verifiable justification. The budget request states, and this Mr. Dolan acknowledged, that IRS does not now have plans to spend these funds, be-

cause its modernization architecture and system deployment plan have not yet been finalized.

The administration is also proposing an information technology investments account of $1 billion; $500 million for 1998 and $500 million for 1999. This is to fund yet to be specified developmental efforts.

Again, the Clinger-Cohen Act, GPRA and OMB require that these requests be justified, and that agencies develop accurate, complete cost data and thoroughly analyze the business need for the systems. IRS has not prepared such an analysis for its investment account.

Given IRS' poor track record in delivering cost beneficial systems, persistent weaknesses in its software development and acquisition capabilities, and the lack of justification and analysis for proposed system expenditures, we believe Congress should consider not funding either the $131 million request for systems development, or the $1 billion capital account until the management and technical weaknesses in IRS' Modernization Program are resolved, and the required justifications are complete.

That is not to say that we think IRS will not need money to modernize their systems, but rather before the money is authorized for spending that IRS be required to have the appropriate cost/benefit analysis and justifications for these systems, and that they have developed the capability to deliver the projects they propose to deliver.

The budget request for 1998 also includes $84 million for IRS' turn of the century date change. However, the 1998 request was based on September 1996 cost estimates for IRS' main tax processing systems. It did not include estimates for IRS' secondary systems that are also critical to tax administration.

It also did not factor in many other activities related to the century date change effort that have since been identified.

Thus far in fiscal year 1997, IRS has identified funding requirements for the century date conversion that would exceed its 1998 budget request. Consequently we believe it's reasonable to question whether the amount requested for this effort in fiscal year 1998 is going to be adequate.

The largest staffing increase in IRS' budget request is for 195 FTEs to process a projected increase in the number of tax returns filed in 1998. However, IRS expects that most of the additional returns will be filed electronically.

Data IRS used to determine how much more money and staff it needed to process these additional returns show only a small difference between the number of FTEs needed to process 1 million electronic returns and the number needed to process 1 million paper returns.

That small difference is inconsistent with what we would have expected, and may reflect at least in part that electronic filing is not truly paperless. Most electronic filers still have to submit a paper signature document.

Finally, I would like to turn to some of the challenges that we believe the IRS and the Congress face in moving the tax system into the next millennium—some of the things that reflect directly on conversations that were held earlier today.

The funding limits and program tradeoffs faced by IRS in 1997 and anticipated for 1998 are likely to continue for the foreseeable future. As has been observed, the administration's projections actually reflect a decline in IRS' funding when inflation is considered.

At the same time, the IRS is faced with competing demands and pressure from external stakeholders, including Congress, to improve its operations and resolve longstanding issues.

In recent years, the statutory framework has been put in place for helping Congress and the executive branch make the difficult tradeoffs that the current budget environment demands. This framework includes the Chief Financial Officers Act, the Clinger-Cohen Act, and the Government Performance and Results Act.

GPRA requires each agency to develop a strategic plan that lays out its mission, its long-term goals and strategies for achieving these goals. GPRA requires agencies such as the IRS to consult with the Congress as they develop these strategic plans.

For IRS, these consultations provide an important opportunity for Congress, IRS and Treasury to work together to ensure that IRS' mission is focused, its goals are specific and results oriented, and strategies and funding expectations are appropriate and reasonable.

The consultations may prove difficult as they are likely to underscore the competing and conflicting goals of IRS programs, as well as the sometimes different expectations of the numerous parties involved.

Madam Chairman, that concludes my statement. I would be happy to answer any questions you may have, as would Dr. Stillman.

[The prepared statement follows:]

Statement of Lynda D. Willis, Director, Tax Policy and Administration Issues, General Government Division, U.S. General Accounting Office

Madam Chairman and Members of the Subcommittee:

We are pleased to be here today to participate in the Subcommittee's inquiry into the Internal Revenue Service's (IRS) actions to implement its fiscal year 1997 appropriation, the status of the 1997 tax return filing season, and the administration's fiscal year 1998 budget request for IRS.

This statement is based on our review of the administration's fiscal year 1998 budget request, the interim results of our review of the 1997 tax return filing season, a review of IRS' fiscal year 1997 spending plans for information systems, and our past work on Tax Systems Modernization (TSM).

Our statement makes the following points:

—IRS' fiscal year 1997 appropriation act and accompanying conference report indicated that Congress was concerned about, among other things, the level of taxpayer service and the lack of progress in implementing TSM. In response to congressional concerns and direction, IRS allocated about 1,000 additional full-time equivalent (FTE) staff to taxpayer service activities and realigned its fiscal year 1997 information system spending plans. IRS has since cancelled some of the projects that were included in those plans and that it had estimated would cost a total of $36 million in fiscal year 1997.

—The 1997 filing season has seen significant increases in two areas where we have criticized IRS' performance in the past—electronic filing and telephone accessibility. To help achieve those increases, IRS (1) revised the tax package sent to persons eligible to file by telephone, hoping, as a result, to encourage them to file by phone; (2) assigned more staff to answer the phone; and (3) revised its procedures for handling more complicated telephone requests for assistance.

—IRS' basic budget request for fiscal year 1998 is for $7.4 billion and 102,385 FTEs. Included in that request is $131 million for developmental information systems, the same amount that was provided in fiscal year 1997. In addition to that basic request, the administration is proposing a capital account for information tech-

nology investments at IRS—$500 million for fiscal year 1998 and another $500 million for 1999. Neither the $131 million or the $1 billion is supported by the type of analysis required by the Clinger-Cohen Act, the Government Performance and Results Act (GPRA), and the Office of Management and Budget (OMB).

—The budget request also includes $84 million for IRS' turn of the century date change effort. IRS has already determined that it will need several million dollars more for this effort in fiscal year 1997 than had been allocated. Given that and because IRS' overall conversion needs are still being determined, it seems reasonable to question whether the amount requested for this effort in fiscal year 1998 will be sufficient.

—IRS is also requesting funds to replace two old systems used to process paper returns and remittances. Because extra money is being spent on those replacement systems in 1997, all of the funding being requested for 1998 may not be needed.

—The largest staffing increase in IRS' budget request is for 195 FTEs (with an associated cost of $11 million) to process a projected increase in the number of tax returns filed in 1998. IRS expects that most of the additional returns will be filed electronically. Data IRS used to determine how much more money and staff it needed to process those additional returns show only a small difference between the number of FTEs needed to process a million electronic returns and the number needed to process a million paper returns. That small difference is inconsistent with what we would have expected and may reflect, at least in part, the fact that electronic filing is not truly paperless.

—Finally, IRS and Congress face many challenges in moving the nation's tax system into the next millennium. Funding limits faced by IRS in fiscal year 1997 and anticipated for fiscal year 1998 are projected to continue until at least 2002. Fiscal constraints as well as longstanding concerns about the operations and management of IRS make consensus on IRS performance goals and measuring progress in achieving those goals critically important. The provisions and requirements of the Chief Financial Officers Act, Clinger-Cohen Act, and Government Performance and Results Act provide a mechanism for accomplishing this.

OVERVIEW OF 1997 APPROPRIATION ISSUES

IRS' fiscal year 1997 appropriation act[1] and accompanying conference report[2] indicated that Congress was concerned about various aspects of IRS' operations. Among other things, Congress expressed concern about (1) TSM and the need to direct more systems development work to the private sector; (2) TSM funds being directed at "feeding the beast" rather than at true modernization; (3) the ability of taxpayers to reach IRS over the telephone; (4) the need to maintain taxpayer service at fiscal year 1995 levels, at a minimum;[3] and (5) the need to develop a strategic plan and performance measures for inclusion in IRS' fiscal year 1998 budget request.

As shown in table 1, IRS' final appropriation for fiscal year 1997 was $7.2 billion—$142 million less than its fiscal year 1996 appropriation. The fiscal year 1997 appropriation also rescinded about $174 million in information systems funds. Table 1 also shows that the fiscal year 1997 appropriation provided (1) all of what IRS requested for processing, assistance, and management; (2) $424 million less than requested for tax law enforcement; and (3) $365 million less than requested for information systems.

In response to its fiscal year 1997 appropriation and the congressional direction specified therein, IRS (1) revised its spending plans for information systems; (2) reallocated resources within the processing, assistance, and management account to direct more resources to taxpayer service activities; and (3) reduced the number of compliance staff.

IRS' Fiscal Year 1997 Systems Spending Plans Are Consistent With Congressional Direction, But $36 Million May No Longer Be Needed

For fiscal year 1997, IRS was appropriated about $1.3 billion to fund its information systems. The appropriation act specified that the $1.3 billion be spent as follows:

—$758.4 million for legacy systems,
—$206.2 million for TSM operational systems,
—$130.1 million for TSM development and deployment,

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[1] The Omnibus Consolidated Appropriations Act (P.L. 104–208, Sept. 30, 1996).
[2] H.R. Report No. 863, 104th Cong., 2d sess. (1996).
[3] Congress added this requirement because it was concerned that IRS' pending reorganization of certain field activities would adversely affect taxpayer service.

—$83.4 million for program infrastructure,
—$62.1 million for "stay-in-business" projects,
—$61.0 million for staff downsizing, and
—$21.9 million for telecommunication network conversion.

IRS' plans for spending its fiscal year 1997 information systems appropriation and IRS' obligations through December 31, 1996, appear consistent with the act's direction. Specifically, at the beginning of fiscal year 1997, we judgmentally selected eight projects, totaling approximately $197 million, that IRS planned to fund with its information systems appropriation and analyzed each relative to the categories and amounts specified in the act. Our analysis showed that IRS identified its projects in accordance with the legislative categories and that all of the projects we reviewed appeared to be consistent with the act's categories and spending levels.

Table 1: IRS' Fiscal Year 1997 Appropriation Compared to Its Fiscal Year 1997 Budget Request and Fiscal Year 1996 Appropriation

In billions

Appropriation account	Fiscal year 1996 appropriation	Fiscal year 1997 budget request	Fiscal year 1997 appropriation
Processing, assistance, and management	$1.724	$1.780	$1.780
Tax law enforcement	4.097	4.528	4.104
Information systems	1.527	1.688	1.323
Total [1]	$7.348	$7.995	$7.206

[1] Totals may not add due to rounding.
Source: P.L. 104–52, fiscal year 1997 President's budget request for IRS, and P.L. 104–208.

In analyzing IRS' spending, we also found that IRS has ongoing or completed one-half of the projects (with fiscal year 1997 costs totaling about $87.3 million) that were used to justify the allocation of $130.1 million for systems development and deployment. IRS is reviewing one other project for $7 million and has canceled the remaining projects, which had projected fiscal year 1997 costs totaling about $36 million.

According to IRS' Chief Information Officer (CIO), IRS canceled these systems because business case analyses did not justify continued development. The canceled projects include the Corporate Accounts Processing System, the Integrated Case Processing System, and the Workload Management System.

The CIO also stated that IRS does not plan to start any new system development projects until it has developed the internal capability needed to effectively manage system development projects, which includes developing a modernization systems architecture and a systems deployment plan. The CIO said that it would be 12 to 18 months before IRS begins acquiring and developing new systems. Therefore, Congress should consider rescinding the $36 million that IRS will not be using for systems development and deployment in fiscal year 1997.

As noted earlier, $61 million of IRS' fiscal year 1997 information systems appropriation was allocated for staff downsizing. We question whether all of the $61 million will be needed for that purpose. IRS had requested those funds to downsize its information systems staff by 819 positions. According to IRS' Chief for Management and Administration, however, attrition among information systems staff has been higher than expected and IRS' current downsizing plans include only 228 information systems positions.

Increased Resources Provided for Taxpayer Service in 1997

Given congressional concerns about the level of taxpayer service and the low level of telephone accessibility documented in our annual filing season reports,[4] IRS decided that its highest priority in 1997, other than processing returns and refunds, would be to improve taxpayer service, especially the ability of taxpayers to reach IRS on the phone. One important step IRS took to achieve that end was to increase the number of FTEs devoted to taxpayer service. According to IRS estimates, the number of taxpayer service FTEs will increase from 8,031 in fiscal year 1996 to

[4] *Tax Administration: Continuing Problems Affect Otherwise Successful 1994 Filing Season* (GAO/GGD–95–5, Oct. 7, 1994); *The 1995 Tax Filing Season: IRS Performance Indicators Provide Incomplete Information About Some Problems* (GAO/GGD–96–48, Dec. 29, 1995); and *IRS' 1996 Tax Filing Season: Performance Goals Generally Met; Efforts to Modernize Had Mixed Results* (GAO/GGD–97–25, Dec. 18, 1996).

9,091 in fiscal year 1997. The estimated number of FTEs for fiscal year 1997 is also higher than in fiscal year 1995, which is in accord with congressional direction in IRS' fiscal year 1997 appropriation. According to IRS budget officials, some of these additional FTEs were achieved by reallocating resources originally targeted for submission processing; the rest were funded with user fees that IRS is authorized to retain.

The bulk of the staffing increase for taxpayer service is directed at helping taxpayers reach IRS by telephone. To augment that increase, IRS has also been detailing staff from other functions to help answer the phone, including staff who would normally be doing compliance work. As discussed later, this increased staffing, along with other steps IRS took, seem to have succeeded in significantly improving telephone accessibility this filing season.

IRS Reduced Compliance Staff in 1997 to Accommodate Roll-over of 1996 Funding

The fiscal year 1997 appropriation for tax law enforcement was essentially a roll-over of the 1996 appropriation. However, IRS, in its budget request for 1997, said that it needed an increase of $116 million just to "maintain current levels" for enforcement. According to IRS, getting a roll-over in funding for 1997 rather than an increase forced it to reduce staffing levels for compliance activities so it could pay on-board staff. Specifically, IRS reduced certain compliance positions (i.e., revenue agents and revenue officers) by more than 1,000. As one result of this reduction, IRS estimates that audit coverage will drop from 1.6 percent to 1.2 percent. We should note, however, that these reductions were directed at those enforcement staff that IRS has characterized as "representing the least efficient use of IRS resources on the margin."

THE 1997 FILING SEASON

By various statistical measures traditionally used to assess a filing season, the 1997 filing season is going well. Especially noteworthy are significant increases in electronic filing and telephone accessibility. One major change this year involves a new procedure IRS is using to deal with returns that have missing or incorrect Social Security Numbers (SSN). However, the impact of this procedure will not be evident until after the filing season. Another area that we cannot address at this time is refund fraud. IRS had not compiled data on the number of fraudulent returns and refunds identified this year as of the time we prepared this testimony.

Significant Increases in Electronic Filing and Telephone Accessibility

As of March 7, 1997, the number of returns filed electronically, including those filed over the telephone, was 24.7 percent more than at the same time last year. This increase is even more significant considering, as shown in table 2, that the total number of individual income tax returns filed as of March 7, 1997, was 1.5 percent *less* than at the same time last year.

Table 2: Individual Income Tax Returns Received

Type of filing	March 7, 1997	March 8, 1996	Percent of change
Traditional paper	28,057,000	31,980,000	−12.3
1040PC [1]	2,746,000	2,373,000	15.7
Total Paper	30,803,000	34,353,000	−10.3
Traditional electronic [2]	10,921,000	9,273,000	17.8
TeleFile	3,495,000	2,284,000	53.0
Total Electronic	14,416,000	11,557,000	24.7
TOTAL	45,219,000	45,910,000	−1.5

[1] Under the Form 1040PC method of filing, taxpayers or tax return preparers use personal computer software that produces paper tax returns in answer-sheet format. The Form 1040PC shows the tax return line and the data on that line. Only lines on which the taxpayer has made an entry are included on the Form 1040PC.

[2] Traditional electronic returns are those that are filed through third parties, such as tax return preparers.

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

As table 2 shows, the largest percentage increase is in the number of returns filed by telephone (i.e., TeleFile). That increase may be due, in large part, to a change in the tax package IRS sent eligible TeleFile users this year. In past years, IRS sent taxpayers who appeared eligible to use TeleFile a package that included not only TeleFile materials but also a Form 1040EZ and related instructions. Thus, taxpayers who could not or did not want to use TeleFile had the materials they needed

to file on paper, assuming they were still eligible to file a Form 1040EZ. This year, IRS eliminated the Form 1040EZ and related instructions from the package sent eligible TeleFile users—hoping that more taxpayers would be inclined to use TeleFile if they only received the TeleFile materials.

A second noteworthy trend this year is an increase in the ability of taxpayers who have questions about the tax law, their refunds, or their account to reach IRS by telephone. As shown in table 3, the accessibility of IRS' telephone assistance, as we have defined it in the past, has increased substantially.[5]

Table 3: Accessibility of IRS' Telephone Assistance [1]

Filing season	Number of call attempts (in millions)	Number of calls answered (in millions)	Percent accessibility
1997	21.6	11.3	52.3
1996	42.3	9.0	21.3

[1] These data are for January 1 through February 22, 1997, and January 1 through February 24, 1996.
Source: IRS data.

As table 3 indicates, the increase in accessibility is due to a combination of fewer calls coming in and more calls being answered. The two factors are not unrelated. The more successful IRS is in answering the phone, the fewer times taxpayers should have to call in an attempt to get through.

IRS has another way of measuring accessibility, called "level of access," which tracks the percentage of callers who were eventually able to get through to IRS rather than the number of call attempts. As of February 22, 1997, according to IRS data, the level of access was 71 percent, a substantial increase over the 52-percent level of access as of the same time last year.

There are several factors that appear to have contributed to IRS' increased telephone service: (1) an increase in the number of staff assigned to answer the phone, some of which was achieved by detailing staff from other IRS functions;[6] (2) an attempt to reduce the need for persons to call IRS by eliminating certain notices that IRS deemed to be unnecessary; and (3) revisions to IRS' procedures for handling calls.

As an example of the latter, this year, unlike past years, callers who indicate, through the choices they select on the automated telephone menu, that they have a question in a complex tax area (such as "sale of residence") are to be connected to a voice messaging system. Those callers are asked to leave their name, telephone number, and best time for IRS to call back, and they are told that someone will be calling back within 2 working days. Those return calls are being made by staff detailed from IRS' Examination function. According to IRS, it made this change after a study showed that several areas of complicated tax law involved 20 to 30 minute telephone conversations and that an assistor could answer about 5 simpler calls within the same amount of time.

Too Soon to Assess Impact of IRS' New SSN Procedure

One important change this filing season involves the way IRS is handling returns filed with missing or incorrect SSNs. Over the last few years, when IRS identified a missing or invalid SSN, it delayed the taxpayer's refund and corresponded with the taxpayer to resolve the issue. As we noted in our report to the Subcommittee on the 1996 filing season, IRS was unable to pursue many of the problem SSNs it identified under those procedures.[7]

Effective with this filing season, IRS was given the legislative authority to treat missing or invalid SSNs as an error made by the taxpayer, similar to the way IRS handles math errors. Under that new authority, when IRS detects a missing or invalid SSN, it is to disallow any related deductions and credits and adjust the taxpayer's tax liability.

[5] Accessibility, as we have traditionally defined it, is the total number of calls answered divided by the number of call attempts, which is the sum of the following: (1) calls answered, (2) busy signals, and (3) calls abandoned by the caller before an IRS assistor got on the line.

[6] In one service center, for example, 26 staff from the Collection area were detailed on an as-needed basis to answer the phones, 45 staff from that center's Adjustment/Correspondence Branch have been detailed to answer phone calls during the filing season, and another 24 staff from that Branch have been detailed to answer calls for 2 hours each afternoon.

[7] *IRS' 1996 Tax Filing Season: Performance Goals Generally Met; Efforts to Modernize Had Mixed Results* (GAO/GGD–97–25, Dec. 18, 1996).

For example, if a taxpayer claims one dependent and the child care credit, but lists an invalid SSN for the dependent, IRS is to increase the taxable income by the personal exemption amount claimed for the dependent and not allow the child care credit. IRS is then to adjust the taxpayer's tax liability and reduce the taxpayer's refund, if any. The taxpayer is to receive a notice explaining the changes to his or her tax liability and refund. The standard notice IRS is using provides a special toll-free telephone number that taxpayers can call if they want to discuss the changes and/or provide corrected information to support their claims. Taxpayers can also write to IRS to resolve the issue.

IRS estimated that about 2.4 million taxpayers will receive these "SSN-math error" notices in 1997. According to an IRS official, IRS had issued about 70,000 such notices as of February 21, 1997. At the time we prepared this testimony, officials at three IRS customer service centers, which are responsible for answering taxpayers' inquiries, told us that assistors were not yet getting many calls or letters from taxpayers who received the notices. Thus, it is too early to assess the impact of this new procedure.

Data Not Yet Available on Refund Fraud

As we noted in our report on the 1996 filing season, IRS identified many fewer fraudulent returns last year than it did in 1995. According to IRS, the decline was due to a 31-percent staffing decrease in IRS' Questionable Refund Program. Program officials told us that the reduced level of staffing has continued in 1997. However, we do not know how the reduced staffing has affected the number of fraudulent returns and refunds identified this year because IRS had not compiled that data as of the time we prepared this testimony.

FISCAL YEAR 1998 BUDGET REQUEST FOR INFORMATION SYSTEMS RAISES SEVERAL QUESTIONS

IRS' fiscal year 1998 budget request includes $1.27 billion and 7,162 FTEs for information systems. Of the $1.27 billion, $1.14 billion is for operational systems, including funds for IRS' century data change effort and for replacing two old processing systems. The rest of the request ($131 million) is for developmental systems. In addition to the $1.27 billion, the administration is requesting $1 billion over 2 years to fund a multi-year capital account, referred to as the Information Technology Investments Account, for new modernization projects at IRS.

Our analysis of the information systems request raised several questions: (1) Should Congress approve the $131 million for developmental systems and the $1 billion capital account given the absence of the kind of supporting analyses required by the Clinger-Cohen Act, GPRA, and OMB? (2) Is the money being requested for IRS' century date conversion effort sufficient? and (3) Will IRS need all of the money requested for replacing two processing systems?

Budget Request for Systems Development Not Justified

The Clinger-Cohen Act, GPRA, and OMB Circular No. A–11 and supporting memoranda require that information technology investments be supported by accurate cost data and convincing cost-benefit analyses. For fiscal year 1998, IRS is requesting $131 million for system development. However, IRS' request does not include a credible, verifiable justification. The budget request states that IRS does not know how it plans to spend these funds because its modernization systems architecture and system deployment plan have not yet been finalized. These efforts are scheduled for completion in May 1997 and are intended to guide future systems development. According to IRS budget officials, $131 million was requested for fiscal year 1998 because it was approximately the same amount IRS received in fiscal year 1997 for system development.

No Justification to Support Billion Dollar Information Technology Investments Account

The administration is proposing to establish an Information Technology Investments Account to fund future modernization investments at IRS. It is seeking $1 billion—$500 million in fiscal year 1998 and another $500 million in fiscal year 1999—for "yet-to-be-specified" development efforts. According to IRS' request, the funds are to support acquisition of new information systems, expenditures from the account will be reviewed and approved by Treasury's Modernization Management Board, and no funds will be obligated before July 1, 1998.

The Clinger-Cohen Act, GPRA, and OMB Circular No. A–11 and supporting memoranda require that, prior to requesting multi-year funding for capital asset acquisitions, agencies develop accurate, complete cost data and perform thorough anal-

yses to justify the business need for the investment. For example, agencies need to show that needed investments (1) support a critical agency mission; (2) are justified by a life cycle based cost-benefit analysis; and (3) have cost, schedule, and performance goals.

IRS has not prepared such analyses for its fiscal year 1998 and 1999 investment account request. Instead, IRS and Treasury officials stated that, during executive-level discussions, they estimated that they would need about $2 billion over the next 5 years. This estimate was not based on analytical data or derived using formal cost estimating techniques. According to OMB officials responsible for IRS' budget submission, the request was reduced to $1 billion over 2 years because they perceived the lesser amount as more palatable to Congress. These officials also told us that they were not concerned about the precision of the estimate because their first priority is to "earmark funds" in the fiscal year 1998 and 1999 budgets so funds will be available when IRS eventually determines how it wants to modernize its systems.

In 1995 we made over a dozen recommendations to the Commissioner of Internal Revenue to address systems modernization management and technical weaknesses.[8] We reported in 1996 that IRS had initiated many activities to improve its modernization efforts but had not yet fully implemented any of our recommendations.[9] Since then, IRS has continued to address our recommendations and respond to congressional direction. But, there is still no evidence that any of the recommendations have been fully implemented and, as we reported in February 1997, IRS' systems modernization effort continues to be at risk.[10] Much remains to be done to implement essential improvements in IRS' modernization efforts. IRS has not yet instituted disciplined processes for designing and developing new systems and has not yet completed its systems architecture.

Given IRS' poor track record delivering cost-beneficial TSM systems, persisting weaknesses in both software development and acquisition capabilities, and the lack of justification and analyses for proposed system expenditures, Congress should consider not funding either the $131 million request for systems development or the $1 billion capital account until the management and technical weaknesses in IRS' modernization program are resolved and the required justifications are completed.

Funding Needs for Century Date Change Are Uncertain

IRS, like other federal agencies, is in the midst of a major project aimed at making its computer systems "century date compliant." Currently, IRS' computer systems can not distinguish between the years 1900 and 2000 because the systems year is represented by two-digit date fields (i.e., 00 in both cases). IRS estimates that the failure to correct this situation before 2000 could result in millions of erroneous tax notices, refunds, and bills. Accordingly, IRS' CIO has designated this effort as a top priority. The CIO established a year 2000 project office to coordinate work among the various IRS organizations with responsibility for assessing, converting, and testing IRS systems.

IRS' fiscal year 1998 budget request includes $84 million for the century date change effort, an increase of $39 million over the $45 million included for that effort in IRS' fiscal year 1997 budget. However, the fiscal year 1998 request was based on September 1996 cost estimates that, in turn, were based on an estimate of lines of computer code for IRS' main tax processing systems. The request did not include estimates for IRS' secondary tax processing systems that are also critical to the tax administration process. It also did not factor in many other activities related to the century date change effort that have since been identified, such as the need for additional hardware and software for testing, operating system upgrades, and possibly additional storage capacity due to expanded date fields.

Thus far in fiscal year 1997, IRS has identified requirements for the century date conversion that would exceed its fiscal year 1997 budget by as much as $49.5 million. Of this amount, $13.5 million is for additional labor costs and the remaining $36 million is for nonlabor costs (i.e., the purchase of updated operating system environments, contractor support for software conversion and testing, and additional hardware for expected capacity increases). IRS' Investment Review Board recently approved a request for these additional funds. However, according to IRS budget officials, a funding source has not been identified. Once that source is identified, they said they plan to notify the Appropriations Committees.

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

[9] *Tax Systems Modernization: Actions Underway But IRS Has Not Yet Corrected Management and Technical Weaknesses* (GAO/AIMD–96–106, June 7, 1996).

[10] *GAO High-Risk Series, IRS Management* (GAO/HR–97–8, Feb. 1997).

IRS is currently assessing what it needs to do to make its main tax processing systems century date compliant and what that will cost. However, there are other potentially significant project costs, including those associated with converting and testing secondary tax processing systems. IRS project officials told us that they hope to have a complete cost estimate for the century date conversion effort by this summer. In the meantime, given the status of IRS' needs assessment, it seems reasonable to question whether the amount requested for this effort in fiscal year 1998 will be sufficient.

Replacement of Systems That Process Paper Tax Returns and Remittances

Also as part of its information systems request, IRS is asking for a $35 million increase over the $9 million it received in fiscal year 1997 to replace two systems—the Distributed Input System (a 12-year old system used to process paper returns)and the Remittance Processing System (an 18-year old system used to process tax payments). IRS reports that the systems are unreliable, costly to operate and maintain, and not year 2000 compliant. IRS is requesting $44 million for fiscal year 1998 to develop a replacement for these two systems and begin pilot testing in January 1998.

Project officials told us that to meet the January 1998 milestone for piloting the new systems, they accelerated the project schedule. As a result, they requested and the Investment Review Board approved, on March 4, 1997, an additional $11.8 million—$5.7 million for fiscal year 1997 requirements and $6.1 million for fiscal year 1998 requirements. Consequently, the project will not need this $6.1 million in fiscal year 1998. Accordingly, Congress should consider reducing the fiscal year 1998 request for this project by $6.1 million.

REQUEST FOR ADDITIONAL RETURNS PROCESSING STAFF RAISES QUESTIONS ABOUT BENEFITS OF ELECTRONIC FILING

IRS' largest requested budget increase is for $214 million and 195 FTEs to maintain its fiscal year 1997 program levels in fiscal year 1998. According to IRS, most of the $214 million is needed to cover pay and benefits for the employees it has on board. However, $11 million and all 195 FTEs are intended to cover "mandatory workload increases" in its returns processing function. More specifically, IRS has projected that the number of primary tax returns filed will increase from 197.9 million in 1997 to 200 million in 1998. IRS has also projected that 91 percent of the increase in primary tax returns (or 1.9 million returns) will be filed electronically.

The data IRS used to determine its need for $11 million and 195 FTEs indicated that IRS only saves about 5 FTEs for every 1 million returns that are filed electronically. This is contrary to what we would have expected. Because up-front filters keep certain taxpayer errors that are common on paper returns from contaminating electronic returns and because electronic returns bypass the labor intensive and error prone key punching process IRS uses for paper returns, we would expect that the labor and related costs to process electronically-filed returns would be substantially lower than the labor and costs associated with processing paper returns.

Part of the explanation for the smaller-than-expected savings is that electronic filing is not truly paperless. Taxpayers filing electronically, other than through TeleFile, must submit a paper signature document to authenticate the electronic portion of their return. And IRS has to process that document. In January 1993, we reported that IRS needs to resolve various issues that adversely affect the appeal of electronic filing.[11] One of those issues is the need to submit paper documents with an electronic return.

CHALLENGES FOR THE FUTURE

Probably the most noteworthy part of IRS' performance during the 1997 filing season to date is the dramatic increase in telephone accessibility. The improvement, however, is not without cost. IRS is using various strategies to improve accessibility, one of which involves detailing staff from other functions to answer the phone. The funding limits and program tradeoffs faced by IRS in fiscal year 1997 and anticipated for fiscal year 1998 are likely to continue for the foreseeable future. The administration's outyear projections actually reflect a decline in IRS funding when inflation is considered.

At the same time, IRS is faced with competing demands and pressure from external stakeholders, including Congress, to improve its operations and resolve long-

[11] *Tax Administration: Opportunities to Increase the Use of Electronic Filing* (GAO/GGD–93–40, Jan. 22, 1993).

standing concerns. Modernization of IRS' processes and systems is critical to doing this. So is reaching consensus on IRS' strategic goals and performance measures.

In recent years, Congress has put in place a statutory framework for addressing these challenges and helping Congress and the executive branch make the difficult trade-offs that the current budget environment demands. This framework includes as its essential elements the Chief Financial Officers Act; information technology reform legislation, including the Paperwork Reduction Act of 1995 and the Clinger-Cohen Act; and GPRA.

In crafting these acts, Congress recognized that congressional and executive branch decisionmaking had been severely handicapped by the absence in many agencies of the basic underpinnings of well managed organizations. Our work has found numerous examples across government of management-related challenges stemming from unclear missions accompanied by the lack of results-oriented performance goals, the absence of detailed business strategies to meet those goals, and the failure to gather and use accurate, reliable, and timely program performance and cost information to measure progress in achieving results. All of these problems exist at IRS. To effectively bridge the gap between IRS' current operations and its future vision while living within the budget constraints of the federal government, these challenges must be met.

Under GPRA, every major federal agency must ask itself some basic questions: What is our mission? What are our goals and how will we achieve them? How can we measure performance? How will we use that information to make improvements? GPRA forces a focus on results. GPRA has the potential for adding greatly to IRS performance—a vital goal when resources are limited and public demands are high.

GPRA requires each agency to develop a strategic plan that lays out its mission, long-term goals, and strategies for achieving those goals. The strategic plans are to take into account the views of Congress and other stakeholders. To ensure that these views are considered, GPRA requires agencies to consult with Congress as they develop their strategic plans.

Congress and the administration have both demonstrated that they recognize that successful consultations are key to the success of GPRA and therefore to sustained improvements in federal management. For IRS, these consultations provide an important opportunity for Congress, IRS, and Treasury to work together to ensure that IRS' mission is focused, goals are specific and results oriented, and strategies and funding expectations are appropriate and reasonable. The consultations may prove difficult because they entail a different working relationship between agencies and Congress than has generally prevailed in the past. The consultations are likely to underscore the competing and conflicting goals of IRS programs, as well as the sometimes different expectations of the numerous parties involved.

As a GPRA pilot agency, IRS should be ahead of many federal agencies in the strategic planning and performance measurement process. Nonetheless, IRS remains a long way from being able to ensure that its budget funds the programs that will contribute the most towards achieving its mission goals. While IRS needs more outcome-oriented indicators, it also has difficulty in measuring its performance with the indicators it has. For example, IRS' top indicator is its Mission Effectiveness Indicator. This is calculated by subtracting from the revenue collected the cost of IRS programs and taxpayer burden and dividing that result by true total tax liability. While this approach may be conceptually sound, IRS does not have reliable data to calculate taxpayer burden nor can it calculate true total tax liability.

In summary, IRS' 1997 filing season is going very well in two areas that we have criticized in the past. Telephone accessibility is much higher and more taxpayers are filing electronically.

Regarding IRS' fiscal year 1997 spending and IRS' fiscal year 1998 budget request, there are several questions that Congress may wish to consider as it continues its oversight and appropriations activities. Among these are:

—Should the $36 million that IRS will not be using for systems development and deployment in fiscal year 1997 be rescinded?

—What level of funding will IRS need to make its information systems century date compliant, and will those changes be made in time?

—Does IRS need all of the fiscal year 1998 funding it is requesting for the Distributed Input System/Remittance Processing System replacement project?

—What level of funding should Congress provide for developing new information systems, given the lack of any justification for the $131 million requested for fiscal year 1998 and the $1 billion investment account for fiscal years 1998 and 1999?

—What reliable, outcome-oriented performance measures should be put in place to guide IRS and Congress in deciding how many resources should be given to IRS and how best to allocate those resources among IRS' functional activities?

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

Chairman JOHNSON. Thank you very much, Ms. Willis. Two questions come to mind. Until the Taxpayer Systems Modernization is moving forward, and some of the other major projects that you referred to, there aren't likely to be savings that can be used to fund other functions.

So how is this agency going to continue to deliver the current level of service, and at the same time prepare itself for the future? The money is not there yet for the Project 2000. Clearly the major Systems Modernization Program is not going to be implementable until toward the end of the century. Then a flat budget is going to be an enormous problem in terms of service delivery and preparation for the future, is it not?

Ms. WILLIS. Absolutely. And I think, Madam Chairman, that one of the things we need to know more about is the effectiveness of current programs, and where existing programs are providing us good return on our investment and are moving us forward in a results-oriented fashion and achieving IRS' goals.

We frequently don't know when we make tradeoffs among the different programs what impact we are going to have, either in terms of improving service in one area, or decreasing service in another. If we understood more about certain types of programs, we would have a better understanding of how to allocate the money.

Let me give you an example, and I would use taxpayer service or telephone accessibility as one good place to start. Funding enough money to have every phone call answered is not the most efficient way, as Mr. Dolan observed, to meet the needs of taxpayers.

A key part is also understanding where we can reduce the demand that's coming in by getting rid of unnecessary calls—you know, anticipating where we can eliminate a notice and get rid of calls that are coming in. We also need to look at more efficient ways of providing that service.

Some of the new interactive systems that IRS is designing and their Web site are ways of providing the same service at a lower cost. We also need to look at more efficient ways of using the resources that we have to reach those taxpayers who need to be reached by an individual assister or by an IRS staff member.

So I think when you look at a particular program, we need to disaggregate it into its component parts and the causes of the service that we're looking to provide, and then understand what's the best way to provide that service.

Chairman JOHNSON. Isn't their effort to look regionally at sort of sector specific demands going to help with this?

Ms. WILLIS. Yes. I think their market segment approach should provide them with additional information on local conditions in the local economy and the nature of noncompliance that will allow them to better target the resources going into an individual location, and better identify and better design programs to both put preventative measures in place as well as to better target compliance efforts.

Chairman JOHNSON. In looking at the IRS Programs, in your estimation, both of you, do we understand, does somebody understand enough, about what programs work for us to be able to effectively target our dollars at the programs that work now, while we're making those plans for the architecture and discipline of TSM and the Project 2000 effort, and some of the other major efforts that are going on?

Could we use that approach to target our resources now to maintain a certain level of functioning and service while we leapfrog ourselves into this next era?

Ms. WILLIS. I think on the margin we know enough about certain programs and certain parts of the function of IRS and the types of service it is trying to deliver to make improvements within the existing resource framework.

And I would put into that category such things as electronic filing, and things that provide new ways of getting information into the system, while we wait for the new major modernization efforts to come in place after the turn of the century.

So I think we can't afford to wait until we have everything modernized in place to move forward. And there are opportunities. I think one of the first things that we need to do in identifying those opportunities however is to come up with better performance measures, and performance measures that the various stakeholders can agree to, so that when we measure what performance a particular program is giving us, we know exactly what we're talking about, and it's targeted to the strategic goals of the organization, as well as its strategic mission.

I also think—and I'm going to anticipate your question here, Madam Chairman—that there are ways to look at the Tax Code, and to decide whether that's an effective way to deliver a particular service given the resource constraints that face us.

Decisions that we made 5 or 10 years ago about delivering a particular service within the constraints of the Tax Code may no longer be ones we would make today. And I think there are a variety of ways that we can go about identifying those areas of the Code that we could simplify while waiting for the structural reform debate to take place.

One of those is looking at recurring audit issues. Are there certain issues that IRS audits repetitively among businesses year after year? And that's true. There are. What are the issues that are coming up when taxpayers call the IRS? Where are they running into problems?

If the IRS is having problems administering a particular provision I can guarantee you that the taxpayer is having difficulty being compliant with that provision, and vice versa.

So looking at where taxpayers are having difficulty being compliant, as well as where IRS is having difficulty administering this system will give us a real window into parts of the Code that we could potentially simplify.

Chairman JOHNSON. And you think we could mobilize information that's already there in a way that would help us begin this project now?

Ms. WILLIS. I think there is information out there that we can use. We may have to manipulate it. We may have to clean it up,

but I think there is information out there that we can use to help do that, yes.

Chairman JOHNSON. I think that's enormously important for us to start on. I'm talking about in the next 2 and 3 months. Because if we don't strip out some of the, in a sense, costly and nonproductive activities of the IRS, then I don't see how they have the resources to continue, in a sense, to hold, and to make the improvements in certain areas as they have been, and as we see they can do, and at the same time deal with the major problems that face them.

You were very effective in identifying early some of the contracts that were nonproductive and the systems projects that were not going to prove to be worth it. And if you would like to give some thought to what you think needs to be focused on in terms of funding and things of lesser importance, and how we get the information about where Code simplification could have actually an administrative cost impact, I'd appreciate it.

I don't even know whether it's possible under the IRS system right now to identify the administrative cost of certain Code requirements.

Ms. WILLIS. No, I don't think it is. And it's also very difficult to quantify the compliance costs on the taxpayer's side. And it is frequently difficult to tease out of any compliance or taxpayer burden question what part IRS can control and can enhance as opposed to the underlying statute, which is one of the things in looking at tax administration that we always have to be very careful about—can we manage to tease the component parts apart far enough to be able to identify strategies for addressing them.

Chairman JOHNSON. There are some particular glitches that we know about that we ought to be able to sort of tease apart a little bit. We know there are lots of companies that are having to do a second tax exercise to identify their alternative minimum tax even though they aren't going to pay an alternative minimum tax, in order to determine other tax liabilities that they may have.

Now, while we may not be able to exactly identify the costs of that problem, we ought to be able to have some rough estimate of how many companies have to do this, what part of the private sector is affected, what the rough cost of that would be, and what the alternatives are in this area.

Certainly with the EITC we know how many of those people have to hire someone to help them apply, and what the costs of submission are the way we require the forms to be submitted, and how much of the benefit to the low-income person is taken by the costs of applying, and therefore what the net effect is.

So I think if we can get some better insight into those kinds of transactional costs to both the taxpayer or the taxpayer's beneficiary, it would help us to make the kinds of changes we really have to begin making.

And there are certainly other areas that you are far better prepared to bring to my attention than those ones that I have mentioned. But I really invite you to help us over the next couple of months focus in on these areas as we have invited the IRS to do, because we can't wait until next year to start on this.

Ms. WILLIS. We would be happy to do that. In fact, we have a body of work that is kind of crosscutting that has identified areas of the Code that we think could be improved, some related to the earned income tax credit.

We have done some work on the alternative minimum tax, and you're absolutely right. A lot more people have to keep books and records than ever qualify to have to file under the alternative minimum tax regime.

And so we could certainly go through and take an inventory of those provisions that we've looked at and work with you on it.

Chairman JOHNSON. And then we have some problems waiting to explode, in terms of number of taxpayers affected.

Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman. Ms. Willis, staff of the Appropriations Committee recently testified before the National Commission on Restructuring of the IRS that it's not likely that the appropriators are going to give the full funding that was requested for 1998 to the IRS.

Would you be able to gauge the results of that relative to the IRS' performance in providing taxpayer services, collecting taxes, and preventing fraud?

Ms. WILLIS. Congressman Coyne, without knowing specifically where the appropriators are anticipating making cuts, I couldn't comment on that. If, for example, the cuts are in the information systems developmental budget, the $131 million that I spoke of, where IRS has not even decided where it's going to spend that money, not appropriating that money would not affect compliance, taxpayer service, and so forth.

But I am not aware of where the appropriators are proposing to do additional cuts, perhaps within compliance or taxpayer service, that would result in the sort of impacts you're talking about.

Ms. STILLMAN. I could amplify that a little. Consistent with the $131 million that hasn't been justified is an additional $500 million in the information technology investments accounts whose use has not been specified. There is no explanation of what it would be for, how it would be used, when it would be used. Mr. Gross has testified that money would not be spent before July 1, 1998. He said the IRS and Treasury would exert their own discipline in not spending it until they could ensure that it would be wisely spent.

July 1, 1998, is just 3 months before the start of fiscal year 1999. That gives IRS just 3 months to spend a fund of $500 million, the purpose of which is unknown today. I can't imagine that they would need $500 million at that point in fiscal year 1998.

Mr. COYNE. Thank you.

Chairman JOHNSON. If I could pursue that just for 1 minute, certainly money shouldn't be spent until the justification is clear, the plan is clear, the justification is clear. However, if we don't allocate it in an orderly process, in anticipation, when it goes out, it's going to go out in big amounts.

There are going to be big contracts. And if we don't start in a sense laying it aside now, perhaps with stronger fencing language or something, then in my experience when the time comes we will phase it in.

And we went through this with fuel assistance, when we transferred—we took the money from the windfall profits tax, and substituted it for our own money, and we have never put our own money back in because you have to take it from someplace else.

So I am terribly concerned that if we don't make some commitment to a capital fund, even if we fence it off more clearly than we have, when the time comes, we'll not allocate the money at the pace we need to then implement the plan.

Ms. STILLMAN. One of the lessons that history has taught us is that organizations in general and IRS in particular do not do well trying to build and deploy huge projects. Laying out money in huge amounts has not led to successful systems.

Clinger-Cohen specifically says that, as much as is possible, IT projects ought to be incrementalized. Projects should be smaller, the planning should be better, the performance measures should be clearer, and, at the end of each increment, it ought to be clear that we got the benefit that was intended when we made the investment. This is much better than the older paradigm of allocating humongous amounts of money for huge projects.

If TSM has taught us anything, it ought to be to develop systems more slowly.

Chairman JOHNSON. So in your view even when we get TSM planned, and we understand what the macroplan is, then the individual projects should be implemented in a way that allows us to look and see if it worked before we go forward.

That's interesting. Thank you. That's very helpful.

Ms. STILLMAN. Absolutely.

Chairman JOHNSON. Congresswoman Dunn.

Ms. DUNN. Thank you, Madam Chairman. I feel like I want to ask you for a value judgment, Ms. Willis, but maybe you can help me answer the question in my own mind. I am interested in how the IRS stacks up against other agencies as you do these evaluations.

How, for example, have they done under the Results Act?

Ms. WILLIS. I think we could give IRS credit for being ahead of a lot of Federal agencies in terms of its strategic planning processes and getting itself ready to implement the Government Performance and Results Act.

IRS has had a strategic planning process and performance measures for some years that have been incorporated into its budget. And while we might take exception to some of the performance measures, and how well they're linked to the strategic outcomes, and whether they're truly results oriented, at least you have an acknowledgment within the organization that this type of planning is important.

As a GPRA pilot agency, and IRS was one of two agencywide pilots, IRS has been initiating the process to operationalize these type of activities, and has taught us a number of lessons as we move out to implement GPRA across the government, not the least of which is this is not going to be easy.

Agencies have not traditionally avoided doing results-oriented measurement because they didn't think it was good, but because it's very hard. It's very critical and has become even more critical

as we're allocating short resources, and I think IRS is certainly at the point of recognizing that.

Although I think the IRS can be given a positive value judgment in terms of where they are in GPRA compared to some other Federal agencies, I wouldn't want that to imply that they don't have a long way to go, as does the whole government.

Ms. DUNN. That helps me a lot. Thank you very much. One of the things you talked about was the taxpayer phone calls for information and that the number of folks gaining access had multiplied by, I think you said, 100 percent, something like that. There were fewer phone calls because taxpayers were getting information in other ways.

And I guess what I would like to do is sort of get a bottom line answer from you—is there a way of evaluating the degree to which those telephone callers who gained access were given correct answers to their questions?

Ms. WILLIS. The IRS actually has a procedure that they worked out with us some years ago to evaluate the accuracy of the questions in which they test the response rate in terms of are taxpayers getting the correct answers.

I have not seen figures for this year's filing season yet, but last year the accuracy rate was over 90 percent. And I have no reason to believe that it has declined this year, but again I have not seen any numbers.

Ms. DUNN. That's very encouraging. I did talk to a group of employees in my local IRS department, and one of the problems that they brought to my mind was that when they increased the number of employees answering those phone calls, that people were moved over from management positions, other positions where they didn't necessarily have the right answers to the questions.

Ms. WILLIS. Always a concern.

Ms. DUNN. Yes. All right, thank you. Thank you, Madam Chairman.

Chairman JOHNSON. Thank you very much, and thank you for your testimony. Is there any comment you wanted to make in closing?

Ms. WILLIS. No.

Chairman JOHNSON. Thank you very much. It was a pleasure to have you.

Ms. WILLIS. Thanks for the opportunity.

Chairman JOHNSON. I'd like to call Beanna Whitlock, an enrolled agent, from the National Association of Enrolled Agents and Michael Mares, the chairman of the tax executive committee of the American Institute of Certified Public Accountants.

STATEMENT OF BEANNA J. WHITLOCK, ENROLLED AGENT, NATIONAL ASSOCIATION OF ENROLLED AGENTS

Ms. WHITLOCK. Madam Chairman, my name is Beanna Whitlock. I am an enrolled agent. I am here today to represent the National Association of Enrolled Agents, as their government relations co-chair. I also am privileged to sit on the Commissioner's Advisory Group.

I would like to first of all, on behalf of our 9,000 members, thank this Oversight Subcommittee for the work it's done. We have cer-

tainly seen a great change in the Internal Revenue Service in the last several years.

I am personally a practitioner of almost 30 years, and an enrolled agent 20 of those. And, as an enrolled agent, I am licensed by the U.S. Treasury. In 1884 we represented taxpayers before their government when they had problems with their government, and of late we represent those same taxpayers before the Internal Revenue Service.

We want to give as a filing season report card a verification of what you've heard from GAO and from the IRS. We feel this is a very smooth filing season, and our national office that hears complaints of our members reports that this is the smoothest filing season in recent years.

We report to you four instances that we think are problems. First of all a delay causing practitioners a problem. We did not receive our volume II of package X which is our bible. It has the tax forms. It has the instructions. And we didn't receive it until mid to late February as reported by most of our members—much into the tax season.

Second, we received a lot of customer or taxpayer concerns that they did not receive their tax package, which usually came about Christmastime, nor did they receive the card that had their label for it. Even though most of those taxpayers didn't use them, because they were afraid that it would subject them to audit, they were concerned that they did not receive them.

We do, however, applaud the IRS in this move omitting their issuance. We felt it was a cost savings move, and one that the taxpayer would not mind having their funds diverted to another use for.

We are concerned about the ITIN, Individual Tax Identification Number, Program. In many of the districts, our members report that taxpayers are having difficulty getting those identification numbers.

These are individuals wanting to file tax returns or use as dependents those individuals that do not qualify for Social Security numbers. And because of legislation in the fall, this new legislation caused those individuals to have to get those ITIN numbers.

Finally, as far as a glitch in the system toward electronic filing, early in February, the Internal Revenue Service reported they were having trouble with electronic filing. Several who had filed electronically were actually coming up showing as deceased, and that's one of the glitches in the program. A deceased taxpayer cannot file his return electronically.

But we applaud the Service because immediately information went out to all electronic filers, on this problem, how they could best go around the problem, and how soon it would be fixed by the IRS, and when they could go ahead and file those returns electronically once again.

Overall, we think it's a very smooth filing season, but we attribute that to the very focus that the Internal Revenue Service put on this filing season, and we encourage that this focus will become the norm and the standard operating procedure for all filing seasons.

I have listened to the testimony this morning, and I agree, and the practitioner community agrees, that this is not the same old IRS. And we attribute that in great part to the Oversight Subcommittee.

Indeed, it's not the same IRS, because they are listening now with full and open ears, and they don't react as much as they act.

Some of the instances I can give you as to how the IRS is listening to the practitioner and to the taxpayer community is, number one, in this independent contractor issue.

This is a tremendous problem for our small business owners. They don't understand the term of contract laborer as much as they understand the term casual laborer. Now when does that casual laborer or contractor become in actuality an employee? And the Internal Revenue Service has addressed that very effectively with the settlement program of last season.

Indeed, they are taking a look at the collection standards. These are the new standards applied to individuals who are trying to set up installment agreements, or offers in compromise with their government. And those new standards should be released very quickly.

And as practitioners, we are looking at the ability to use the form 656, which is the offer in compromise form, that is now able to be computer generated.

Heretofore, the IRS has been very reluctant to let us use our own computer-generated forms. But in this one particular instance, they listened to the practitioner community, felt that there were advantages and reasons why they should relax their attitude toward this, but yet they were very sensitive to this being a legal document entered into between the taxpayer and their government, compromising the integrity of the document.

But working with the practitioner community, they did develop one that can be computer generated and used much more easily by the practitioner community and the taxpayer.

And finally I would just lift up several changes that happened in my own district this year. I practice in Plano, Texas, and our district is the North Texas District.

We were very heavily hit with a requirement for these ITINs, the completion of a form W–7 which would give those individuals who could not have a Social Security Number an identification number so that they could either file a tax return, have a spouse reported on the tax return, or a dependent.

We live in a large community that is Hispanic and Spanish speaking. The Internal Revenue Service went outside of its box. It went outside to the community, visiting several Catholic Churches in both Fort Worth and in Dallas, and they had this tremendous outreach, having an opportunity to be with the taxpayer or these individuals in settings in which they were very comfortable, in their church setting.

They had interpreters there who could speak to them in their own language and, indeed, had interpreters for the deaf there as well.

In this comfortable setting, they instructed them as to why they needed these numbers, how it would facilitate the filing of their tax return, and in many instances result in a refund to them.

I am proud to tell you that over 10,000 taxpayers were helped through this outreach program by volunteers of the Internal Revenue Service. In addition to that, they have kept their telephone hours open much longer than that 8 to 5 period of time.

Most taxpayers don't have an opportunity to be on the telephone waiting during their break or their lunch hour. So this became very important to them, that they could go home, and in the privacy of their own home, call the Internal Revenue Service and get answers.

In addition to that, the time spent on the telephone waiting, from 1995, where it was 3.5 minutes, has now been reduced to only 1 minute and 10 seconds, to wait for either an assister or to be prompted through the telephone lines.

And one other thing about the North Texas District, makes my practice there much easier. They have enlisted the community in this effort in order to get information out to the public. They've enlisted the DART service, which is our bus service in Dallas, and the little message that goes around the inside of the bus that tells them about community affairs also told them about all the outreach opportunities, where the Internal Revenue Service had VITA, Volunteers in Taxpayer Assistance, sites where the taxpayer could be helped preparing tax returns, when the office hours would be extended, and, in fact, two Saturdays be available for the taxpayer to come into the Internal Revenue Service.

We feel the Internal Revenue Service has made many improvements in the way that they have administered the Tax Code in this filing season and encourage even more endeavors in this way.

Finally I would only mention to you the things that as a practitioner community we think are very vital. Because we are the eyes and the ears, and oftentimes the conscience of the IRS as it deals with the American taxpayer, we know that there is a credibility gap between the IRS and the taxpayer.

We're further concerned that without the budget to provide what the American taxpayer sees as their individual needs, taxpayer assistance, forms, accessibility to the IRS, that the budget limitations will further erode the taxpayer's confidence in the IRS, and therefore encourage noncompliance, putting further burden on the Internal Revenue Service.

We would further say that we feel that indeed the employee morale issues of the Internal Revenue Service are indeed a concern to us. American taxpayers, when they call the taxman, aren't oftentimes as courteous as they should be. And when the press comes down on the IRS, as it has in several months, then it does breed those morale issues within the Internal Revenue Service.

Finally, I was very encouraged to hear everyone who participated in these hearings today, acknowledged that indeed not only is the practitioner community a real part of tax administration with the IRS, but so is Congress. And we would simply encourage this, that when Congress considers a bill, before Congress considers sending a bill to the President to sign, that perhaps at those initial stages of planning that the Internal Revenue Service who is charged with administering those tax laws be consulted, and that, indeed, one step further, that the practitioner community be consulted as well, so that we might be those eyes and the ears and the conscience of

Congress in how the American taxpayer will view that legislation. Thank you.

[The prepared statement follows:]

Statement of Beanna J. Whitlock, Enrolled Agent, National Association of Enrolled Agents

Madame Chair Johnson, Members and guests, my name is Beanna J. Whitlock and I am an Enrolled Agent engaged in private practice in both Houston and Plano, Texas. I have been an Enrolled Agent for more than 20 years and am an instructor in small business tax and accounting. I currently serve as Co-chair of the NAEA Government Relations Committee and am a member of the Commissioner's Advisory Group (CAG).

I am very pleased to have this opportunity to present testimony on behalf of the more than 9,000 Members of the National Association of Enrolled Agents, all of whom are small business owners and tax professionals. NAEA receives no Federal grants or contracts.

As you know, Enrolled Agents are licensed by Treasury to represent taxpayers before the Internal Revenue Service. Enrolled Agents were created by legislation signed into law by President Chester Arthur in 1884 to remedy problems arising from claims brought to the Treasury after the Civil War. We represent taxpayers at all administrative levels of the IRS, thereby affording us the opportunity to be the eyes, ears and oftentimes the conscience of the IRS in its administration of the tax laws. Since we work closely with more than 4 million taxpayers each year, we are at the front lines of tax administration and know just how well the IRS is doing its job of administering the nation's tax laws.

We would like to express our appreciation to the Oversight Subcommittee members and staff for your annual review and evaluation of the direction and programs administered by the Internal Revenue Service. NAEA believes you are making an invaluable contribution to improving tax administration by this effort.

1997 FILING SEASON REPORT CARD

This is definitely not the filing season of two years ago. The perception of Enrolled Agents around the country is that filing season is going very smoothly. More taxpayers have come in earlier this year than last and we are seeing more nonfilers who want to come back into compliance. The NAEA national office staff reports the lowest level of filing season complaints in the last several years. In fact, only a handful of significant issues have come to our attention and we would like to share them with you:

1. Late distribution of Volume 2 of Package X, tax forms and filing instructions. The package was not received until well into February by most practitioners. The delay may have been the result of late Congressional legislative action last year because several forms were not ready for printing. More on that later.

2. Early in the filing season, electronic filers experienced a "glitch" in the system whereby certain taxpayers, filing their tax returns electronically, were precluded from doing so with the system reporting the taxpayer as deceased. Immediately, the Service notified electronic filers and tax practitioner groups with instructions on the program error, how to correct and alternatively file, and when the system error would be corrected and electronic filing resumed.

3. Many taxpayers who regularly use paid tax preparers continue to be concerned that they received neither a tax forms package nor a postcard with a label this filing season. We understand that in order to economize, the Service cut down on needless paperwork and mailings. NAEA strongly supported that decision. Too often, our Members reported, they did not use the forms, instructions and labels their clients brought in because as practitioners they use computer generated forms. Instead the paper and postcards were thrown away. However, it's going to take taxpayers a little while to get acclimated to this change. In the meantime, IRS continues to evaluate the suitability of its forms, instructions and publications in consultation with practitioner groups and is eliminating those that are obsolete or can be obtained in some other manner. We applaud this cost-cutting effort because in addition to being tax practitioners, Enrolled Agents are also taxpayers.

4. Individual Tax Identification Numbers (ITINs): We have surveyed our Members as to how the new ITIN program for taxpayers who are not eligible for Social Security Numbers has been working. Taxpayers who do not have SSNs must have an ITIN in order to file. The reaction has been mixed. Some of our Members report that their clients have had no problem at all while others are finding it difficult to work through the requirements. To get quick service from IRS, most EAs say they send

clients directly to the local IRS office with their documents. Others have praised IRS outreach efforts, notably in IRS' North Texas District where approximately 10,000 taxpayers have been reached. The Acceptance Agent process for ITINs has gone slower than expected. Again, this is a new program, started just this year, and it will take some time for tax practitioners and taxpayers to get accustomed to it. Some additional education work would probably be helpful, including more outreach by local IRS offices.

Overall, however, we are very pleased that the IRS appears to have focused its efforts on the 1997 filing season in an unprecedented fashion.

The Service is to be commended for its public awareness efforts on alternative ways of filing and the availability of the IRS website. The website makes it possible for taxpayers and tax practitioners to download forms, instructions for those forms, and publications at any time of the day or night, any day of the week. In addition, the IRS fax on demand service makes available the most widely used forms and instructions in a very convenient and user friendly fashion for taxpayers and tax practitioners alike.

We hope these efforts to divert telephone calls out of the system will pay off by providing alternative ways of obtaining information. We believe that they will continue to improve as more taxpayers and tax practitioners become familiar with them. This year's increased use of TeleFile is certainly an example of how it may take a year or two for taxpayers to become comfortable with the technology and then you can see usage skyrocket.

If I were to summarize what NAEA is seeing in terms of IRS operations, it would be that a more business-like, customer service approach to tax administration is being adopted in the National Office. There is a great deal more innovation and outreach to practitioner organizations. The culture of the National Office has changed dramatically over the past two years. They are doing a lot more listening to practitioners and taxpayers. In recent months, practitioner groups have been consulted on worker classification issues, strategies for electronic filing, the implementation of Congressionally mandated Electronic Federal Tax Payment System (EFTPS). We are awaiting revision of national collection standards which we hope will address and resolve problems raised by practitioners around the country.

Within the week or so, we received word about resolution of a major problem for practitioners. For some time now, practitioners have complained that IRS would not accept a computer generated Form 656 for Offers in Compromise. After collaborative work with Enrolled Agents and the Commissioner's Advisory Group, among others, the IRS has arrived at a solution. Practitioners—the vast majority of whom now do their work on computers—can now use the computer generated Form 656 without sacrificing the integrity of the agreement between the taxpayer and the IRS.

Is everything perfect? No. Employee morale is a major problem which I address later in my remarks. And following the recent wave of retirements and the consolidation of Districts and Regions, we have many Districts with new Directors and Assistant Directors who are just getting their bearings. Since they are just getting to know their staff and districts, some haven't been able to initiate all the outreach efforts we'd like to see. We feel confident that this will change in the coming months. If not, rest assured we'll be back to let you know.

I would like to share with you some other examples about how we are seeing a 180-degree shift in approach at IRS on a number of levels. In my own North Texas District, IRS personnel have done a superb job. Their outreach work on ITINs has been outstanding. In an effort to meet anticipated walk-in traffic demand and to maintain the same level of service as last year, the North Texas District trained eight Revenue Officer Aides and one Revenue Officer to provide back up assistance at the Post of Duty walk-in counters. In addition, five temporary employees were hired to handle the Form W–7 (ITINs) program. Approximately 5,000 W–7s have been certified through the walk-in operation.

I would also mention improvements to the much maligned telephone system. Here you can see the more business-like approach and more targeting of effort. The North Texas District Customer Service Division has as its objective to answer 5.2 million calls during this filing season. Through Feb. 15, a total of 1,289,287 calls were answered compared to 1,170,394 at the same time last year. The average hold time is running 1 minute 10 seconds compared to 3½ minutes in 1996.

Callers requesting Customer Service Division assistance may do so by either dialing one of two 800 telephone numbers. (Both practitioners and taxpayers give high marks to toll free numbers, by the way.) This leads to an automated assistance feature which gives the caller much faster service than waiting for a "real person." However, assistors are available for callers who are unable to work with the automated system or who have problems not addressed by the automated system. IRS

has identified the most frequent needs a taxpayer has to call so the automated list includes:

• Automated installment agreements: Under this system, callers who qualify may make an installment agreement for a balance due tax account.

• Refunds: A taxpayer may check the status of their current refund of overpaid taxes.

• Locator: Tells where to send a completed tax retu

• Personal identification number: Callers can establish or modify their PIN which is needed to access account information.

• Transcripts: Callers can obtain transcripts of their past tax year accounts or photocopies of returns filed with the IRS.

Inquiries into certain technical tax law issues are currently being referred to a call-back messaging option. The caller is advised that due to current heavy demand for assistance in the subject selected, assistance is being provided via the call-back service. The caller is then prompted to leave their name, day time telephone number, and the best time of day for contact. The caller is told he/she will receive a call back within two business days. Answers to these inquiries are provided by Examination Division personnel.

If the queue time is excessive on other selected technical topics normally answered "on-line," the caller is advised that recorded tax information is available elsewhere and referred to the topic number of that recorded information. The caller may then choose to be transferred to TeleTax to listen to the recorded information. The important point here is that the caller is given the option of choosing to go to TeleTax or staying in the queue and waiting to speak to the next available IRS representative.

We are seeing better measurement of IRS efforts. For example, a total of 43,636 forms have been distributed at the IRS walk in offices in North Texas this year, compared with 36,551 last year, a 20% increase. There have been 33,364 requests for assistance in other IRS program areas such as tax law, collection, account questions compared to 29,874 last year, a 12% increase.

In an effort to discourage procrastination, the IRS is not promoting its annual April 15 Texas Stadium filing event. Instead, two filing events, called IRStravaganza, have been scheduled. One was held February 15 and another is planned for March 22. At these events, IRS trained volunteers provide free tax help in an event open to all taxpayers. Spanish-speaking assistance and interpreters for the deaf are provided. Local businesses help sponsor the event in cooperation with local media.

Besides these special events, the District currently has 238 VITA (Volunteers in Taxpayer Assistance) sites to help taxpayers needing assistance with their tax return preparation. All of the VITA sites are open, with several one-day sites having held special events including Dallas, Ft. Worth, Longview, Amarillo, Tyler, Abilene, Texarkana, Lubbock, Lufkin, Midland and Wichita Falls.

ALTERNATIVE WAYS OF FILING

As we are all aware, the IRS is choking on paper returns and has embarked on an effort to promote electronic filing. In the North Texas District, we are seeing substantial growth in the number of tax preparers who are participating in the Electronic Filing (ELF) program and in the number of returns filed.

The North Texas District has embraced a number of marketing efforts—when did you last hear of IRS involved in market analysis?—which include:

• conducting demographic market analysis

• identifying the top 20 zip codes receiving TeleFile packages for marketing strategy

• identifying zip codes which meet demographics of the targeted population and with less than 50% ELF penetration

• writing letters to financial institutions suggesting they offer ELF as a customer benefit

• contacting federal credit unions to offer ELF to new or existing customers

• coordinating with Public Affairs to develop news releases on alternatives ways of filing

• conducting media appearances—TV, radio, newspaper interviews

• providing information stuffers to various large companies for inclusion in employee pay statement and/or customer billing statements.

They also developed a marketing plan for ELF. And, in view of last year's smooth operation of ELF, the effort seems to be paying off with a 22% increase in traditional ELF, a 30% increase in TeleFile; and a 283% increase in online filing as of 2/21/96.

The 1997 filing season found the IRS facing the expectation of doing more with fewer resources. Additionally, burdened with negative public perception, declining employee morale, coupled with a number of late tax law changes, the Service has focused on what it needed to do and has met the challenge of the filing season. We have about a month to go and while the pressure is clearly on the IRS, tax practitioners and taxpayers alike, we have had no indication that the process will not conclude successfully.

At this time, we think it appropriate to express our appreciation to those Service employees and administrators who dared to accept the challenge amid the many obstacles they faced and have endeavored to succeed. They dared to arrange assistance for taxpayers in settings the taxpayer felt comfortable with. They dared to extend taxpayer assistance telephone lines beyond the normal working hours and have arranged for taxpayer assistance walk-in offices to be open two Saturdays during March. They enlisted the community in taxpayer awareness, so even the Dallas Area Rapid Transit buses now flash ELF information for daily bus riders. They utilized other resources, enlisting Examination personnel to assist taxpayers with tax law questions. They talked with practitioners and taxpayers, anticipated the needs, shifted resources and addressed specific concerns. This year's focused effort must become the standard operating procedure for filing season.

LOOKING TO THE FUTURE

There are three areas—public perception, employee morale, and greater communication—to which this Subcommittee must pay attention if the IRS is to succeed in its mission.

A. PUBLIC PERCEPTION

Key to successful tax administration is taxpayer confidence. Taxpayers, as they attempt to meet their legal obligations to file complete and accurate returns, get very frustrated if they cannot acquire the necessary forms and publications. They are further angered if they cannot get answers to their questions when telephone lines to the IRS are backed up and wait time is unduly long. Many working taxpayers call the IRS on their break and lunch time and cannot afford a lengthy wait. Unavailability of tax forms and information, coupled with difficulty in getting answers to filing questions, breeds contempt of the tax system by the public and therefore encourages noncompliance and inaccurate reporting. In order to address these problems, NAEA respectfully requests that you recommend to the Appropriations Committee the allocation of sufficient financial resources to IRS so that it can meet its obligations to this nation's taxpayers.

B. MORALE ISSUES

In our testimony before this Subcommittee last year, we urged that Congress request that GAO study this issue. We continue to be concerned due to the dependency of our voluntary compliance system on competent, motivated individuals who have the ability to insure that the laws are administered consistently and fairly.

The perception of taxpayers about the fairness and impartiality of the tax administration system is dependent upon confidence that their interests are adequately represented by the officers and agents of the Service. We believe the current state of employee morale is so low that it jeopardizes this perception of adequate representation of the public interest.

Our Members around the country continually provide us with information about dispirited employees and how their attitudes have detrimental effects on taxpayers. Government agents who feel put upon and victimized by continual criticism and harping in the media and political arenas easily develop a callousness when dealing with taxpayer cases assigned to them. This is a human reaction and is very understandable. However, it is as serious a threat to our voluntary system as anything confronting it today.

By the very nature of its function, the IRS is not a popular place to work and will always encounter problems in recruiting the best talent available. They are further hampered in their effort to bring in new talent when morale falls to the level where employees are discouraging prospective employees from applying. This leaves the Service with the unenviable task of revising job criteria to fill jobs with the people available rather than recruiting choice personnel. Often those selected have limited promotion potential within the organization. We have recently testified before the National Commission on Restructuring the IRS on this subject and have urged the Commission to study the whole issue of employee morale and task the GAO with addressing what incentives could be pursued to bolster the IRS recruitment of

competent, well-educated, promotable individuals for government service. One suggestion we've made is that the IRS explore the possibility of paid internships for tax accounting students to work within the Service for several years prior to commencing private practice. This would provide excellent on the job training and development experience for future practitioners; insure a steady supply of well-educated government employees; regularly give the IRS an infusion of new view points with the end product being increased taxpayer confidence and satisfaction.

C. CONGRESSIONAL/IRS/PRACTITIONER COOPERATION IN TAX ADMINISTRATION

Finally, Enrolled Agents view themselves as an integral part of tax administration. We would boldly suggest that there is another partner, the Congress. We respectfully request that with regard to matters involving implementation of proposed laws, that IRS and tax practitioners be consulted early and often to smooth the way.

Earlier I made reference to the delay in Volume 2 of Package X. This may seem like a small issue but considering that Package X is the tax practitioner's Bible, it's timely availability is critical to the smooth functioning of tax season. Late Congressional action on tax legislation—anything much beyond July—plays havoc with the operation of the next filing season. Once Congress has approved a bill and the President has signed it, a whole series of steps must be taken to implement the law. Regulations may need to be written. Forms need to be developed, instructions drafted, publications created. These documents must be printed and distributed. All of this is labor intensive and requires that most elusive of all commodities—time.

A few days ago, expired aviation excise taxes were reinstated. We just received an e-mail message from one of our Members whose clients have been caught crosswise in the new law. He's hoping that petroleum distributors and suppliers will have the opportunity to recoup the lost revenue in taxes paid on product that remained in inventory when the prior law terminated at midnight, Dec 31, 1996.

This Member's reaction is hardly unique. We receive this type of message regularly. It points to the need for greater communication among Congress, the IRS, and the practitioner community. With all due respect to Treasury's tax policy role, we think it absolutely imperative that IRS be at the table as you conduct your deliberations so that you can be made aware of implementation problems. I can think of no action you can take which would have a more beneficial impact on tax administration at virtually no cost and I hope you will give it serious consideration.

On behalf of the National Association of Enrolled Agents, I thank you for this opportunity to present this testimony. I will answer any questions you may have.

Chairman JOHNSON. Thank you very much.

Mr. Mares.

STATEMENT OF MICHAEL E. MARES, CHAIRMAN, TAX EXECUTIVE COMMITTEE, TAX DIVISION, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. MARES. Thank you, Madam Chair, and Members of the Subcommittee. My name is Michael Mares, and I am here today on behalf of the American Institute of Certified Public Accountants.

I would like to first thank you for inviting the AICPA to testify here today. We are the national professional organization of certified public accountants, comprised of 331,000 members.

Our members advise clients on Federal, State and international tax matters as well as prepare returns for millions of Americans. Our clients range from individuals to nonprofit organizations, to small- and medium-sized businesses as well as to the largest businesses in America. It is from this base of experience that I draw my comments.

The mission statement of the IRS provides that

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality

of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

To achieve this mission, the Internal Revenue Service has developed three strategic initiatives: Increase compliance, improve customer service, and increase productivity—all of which you heard testimony about today.

Although the AICPA does not always agree with the Internal Revenue Service in its attempts to achieve these objectives, we do agree that these objectives are very important, both to the Service's mission, and to its objectives.

The efficient and effective administration of the tax laws are critical to the success of this Nation. We have long been concerned that insufficient IRS budget allocations might weaken the Service, and thereby erode public confidence in the Internal Revenue Service, which is an essential component of our self-assessment system.

Because of this concern, in 1986 we participated in funding a study of the Internal Revenue Service financing process. C. Eugene Steuerle, in a book entitled "Who Should Pay for Collecting Taxes," set forth the results of that study.

In the introduction to that book, Mr. Steuerle stated, "the agency's ability to perform its mission ultimately depends upon the sufficiency of its funding." We could not agree more.

It is widely acknowledged, and you heard some testimony this morning, that the IRS has serious problems that need to be resolved. It is also acknowledged, although not perhaps as widely and certainly not as frequently, that the Internal Revenue Service is in many respects doing a good job.

The National Commission on Restructuring the IRS, this Subcommittee and many other groups are presently studying the strengths and weaknesses of the Internal Revenue Service with a view toward recommending reforms.

While this studying continues, and reform proposals are being developed, however, it is crucial to the well-being of our country that the IRS be adequately funded so that it can fulfill its mission.

We hope that these hearings result in constructive action for continued improvement of the Internal Revenue Service. Where there are problems, we expect Congress will work to help the IRS solve them, rather than attempt to chastise them by withholding needed funding.

Any such action would likely be detrimental to us all, not just to the Internal Revenue Service. With insufficient funding, the IRS would not be able to adequately perform its job, and taxpayers would become increasingly frustrated in their dealings with the agency.

We believe also that lack of congressional support for the IRS could adversely affect individuals' attitudes toward participation in our voluntary compliance tax system.

Finally, the inability of the IRS to adequately perform its job would undoubtedly mean less revenue for our Nation.

We are not commenting on the merits of specific dollar amounts or allocations in the budget proposal. Such comments would be beyond the analysis we performed to create these comments.

What we do urge is a businesslike approach be taken to the Internal Revenue Service budget. The IRS performs an essential, al-

beit unpopular role, by collecting the revenue needed to operate our government. To continue and improve that activity, it needs to be provided with adequate funds.

This is not to say that nothing should be done to improve the IRS. Indeed, to the extent problems exist, reforms should be implemented and monitored so that those reforms can continue to be effective.

However, budget cuts should not be used to penalize the IRS. In my written comments, I provided a list of proposals that we believe will help not only decrease customer dissatisfaction with the IRS, but also increase the effectiveness of the tax system.

I would urge the Subcommittee to take appropriate notice of those comments.

We recognize that Congress faces a challenge in reducing a multibillion dollar budget deficit, and an enormous task in trying to balance the budget.

Conceptually, asking all Federal agencies to bear a fair share of the cuts makes sense. However, the IRS is in the unique position among agencies in that changes to the IRS budget have a converse revenue effect.

While the exact amount of that correlation is debatable, Mr. Steuerle's study concludes that additions to IRS resources would lead to an increase in enforcement revenues several times larger than costs.

We urge you not to lose sight of the big picture during these deliberations.

Once again, I would like to thank you for the opportunity to testify here today, and I'll be happy to answer any questions you may have.

[The prepared statement follows:]

Statement of Michael E. Mares, Chairman, Tax Executive Committee, Tax Division, American Institute of Certified Public Accountants

I. INTRODUCTION

Madam Chairperson and members of the Subcommittee: Thank you for inviting the American Institute of Certified Public Accountants ("AICPA") to testify before you today. The AICPA is the national, professional organization of certified public accountants comprised of 331,000 members. Our members advise clients on Federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, small and medium-size businesses, as well as America's largest businesses. It is from this base of experience that we offer our comments.

II. NEED FOR ADEQUATE FUNDING

The Mission Statement of the IRS provides: "The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness." To achieve its mission, the IRS has developed three strategic initiatives: increase compliance; improve customer service; and, increase productivity.

Although the AICPA does not always agree with the actions of the IRS in attempting to achieve these objectives, we do agree with the importance of the Service's mission and objectives. The efficient and effective administration of the tax laws and collection of tax are of benefit to taxpayers and the nation. The AICPA has long been concerned that insufficient IRS budget allocations might weaken the Service and erode the public confidence in the IRS that is essential to our self-assessment system of taxation. Because of this concern, in 1986 the AICPA partici-

pated in funding a study of the IRS financing process. C. Eugene Steuerle, in a book entitled Who Should Pay For Collecting Taxes, set forth the results of that study. In the Introduction of that book, Mr. Steuerle stated: "The Agency's ability to perform its mission ultimately depends upon the sufficiency of its funding." We could not agree more.

It is widely acknowledged that the IRS has serious problems that need to be resolved. It also is acknowledged, although perhaps not as widely and certainly not as frequently, that the IRS is in many respects doing a good job. The National Commission on Restructuring the Internal Revenue Service, your Subcommittee, as well as other groups, are studying the strengths and weaknesses of the IRS with a view toward recommending reforms. While this studying continues and reform proposals are being developed, however, it is crucial to the well-being of the country that the IRS be adequately funded so it can fulfill its mission.

We hope this hearing results in constructive action for the continued improvement of the IRS. Where there are problems, we expect Congress to work to help the IRS solve them, rather than attempt to chastise the IRS by withholding needed funding. Any such action would likely be detrimental to us all, not just to the IRS. With insufficient funding, the IRS would not be able to adequately perform its job and taxpayers would encounter additional problems and frustrations in their dealings with the IRS. We believe the lack of Congressional support for the IRS could adversely affect individuals' attitudes towards participation in our voluntary compliance tax system. Finally, the inability of the IRS to adequately perform its job would undoubtedly mean less revenues for our nation.

The AICPA is not commenting on the merits of specific dollar amounts or allocations in the budget proposal. Such issues require analysis beyond the scope of our review. What we do urge is that a businesslike approach be taken to the IRS budget. The IRS performs an essential, although unpopular, role by collecting revenue needed to operate our government. To continue and to improve that activity, the IRS needs to be provided with adequate funds. This is not to say that nothing else should be done. Indeed, to the extent problems exist within the IRS, reforms should be implemented and monitored. However, budget cuts should not be used to penalize the IRS.

Congress faces a tough challenge in reducing a multi-billion dollar budget deficit and an enormous task in trying to balance the budget. Conceptually, asking all Federal agencies to bear a fair share of the cuts makes sense. However, the IRS is in a unique position among agencies in that changes to the IRS budget have a converse revenue effect. While the exact amount of the correlation is debatable, Mr. Steuerle's study concludes that "additions to IRS resources would lead to an increase in enforcement revenues several times larger than costs." We urge you not to lose sight of the big picture during these deliberations.

III. Consequences of Inadequate Funding

Training

We are currently seeing effects of the IRS budget cuts over the last few years. A few months ago, the AICPA asked members of the Tax Division to provide comments and suggestions which would be submitted to the National Commission on Restructuring the IRS. A high percentage of those responding commented that, to a large extent, the problems they encounter with the IRS are the result of a lack of training for the IRS agents. Inappropriate issues are being raised in examinations and, as a result, taxpayers and their representatives have to expend time and resources to educate the IRS agents on the applicable law. This can lead to frustration and a loss of respect for the IRS and the tax system on the part of taxpayers and their representatives. It also can lead to frustration and low morale on the part of IRS agents. Considering the complexity and ever-changing nature of the tax laws, extensive and frequent training of agents is essential. Without it, the IRS cannot effectively perform its mission.

Customer Service

In May 1989, the AICPA conducted a nationwide survey of its members who are sole practitioners and/or members of the Institute's Tax Division, in an effort to ascertain their views and attitudes toward the IRS. To be able to measure changes in these views over time, an updated version of the 1989 survey was sent in mid-July 1995, to 3,000 of those members, randomly selected from a stratified list.

Members surveyed were presented with a variety of statements about the IRS and asked to indicate whether they agreed or disagreed with each. On balance, the 1995 survey responses tended to paint a negative picture of the IRS. For example, nearly 9 out of every 10 respondents agreed that "there are often delays in responses from

the IRS" and three-fourths agreed "it is difficult to communicate with the IRS." In addition, 7 out of every 10 respondents disagreed that "IRS communications are adequate," or that "the IRS provides good customer service," while about two-thirds disagreed that "IRS employees are adequately trained," or that "the ability of the IRS to resolve problems is adequate."

It should be noted that the 1995 survey results indicated some improvement in these areas since the 1989 survey. It also should be noted that not all results were negative. For example, two-thirds of members responding to the survey agreed with the statements that "IRS employees are consistently courteous" and that "the IRS keeps clients' tax return information confidential," while 54 percent agreed that "IRS employees are reasonable/fair." Further, 49 percent agreed that "the IRS maintains the highest standards of integrity."

Despite these positive responses, the overall ratings for the IRS's customer service in 1995 were not good. IRS management has tried hard to prevent budget cuts from affecting customer service. Nevertheless, since 1995, we have heard reports from members that there has been a noticeable reduction in the services available and in the timeliness of responses from the IRS, allegedly due to budget cuts. Thus, it appears the budget cuts have already hurt the IRS's customer service activities—activities which already were poorly rated. Customer service is a very important function of the IRS. Adequate funding needs to be provided to enable the IRS to properly fulfill that function.

Taxpayer Rights Issues

Three weeks ago, the AICPA testified at a hearing of the National Commission on Restructuring the IRS on taxpayers rights issues. (A copy of the AICPA's written testimony from that hearing is being submitted to this Subcommittee with this testimony.) Included in that testimony was a discussion of taxpayer rights issues the AICPA felt should be addressed. It appears that three of those taxpayer rights issues are, at least in part, the result of inadequate funding of the IRS. Those three are: the need for a "realistic possibility of success" standard for the IRS to raise an issue on audit; the need for comprehensive interest netting; and, the desirability of presenting taxpayers with detailed interest computations in connection with adjustments in tax liabilities. Thus, IRS budget shortfalls may be linked to the denial of rights of taxpayers.

1. *Need for a Realistic Possibility of Success Standard for the IRS to Raise an Issue in an Exam.*

As mentioned above, currently, presumably due to a lack of adequate training, IRS agents often raise inappropriate issues in examinations. Treasury Department Circular No. 230, IRC section 6694, and professional ethics guidance of the AICPA and the American Bar Association ("ABA") provide that tax advisers may not recommend a position in a return that lacks a realistic possibility of being sustained on its merits. A position is considered to have a realistic possibility of being sustained on its merits if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits.

Although the AICPA and the ABA prefer not to assign mathematical probabilities to the realistic possibility standard, nevertheless, both professions subscribe to the standard. Unfortunately, the IRS has not chosen to instruct revenue agents to apply the same "realistic possibility" standard before raising issues in examinations and, in many instances, has not provided adequate training so that the agents would know whether they have a "realistic possibility of success."

For example, in a recent IRS examination, a revenue agent asserted in his Revenue Agent's Report ("RAR") that a taxpayer corporation must switch from the cash method of accounting to the accrual method of accounting based on an IRS Industry Specialization Paper for Health Care. Although the taxpayer was a personal service corporation (with no inventories), entitled by statute (IRC sec. 448) to be on the cash method of accounting, the revenue agent insisted the taxpayer had to change to the accrual method of accounting. The taxpayer protested to the Appeals Office, which dropped the issue. The taxpayer incurred the expense of protesting the revenue agent's adjustment to the Appeal's Office even though there was no realistic possibility of the IRS prevailing on the accounting method issue.

As a matter of fairness and consistency to taxpayers, we recommend that the IRS require revenue agents to have concluded that there is at least a realistic possibility of success before proposing an adjustment against a taxpayer. We also recommend that the IRS budget include sufficient funding for training of IRS agents so they will be able to make knowledgeable determinations regarding the issues.

2. *Need for Comprehensive Interest Netting*

Currently, there is a differential between the interest rate a taxpayer pays on a deficiency and the interest rate the government pays to a taxpayer on an overpayment; the differential rate can vary from 1 percent to 4.5 percent. Situations often arise when a taxpayer is indebted to the government at the same time that the government is indebted to the taxpayer. Absent netting, a taxpayer who owes the government the same amount that the government owes the taxpayer would incur an interest obligation in favor of the government.

The Service's current policy with respect to interest netting is fundamentally unfair, both because of the manner in which the Service makes interest netting calculations and also because of the Service's inconsistent application of netting principles, resulting in similarly situated taxpayers receiving disparate treatment.

Interest provisions in the Code are intended to compensate the government or the taxpayer for the use of the money. (Rev. Proc. 60–17, 1960–2 C.B. 942) Interest applies only if there is an amount that is both due and unpaid. (See, e.g., IRC § 6601(a); and Avon Products, Inc. v. United States, 78–2 U.S.T.C. (CCH) ¶ 9821 (2d Cir. 1978).) To the extent there is a "mutuality of indebtedness" between the taxpayer and the government (i.e., to the extent the government and the taxpayer owe each other the same amount of money over the same period of time), there is no unpaid balance and, therefore, no amount on which interest should accrue.

The Service's current policy (See Treas. Reg. § 301.6402–1.) of only netting outstanding overpayments against outstanding liabilities for both computational and collection purposes is unfair to taxpayers that promptly pay contested amounts of tax and, therefore, have no "outstanding" liabilities. This is illustrated by the recent case of Northern States Power, in which the company's prompt payment of alleged deficiencies cost it $460,000 more in interest than it would have had to pay if it had delayed in making the payment. (See Northern States Power Co. v. United States, 73 F3d 764 (8th Cir. 1996), cert denied 117 S.Ct. 168.)

Finally, and of significant import, despite the Service's stated policies toward interest netting (i.e., that netting can legally occur when both deficiencies and overpayments are outstanding and unpaid, see, e.g., Notice 96–18), netting continues to be performed on an ad hoc basis. A revenue agent's decision to deny a taxpayer netting is supported and justified by language in the Eighth Circuit's opinion in Northern States Power, which states that such netting is discretionary. However, the Service's discretionary application of the law without any formal or enforced guidelines, policies or procedures is inherently unfair to taxpayers. The virtual absence of any clear legal standards for interest netting also is unacceptable from a systemic standpoint, because it affords the IRS unfettered power to convert a taxpayer from a creditor to a debtor, with the size of a potential interest debt quickly becoming astronomical.

Further, viewing comprehensive netting as entirely within the discretion of the Service interjects serious fairness concerns into the settlement process. The Service has used the netting issue as a bargaining chip in negotiations to extract concessions from taxpayers on issues under examination. This inappropriately distances negotiations from the merits of the underlying issues. It also has the inappropriate effect of using netting (or the absence of netting) as a tool to raise revenue, rather than as a means to compensate for the use of money.

The Service counters taxpayer comments regarding unfairness with claims that netting in all situations is not administratively feasible. While comprehensive interest netting raises concerns of administrative feasibility, more progress must be made in balancing these concerns against concerns of taxpayer fairness. Congress must be aware that IRS budget cuts may result in cuts in taxpayer rights, as has been the case in the interest netting area.

We recommend that adequate funding be provided to enable the Service to provide comprehensive interest netting in all situations. In the meantime, we recommend that guidance be issued to implement comprehensive netting in all situations in which the IRS currently has the administrative capability to do so. In all other situations, as an interim measure, guidance should be issued providing that the Service will net comprehensively at the request of the taxpayer, provided the taxpayer furnishes the Service with relevant information and interest computations. By "comprehensive netting" we mean netting for all interest accruing after December 31, 1986 for all types of taxes and all years (open or closed) to the extent necessary to compute interest accurately for a refund or an assessment in an open year. This interim recommendation is similar to the elective approach recently recommended by this Subcommittee, as well as the approach of a draft revenue procedure submitted by the Compliance Subgroup of the Commissioner's Advisory Group at its January 1995 meeting.

3. *Desirability of Detailed Interest Computations*

We believe the IRS should provide interest computations, as a matter of course, to taxpayers when adjustments involving interest are made. Although it is not clear why this is not done currently, it appears at least part of the reason may be lack of adequate funding.

Currently, a taxpayer only receives a notice showing the amount of tax and the interest due on such amount. IRC section 7522, which is applicable for notices mailed on or after January 1, 1990, requires that such notices describe the "basis for, and identify the amounts (if any) of, the tax due, interest, additional amounts, additions to the tax, and assessable penalties included in such notice." At the present time, the starting date for the interest, the principal amount upon which such interest is based, and the rate charged on such amount are not provided to taxpayers as part of the notice procedure.

We believe the "basis for" description in the notice should apply to interest computations and should include interest rates and the dates for which the interest applied, the dates and amount of payments and credits, and the interest compounding method. With this information, taxpayers and practitioners will be able to verify the accuracy of interest computations and expeditiously resolve any discrepancies. We recognize that detailed interest computations could result in a burden to the IRS. Therefore, an exception could be made for de minimis interest amounts such as less than $50 or $100.

IV. Potential Cost Savers

Also included in the AICPA's written testimony to the National Commission on Restructuring the IRS were proposals that, if implemented, would likely reduce some of the IRS's costs. These proposals deal with: penalty abatements; disclosure changes utilizing a PIN; and notification of intention to offset. We recommend that consideration be given to these proposals as a means not only to improve IRS's customer service but also to achieve a more efficient tax administration system.

Penalty Abatements

The IRS assesses numerous penalties in response to which taxpayers spend a great deal of time documenting reasonable cause for having the penalties abated. The process is both time consuming and expensive. However, based on both reasonable cause and IRS errors, the IRS abates as much as 50 percent of some types of penalties it proposes. Unfortunately, taxpayers without representation are often unaware of the opportunities for abatement. It may be possible to achieve a more cost-effective outcome by establishing criteria for reducing assessments that are likely to be abated.

To reduce the burden on both the IRS and taxpayers, the IRS could establish safe harbor provisions for a variety of penalties which would automatically be deemed to be reasonable cause for abatement. This could be confined to late filing, late deposit and certain information return related penalties. The object would be to concentrate on those penalties that are regularly assessed and abated. Safe harbor provisions could take the form of:

- No penalty assessments for an initial occurrence; however, the taxpayer would receive a notice that a reoccurrence will result in a penalty;
- Automatic non-assertion based on a record of a certain number of periods of compliance; or
- Voluntary attendance at some type of educational seminar on the issue in question, as the basis for non-assertion or abatement.

Use of this approach would encourage and create a vested interest in compliance, since a good history of compliance could automatically result in relief. Additionally, the likelihood of future abatements would diminish if the taxpayer has a history of non-compliance. Furthermore, a system of automatic abatements would reduce the time spent and costs incurred by the IRS and taxpayers on proposing assessments, initiating and handling correspondence, and subsequently abating a high percentage of penalties. The ability to abate a penalty for a reasonable cause other than those used for automatic abatements would exist; however, reasonable cause abatements requiring independent evaluation may be reduced.

Disclosure Changes (PIN/POA)

IRS statistics indicate approximately 50 percent of all returns are prepared by commercial preparers. We believe, especially because of the complex nature of the tax law, that taxpayers have a right to expect that the hiring of a preparer will avoid personal inconvenience and unnecessary loss of their own productive time in having their return accepted in the processing phases by the IRS. Our experience and IRS records show that the processing of notices during the return perfection

and processing phase is a significant workload factor and must, therefore, result in significant costs to the IRS. Many practitioners and taxpayers, unaware of the strict enforcement of the disclosure rules, attempt to resolve these notices by having a preparer "do what the preparer is being paid to do"—prepare the return, solve any processing problems, and appropriately interact with the Service.

We believe changes in the disclosure rules would reduce IRS correspondence and costs in dealing with ineffective contacts by preparers without a power of attorney, reduce taxpayer burden, and support the taxpayer's rights to be represented. Accordingly, we recommend that third parties be allowed to discuss a notice and its related account with the IRS by use of a Personal Identification Number ("PIN") on the notices sent to taxpayers.

The use of a PIN was under active discussion between the AICPA Tax Practice and Procedures Committee and the IRS in the past, but we were unable to reach agreement with the Service regarding implementation of such a procedure.

The ability of a practitioner, parent, child or neighbor to assist a taxpayer who does not understand, see well, hear well, etc., in handling his or her business affairs with the IRS immediately (i.e., a telephone reply or discussion), would reduce burden (both time and cost) and frustration, in addition to the cost of tax administration for the IRS, taxpayers, and preparers. A system of interacting via telephone with the IRS is the future of "one-stop" service and efficiency in a modern-day tax system. Holding two-way conversations with the IRS to discuss notices, payments, penalties, errors, missing information, etc. must be distinguished from representing taxpayers before the Service and entering into binding agreements on their behalf, for which there is a need for a formal power of attorney.

Notification of Intention to Offset

Current IRS procedures require that before any overpayment is refunded or credited to estimated tax, as requested by the taxpayer, there must be a review of a taxpayer's accounts for any balances due. If a balance due is showing for the taxpayer on another account or module, the overpayment will be offset and the remaining balance, if any, refunded or credited. The taxpayer is not given an opportunity to verify the correctness of the IRS data before this action is taken.

We believe the IRS should provide taxpayers with notification of its intention to offset an overpayment from one account to a balance due on another account or module. We recognize the IRS's authority to credit amounts due the taxpayer to any other liability of the taxpayer, in accordance with IRC section 6402. However, the taxpayer should be notified of such credit application before the action is taken. In many instances, the balance due is erroneous or subsequently abated. Also, the credit application may have serious ramifications for the taxpayer, particularly an individual or a smaller business that cannot afford to engage a representative to deal with the IRS on such issues.

For example, a taxpayer may elect to apply an overpayment of income tax from one year to the next as an estimated tax payment. This overpayment is sufficient to cover the taxpayer's first quarter estimate for the subsequent year. The taxpayer, a sole proprietor, may have been assessed an employment tax penalty on a given quarter. The penalty is due to the fact that a proper liability breakdown was not included with the Form 941. Once this information is supplied by the taxpayer, the penalty will be abated.

Under the IRS's current system, the taxpayer's overpayment of income tax will be applied to the outstanding assessment for the employment tax penalty. The remaining amount applied to the first quarter estimated tax payment for the subsequent year may then be insufficient to cover the required quarterly payment and cause the taxpayer to be subject to an estimated tax penalty on the subsequent year. If the employment tax penalty is subsequently abated, the amount credited to the account will then be refunded to the taxpayer from the employment tax account; the estimated tax penalty will not be abated automatically.

We recommend that taxpayers be notified prior to the application of overpayments to balances due on other accounts or modules. There may be other actions in progress to rectify such accounts or significant mitigating factors under consideration by another area within the IRS. The application of such overpayments, without providing the taxpayer an opportunity to address the situation, is a denial of "due process" and may create unnecessary complications and frustrations and costs for both the IRS and taxpayers.

Rounding

We believe requiring the rounding of numbers on most tax returns would decrease the number of errors and, therefore, the costs involved in tax return preparation

and processing. Rounding could greatly enhance efficiency in processing tax returns and would not affect the rights of individual taxpayers.

V. CONCLUSION

The AICPA appreciates the opportunity to testify at today's hearing and is willing to provide the Subcommittee with additional assistance and comments as requested. Thank you for your attention.

Chairman JOHNSON. Thank you very much for your testimony. Both of you were very interesting and very helpful. It was very helpful, Ms. Whitlock, to hear you go through the problems that occurred.

They are, luckily, relatively narrow compared to the problems we've identified in the past. I would say that this Subcommittee has had a very good working relationship with the IRS in the last couple of years.

We have tried to listen to them at the same time we have also tried to prod them forward, through the Taxpayer Bill of Rights. And it was interesting that when we had trouble moving it in a timely fashion, they were able to implement part of it administratively, but not the major recommendations.

So good government really is a team effort between administrators and legislators. And I believe that the hearings we're having this year as a result of the Taxpayer Bill of Rights, and the actions of the agency in terms of focus, do reflect that closer working relationship and the legitimacy of solid input through representatives into administrative priorities.

I did want to ask you, Ms. Whitlock, whether you felt that the IRS' administrative actions in regard to the independent contractor issue were sufficient to solve the problems in that area, or whether we still need to legislate to clarify a number of the issues raised in the last session?

Ms. WHITLOCK. I believe what was done in the last session, as far as being able to resolve the issues, early intervention, and an examination where independent contractor issues were involved, brought us a long way.

The Commissioner's Advisory Group is also addressing independent contractors, as it looks at the whole life of a small business. Indeed, the startup of a business, as the business increases, if there is a need for employment, educating that taxpayer on his responsibilities as an employer, and, indeed, should that taxpayer really have the availability to use contract labor in the true sense of the word.

And I believe the legislation enhanced the need that the IRS had in order to educate the taxpayer. And in fact we're developing a whole line of taxpayer information that will keep that taxpayer in compliance.

Chairman JOHNSON. I certainly do believe that the IRS' actions have been helpful. But it doesn't seem to me that we are—and I also recognize you can't have an absolute bright line in this area.

But given the pace of change in the way we do business, and the relationships between business entities and various functions that they used to hold within them, and, frankly, the need for expertise

of a level that most businesses can't afford, and really need to contract, I see the number of independent contractors as growing.

I think this could be a very healthy thing in a society that has always gained its strength from entrepreneurial enterprise. But I am conscious of the dangers of arbitrarily pushing people off payroll to eliminate the requirement to fund benefits, and yet hire them back in exactly the same positions.

So there are problems that we need to be conscious of. But it seems to me that we have not moved far enough in dealing with this problem, and that we still need to legislate this year.

I appreciate if you would give that some thought, and perhaps give us your recommendations on that.

Ms. WHITLOCK. I would certainly do that, and I appreciate the opportunity.

Mr. MARES. We are in the process of developing some legislative proposals to bring before Congress that address that specific issue.

Chairman JOHNSON. We do expect to come back to it, because that's an example of complexity or lack of clarity that also is very costly to the taxpayers and to the agency.

I do appreciate, Mr. Mares, in your written testimony, your suggestions for how we could save money, what could be more efficient, and some of the changes that need to be made, and we will certainly take those under advisement.

Mr. MARES. Thank you.

Chairman JOHNSON. Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman. You have commented already on adequately funding the IRS in order for it to be able to successfully conclude its mission. I wonder if funding for the administration's five-point plan should be included relative to making sure that that five-point plan is implemented.

Would you advocate that adequate funding be included for implementing the five-point plan that was outlined yesterday by Deputy Secretary Summers?

Mr. MARES. Mr. Coyne, I have not really had an opportunity to review it. I flew in this morning. So I really have not had an opportunity to go through it. It is certainly something that I will get back to you on, once I've had an opportunity to go through the administration's plan.

Mr. COYNE. Would you care to comment, Ms. Whitlock?

Ms. WHITLOCK. I would simply say—in fact, I sat in on the Deputy Secretary's meeting earlier this morning—that that five-point plan can only be successful if it's adequately funded, and monitored to reach its goal.

Mr. COYNE. OK. I wonder if either one of you, or both of you, would want to comment on the IRS' efforts to reduce tax refund fraud. Has it been successful, or have you had an experience with it to the point where you could comment?

Ms. WHITLOCK. From the standpoint of a practitioner, we are put in a very unusual position. We are there to serve the taxpayer, but we are also taxpayers ourselves.

And oftentimes when there is an apparent fraud being presented before us, as a preparer, the Internal Revenue Service has given us a fraud hotline to call. Not putting ourselves in a difficult position, but just informing the Service that there is a potential for

fraud in what we might be seeing developed in the taxpayer community.

From that standpoint, from the practitioner point of view, I do feel like the Service has tried to protect us and stay in tune to what the practitioner community is seeing.

Mr. COYNE. OK.

Mr. MARES. And I think where appropriate the Internal Revenue Service has adopted programs such as they did with the earned income tax credit problems that arose. I know in my dealings with the service center personnel, in Memphis and in Philadelphia, that there is an ongoing concern about identifying programs or taxpayers who may be committing fraud, and addressing those needs as they arise.

Mr. COYNE. Thank you very much.

Chairman JOHNSON. Are you going to in your recommendations that you referred to, Mr. Mares, are you going to have any comment on how to simplify the EITC, or how to change it so that it would be easier to administer and possibly easier for recipients for apply for?

Mr. MARES. Yes, we are. As a matter of fact, we will be presenting a substantial number of simplification proposals to the National Commission on Restructuring the Internal Revenue Service very shortly.

And we would be delighted to make a copy of those available to this Subcommittee as well.

Chairman JOHNSON. Thank you. We would appreciate that. Thank you very much. Thank you for your testimony today. And the hearing is concluded.

[Whereupon, at 1:52 p.m. the hearing was concluded.]

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