IMPLEMENTATION OF THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

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IMPLEMENTATION OF THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT

THURSDAY, JULY 22, 1999

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

The Subcommittee met, pursuant to notice, at 9:05 a.m., in room 1100, Longworth House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) presiding.

[The advisories announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
July 15, 1999
No. OV–10

Houghton Announces Hearing on Implementation of the Internal Revenue Service Restructuring and Reform Act

Congressman Amo Houghton (R–NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing to review the progress of the implementation of the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (P.L. 105–206) one year after its enactment. The hearing will take place on Thursday, July 22, 1999, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.

Oral testimony at this hearing will be from invited witnesses only. Invited witnesses will include IRS Commissioner Charles O. Rossotti; Tax Policy and Administration Issues Director James R. White, U.S. General Accounting Office; and Chairman Charles A. Lacijan, Electronic Tax Administration Advisory Committee. Any individual or organizational not scheduled for an oral appearance may submit a written statement for consideration by the Committee or for inclusion in the printed record of the hearing.

BACKGROUND:

The passage of the Internal Revenue Service Restructuring and Reform Act (RRA) reflected the recognition by the Congress that the IRS required major reform. The RRA established an Oversight Board within the U.S. Department of the Treasury, including a super-majority of members from the private sector, to monitor the administration, management, conduct, direction, and suppervision of the execution and application of the tax laws. The RRA also mandated specific structured and management reform including:

(1) an independent appeals function,

(2) authority to hire experts and high level managers,

(3) an independent National Taxpayer Advocate who represents the interests of taxpayers with broad authority,

(4) provisions to hold IRS employees accountable for their actions, and

(5) streamlined oversight by the Congress and the Treasury Inspector General.

Congress also took steps to ensure that taxpayers are treated fairly and that they are accorded additional rights when dealing with IRS officials. The RRA created more than 50 taxpayer rights including:

(1) providing that divorced or separated individuals are not liable for taxes as an innocent spouse or only responsible for taxes on his or her own income,

(2) shifting the burden of proof to the IRS in court proceedings,

(3) suspending interest when the IRS does not provide appropriate notice within 18 months, reducing the failure to pay penality by one half while the taxpayer is participating in an installment agreement, and requiring management approval of non-computer generated penalities,

(4) making it easier for taxpayers to enter into installment agreements, and

(5) ensuring due process for taxpayers in collections activities.

In announcing the hearing, Chairman Houghton stated: "One year ago, the President signed into law the most significant reform of the Internal Revenue Service in its history. We intend to review the progress that the IRS has made to reform itself into a modern, efficient, customer-friendly agency and what challenges remain to be met. We also intend to review the effectiveness of taxpayer rights created by the law."

FOCUS OF THE HEARING:

The Subcommittee will review the efforts of the IRS to reorganize, modernize, and reshape itself into a service-oriented agency.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the *close of business,* Thursday, August 5, 1999, 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 Committee office, room 1102 Longworth House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

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

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing of the official hearing record.

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

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

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

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

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://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 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

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NOTICE—CHANGE IN TIME

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
July 21, 1999
No. OV–10–Revised

Change in Time for Subcommittee Hearing on Thursday, July 22, 1999, on Implementation of the Internal Revenue Service Restructuring and Reform Act

Congressman Amo Houghton (R–NY), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee hearing on the Implementation of the Internal Revenue Service Restructuring and Reform Act scheduled for Thursday, July 22, 1999, at 10:00 a.m., in the main Committee hearing room, 1100 Longworth House Office Building, **will now be held at 9:00 a.m.**

All other details for the hearing remain the same. (See Subcommittee press release No. OV–10, dated July 15, 1999.)

—

Mr. HOUGHTON. Good morning, everybody. The meeting will come to order.

In June 1997, after a year of work, the National Commission on Structuring and Internal Revenue Service issued its report, which was a vision for the new IRS. The Commission was co-chaired by our Subcommittee colleague, Rob Portman, along with Senator Bob Kerrey. Our Ranking Democrat, Bill Coyne, served on the Commission as well. An enactment of the report's recommendation began with hearings and a report from the Subcommittee, culminating in passage of the IRS Restructuring and Reform Act of 1998, which was signed into law about a year ago.

Now, the Commission identified three broad concerns, including No. 1, a lack of long-term vision, No. 2, difficulty in developing structured plans to obtain specified goals, and No. 3, an inability to follow through and sustain efforts to meet those goals.

So in addressing these issues, it is not as glamorous as enacting new taxpayer rights. And it is equally important. Mac McKinney had a wonderful story that I was going to tell, but it took about half an hour to tell it, so I'm eliminating that story, it had to do with Will Rogers. I'll tell you, Commissioner, about it a little later.

As difficult as I'm sure it was to achieve a consensus within the Commission, and as challenging as it was to secure passage of the reform implementation, that of course is the hard part. We are now entering a time of risk, a time of changing processes, spending large dollars and moving people around.

So the responsibilities of the Commissioner, the Treasury and the Oversight Board, and I'm assuming that a board will soon be in place, are clear. And of course, Congress is equally responsible for making it clear that these reforms are not just a flash in the pan, and for making sure that they are implemented effectively.

The RRA requires us to coordinate congressional oversight, and our first joint review was held last May. The review provided an excellent overview of the many challenges facing the IRS, completing our Y2K readiness, modernizing systems, reorganizing major business groups and implementing a new taxpayer protection policy.

So today we need to focus on specifically the implementation of the RRA. We need to determine whether the Service has the financial and management and personnel resources it needs to do the job. And we need to learn more about what the Service is doing to train employees to implement the new taxpayer rights. Also, we'd like to find out about the reports that collection and enforcement activities have dropped.

So as we consider the difficult steps that lie ahead, the Subcommittee will be examining them against the backdrop of the Commission's findings and the need for long-range vision and strategic business plan, and a consistent follow-through.

What I'd like to do now is recognize the Ranking Democrat, Mr. William Coyne, for his opening statement.

Mr. COYNE. Thank you, Mr. Chairman.

On the first anniversary of the enactment of the IRS Restructuring and Reform Act of 1998, it is appropriate that the Ways and Means Oversight Subcommittee hold today's hearings. Over the past 2 years, the Subcommittee has served as the catalyst for the development of the IRS reform legislation. Most recently, the Subcommittee has engaged in continued oversight of the IRS. Today we have discussion of the progress the IRS has made to date in implementing the 1998 IRS reform bill.

This major reform legislation included over 70 taxpayer rights provisions, including those providing innocent spouse relief, abatement of interest and penalties, streamlined installment agreements and offers of compromise, a more powerful Office of Taxpayer Advocate and funding for low-income tax clinics. Also, the new law provides for IRS reorganization, hiring of management experts and the creation of public-private IRS oversight board.

The IRS reform legislation enacted last year has had a positive effect on the taxpaying public. A new IRS management team, a modernized tax system, and improved taxpayer services are beginning to have an effect. Taxpayers are seeing the impact of reformed innocent spouse rules, improved taxpayer notification of audit issues, and clearer IRS forms and instructions.

However, there is disconcerting news as well. Press reports raise serious questions about recent trends in tax compliance and IRS enforcement. IRS statistics show that the IRS has largely shut down its compliance programs, with liens, levies and seizures at an all-time low and dropping. Interviews with IRS employees have indicated that they considered their jobs at risk when talking to taxpayers, should they commit one of the 10 deadly sins, or worse, fear that they would be subject of the next Senate hearing alleging that they abused taxpayers.

I have attached three recent news articles which raise these issues and should be discussed by the Subcommittee today. Now is the time for us to assess the current state of the IRS and to make any adjustments that we need to. We must make sure that our tax system is balanced, fair, for all taxpayers, especially the 98 percent of individual taxpayers who voluntarily pay taxes on time by April 15.

Finally, it is unfortunate that the House last week adopted an amendment to cut the IRS budget for fiscal year 2000 by $135 million. The IRS Commissioner had communicated to the Congress before the vote in no uncertain terms that such action would result in the inability of the IRS to deliver the mandates of the IRS reform bill.

In the words of the IRS Commissioner, Mr. Rossotti, by letter dated July 15:

> A funding reduction would severely restrict, if not completely impair, IRS' ability to deliver the Restructuring and Reform Act mandated by Congress in 1998. Every aspect of the agency's commitment to reorganize the organization and improve customer service and taxpayers' rights would be in jeopardy. It would constrain the agency's ability to implement the initiatives so critical to changing how IRS delivers on customer service and improves its treatment of taxpayers and focus on taxpayer's rights.
>
> The cut would result in reduced plans to deliver better telephone service and tax assistance in Spanish. IRS staff has already been reduced 14 percent since fiscal year 1993, thereby continuing the rapid decline and exam collection and criminal tax compliance operations. It would reduce funding for the electronic tax administration program, thereby jeopardizing the congressionally mandated goal of 80 percent electronic filing by the year 2007. It would impair the creation of operating units to help in specializing groups of taxpayers, including small business and ordinary wage earners. Finally, it would delay the implementation of important taxpayer rights initiatives.

I have attached a copy of this letter, which discusses the threat that inadequate funding poses to the IRS reform effort. I look forward to working with Subcommittee Chairman Houghton and others to ensure proper implementation of IRS reform as well as the necessary funding for IRS in fiscal year 2000 and into the future.

Thank you.

[The opening statement and attachments follow:]

Statement of Hon. William J. Coyne, a Representative in Congress from the State of Pennsylvania

On the first year anniversary of enactment of the IRS Restructuring and Reform Act of 1988, it is appropriate that the Ways and Means Oversight Subcommittee hold today's hearing.

Over the past two years, this Subcommittee served as the catalyst for the development of the IRS reform legislation. Most recently, the Subcommittee has engaged in continued oversight of the IRS, review of the 1999 tax return filing season, and consideration of the IRS's fiscal year 2000 budget.

Today I look forward to discussion of the progress that the IRS has made in implementing the 1998 IRS reform bill. This major reform legislation included over seventy taxpayer rights provisions, including those providing innocent spouse relief, and abatement of interest and penalties, streamlined installment agreements and offers-in-compromise, a more powerful Office of the Taxpayer Advocate, and funding for low-income tax clinics. Also, the new law provides for IRS reorganization, the hiring of management experts, and creation of a public-private IRS Oversight Board.

The IRS reform legislation enacted last year has had a positive effect on the taxpaying public. A new IRS management team, a modernized tax system, and improved taxpayer services are beginning to have an effect. Taxpayers are seeing the impact of reformed innocent spouse rules, improved taxpayer notification of audit issues, and clearer IRS forms and instructions.

However, there is disconcerting news as well. Press reports raise serious questions about recent trends in tax compliance and IRS enforcement. IRS statistics show that the IRS has largely shut down its compliance programs, with liens, levies and seizures at an all-time low and dropping. Interviews with IRS employees indicated that they considered their jobs at risk when talking to taxpayers (should they commit one of the "10 deadly sins") or, worse, feared that they would be the subject of the next Senate hearing alleging that they abused taxpayers. I have attached three recent news articles which raise these issues and should be discussed by the Subcommittee today.

Now is the time for us to assess the current state of the IRS and to make any adjustments needed. We must make sure that our tax system is balanced and fair for all taxpayers, especially the 98 percent of individual taxpayers who voluntarily pay taxes on April 15.

Finally, it is unfortunate that the House last week adopted a Republican-sponsored amendment to cut the IRS's budget for fiscal year 2000 by $135 million. The IRS Commissioner had communicated to the Congress before the vote, in no uncertain terms, that such action would result in the inability of the IRS to deliver on the mandates of the IRS reform bill.

In the words of the IRS Commissioner, by letter dated July 15, 1999, "A funding reduction of $135 million would:

- Severely restrict, if not completely impair, IRS's ability to deliver on the Restructuring and Reform Act mandated by Congress in 1998. Every aspect of the agency's commitment to reorganize the organization, improve customer service and taxpayer rights would be in jeopardy
- Constrain the ability (of the IRS) to implement the initiatives so critical to changing how IRS delivers on customer service and improves its treatment of taxpayers and focus on taxpayer rights. For example, the cut would result in reduced plans to deliver better telephone service and tax assistance in Spanish.
- Require reduced staffing levels in order to free up the funds necessary to implement congressionally mandated RRA requirements. IRS staff has already been reduced 14 percent (or 15,600 FTE) since FY 1993—thereby continuing the rapid decllne in exam, collection and criminal tax compliance operations.
- Reduce funding for the Electronic Tax Administration program, thereby jeopardizing the Congressionally mandated goal of 80 percent electronic filing by the year 2007.
- Impair the creation of operating units to help specialized groups of taxpayers including small businesses and ordinary wage earners.
- Delay implementation of important taxpayer rights initiatives."

I have attached a copy of this letter which discusses the threat that inadequate funding poses to the IRS reform effort.

I look forward to working with Subcommittee Chairman Houghton to insure proper implementation of IRS reform, as well as the necessary funding for IRS in fiscal year 2000 and into the future.

COMMISSIONER

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

July 15, 1999

The Honorable William J. Coyne
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Coyne:

As the House considers the Fiscal Year 2000 Treasury, Postal Service and General Government Appropriations bill, which includes the Internal Revenue Service (IRS) budget, I want to urge your support for full funding for the IRS. Adequate funding for FY 2000 is critical to the success of the Restructuring and Reform Act of 1998 (RRA), passed almost unanimously a year ago. As you know, that legislation established 71 new taxpayer rights provisions and mandated an entire new direction for the IRS.

I understand that on July 13, 1999, the Full Appropriations Committee approved an amendment to trim approximately $240 million from the Subcommittee mark, including approximately $135 million from the IRS (approximately $139 million from the President's budget request). While I can appreciate the new budget constraints under which the Committee must operate, I am gravely concerned that a cut of $135 million will seriously jeopardize the IRS's ability to implement its reform effort mandated by the Restructuring Act.

A funding reduction of $135 million would:

- Severely restrict, if not completely impair, IRS' ability to deliver on the Restructuring and Reform Act mandated by the Congress in 1998. Every aspect of the agency's commitment to reorganize the organization, improve customer service and taxpayer rights would be in jeopardy.

- Constrain the ability to implement the initiatives so critical to changing how IRS delivers on customer service and improves its treatment of taxpayers and focus on taxpayer rights. For example, the cut would result in reduced plans to deliver better telephone service and tax assistance in Spanish.

(over)

- Require reduced staffing levels in order to free up the funds necessary to implement congressionally mandated RRA requirements. IRS staff has already been reduced 14% (or 15,600 FTE) since FY 1993 – thereby continuing the rapid decline in exam, collection and criminal tax compliance operations.

- Reduce funding for the Electronic Tax Administration program, thereby jeopardizing the Congressionally mandated goal of 80 percent electronic filing by the year 2007.

- Impair the creation of operating units to help specialized groups of taxpayers including small businesses and ordinary wage earners.

- Delay implementation of important taxpayer rights initiatives.

I sincerely hope that the $135 million will be restored so that the IRS and Congress can achieve its mutual goal of meaningful IRS reform. I look forward to continuing to work with you and the rest of the Congress to ensure that the American people have the modernized revenue service that they deserve.

Sincerely,

Charles O. Rossotti

Charles O. Rossotti

NY Times 7-18-99

Tax Professionals See Pitfalls in the New I.R.S.

By DAVID CAY JOHNSTON

For Robert N. Kolb, a lawyer in Walnut Creek, Calif., 1997 and 1998 were especially good years as people with overdue taxes sought his help fending off collectors from the Internal Revenue Service.

"People had to wait two or three weeks just to see me," Mr. Kolb said, "and I had to work weekends to keep up until, finally, I had to tell my secretary to cut back" on accepting new business.

Then in December the telephones abruptly stopped ringing.

The I.R.S., operating under a new law and led by a commissioner who calls taxpayers "customers," radically cut back on its traditional collection techniques: garnishing wages, tapping bank accounts, placing liens on property so the Government gets paid first when the property is sold, and seizing businesses and homes.

The I.R.S. now lets low-level employees make installment agreements on exceptionally easy terms to people who owe $25,000 or less on the theory that it would collect more and write off fewer tax bills.

To Mr. Kolb and other tax professionals across the country who specialize in dealing with tax collectors, however, it was a disastrous development for their business and, they warn, taxpayers may come to regret the new policies.

"The new I.R.S.," Mr. Kolb said, "has almost put me out of business."

Much of the decline in tax enforcement was prompted by the the I.R.S. Restructuring and Reform Act of 1998, a bill enacted after Senate Finance Committee hearings in which some taxpayers and I.R.S. workers accused the tax agency of abuses, although much of the testimony has since been discredited.

Tax collectors say the new law puts them at risk of being fired if they make any mistakes, a fear that the tax commissioner, Charles O. Rossotti, says is overblown.

Still, one result of a combination of fear among collectors and the fact that their numbers are shrinking is that wage garnishments and bank account seizures now run just one-fourth the rate of two years ago and many tax collectors complain that they have been pulled off collections to answer telephones and do public relations work.

Mr. Rossotti has repeatedly told Congress that his efforts to make changes will fail unless the agency gets more money, both for computer technology and for sufficient law-enforcement resources to assure taxpayers that chiseling and cheating is being policed effectively. But just last week the House Ways and Means Committee voted to cut another $135 million from the proposed $8.2 billion budget.

But tax lawyers, accountants and tax preparers known as enrolled agents said in interviews that in the agency's zeal to be friendly, and to cope with too many demands, tax enforcement has shriveled.

Steve Kassel, an enrolled agent in Daly City, Calif., said that for years two-thirds of his clients came from mailing 1,000 letters a month to people in the San Francisco Bay Area who had a tax lien placed on their home or business.

"So few liens are being filed now that I have seen a drastic decline in my business," Mr. Kassel said. "But I replaced most of my business by moving my marketing to the Internet and renaming my business Irstaxes.com."

Bobby Covic, an enrolled agent in Incline Village, Nev., who teaches negotiation of tax discounts, said that everywhere he travels, other tax professionals tell of "much heat within the service for revenue officers to bend over backwards and solicit offers to settle and then to help the taxpayer make them into offers good enough to be accepted."

Mr. Kolb said he encountered this change in attitude recently when the case of one of his few remaining clients, who wanted to settle his tax debt at a discount, was assigned to a revenue officer with a reputation for being aggressive.

"She called me and said, 'How much time do you want? 30 Days? 60? 90?'" Mr. Kolb recalled. "Even before I filed the offer in compromise papers she called me again to suggest we meet so she could help me fashion the offer. I was astounded. She told me that she has to get cases out of her inventory and so closing the file was all she cared about."

He added: "If this keeps up billions of dollars are going to go uncollected because I.R.S. officers do not want to risk putting their neck on the block, they just want to close cases and move on. The I.R.S. is not in an enforcement mode and it is going to cost billions and billions of dollars."

The I.R.S. believes that its new collection strategies will bring in more revenue, not less, principally by contacting taxpayers earlier and offering easy payment terms.

Joel A. Goverman, who is in charge of revising I.R.S. collection strategies, said: "We are emphasizing customer service and working with the taxpayer to come to the proper resolution. When we studied the best practices of businesses in collecting delinquent accounts we found that where the customer and the organization came to terms, especially on a monthly basis, they had a higher success rate in seeing accounts paying in full, and we believe that taking hard immediate action will result in our ending up collecting less money."

Last year taxpayers owed $246 billion in overdue taxes, up $12 billion or 5 percent from 1997. But more than half of that money is no longer collectible, the I.R.S. has concluded.

Tax professionals warn that the newer, friendlier I.R.S. policies are traps for taxpayers, especially in new easy payment plans.

Rick Oelerich, an accountant in Davenport, Iowa, who serves on a national I.R.S. advisory panel, said the new policies might create a class of taxpayers perpetually in debt.

"If you get an installment agreement for past due taxes," Mr. Oelerich said, "the official stance is that if you violate your installment agreement you can never get another one. But in fact they will usually sit down and work it out with you because they do not have the collection manpower to deal with you any other way. This may turn into disaster because people who owed an amount they could work out will have larger and larger debts."

Kenneth Martin, a tax preparer in Manhattan, said the I.R.S. often agreed to take too little.

"I had a guy who owes $20,000 and the I.R.S. agreed to $200 a month in payments," he said.

Mr. Martin said he was pleased for his client but, as a matter of policy, "that's crazy because the interest alone will be most of that." At the current 8 percent interest rate, it would take nearly 14 years for the client to pay his past due taxes.

Marc Albaum, a tax accountant on the Lower East Side of Manhattan, said he had made deals for as little as $75 a month, far below the interest charges alone, meaning that each month the taxpayer gets deeper into debt to the Government.

"That is not a long-term solution, but for the moment it keeps the I.R.S. at bay," Mr. Albaum said.

Mike Wellman, a tax accountant in Longview, Tex., who said his inventory of collection cases had begun to dwindle, warned that "the new streamlined easy payment plans an a formula for disaster because it wil get some people who had a manage able tax debt at one time into an eas payment plan this year and nex year and the next year and soon the will end up up owing $50,000 o $100,000 before they get help."

(over)

Mr. Wellman predicted that "nex year you will begin to see problem with people who are in so deeply wit the I.R.S. that there is no way the can pay the debt because of thes installment-payment agreements."

Marti Myers-Garver, an enrolle agent in Alamogordo, N.M., sai many people were not aware of thes nuances because as part of its nev policies the I.R.S. had made man people with overdue taxes believe that they did not need to pay fo professional help.

"The I.R.S. Web site gives yo almost everything you need in al most plain English," to make pay ments on or negotiate a discount o an overdue tax bill, Mrs. Myers Garver said.

Mr. Covic, the enrolled agent i Nevada, said the fine print in thes deals could trap unwary taxpayer by waiving their right to file persona bankruptcy and have their tax debt wiped out. In some cases, he said taxpayers who negotiates a discoun on their tax bill can end up owing th full amount plus penalties and inter est that cannot be wiped out in bankruptcy proceeding.

THE NEW YORK TIMES
MAY 18 1999

A1
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Fearing for Jobs, I.R.S. Workers Relax Effort to Get Unpaid Taxes

By DAVID CAY JOHNSTON

Internal Revenue Service tax collectors, under intense pressure from Congress to be nicer to taxpayers, have drastically scaled back efforts to collect unpaid taxes, newly available statistics show.

Seizures of property are down 98 percent over the last two years, according to the I.R.S. Levies and garnishments of bank accounts and paychecks are just one-fourth the level of two years ago. And filings of tax liens, which make sure that back taxes are paid when a property is sold, are down two-thirds.

Part of the drop-off in enforcement is because the I.R.S. has been shifting some resources to pay for customer service, new computers and retraining. But I.R.S. officers in six states said in interviews that the biggest reason for the retreat was their fear of being dismissed for running afoul of a new law intended to protect taxpayers from overzealous collectors.

Workers' fears prompted Charles O. Rossotti, the Tax Commissioner, to send a memo with the March paychecks for the I.R.S.'s 98,000 employees assuring them that their jobs were safe unless they willfully abused taxpayers' rights. On May 5, Mr. Rossotti issued regulations aimed at carrying out the new law.

"We are concerned about it," Mr. Rossotti said yesterday about the reluctance of many tax collectors to undertake enforcement actions. The Government has not tallied the lost revenue, but based on historic rates it expected to collect about $30 billion this year from enforcement actions such as issuing liens, filing levies and seizing property.

Tax experts who have worried that Congress overreacted to complaints about the I.R.S. said that the collapse of collection efforts would lead to widespread tax evasion if some balance was not quickly restored to the political climate surrounding the agency.

"It's a dumb law," said one critic, Donald C. Alexander, the Nixon Administration Tax Commissioner. Mr. Alexander, now a Washington tax lawyer, said the fall-off in collections was causing alarm among I.R.S. executives.

"When someone can fail to meet his or her tax obligations without a worry about having enforcement actions taken, then other creditors are going to come in first and get paid, and the deadbeat taxpayer wins," he said.

A spokeswoman for William V. Roth Jr., the Delaware Republican who as chairman of the Senate Finance Committee was a principal sponsor of the new law, said he saw no problems with its requirements.

"Clearly the Senator's intention was not to either frighten good I.R.S. employees or encourage tax evasion," said the spokeswoman, Ginny Flynn. "His intention was to insure that I.R.S. employees do not treat either their colleagues or taxpayers unfairly and to insure that the Tax Commissioner can deal with them."

The new law, the I.R.S. Restructuring and Reform Act of 1998, states that agency employees must be dismissed if, following an administrative inquiry, they are found to have committed any of 10 acts, among them violating a taxpayer's constitutional or civil rights; threatening an audit for personal gain, making a false statement under oath or falsifying or destroying documents to conceal mistakes. Employees terminated under the law have no right to appeal.

Mr. Rossotti, who ran a successful computer consulting firm before joining the Government late in 1997, gently suggested that I.R.S. employees were overreacting to the law.

"I don't want to denigrate the fears and concerns of front-line employees," he said last week, "but the reality is that this law deals with willful and serious misconduct."

Yet the carrying out of the law — and the sharp decline in collections — come amid a cultural revolution at the I.R.S. that has many longtime employees struggling to shift from an adversarial approach to a new customer-service mindset.

Many longtime auditors have chafed, for example, at being pulled off examining tax returns to answer telephone calls from taxpayers. Other employees say that Mr. Rossotti is naïve and fails to realize how many taxpayers chisel and cheat, requiring costly collection efforts.

The result, current and former I.R.S. officials said, is near-paralysis in the agency's enforcement apparatus.

Margaret Richardson, the Clinton Administration's first Tax Commissioner, said "there is a lot of healthy skepticism" among tax collectors about Mr. Rossotti's promise that only willful acts will result in dismissals.

No I.R.S. employees have yet been disciplined under the law, but as of the end of March, about 240 formal investigations were under way by an inspector general's office set up within the Treasury Department under the new law, officials said.

"If I were a revenue officer today I would have great hesitance to take any enforcement action," Mr. Alexander said.

Congress, meanwhile, has frozen the I.R.S. budget just when Mr. Rossotti is seeking billions of dollars to build new computer systems, retrain the agency's staff and recruit new managers from outside the Government. Some of the money to finance these moves has come from scaling back audits and collection efforts, officials acknowledge.

In the six months ended March 31, the I.R.S. seized property to satisfy long-overdue taxes 108 times, down from 1,150 seizures in the comparable period a year earlier and 5,000 seizures two years ago.

Garnishments of paychecks and levies of bank accounts in the latest six months fell to 458,000, down from 1.8 million two years earlier. Liens, which insure that taxes are paid when property is sold, fell to 98,000, compared with 272,000 two years ago.

Concerns that widespread tax evasion is just around the corner.

Both I.R.S. executives and leaders of the National Treasury Employees

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THE FEDERAL PAGE

New Commitment to 'Service' May Be Taxing

By ALBERT B. CRENSHAW and STEPHEN BARR
Washington Post Staff Writers

Internal Revenue Service workers' use of the harshest available tactics to collect back taxes—seizure of taxpayers' assets and placing of liens against property—has declined sharply since the outpouring of criticism of the agency two years ago and the subsequent enactment of broad new rights for taxpayers last year.

The decline has prompted fears that IRS managers have become so focused on taxpayer "service"—and workers so fearful of losing their jobs if taxpayers complain—that they are allowing cheats and scofflaws to game the system.

Agency executives conceded there is a problem but said they are working on new procedures and worker training to make sure that tax law enforcement is effective.

"There was a period of time where our employees were questioning what their roles were," said John Dalrymple, IRS chief operations officer.

Seizures of taxpayer assets plunged from 10,000 in all of fiscal 1997 to just 108 through the first six months of this fiscal year. Levies—orders placed on taxpayer bank accounts and paychecks—dropped from 3.66 million in fiscal 1997 to 458,000 in the first half of this year, and liens, IRS claims against assets, went from 544,000 to 98,000 in the same period.

FILE PHOTO/BY JAMES M. THRESHER—THE WASHINGTON POST

Commissioner Charles O. Rossotti urged IRS workers to ask questions.

IRS managers and workers ascribe much of the decline, which was first reported yesterday in the New York Times, to two factors: the shifting of significant numbers of employees from enforcement activity to taxpayer assistance in recent months, and worker uncertainty over what actions might place their jobs in jeopardy under the new law.

A provision of the new law, known as Section 1203, dictates that IRS workers be fired if they willfully abuse taxpayers or violate their rights. Dalrymple conceded that "we in management did not do a very good job in getting information out on 1203," so workers overreacted to it.

Collections from enforcement actions have slipped about 5 percent, to $16.1 billion for the first seven months of fiscal 1999, from about $16.9 billion in the same period last year. Overall, the IRS collects about $1.7 trillion annually.

"There's no question the revenues we bring in from enforcement actions are down," Dalrymple said, but he cautioned against drawing conclusions at this point. The agency hopes that added training and new employee procedures will restore collections to normal levels.

Dalrymple noted that in the 1970s after a Supreme Court ruling outlawing certain IRS procedures, "we did not do any seizures" for a year or more while new procedures were developed.

Still, concerned about workers pulling back from reasonable enforcement actions, IRS Commissioner Charles O. Rossotti included in workers' pay statements in March a brochure explaining Section 1203 along with a memo urging workers to seek clarification on any provisions that they find unclear.

Senate Finance Committee Chairman William V. Roth Jr. (R-Del.) said he believes "the IRS is capable of collecting the proper amount of tax while at the same time treating taxpayers fairly and with respect. Let me be clear, there are those out there who don't want IRS reform. They want the status quo. I believe the service must change . . . and it will."

Others pointed to budget and employee training limitations as a factor in the falloff of tax collection efforts.

Robert M. Tobias, president of the National Treasury Employees Union, said the new law "substantially changed the way collection activities are to proceed in the IRS. . . . So it requires a lot of training to reorient IRS employees to what they are supposed to do."

But, Tobias said, the IRS has not issued a new manual that "provides the real details about how collection activities are to be done, the step-by-step procedures."

"I don't think there is any question that there is fear and trepidation in people's hearts with this new statute, but I don't think this is the only thing going on," added Ray Woolner, president of the Professional Managers Association, which represents Treasury Department and IRS management officials.

"There have been some diversions of [IRS] staff in the last eight or nine months to support increased customer service, and when you're not in a growth environment, you have to rob Peter to pay Paul," Woolner said. He noted that during tax-filing season, "You can't provide seven-day, 24-hour-a-day service without shifting some resources."

Woolner said employees have little experience with what the new law means. "The employees know what it is like across the table from a taxpayer. . . . What they don't know, if the taxpayer slaps a charge on you, what happens. We haven't been there yet," he said. "It's the skunk juice theory. Once you've been the target of one of these investigations, is life ever the same for you in the organization? I don't know."

The IRS always has warned employees against violating the rights of taxpayers, Woolner said, but "what has changed here is the

(over)

Back Taxes

IRS collections have declined since 1997.

	1997	1998	1999 (1st half)
Liens	544,000	383,000	98,000
Levies	3,659,000	2,503,000	458,000
Seizures	10,000	2,300	108
Collections by installments	2,815,662	2,827,732	778,043

SOURCE: Internal Revenue Service

THE WASHINGTON POST

vulnerability that people feel to those taxpayers who are really out not to do their fair share. . . . If you go after one of those folks, that person has a huge club to use. Whether it is righteously used or not is not the question for the employees, it is the fact that it can be used at all."

And Dalrymple said there are "anecdotal examples" of taxpayers trying to capitalize on the employees' fears.

He said one tax preparer in Los Angeles wrote to a revenue agent claiming to have noted several 1203 violations and saying that he might report them depending on what issues the agent brought up during a client's audit.

That case, instead, resulted in an investigation of the preparer. However, the Treasury Department inspector general's office said there are 240 probes underway of alleged 1203 violations.

The IRS also has diverted "quite significant numbers" of employees from enforcement and collection duties to answer telephones and provide help to taxpayers, Tobias said.

Even if IRS employees become more comfortable with the new rules, Rossotti and members of the IRS employee restructuring teams hope that enforcement actions will actually remain below historical levels. They believe that if taxpayers receive attention promptly when problems arise they will comply with the tax code, reducing the need for enforcement actions.

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Mr. HOUGHTON. Thank you very much, Mr. Coyne.

Mr. Hayworth, Mr. Watkins, do you have any comments?

All right, fine, thank you. We're honored to have Hon. Charles O. Rossotti, Commissioner of the Internal Revenue Service, here today. Commissioner.

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

Mr. ROSSOTTI. Thank you, Mr. Chairman, and thank you, Mr. Coyne. I appreciate your holding this hearing on the anniversary date. It does give us a good opportunity to look back and see what our progress has been so far on implementing this important legislation. But I think it's also important, to look forward and see what we need to do in the future to continue on course.

As important as are all these individual provisions of this Act, I think it's even more important what the legislation told us about the IRS. I think it told us that we needed to fundamentally change direction. We must not only collect taxes, but we must see our job as serving the people who are paying the taxes, America's taxpayers.

In the 20 months that I've now been in office, I have become even more convinced than I originally was that we can succeed in this mandate that Congress has given us, provided we are given necessary resources. I do not believe that this mandate implies or requires less effective tax collection. What I do believe is that we can have a tax agency that does a better job across the board on all aspects of our mission.

One of the Act's critical components was the expansion of taxpayer rights. I think a year ago when this bill was passed none of us fully understood the consequences of some of the dramatic changes incorporated in some of these provisions. Especially the tremendous amount of time and resources that were going to be needed to implement some of these rights. I think it's honest to say that we did not fully understand the budgetary consequences either until recently.

I want to stress that we are completely and wholly committed to implementing every one of the taxpayer rights in RRA 1998. It is a No. 1 priority for us and we are committed to getting the job done and getting it done right, notwithstanding the fact that we have made some mistakes and we've been delayed in implementing some of these changes. But we're going to persist until we get them right.

But we do have to understand that delivering on the hundreds of specific changes and major implications for the way we do business in our organization is a large undertaking. It has placed a strain on our resources.

I would like to just mention one important example, which is the innocent spouse provision. From April 1998 until the passage of the Act, there were about a total of 3,000 claims under the innocent spouse provisions at that time. Since the passage, there have been about 27,000 claims. And we are continuing to receive these claims at a rate of 4,000 per month.

This is far greater than we ever thought, and in addition, the complexity of implementing these provisions is quite large. The net effect is that we've had to increase the number of staff assigned by about tenfold, from 30 to about 359. In spite of adding these resources, there is still a very large backlog.

Also related to this one example is the fact that the old technology we have in place just does not allow us to do what this provision requires, namely separating a single tax liability on a single

return into spouses with multiple liabilities. So, we have to do this kind of tracking manually, which of course increases the time and increases the risk of error.

So this is an example of one provision that is very important. We do have a backlog. We will clear it up and we will get it right, but it's going to take some time and resources.

Very closely related to this problem of resources is the amount of training that is required in order to meet the Act's mandates and provide better service. Essentially, every one of the more than 100,000 IRS employees requires training. For example, Congressman Coyne mentioned section 1203, which is dealing with termination of employment for misconduct. Every employee needs this training.

We gave training to every employee within 6 months of the passage of the Act. And frankly, it had the effect of probably raising concerns about employees, but without necessary answering the specific questions they had about this. So we are now continuing to work and going forward with another set of training. In June, we began to implement additional instructions on procedures.

We know that some IRS employees have been reluctant to pursue some collection actions for fear of 1203 violations. However, this is only one factor that has reduced the number of collection actions. The additional processing time required by the Act and the reduction in resources have also been important factors, which we are working on.

The Act not only contains specific taxpayer rights, it also created an expectation that every taxpayer would receive a better level of service, while ensuring that the law is applied fairly. We have a new mission statement that reflects that expectation and three strategic goals needed to achieve the mission, which are listed on this chart over here. By clarifying this mission and our goals, through a series of new balanced performance measures, we are transmitting in a practical way this new set of goals and mission to every employee in the IRS.

These directional changes and communications are very important. But we won't succeed without also revamping the way we do business. We need to take advantage of better business practices and better technology. We don't have time to go into them here, but listed on that chart are just an example of some of the major kinds of business changes that we are beginning to make and will make over time that can help us on all aspects of our goal, both service to taxpayers and compliance. In the short term, we're concentrating on 161 near term actions to move in this direction.

Another important part of RRA, which I think is essential to achieving our goals, is the reorganization into customer focused units, so that we can manage according to the way the customer sees the world, rather than just the way the IRS sees the world. We've made some progress on that, although there is a great deal of work to do.

The first two of the four operating divisions are going to be coming up later this year or early next year, and we've selected the heads of those units and announced them, which was an important step. You're going to have more information on electronic tax administration later. We have prepared our first strategic plan to en-

able us to move toward the goal of 80 percent electronic filing by 2007. We conducted several important pilots which next year we hope to build on for the 2000 season.

Finally, let me mention something about technology. We clearly are not going to succeed in achieving these new business practices and goals without replacing this 30-year old base of fundamentally deficient technology, which really does not provide us up-to-date, accurate information about taxpayers, which is the foundation of everything we do.

I'm very pleased to report to the Committee that earlier last month we received from the Appropriations Committees authorization for the first release of funds from the Information Technology Investment Account. This is $35 million that really will enable us to complete planning. The important thing is it's really the first installment toward developing a complete new set of systems.

This is going to take years to do and a significant financial investment. But it will be a foundation for everything that the IRS does in years to come, including transitioning all of our taxpayer accounts eventually from our tape-based master file system to a modern data base.

Finally, just let me comment briefly on our budget request and not really so much in terms of the details of the current budget request. Which I believe is the bare minimum that we need to move forward, but just look a little bit more broadly at the relationship between the IRS mission and goals, the assignments that Congress has given us and our resources.

I think if you look at this colored chart over here which says, IRS shrinks as a fraction of the economy, you can see that even before RRA and continuing now, we have shrunk by about 30 percent relative to the economy. And even if the full budget request of 2000 is granted, we will continue that shrinkage during 2000.

So what we have here is a case of increased demands due to the increased economy and the additional provisions of the law, while we have reduced resources. The effect of this is simply to reduce the level of activity, especially in the most case-oriented, labor-intensive activities, which are examinations, criminal investigations and collections.

So for example, the number of individual tax returns with over $100,000 income has increased by 56 percent over the last 5 years. But the number of returns that have been examined in that category has decreased by 21 percent. And now with RRA, because of the other increased resources, even fewer resources are going to be available for initiating new such cases. So this decline will continue.

I think doing business the same way and continuing this trend, resources declining, economy growing, is eventually going to undermine our whole tax system. I think as we've discussed in earlier hearings, there is a better way to do this, and we can succeed. But it does depend on getting assured investment funds every year for the improvements that we need to make in organization, training, business practices and technology, while we stabilize the level of activity in our current operations.

We are obviously doing what we can with short-term changes. But in the meantime, we have just in the taxpayer rights area, a

requirement of about 3,000, the equivalent of about 3,000 full time employees just to implement these new requirements on existing cases. We do need, of course, at the same time, for funds to make the investments needed to implement these new practices.

So we have a stress on resources that is really quite severe, in current year and going forward over the next several years.

Mr. Chairman, I believe that the IRS is fundamentally changing in the direction that was mandated by the Restructuring Act. It's changing in virtually every aspect.

But we are at a crossroads. I think we need the understanding of the Congress for the magnitude of this challenge. We need the understanding in really two ways, one in that it is going to take some time to carry out all these mandates, and it will take some resources.

One forecast that I made when I took office was that it would take the better part of a decade to reach our goals for the IRS. Now having been here for 20 months, I think that's one forecast that I will stand by. I believe it is doable, I believe it is worthwhile. But it is a long and difficult journey, and we need your support.

Thank you, Mr. Chairman.

[The prepared statement follows:]

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

INTRODUCTION

Mr. Chairman, I am pleased to testify before the Subcommittee on the anniversary of the signing of the IRS Restructuring and Reform Act of 1998 (RRA '98 or Act).

Today's hearing presents an excellent opportunity to examine our progress on the mandates set forth by this landmark bipartisan legislation, the challenges and obstacles, and more importantly what we must do now and in the future to keep on course to achieve all of the RRA '98 goals.

As important as the individual provisions of the RRA '98 are, the Act as a whole said something even more important. It told the IRS we must fundamentally change direction. We must not only collect taxes, but we must think of our job as serving the people who are paying the taxes, America's taxpayers.

In the nearly 20 months that I have been in office, I have become even more convinced that we can succeed in the mandate Congress gave us if we are given the necessary resources. I do not believe this mandate implies or requires less effective tax collection. I firmly believe we can have a tax agency that does a far better job across the board on all aspects of our mission.

Today I would like to discuss how we are interpreting and implementing the RRA mandate and how it relates to the resources we will require. I am also submitting for the hearing record a document entitled "Modernizing America's Tax Agency," which describes our overall change program.

TAXPAYER RIGHTS AND EMPLOYEE TRAINING

One of the critical components of RRA '98 was the expansion of taxpayer rights. However, the Act also differed strikingly from other tax legislation the IRS previously implemented. RRA '98 not only changed the Tax Code; it broke new ground by substantially altering the internal processes and procedures needed to manage these changes.

A year ago, no one fully understood the consequences of such a dramatic change, especially the enormous amount of time and resources needed to implement these new taxpayer rights. Certainly, the IRS did not fully appreciate the budgetary consequences of RRA '98 until recently.

I want to stress that we are wholly committed to implementing each and every taxpayer right in RRA '98. It is our number one priority and we will get the job done, and we will get it right, not withstanding some delays and mistakes.

Delivering on the Restructuring Act and the hundreds of specific changes to both the tax code and our organization is an enormous task. We are in the process of:

(1) implementing 82 near-term RRA '98 initiatives to improve service and treatment of taxpayers; (2) implementing 423 tax code changes, many of which require significant and complex interpretations to guide taxpayers and employees; and (3) providing essential training related to these many changes to nearly every one of our over 100,000 employees, including technical training for 75,000 of them.

Let me highlight some of the progress to date in implementing RRA '98: a massive training effort is underway; two new forms are being developed; 153 forms have been revised; 39 publications have been revised; 33 items from Chief Counsel were published (14 regulations, 8 revenue procedures, and 11 notices/announcements); more than 75 guidance memoranda have been issued; and 1,300 implementing actions have been identified. Obviously, this is an enormous undertaking that has placed an enormous strain on IRS's resources. The direct effect on operations is equivalent to nearly 3,000 FTEs.

I want to particularly stress that increased training of our employees is essential for delivering on the mandates that Congress gave us and the service that taxpayers expect. About 70 percent of IRS employees deal directly with taxpayers. Taxpayers have every right to expect that in every such encounter with an IRS employee, whether it is a phone call asking a question about how to fill out a return, or a meeting with a revenue agent in an audit, the IRS employee should understand the current tax law and have the skills to understand the facts and circumstances of that taxpayer.

A year and a half ago, when I took office, it was abundantly clear that there was already a serious deficit in this area. Since then, Congress has given us the responsibility of implementing 1260 changes to the Tax Code, including those in RRA '98, and a mandate to restructure the whole way we do business with taxpayers. This will require extremely complex training for our employees. The money in our FY 2000 budget request, including that part included for the modernization program, is essential and will only begin to rectify our training deficit.

There are three phases to our RRA '98 training, and even prior to enactment of RRA '98, we began to take action. In July of 1998, we established a National Resource Center to coordinate policy and program questions to insure that consistent messages were sent to stakeholders. Also in July, approximately 185 RRA '98 field coordinators in each IRS district, region and service center were identified and trained to be local points of contact for coordination and questions. I held my first RRA video conference on July 17, five days before the President signed the legislation into public law.

RRA '98 Phase I training took place from July 1998 to January 1999. Some of the actions we took included: (1) providing 60,000 front-line employees with up to 1.5 million hours of basic implementation training on new statutory requirements and key procedures; (2) developing individual training plans for each IRS function; (3) implementing a course completion certification process; (4) establishing weekly conference calls with over 180 RRA '98 Coordinators and Education Branch Chiefs; and (5) posting information on our Corporate Education Web Site and links to the National Resource Center.

We are now in the midst of RRA '98 Phase II training. Our overarching goal is to provide formal training with clear learning objectives, testing and evaluation. We have developed video courses on: Collection Due Process, Installment Agreements, Offers in Compromise, Seizures, Relief from Joint and Several Liability, Third Party Contact and Interest Netting.

The goals for RRA Phase III Technical Training for FY 2000 are to: (1) embed specific provisions of RRA '98 and the newly revised Internal Revenue Manual into IRS day-to-day operations; (2) supplement Phase I and Phase II training as needed; (3) deliver Phase II of Customer Service Training; and (4) continue to evaluate, monitor and update training as necessary.

Another one of our critical training needs is Section 1203 (Termination of Employment for Misconduct) for which all 100,000 IRS employees must be trained. The initial mandatory training that all employees received was certainly an important first step, but we found that it raised concerns among employees without answering their specific questions. In March, all employees received with their pay stub a special brochure on Section 1203. It includes a plain language summary of all the provisions, how potential violations are reported, employee appeal rights and other important reminders. We are also encouraging our employees to take advantage of the IRS Labor and Employee Relations Resource Center that can help answer many of their Section 1203 questions.

We will then build on this information with better training and guidance. In June, we began to provide employees with detailed instruction on the procedures to be used in handling Section 1203 cases. This instruction, including a training video,

was based on a new Section 1203 Procedural Guide issued in May. It emphasizes good customer service and case management practices.

Some IRS employees have been reluctant to pursue collection actions for fear they will be charged with a Section 1203 violation. However, this is only one factor that has reduced the number of collection actions. The additional processing time required by RRA '98 and a lack of resources have contributed to the overall decline in compliance activity.

We are working very hard to re-enforce the message among all IRS employees that the Section 1203 provisions are intended to address serious and willful incidents of misconduct. Simple mistakes in the course of doing your job in good faith are not Section 1203 violations.

At this point, I would like to address the implementation of three specific RRA '98 taxpayer rights that I believe illustrate the challenges we faced, the lessons we learned and how we are better managing the implementation process: innocent spouse, third party notices, due process and offers in compromise.

Innocent Spouse

In January 1999, the IRS issued new versions of its form and publication for innocent spouse relief, each revised to incorporate the changes made by RRA '98. This is the latest of several steps we have taken in our ongoing effort to help innocent spouses. We hope that our materials will effectively explain the new law to taxpayers and assist them in taking full advantage of their rights. We also appreciate the comments we received last fall on the draft form and welcome suggestions on how we might further improve these items. In addition, the IRS plans to incorporate additional feedback from taxpayers and practitioners—as well as our own experience in processing these requests—so we can provide even better products.

Nevertheless, there have been problems associated with processing the innocent spouse claims. Foremost are the number of claims. From April 1998 until the passage of RRA '98, there were 3,000 innocent spouse claims; since passage of RRA '98, there have been approximately 27,000 claims. Claims are continuing to rise at a rate of 4,000 per month. Nevertheless, this growth in claims is a good sign that America's taxpayers are learning about the innocent spouse provision from many sources, including our aggressive outreach program and the Taxpayer Advocates.

However, to meet this unprecedented demand, the estimated number of FTEs needed to process these cases surged from 30 to 359, and the estimated time per case grew from 10 hours per-case to 12 hours per-case. In spite of shifting resources, there is still this very large backlog in these claims. We are also hamstrung by our current technology that does not allow separating single tax liability for spouses into multiple liabilities. We still must use manual tracking that increases costs, errors and delays. Furthermore, to insure that we get these important claims right, we are subjecting them to a thorough review.

We are taking steps to address not only the backlog of cases, but the process for handling them. We recently developed a method for identifying the simpler cases that can be examined in a correspondence/telephone contact with the taxpayer. The complex cases will be examined through a face-to-face contact with the taxpayer.

We are also identifying two, full-time, innocent spouse issue specialists whom IRS examiners can contact to receive guidance on innocent spouse relief as they are working these cases. We are also identifying a part-time innocent spouse issues specialist for community property states as these states present unique innocent spouse issues.

Beginning this month, additional training will be provided to examiners looking at the simpler cases to ensure that taxpayers provide the specific documentation needed to qualify for innocent spouse relief.

Third Party Notices

The third party notice was a classic example of the IRS trying to implement an RRA '98 improvement but not succeeding the first time. The third party notice was intended to help taxpayers, including small business owners, by requiring that the IRS give notice to taxpayers whenever we might be contacting a third party, such as a bank, about that taxpayer's situation.

I want to stress that in the vast majority of cases, it is the IRS' practice to get information directly from the taxpayer. In only a small percentage of cases is it necessary to get information from third parties.

In implementing this provision, the new notice was sent to many more taxpayers than needed. In addition, it was poorly written, causing undue concern to many taxpayers. Senate Small Business Committee Chairman Christopher Bond, as well as several practitioner groups, called this mistake to our attention. With his assistance,

we moved as quickly as possible to fix the problem, including soliciting input from practitioners and other interested parties.

We have now issued internal instructions so that in audit cases, the notice will only be provided when there is a possible need to contact third parties. We are continuing to work on improving the content and distribution of the notice to cover all situations appropriately, and as I noted, we are accomplishing this with the active involvement of our various stakeholder groups. When we finish this process, we will have a clearer, better written notice and process for distributing this notice.

Mr. Chairman, obviously, we would have preferred to have gotten the third party notice right the first time, but we didn't. However, we recognized our mistake and took actions to fix it. More importantly, we learned some important lessons from this experience that can be used beyond the third party notice. Foremost, we must always apply one of our modernization guiding principles when we implement these important RRA provisions, or anything affecting taxpayers, namely: "Understand the customer's point of view and use this understanding to prevent and solve problems and provide quality service." That means that we get Congress, stakeholder groups and taxpayers involved earlier in the process to make sure that we are meeting their needs and expectations.

Due Process in Collection

In the area of due process, taxpayers now have the right to request a hearing before an impartial appeals officer after a notice of lien has been filed or a notice of intent to levy has been sent. In addition, the IRS must provide the taxpayer with a written notification of this appeals right. If the taxpayer requests a hearing during this period, the proposed levy may not take place until after the appeals officer makes a finding.

The taxpayer also has 30 days to challenge the appeals finding in U.S. Tax Court or U.S. District Court, during which the IRS may not levy. During the appeals process the taxpayer can also request the IRS to consider establishing collection alternatives, such as an installment agreement, to pay off the tax bill. Under the new law, the IRS must consider all other payment possibilities before seizing the assets of a business.

The significant changes to the notice of levy process have not been without effect. First, is the number of levies. From February to April 1998, there were 586,685 levies. For the same period in 1999, there were 16,490. Most of this drop in levies can be attributed to the process time. Prior to the changes to the notice of levy process made by RRA '98, the turnaround time was 156 days. Following last year's changes, the turnaround time is estimated to be anywhere from 156–411 days.

As I discuss in greater detail in the "Resource" section of the testimony, in the exam and collection compliance functions, the combination of reduced total staff and mandatory allocation of staff to implement new RRA provisions will also significantly reduce available staff for audits and collections.

MODERNIZATION AND RESTRUCTURING

Mr. Chairman, as I mentioned at the beginning of my testimony, the Restructuring Act is not only specific taxpayer rights. It also created an expectation that all taxpayers would receive far better service while ensuring that the law is applied fairly and that the highest level of compliance is achieved. In addition, RRA '98 mandates an entire reorganization of the IRS from its present geographic structure to one based on serving distinct groups of taxpayers with similar needs. The Act includes sweeping directives on electronic filing, improved customer service and balanced measures of performance, to name some of the more prominent. The challenge is whether we can pull together all the pieces and make the entire change program work.

As required by RRA '98, we have restated our mission to clarify the purpose of the agency. It is: "Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all." To make this mission a reality we have reformulated our strategic goals—the standards by which we will measure our own performance in achieving our mission.

As shown on the chart entitled "IRS Mission and Goals," we have three strategic goals. We will not achieve our mission unless we achieve all three of these strategic goals. The first two are derived directly from our mission statement that describes the two ways we serve taxpayers. Individually, we must provide each taxpayer the service he or she expects and protect the rights he or she deserves. Collectively, we must serve all taxpayers by administering the law fairly, ensuring that those who do not comply are not allowed to unfairly burden those who do. Finally, our third

strategic goal is to conduct our mission with the fewest possible resources, which we will achieve by providing a high-quality, productive work environment.

One of the most important steps we have taken is to clarify and communicate our mission and goals through the new system of balanced performance measurements we are beginning to implement this year. In this fiscal year, we are conducting extensive training for every executive and nearly every manager on this balanced measurement system. We are also revising our job descriptions and appraisal system for most employees, aligning it with the mission and goals.

Business Practices

As important as are the changes in mission, goals and measurements, we will not succeed in achieving all three strategic goals without revamping the way we actually go about doing business. We must take advantage of modern and well-established business practices and strategies.

Within the IRS itself and in other private and public sector organizations, there are innumerable successful examples of how we can improve our way of doing business. These improvements hold out the prospect of advancing all three of our strategic goals to a great degree. However, these kinds of advancements often depend on making investments in organization, training and technology.

The chart entitled "Improved Business Practices Advance All Three Strategic Goals" lists some of the areas for improvement in IRS business practices. This is not a complete list; yet, each one of these broad areas implies hundreds or even thousands of more specific changes in the way business is done at the IRS. We have a process in place to set priorities for improvements to be made over the next 12–18 months and have settled on 161 near-term actions. These are but a small beginning on what we can do over the longer term.

Reorganization

As directed by RRA '98, the modernized IRS will be organized around the needs of specific groups of taxpayers. Four operating divisions will be responsible for serving specific groups of taxpayers. They are: Wage and Income, Large and Mid-sized Business, Small Business/Self Employed and Tax Exempt and Government Entities. This structure is similar to one widely used in the private sector. Four functional organizations will be responsible for specific issues and cases. Two support organizations will be responsible for providing common services across the entire agency. Finally, a much smaller National Office will provide high-level strategy and policy setting.

Working with our management consultants, the IRS is undertaking a phased-in approach to designing and implementing this new organization structure. Implementation will proceed on a separate track based on the size, complexity and level of change required of the specific organization. For example, the Information Systems and Taxpayer Advocate organizations began implementation in April, while the four primary operating divisions will be established over the next few years. Implementation will include physically establishing new offices, transitioning employees and managers to the new organization and reassigning workflow. The entire implementation will take approximately 2–3 years.

The IRS recently announced that we are recruiting for the newly-created, top executive positions of Division Commissioner, Wage and Investment Operating Division, and Division Commissioner, Small Business and Self-Employed Operating Division. These are four-year appointments with special pay rates, as outlined in RRA '98. The head of the Tax Exempt and Government Entities Division was selected earlier this year and our choice for Division Commissioner for the Large and Mid-size Business was announced last week.

Electronic Tax Administration

The IRS made significant progress implementing the Restructuring Act's Title II provisions relating to Electronic Filing. The following are some of our accomplishments to date.

As required by RRA '98, the IRS issued its first-ever Strategic Plan for Electronic Tax Administration (ETA), entitled a Strategy for Growth. It was released for public comment on December 3, 1998. Based on the comments received and current developments, the IRS will be issuing an updated version of the Strategic Plan in December 1999. A Strategy for Growth is designed to eliminate barriers, provide incentives and use competitive market forces to make significant progress toward the congressionally-mandated goal of 80 percent of all tax and information returns being filed electronically by 2007.

As also required by RRA '98, the IRS established the Electronic Tax Administration Advisory Committee (ETAAC) in September 1998 to provide an organized pub-

lic forum for the discussion of ETA issues in support of paperless filing. On June 30, 1999, the ETAAC issued its first annual report to Congress on the status of Electronic Tax Administration. In the report, the ETAAC compliments the IRS for making a good start in setting out a program to achieve the electronic filing goals established by Congress. However, it also notes that the IRS faces a number of strategic challenges and opportunities while seeking to achieve these goals.

During the 1999 filing season, the IRS also took advantage of the provision contained in RRA '98 which authorizes the use of mass communications to promote the benefits of and to encourage the use of ETA programs. The IRS' use of paid advertising in the print media, radio and television contributed to another successful filing season during which over 29 million taxpayers filed their tax returns electronically.

The IRS is on target to implement successfully the provision that extends the date that information returns are due to the IRS if they are filed electronically. Beginning next year, electronically filed information returns will be due to the IRS by March 31 instead of by February 28.

In conjunction with the Department of Treasury, the IRS plans to issue an interim report to Congress in the near future regarding the feasibility of extending the due date for providing information returns to taxpayers from January 31 to February 15. Although an across-the-board extension of the due date would not be advisable because of the millions of taxpayers who file early to obtain a refund, the findings also indicate that there must be a balance between the needs of early filers of tax returns and the need for correct and complete information returns that avoid confusing taxpayers and causing subsequent amendments to income tax returns.

As also envisioned by RRA '98, the IRS conducted two pilots during the 1999 filing season which provided a paperless filing experience for over one million taxpayers. These pilots involved the use of Personal Identification Number (PIN) as the taxpayer's signature, eliminating the need to file the paper jurat.

Over 650 thousand taxpayers participated in the On-Line Signature Pilot where the IRS distributed e-file Customer Numbers to taxpayers who prepared their own returns using tax preparation software to file from their home computers.

Another 490 thousand taxpayers participated in the Practitioner Signature Pilot where taxpayers choose a PIN when filing through 8,100 participating practitioners.

Technology

Updating our business practices to better serve taxpayers requires almost a complete replacement of IRS' information technology systems. They are built on a 30-year old fundamentally deficient foundation that cannot provide accurate up-to-date information about taxpayer accounts. GAO has repeatedly reported that IRS cannot provide reliable taxpayer account and financial information to manage the Agency.

Implementing new technology based on revamped business practices is critical to properly supporting our modernization concept and fully complying with the mandates of RRA '98. If properly funded, we expect our technology modernization initiative to realize the following benefits. In the short term, there will be: improved access to IRS customer service representatives; improved service to internal and other Federal customers; the start-up of electronic communication with taxpayers; and timely, accurate information for personnel systems.

Mid-term benefits include: improved financial management; expanded electronic filing and payment options; and expanded electronic interaction with taxpayers. And the long-term benefits are: more accurate and timely information for increased customer service; more customer friendly collection capabilities; faster refund processing; secure and auditable access to all taxpayer account information through a single terminal; and far greater productivity for all IRS employees.

On December 9, 1998, the IRS awarded a Prime Systems Integration Services Contract (PRIME) to Computer Sciences Corporation (CSC) and their partners to help begin the long process of modernizing IRS' core business and technology systems.

Earlier this month, we received from the Appropriations Committees authorization for the release of funds from the Information Technology Investment Account. This is a first installment toward developing a new computer set of systems and a significant financial investment in our overall modernization plan.

This $35 million in funding was released from the overall Investment Account in which $506 million was set aside in 1998 and 1999 for use in modernization. To receive the funding, IRS met stringent requirements, including demonstrating improvements in our management of the program and a strong partnership between the business and IT organizations.

The IRS received approval from the Treasury Department, the Office of Management and Budget, and a favorable review from the General Accounting Office. GAO

praised the IRS' plan, calling it an appropriate first step toward a successful systems modernization. House Appropriations Subcommittee on Treasury, Postal Service and General Government Chairman Jim Kolbe wrote: "The incremental approach that you have proposed for proceeding with the modernization should help avoid many of the problems associated with past attempts at modernizing the Internal Revenue Service's information systems."

With this money, we can continue to roll out improvements for the 2001 filing season. Some of these include enhancing our customer service call-management capabilities, improving electronic tax administration, and upgrading systems security.

The funding will also allow us to complete a business systems plan which will define the major projects to be undertaken over the next two to five years, including transitioning taxpayer accounts from a tape-based Master File to a more modern database. We will make a full report of the five-year plan available in October.

In addition to technology modernization work performed in partnership with the PRIME partners, IRS is undertaking significant work to build bridges between today's systems and modernized systems. This requires sustaining the old while planning and implementing the new. The transition also requires a large training effort. IRS will be training its IT professionals to ensure they can operate successfully in the new environment as well as training the entire workforce on new end-user software to be implemented over the next few years.

This year, IRS successfully delivered several technology improvements even as we are continuing to finalize and test our Y2K work. The new Integrated Submission and Remittance Processing System (ISRP) combines and improves the processing of return submissions and payments. And the consolidation of mainframe computers into central computing sites upgraded the IRS' disaster recovery capabilities. These efforts will need continued support over the next few years. In addition, IRS will continue the Service's commitment to ensure adequate testing of its tax systems.

One of the most significant challenges over the next few years will be system realignments and technology changes needed to implement the new IRS organization. These requirements include applications changes to align taxpayer segments and employees with the new operating divisions and modifications in payroll, financial management, personnel, accounting, reporting relationships, and workload management. Finally, determining changes and reworking infrastructure based on capacity, performance, and telecommunications assessments for the new organization structure are a major part of our modernization effort.

RESOURCES

At many of my hearings so far this year, I have been asked what resources are needed to accomplish the mandate we have been given. I do not believe I am different from most other heads of organizations in the philosophy that we can do more if we are given more resources. And given the enormous job we have at the IRS, more resources can most definitely be put to good use to benefit taxpayers. At this hearing, however, I think it would be most useful to step back from the details of our current budget request—which I consider to be a bare minimum—and consider the relationship between the IRS and our mission and goals and resources over the next few years.

Looking at the chart titled "IRS Shrinks as a Fraction of the Economy," we can see that the IRS has been shrinking in size relative to the economy, and this trend will continue through FY 2000. Over this period, the economy grew in real terms by 20.1 percent, and the number of full-time equivalent employees shrank by 13.7 percent. Thus, in relative terms the IRS shrunk by 28.7 percent. It is also important to note that about 70 percent of IRS employees deal directly with taxpayers, either in providing information or assistance or in working on specific cases.

While some of the shrinkage in staff has been offset by real productivity improvements, for the most part this shrinkage has simply resulted in less activity, especially in the most expensive, case-oriented activities such as examinations, criminal investigations and collections. For example, the number of individual returns with over $100,000 income increased by 56 percent over the last 5 years, while the number of such returns examined decreased by 21 percent. The recent press publicity about the decline in examination coverage simply reflects this basic arithmetic. Furthermore, as it has become evident that service to taxpayers is inadequate and a backlog of problem cases has built up, and with the passage of the many new taxpayer rights provisions of RRA '98, even fewer resources are available for initiating new cases.

Clearly, doing business the same way while the economy grows and resources decline will eventually undermine the whole tax system of the U.S. Fortunately, as I have discussed briefly here today and in more detail in the document submitted

for the record, I believe there is a better way. One part of it is to take advantage of improved management and business practices and new technology to improve the way we accomplish our mission and goals.

This approach also critically depends, however, on obtaining assured investment funds every year for improvement of organization, training, business practices, and technology. I want to stress again that in the past five years, the IRS has shrunk 28.7 percent relative to the economy. IRS staff has declined by 11,000 FTEs while the economy and the tax code have been growing in size and complexity.

In addition to the continuing decline in relation to the economy, the IRS is responding to RRA '98 with a program of both short-term and long-term changes aimed at fulfilling its mandates efficiently. As I previously discussed, in the short term we are implementing taxpayer rights provisions, such as innocent spouse, due process in collections and offers in compromise. We are also implementing service improvements, such as electronic filing, longer hours of phone service and walk-in service at times and locations convenient to taxpayers. In the long-term, we must modernize our organization and management.

The short-term changes have required us to divert resources, training and contract support from other areas (specifically compliance programs). In particular, the taxpayer rights provisions (e.g., innocent spouse) call for 2,955 person years of staff time for procedural requirements to process existing cases.

The long-term changes require investments in contract support, training, technology and related costs (e.g., relocation, buyouts and facilities renovation), but will also result in improved long-term efficiency and effectiveness.

In the exam and collection compliance functions, the combination of reduced total staff and mandatory allocation of staff to implement new RRA '98 provisions will reduce available staff for audits and collections by 19 percent compared to FY 1997. Combined with the continued growth of the economy, the effect will be a continued decline in audit coverage and collection action.

While enforcement levels are declining, service levels are also still below acceptable levels. Phone service is available for longer hours, but the chances of a taxpayer actually getting through were only 54 percent in 1999, lower than in 1998, and may not improve in 2000. About 80 percent of these "customer service" calls are taxpayers calling because they have received a notice from the IRS or because there may be an error in their account with the IRS. Mr. Chairman, answering these calls is not optional.

The IRS will need continued support for its modernization program in order to succeed. In particular, it will need support for its technology modernization program, begun earlier this year, and, resource requirements resulting from the passage of RRA '98.

CONCLUSION

Mr. Chairman, I believe that the IRS is fundamentally changing in the direction mandated by RRA '98. And it is changing in virtually every aspect—in mission, goals and principles, practices and procedures, management and organization, training, performance measures and technology. Through these changes, we can succeed in producing an IRS that better serves America's taxpayers—individually and collectively—but we must realize that there are no quick fixes, magic bullets or low risk plans. We must realize too that RRA '98 comes with a price tag.

Mr. Chairman, we are at a crossroads. Without adequate funding, the entire reform and restructuring program demanded by Congress and the public could stall, and in the worst case scenario, fail.

What we need most of all, given the current situation at the IRS, is the sustained support of Congress and the public while we make these fundamental changes and while we administer a huge and complex tax system. And I have been very pleased at the support we have received to date from all quarters.

However, we will also need your understanding of the enormity of our challenge. We need your understanding of the time it will take to carry out all of RRA '98 and the resources it will demand. One forecast I made at my confirmation hearing before this committee was that it would take the better part of a decade to reach our goals for the IRS. Having now been in office for 17 months, this is one forecast that I stand by. But I believe that the destination is worth the long and difficult journey we have begun.

The IRS Mission Statement

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Goals

Service to Each Taxpayer

- Make filing and paying easier
- Provide top quality service to each taxpayer needing help
- Provide prompt, professional, helpful treatment in cases where additional taxes may be due
- Ensure taxpayer rights are observed

Service to All Taxpayers

- Increase fairness of compliance
- Increase overall compliance

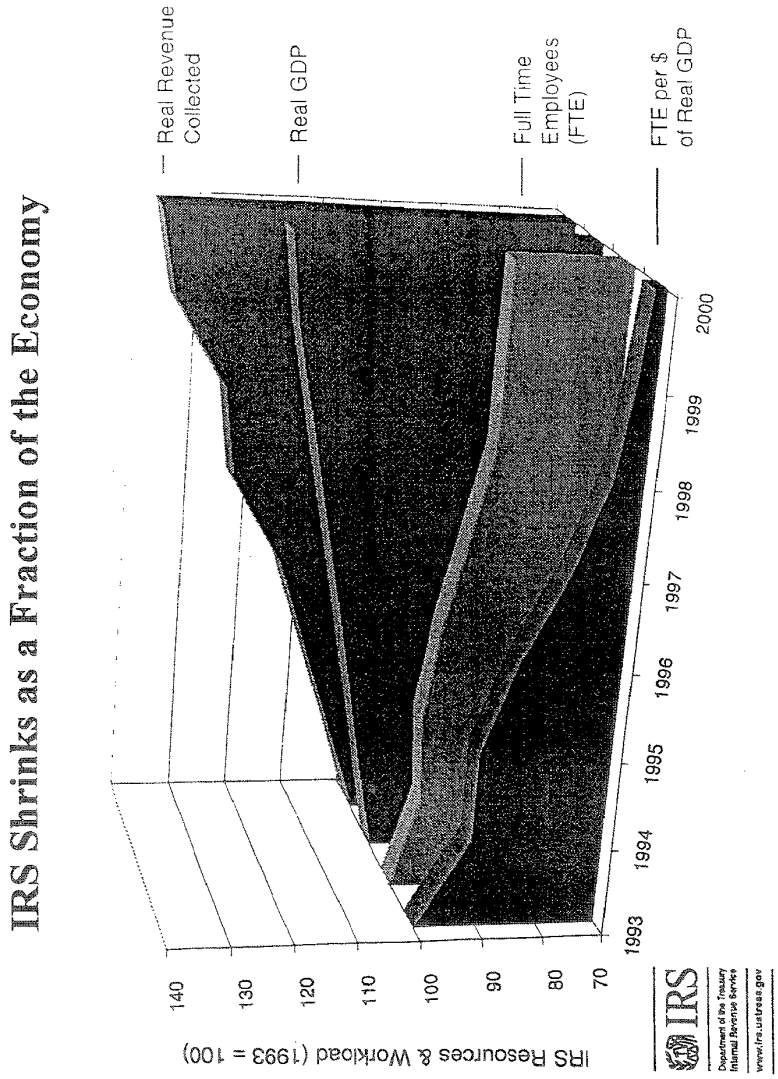
Productivity Through a Quality Work Environment

- Increase employee job satisfaction
- Hold agency employment stable while economy grows and service improves

IRS
Department of the Treasury
Internal Revenue Service
www.irs.ustreas.gov

Improved Business Practices Advance All Three Strategic Goals

- Increase electronic information exchange.
- Educate and assist taxpayers to avoid common errors.
- Leverage IRS resources with partnerships.
- Increase use of technology to identify and correct taxpayer errors.
- Provide IRS employees with accurate, up-to-date information on taxpayer accounts and applicable tax laws.
- Increase knowledge and understanding of taxpayer's business by IRS employees and managers.
- Develop voluntary agreements with taxpayers to address specialized issues.
- Make greater and faster use of knowledge gained in taxpayer cases to clarify tax law interpretation and requirements.
- Identify and resolve collection risks much faster.
- Carefully target enforcement actions to cases where risk of non-compliance is greatest.
- Develop integrated strategies for areas of high non-compliance.



Mr. HOUGHTON. All right, thank you very much, Commissioner.

I'd like to ask a question or two, and then I'll pass it off to Mr. Coyne and then go down the row.

Let's get right into this budget issue, because this is obviously very important to you and very important to us. There were three areas I understand that you felt would be impacted here. One is the law enforcement. Second would be the processing and third really is the Y2K computer repairs, or the Year 2000 computer repairs. Do you want to break that down a little bit?

Mr. ROSSOTTI. Basically what you have is a budget which no matter how many labels you put on it has mainly two components that drive most of the budget. One is the staffing that we need to do, process cases and process returns. The other is the supporting technology that we need to help do both of those.

So when we cut the budget, or have less budget, it has to come out of one of those two places. When we cut the staff, the only thing that we can do is reduce the number of cases. In the short-term, the only thing we can do is reduce the number of cases that we follow. That is why the statistics that you cited and Mr. Coyne cited are going down so rapidly, because we've had a decline in resources. Before RRA, we've had an increased demand in processing time as a result of the new rights in the cases. The net of those is that the enforcement or compliance activity goes down.

The other part of it is the technology, there is really very minimal investment money, in fact, virtually none in the 2000 budget request as it is. So to the extent that it is cut, what happens is that basically, we would have to cut the few things that are deferrable, such as purchase of equipment, which leaves us then with obsolete equipment, which then costs more money to operate in the long run.

Then finally, with respect to some of the change initiatives that we have underway, I mean, we are in a situation where we have a 100,000 person organization that is undergoing a massive change, not only organizational, but cultural. It's very, very risky in my view, to leave that in a state of suspended animation.

Actually, our employees and our managers are asking me now, not what they said a year ago, do we need the change, but they're saying, let's get this done, let's get this change done so that we can really operate according to the new way. To operate in a state of suspended animation is a very risky and difficult thing to do. I think, Mr. Houghton, you know that from your work with some large organizations.

The impact of cutting, even compared to the minimal budget request we had I believe is going to increase risk as well as reduce in very tangible ways current operational activities.

Mr. HOUGHTON. So you don't believe this is chump change, as indicated in the article?

Mr. ROSSOTTI. Mr. Chairman, I do not believe it is chump change. We have to remember that we started with the request as a result of a tight budget situation, which was virtually level to begin with. It was not a budget request that was in any sense inflated. In fact, I would say to put it in the most optimistic way, the bare minimum that you would need to continue to make progress if we got every dollar of it.

Mr. HOUGHTON. I wonder whether Mr. Portman at some point in his questioning could refer to the plan, I think it was, of set a level funding over 3 years, which was originally accepted. But anyway, that's enough for my questions, and I'll turn it over to Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Commissioner, how many taxpayers have claimed since enactment of the IRS Reform bill that IRS employees are abusive in a manner prohibited by section 1203 and what is the basis for most of the complaints?

Mr. ROSSOTTI. Well, let me see if I've got the statistics here. The number of complaints that have been accepted by the IG under the section related to harassment is, I believe, somewhere, I will have to get you the precise number, but it's somewhere in the vicinity of about 60 that have been accepted for investigation. The precise number, I can't quite find it here, but it's in that vicinity.

This does not mean that they were found to be substantive. That's just the number that got through the preliminary screening to be accepted. I think that the important thing I've tried to communicate to employees, that is not, compared to some of the beliefs out there that hundreds of thousands of complaints are coming in, willy nilly, it is really not the case. There are complaints, but they are in relatively limited numbers.

And of course, that's only the first step. Then they have to be investigated, evaluated, and you know, many of those will be found not to be substantiated.

[The following was subsequently received.]

August 18, 1999

Memorandum for all IRS Employees

From: Charles O. Rossotti, Commissioner of Internal Revenue

Subject: Report on Actions Concerning Misconduct Allegations and Disciplinary Actions

Bob Wenzel and I are committed to open communications on all matters affecting IRS employees. Few matters are of greater interest than the actions taken by the agency to investigate and resolve allegations of misconduct. Surveys over the years have indicated great concern about how such matters were addressed in the Service, including concerns over lack of appropriate action, disparate treatment among various groups and levels, and, most recently, how Section 1203 of the Restructuring and Reform Act of 1998 would be administered.

One of the factors that fuels concern is lack of accurate information about actions actually taken in these matters. Therefore, in accordance with our policy of open communications, with this memo we are beginning some important steps to share with all employees on a continuing basis information about how misconduct allegations at all levels have been resolved. You may recall that this was one of the key recommendations of the Bowsher report that I commissioned in 1998. Earlier this year, we established the Commissioner's Complaint and Analysis Group, headed by Steve Whitlock, a former DoD executive with experience in these matters. An important part of the responsibility of this unit is to prepare regular reports to employees on how allegations are resolved.

With this memo, we are taking three important steps:

1. We are announcing a plan, in agreement with the National Treasury Employees Union (NTEU), to report periodically on every disciplinary action taken in the IRS.
2. We are including a review of the results of the first year of activity under Section 1203.
3. We are releasing a detailed review of all of the actions taken over the past two years to investigate and resolve allegations related to misuse of enforcement statistics and inappropriate seizures. This includes a summary of all disciplinary actions taken.

Summary of Plan for Release of Disciplinary Actions

We have entered into an agreement with the NTEU regarding the release of information on disciplinary actions. Under this agreement, we will provide regular periodic summaries of disciplinary actions taken. The summaries will not identify the particular employees affected, but will include enough information to understand the nature of the offenses, the actions taken and the level and general positions of the employees. The first report will be issued this fall, and will address actions involving IRS executives and GS–15s. Future reports will cover all IRS employees.

Results of Investigation into 1203 Allegations

The second issue relates to Section 1203 of the Restructuring and Reform Act of 1998. I know that Section 1203 has been a source of concern for many of you. The

processes we have established are designed to ensure protection of the rights of taxpayers, taxpayer representatives, and IRS employees—including employees who are the subject of Section 1203 allegations. We will provide updated information in the future so that you can see how those processes are working.

The key point is that we are committed to investigating and resolving every case based on the facts of the case and in accordance with the intent of the law, which, as I have said repeatedly, is aimed at serious and willful instances of misconduct.

The missing element in our communications on this subject to date has been information about our experience in applying Section 1203 to the allegations received. We now have preliminary data to share with you, and will provide more on a regular basis.

As of July 15, 1999, we have received 449 allegations that, if substantiated, would be violations of Section 1203. When a Section 1203 allegation is made, we must determine the relevant facts and then make decisions about what those facts mean. We must then decide whether those facts indicate a violation of Section 1203 or some other type of misconduct. The inquiry and analysis is essential to our commitment to ensure fair and equitable treatment for taxpayers, for their representatives, and for IRS employees—including those employees who are the subjects of a Section 1203 allegation. This takes time, and so far we have completed the analysis of 214 of the 449 allegations.

The results of the analysis and inquiry into the 214 completed so far indicate that 15 percent are probable Section 1203 violations (probable pending final Deciding Official or Review Board determination), 75 percent were not substantiated, and 10 percent indicate other types of misconduct that do not meet Section 1203 criteria, but are serious nonetheless. Following is a summary of the analysis, and Attachment I to this memo contains a breakdown of the types of allegations received. Attachment II flowcharts the process from allegation and inquiry to disposition.

Summary of Analysis of Section 1203 Allegations

		In percent
Probable 1203 Violations	33	15%
Probable Other Misconduct	20	10
Allegations Not Substantiated	161	75
Total	214	100

Of the 33 allegations that involve Section 1203 violations, the Service has completed action on 4 cases, all of which demonstrated willful non-compliance with tax laws. Three of the four employees claimed that the tax laws do not apply to them, and one had a series of disciplinary actions for previous non-compliance. All four employees were recommended for removal; the Review Board, which evaluates the potential for lesser penalties in these cases, concurred with the recommendation; and the employees were removed. The Service is continuing to work the remaining 29 cases using the process illustrated in Attachment II.

When I hear employees' concerns about Section 1203 conduct provisions, I hear most about Section 1203 (b)(6) which involves violations of the Internal Revenue Code, Treasury Regulations, or IRS Policy with the intent to harass or retaliate. It is also the most frequently cited provision of the cases in inventory, accounting for over 60 percent or 269 of the total allegations. Inquiries have been completed on 141 of these 1203(b)(6) allegations with one substantiated as a probable violation, 14 as other misconduct, and 126 not substantiated.

While we are just beginning to gather enough data to start identifying trends and drawing conclusions, I think there are two important observations to make at this stage. First, we are taking a very thoughtful and thorough approach to making the best determination regarding willfulness and intent to be sure that mere mistake or inadvertent action does not trigger the mandatory removal penalty. Second, while the majority of allegations made have been determined *not* to be potential Section 1203 violations, there have been some substantiated violations, and these should not be tolerated in the IRS.

Finally, I will continue to share information with you about these types of conduct cases and their disposition as we gain more experience in the process. As we learn more, we can identify problem areas on which to concentrate our education efforts and provide information to you that can help you do your jobs with confidence.

Attachment I

RRA'98 Section 1203 Allegations

1203 Section	Allegations Received	Status: Inquiry in Process	Inquiry Does Not Substantiate Allegation	Inquiry Substantiates Non-1203 Misconduct	Inquiry Substantiates 1203 Misconduct
Unauthorized Seizure of Taxpayer Assets	12	11	1	0	0
False Statements Under Oath	2	0	2	0	0
Civil Rights Violation	48	30	17	1	0
Falsification/Destruction of Documents to Hide Error	17	19	5	0	2
Convicted of Assault or Battery Relating to IRS Duties	3	1	0	1	1
Violated IRC/IRM to Retaliate or Harass	269	128	126	14	1
Violated 26 U.S.C. 6103 to Conceal Information From Congress	1	1	0	0	0
Willful Untimely Filing of Federal Tax Return	70	36	6	2	26
Willful Understatement of Federal Tax Liability	5	2	2	0	1
Threaten Audit for Personal Gain	13	7	2	2	2
			161	20	33
Total Inquiries Completed			214		
Total Inquiries In Process		235			
Total Inquiries Received	449				

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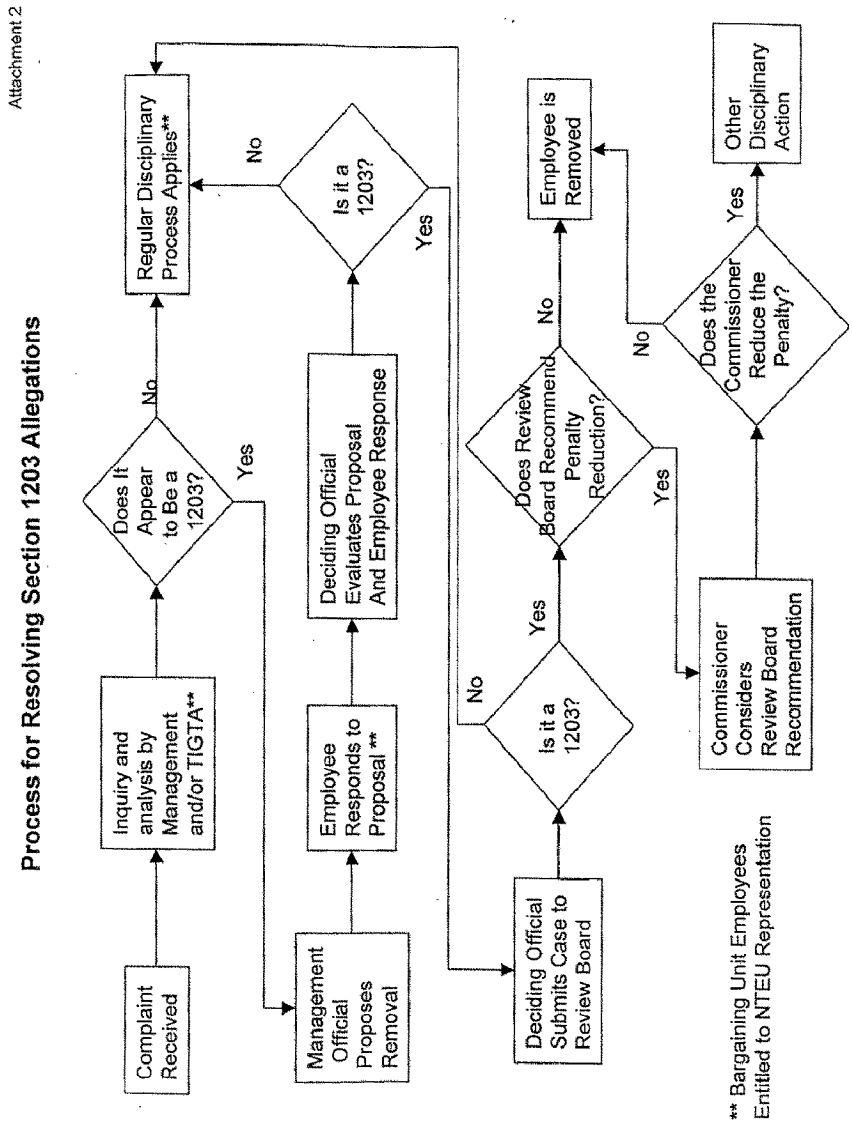

RESULTS OF INVESTIGATIONS CONCERNING MISUSE OF ENFORCEMENT STATISTICS AND INAPPROPRIATE SEIZURES

Chronology of Events

The Service has taken a number of actions regarding misuse of enforcement statistics, identified in the September 1997 hearings before the Senate Finance Committee. The Special Review Panel noted that "there is a tension between the requirement of the IRS to perform effectively in collecting the largest amount of lawful taxes due at the least cost to the taxpayer and the equally rational view that, in a free society, fairness is questioned when the performance of tax collection workers is driven by quotas or goals in their work plans." I am confident that effective implementation of our balanced measures will ensure that we do not again allow our priorities to be skewed in favor of the collection at the expense of fairness. While

a few individual cases remain to be resolved, I am pleased to report that Service-wide efforts to review past practices in this area have concluded, and we can now focus on the future.

In September 1997, the Senate Finance Committee held three days of oversight hearings on the Internal Revenue Service (IRS). During these hearings, several taxpayers testified that they felt the IRS used unreasonable enforcement tactics. Several current IRS employees testified that certain IRS practices violated restrictions on the use of enforcement statistics. These practices, the employees believed, might have resulted in inappropriate actions against taxpayers.

Following the hearings, the IRS Inspection Service conducted internal audits overseen by the Office of the Inspector General, Department of the Treasury. These reports documented considerable historical pressure on the IRS to improve productivity, resulting in a strong emphasis on productivity results throughout the organization. Congressional scrutiny, General Accounting Office reports, the Government Performance and Results Act of 1993, and various Administration initiatives required the IRS to generate more revenue with fewer resources. In response, the IRS measured and reported progress against dollar productivity goals. The reports found that the IRS environment emphasized revenue production without always providing a corresponding emphasis on quality or the fair treatment of taxpayers.

In January 1998, IRS Commissioner Charles Rossotti established a Special Review Panel comprised of executives from outside the IRS to objectively and independently review and assess the evidence developed by IRS Inspection Service concerning allegations of misuse of enforcement statistics, and to recommend, if appropriate, disciplinary or adverse actions. The Panel members were Douglas Browning (Assistant Commissioner for International Affairs, U.S. Customs Service), Stephen Colgate (Assistant Attorney General for Administration, Department of Justice) and Richard Hankinson (Assistant Director, Office of Inspection, Bureau of Alcohol, Tobacco and Firearms).

Over the course of its 6-month thorough investigation, this Panel found that, in IRS's efforts to achieve greater productivity, IRS policy guidance was modified regarding the use of enforcement statistics and the importance of safeguards was minimized or lost.

In addition, Commissioner Rossotti sponsored an independent review of the IRS Inspection Service, led by former Comptroller General Charles A. Bowsher. This review reported that management's lack of attention to early warnings about the inappropriate use of enforcement statistics illustrated the need for an effective system to track and manage the handling of employee and taxpayer complaints within IRS from time of receipt to final disposition.

Following up on the Special Review Panel issues, Commissioner Rossotti asked John Layton, former Inspector General for the Department of Energy and the Department of Treasury, to head the Disciplinary Action Review Project (DARP). Mr. Layton reviewed the investigative reports concerning statistics and seizures and, using the same criteria as the Special Review Panel, recommended any necessary disciplinary action. Mr. Layton also considered the findings of the audit reports, and other reviews conducted by Chief Operations Officer, Chief Counsel and regional staffs.

The disciplinary actions resulting from these four very thorough reviews underscore the IRS's commitment to thoroughly investigating every allegation of misconduct or failure to observe taxpayer rights, and to take action based on the specific facts of each case.

Internal Audit Reports: Key Findings

The IRS Chief Inspector's Internal Audit function produced two reports immediately after the Senate Finance Committee September hearings: one concerning the use of statistics in the Collection field function and the other on the Arkansas-Oklahoma District. From those initial audits, IRS requested two further audits on the use of statistics in the Examination Division and on the use of seizure authority in the Collection field function. The audit of the use of seizure authority in the Collection field function resulted in a more focused review of "special projects" in the New Jersey District Collection Division. The table below describes each report's key findings.

Internal Audit Report	Date	Key Findings
Review of the Use of Statistics and the Protection of Taxpayer Rights in the Arkansas-Oklahoma District Collection Field Function This report evaluated managment's use of enforcement statistics in Arkansas-Oklahoma, including whether the alleged impropriety led to the abuse of taxpayers.	Dec 1997	The audit concluded that this District office had an unbalanced focus on measuring performance by productivity. Statistical goals and expectations had become the primary means to measure productivity. The audit also concluded that although legal requirements were met in all of the seizures examined, some cases might not have followed all of the IRS procedures.
Use of Enforcement Statistics in the Collection Field Function This report evaluated the use of statistics in the district Collection field function at national and regional levels and twelve districts.	January 1998	The report concluded that the IRS had created an organizational environment driven by statistical accomplishments that placed taxpayer rights and a fair employee evaluation system at risk. Four issues created this environment: • Statistical ranking of Districts encouraged an emphasis on enforcement results without a corresponding emphasis on case quality. • Guidance focused on productivity, did not have appropriate coordination or oversight, and encouraged sharing group goals. • The environment inappropriately emphasized statistical goals and use of enforcement tools. • Taxpayer Bill of Tights (TBOR) certification was perfunctory.
Use of Seizure Authority in the Collection Field Function	July 1998	The IRS did not properly exercise its seizure authority in 130 of 467 cases reviewed; in 116 other cases, established procedures may not have been followed. These seizures resulted in part from a desire to enhance statistical measures without a corresponding focus on the appropriateness of the actions taken and on adherence to policy and procedures.
Examiniation Division's Use of Performance Measures and Statistics This report evaluated the use of statistics in Examination at national and regional levels and twelve districts.	July 1998	This report found inappropriate use of Examination statistics in all twelve districts reviewed, due in part to unclear and inconsistent guidance given to Examination personnel. In addition, Examination Division's corporate measures focused primarily on enforcement statistics, which fostered improper use of enforcement statistics in the regions and districts. There were no corporate measures that addressed case quality, treatment of taxpayers, and the proper amount of tax assessed. This led to an environment at the group manager and employee levels that put emphasis on revenue and other statistical goals.

Internal Audit Report	Date	Key Findings
Review of Special Project in the New Jersey District	March 1999	This audit found that special projects were used to ensure the Collection Division of the New Jersey District met statistical goals. Those projects resulted in mistreatment of taxpayers. For example, as a result of instructions to initiate levy actions without ensuring notices had been issued or performing initial analysis, some levies were issued on taxpayers who were deceased, had financial or medical hardships, or were not liable for the tax.

Note: The functions of the Office of Chief Inspector were transferred to the new Treasury Inspector General for Tax Administration (TIGTA) in January 1999. Prior to that date, Internal Audit examined, evaluated and reported on the operation of IRS management policies and procedures. It referred to Internal Security any possible violations of law or IRS rules of conduct by individual IRS employees. In its Reports of Investigation (ROIs) and Special Inquiries, Internal Security determined whether any such violations did indeed occur.

Internal Audit Reports: Actions Taken

Beginning with the release of the very first Internal Audit report, the IRS has announced a series of actions that it had already taken or planned to address the various issues raised in the Senate hearings and the Inspection reports. Some of these corrective actions were subsequently legislated in the IRS Restructuring and Reform Act of 1998. Among these actions were:

- Stopping the practice of ranking regional and district offices and evaluating employees on enforcement-related statistics, for both the Collection and Examination functions.
- Suspending distribution of goals relating to revenue production to field offices.
- Requiring higher management approval of proposed seizures of property.
- Updating and clarifying seizure procedures, as required by the IRS Restructuring and Reform Act of 1998, to incorporate consideration of reasonable alternative collection methods before deciding to seize assets.
- Forming an executive task force to develop balanced performance measures that will promote quality, customer service, taxpayer rights and productivity.
- Implementing new quarterly certification requirements that affirm Collection Divisions are following the restrictions on use of statistics.
- Establishing a task force (part of the Disciplinary Action Review Project) to institute improved ways of evaluating and acting on complaints made by or against IRS employees. As has already been noted, John Layton, former Inspector General for the Department of Energy and the Department of Treasury, was appointed to head this effort.

In addition, Internal Revenue Commissioner Rossotti announced the following

- A complete management evaluation of all open and recently closed seizures for compliance with legal requirements and IRS procedures to be completed in all 33 District offices by the end of September 1998.
- A directive to all employees underscoring the importance of an the need to comply with Taxpayer Bill of Rights, and the severe consequences of failing to do so.
- The creation of an independent panel from outside the IRS to objectively determine disciplinary actions to be taken in cases arising from the Chief Inspector's investigation.

Special Review Panel: Key Findings

On January 13, 1998, Commissioner Rossotti announced the creation of a panel of senior officials from the other Federal agencies. The panel's purpose was to objectively and independently determine disciplinary/adverse actions to be taken in cases arising from the Chief Inspector's investigation into the inappropriate use of enforcement statistics in the IRS Collection field function and possible abuses of taxpayer rights.

The Special Review Panel reviewed the Internal Audit reports as well as Reports of Investigation and Special Inquiries resulting from the Internal Audit reports. One Report of Investigation covered development and issuance of policy guidance in the national office and two regions. The second Report of Investigation was specific to the Arkansas-Oklahoma District office. The Panel's report was delivered to the Commissioner of Internal Revenue in late August 1998.

While the Panel's specific recommendations concerning disciplinary action covered the national and regional office and one district office, the Panel's general findings took into account all of the information available to the Panel, comprising some 5,000 pages of information.

The Panel's report stated that the IRS felt external pressures from the Administration, Congress, and GAO to close the revenue gap through improved productivity. The Panel found that "there is a tension between the requirement of the IRS to perform effectively in collecting the largest amount of lawful taxes due at the least cost to the taxpayer and the equally rational view that, in a free society, fairness is questioned when the performance of tax collection workers is driven by quotas or goals in their work plans. This is not an easy difference to reconcile or administer; and managing between those two principal goals is greatly complicated in an organization with over 100,000 employees in 33 district offices and ten service centers nationwide." During this period, the IRS was shifting to a more productivity-focused work environment, managed primarily by revenue statistical goals and measures, with heavy emphasis on use of enforcement statistics.

As policy guidance was modified regarding the use of statistics, safeguards on use of enforcement statistics to measure or set goals for front-line employees were minimized or lost. The Panel found that policy guidance documents both in the national office and in two regions were flawed both in process and content. Proper coordination did not occur on all issues, and executives at the national and regional levels failed to exercise due diligence in administering Collection programs and policies. As a result, provisions in the documents allowed the sharing of enforcement statistics in a manner that led to violations of the Taxpayer Bill of Rights (TBOR) and the IRS Policy Statement P–1–20, *The Use of Enforcement Statistic*. In fact, violations of P–1–20 and TBOR occurred in the Arkansas-Oklahoma District, as well as other districts studied.

Special Review Panel: Actions Taken

As the Special Review Panel recommended, disciplinary actions were taken concerning executives and managers, primarily at the national office. The table below summarizes those disciplinary actions. The panel did not have investigative reports concerning seizures before it for consideration. In addition, the Panel did not consider additional investigative reports on possible misuse of enforcement statistics at the District level.

Employees	Reprimands	Admonishments
Executives	6	0
Managers and Management Officials	6	2

Disciplinary Action Review Project Action on Misuse of Statistics and Levy and Seizure Cases

The DARP, as a successor to the Special Review Panel, reviewed 81 specific matters concerning possible misuse of enforcement statistics developed by the IRS Inspection Service. These matters included the use of enforcement statistics in performance appraisals and the establishment of collection goals that followed the pattern identified by the Panel. The DARP was also provided 72 cases developed by the IRS Inspection Service concerning levies and seizures that may have violated the Internal Revenue Code, the Internal Revenue Manual, or both. At the request of DARP, inquiries were also made by the TIGTA into managers' conduct related to the approvals of the defective levies and seizures. A total of 94 levy and seizure matters were considered by the DARP.

The DARP reviewed the results of the Inspection Service/TIGTA investigations of levy and seizure actions and found that deficiencies in individual performance occurred at the group manager levels as well as with the revenue officers. There also were deficiencies at the district, division, and branch levels. In most of the instances the supervising managers, at a minimum, approved the seizures.

The authority to levy and seize taxpayers' property is a function of the IRS Collection program and with significant impact on taxpayers. The levy and seizure cases provided to DARP by both the former Inspection Service and TIGTA contain evidence of failures to correctly apply the Internal Revenue Code and the Internal Revenue Manual. Taxpayers were not provided with adequate notice of seizures, and group managers were not adequately reviewing seizure documentation prior to approving. Levies were issued within a particular industry segment as part of a dis-

trict project that focused on the expeditious levying of a large number of sources without verification of the validity of the sources. IRS management failed to effectively control levy and seizure activities. Failures to adhere to the specific requirements of the IRM were neither adequately identified or corrected. Ambiguous provisions of the IRM were not clarified. The IRS emphasis on statistical results, as reported by the Special Review Panel, when combined with a lack of compliance with the IRM and the IRC created an environment where taxpayer interests were not adequately considered with conducting levies and where taxpayer interests were not adequately considered when conducting levies and seizures.

Application of Criteria for Discipliary Action

The DARP considered the impact on the IRS and the taxpayers of the failures to follow the Internal Revenue Code, the Internal Revenue Manual, or both. Further, DARP considered the relationship of the nature and seriousness of the offenses to the employee's position, the employee's duties, and the notoriety of the offenses. For example, in cases, where revenue officer's inappropriate levy and seizure actions were expressly directed by others, or approved or allowed to happen as a result of the negligent or careless performance or reviewers, the DARP recommended a lesser penalty than otherwise suggested. The violation of taxpayer rights was considered an aggravating factor. Also the DARP considered the clarity with which the employee was on notice of nay rules violated, and did not recommend disciplinary actions in cases where IRS guidance was ambiguous. Finally, some matters for which the DARP recommended closing without action involve practices that, because of legislation and policy changes, would be incorrect today. However, the DARP could not say the actions were inconsistent with the guidance and expectations applicable to collection activities when the enforcement actions occurred.

Disciplinary Action Review Panel: Actions Taken

The DARP reviewed 81 specific matters concerning possible misuse of enforcement statistics, and recommended disciplinary actions were taken with regard to seven managers. Seventy-two matters concerning misuse of enforcement statistics were closed because the actions taken by the emoloyees appeared to be based on the flawed guidance discussed in the Special Panel report, and two others remain open with the Treasury Inspector General for Tax Administration (TIGTA).

The DARP also reviewed 94 matters involving levies and and/or seizures, including an organized effort in one district to issue mass levies and conduct seizures that resulted in a failure to provide adequate notice to taxpayers of the pending seizure or levy. Analysis of the quality of the levy sources and the likelihood of collecting taxes were not adequately considered in the haste to turn over approximately 3400 cases in a few months prior to the end of an evaluation period. The problems with levies and seizures in that district were linked to the misuse of enforcement statistics.

Based on its review of the 94 matters involving levies and seizures, the DARP-recommended disciplinary actions were taken with regard to 19 managers employees. Sixty-nine matters were closed without action, and six others remain.

Disciplinary Action Review Project Dispositions

Type of issue	Closed without action	Disciplinary actions proposed	Open	Total
Misuse of Enforcement Statistics	72	7	2	81
Inappropriate Levy and Seizure Activity	69	19	6	94
Total	141	26	8	175

Disciplinary Action Review Project Disciplinary Actions Proposed

Employees	Reprimands	Admonishments	Suspensions	Total
Managers	6	12	2	20
Revenue Officers	0	6	0	6
Total	6	18	2	26

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Mr. COYNE. On another subject, what is the overall individual tax return audit rate? Just for returns over $100,000.

Mr. ROSSOTTI. For fiscal year 1999, we are estimating that the audit rate overall for individual returns, and I'm talking now about field audits, which is what most people think of, that's when you actually have a person, because there are some other audits, what we call correspondence audits which is a letter, basically, that's sent to the taxpayer. But just talking about field audits, the overall rate for fiscal year 1999 is going to be approximately .38 percent, that's .38 percent. For returns over $100,000, it will be 1.31 percent.

Just to compare that to 2 years ago, it's almost a reduction in half for the overall coverage, because it was .65 percent in 1997. For the over $100,000 returns, it was down from 1.98 to 1.31. So that's about a 30- or 40-percent reduction in 2 years.

Mr. COYNE. Today we're going to act in the House of Representatives on H.R. 2488, the Financial Freedom Act of 1999. It contains over 250 major tax changes as a result of it.

Is there any provision made in your budget to implement that, or have you had a chance to look at the proposed changes?

Mr. ROSSOTTI. As far as the provision in the budget, there's no specific provision in the budget, because obviously we didn't know what the provisions would be in the Act. With respect to having had a chance to look at it, under the provisions of the new law, we have given some information to the Joint Committee commenting on the so-called complexity analysis of some of the provisions. We've provided that information to the Joint Committee.

Mr. COYNE. Well, whether it's this legislation that we're going to act on today or any piece of legislation that contains 250 changes, could you talk about what impact that might have on your operation?

Mr. ROSSOTTI. Of course, what happens when there are these changes, and it depends very much on what they are, but when there are provisions that basically change forms, for example, or change the way that a provision is interpreted, or particularly when there's a brand new provision in, like a new kind of credit, it ripples through the system in a number of ways. No. 1 is, we have to change all of our forms, or many of our forms and instructions and publications.

We then have to train our employees in these new forms. We have about 25,000 employees right on the frontlines that answer questions from taxpayers over the phone. We then of course have to reprogram the computer systems to deal with these matters. Then finally, downstream, there are the compliance issues, that if people don't follow the new rules, correctly, we need to check on those returns and we need to train our examiners, provide the support to them that we need to do the compliance activity.

So when we do make a tax law change, it does ripple through the entire system.

Mr. COYNE. Thank you very much.

Mr. HOUGHTON. All right, Mr. Watkins.

Mr. WATKINS. No questions, thank you.

Mr. HOUGHTON. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman, and Commissioner, thank you for being here.

I'm sure I do have problems in the district, but I won't get into those at this point, because there's a lot of other questions I'd love to ask you and our time is limited. But just following up on Mr. Coyne's comments if I could, I was delighted to see that under the law that we passed to reform the IRS, we also asked Congress to do some things. As you know, we had a joint meeting which you attended with the seven Committees who have jurisdiction over the IRS, which I thought was very productive.

We also have in place in the Committee report of the tax bill that we're going to consider later today the complexity analysis that many of us fought for over some objections here on the Hill. I think it's very valuable. I've read through it. It's useful for me to see, in response to Mr. Coyne's question, what some of the new tax provisions that we'll be voting on today will do with regard to the Code, and specifically with regard to your administration of those provisions.

I think we did a pretty good job this time of not, as you know, adding a lot of new complexity, including the Chairman's admonition that there be no new credits, which we stuck with through unbelievable pressure from both sides of the aisle, probably particularly our side. When you look at the complexity analysis, you also note that at the end, again, printed in the Record for the public to see and for all members to see, the IRS comments on the major tax provisions that were identified for complexity analysis. I think this is also very helpful.

I will say that the repeal of the AMT, the repeal of the estate tax, the small savers provision, which is going to take millions of Americans out of dealing with interest and dividend income, should lead over time to remarkable simplification for you all. Now, these provisions, as you know, are phased in over time, particularly the AMT and the estate tax. So it's not going to be immediate. But that will, I imagine, just as it will help a lot of taxpayers, lighten your load considerably in terms of compliance.

My question to you would be, were you pleased with the way in which this process worked this year? Did you have adequate interaction with the Joint Tax Committee to feel as though you had opportunity to make your views known?

Mr. ROSSOTTI. I was very pleased, it was something new, it was a little bit of learning, but we worked with the Joint Committee I think very well, and were able to provide some information. As we learn more about this, we may be able to be a little more elaborate. Right now we started on kind of the basic thing, such as Mr. Coyne noted, the impact on the forms, the impact on the processing. But over time, I think we'll learn how to explain even more clearly. But I was very pleased with the process.

Mr. PORTMAN. OK, well, again, I'm delighted that you were part of the process and that you were able to give some very specific information, for example, whether a new form was needed or not, what new boxes were needed and so on. I would encourage you to continue to focus on that, because that will help us legislate better. Most importantly, it will help the taxpayers and the administration

and you all over time to be able to administer this code, this monstrosity that we all have to deal with at this point.

Quickly, with regard to performance measures, as you know, the employee evaluation piece I feel very strongly about. So does the Subcommittee. It was part of the legislation and part of the Commission's report. This is not an easy task moving from quantitative measurements, i.e., how much money you bring in from a taxpayer, to more qualitative ones. Can you give us a report on how you think the employee evaluation system is going, and could you talk briefly about how it fits in with the overall mission?

Mr. ROSSOTTI. The whole issue of measurement and performance measurement and evaluation is what we call one of the five major, to use our buzz word, levers of change, the things that are going to move us in the direction we want. So we've got a whole set of activities going on in that regard.

The first thing to do is decide what direction you want to change, too, which is why it was important to get the new mission statement and the goals out. Then we have been working on this new set of quantitative, what we call balanced performance measures, which we spent a great deal of time the first year developing and are now rolling out, as we call it. In other words, we're actually implementing these, not in every part of the organization, but most parts. By the end of this fiscal year, we'll have the first set of those done.

Then the other major piece, the really big, big piece, is actually rewriting the job descriptions and the performance appraisal systems for essentially every employee. And we're well on the way to doing that. We will have the managers evaluations done basically by the end of this calendar year. We're working with our union, by the end of 2000 we will have basically most of those done.

In the meantime, we have done one of the specific things that was called for by the law, which is putting in a new standard in every evaluation that talks about fair and equitable treatment of taxpayers. That's already been done, including the frontline employees. So on top of all this, of course, the big thing is training. Because it doesn't do a lot of good to have a lot of new measures and a lot of new performance standards without training people in them. We are going through, we have about 400,000 hours just this year of training for managers in this new system, and it will escalate next year as we get the frontline employees.

So this is one of the most immediate change agents, if you will, that we are employing to move toward the mission and the goals, and basically the direction that was given us by the Act.

Mr. PORTMAN. Thank you, Mr. Chairman.

Mr. HOUGHTON. Mr. Weller.

Mr. WELLER. Thank you, Mr. Chairman, and Mr. Rossotti, good to see you this morning.

Mr. ROSSOTTI. Good morning.

Mr. WELLER. Good to have you before us, we appreciate the good work you're doing in moving forward on the reforms that this Congress passed and the President signed into law.

I believe one of the greatest victories of IRS reform, first-ever IRS reform, of course, was addressing the issue of innocent spouses, a case where in many cases, you have a single working

mom with the kids who not only is dealing with a child support deadbeat but also that child support deadbeat is a tax deadbeat. Of course, in the past, they couldn't find the deadbeats, so they went after the single working mom with the kids who's struggling to make ends meet who wasn't receiving her child support.

And we worked to address that in the IRS reform. I guess the first question I'd like to ask of you, focusing on this issue is, tell me how you're implementing that. How many cases have you dealt with and how has this process been working?

Mr. ROSSOTTI. First let me say that this is one of the most important taxpayer rights provisions, new taxpayer rights provisions, and is one that we've been spending a great deal of time on. I have to honestly tell you that we've found that the implementation of this has been more difficult than perhaps was initially anticipated for two reasons. One is that there simply have been more claims than I think, we really didn't know how many there would be, but we've gotten a whole lot of them. We've gotten approximately 32,000 this fiscal year, and they're coming in at a rate of over 1,000 a week. Which is far in excess of the innocent spouse provision under the old law, this is far in excess of what there is.

So first of all this is just a sheer number of claims. The second thing is what we've learned is that the law provided really three different kinds of relief under different kinds of circumstances. Only one of which was incorporated under the old law. So you have really a whole new method of doing this. And just to give you an example, this is a flow chart that we have of what it takes to process one case. It's about 10 pages of flow charts that you have to look at. Each one of these requires a determination. The process of training people to get this right has turned out to be quite significant.

And finally, there's just the issue of interpreting, for example, what is meant by equitable relief. We had to get a regulation out that interpreted that, and even after we had the regulation out, it's a new concept, and we have to work on it to get it right. So these are some of the things that we've been facing.

But we have also made a real determination that we're going to get this right, we're going to get every case right, and we're going to process them. The collection action, by the way, on any given case, is held in abeyance while these cases are in inventory. So at the present time, we have about 29,000 cases in inventory, which is far more than we should have. We have applied a special task force to basically try to work on getting this right, getting this inventory down. We're coming up with some new job aids and some new training for the employees.

We have actually employed, in addition to what we originally planned to do, which was to have most of it centralized in a couple of places, we've had to, just because of the resources, use resources in basically all of our districts. So we have just recently done that, to farm some of these cases out to more places.

We're also forming, in some of these districts, teams so they can work together with some examiners that get extra support from experts. I could go on with more details.

But the net effect is that this has turned into something that is really quite a substantial effort. I think once we get through this

initial backlog and we learn how to do this more, hopefully the number of claims will stabilize and we will become more efficient in processing them. But in the meantime, it has been a very, very challenging effort.

I do think, however, I must say that I'm not saying any of this along the lines of criticizing the law, because I think it's absolutely the right thing to have done, and your point was, I think in your opening statement, quite accurate, that there were some really very bad cases that came to our attention under the old law which just didn't fit the modern circumstances.

So notwithstanding the difficulty of this, it is absolutely the right thing to do, it's the way the law should work. And it's just an example of the challenge we have in trying to work under this new way.

Mr. WELLER. Commissioner, of course, 32,000, 1,000 a week, is quite a few.

Mr. ROSSOTTI. It is.

Mr. WELLER. Compared, I'm sure, to the past number of applicants under what was a very weak innocent spouse opportunity at that time, probably you're receiving much more in applications.

Do you have any, as you are now implementing what we provided for you in the law, do you have any recommendations and changes in the law that would ease your ability to process it?

Mr. ROSSOTTI. No, I don't at this point. I think we might at some future time, but frankly we're still learning about how this applies. I mean, one of the things we're going to do is on most of the cases, those that get into the more complex provisions of the law, we're actually going to do 100 percent quality review on these cases in order to first of all make sure they're right. Because we can't be really sure they're right the first time.

But second, I think it will help us to learn more about what are some of the particular aspects of this law. I think especially through the Taxpayer Advocates Report, which will come to Congress next year, if there are any issues like that, we would be able to surface them. But right now, I think the problem we have is more internal. It's a matter of understanding this law, of learning from the cases that we process under the law, and I just want to stress that we are determined that we are going to make every one of these cases right, even to the extent of doing 100 percent review of the more complex cases.

Mr. WELLER. Thank you, Commissioner. Mr. Chairman, thanks for the opportunity. I see my time has expired, Mr. Chairman.

Mr. HOUGHTON. Mr. Hulshof.

Mr. HULSHOF. No questions, thank you.

Mr. HOUGHTON. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. Commissioner, I referred earlier to the 10 deadly sins that we have had some experience with. I was just wondering if you think based on experience so far that they need to be modified. Would that be something?

Mr. ROSSOTTI. I think as I just answered to Mr. Weller, I think with all the complex provisions of this law, we're going to learn as we apply them. I think if there are needs to change them, we would certainly come back to the Congress and ask. I think with respect to this one in particular, we really are still in a learning,

we're just barely getting the experience of having these cases go through.

So I don't think we're ready yet on any of these provisions, to come back and ask for changes. But I do want to say that just as with innocent spouse, 1203 is one of the most important, those are probably the two provisions of the law, two of the three or four most important provisions that we're working on the hardest to get right.

Right now our concentration is on making sure that we train our employees correctly what this means and we set up the right procedures to make sure everything is fair. The last step is that once these cases work through the pipeline they do come up, if there are any cases where there's a recommendation of termination of an employee, they do come up to the Commissioner, to me, for final review. We have set up a special process to do that. I think by that process, I will have the opportunity to learn very concretely how this law is working, and I can assure you, if there are any cases of what I consider to be unfair treatment of employees under this Act, I do have the authority to mitigate that and make sure it doesn't happen.

But I also then would have the information, potentially, if necessary, to come back to the Congress and discuss it. But we just haven't gotten through that pipeline yet. So I think as with all the provisions, we're not quite in a position yet to really say anything really intelligent or informed about what should be done with these provisions.

Mr. COYNE. Well, I would hope, based on experience that comes about moving into this operation that you wouldn't be hesitant to come back to the Congress and make recommendations about whatever changes would be helpful.

Mr. ROSSOTTI. We won't be. Thank you, Mr. Coyne. We will.

Mr. HOUGHTON. Mr. Watkins.

Mr. WATKINS. Thank you, Mr. Chairman. A little while ago I was kind of asking about some things in my district. Mr. Commissioner, I want to say thank you for the cooperation that we received on some past problems and concerns.

Mr. Chairman, if I could make this statement, I came from the business world into the political, I know my Chairman has done the same thing. If I can put it this way, I think you've been a breath of fresh air coming into an agency that's criticized so much, and sometimes rightly so. But then there are other times probably you've got to do the Lord's work for this Uncle Sam of ours.

With the positive attitude that you've had about trying to bring changes, which I think is quite significant, have you seen internally the kind of changes come about that you've been hoping to bring?

Mr. ROSSOTTI. Well, Mr. Watkins, you have to sort of categorize these changes. The first change was a change in direction and attitude. That was the first thing that we really tried to work on through communication. We've got a new mission statement, we've got a new set of goals. We're now, as I answered to Mr. Portman, changing the whole set of evaluations for people to track with these things.

I think frankly, most of what you've seen in your districts and from your constituents so far has been the result of a change in direction and attitude more than any tangible changes that we've been able to implement yet so far in terms of improved service.

So my answer is, I think we have seen among our employees a very significant understanding of the direction we're trying to go. I think our employees in the IRS, as I've learned, and I came into this without knowing one of them, literally not one, basically are good employees who want to be given clear direction as to what it is that's expected of them and try to do that. So we've spent a lot of time trying to give them just that, clear direction.

Now, in some areas, like in collection, there are so many changes that they are a little confused at times what the new role is, because it's so different as compared to what it was in the past. But on the whole, our employees have responded very well to this change in direction, and have tried to figure out in their own ways how they can implement it. I think most of what we have accomplished so far has been in that area, because we have not yet been able to implement many of these new business practices and new technology that are really in the long run, the way that we're going to deliver them through service to taxpayers.

So this whole change really includes some very intangible things like attitudes and directions, which are reinforced with communication goals. But then in the long run, we really have to follow through to give these employees and to give the taxpayers the treatment they deserve through better ways of doing business.

So I guess that's the best answer I can give you as of now.

Mr. WATKINS. Like you said, you didn't know one single employee. But Mr. Chairman, I think the example, you didn't come with an ax to grind, you came with an attitude, and I think that attitude is probably filtered all the way down and around and among all the personnel. I think that is so revealing, or in my mind, I think that.

That's why I'm asking in my own mind, is it really happening. Because I feel like you have brought a new direction and attitude to the lot. And I think that's very meaningful and very significant. We all run into different problems out there. You and your good people will find the same thing. It depends on how we handle those problems and what kind of a way. You can make people walk away gnashing their teeth, wanting to commit suicide, do all these other things, or you can really work with them through some real problems they have out there. It all goes back to attitude. I think in this case, definitely the attitude that you have brought about has really brought some changes, I think.

Mr. Chairman, I feel down in the district, people are trying to solve problems. And that's one of the things that I want you to know I appreciate very, very much. I know you cannot control every single employee, you cannot change their thought or their attitude. There's no way any of us dealing with personnel can. But you can try to convey to them and let them know what you're wanting to try to do. I think some of that's been kind of falling into place out there.

I know there's things that we'll go through and have many other problems that we'll have coming before us. But I want to say, I appreciate your attitude very much.

Mr. ROSSOTTI. Thank you very much, Mr. Watkins.

Mr. HOUGHTON. Thanks, Mr. Watkins.

Ms. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman.

Commissioner Rossotti, can you give us an update on the status of the oversight board? Are they being appointed, and as you move toward working with them, are you sacrificing anything right now in long range policy planning because they're not all in place?

Mr. ROSSOTTI. Well, of course, the oversight board is something that is not handled by me, it's handled by the Treasury and the White House. So I don't have too much detail to be able to provide on that. But some of the names have been provided to the Senate Finance Committee. There are still, I believe it's two or three, that still need to be provided.

So that's basically all I know about the status of the nominations.

But I will say this. What we're trying to do is put in place from one of the key things that was in the legislation, and you noted it, is to work with the board on strategic planning and budgeting. That's another area where a lot of work is needed in the IRS, to really improve where we are. We in all honesty don't really have what I would consider to be viable strategic planning and budgeting process in place.

And I think if we had the oversight board in place, they'd be wanting to know where it was. So in some ways I count myself lucky that I feel like I'm one step ahead of the sheriff here in trying to get this process in place, so that we'll have something that I think any board that I've ever worked with would expect.

We are making some progress on that in the sense that internally we're getting ready, we're defining what we mean by a strategic planning and budgeting process. We're putting some staff in place, hiring some people. And I think very importantly, these performance measures and the organization structure are necessary because without having a clear set of goals, and without having people to carry it out, you really can't put a strategic plan and process in place.

So I think what we are doing internally is doing what I would anticipate our board, when it does come into place, would want us to have, based on my experience. So that when they do come in, we will at least be able to talk to them in some intelligent way about. Even though we don't have it all in place, where it's going to be. That's what we're attempting to do to get ready.

From my personal point of view, I'm looking forward to having this board appointed and working with a set of people that I hope will provide good oversight for us, but be good people to work with in terms of helping us make sure we're on the right direction and supporting us where we need support.

Ms. DUNN. Good. Mr. Chairman, maybe we could put a note in the record that it's time to start nipping at heels of folks who should be appointing this oversight board. Because I'm sure that as Commissioner Rossotti has said, that it would be useful as a sup-

port group for him as he moves ahead in public policy planning in the IRS.

I'm also interested, Commissioner, in the Office of the Taxpayer Advocate and the continuing increase in independence from the IRS. How is that moving right now? Have these budget cuts done damage to that? I certainly hope we'll be able to get those dollars back in the conference. Could you just give us an update on the Taxpayer Advocates' independence?

Mr. ROSSOTTI. In our whole reorganization, one of the first areas that we wanted to reorganize was in fact the Taxpayer Advocate, both because it was important and because of certain provisions in the bill. So we are actually on an accelerated schedule in implementing the Taxpayer Advocates new organization.

As a matter of fact, by the end of this fiscal year, which is only a few months from now, we should have that new organization pretty much in place. The essence of it is of course, first of all, we recruited an outside person to be the National Taxpayer Advocate. The new organization structure will parallel, it will not be as it has been previously, where most of the people who do that work were part of the compliance functions in the IRS. Instead, it will be an independent parallel structure nationwide. There will be taxpayer advocates in every State and an area-wide set of advocate organizations.

What we are doing is actually doing an internal competition for every single job, or almost every single job, in the Taxpayer Advocate, which is around 2,000 people when it is all done. In other words, all the way down the management chain we've reposted these jobs, we've had internal competition, and we've now selected most of the new management structure and we're now selecting the frontline employees.

You might be interested to know that we have gotten about an eight to one, an eight to one response of people wanting to get into the Taxpayer Advocate's office. I can assure you, that's a very, very big change over where we were. It's really quite remarkable.

Now, we haven't selected them all yet. But by the end of this year, this fiscal year, we will have those individuals selected. We will have basically this taxpayer advocate organization all the way up and down the line in place.

There are issues that we're still working out over precisely what their authorities are, since they are now an independent, within the IRS but a parallel structure, precisely how they relate to the other parts of the IRS, including the Appeals Office, which gets a little complex. But we're working on those kinds of problems, and I'm very satisfied, I think you may have next Mr. Ovison, who is the National Taxpayer Advocate. He's taking a very strong leadership role in establishing this organization with the support of others.

So actually, of all the pieces of our organizational puzzle, the one that will be in place absolutely first will be the Taxpayer Advocate organization.

Ms. DUNN. Sounds good. Good news. Thank you. Thank you, Mr. Chairman.

Mr. HOUGHTON. OK, thank you.

Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman.

Commissioner, as you know, there was a recent report by the Electronic Tax Administration Advisory Committee established by the legislation this Subcommittee worked on. We're going to hear later from the chair of that Committee.

Among their recommendations in their report that we're going to look at today is that there ought to be a single strategic plan that integrates the multiple plans. And I would use as an example their own strategic plan for electronic tax modernization, that you all are working through the modernization blueprint, of course.

Also proceeding, of course, is the reorganization, modernization of the IRS along the lines of taxpayers. This recommendation to have a single strategic plan seems to make an awful lot of sense. I would think from the private sector experience you have that would be the way you would want to go. And yet you don't have one.

Can you tell me what kind of progress you are making in achieving a single strategic plan for all these multiple plans?

Mr. ROSSOTTI. Well, as I was just talking to Congresswoman Dunn, in all candor, the IRS today does not have a good process for doing what I would consider strategic planning. We have a process for doing some specific kinds of planning, which is very important, and some budgeting. But pulling the whole thing together, it really is not in place.

And it's not a simple thing to do with our organization, being the scale it is. So that is one of the key processes we're working on. I would not say that we will have a complete strategic plan with all components in place, in all honesty, probably for a couple of years.

But that doesn't mean there isn't anything we're doing. One of the key priorities that is most immediately needed is the plan for the technology aspect, and we can work on this because we now know the direction we're going in terms of organization.

By the end of this calendar year we will have the first version of the technology, what we call business systems plan, in place, which will lay out for at least the next 3 to 5 years what the overall plan is for the major pieces of the systems work we're going to do. In that plan, it will include as I think, what is the ETAAC's view of what it should be, the essential integration of electronic tax administration systems aspect into the basic systems that we use throughout the agency, as opposed to being as it is now, basically just an add-on at the front end.

That will be an important step. But there are a lot more steps we need to do, as was indicated in their report, to integrate not just the business systems and the technology, but all of the other promotional activities and the way we outreach to taxpayers, the way we do compliance, basically building that into the whole way we do business. That's going to take a little bit longer, and really depends to some level on getting some of these new organizational structures in place.

Mr. PORTMAN. I guess it generally sounds as though you're speaking in support of the recommendations that are coming out of ETAAC. I would ask, if you have concerns about the rec-

ommendations, if you would forward those to the Subcommittee, so the staff is aware of that, and the members are aware of it.

Let me just make a comment, rather than ask a question. I was going to ask a question, but I think I know what your answer is going to be. If the oversight board were in place, I would assume the oversight board would play a very important role in the strategic plan. You said earlier in response to Ms. Dunn that a viable strategic planning process and budgeting process is not in place yet, or a viable strategic plan or long-term budget plan. And that in many ways, that is better that the board's not in place yet in some senses, because you'd like to get ahead of the sheriff, as you said.

I would just beg to differ, and I think this board can provide you with the kind of support you need to develop those plans. As you know, better than I, the kind of people who we're looking for on this board are precisely people who can help develop the strategic plan and a budgeting plan and bring together, as this ETAAC report tells us today, the multiple plans on the information side.

I am very concerned, actually shocked, that the administration, more than 6 months after it was required under the law, that this Subcommittee began the process of enacting, has yet to send the names forward in a formal way. You're right, some names have been floated. There are now I guess three missing, because one apparently has been dropped out.

But I would again make a very strong statement that needs to be a part of the record, and we've been nipping at the heels, not for 6 months, but for a year. And I think the record will show at least 9 months of correspondence with the White House and with the Treasury Department. I know that you share that concern.

But I would only feel constrained to comment, because of your responses to Ms. Dunn, that I think at least it was the intent of this Congress, based on the Commission's report, based on the legislation, clearly based on the report language, that this group was meant to help you do precisely what you are trying to do now. If you don't get these people in on the ground level now, as you're undergoing all these major changes at the IRS, and again, I commend you for your efforts in that regard, I think it will be a great loss to the taxpayer. Because I think given the realities of the IRS, the difficulty making these changes, the long-term viability of these reforms will be at risk.

Mr. ROSSOTTI. I just want to clarify. In responding, I was being a little bit facetious, which is always a little risky. Basically my point was saying that we are trying to put in place what I anticipate the board would want us to put in place if they were here. I didn't really mean that we wouldn't benefit by not having them.

But what we're trying to do is not wait until they get here, but try and see if we can anticipate what I think a good oversight board would want to have in the way of a strategic planning process, so that when they do get here, we'll at least be somewhat ahead of the game, rather than just waiting for them to come.

Mr. PORTMAN. That's commendable, and you're doing the best you can in a bad situation. I just wouldn't want to leave the record stating that somehow the board is not necessary, because the plan is in place, the board should be part of the planning process. I

thank the Chair for his indulgence, and Commissioner, thank you for your great testimony today.

Mr. HOUGHTON. Mr. Hulshof, did you have any questions?

Mr. HULSHOF. No.

Mr. HOUGHTON. Could you give us sort of a feel when this board is going to be there? I know you've got some inputs into this, but you know, we keep talking about this thing as if it isn't happening.

Mr. ROSSOTTI. Did you say when?

Mr. HOUGHTON. Yes.

Mr. ROSSOTTI. Well, it depends on when the remaining nominees are put forward. I have some insight into it. I know that there are two individuals that are being vetted, going through a vetting process. When that's completed, I think they will be forwarded. But I don't have any insight as to when that would be completed.

Mr. HOUGHTON. Because it's a little ridiculous, we keep talking about this thing, and it really doesn't take place. That was one of the cornerstones of the report.

Well, Commissioner, thank you very much. Mr. Coyne has talked about the 10 deadly sins, and I mentioned the three life-giving assets, which are people, money and attitude. We've got to work together on all of these. Thank you so much for the job you're doing. You're a great credit to all of us. And we'll have the next panel. Thank you, sir.

Mr. ROSSOTTI. Thank you, Mr. Chairman.

Mr. HOUGHTON. I'd like to call Mr. Charles Lacijan, who is Chairman of the Electronic Tax Administration Advisory Committee and Senior Policy Advisor of the Implementation Group. Mr. Lacijan is here with his lovely wife. Welcome, thank you very much, and any time you'd like to begin your testimony would be fine.

STATEMENT OF CHARLES A. LACIJAN, SENIOR TECHNICAL ADVISOR, IMPLEMENTATION GROUP, AND CHAIRMAN, ELECTRONIC TAX ADMINISTRATION ADVISORY COMMITTEE

Mr. LACIJAN. Thank you. Good morning, Mr. Chairman, Ranking Member Coyne, Members of the Subcommittee. My name is Chuck Lacijan, I'm the senior technical advisor to the Implementation Group, a Washington, DC., consulting firm. But since September 1998, I've also served as chairman of the Electronic Tax Administration Advisory Committee, also known as ETAAC. It's my pleasure to testify before you today in that capacity.

I have submitted a written statement that I ask be entered into the record, which I now intend to summarize.

Let me preface my remarks by saying that electronic filing is a very important part of a modern IRS. The IRS restructuring commission, which was so ably chaired by Congressman Portman, fully recognized this fact. The inclusion of title II, electronic filing, into the IRS Restructuring and Reform Act, is due in large part to the leadership shown by this Subcommittee, which also clearly recognized the importance of electronic filing. In fact, in September, 1997, the Subcommittee had an entire hearing dedicated just to that subject.

In electronic interaction with taxpayers, it has the potential to improve the IRS' ability to provide taxpayers with the type of cus-

tomer service that they receive from other modern financial institutions and have come to expect. Electronic filing also introduces productivity gains into the IRS, or productivity savings, that allows them to shift both resources and focus from the labor intensive processing of paper returns and shifting that to providing more customer service.

Taxpayers also benefit directly because of the much lower error rate associated with electronic filing. So for these reasons, the Act established a policy that paperless filing should be the preferred means of filing tax and information returns and actually set a goal of 80 percent of those returns that should be filed electronically by the year 2007.

Before I summarize the key findings of the ETAAC, I would like to say a few words about the Committee members. The strength of the ETAAC is its diverse membership, which covers a broad spectrum of stakeholder interests. Although our members are volunteers, they do work very hard at this. They take their responsibilities to serve very seriously and I would say are very thoughtful in their work.

And our report, was delivered to Congress on time, June 30, and because we're a volunteer Committee, on budget as well—zero.

I think ETAAC believes that IRS has made a very good start in setting out a program to achieve its electronic filing goals. My written statement does provide several examples of that.

However, I think the question of most importance to the Subcommittee is not whether IRS has made a good start, but whether it will make a good finish. ETAAC believes that the IRS can achieve the goal, but it does need to implement a broader set of initiatives than is currently planned.

Although the IRS has established a separate group responsible for electronic tax administration within it, this goal is much too sweeping in scope to be achieved by a single group within the IRS. The goal must be an agency-wide priority, with the proper resources behind it. Continual progress evaluation and updating of the plan is absolutely essential.

Now, the Act also requires the IRS to receive electronically by 2003 all information and tax returns that are prepared electronically. ETAAC believes that this is an excellent strategy and an extremely important goal. But it requires that all paid preparers who almost universally use computers to prepare their tax returns, would actually file all their computer generated returns electronically by 2003. This would be very difficult to achieve. It would actually require a paradigm shift in the thinking of most preparers.

However, this level of acceptance by paid preparers must be achieved by 2007 if the IRS is to reach the 80-percent goal.

Let me quickly summarize a few strategic challenges that face the IRS. First, they must create new processes and incentives that deliver value for all taxpayer segments, individual, small business, large business and tax-exempt organizations. They must integrate agency-wide strategic plans including some of the ones that were mentioned earlier, the strategy for growth, the modernization blueprint, the reorganization, modernization, into one cohesive strategic plan that serves the entire Service.

They have to develop the technology infrastructure to receive electronically all forms from all types of returns from all taxpayers. A strategy for growth indicates the IRS must position itself to take full advantage of the public's growing use of the Internet. We believe this is essential.

ETAAC also believes the IRS has opportunities to expand its business partnerships with external stakeholders, the taxpaying public, and businesses. In the view of ETAAC, businesses should interact with a modern IRS much like they interact with other businesses.

And let me quickly finish by identifying what ETAAC believes that Congress should do to assist the IRS. First, we believe they should maintain high visibility on these electronic filing goals in its oversight efforts. Second, they should evaluate new legislative action where it is recommended by the IRS or by ETAAC. And third, Congress should appropriate the necessary funds for electronic tax administration and related technology infrastructure initiatives.

That concludes my testimony, and I will be glad to answer any questions you may have.

[The prepared statement follows:]

Statement of Charles A. Lacijan, Senior Technical Advisor, Implementation Group, and Chairman, Electronic Tax Administration Advisory Committee

Mr. Chairman, Ranking Member Coyne, and Members of the Subcommittee, my name is Chuck Lacijan, and I am the Senior Technical Advisor for The Implementation Group, a Washington, D.C. consulting firm. Since September 1998 I have also served as the chairman of the Electronic Tax Administration Advisory Committee (ETAAC), and am testifying in this capacity before you today.

Two members of the Ways and Means Committee, former Oversight Subcommittee Chairwoman Nancy Johnson and Representative Rob Portman, nominated me for the ETAAC. I worked with both these Representatives while working electronic filing issues on the staff of the National Commission on Restructuring the Internal Revenue Service (IRS). It is with great pleasure and a sense of honor that I testify today.

The IRS Restructuring and Reform Act of 1998 set a new direction for the IRS in many areas, including electronic filing. Title II of the Act establishes a Congressional policy that paperless filing should be the preferred and most convenient means of filing Federal tax and information returns, and sets a goal for the IRS of having at least 80 percent of these returns filed electronically by the year 2007. The Act expects that the IRS will achieve this goal by cooperating with the private sector and encouraging competition, and further requires that the IRS establish a private sector advisory committee to assist it in meeting these goals.

The inclusion of Title II, Electronic Filing, in the Act is due in large part to the leadership shown by the Oversight Subcommittee, which recognized the importance of electronic filing and other electronic tax administration services. Electronic filing has the potential to improve the IRS' ability to provide taxpayers with customer service on a par with other modern financial institutions with which many taxpayers interact. It also introduces productivity savings to the IRS that allows it to shift resources away from the labor intensive processing of paper returns into customer service. Taxpayers benefit directly also, as electronic filing has a much lower error rate than paper filing.

The IRS Restructuring and Reform Act establishes two missions for the ETAAC. Our first mission is to help the IRS meet its electronic filing goals by providing it with private sector input. Our second mission is to provide Congress with an annual report that describes IRS' progress in meeting its electronic filing goals, the status of its strategic plans, any legislative changes necessary to assist the IRS in meeting the goals, and the effects of electronic filing on small businesses and the self-employed.

To provide the most comprehensive advice to the IRS, the ETAAC membership covers a broad spectrum of stakeholder interests, including:

- tax preparers, including some who operate small businesses
- tax preparation software companies serving both individual and business filers
- payroll services

- the financial community
- big business
- the academic community
- state government

A list of the ETAAC members is attached to a copy of this statement.

The ETAAC has worked with the IRS since its establishment in September 1998. Our priorities for this year included the following activity:

- reviewing the IRS' strategic plan, A Strategy for Growth, and assessing the ability of this plan to meet IRS' electronic filing goals
- working with the IRS to develop an annual calendar for strategic planing and evaluation
- identifying the strategic challenges facing the IRS
- developing our report to Congress

Our report documents the advice the ETAAC has provided the IRS and identifies the major challenges, risks, and opportunities facing the IRS, as well as recommendations for further action.

The ETAAC believes the IRS has made a good start in setting out a program to achieve the electronic filing goals established by Congress. Examples of progress include:

- Release of a strategic plan, A Strategy for Growth, in December 1998, which described IRS' approach for achieving its electronic tax administration goals.
- An increase of 19 percent in electronic filing during the 1999 tax filing season.
- Initiation of programs in 1999 designed to increase the attractiveness of electronic filing and the development of plans for additional initiatives for 2000 and future years.

I believe the question of most interest to the subcommittee is not whether the IRS has made a good start, but whether it will meet the 80 percent electronic filing goal in 2007. The ETAAC believes the IRS can achieve the goal, but it needs to implement a broader set of initiatives than is currently planned. In fact, the IRS strategic plan, A Strategy for Growth, estimates that the initiatives described in it will result in up to 70 million electronic returns being filed electronically in 2007, far short of the goal. Clearly, although the IRS has made a good start, the broadest possible set of new initiatives must be considered, including those that require legislative action.

Reaching the electronic tax administration goals in 2007 will require a sustained effort throughout the service to implement A Strategy for Growth. Although the IRS has established a separate group responsible for electronic tax administration, the goal of achieving 80 percent electronic filing by 2007 is too sweeping in scope to be achieved by a single group within the IRS. The goal will only be achieved by placing responsibility for achieving these goals on each business unit as well as the ETA group. The plan established in A Strategy for Growth must be an agency-wide priority with application of the necessary resources throughout the agency. Continual progress evaluation and updating of the plan, with input from each of the business units, is essential.

In addition to the 80 percent goal for 2007, the IRS Restructuring and Reform Act of 1998 requires the IRS to plan that, to the extent practicable, all information and tax returns prepared electronically should be filed electronically by the 2003 tax filing season. The ETAAC believes this to be an excellent strategy and an extremely important goal, but achieving this goal requires that paid tax preparers, who almost universally prepare returns using computers, file all their computer-prepared returns electronically by 2003. Achieving this level of acceptance from paid preparers in four years is a very difficult challenge, and requires a paradigm shift in the thinking of many paid preparers. However, this level of acceptance from paid preparers must be achieved by 2007 if the IRS is to reach the 80 percent goal.

Making this paradigm shift a reality requires that paid preparers see electronic filing as a means of making their businesses more efficient and allows them to offer additional services that paper preparers cannot offer. Every return would have to be capable of being received electronically, and signature barriers eliminated. While the IRS is moving to make electronic filing more attractive to paid preparers, the ETAAC believes additional initiatives are needed. The IRS must make electronic filing so attractive to paid preparers that they couldn't be competitive without offering this service to their clients.

A similar reasoning applies to taxpayers who prepare their own returns. If the IRS can capture 95 percent of the paid preparer market in 2007, then it must receive electronically approximately 65 percent of self-prepared returns to meet the 80 percent goal.

The ETAAC has identified in its annual report a number of strategic challenges the IRS faces in seeking to reach its electronic filing goals. The ETAAC has categorized these challenges into the following three groups:

Business challenges

• Creating new processes and incentives for electronic tax administration that deliver value to all taxpayer segments (individuals, small businesses, large corporations, and tax-exempt organizations).

• Developing a strategy that provides strong incentives to all professional tax practitioners to enroll as Electronic Return Originators.

• Convincing taxpayers and professional tax preparers, through communications and marketing, that e-filing should be the filing method of choice.

Internal Management Challenges

• Transitioning to a customer-centric organization providing taxpayers with customer-segmented, tailored, and responsive products and services while concurrently transitioning to electronic services and systems and maintaining legacy systems that support paper filing.

• Integrating multiple agency-wide strategic plans, including A Strategy for Growth, the Modernization Blueprint, and the organizational modernization plan, into one cohesive business and strategic plan for the Service.

• Ensuring adequate resources are committed to the implementation of electronic tax administration projects and initiatives.

• Holding the executives of each new operating division accountable for achieving the electronic tax administration goals for the taxpayer segment assigned to the division.

Technology Challenges

• Implementing the necessary technology infrastructure to support the IRS electronic tax administration business goals, including security, privacy, database, and communications systems.

• Developing and maintaining the ability to receive electronically all the forms from all types of returns from all filers.

• Developing a scaleable technology architecture that will support the growing volumes associated with achieving the electronic tax administration business goals.

A Strategy for Growth indicates that the IRS must position itself to take full advantage of the public's growing acceptance and use of the Internet. The ETAAC strongly endorses the formulation of an Internet strategy.

The ETAAC believes the IRS has opportunities to expand its business partnerships with professional preparers, large transmitters, software providers, payroll and tax processors, and state taxing agencies, as well as expand its relationship with the taxpaying public and businesses.

The ETAAC recommends the IRS take the following actions to meet its strategic challenges:

• Ensure all initiatives identified in *A Strategy for Growth* are incorporated within overall IRS strategic planning efforts. If the IRS cannot establish an overall strategic plan and planning process quickly, the IRS may not achieve its electronic tax administration goals.

• Apply the necessary resources to accomplish the initiatives described in *A Strategy for Growth* and create and implement an integrated strategic plan.

• Align electronic tax administration customer segments with the four business units now being established by the IRS organizational modernization plan.

• Develop a strategy to encourage every professional tax practitioner to file electronically. Professional tax practitioners include tax attorneys, Certified Public Accountants (CPAs), Enrolled Agents (EAs), and unlicensed tax preparers.

• Implement a strategic management process that is based on continual progress evaluation against established milestones, with provision for identifying new projects and corrective action. Because of the importance of identifying new projects, the ETAAC has assisted the IRS in identifying such a plan.

• Focus IT modernization on electronic transmission of information and engagement of the private sector for solutions rather than improvement of paper processes.

• Make electronic tax administration initiatives a high priority in the IRS IT modernization so they are synchronized with major IRS modernization blueprints rather than competing for attention in later years. It is imperative that IRS electronic tax administration projects be integrated into the IRS modernization blueprint at an early stage.

• Advertise taxpayer and preparer benefits for e-filing more aggressively. Effectively deliver and enhance such benefits to create taxpayer awareness and trust in e-filing.

• Continue to assign authentication, security, and privacy initiatives a high priority and continue to move forward quickly in this area. The 1999 tax filing season PIN and digital signature projects are major steps forward.

• Use *A Strategy for Growth* to articulate how partnerships with the private sector and governmental partners, such as states, can be facilitated and supported.

The ETAAC believes that Congress can assist IRS meet its electronic filing goals. Congress can do this by maintaining high visibility on these goals in its oversight efforts, evaluating new legislative action where recommended by the IRS or the ETAAC, and by appropriating the necessary funds for electronic tax administration and related technology infrastructure initiatives.

That concludes my testimony. I will be glad to answer any questions you may have.

ETAAC Members

Name	Title
Fran Bartlett	President & CEO, Federal Liaison Services, Inc.
Michael P. Boyle	Chief Tax Counsel & General Auditor, Microsoft Corp.
Margaret Drescher	National Advisor, Chair National Technology Committee, AARP.
Keith T. Dusenbery	Professor of Accounting and Information Systems, Johnson State College.
Edward B. Feinstein	AVP, Electronic Commerce, H&R Block Tax Services.
Connie L. Grimes	President, Grimes Income Tax, Inc.
Mary B. Harris	Jackson Hewitt Tax Service, franchise owner in Arkansas
Yvonne D. Kirkendall	Co-owner, W. R. Kirkendall, EA.
Charles A. Lacijan	Sr. Technical Advisor, The Implementation Group.
Frank L. Lanza	Director, Processing Services, California Franchise Tax Board.
Robert O. Lewis	President, Tax Back, Inc.
Susan W. Martin	Professor of Accounting & Taxation, Grand Valley State University.
Issac A. Nooe, III	Administrator, Information Resources Management Division, South Carolina DOR.
Bette Rice	Director, Enterprise Technology Services, Merrill Lynch.
Elizabeth M. Seymour	Vice President, Wachovia Bank, N.A.
William C. Shepard	VP & General Manager, Professional Products Group, Intuit, Inc.
John A. Stauffer	Sr. VP of Product Planning, Ceridian Corporation/ Ceridian Tax Service.

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Mr. HOUGHTON. Thank you very much, Mr. Lacijan.

Mr. Coyne.

Mr. COYNE. How are you?

Mr. LACIJAN. Good morning, it's a pleasure to see you again, sir.

Mr. COYNE. One of the major IRS reforms involves elimination of the barriers to electronic filing to be sure. Which barriers to expanding that base still exist and still need to be eliminated?

Mr. LACIJAN. I think there are several. When I think of barriers, I like to think of individual segments of the taxpayer population and think of barriers that might exist for different segments. So over 50 percent of tax returns are done by paid preparers. So let me address that first.

Several things still impede paid preparers. First, one of the biggest complaints they have is that the IRS doesn't accept electronically all forms and all schedules. The IRS counterpoint to that is that, the volumes we don't accept are very low. However, the pre-

parers, I think, come back with the argument that, well, we're running a business, we want to have a single method of doing tax filing in our office. We want a single pipeline.

So we don't want to, in the middle of a busy tax filing season, have to make a lot of decisions about, we can file this electronically, we can't file electronically. They would like a single way to do it so they can streamline their businesses and make them more efficient.

Another barrier is the signature. IRS paperless, electronic filing has not been entirely paperless in the past. There's form 8453, a signature form, which still must be mailed in. A barrier that this presents to taxpayers, or tax preparers, a taxpayer will come in early in the season, drop off all his records, and the tax preparer will take those records, fill out the taxpayer's return, normally using a computer. Then he would take the paper, if it's a paper return, he would send it to the taxpayer, and say, "If you approve this, sign it and mail it in." So the taxpayer, the client, only makes one visit to the office.

With electronic filing, the taxpayer has to make a second visit to the office to sign the return and have the spouse sign the return. So it takes up more time for the preparer, especially in the middle of tax filing season. So they would much prefer to have a one visit model instead of a two visit model.

So I think those are a few of the barriers. It does cost them extra money, because they have to pay their external transmitters to file electronically. That would be another example.

Let me shift to another taxpayer segment where I still think we have a problem. One of the advantages of electronic filing is that if you're a refund taxpayer, you get your refund in 2 weeks instead of 6 weeks. So you have an acceleration of funds by 4 weeks.

If you're a balance due taxpayer, which constitutes about 30 percent of the tax-paying public, you don't have the advantage of a rapid refund. In fact, filing electronically actually separates you from your money more quickly than if you were paying by check. There's always been a lot of concern that electronic filing does not present to the balance due taxpayer the advantages that it presents to the refund taxpayer.

Mr. COYNE. At the bottom of page 2 in your testimony, you say clearly, although the IRS has made a good start with electronic filing, the broadest possible set of new initiatives must be considered.

Mr. LACIJAN. Yes.

Mr. COYNE. Including those that require legislative action. Would you just touch on a few that you think require legislative action?

Mr. LACIJAN. Certainly. Let me give a few examples. It depends on how far out of the box you want to think. But basically, things that have been brought up in the past would be tax credits filing electronically. This could be an expensive item. If you gave people a $5 tax credit for filing electronically, 100 million returns end up costing you a half a billion dollars.

On the other hand, if you think of it as a reduction of taxes for people who help their government by filing electronically, maybe in that perspective it's not so expensive.

The IRS Restructuring Commission actually recommended due date extensions for electronic filing. Really that would require legislative action.

Likewise, instead of a due date extension, if there was a warehousing of payments so if people who filed and paid electronically would at least get the same type of float that paper filers do, that would require a legislative extension, legislative action. And if we wanted to introduce new legislation, or to change the signature requirement around to allow IRS to waive the signature requirement, that actually has been done in the IRS Restructuring Act, but apparently the IRS has not taken advantage of that. It's possible that even more legislative action could be taken in that area.

Mr. COYNE. Thank you very much.

Mr. HOUGHTON. Thank you. Mr. Portman.

Mr. PORTMAN. Mr. Lacijan, thank you for your service as Chair of this important Committee and your ongoing interest in the IRS. I thought you might have had enough after being on the commission staff, and working at this diligently for about a year and a half. But apparently you haven't, and I'm very happy that you continue to focus on this so much and spend so much of your time on it.

There's nobody I know of who has a better grasp of this and has a more objective approach to it. So we are lucky to have you, we being the taxpayers of the United States.

As you know, I feel that we could have done more in the legislation, and I wish the IRS were doing more even with what we did legislate in this area. I don't want to get into a lot of issues where we can't make progress this morning. But if you could just briefly tell us what your recommendation would be, either personally or representing the Committee in your role as Chairman, with regard to time extensions.

As you know, I believe that is something that could provide an incentive to electronic filers. The 80 percent goal is going to be tough to reach. I think by having a 19-percent increase in electronic filing, we have made a first good step. But every additional percentage beyond that 19 percent is going to be harder and harder to achieve, I would think.

And finally, to get that marginal increase at the end is going to be, I would imagine, tougher than any of us had anticipated. So if you could comment briefly on whether you think that's a specific issue where we could make some progress through legislation and the IRS implementation.

Mr. LACIJAN. I think there are several issues surrounding this. We did some analysis during the Restructuring Commission, which you may recall, looking at when people file. Basically, there's a group of refund taxpayers who tend to file early, February, March, because they want to get their refund quickly. Electronic filing is very appealing to this group.

There's also a group of balance due taxpayers who tend to wait until the very end, April 15. They put their check in the mail along with their return, and because of the flood of, there's virtually 20 million returns that come in the last week. So their return and their check goes up to the local service center. It might sit in a van for a couple of days, it gets opened eventually. By the time the IRS

gets around to cashing that check, it probably doesn't hit their account until maybe the 1st of May.

So people want to take advantage of that float.

Mr. PORTMAN. That's the warehousing of tax payments you talked about earlier.

Mr. LACIJAN. People who file on paper get an automatic warehousing of 2 weeks, because it's literally in the truck or in the service center and doesn't hit their accounts. Then you have a third group of people who I would call the procrastinators, who are probably the best example of this. I once saw a cartoon during the Restructuring Commission, it showed this harried executive getting on a plane. And it says, Harry is flying to the West Coast so he can have three more hours to file his tax return.

So we have about 10 million refund taxpayers who also file during the last week of April, which doesn't make economic sense, but it's somewhat human nature that people put things off. So if you look at especially those last two groups, these are people who would like to take the extra time, the balance due people obviously have a rational reason for filing late, because they want to get another extension, and the procrastinators, clearly, they're just too harried.

One of the things we find is, if you talk to paid preparers, they are responding to their clients' needs. If clients would come to their preparers and say, look, we don't want to file until the 30th, we'll gladly file electronically just to get that extra 2 weeks, I think there would be a lot of demand that would enter from the client side of the preparer segment saying, we want to file electronically just to take advantage of those 2 weeks.

Now, I would like to address the economic issues associated with that for a second. Because if you do, if you allow either a time extension of two or 4 weeks, which is what the Commission recommended, for the balance due taxpayers, you would lose two to 4 weeks of float, of that money. However, if you consider the equivalent for paper, they're already getting 2 weeks of float, so the IRS actually is incentivizing them in a way to stay in paper.

Also, we have already accelerated the refunds for 70 percent of taxpayers by cutting down their refund from 6 weeks to 2 weeks. So no one has really ever costed that out in terms of the extra service we're giving taxpayers. I say we should at least give balance due taxpayers the same type of break we're giving the refund taxpayers.

Mr. PORTMAN. But the other point you made, of course, was the net cost to the Federal Government would probably be lower, based on the analysis that you and others did at the Commission, because of the savings to the government of not having all those costs, overhead, labor costs and so on, and error costs that are incurred in paper returns as opposed to electronic filing.

Mr. LACIJAN. That is correct. Also, if people file electronically and they pay electronically, that does reduce a lot of the processing costs associated with the payment as well, not just the filing.

Mr. PORTMAN. Well, I hope that as you try to reach your goal of 80 percent, you will continue to encourage us, nip at our heels here in Congress, try to get us to move forward with new initiatives to

meet what is a very ambitious but very important goal for the taxpayer. Thanks, Chuck.

Mr. LACIJAN. One thing I've discovered during the ETAAC meetings is that our members are definitely not bashful.

Mr. HOUGHTON. Thank you very much. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman. Mr. Lacijan, welcome. Earlier this morning I had the opportunity to address a group of Washington interns. I had one bright, energetic young fellow who actually is doing an internship right now with the Internal Revenue Service.

During the question and answer session, we talked about electronic filing. He posed the hypothetical that maybe we should provide some financial incentive to taxpayers, through a tax deduction or tax credit. I think he's got a bright future on the Ways and Means Committee ahead of him. I think he's from your district, Mr. Portman, so you may want to inquire.

Earlier this Committee had a hearing on simplification, and it was on the Chairman's idea. I had a constituent who was sitting where you are, a tax practitioner. The essence of his testimony was that taxpayers really don't have an intimate knowledge of their financial affairs, and thus, many more paid preparers are being brought into the loop.

What can the Service do, the IRS do, to make it more attractive for paid preparers? I notice on Table 1, Page 3, that there is an increase, at least a projected increase and an actual change of positive increase as far as practitioners. But what can be done to encourage paid preparers to utilize electronic filing?

Mr. LACIJAN. I think ultimately to attract paid preparers, and I really believe that if we're going to reach the goal in 2007, the IRS needs virtually every paid preparer to file electronically. That's a big hurdle to overcome. But I think that's actually what it's going to take.

What that means is the IRS will have to make it so attractive to paid preparers that it really provides them such a competitive edge over the paper preparer that there's no choice, they have to do it.

Now, let me talk about some of the things that might motivate that. And I think that some recent research has indicated, it's not necessarily just money. It wouldn't necessarily be reimbursing the paid preparer like $2 or $3 per every electronically filed return they sent in. It has more to do possibly with services they could offer their clients that paper preparers could not.

Some of the things that have been considered here are electronic power of attorney. If paid preparers could have electronic power of attorney, they could intercept some of the notices or deal with IRS directly on their client's behalf much more easily. That would be very attractive to paid preparers.

Another item might be access to account information. If paid preparers with the appropriate power of attorney could actually access an IRS account for their clients, and this is especially true in the business world, because you know, as individuals we pay once a year and we file, but businesses pay many more taxes, withholding, they have 941s, 942s, their own corporate tax. So if they could,

sometimes things are more likely to go awry in terms of payments being misapplied over different periods.

So if a tax preparer could actually access the client's account electronically on his own and find out where his client stood, I think that would be another very attractive service for tax preparers. We can't know too much about how the tax preparers do their businesses and what makes their businesses more efficient. Those are the types of things, I think, that would make it far more attractive.

Let me touch on one other item. The IRS calls this third party rules. But right now, there are a number of different types of preparers. One would be a circular 230 preparer. These are tax professionals, they are either accountants, CPAs, they're lawyers or they're enrolled agents. They have licenses, they have standards of conduct, they have what they call continuing professional education, or CPE, requirements. They are regulated, CPAs and lawyers, they all have a different way of getting their license, but they're all basically regulated.

Then we have a process called electronic return originator. These are people who have been licensed or approved by the IRS to file electronically. They also have an application and approval process they go through.

Then there's another group, people who just file on paper. That could be virtually anybody. I could go home and hang out a shingle, as could you when you retire, and offer tax preparer services. These people don't go through the suitability checks that EROs go through or the licensing checks that the circular 230 preparers go through.

So one of the concerns of ETAAC, and this is mentioned in our report, is that the IRS is sending out a clear, but somewhat unintentional message, that if you really want to avoid standards, stick to the world of paper. We think this is something that deserves some scrutiny. It's been pointed out to me that it takes 1,000 hours of training before someone is license as a barber. But yet we allow anybody to do tax returns.

No one has suffered financially that I'm aware from a bad haircut. Yet anybody can do a tax return.

Mr. HULSHOF. Thank you, Mr. Lacijan. Thank you, Mr. Chairman.

Mr. HOUGHTON. Thank you very much. Thanks, Mr. Lacijan, certainly appreciate your testimony. It's wonderful to have you here.

Mr. LACIJAN. It's a pleasure to be here.

Mr. HOUGHTON. All right, thank you.

Now we're going to hear from Mr. James R. White, Director of Tax Policy and Administration Issues in the General government Division of the U.S. General Accounting Office.

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

Mr. WHITE. Mr. Chairman and Members of the Subcommittee, I'm very pleased to be here today on the anniversary of the IRS Restructuring and Reform Act to discuss management challenges that IRS faces as it modernizes. Accompanying me is Randy Hite, Associate Director responsible for our work on IRS' information systems.

In passing the Restructuring Act, Congress signaled its strong concern that IRS had been over-emphasizing revenue production at the expense of service and fairness to taxpayers. In that spirit, Commissioner Rossotti has provided a compelling vision of a new IRS, one that provides top quality service to taxpayers.

The Commissioner has more than a vision, however. In addition to a new mission statement and strategic goals, he has outlined and begun to implement a modernization strategy that includes reorganizing IRS, new business practices, new accountability, new performance measures and new technology. If successfully implemented the modernization strategy could fundamentally change IRS' culture to one that embraces taxpayer service as a core value.

Given the magnitude of what is planned, it should surprise no one that IRS, an agency with a long history of stovepipe management and a culture driven by enforcement statistics, will be challenged to accomplish its ambitious agenda. Three areas of challenge stand out.

First, implementing such a comprehensive strategy while continuing the business of day to day tax administration will push IRS managers and staff to their limits. While challenging, we agree with the Commissioner that a comprehensive approach is proper. Simply reorganizing IRS, for example, without concurrent changes to work process and information systems, will do little to improve the quality of service to taxpayers.

Second, if it is to deliver better service, IRS must deal with several challenges in how it develops and manages its human capital. For example, performance measures can create strong incentives to change behavior. But IRS has yet to develop one of its measures of organizational performance, the taxpayer compliance rate. Without this, IRS has said that:

> Informed decisions on strategies to encourage voluntary compliance . . . will be impossible, and the historic tendency to fall back on enforcement revenue as a measure of performance may reoccur.

Another human capital challenge involves IRS' employee evaluation system. In ongoing work for this Subcommittee, we found that the current evaluation system does not support the new IRS mission, and some IRS managers seem confused about the distinction between good customer relations and revenue collection. For example, one manager in commenting favorably on an employee's customer relations skills wrote, "The agent always seeks to obtain full payment of the deficiency, penalties and interest."

While collecting outstanding tax liabilities is important, this is not what is meant by customer relations. It may be years before IRS has a new evaluation system fully in place. Fortunately, our ongoing work also shows there are opportunities in the interim to better utilize the existing evaluation system to support improved taxpayer service.

One more human capital challenge is ensuring that IRS managers from frontline supervisors through the senior executive corps have the skills they need to lead and manage the new IRS. Our work has shown that basic management tools are not always routinely used. To illustrate, when we reviewed 19 of IRS' customer service improvement initiatives that had progressed beyond the planning phase, we found many were missing basic management information such as completion dates and performance measures. To their credit, IRS executives have been responsive to our findings. But we believe generating and using such basic management information needs to become routine.

The third area of challenge I want to discuss is information systems modernization. The challenges include completing the modernization blueprint, establishing the capability to build and acquire modern systems, and investing in small, low-risk increments. The key to effectively addressing these challenges is to ensure that longstanding modernization management and technical weaknesses are corrected before IRS invests large sums of modernization funds.

There is some good news. Last month we reported that IRS has initiated appropriate first steps to address these weaknesses. While IRS is on the right track, these first steps will not fully implement our past recommendations or eliminate systems modernization weaknesses. IRS leadership says it understands and is committed to fully implementing our recommendations.

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

[The prepared statement follows:]

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

Mr. Chairman and Members of the Subcommittee: I am pleased to be here today on the 1-year anniversary of the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (Restructuring Act)[1] to discuss management challenges that IRS faces in modernizing its organization and reforming its culture. As my testimony underscores, the challenges that the agency faces in implementing these reforms are no less significant than the value of the improvements that could be achieved.

Depending on the outcome of IRS' efforts, enactment of the Restructuring Act may prove to be a significant turning point in the history of IRS. Its passage signaled Congress' strong concern that IRS had been overemphasizing revenue production and compliance at the expense of fairness and service to taxpayers. It also mandated changes to improve the situation. Among other things, the Restructuring Act required IRS to (1) adopt a new mission statement to place greater importance on serving the public and meeting taxpayer needs, (2) develop and implement a reorganization plan to include the establishment of new operating units serving particular groups of taxpayers having similar needs, (3) conduct training programs to ensure that managers and frontline employees are schooled in the importance of customer service and have the skills to provide it, and (4) carry out numerous specific actions to enhance taxpayers' rights.

Commissioner Rossotti has embraced the spirit of the Restructuring Act and provided a compelling vision of what he wants IRS to become—a fully modernized agency providing top-quality service to taxpayers. The Commissioner has more than

[1] P.L. 105–206 (July 22, 1998).

a vision, however. In addition to a new mission statement and supporting strategic goals,[2] he has also outlined and begun to implement a modernization strategy that includes five interdependent components—what IRS has dubbed its "five levers of change." The five components are (1) revamped business practices, (2) organizational restructuring, (3) management roles with clear responsibility, (4) balanced measures of performance, and (5) new technology. If successfully implemented, the modernization strategy could fundamentally change IRS' culture to one that embraces customer service as a core organizational value.

Given the reforms that are planned, it should surprise no one that IRS—an agency with a long history of stovepipe management and a culture driven by enforcement statistics—will be challenged to accomplish so ambitious an agenda. IRS has a poor track record for implementation, and many of its past efforts would be considered modest in comparison to the current modernization.

My statement today is based on our past work and our ongoing reviews of IRS' reorganization process, its performance management system, and systems modernization efforts. My statement makes the following points.

• We agree with the Commissioner that the various components of IRS' modernization must be implemented in an integrated fashion. Simply restructuring the organization, for example, without concurrent revisions to work processes and related information systems, will do little to improve the quality of service being provided to taxpayers. However, successfully implementing such a comprehensive modernization strategy, while continuing the business of day-to-day tax administration, will push IRS managers and staff to their limits. Particularly important will be the capacity of middle managers to lead and manage comprehensive change.

• No matter how much IRS changes its organization, work processes, and information systems, its ability to fundamentally change the way it interacts with taxpayers hinges on its ability to ensure that employees demonstrate the desired attitudes and behaviors. A results-oriented approach to managing human capital has the potential to deliver such a result. To fully realize this potential, IRS must finish developing key organizational performance measures, deal with an employee evaluation process that is not currently aligned with IRS' new mission, and develop and deliver a comprehensive training program for both frontline staff and middle managers.

• IRS continues to face formidable system modernization challenges. They include (1) completing the modernization blueprint that IRS issued in May 1997 to define, direct, and control future modernization efforts; (2) establishing the management and engineering capability to build and acquire modernized systems; and (3) investing in small, low-risk, cost-effective modernization increments. The key to effectively addressing these challenges is to ensure that long-standing modernization management and technical weaknesses are corrected before IRS invests large sums of modernization funds. IRS recently initiated appropriate first steps to address these weaknesses via its initial modernization expenditure plan that represents the first step in a long-term, multi-increment modernization.

ABILITY TO MANAGE AND INTEGRATE THE INTERDEPENDENT CHANGE EFFORTS IS CRITICAL TO IRS' SUCCESS

One great strength of IRS' modernization strategy is its comprehensive approach to change. If implemented in an integrated manner, the five levers of change can fundamentally alter the way IRS interacts with taxpayers. However, this comprehensive approach also presents a major challenge for IRS. Effectively implementing such a broad and complex set of interdependent changes will strain IRS managers and staff. Having to do so while continuing to operate the existing tax administration process will strain them even further.

The Commissioner believes, and we agree, that to effect real change, IRS must address all five components of its change strategy concurrently because the components are interdependent. Simply restructuring IRS, without concurrent changes in processes for interacting with taxpayers and in the measures that are used to assess those interactions, will have little impact on service to taxpayers. Similarly, it makes little sense to design new work processes without providing employees with the tools they need to effectively implement the new processes. For example, IRS cannot provide top-quality service to taxpayers who have questions about their ac-

[2] IRS' new mission statement reads, "Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all." IRS' supporting strategic goals are to (1) provide top quality service to each taxpayer, (2) provide service to all taxpayers by applying the law with integrity and fairness, and (3) increase productivity by providing a quality work environment for its employees.

counts unless employees can quickly access a modern information system that contains accurate and up-to-date information on taxpayers' accounts.

Undertaking all of the work associated with business and systems modernization while continuing to process returns, maintain taxpayer accounts, and enforce the tax law will push IRS managers and staff to their limits. Accordingly, the Commissioner and his senior executives are attempting, among other things, to set priorities and adjust time frames. For example, in light of the provision in the Restructuring Act that specified a goal of having 80 percent of all returns filed electronically by 2007, the Commissioner adjusted the sequencing of information system development efforts by accelerating electronic filing elements.

For IRS modernization to succeed, however, middle managers will also have to play a role. Because of the magnitude of the proposed changes, these managers will have to take responsibility for developing many of the details of change initiatives and pushing the initiatives down through the organization. Particularly important is the capacity of middle managers to lead and manage comprehensive change. I will talk more about management capacity later.

IRS will also have tough choices to make in balancing "stay-in-business" needs with long-term improvements. For example, IRS will have to evaluate the trade-offs between changing existing information systems to support or enhance current operations and waiting for the new business processes and systems to be rolled out.

Based on over a decade of work, we believe that a results-oriented, performance-based approach to management can provide IRS with the tools it needs to meet the formidable challenges inherent in its comprehensive approach to change. We are heartened by the fact that the modernization strategy outlined by the Commissioner is consistent with such an approach. As noted earlier, reorganizing IRS alone will not fundamentally change the way IRS interacts with taxpayers. Indeed, our case studies of leading organizations using performance and accountability management principles found that the organizations had varied structures, but similar results-oriented management strategies.[3] By integrating results-oriented management into the day-to-day activities and culture of the organization and holding managers accountable for doing the same, IRS can help avoid the danger of its reforms becoming hollow, paper-filled exercises. Among other things, results-oriented management includes (1) building, maintaining, and marshaling the knowledge, skills, and abilities of employees (i.e., human capital) and (2) developing and effectively using information systems to achieve program results. As discussed in the next two sections, results-oriented management of its resources, both human capital and information systems, poses significant challenges for IRS.

MANAGING FOR PERFORMANCE POSES SIGNIFICANT HUMAN CAPITAL CHALLENGES

New business processes, organizational structure, and technology—alone or together—will not significantly improve service to taxpayers without corresponding improvements in how IRS manages and develops its human capital. A results-oriented approach to managing human capital—an approach that aligns employee performance management and training with IRS' new mission statement, strategic goals, and performance measures—has the potential to deliver such improvements. However, to realize the potential, IRS needs to overcome three challenges. First, a key organizational performance measure, the rate of taxpayer compliance with the tax laws, has not been developed. Second, a new employee appraisal system aligned with the organizational measures is years away from complete implementation. And third, training that addresses the needs of different employee groups, such as middle managers, has not been developed.

Performance Measures

Performance measures can create powerful incentives to achieve the cultural and behavioral changes that will be needed for IRS to effectively perform its new mission. IRS has begun implementing a new set of organizational performance measures that are to balance customer satisfaction, employee satisfaction, and business results. However, some measures have yet to be developed.

Developing a business results measure of taxpayer compliance[4] that can be balanced with customer satisfaction will be particularly important. As IRS has stated,

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[3] Numerous reports in recent years have discussed results-oriented management principles and implementation of the Government Performance and Results Act (P.L.103–62) by federal agencies. A major report addressing these issues was *Effectively Implementing the Government Performance and Results Act* (GAO/GGD–96–118, June 1996).

[4] Taxpayer compliance is the extent to which taxpayers file required returns, correctly determine their tax liability, and pay the taxes they owe.

in the absence of such compliance measures, "informed decisions on strategies to encourage voluntary compliance . . . will be impossible, and the historic tendency to fall back on enforcement revenue as a measure of performance may reoccur."[5] In a hearing held by this Subcommittee almost 2 years ago, we highlighted our concerns about overreliance on enforcement revenue as a measure of performance.[6] We concluded that such overreliance could create undesirable incentives for IRS auditors to recommend taxes that would be unlikely to withstand a taxpayer challenge, imposing an unfair and unnecessary burden on some taxpayers.

In the past, IRS measured compliance through its Taxpayer Compliance Measurement Program (TCMP). Studies done under that program involved detailed audits of a statistically valid sample of tax returns. IRS discontinued these studies because of concerns about the additional burden placed on the taxpayers who were the subjects of the detailed audits. Since then, IRS has not identified a viable substitute for TCMP studies to assess overall compliance.

Without a measure of taxpayer compliance, IRS cannot balance business results with customer satisfaction. Further, taxpayer compliance studies have been used to help IRS target audits on the most noncompliant taxpayers. Consequently, the lack of current compliance data could actually decrease service to taxpayers. IRS is concerned that increasingly out-of-date information on compliance will result in more and more compliant taxpayers being hit with unnecessary audits. For both these reasons, we believe that IRS needs a strategy for ensuring the availability of statistically valid compliance data, while limiting the burden that collecting such data imposes on taxpayers.

Employee Evaluation Process

Because IRS' current employee evaluation process is not aligned with its new mission and does not support the culture that IRS hopes to create, it must be revised. Last year, we reported that 75 percent of IRS' revenue agents, tax auditors, and revenue officers believed that tax enforcement results affected their evaluations—despite an IRS policy prohibiting the use of such results in evaluating employee performance.[7] Our ongoing review of the two most recent evaluations received by these employees bears out such perceptions. In examining a random sample of their evaluations, we found a strong emphasis on compliance compared to customer service. Moreover, when supervisors made comments on customer service, they sometimes seemed to equate good customer relations with success in obtaining full payment in every case. To illustrate, when discussing customer relations skills, one manager wrote in an employee's evaluation:

> Over the last year, the Service is emphasizing that payments be obtained at the conclusion of the examination. It can truly be said that the agent has kept to this philosophy. The agent always seeks to obtain full payment of the deficiency, penalties, and interest. This shows a strong commitment to the Service programs.

IRS says that it recognizes the problems with the current evaluation process and the important role that employees will have in modernizing the agency. IRS expects to change the evaluation process when it revamps its entire performance management system.

Although IRS is on the right track, it will be years before a new evaluation process is fully operational. IRS cannot afford to wait that long. It is frontline employees—not their supervisors or other IRS managers—who have the most direct and potentially confrontational interactions with taxpayers. Continued reliance on an evaluation process that fails to adequately balance service to taxpayers with compliance potentially could undermine the success of the entire modernization effort. Although organizational structure and systems are important, it is the attitudes and behaviors of employees that will ultimately affect taxpayers.

Fortunately, there are opportunities for reinforcing the importance of serving taxpayers within the current evaluation process. During our ongoing review of the existing evaluation process, we identified several features, such as narrative comments and field visits, that supervisors do not use systematically when evaluating their employees. These features could be used to greater advantage to reinforce the importance of customer service among enforcement employees. For example, the narrative portion of an employee's written evaluation provides supervisors with an

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[5] *Modernizing America's Tax Agency* (IRS Publication 3349, Feb. 1999, pp. 44–45).

[6] *Tax Administration: Taxpayer Rights and Burdens During Audits of Their Tax Returns* (GAO/T–GGD–97–186, Sept. 26, 1997).

[7] *IRS Personnel Administration: Use of Enforcement Statistics in Employee Evaluations* (GAO/GGD–99–11, Nov. 30, 1998).

opportunity to focus on employees' customer service skills and contributions. Also, field visits that are to be conducted as part of the employee evaluation process could provide excellent vehicles for supervisors to directly observe employee-taxpayer interactions and to provide coaching and feedback to employees.

Training

Training has proven to be an important tool for agencies that want to change their cultures. To have this kind of impact, IRS' training will have to be comprehensive both in its subject matter and in who receives it. Training will need to (1) cover the new organizational structure, new business processes, and new information systems; (2) cover performance measures and the use of such measures to manage IRS; (3) be provided to all employees from frontline staff to senior managers; and (4) be aligned with the performance management system and new mission. For training to have real impact, it will have to be continuously reinforced in the day-to-day work environment. IRS is still defining its modernization-related training requirements and assessing its ability to deliver those requirements, but the plans we've seen thus far address all four of the issues outlined above. However, implementing all of this will be neither cheap nor easy.

After reorganization, most frontline employees and their immediate supervisors are to be in the same or similar jobs. Job-specific training will be important, however, because IRS is beginning to implement significant changes to its organization, processes, and information systems. For example, in lieu of hiring a large number of seasonal employees to handle the return processing workload during the annual filing season, IRS plans to increase the number of permanent employees and expand their job responsibilities to include compliance work that they can do after the filing season. Those employees will have to be cross-trained so that they can handle both their return processing and compliance responsibilities. Other employees who will have to be cross-trained to handle the responsibilities envisioned by IRS' plans include (1) managers who are to supervise groups that include persons doing audit work and persons doing collection work and (2) employees, referred to as "tax resolution representatives," who are to provide an array of services, including certain audit and collection services, to taxpayers visiting IRS walk-in sites. This kind of cross-functional expertise is consistent with IRS' efforts to provide top-quality customer service. It remains to be seen whether employees can effectively fill these kinds of cross-functional roles, but it is clear that training will be a critical factor in their success. Another factor will be the way training is reinforced outside the classroom, for example, by supervisors acting as role models.

As I mentioned earlier, the changes envisioned at IRS are so comprehensive that the agency's top leadership cannot work below a very strategic level. Fundamentally changing the way IRS interacts with taxpayers depends on the capacity of lower-level managers, from frontline supervisors up through the senior executive service, to do the detailed planning, leading, and managing necessary for successful IRS modernization. These lower level managers must be skilled in planning, performance measurement, and the use of performance information in decision-making. Our work has shown that ensuring that IRS has the capacity it needs in this area will be a challenge.

For example, in January 1998, IRS established a central Taxpayer Service and Treatment Improvement Program to oversee implementation of numerous customer service improvement initiatives that were on the books at that time. By January 1999, IRS had set priorities and assigned accountability for their completion to specific executives. However, when we reviewed 19 of the initiatives that had progressed past the planning and design phase, we found that many were missing basic management information such as completion dates and performance measures.[8] Such basic management information should allow IRS to track progress toward goals and provide a better basis for organizational and management decisions.

To their credit, IRS executives have been responsive to our findings and now have draft guidance for implementing our recommendations. Our point today is that such guidance should not have been necessary. Generating and using basic management information needs to become routine for all levels of IRS management.

IRS Continues to Face Formidable Systems Modernization Challenges

The challenges that IRS faces in modernizing its tax systems are significant, and the stakes are high. IRS' well-publicized, failed prior attempts to leverage information technology in administering our nation's tax laws serve as an alert to the sig-

[8] *IRS Customer Service: Management Strategy Shows Promise But Could be Improved* (GAO/GGD–99–88, May 5, 1999).

nificant challenges that lie ahead. The key to effectively addressing these challenges is to ensure that long-standing modernization management and technical weaknesses are rectified before IRS begins investing large sums of money.

In 1995, we reported on the weaknesses that were the root causes of IRS' past modernization problems, recommended ways to correct them,[9] and designated the modernization as a high-risk or "challenged" federal program.[10] Since then, we have reviewed IRS' actions to address our recommendations and strengthen its modernization capability, such as the development of a modernization blueprint in May 1997, and we have made additional recommendations in light of IRS' actions.[11]

The good news is that IRS' executive team, under the direction of the Commissioner and Chief Information Officer, have initiated appropriate first steps to begin addressing system modernization management and technical weaknesses. Last month, we reported on IRS' initial modernization expenditure plan.[12] We concluded that the initiatives defined in the plan were consistent with our past recommendations for establishing effective modernization management and engineering capabilities and incrementally acquiring architecturally sound system solutions to satisfy validated business needs. Additionally, we found that the plan satisfied legislated conditions for systems modernization.

The initial expenditure plan defines modernization initiatives for a 5-month period ending in October 1999 and thus represents the first incremental step in a long-term, multi-increment modernization process. Once implemented, this initial expenditure plan alone will neither fully implement our past recommendations nor eliminate the systems modernization weaknesses and challenges that our recommendations are intended to effectively mitigate. IRS leadership says that it understands this and is committed to fully implementing our recommendations and effectively addressing the many challenges that lie ahead.

Our recommendations and the challenges still confronting IRS fall into the following three groups, each of which is discussed below: (1) completing the modernization blueprint; (2) establishing project management and system/software engineering capability; and (3) investing in small, low-risk, cost-effective modernization increments. Until our recommendations are fully implemented, we will continue to designate IRS' tax systems modernization as a high-risk and "challenged" federal program.

Completing the Modernization Blueprint

In response to our 1995 recommendations,[13] IRS issued, in May 1997, its modernization blueprint, including about 3,600 high-level business requirements, a target enterprise systems architecture that described in general terms the future systems environment needed to satisfy the business requirements, and a general sequencing plan for transitioning from IRS' current systems environment to its future systems environment. In September 1997 congressional briefings and in a subsequent report,[14] we concluded that the blueprint provided a solid foundation from which to define the level of detail and precision needed to effectively and efficiently build a modernized system of interrelated systems. At the same time, we noted that the blueprint was not yet complete and did not provide enough detail for building or acquiring architecturally compliant systems. Additionally, because the blueprint was developed before the Restructuring Act and the Commissioner's organizational modernization, we reported in January 1999 that the blueprint needed to be validated in light of these organizational and business process changes.

IRS has acknowledged these limitations and plans to complete the blueprint. In fact, its initial expenditure plan defines initiatives intended to validate business requirements and provide missing architecture precision and detail for ongoing system initiatives. Additionally, the initial expenditure plan provides for a revised modernization sequencing plan as well as the selection of enterprise architectural standards in such areas as data base management, security, communications, user interface, and client and server platforms.

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

[10] *High-Risk Series: An Overview* (GAO/HR–95–1, Feb. 1995).

[11] For example, see *Tax Systems Modernization: Actions Underway But IRS Has Not Yet Corrected Management and Technical Weaknesses* (GAO/AIMD–96–106, June 7, 1996) and *Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems* (GAO/AIMD/GGD–98–54, Feb. 24, 1998).

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

[13] GAO/AIMD–95–156, July 26, 1995.

[14] GAO/AIMD/GGD–98–54, Feb. 24, 1998.

Completing the modernization blueprint poses a formidable challenge for several reasons.

• First, IRS' organizational and business restructuring is ongoing, meaning that both completion of IRS' enterprise systems architecture and revision of its sequencing plan must be closely coupled with and validated against these restructuring efforts. Doing so will not be easy and will require an unprecedented integration of IRS' business and systems organizational cultures. To do less presents the risk that modernized systems will not effectively and efficiently support IRS' core mission needs.

• Second, IRS has a series of enterprise architectural decisions that need to be made before investing in modernized systems, beginning with architectural principles (e.g., Will users be supported regardless of geographic location? Will IRS' existing investment in mainframe technology be preserved?), followed by logical architectural characteristics (e.g., What data structure will facilitate business process reengineering efforts? Should a geographic or a business process "tiered" architecture be adopted?), and culminating in how technology will be physically implemented (e.g., What operating system, hardware platforms, and database management system standard should be used?). The long-term implications of these interrelated enterprise architectural decisions are enormous. If properly made and effectively implemented, these decisions can guide and constrain the architectural makeup of a secure, interoperable, scalable, and maintainable future systems environment. If not, IRS will likely remain mired in its currently inefficient and ineffective stovepiped systems environment.

• Third, IRS must minimize the number of new system development and acquisition projects that it undertakes until it addresses the above key architectural decisions. Otherwise, IRS will be forced to align certain system-unique architectures with its "to-be-completed" enterprise architecture. A case in point is IRS' ongoing Integrated Personnel System project, which is part of a Treasury-wide effort that will use an Oracle database management system running on a UNIX platform.[15] Once IRS' enterprise architectural decisions have been made, IRS will have to integrate this personnel system with its systems developed or acquired according to its enterprise architecture. Depending on the extent of compatibility, this could mean that IRS will have to incur the cost of additional hardware and software associated with integrating the different products.

Developing Project Management and System/Software Engineering Capability

IRS has historically lacked disciplined and structured processes for managing information technology (IT) projects and internally developing software-intensive systems. In 1995, we made recommendations to correct these weaknesses,[16] and, in response, IRS defined (as part of its 1997 blueprint) a systems life cycle framework that described the "cradle-to-grave" processes for managing IT projects and building systems. At the same time, IRS stated its intention to rely more on contractors to build modernized systems, and thus become a system/software acquirer rather than an in-house system/software developer as it had been in the past. To this end, IRS also stated that it planned to "partner with" a Prime Systems Integration Services (PRIME) contractor in the acquisition and integration of modernized systems.

In February 1998, we reported that although the systems life cycle overview provided a reasonable framework, it was not yet complete and did not provide the needed specificity to adequately build modernized systems.[17] For example, IRS did not have detailed process definitions for any of the systems life cycle phases. In addition, organizational roles and authorities had not been adequately specified, making it unclear who does what in each systems life cycle process and phase. We also reported that IRS had not yet defined and implemented the mature software processes, including software acquisition processes, that would be essential for IRS to effectively manage contractors under its strategy for acquiring, rather than developing, software-intensive systems.

IRS has since hired a PRIME contractor, and in association with the PRIME, has initiatives under way that are intended to establish the requisite management and engineering capability needed to effectively modernize its systems. In particular, IRS' initial expenditure plan provides for establishing "enterprise life cycle" or ELC management and engineering processes. ELC is to be an adaptation of the PRIME contractor's commercially available systems life cycle management approach and as-

[15] A UNIX platform consists of UNIX operating system software (originally developed at AT&T's Bell Laboratories and commercially available from various companies) and compatible hardware, which together support the operation of application software.

[16] GAO/AIMD–95–156, July 26, 1995.

[17] GAO/AIMD/GGD–98–54, Feb. 24, 1998.

sociated tools, incorporating needs that are unique to IRS, such as key life cycle decision points. IRS concluded that adapting the PRIME contractor's commercially available methodology to meet IRS' needs would be less costly and faster than completing the systems life cycle contained in its 1997 blueprint. We reviewed the PRIME contractor's commercially available methodology and found that it meets the requirements specified in the blueprint's systems life cycle overview and is consistent with the approaches that successful private and public sector organizations use to manage large IT projects.

In addition, IRS' initial expenditure plan provides for institutionalizing mature software/system acquisition processes. That is, as part of the ELC, IRS intends to define and implement software development and acquisition processes in accordance with Software Engineering Institute capability maturity model requirements.[18] Among this maturity model's requirements are disciplined and rigorous processes, procedures, and practices for effectively acquiring software-intensive systems through the use of contractors, including processes concerning requirements development and management, contractor solicitation and selection, contractor tracking and oversight, and evaluation of contractor delivered products.

Significant challenges still confront IRS in institutionalizing project management and software/system engineering rigor and discipline and thus putting in place the capability needed to effectively modernize. For example, the ELC processes, procedures, practices, handbooks, models, methods, and tools need to be established, which means that the contractor's commercially available methodology must first be tailored to meet IRS' needs. Next, IRS has to implement the ELC on its IT projects, which requires training IRS personnel on how to use and apply the ELC. Further, IRS will need to establish structures and processes to ensure that IT projects comply with the ELC.

Compounding these challenges is IRS' simultaneous need to ensure that it effectively manages the PRIME and other contractors involved in each of the ongoing modernization projects, pending completion and institutionalization of the ELC. For example, we reported in June 1999[19] that IRS had not yet defined the respective roles of the Service and its modernization contractors. Consequently, IRS undertook an effort to develop a Concept of Operations document that defines the roles, responsibilities, authorities, structure, and rules of engagement for the PRIME, IRS, and other IRS support contractors. To ensure that this important task is completed before modernization begins, we recommended in our June report that IRS report on its progress in completing this task in its next modernization expenditure plan.

Incrementally Investing in Modernized Systems

To minimize the risk of IRS investing in systems before our recommendations were fully implemented, we have recommended every year since June 1996 that Congress limit IRS' IT spending to certain cost-effective categories, such as small, low-risk, and cost-effective efforts that can be delivered in a relatively short time frame.[20] In IRS' fiscal year 1997, 1998, and 1999 appropriations, Congress limited IRS' IT spending to efforts consistent with these categories.[21] Such an incremental approach to investing in modernized systems is used by leading public and private sector organizations. In addition, the Clinger-Cohen Act[22] and Office of Management and Budget (OMB) policy[23] endorse this approach to funding large system development investments. Using this approach, organizations take large, complex modernization efforts and break them into projects and subprojects that are narrow in scope and brief in duration.[24] This enables organizations to determine whether a project delivers promised benefits within cost and risk limitations and allows them to correct problems before significant dollars are expended, which in turn mitigates the risk of program failure.[25]

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[18] This model was developed by the Software Engineering Institute at Carnegie Mellon University to evaluate an organization's software development or acquisition capability.

[19] GAO/AIMD/GGD–99–206, June 15, 1999.

[20] GAO/AIMD–96–106, June 7, 1996.

[21] P.L. 104–208, Sept. 30, 1996; P.L. 105–61, Oct. 10, 1997; and P.L. 105–277, Oct. 21, 1998.

[22] P.L. 104–106, Feb. 10, 1996.

[23] *Evaluating Information Technology Investments, A Practical Guide* (Executive Office of the President, OMB, Nov. 1995) and OMB Memorandum M–97–02, *Funding Information Systems Investments* (Oct. 1996), referred to as the "Raines Rules."

[24] *GAO Executive Guide: Improving Mission Performance Through Strategic Information Management and Technology, Learning From Leading Organizations* (GAO/AIMD–94–115, May 1994).

[25] *Assessing Risks and Returns: A Guide for Evaluating Federal Agencies' IT Investment Decision-making* (GAO/AIMD–10.1.13, Feb. 1997).

Consistent with our recommendation for incremental investment, IRS has adopted a modernization investment strategy under which it is to first develop and implement the management and engineering capability to build modernized systems and then incrementally invest in manageable, discrete system initiatives that are to be specified in its revised sequencing plan. IRS' commitment to incremental investment management is the initial step. The real challenge is translating commitment into everyday practice. To do so, IRS must define structures and processes for project selection, control, and evaluation that specify, among other things, who is responsible and accountable for making investment decisions, the criteria that will be used to make decisions, the analysis and information upon which to base decisions, and the tools and methods to be used in performing the analysis and generating the information. IRS will also need to ensure that these structures and processes are institutionalized through training and enforcement.

Central to IRS' incremental investment management strategy will be the need to break large system projects into a sequence of incremental builds that is economically justified on the basis of a compelling business case. Additionally, IRS will need to track and monitor whether each increment is producing promised benefits and meeting cost and schedule baselines and ensure that this information is reliably reported to executive decisionmakers. By doing so, organizations can address variances from expectations incrementally, before significant dollars are expended. To this end, we recommended in our June 1999 report[26] on IRS' initial expenditure plan that IRS fully disclose in future expenditure plans its progress against incremental goals, deliverables, and benefit expectations. As it has with each of our recommendations aimed at mitigating the systems modernization challenges that it faces, IRS has agreed to do so.

In summary, the modernization effort under way at IRS has the potential to deliver improved service to taxpayers. IRS' agenda, though, is both ambitious and high-risk. We have been impressed by the Commissioner's leadership and commitment to change as well as IRS' efforts to date. However, sustainable improvement in service to taxpayers will depend on IRS' managers successfully marshaling the agency's resources, both human and systems, to deal with that challenging agenda.

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

Contact and Acknowledgments

For future contacts regarding this testimony, please contact James R. White at (202) 512–9110. Individuals making key contributions to this testimony included Randolph Hite, David Attianese, Deborah Junod, Gary Mountjoy, Agnes Spruill, and Lorne Dold.

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Mr. PORTMAN [presiding]. Thank you for your testimony.

Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. White, the GAO and in recognizing the GAO's ongoing oversight of the IRS, are there any additional taxpayer rights that this Subcommittee should consider enacting into law?

Mr. WHITE. The work we do at IRS, or much of the work we do, involves looking at IRS controls to protect, among other things, taxpayer rights. And as we do that work, for example, in the audit process at IRS or the collections process at IRS, we do make recommendations about how to improve those controls.

We have ongoing work on the seizures process at IRS, for example. Part of that work was requested by this Subcommittee and in that work, we may be making recommendations about improving those controls.

Mr. COYNE. Does the GAO support the IRS budget as proposed by President Clinton, that is $8.2 billion, and 97,800 employees for the fiscal year 2000?

[26] GAO/AIMD/GGD–99–206, June 15, 1999.

Mr. WHITE. We reported on the budget 3 months ago. At that point, we said that the steps the Commissioner has outlined for modernizing IRS are crucial if there's going to be fundamental change in the way that IRS interacts with taxpayers. At that time what we said about the modernization part of the request was that we didn't have enough detail.

IRS is still very much in a planning stage. They've started implementing, but there's still a lot of planning, a lot of detailed planning that they're doing. So we didn't have a basis for judging whether the specific amount of money was the right amount, too much or too little.

Mr. COYNE. Do you care to comment on the number of employees?

Mr. WHITE. We know that changes in the plan will be difficult to implement, but we're working on it.

Mr. HOUGHTON [presiding]. Mr. Portman.

Mr. PORTMAN. All right, thank you, Mr. White, Mr. Hite. You provide for us a window on the IRS that we simply can't get otherwise. Looking behind you I see a number of members of your staff who have spent a lot of time on this, too. We appreciate the expertise and experience you bring to it.

I have a lot of specific questions about your testimony, but I have one general question for you. And that is whether the General Accounting Office believes that the oversight board that would otherwise be in place under the provisions of the RRA that passed, again, this Subcommittee and the Congress, would be making a difference in terms of the issues you address.

Let me just list some of those issues. The middle management challenges you talk about. The reorganization challenges you talk about, the modernization effort. The issue of compliance, to have some expertise on how do you get at the question of measuring compliance and therefore changing your systems to adjust to that and targeting better employee performance, which is much more along the lines of the private sector with these more qualitative measurements like taxpayer service.

And finally, of course, the information technology challenge. As you know one of the specific expertises looked to for members of the board is information technology. I just wondered if you had any general thoughts on that, Mr. White.

Mr. WHITE. I think the GAO's work supporting the Government Performance and Results Act, for example, showed that the role of external stakeholders is crucial in improving management at all government agencies. I think the oversight board is a way of providing that, is one way of providing external oversight. The oversight that this Committee provides is obviously another very important way to do that.

But the oversight board, the oversight that they would provide, and especially in some of the areas that you mentioned, such as developing performance measures, I think that oversight in an area like that is very important.

Mr. PORTMAN. I appreciate that response. I also understand the importance of GPRA, and I know this Subcommittee would look to the IRS to reference that. This is an important overall Federal Government approach to better management. The oversight board,

as you know, goes well beyond GPRA in terms of providing external stakeholders, because these board members would be, in many senses, like a board of directors having direct responsibility and therefore accountability and also continuity because of the 5-year terms and then finally the expertise we talked about earlier, bringing in information technology, and customer service.

So I appreciate your response, and I agree with you. I think if anything, this would be an interesting model for the rest of government, if we can get it up and going. It would expand what GPRA already provides.

I finally will say that as much as I have respect for this Subcommittee and this Full Committee and our staff, the kind of expertise we're talking about simply doesn't reside in Congress. So we can't play that role. We can play a role. And again, you give us a window on the IRS in other ways in terms of analysis of how they're doing. But we can't, the GAO, nor this Subcommittee, provide what we're looking for.

But I'll get off that and just briefly touch on your issues with regard to the current modernization effort, the effort to reorganize along taxpayer lines, I know two of the heads have now been named and the Commissioner is moving ahead with that. Can you give me what you think they're not doing right, and I think generally speaking, you're inclined to think they are moving in the right direction, but what are some of your concerns about the reorganization?

Mr. WHITE. I don't know if concerns is the right word, but certainly there are challenges facing the reorganization as they go ahead. I think one challenge is developing a complete set of organizational performance measures. What's key to the sort of organization that the Commissioner has planned or that IRS has planned is that it's comprehensive and consistent.

They have a new mission statement, they have strategic level goals, but the measures that they put in place to measure performance need to be consistent with those strategic goals and the mission statement. And finally at the level of individual employees, the evaluation system at that level has to be consistent with the organizational performance measures as well as the mission. That also still has to be put in place.

And as I indicated in my oral statement, there seems to be some confusion on the part of IRS supervisors on what things like customer relations actually means. So it's important that they get this into place.

Mr. PORTMAN. According to the Commissioner this morning, they are moving to implement those, I guess we'd call it, overall organizational standards and performance measurements and so on. Are you satisfied that they understand the concern that you raise and that that's being put in place, or do you think there still is a lack of appreciation for the problem?

Mr. WHITE. They clearly understand the issues. The Commissioner has made these things priorities. He talked about his five levers of change, for example, these are part of his five levers of change. So he's clearly made it a priority.

At the same time, doing this is going to be hard. Developing a measure of taxpayer compliance, for example, is not an easy thing

to do. It's going to take time. Revising the employee evaluation system is going to take time.

We have ongoing work, as I said, that shows there are some steps they can take in the interim with the existing evaluation system to reinforce the shift toward a more service-oriented IRS.

Mr. PORTMAN. For instance, the Commissioner noted that he already has fair and equitable treatment of taxpayers as one of the evaluations that's in everybody's file. So they're doing some things even in the interim basis.

Mr. WHITE. Following up on that also, we've found in our work that the narrative portion of the evaluations, for example, is underutilized. That's an opportunity right now that could be better utilized to reinforce good customer service. Similarly, field visits, to actually watch revenue officers in action as they deal with taxpayers, would be another thing that they could do right now.

Mr. PORTMAN. Thank you, Mr. White. Thanks, Mr. Chairman.

Mr. HOUGHTON. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman.

Mr. White, on page 10 where you discuss in your statement completing the modernization blueprint, and I know in response to GAO's recommendations, I think back in 1995, the IRS began their blueprint, which of course was before the Restructuring Act. But what I want to talk about is, in your statement, you say that the Service's initial modernization efforts is a good step, but that it will not fully correct past modernization weaknesses.

Now, what I want to know is why is that, and especially why is there difficulty in implementing GAO's recommendations in this regard?

Mr. WHITE. Your question is about the information systems at IRS, and I'll let Mr. Hite address that.

Mr. HULSHOF. Mr. Hite, welcome.

Mr. HITE. Thank you.

My point would be that the nature of our recommendations dealing with the modernization were a multi-year series of steps that would have to be taken. For example, definition of a blueprint and implementation of a blueprint is something that's going to occur over many, many years. I think Mr. Rossotti mentioned that organizational modernization is a 10-year endeavor. Modernization of systems is, in fact, something that's going to go along that same time line.

The steps that you take initially in defining blueprint content have been taken. They were actually initiated under the predecessor CIO's blueprint document in 1997. Now, when we looked at that blueprint in terms of the technical architecture and the sequencing plan for moving to that future systems environment that you want to get to, so that you have the information to effectively administer the tax system, that is going to take a number of years.

What Mr. Rossotti has done thus far in terms of his steps is to put together the initial steps to complete some of the missing specificity that is associated with that technical architecture and that sequencing plan and the initial expenditure plan that IRS put forth to the Appropriations Committees in asking for that $35 million over the period ending in October of this year is designed to complete those tasks, so that in fact you have architectural definition

and a strategic business systems plan that shows how you're going to transition over time, many years, to that target systems environment.

Mr. HULSHOF. I appreciate that. Mr. Chairman, that's all I have. Thank you.

Mr. HOUGHTON. Thanks very much.

I'd like to ask you a question. I'm so interested in the people functions here. Are you really saying that the plans and the vision of Mr. Rossotti are good? There are some blips, but they're good, but they just haven't gotten down into the organization?

Mr. WHITE. We are saying that the plans are good. I think the plans are comprehensive, they're consistent. Obviously, implementation is crucial. And in order to implement them, one of the things we're saying is that top leadership, no matter how good it is, and IRS now has very good top leadership, but top leadership alone cannot implement this kind of comprehensive change in an organization as large as IRS. It's going to have to be implemented in a very real way by managers below the Commissioner.

So those managers are going to have to be able to develop the details of the plans, to lead at their level of the organization a change in attitudes and a change in behavior, and develop things like the employee evaluation system, to reinforce improved customer service.

Mr. HOUGHTON. Well, I guess the thing that I'm reaching for is the practical impact in the organization. Because you've alluded in many ways, for example, on page 6 of your testimony, you said the employee evaluation process is not aligned with this new mission, does not support the culture the IRS hopes to create. Now, you know, that's not a particularly helpful sign for the IRS, and yet at the same time, are they moving in the right direction? Have they got people ultimately when they get these two things aligned, to do the job which is required? That's the sense I don't get.

Mr. WHITE. They understand the need for alignment. The Commissioner has talked repeatedly about the importance of alignment, that how employees are evaluated must be consistent with the mission of the agency and with the strategic goals and with the organizational performance measures. So at that level, that's understood. They are beginning the process of trying to develop a new employee evaluation system.

And as I said, in the interim, there are some things they can do better with the existing system to reinforce improved customer service.

Mr. HOUGHTON. Have you talked to the Commissioner about your report?

Mr. WHITE. Yes, we have.

Mr. HOUGHTON. What is his reaction, and what are some of the more important issues you have discussed?

Mr. WHITE. We have an entrance conference with IRS officials on every report we do. He was so interested in this that he participated in the entrance conference on this report. So that shows the level of his involvement in this.

He clearly understands the importance of this. He also recognized that it's going to take some time to develop this.

Mr. HOUGHTON. How many reports have you done on the IRS?

Mr. WHITE. On this particular issue?

Mr. HOUGHTON. No, just in general. Are you in constant contact with them, or is it just periodic?

Mr. WHITE. We are in constant contact. We will issue 35 to 45 reports a year on IRS. So we're in constant contact with them.

And I do want to say that under the new Commissioner, the cooperation I think that we've gotten from IRS is at a different level than it's been in the past.

Mr. HOUGHTON. If the Commissioner were to ask you for one significant suggestion out of all the things you've touched on, what would it be?

Mr. WHITE. I think to continue with the integrated approach that he has underway. It's difficult to do, to do this kind of change in the comprehensive way that he's trying to do it. But I think it's crucial to do that. For example, systems modernization has to be done in an integrated way with the business-side changes that they want to make. You can't do one independent of the other. It has to be done in an integrated way. That makes it more difficult. That's a part of the challenge they face here. But that's the right way to do this.

Mr. HOUGHTON. One final question. Do you feel that the concept of customer orientation, rather than internal mechanics, is getting through? This is something he has stressed.

Mr. WHITE. I absolutely do. There is no doubt. The issue is whether you drive that down through the organization. And that's where implementation again becomes important, it's where training becomes important. It's where performance measures are important, because they reinforce the training. All of this has to be mutually reinforcing and consistent.

And driving it down through the organization also shows, again demonstrates the importance of managers below the level of the Commissioner being engaged in leading this effort.

Mr. HOUGHTON. Well, I have no further questions. Mr. Coyne, do you?

Mr. COYNE. I just want to follow up on your concept about—it's fine for the top leadership to be involved and be on top of things, but it's really going to take lower level managers to implement them. Could you put a number on those managers that you're referring to, within the IRS?

Mr. WHITE. I can't put a number on it right here. I can get back to you on that.

What I'm talking about, though, are people from frontline supervisors all the way up through the senior executive service at IRS. All of those people, their roles will be somewhat different, but they all will have to take real responsibility for making this kind of change in direction work.

Mr. COYNE. Thank you.

Mr. HULSHOF. Mr. Chairman, one follow-up question. Mr. White, then what is it about the Service's current modernization efforts that leads GAO to believe that the chances of success are any better than in the past?

Mr. WHITE. There are several things. One is it's comprehensive. They aren't doing information systems alone. They're trying to do information systems, their process for interacting with taxpayers at

the same time, reorganization, all of this is being done simultaneously.

Something else, it's consistent from a level of the mission statement down through employee evaluations. They're trying to get to a point where that is all aligned and staff and managers throughout the organization therefore are getting a consistent message about what the goals of the organization are.

In addition to that, I would repeat again what I said about the leadership of the IRS. That leadership that the Commissioner is providing is clearly helpful.

Mr. HULSHOF. Thank you.

Mr. HOUGHTON. OK, thank you very much. Mr. White, we certainly appreciate your being with us. Thank you for your contribution.

Mr. WHITE. Thank you.

Mr. HOUGHTON. We are adjourned.

[Whereupon, at 10:53 a.m., the hearing was adjourned, to reconvene at the call of the Chair.]

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