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THE 1998 TAX RETURN FILING SEASON AND THE IRS BUDGET FOR FISCAL YEAR 1999

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

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THE FISCAL YEAR 1999 BUDGET REQUEST FOR THE INTERNAL REVENUE SERVICE AND THE 1998 TAX RETURN FILING SEASON

TUESDAY, MARCH 31, 1998

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

The Subcommittee met, pursuant to notice, at 2:07 p.m., in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson [Chairwoman of the Subcommittee] presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
March 24, 1998
No. OV-14

CONTACT: (202) 225-7601

Johnson Announces Hearing on the 1998 Tax Return Filing Season and the IRS Budget for Fiscal Year 1999

Congresswoman Nancy L. Johnson (R-CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the 1998 tax return filing season and the Administration's budget request for the Internal Revenue Service (IRS) for fiscal year (FY) 1999. **The hearing will take place on Tuesday, March 31, 1998, in the full Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

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

BACKGROUND:

The 1998 tax return filing season refers to the period of time between January 1st and April 15th when Americans will file over 208 million individual and business tax returns. During this period, the IRS is expected to issue over 89 million tax refunds and answer 121 million telephone calls from taxpayers asking for assistance.

The Administration's budget requests $8.2 billion to fund the IRS for FY 1999, plus an additional $323 million to establish a new account to fund future computer modernization. This level of funding would support about 102,000 employees who would collect an estimated $1.7 trillion in taxes, according to Administration estimates. Beyond the traditional activities of the filing season, the FY 1999 budget also would fund, among other things: IRS examination activities, criminal tax law investigations, efforts to improve customer service, employee salaries, the operation of the IRS's computer systems, and the effort to make the IRS's computer systems compliant with the century date change.

In announcing the hearing, Chairman Johnson stated: "The IRS is experiencing a whirlwind of change. Congress is on the verge of passing legislation to restructure and reform the IRS. The IRS Commissioner has proposed the most sweeping reorganization of the IRS in 40 years. And during the midst of these changes the IRS must implement many recent changes in the tax law while it simultaneously tries to make its computer systems compliant with the century date change. The IRS looks like a juggler trying to keep one-too-many plates in the air. We want to review the IRS's budget and its operations to see if it is meeting all of these challenges in a balanced, timely manner."

FOCUS OF THE HEARING:

The Subcommittee will explore how the IRS intends to allocate its FY 1999 budget resources, and what effect its funding level will have on the IRS's ability to fulfill its mission "to collect the proper amount of tax revenue at the least cost, and serve the public by continually improving the quality of its products and services. . . ." In particular, the Subcommittee will examine: what effect the budget request will have on the quality of IRS taxpayer services, the effort to make the IRS computer systems compliant with the century date change, and the effect of the Commissioner's proposed reorganization plan.

(MORE)

With respect to the current filing season, the Subcommittee will explore how effectively the IRS is responding to taxpayers requests for assistance, how efficiently it is processing taxpayers' refunds, and the progress of IRS efforts to promote the electronic filing of tax returns.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should *submit at least six (6) single-space legal-size copies of their statement, along with an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format only, with their name, address, and hearing date noted on a label*, by the close of business, Tuesday, April 14, 1998, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

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

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format. **Witnesses are advised that the Committee will rely on electronic submissions for printing 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, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

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

Note: All Committee advisories and news releases are available on the World Wide Web at "http://www.house.gov/ways_means/".

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 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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Chairwoman JOHNSON. The hearing will come to order. Good afternoon, everyone. Today the subcommittee will examine the current tax return filing season and the budget request for the Internal Revenue Service for Fiscal Year 1999.

The IRS is caught up in a whirlwind of change I think it's fair to say. Beyond the current filing season, the IRS still must implement the remaining tax code changes contained in last year's Taxpayers Relief Act. Second, Congress will soon finish legislation to restructure and reform the IRS. The new Taxpayer Bill of Rights 3 will include the important new taxpayer safeguards, such as expanded relief for innocent spouses and that will require a response from the Department. Third, the Commissioner has proposed the most ambitious reorganization of the IRS in 40 years for which we commend him. Fourth, the IRS must assure that its computer system is compliant with the century date change. And finally, the IRS must oversee a multibillion dollar contract with the private sector to upgrade its aging computer system into the 21st Century. The IRS looks like a juggler trying to keep one too many plates in the air.

The administration is requesting $8.3 billion for the IRS in Fiscal Year 1999 to support a workforce of approximately 102,000 employees. These resources should enable the IRS to collect $1.7 trillion in revenue. The budget request represents a $529 million increase over the current fiscal year. Part of this increase will fund over 1,400 additional IRS employees in Fiscal Year 1999.

This budget request marks the first real increase in several years. The increased resources are necessary to meet a growing workload and to improve customer service. For example, the number of primary tax returns will increase from 203 million to 212 million in just two years. And, the number of telephone inquiries which the IRS must answer will increase from 104 million to 127 million over the same period.

Beyond the statistical growth in the IRS' workload, the complexity of the subject matter is becoming more difficult to administer. Some of this may stem from the Taxpayer Relief Act of 1997. The changes affecting capital gains and the sale of principal residences were effective in 1997 so they are affecting the current filing season. Many more tax law changes became effective in 1998 so they will affect the 1999 filing season. This includes educational tax credits related to the Hope Scholarship and to the Lifetime Learning Program, as well as the new deductible Roth IRA.

In addition, the IRS must strive to make sure that its computer system is compliant with the century date change. The IRS will spend almost a billion over five years on this effort.

In view of the changes in the next few years, it is a welcome relief that the current filing season appears to be mostly trouble-free. The IRS is processing tax returns at good pace and issuing refunds in a timely manner. There also has been a significant increase in the number of persons filing their tax returns electronically, as well as receiving their refunds by direct deposit to their bank accounts. This is all very good news. It suggests that the IRS is making good progress towards its goal of promoting electronic filing as well as significant progress towards better customer service.

The subcommittee wants to review the IRS' budget and its operations in order to see if the budget meets all of the challenges in a balanced and timely manner. I welcome today's witnesses and I particularly welcome the new Commissioner, Commissioner Rossotti.

At this point, I'd like to yield to my Ranking Member, Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman. Today we will hold the annual hearing to discuss the administration's proposed Fiscal Year 1999 budget for the IRS and the status of the 1998 tax return filing season.

The issues we will discuss today are critically important to the integrity of our tax collection system and the public's expectations of customer service, fairness, and efficiency. While it is easy to attack the IRS and its workforce, such an approach does not solve any of our problems. What is needed, in my opinion, is: No. 1, better focused IRS management; No. 2, better IRS employee training; No. 3, better IRS tax administration technology systems.

The President's proposed budget targets each of these areas and does so in a very accountable fashion. The President has proposed $8.2 billion in funding for the IRS in Fiscal Year 1999. This is a significant increase from IRS funding levels in prior years. The President's budget would provide for a net increase of $530 million over the IRS' Fiscal Year 1998 operating level. Almost half of this increase would be for investment in IRS information systems and organizational modernization.

Further, the administration's budget request calls for $323 million to fund a second year of the IRS investment technology account. This is seed money which the IRS needs to continue its modernization of IRS computer and technology systems.

The President's budget also calls for $143 million for EITC activities. This Earned Income Tax Credit account was established last year outside the budgetary caps to: number one, expand EITC customer service and public outreach programs; number two, to strengthen EITC enforcement activities; and number three, to research efforts to reduce EITC overclaims and erroneous filings. I am pleased that we are continuing to improve administration of the EITC on a bipartisan basis.

Finally, I believe that the administrative actions that IRS Commissioner Rossotti has taken to streamline the way the IRS does business and to expand the availability of taxpayer services are fundamental to development of a first-class federal tax system. The current tax return filing season appears to be going well and, undoubtedly, the Commissioner's decisions to expand the IRS' hours of operation to nights and weekends across the country and to shift IRS auditors and collection staff to taxpayer assistance activities have contributed to a problem-free filing season. I commend Commissioner Rossotti for his efforts and I thank the subcommittee Chairwoman, Mrs. Johnson, for holding this hearing today. Thank you.

Chairwoman JOHNSON. Thank you.

Commissioner Rossotti.

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

Mr. ROSSOTTI. Thank you, Madam Chairwoman and members of the committee. Before I begin my testimony, I would like to make one announcement that I think will please the committee, and that is that our electronic federal tax payment system has made a very substantial amount of progress with existing business users, and, therefore, it will not be necessary to impose a penalty on July 1, 1998, as was previously planned and——

Chairwoman JOHNSON. Excellent.

Mr. ROSSOTTI [continuing]. This penalty waiver will extend to those employers who were first required to use the EFTPS on or after July 1, 1997, and who continue to make timely deposits by paper coupons. So, I'm sure that will be good news for your constituents.

Chairwoman JOHNSON. And just to that point, what percentage of the small businesses required to file under the EFTPS at this point are filing electronically?

Mr. ROSSOTTI. Well, I believe that there is about 1.1 million that are required and there's only about 80,000, if I'm correct, who are not filing. So, it's the majority of people that are enrolled. But, I'll get you those precise numbers, Madam Chairwoman.

[The following was subsequently received:]

Currently, there are about 1.4 million employers who are required to pay using EFTPS. (There is no requirement to file electronically). Of that number, about 1.3 million are enrolled to pay using the electronic system. In addition to the required taxpayers, we have more than 500,000 business taxpayers who are voluntarily enrolled.

Chairwoman JOHNSON. But almost the whole group is filing electronically?

Mr. ROSSOTTI. Of those that were mandated to——

Chairwoman JOHNSON. Right. Well, that's very good news——

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON [continuing]. And I think that reflects well on the small business community, their——

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON [continuing.] Ability to learn and change, but it also reflects that the IRS did make quite dramatic change in its presentation of how to do this and of its information to the small business community after the program kind of ran amuck——

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON [continuing]. And it was those changes and the improvements in your materials and your outreach to the small business community that certainly brought about this compliance and in a way that none of us had any—heard from any of our troubled small businesses about it. I commend you on that and I think the fact that you did respond to the difficulties that the program was having constructively ought to be noted for the record.

Mr. ROSSOTTI. Yes. Actually, Madam Chairwoman, I'm glad you mentioned that because it's one of the first things that I looked into when I became Commissioner, having heard about it from a number of members, and, you know, it immediately became apparent to me that this was an excellent program that had not been presented, as you put it, very well—

Chairwoman JOHNSON. It had not been excellently described and so it was not beloved——

Mr. ROSSOTTI. And we're continuing now to actually do some additional things. I mean, the decision we made to waive the penalty anticipates the results of some additional outreach we're going to do——

Chairwoman JOHNSON. Excellent.

Mr. ROSSOTTI [continuing]. To help people use it.

I'm pleased to go on now to discuss the 1998 filing season as well as our 1999 budget request and some other issues of interest to the subcommittee, especially the commitment that we've made to customer service.

Of course, one of the IRS' most important responsibilities is to manage a successful filing season and, as you noted, Madam Chairwoman and Mr. Coyne, we are doing that this year. Total return receipts are about even with last year but our electronic filing and TeleFile are up 24 and 26 percent, respectively, over the same time period, and, as of March 20, refunds are up 6 percent and the average refund is $1,397.

As of March 20, 4.8 million individual taxpayers have filed by phone and, continuing this approach, this spring small businesses nationwide will also be able to file the 941 Employers Quarterly Federal Tax Return by telephone and we expect this year that 1.2 million 941's will be filed using this option.

Beginning in January, as Mr. Coyne noted, we expanded our telephone service to 16 hours a day, Monday through Saturday. And, largely through better scheduling, the overall access, as defined by GAO, for telephone assistance has increased from only 30 percent in 1996 to about 91 percent so far this season. This means that there have been 12.7 million fewer busy signals experienced by taxpayers.

We've also just very recently begun a pilot technology program called the "Intelligent Call Router" which will enable us on a real-time basis to route calls to the next available assister anywhere in the United States which is part of our program to improve access even more.

We also expanded walk-in service hours during the last six Saturdays of the filing season. Over 150 IRS walk-in offices are open from 9:00 to 3:00. This recent Saturday was designated as "EITC Awareness Day" and the last two Saturdays are designated as "Problem Prevention Days." And I will say that this Saturday I visited one of those cites at a mall in Charles County, Maryland and found that many taxpayers were, in fact, very pleased at the ability to get service on a Saturday morning in a location that was convenient to them.

A growing number of taxpayers are also getting the tax information they need from our Internet cite, from IRS CD–ROMs and our fax system. So far this fiscal year, our Internet site has had over 277 million hits, which is about triple the number for the same period last year, fax traffic is up 63 percent, and over 530,000 successful transmissions of tax forms and information have been made by fax. And I would like to say that just today,—the form to claim innocent spouse relief has gone up on our website.

Chairwoman JOHNSON. Excellent.

Mr. ROSSOTTI. The IRS has also made considerable progress, as we've noted at the beginning, in electronic payment methods. Last Fiscal Year 1997, more than $655 billion was deposited electronically which was an increase over $416 billion the previous year. But, as of March 20 of 1998, deposits are already over $520 billion through 21 million transactions. Enrollment, as we noted, continues to grow in the EFTPS system with 1.8 million taxpayers currently enrolled, and that includes 500,000 small business volunteers who are not required to use the system. That success, of course, is why we were able to waive the penalty.

In addition, in Fiscal Year 1997, over $213 billion went through the Lock-Box payment system which is a $4 billion increase over the prior year and, as of February 28 of this year, $53.6 billion was deposited. So, Lock-Box is also growing.

Madam Chairwoman, without exception, the century date change conversion together with the annual filing season changes are our highest technology priorities. I stress that we are very aggressively managing the program so as to identify risks and be able to take timely actions when necessary to see that our overriding goal—which, of course, is to maintain continuous service—is realized. As part of this management process, we do need to adjust on a regular basis deadlines and timetables to reflect the work in progress. The program remains not only a high priority but a high risk that will require continued intense management focus to succeed.

As members of the subcommittee are aware, I've also proposed a large-scale and long-term modernization program for the IRS. Despite the short-term progress we are making, we will only reach our goal—first quality service to each and every taxpayer—through changes in five key areas, each complimenting the other. And I'll just briefly describe these.

The first is revamped business practices that will focus on understanding, solving and preventing taxpayer problems. The second is an organization structure that each divides the IRS into four units; each specializes in serving a particular set of taxpayers with similar needs. Third, the creation of management roles with more clear responsibility. Fourth, measuring our organizational performance by balancing customer satisfaction, business results, employee satisfaction and productivity. And fifth, of course, new technology.

The IRS' current computer systems simply cannot support the agency's missions and goals in the long term. We have engaged the consulting firm of Booz, Allen, and Hamilton to validate this concept in terms of risk, cost, and impact on customers, both external and internal.

For Fiscal Year 1999, we have prepared a budget that supports the beginning of the transformation of the IRS that I have outlined above and that can be also identified into five major priorities.

One, of course, is preparing for the century date change which is the most critical of all elements and the funds I have requested are essential to continuing customer service and avoiding the potentially disastrous effects of an uncorrected century date change problem.

Second, during Fiscal Year 1999, we will pursue a highly focused initiative to improve customer service through improved clarity of notices, forms, and publications, better telephone service, more walk-in service, expanded electronic filing, improved training of customer service representatives, strengthened support for small businesses, increased staffing for the taxpayer advocate's office, and creation of citizen advocacy panels.

Third to ensure that customer service remains a top priority, the budget request also includes some near-term investments that are necessary in order to enable us to maintain an acceptable level of service. This includes the Call Router, which I mentioned earlier, deployment of computers to field collectors who currently have no computers, and replacement of old computers used by field agents who depend on them to do examinations of taxpayers.

Fourth, in 1999, the process of modernization will continue with the strengthening of the IRS' internal systems management processes and capabilities and the award of the "Prime Contract." The Fiscal Year 1999 budget request for long-term technology modernization comes in two parts; IRS capabilities for managing and supporting modernization and funding for the information technology investment account for the prime contractor itself.

And finally, the Fiscal Year 1999 budget includes $25 million to support the organizational modernization proposal that I've advanced. This money is not yet fully specified in detail but it will include recruiting, relocation, and retraining of people as well as development of detailed plans for the reorganization.

I would only note, Madam Chairwoman, that over the last three years, the IRS budget—when you subtract out the extra cost of the century date change—has actually declined by 7 percent while the dollars collected have grown by about 24 percent. Returns processed have increased by 8 percent and, as you know, the Taxpayer Relief Act of 1997 has added about 800 changes to the Tax Code.

In conclusion, I believe we can transform the IRS into an agency that helps taxpayers meet the obligations imposed by the tax laws while ensuring the compliance is fair. And I think we can do this while increasing productivity and shrinking gradually the size of the IRS in relation to the economy. It will take time and investments to modernize technology, business practices, and organization. But, with the support of Congress, I'm optimistic that we will succeed. Thank you, Madam Chairwoman.

[The prepared statements and attachments follow:]

TESTIMONY OF
CHARLES O. ROSSOTTI
IRS COMMISSIONER
BEFORE THE
HOUSE WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT

FY 1999 BUDGET AND 1998 TAX FILING SEASON

MARCH 31, 1998

Madame Chairman and distinguished Members of the Subcommittee, I am pleased to appear before you this morning to discuss not only the IRS' 1998 filing season, but our new profound and fundamental commitment to customer service.

The IRS must dramatically shift its focus from its internal operations and see its job from the taxpayer's point of view. We must see the American taxpayers as our customers, and customer service must be the axis around which the IRS turns and operates.

We must give each and every one of our customers a consistent level of service that they have come to expect from the private sector. Each time we deal with a taxpayer, we must provide prompt, professional and helpful treatment. We must help our customers comply with the law and ensure the fairness of compliance.

I am committed to providing increased customer service resources to this effort . We must change the one-size-fits-all IRS into an agency that provides tailored services to specific customer segments. We must provide special programs for retired seniors, students, parents, small businesses and other groups with special needs. We must aggressively cooperate with volunteer groups such as the AARP, trade associations and local volunteers to reach out and serve as many of our customers as possible.

We must expand customer access to service. That means more store-front locations, and hours and days that are more convenient for our customers, not the IRS. That means faster and easier access to telephone services, the Internet and e-mail. That means greater flexibility and ease in filing a return, making a payment or receiving a refund. That means communicating better with taxpayers and providing our customers with clear and concise information they want and from a variety of sources — from faxes to websites to CD ROMs.

Quality customer service cannot exist without accountability Reliable, prompt access over the phone and in person must be coupled with assurances of clear responsibility. We must have trained representatives who understand taxpayers' problems and are committed to solving them. There must be a clear resolution of the customer's problem, and there will be in the new IRS.

This is a bold concept that will take time to implement fully throughout the agency, but I am convinced that we have taken the first steps in a direction that will provide better service to our customer— the American taxpayer.

FILING SEASON

One of the IRS' most important responsibilities is to manage a successful filing season, and we are doing so again this year, due in no small part to improved customer service. I would like to provide the subcommittee with the statistical highlights of the current season.

Projected net collections for FY 1998 are $1.575 trillion. We also project to receive 222 million total tax returns, including 124 million individual returns, and expect to issue 89 million individual refunds. As of March 20, 1998, refunds are up six percent over last year, and the average refund is $1,397. Over 14.5 million taxpayers have taken advantage of direct deposit of refunds.

This season, while total return receipts have remained virtually constant compared to last year, e-File and TeleFile are up 24 and 26 percent respectively over the same time period. As of March 20, 1998, the IRS received more than 19.7 million e-filed returns including 4.8 million TeleFile returns. We have also received 601,000 returns filed electronically by taxpayers using personal computers, more than double last year's figure.

This spring, small businesses nationwide will also be able to file Form 941, Employer's Quarterly Federal Tax Return, over the telephone. We expect over 1.2 million returns to be filed using this option.

In FY 1997, more than $655 billion was also deposited electronically through the Electronic Federal Tax Payment System (EFTPS), a significant increase over the $416 billion deposited in FY 1996. As of March 20, 1998, deposits in FY 1998 are already over $520 billion through 21 million transactions. Enrollment continues to grow with over 1.8 million taxpayers currently enrolled in the system, of which over 500,000 are volunteers who are not required to use the system.

Additionally, by directing many payments made by individual taxpayers to bank lockboxes — so banks may process payments and credit them to the Treasury — the deposit process has been accelerated and accuracy has been increased. In FY 1997, over $213 billion went through the lockbox payment system, an increase of $4 billion over the prior year. As of February 28, 1998, $53.6 billion has been deposited.

A dramatically growing number of taxpayers are getting the tax information they need from our Internet site, IRS CD-ROMs and our fax system. So far this fiscal year, our Internet site had over 277 million hits. That is about a 212 percent increase over the traffic we had in the same period last year. Our fax system traffic is about 63 percent higher than last year. Over 530,000 successful transmissions of tax forms and information have been made by fax. These customers can order any time of day or night, and they can retrieve the information from anywhere in the world.

CUSTOMER SERVICE INITIATIVES

Madame Chairman, as I mentioned at the opening of my testimony, the IRS has a new focus — a customer focus. I am committed to providing quality and consistent service to all of our customers at a level equal to that of the private sector. This filing season, we have made significant improvements to customer service in a variety of areas.

Ease of Filing

Electronic Federal Tax Payments

In conjunction with our private sector partners, we have also made progress toward enhancing electronic payment methods. EFTPS was developed for use by taxpayers to make their employment and other depository tax payments electronically. EFTPS accepted its first payment on November 7, 1996, and continues to expand each year.

Since its inception, the IRS has worked with the business community to provide educational outreach to new users. Companies may make payments by phone or PC. We continue to receive favorable feedback from users on the ease and accuracy of the system.

New Penalty Relief for EFTPS

The $20,000 threshold, originally scheduled to take effect in 1999, for businesses required to make tax deposits through EFTPS, was eliminated last year. EFTPS is now voluntary rather than compulsory for businesses with less than $50,000 in annual Federal tax deposits.

I am pleased to announce today that our EFTPS has made such progress with existing business users that it will not be necessary to impose a penalty on July 1, 1998 as was previously planned. The penalty waiver will extend to those employers first required to use EFTPS on or after July 1, 1997, and who make timely deposits by paper coupons.

E-File and TeleFile

This year, more taxpayers than ever before are taking advantage of our electronic filing and TeleFile options. Electronic filing offers greater accuracy, acknowledgment that IRS accepts the return, an earlier refund, and direct deposit of the refund to the taxpayer's checking or savings account (Direct deposit is also available to paper filers). A taxpayer who e-files early and owes additional tax still has until April 15 to make a payment. We projected that the usage rate for all forms of electronic filing would increase 17 percent over last year. Actual increases to date are slightly over 24 percent.

The IRS website provides links to private sector firms that are participating in its e-File program and some tax preparation software packages include free electronic filing. The IRS website also has links to several company sites where taxpayers may either download software or use an on-line service to complete and file their tax returns. The IRS does not charge for electronic filing, but company fees range from $4.95 to $19.95 for individual returns, depending on the product used.

In addition, the website lists tax preparation software that the IRS accepts for its on-line filing program. The software is available at computer stores or through company websites. Some software includes electronic filing at no additional cost, while others charge for transmission services.

To use on-line filing, a taxpayer transmits a completed tax return file completed using tax preparation software, to an intermediary firm, that electronically converts the file to IRS specifications and forwards it to the IRS. Within 48 hours, the IRS notifies the taxpayer via e-mail if the return is accepted or, if not, which items the taxpayer must correct.

After the IRS accepts the return, the taxpayer mails any W-2 forms to the IRS along with a signed Form 8453-OL. This one-page signature document is provided to the taxpayer by either the tax preparation software or the on-line filing company.

Each on-line taxpayer may transmit up to three income tax returns. For example, a married couple could transmit their joint return and the returns for two of their children. Some software packages also offer on-line filing for state tax returns.

Under the leadership of Assistant Commissioner for Electronic Tax Administration Bob Barr, who joined the IRS last fall from the private sector, we are formulating a broader strategy for electronic service delivery to build products and services through partnerships with the private sector. Last month, we took an important step forward by issuing a Request for Proposal that seeks approaches from both the private and public sectors to expand greatly electronic tax administration.

This year we also launched a public service campaign to better inform and educate taxpayers and tax practitioners about the benefits of electronic filing. This year's campaign, which introduced a new name and logo, IRS e-File, communicates the important messages that taxpayers who file electronically have fewer problems and fewer contacts with the IRS, and should receive their refunds faster than when filing paper forms.

We also expect 5.9 million taxpayers to file their taxes over the telephone using our TeleFile program which recently won the "Innovations in Government" award sponsored by the Ford Foundation.

Direct Deposit of Refunds

Most of the over 89 million taxpayers who will be entitled to refunds this year can have the refunds directly deposited into their bank accounts. By using this option, taxpayers can enjoy the safety and ease of direct deposit. Last year, over 16.5 million taxpayers used this convenient option.

Improved Access

Problem Solving Days

On September 25, 1997, Deputy Commissioner Mike Dolan announced that each IRS district would begin holding monthly Problem Solving Days (PSD) to provide taxpayers an opportunity to meet with Service personnel to resolve special tax problems they might be encountering. Problem Solving Days are held at a variety of sites, including IRS offices, schools, meeting halls and hotels.

On Saturday, November 15, 1997, we held our first Problem Solving Day. Since then, more than 20,000 taxpayers have met with IRS representatives and nearly 75 percent of the problems have been resolved. In addition, many taxpayers who called to set up an appointment for Problem Solving Day had their problems resolved over the phone, and never had to come in person.

Taxpayers have commented that they like the opportunity for a face-to-face contact and that they appreciate that someone is listening to them and trying to resolve their problem. Employees have also responded favorably to PSD. They especially like the multi-functional approach to problem solving which ensures that the taxpayer's problem can be heard by someone with the right set of skills to help resolve the issue.

Both taxpayers and employees recognize that not all of the issues coming in during PSD will be resolved in favor of the taxpayer. Audits must still be conducted and IRS is not offering amnesty. Taxpayers do, however, appreciate the opportunity to sit down with someone to discuss the issue at hand and get a complete explanation of what needs to be done even if the result may be different from their expectations.

To date, the primary issues raised by taxpayers during PSD involve problems with, or requests for information on : 1) audit reconsiderations; 2) offers-in-compromise cases; 3) installment agreements; 4) general information requests; 5) penalty issues; 6) account and notice inquiries; and 7) unable to pay cases.

An analysis of the primary sources of PSD casework is being conducted and should result in the identification of possible procedural or systemic changes that can be made to reduce the incidence of taxpayer problems.

Saturday Service Days

The IRS is doing more to meet our customers' desire for face-to-face service. During the last six Saturdays of the filing season, beginning on March 7, 1998 through April 11, 1998, over 150 selected IRS walk-in offices are open from 9:00 am to 3:00 pm. The Saturday Service sites were selected based on their weekend accessibility, year-round operational status, and high traffic volume.

On each of the Saturday Service Days, IRS employees are providing taxpayers with the following services: (1) distribution of forms and publications; (2) answers to account and tax law inquiries; (3) verification of Individual Taxpayer Identification Number documentation; (4) processing of alien clearances; and (5) acceptance of payments.

This past Saturday, I visited one of our sites at a mall in Charles County, Maryland and found many taxpayers pleased at the ability to get service on a Saturday morning at a convenient location.

The last two Saturdays of the filing season are designated as Problem Prevention Days, and Saturday, March 28 was designated as Earned Income Tax Credit (EITC) Awareness Day.

Problem Prevention Days

Problem Prevention Days emphasize helping taxpayers avoid making mistakes in preparing their tax returns. Problem Prevention Days help taxpayers comply with the tax laws, so they can avoid problems with the IRS. Taxpayers can find the location nearest them by accessing the IRS homepage on the World Wide Web — www.irs.ustreas.gov — or calling the IRS toll-free at 1-800-829-1040.

The IRS also sponsors VITA, the Volunteer Income Tax Assistance program, and TCE, Tax Counseling for the Elderly. Through these two programs, the IRS increases taxpayer assistance by giving taxpayers the opportunity to have direct contact at 18,684 sites with volunteers trained by IRS personnel. Last year, over 72,000 volunteers served almost 3.8 million taxpayers.

EITC Awareness Day

On Saturday March 28, EITC eligible taxpayers were able to go to any of over 150 selected IRS walk-in sites and receive up-to-date EITC information and assistance with tax return preparation. IRS assistors were available from 9:00 am until 3:00 pm to answer questions about the EITC and assist taxpayers in preparing EITC returns.

Taxpayers were able to get assistance from either the IRS walk-in offices or VITA/TCE sites. In addition, information was available on new EITC tax laws and the penalties associated with intentional noncompliance. Eligible taxpayers were made aware that intentional EITC overclaims may prevent them from receiving the credit for up to 10 years. Assistance was available to help prevent future problems with EITC claims and related matters.

Telephone Service

In the past five years, the IRS has answered more calls than ever before. In FY 1997, IRS assistors served nearly 74 million taxpayers, answering their tax law and account questions.

The TeleTax recorded information line offers taped information on 148 topics, 24 hours-a-day, seven days-a-week, and refund information 16-hours-a-day, Monday through Friday. In FY 1997, we replaced two-thirds of the existing, aging TeleTax equipment with new equipment with increased call capacity. Last tax year, over 43 million TeleTax calls were answered.

During the current filing season, the IRS is trying to ensure that it serves even more taxpayers. Beginning in January 1988, IRS expanded its hours of telephone service to enable assistors to answer more tax or account questions. Hours of service were expanded to 16 hours-a-day (7:00 am to 11:00 pm local time), Monday through Saturday. The overall access to telephone assistance has increased from 29.9 percent in FY 1996 to 65.1 percent in FY 1997. So far this season, our level of access is 91 percent. This means that so far this year, there have been 12.7 million fewer busy signals experienced by taxpayers.

In FY 1996 and FY 1997, the IRS used a different access measure level. This year, accessibility is defined as the number of calls answered added to calls that were abandoned before receiving assistance, divided by the total number of call attempts. Call attempts are defined as calls answered, abandoned calls and calls that receive a busy signal. This filing season, as of March 21, we have answered over 26 million calls and identified over 5 million abandoned calls, resulting in a 91 percent access level.

In addition to the general toll-free number, 1-800-TAX-1040, we continue to provide separate toll-free numbers to taxpayers who receive notices or have questions about their refunds. Taxpayers who have complex questions on certain topics, or who call after hours, or who do not wish to hold, may leave recorded messages and the IRS is responding within two business days. We have also established "peak demand teams" so that we can move personnel to the front-line phones when volume rises unexpectedly.

We can now also route calls based on available staffing to assistors who may be in the next county, state, or even across the country. This increases dramatically the ability of taxpayers anywhere in the country to reach an assistor. Earlier this month, IRS began a pilot technology program, the Intelligent Call Router. It will provide, on a real-time basis, call routing to the next available assistor anywhere in the U.S., resulting in better access for callers.

As we implement new technology and processes, taxpayers calling IRS are experiencing improved customer service. Yet, in spite of these improvements, not every taxpayer call is being answered. The Service is also looking for other ways to meet taxpayer needs. We can begin by making the initial information we provide to taxpayers clear, thereby eliminating the need for many follow-up calls asking for clarification.

Providing Information To Taxpayers

Paperwork Reduction and Improved Forms and Publications

The IRS continues to make progress on its notice reengineering efforts. In FY 1997 alone, we eliminated 23 notice types, causing 7.6 million fewer notices to be issued and mailed to taxpayers. This has reduced the burden on many taxpayers and reduced the need for many of them to call or write to us.

We have also listened to the feedback and suggestions from taxpayers and Members of Congress regarding the clarity of our notices. The agency is now working with a consultant to review and revise computer-generated notices related to taxpayer accounts.

The IRS is also exploring other ways to simplify its forms and publications. For example, we are making greater use of focus groups to test the effectiveness of our products. Focus group testing has proven to be an excellent means of gathering data about how to improve our products and to understand better how taxpayers use them.

In addition, we are using new techniques to make our products more customer friendly. These include: greater use of tables and flow charts to present complex tax concepts; better use of graphic design elements; and improved organization of material.

Because taxpayers may not be aware of tax law changes until they review the tax package mailed to them in January, we have developed new publications available during the tax year for planning and education purposes. Taxpayers now have access to publications about adoption and medical savings accounts and will soon be able to obtain a new publication about tax benefits for higher education.

Growth in Use of IRS Electronic Information Services

By working with industry, and using CD-ROM technology, we have also been able to expand the distribution of tax forms, publications and other information. This year, through our "Corporate Partnership Program," we are working with large corporations that make tax information available to their employees on their internal networks. AARP, a partner with IRS in providing free tax assistance to the elderly, began using the IRS CD in over 150 locations nationwide this year.

Internet Impact on Other Programs

Last year, our customers downloaded almost 11 million tax products from the IRS home page. During the same period, we also found that approximately six percent of the tax forms submitted as paper returns were downloaded from the Internet. Since we inaugurated the home page two years ago, the percentage of forms submitted that come from tax packages has decreased. Similarly, the percentage of forms obtained through our toll-free tax forms distribution centers and from walk-in centers has decreased.

Our goal is to make it more convenient for people to get the tax information they want and need. That is why we provide a broad range of choices for taxpayers. For some that may be Internet, for others it may be telephone services or a visit to the local library. Obviously, many taxpayers find electronic media a fast, convenient way to get tax information.

New Electronic Information Services Available This Year

We have thousands of new pages of information on our web site and thousands of new files that may be downloaded. Our CD-ROM has been expanded to include more information, such as industry-specific tax materials and electronic fill-in-the blank tax forms. More tax forms and information are available by fax.

We are providing answers to taxpayers' questions via Internet e-mail. Taxpayers across the country and overseas can e-mail us with tax law questions. However, account questions cannot yet be answered through this service because of security issues.

Our e-mail newsletter, the *Digital Dispatch*, which provides the latest tax news, has grown even more popular. Taxpayers may sign up for this service on our website. This year, instead of a bi-weekly newsletter, we send out tax news as it occurs. When we initiated this enhanced service, the number of subscribers increased by thousands in a single month.

To help tax professionals help taxpayers, we developed the Tax Professional's corner, on our website. It provides advance notice of revenue rulings, procedures and other tax law items; news and administrative information for tax professionals; and information on workshops and how to become an electronic return preparer.

Learning Labs

We are working in partnership with the American Bar Association to develop an Internet on-line learning lab for high school students. Teens aged 14-18 and professional educators will be able to use the Internet as a learning tool for understanding taxes. Important goals of the lab are to help students understand why we pay taxes; where their paychecks go; and their choices in tax filing, particularly alternatives such as TeleFile and other electronic filing options. The first module, entitled, "It's Pay Day!", will be on-line in May 1998.

Taxpayer Problem Solving

Office of the Taxpayer Advocate

Madame Chairman, earlier this year, I testified before this subcommittee on the Taxpayer Advocate's Annual Report to Congress. Today, I would like to reemphasize the important role that the Taxpayer Advocate plays.

As the "voice of the taxpayer," the Taxpayer Advocate will be charged with assisting taxpayers, both individually and collectively, in resolving problems with the IRS. The Advocate would also identify areas in which taxpayers have problems in dealing with the IRS, and propose changes in the administrative practices of the IRS or legislative solutions to mitigate problems. In addition, the Taxpayer Advocate's specific duties will include: advocating for the taxpayers within the IRS; recommending systemic improvements; reporting to the Congress and the public about advocacy issues; managing a staff of approximately 400 employees nationwide and a budget of $24 million; and participating in analyzing proposed changes to tax laws.

Our FY 1999 budget request includes an increase of $10,000,000 to improve the Taxpayer Advocate's Office. One specific change is to give the Taxpayer Advocate the authority to issue Taxpayer Advocate Directives. These will have the effect of mandating administrative or procedural changes on an agency-wide basis within other IRS functional areas. In this way, the Taxpayer Advocate may enforce systemic changes that he or she believes are necessary and in the best interest of taxpayers.

The Taxpayer Advocate's role will also be expanded by: ensuring the full exercise of his or her statutory powers; selecting a Taxpayer Advocate from outside of the IRS; reemphasizing the independence of all local Taxpayer Advocates; and by the Commissioner' and Secretary of the Treasury's endorsement of the Advocate's independence and expanded advocacy authority.

In addition, we must give the Taxpayer Advocate more staff to carry out its mission, establish a new "800" number to provide direct access to the program, and begin a major publicity campaign to advertise the program.

IRS Citizen Advocacy Panels

The IRS is establishing Citizen Advocacy Panels (CAPs) to help the IRS identify and solve customer service problems. CAP members, who are intended to be non-tax experts from the local community, will help identify problems and make recommendations to improve IRS systems and operations.

The CAPs will hold quarterly meetings at which members will consider IRS customer service issues. But CAP work will be ongoing. CAP support personnel will answer toll-free calls and make referrals; provide the CAPs with trend data and reports; and monitor referred cases to ensure their timely disposition. When appropriate, individual taxpayers will be referred to an IRS office for assistance with their problems.

We see a number of benefits in establishing the CAPs. The CAPs will: help the IRS identify what customers really care about, giving citizens a voice in IRS customer service issues; provide an additional avenue of taxpayer access to problem resolution procedures; and help reestablish public trust in the tax administration system.

The IRS has selected four pilot CAP sites: South Florida District (Ft. Lauderdale); Northeast District (Brooklyn); Midwest District (Milwaukee); and the Pacific-Northwest District (Seattle). These sites were selected to ensure geographical and demographic diversity and correspond to each of our four regional offices. The Ft. Lauderdale CAP is scheduled to begin meetings in May and we expect the other three to be operating by the end of this fiscal year.

New Panel Reviewing Alleged Employee Taxpayer Abuse

At my request, the IRS Chief Inspector has been conducting extensive investigations into specific allegations and into such general issues as: IRS compliance with the Taxpayer Bills of Rights; adherence at all levels of the organization to Policy Statement P-1-20; and senior management responsibility for issuing written guidance on the use of enforcement statistics. The Policy Statement prohibits the use of enforcement statistics in evaluations or the imposition or suggestion of goals or quotas for employees and managers responsible for making enforcement determinations.

There will be a two-step review and decision making process coming out of the Inspection Service's investigation, First, we have created a new three-person panel that will review the Chief Inspector's investigations and recommend disciplinary action, as appropriate, for affected IRS managers. Bargaining unit employees will continue to be dealt with separately under existing negotiated procedures. The panel includes two executives from outside the IRS, and one from within the IRS.

Upon completing its review, the panel will propose appropriate corrective actions. Second, for situations where a proposed action requires a reply and final decision by another official, a senior executive from outside the IRS will serve as the deciding official.

I am committed to ensuring that the IRS addresses these issues in a manner that is clearly objective and fair in the eyes of our employees, the Congress and the public.

The Next Tax Season

The FY 1999 budget request includes funding for new or enhanced customer service initiatives. Many of these initiatives were developed by a Customer Service

Task Force convened at Vice President Gore's request under the auspices of the National Performance Review (now the National Partnership for Reinventing Government). They include the following priorities, some of which I have previously discussed:

1. *Improve the clarity of notices, forms and publications* — The IRS plans to rewrite basic forms and instructions, including the Form 1040 and test them for clarity by Tax Year 2000. IRS also plans to completely redesign its tax packages to make them more customer friendly and easier to read.

2. *Provide better telephone service* — IRS plans to increase significantly its telephone service hours. On January 1, 1998, service was expanded to six days a week, 16 hours per day. Next tax season, we hope to extend telephone hours to 24-hours-a-day, seven-days-a-week. Beginning in 1999, the IRS will use new call-routing technology to provide telephone service which is geared to specific customer needs, such as the sale of a house, retirement or job change. Additionally, IRS plans to significantly increase access rates to our toll-free telephone service, proposing to answer 75 percent in FY 1998 and 86 percent in FY 1999.

3. *Make it easier to get answers in person* — To better serve its customers, IRS will open district offices on Saturdays during the busiest weekends of the filing season. During the peak season, IRS will also open additional temporary walk-in centers in community-based locations, such as banks, libraries and shopping malls where forms and publications will be available.

4. *Expand electronic filing* — IRS is developing options to expand electronic filing, including allowing taxpayers to file paperless taxes in FY 1999, eliminating the need for paper signatures and for mailing W-2s and other forms. We are also working to allow taxpayers to use debit cards for next year, and credit cards in the future.

5. *Strengthen customized support for small business* — The IRS is identifying specific groups for "customized service." We plan to provide additional assistance to small businesses, including adding dedicated phone service to provide these taxpayers 24-hours-a-day phone assistance.

6. *Shift how performance is measured* — In FY 1998, the IRS will introduce a balanced scorecard to evaluate the Service and its employees. This scorecard will rate performance on: customer satisfaction, employee satisfaction, and business results. The IRS banned measures that undermine fair treatment of taxpayers.

7. *Improve customer service training* — IRS is undertaking a major retraining of its employees, especially employees engaged in paper-oriented compliance activities in the service centers. They will be trained to supplement regular phone assistors during peak periods. Conversely, employees already involved in telephone activities will be trained to enable them to process paper correspondence when telephone demand is slack.

8. *Strengthen Taxpayer Advocate's Office* — IRS plans to undertake a number of steps to improve the Taxpayer Advocate's office including increasing resources to meet demand; expanding the Taxpayer Advocate's powers; increasing access by actively publicizing the availability of the Taxpayer Advocate program; and expanding reporting to Congress.

9. *Create Citizen Advocacy Panels* — IRS will staff and fund 33 locally-based, independent Citizen Advocacy Panels throughout the country to review issues raised by taxpayers in the field offices.

YEAR 2000 CONVERSION

Managing Risk

Given the scope of the IRS program and its critical importance to both the nation's economy and taxpayers, it is imperative that our mission-critical systems continue to function properly in the new millennium.

Without exception, the Century Date Conversion, in conjunction with the annual filing season systems changes, are our highest technology priorities. The IRS has assigned its most senior and qualified management to the program, and I have underscored the project's priority by organizing and chairing an Executive Steering Committee to oversee these efforts.

I would stress that we are aggressively managing the program so as to identify risks and take timely actions when necessary to see that our overriding goal of continuous service operations is realized. We often need, however, to adjust on a regular basis deadlines and timetables to reflect the work status to date. This program remains not only a high priority, but a high risk that will require continued intense focus to succeed. The IRS must develop and manage the following strategies.

Planning and Implementing an Integrated Century Date Conversion and 1999 Filing Season Strategy

The Taxpayer Relief Act of 1997 mandated systems changes that require reprogramming many of the same legacy systems being made century date compliant by January 1999. It is therefore essential to develop and implement an integrated Century Date/1999 Filing Season Plan. The IRS has accelerated, by several months, the process for identifying the filing season related systems changes that would be incorporated into the integrated plan.

Testing

Even prior to identifying the Century Date Conversion testing requirements, the Information Systems Product Assurance Division, responsible for Systems Acceptance Testing, lacked sufficient resources to fulfill its mission. In 1996, the Division was able to test only 20 percent of the systems placed into production. While some progress has been made, the Division's testing operation is currently limited to only 30 percent of the agency's production systems. The Product Assurance Division continues to recruit new personnel and will increase the percentage of systems tested within the next two years.

Beginning January 1999, the IRS will dedicate significant resources to complete comprehensive, end-to-end Century Date systems tests. This will assure us that our many interlocking applications, which need to pass data to perform their mission critical tasks, are in fact correctly performing all date computations before we reach January 1, 2000. The Product Assurance Division has contracted with a private sector company to accomplish the Century Date Change systems test. The contractor is currently designing the systems test for implementation in January 1999.

Contingency Planning

While the IRS has made significant progress on the year 2000 conversion, the risks are significant and we must be prudent. Accordingly, the IRS must develop contingency plans to neutralize any adverse impacts of a less than fully successful century date program, including schedule slippage for critical program elements.

These contingency plans must reflect the IRS functions, as well as those of our data exchange partners. The overall IRS contingency planning strategy is to focus our efforts on planning for only those aspects of the program that may not be completed on time, and/or may not be completely successful.

Program Scope and Status

The IRS is a huge enterprise, employing in excess of 100,000 individuals located at headquarters, and nationwide in service centers, regional offices, district offices and posts of duty across the United States. We largely depend on highly automated processes as well as the currency, comprehensiveness and availability of vast storehouses of computerized data.

Our technology is particularly challenged given the breadth of the legislatively-mandated systems changes that require extensive reprogramming of systems each filing season. The Taxpayer Relief Act of 1997 requires the IRS to make more than 750 legacy systems changes for the 1999 filing season.

Compounding the problem is the massive century date conversion project. Most legacy application systems are programmed to display 00 in the year fields beginning on January 1, 2000, thereby, causing date-based calculations unintentionally to interpret the year field as 1900.

Failure to identify, recode and retest each of these systems calculations could result in the generation of millions of erroneous tax notices, refunds, bills, interest calculations, taxpayer account adjustments, accounting transactions and financial reporting errors. The IRS' capability to carry out its mission could be jeopardized if the Century Date program is not completed on time.

Adding to the challenge is our largely non-century date compliant technical infrastructure. This includes more than 80 mainframes, 1,400 minicomputers, 130,000 microcomputers and massive telecommunications networks made up of more than 100,000 components.

Because of the age, fragmentation, diversity and local field ownership of the infrastructure, completing the Year 2000 conversion on time depends greatly on our ability to manage corporately, monitor and accurately evaluate adherence with the program's schedule, budget and delivery plans. It is also essential that both the IRS and its landlord, the General Services Administration, ensure that applicable IRS facilities and infrastructure related equipment are upgraded or replaced to ensure century date compliance. The major elements of the program are as follows:

Application Systems Conversion

The IRS currently supports 126 mission critical application systems comprising 85,000 modules and approximately 50 million lines of code. Three out of five phases of code conversion, each scheduled to last six months, are completed. At this time, the IRS has renovated and tested 75 systems, implemented 60 mission critical systems, and is on schedule to complete the systems conversion by January 1999.

Mainframe Consolidation

We have proposed and received congressional approval to consolidate 67 mainframes currently located at 10 service centers into 12 mainframes located at two computing centers.

The program will provide for both century date compliance and will also help the IRS to implement its mainframe centric approach for modernizing its technology. In addition, this also standardizes a major component of IRS telecommunications through the roll-out of a century-date-compliant open-architecture network of nearly 20,000 desktop devices.

The Century Date components of the project are currently on schedule with respect to the reprogramming of the Communications Replacement System and the replacement of desktop devices. These project components are scheduled to be completed by December 1998.

Integrated Submissions and Remittance Processing System

Integrated Submissions and Remittance Processing (ISRP) replaces the antiquated Distributed Input System (DIS) and Remittance Processing System (RPS) that form the core of the tax processing input pipeline.

ISRP is now a pilot program at the Austin Service Center and is on schedule to be fully implemented in all 10 service centers for the 1999 filing season.

Tier II and Tier III Computer Platforms and Associated Systems Software

Both the platforms and software require replacement or upgrades. Century date compliance for the more than 1400 minicomputers and 130,000 microcomputers is largely dependent on obtaining vendor upgrades and/or replacement products. Many of these components are only now being made available in the marketplace. The IRS has initiated a proactive evaluation and testing process to validate the compliancy of these components.

Telecommunications

The critical IRS network is supported through the Treasury Communications System (TCS) contract. Having recently received the network component inventory from the contractor, the IRS is in the midst of reviewing and validating this data, as well as the contractor's site specific plans to convert the network. Given the need to upgrade or replace thousands of components within the TCS network, as well as additional IRS proprietary networks which themselves comprise nearly 30,000 components, the network conversion represents a significant challenge.

Non-Information Technology

A critical component of the non-information technology aspect of the program is dependent on the General Services Administration which recently began developing facilities inventories. Until the GSA and IRS inventories are complete, the Government is exposed to both schedule and cost risk.

External Trading Partners

The IRS is but one of many data dependent public and private sector organizations that exchange information with one another. At this time, we are on schedule with our efforts to validate the accuracy of both incoming and outgoing century date compliant data from a variety of sources.

1997 REVENUE PROTECTION STRATEGY RESULTS

The IRS believes that the 1997 Revenue Protection Strategy was successful in reducing the tax system's vulnerability to fraud and abuse, particularly in the area of the EITC, and in preventing substantial erroneous refunds from being issued. We continued to focus our efforts on identifying questionable claims for refundable credits, primarily the Earned Income Tax Credit and Motor Fuel Excise Tax Credits.

Because of the continued increased validation of Social Security Numbers (SSNs), our prevention efforts for 1997 were most visible to taxpayers with SSN problems and their practitioners. On the electronic filing system, 2.9 million occurrences of missing or invalid uses of SSNs caused tax returns to be rejected.

Public Law 104-188, the Small Business Job Protection Act of 1996, allows the Service to employ "math error procedures" for incorrect Taxpayer Identification Numbers (TINs). Public Law 104-193, the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, requires a valid SSN for the EITC qualifying child. Approximately 2.3 million returns were subjected to math error procedures and refunds were reduced unless taxpayers could provide the correct information. We prevented the issuance of $1.4 billion in erroneous refunds.

We continue suitability requirements for practitioner entry into the electronic filing system. Over 10,000 quality applicants were approved for admission under these requirements. Just as important, over 480 applicants were denied admittance because of problems with personal or business tax obligations, criminal histories, serious financial difficulties, or failure to meet other requirements for admittance.

In addition, almost 300 applicants were denied entrance when they tried to enter the program by being added as responsible officials or new partners on revised applications.

During the 1997 filing season, we performed over 1,800 electronic return originator (ERO) compliance reviews. As we hoped, the vast majority of these practitioners were complying with the revenue procedure governing electronic filing. However, 322 warnings were issued to participants for violations and 65 participants were suspended for serious breaches of the requirements.

Through September 30, 1997, the Questionable Refund Detection Teams identified almost 2,500 fraudulent refund schemes involving multiple paper and/or electronically filed returns. We detected approximately 25,000 fraudulent returns and prevented the issuance of over $79 million in refunds. In addition, patterns of questionable returns that did not warrant criminal investigation were referred to Examination.

The Compliance divisions pursued appropriate enforcement on suspect returns. During FY 1997, the Criminal Investigation Division initiated 248 criminal investigations involving refund fraud schemes. Prosecution recommendations were forwarded in 158 cases, and we obtained indictments on 237 individuals and convictions in 213 cases (totals include cases initiated in prior years).

In addition, the Criminal Investigation Division initiated 172 criminal investigations involving return preparers. Prosecution recommendations were forwarded in 107 cases, indictments obtained on 112 individuals, and convictions in 84 cases. These totals include cases initiated in prior fiscal years and some cases still pending.

For the fiscal year ending September 1997, Examination closed approximately 375,000 cases with assessments exceeding $612.9 million. Significantly, few resources were expended to collect these assessments as the majority of returns claimed refunds that were not issued until eligibility was determined.

1998 Revenue Protection Strategy

As in past years, the Service will not disclose detailed information concerning its plans for fraud control and revenue protection. However, there are broad pieces of the strategy that we are willing to share to assist taxpayers and practitioners to avoid unnecessary problems with meeting their filing obligations.

For the 1998 filing season, the most visible fraud prevention effort is again the validation of TINs, SSNs, individual taxpayer identification numbers (ITINs), and adoption taxpayer identification numbers (ATINs). We plan to expand the validation of SSNs, ITINs and ATINs to the balance of the various forms and schedules of individual income tax returns.

To safeguard fair compliance and taxpayer confidence, the IRS will maintain its enforcement segment of the Revenue Protection Strategy. We will increase resources for the investigation and prosecution of taxpayers and tax return preparers involved in fraudulent refund schemes. We will dedicate additional resources to auditing returns in specific problem categories to verify EITC eligibility prior to issuing refunds. Monitoring visits to EROs will be continued to ensure compliance with participant requirements.

As previously discussed, a highlight of this filing season has been a Problem Prevention /EITC Assistance Day that provided assistance to EITC filers. We coordinated the VITA and TCE assistance for this day as well.

An EITC Communications Strategy was developed which incorporates three components to be used together to improve EITC compliance: (1) **Awareness** — help taxpayers and practitioners to understand the EITC eligibility rules and the consequences of non-compliance; (2) **Deterrence** — inform taxpayers and practitioners of planned compliance programs and the penalties for intentional non-compliance; and (3) **Prevention** — avoid filing problems by publicizing the availability of free return preparation assistance and electronic filing provided through VITA and TCE programs.

Also, during 1998, we plan to gather information on the effectiveness of our current EITC-related products by contracting out this task to a market research firm. Results will be useful in 1999 and subsequent years. The development of new or revised products to simplify the presentation and computation of EITC will also be accomplished with an external contractor.

FINANCIAL AUDIT

For the first time, the General Accounting Office (GAO) has given an unqualified — or "clean" — opinion on the reliability of the Internal Revenue Service's Custodial Financial Statements. The statements audited by GAO were IRS reports on taxes collected and refunds paid during Fiscal Year 1997.

The opinion means GAO could reconcile the total revenue reported to the total taxpayer account records IRS maintains, substantiate the amounts for various types of taxes collected, and determine that accounts receivable estimates were reliable.

In addition, the Treasury Inspector General has given us an unqualified — or "clean" — opinion on our Administrative Financial Statements for FY 1997. This means that the Inspector General can attest that these statements fairly present the financial position and results of operations related to the funds appropriated by Congress and reimbursements from other Federal agencies, state and local governments.

I am very pleased with the progress that we have made managing our finances at the Service. The unqualified "clean" opinions on both our Administrative and Custodial Financial Statements mark a significant first step for the agency — especially in view of the fact that our accounting system was never designed to support these financial statements.

While I am pleased with our progress, I want to acknowledge the six "material weaknesses" identified by GAO that still exist in the following five areas: our general ledger system, supporting documentation, controls over refunds, revenue accounting and reporting, and computer security.

We had already identified these weaknesses in our annual accountability report. Two of the six involve limitations of the existing custodial financial system. While we have taken steps to correct them as a part of the overall modernization effort, it will take more than one or two reporting periods to implement these changes.

In the supporting documentation arena, a study was conducted in the first quarter of 1998 on the IRS's documentation practices. In light of the audit findings, we will now review and possibly update this study.

Actions to address the fourth area that needs to be strengthened, controls over refunds, are scheduled to be completed by the end of FY 1998.

The fifth area, revenue accounting and reporting, requires legislation to mandate that taxpayers allocate receipts at the time of remittance. We are taking actions in our revenue financial systems to accommodate this information if and when it is mandated, or if the taxpayer chooses to provide the information.

We have made significant progress on the final area, computer security, through centralizing responsibility for security and privacy issues. We have targeted a June 1999 completion date for all corrective actions.

IRS MODERNIZATION

As the Members of the subcommittee are aware, I have proposed a sweeping modernization of the Internal Revenue Service. We will reach our goal of service to each and every taxpayer through changes in five key areas, each complementing the other.

First are revamped IRS business practices that will focus on understanding, solving and preventing taxpayer problems. Instead of the historic "one-size-fits-all" agency, we should tailor our efforts to taxpayer groups with common needs.

The second change is an organizational structure built around taxpayer needs. One logical way to organize the IRS is to divide it into four units, each charged with top-to-bottom responsibility for serving a segment of taxpayers with similar needs.

Third, we need to create management roles with clear responsibility. The management teams for each of these units will be held fully accountable for achieving specific goals. We must selectively recruit key people with private sector experience for some of these senior roles.

Fourth, it is essential that we measure organizational performance by balancing customer satisfaction, business results, employee satisfaction and productivity. We must develop a measurement system that influences employee behavior in a positive way, and in a manner that fosters customer service. This will provide a sound basis for insisting on accountability.

Fifth, is new technology. IRS' current computer systems cannot support the agency's mission and goals. Information technology should enable the IRS to achieve its strategic objectives, not drive them.

The IRS has engaged the consulting firm of Booz, Allen & Hamilton to validate the concept for modernization in terms of risk, cost and impact on customers, both external and internal.

FY 1999 BUDGET

For FY 1999, we have prepared a budget that supports the beginning of the transformation of the IRS that I have outlined above. It allows us to continue current operations while working on the five initiatives that form the strategy for near-term improvement and long-term modernization. It also sets the stage for the kinds of productivity improvements we will need to provide good customer service within the budget constraints under which we must operate.

Our total budget request for FY 1999 is $8.196 billion and 99,829 FTE. This covers funding of the Processing Assistance and Management, Tax Law Enforcement, Information Systems and Information Technology Investment Appropriations. In addition, we are requesting $143 million and 2184 FTE in funding outside the caps for the EITC. The total budget request includes a net increase of $529 million and 1232 FTE over the FY 1998 level.

Of this increase, $176 million represents part of the cost that would be needed simply to maintain the current level of operations, taking into account inflation and mandatory pay increases. This $176 million level is less than the full cost of maintaining current levels. We have absorbed as much of the difference as possible without diminishing service to the taxpayer.

The remaining increases from FY 1998 levels are for the priorities previously discussed (less a $2 million reduction in our Information Technology Investment Account):

1. Completing the Century Date Change Program

Preparing for the Century Date Change is one of the most critical elements of our 1999 budget. By the beginning of the 1999 filing season, nearly all of the systems changes required for the Century Date Change must be completed. During the remainder of FY 1999, the principal tasks will be to complete testing and certification, still a large effort that will cost $234 million in FY 1999. This figure does include some Mainframe Consolidation and ISRP funding since a portion is considered Year 2000 related.

The funds I have requested are vital to providing essential customer service and to avoiding the potentially disastrous effects of an uncorrected Century Date Change problem. I discussed in greater detail the year 2000 date change in a previous section.

2. Making near-term improvement to service for taxpayers

During FY 1999, we will pursue a highly focused initiative to improve service to taxpayers through improved clarity of notices, forms and publications, better telephone service, more walk-in service, expanded electronic filing, improved training of customer service representatives, strengthened support for small businesses, increased staffing for the Taxpayer Advocate's office, and the creation of Citizen Advocacy Panels. There are estimated incremental costs of $103 million related to these essential near-term service improvements.

3. Investing in essential near term technology

To ensure that customer service remains a top priority as we move toward the year 2000, the budget request includes investments that are necessary to enable us to maintain an acceptable level of service. The major near-term investments for FY 1999 are the completion of a call router system, funding for which is included in improved service to taxpayers, deployment of computers to field collectors who currently have no computers, and replacement of computers used by field agents who depend on them for examinations. In addition, increases in product assurance are essential for adequate testing of changes to tax systems before they are put in production to maintain the records of millions of taxpayers.

4. Investing in long-term technology modernization.

The IRS' existing base of technology is extremely old and deficient in its ability to support the mission of the agency. In FY 1997 and 1998, careful preparation for replacing the existing technology base began with the publication of the Modernization Blueprint; the beginnings of the establishment of an internal systems life cycle management process; and the publication of a draft RFP.

In FY 1999, the process of long-term modernization will continue with the strengthening of the IRS internal systems management capabilities and processes and the award of the Prime contract. The Prime contract's initial tasks will focus on completing the systems management life cycle and developing the first two subreleases of the technology modernization blueprint, which provide telephone and other communication capabilities. These are basic functions essential to support all IRS operations.

The FY 1999 budget request for longer-term technology modernization comes in two parts: IRS capabilities for managing and supporting modernization, including funding of the integrated support contract, as well as funding for the Information Technology Investment account for the Prime contractor. In addition, increases in product assurance are essential for adequate testing of changes to tax systems before they are placed in production.

No money will be spent on the blueprint beyond the first two releases without my personal review and judgment that there is an adequate business "case" and control over risk factors. Both will be reviewed and monitored prior to and during implementation.

As I stressed in an earlier portion of my testimony, the timetables for all information technology projects are subject to review and change; every date will not stay constant. There is, however, no reason for concern. We are actively managing the risk associated with these projects and we are on schedule.

5. Organizational Modernization

The FY 1999 budget includes $25 million to support the long-term modernization proposal. Although not yet fully specified, this will include recruiting, relocation and retraining of people as well as the development of detailed plans for the reorganization.

Historical Perspective

Over the last three years the IRS budget (net of costs for the Century Date Change) has actually declined by 7 percent while dollars collected have gone up by 24 percent. Returns processed have increased by 8 percent and the Taxpayer Relief Act of 1997 has added about 800 changes to the tax code. These increases in volume of activity and code changes have ramifications throughout the IRS, requiring new forms and publications, employee training and substantial technology updates.

CONCLUSION

In conclusion, I believe that there is a new day at the IRS. I believe we can transform the IRS into an agency that helps taxpayers meet the obligations imposed by the tax laws while ensuring that compliance is fair. We can do this while increasing productivity and shrinking the size of the IRS in relation to the economy. This will take time and investments to modernize technology, business practices and organization. But, with the support of the Congress, I am optimistic that we will succeed.

FILING SEASON STATISTICS

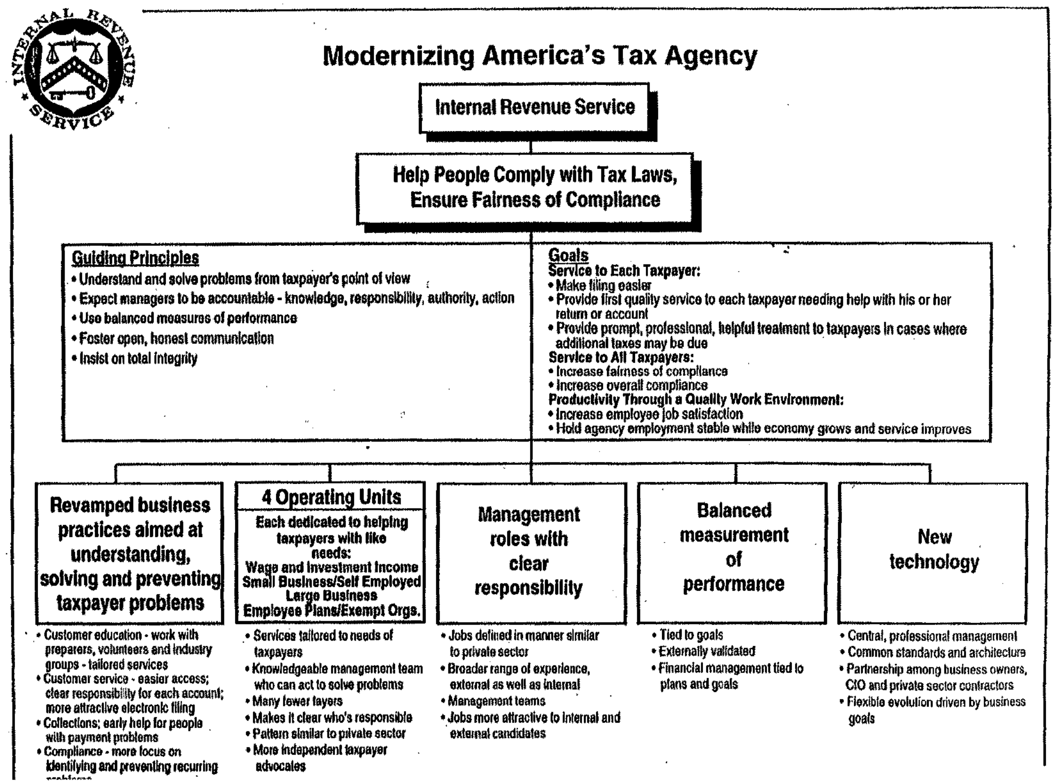
	1997	1998	% of Change
Return Receipts -As of 3/20 Total 1040 (Thousands)	55,703	56,120	0.75%
Alternative Ways of Filing			
Total (Thousands)	15,917	19,750	24.08%
e-file	12,108	14,964	23.59%
TeleFile	3,809	4,786	25.65%
Refunds (Thousands)			
Total #	40,948	43,218	5.55%
Total $(millions)	$55,106	$60,363	9.54%
Direct Deposit #	12,626	14,562	15.33%
IRS Homepage # of System Accesses 1/1/98-3/22/98	69,574,624	208,447,682	200.0%
Total Telephone -As of 3/21 (1040, Notices, Refund, ACS, ADC) # Calls Answered	26,250,421	27,121,210	3.32%
Level of Access	67%	91%	35.8%
Toll-Free Telephone (1040/Notice/Refund)			
# Calls Answered	22,038,653	21,700,069	-1.54%
Level of Access	67.0%	91.0%	35.8%
Accuracy: Tax Law	95.0%	93.2%	-1.89%
Account	90.51%	90.57%	.06%
TeleTax # Calls Answered	25,930,909	24,740,428	-4.59%
Walk-in # Assisted (As of 2/28)	1,675,831	1,598,040	-4.64%

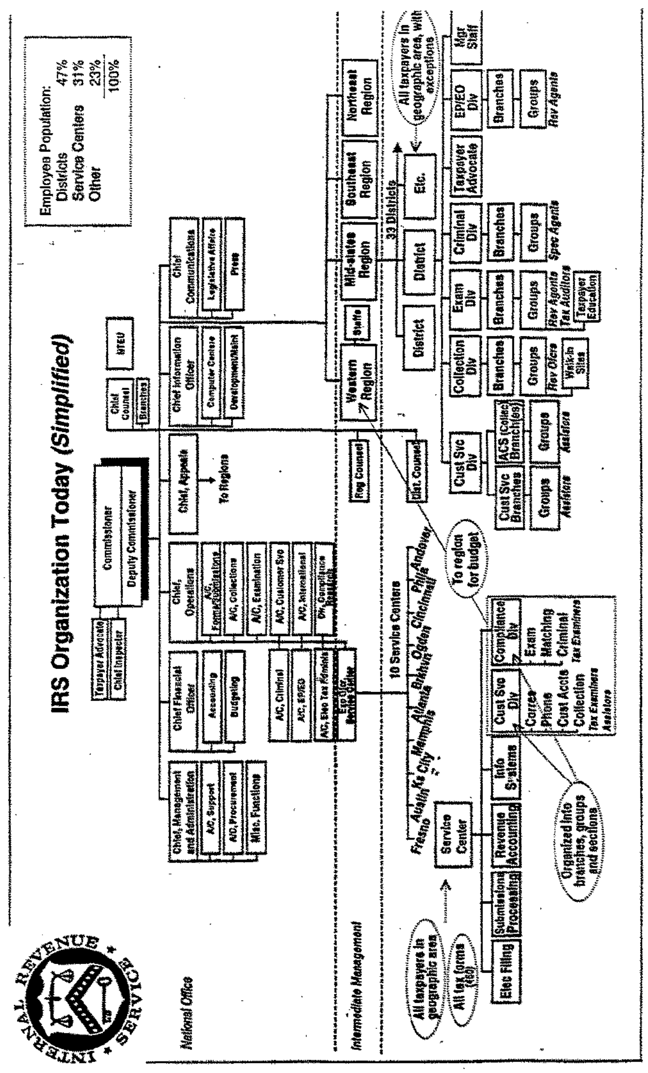
Chief Taxpayer Service

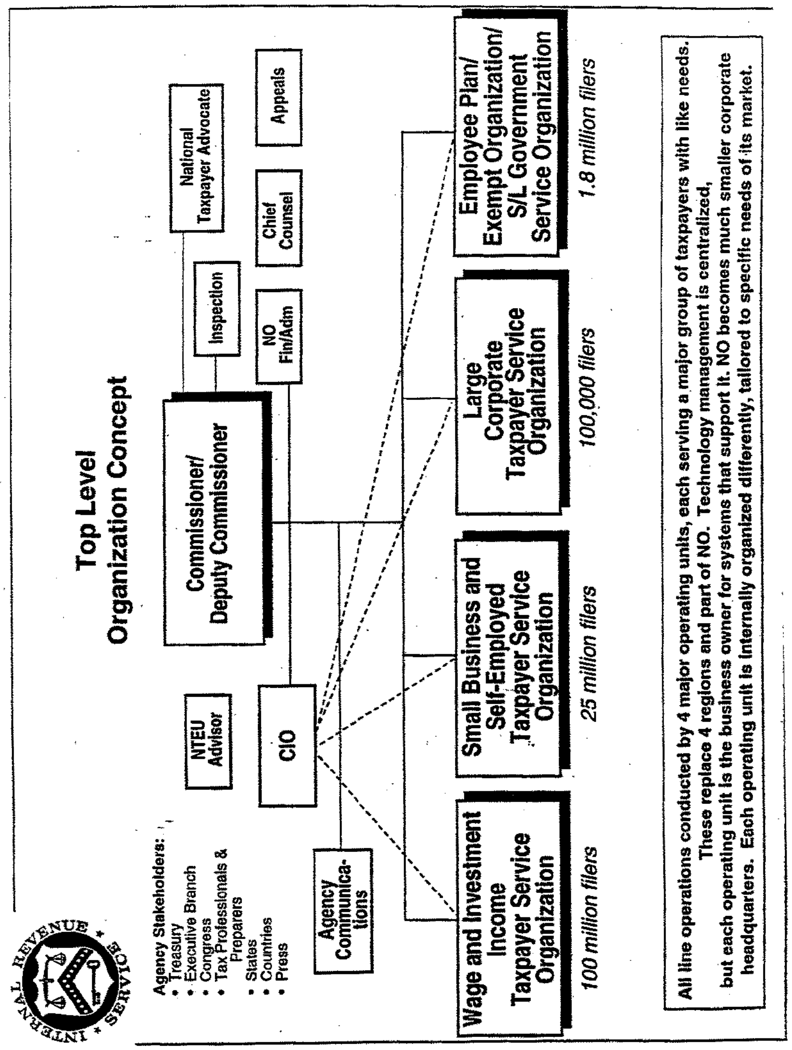
IRS EMPLOYMENT BREAKDOWN

	Full Time FTE	Seasonal OTFTP FTE	Total FTE	Percent of Full Time FTE	Percent of Total FTE
Direct Taxpayer Contact					
Customer Service	15,722	4,735	20,457	18.3%	20.3%
Taxpayer Advocate	383	5	388	0.4%	0.4%
Walk-In Service	830	331	1,161	1.0%	1.2%
Customer Education	217	44	261	0.3%	0.3%
Underreporter	1,357	355	1,712	1.6%	1.7%
Exam	20,906	376	21,282	24.3%	21.1%
Collection	10,537	117	10,654	12.2%	10.6%
Criminal	3,881	159	4,040	4.5%	4.0%
Appeals	2,042	19	2,061	2.4%	2.1%
EP/EO	1,755	41	1,796	2.0%	1.8%
Total Customer Contact	57,630	6,182	63,812	67.0%	63.5%
Submission Processing	7,386	7,175	14,561	8.6%	14.4%
Information Systems	7,165	175	7,340	8.3%	7.3%
Forms Distribution	246	362	608	0.3%	0.6%
Inspection	1,162	6	1,168	1.3%	1.2%
International	432	41	473	0.5%	0.5%
Counsel	2,511	72	2,583	2.9%	2.6%
Management & Support	9,541	413	9,954	11.1%	9.9%
Total	86,073	14,426	100,499	100.0%	100.0%

Notes:
1. Included all people in N.O. and R.O. in Management and Support.
2. Used FY 98 financial plan, as of January 31.
3. Management Support Includes: SOI, Research, Mgt Services, DSS, Finance, HQ, Procurement, Communications, CTR, Bldg Del. and IS-EITC.
4. Direct taxpayer contact numbers include non-SES managers below District level.


Modernizing America's Tax Agency
Internal Revenue Service
Help People Comply with Tax Laws, Ensure Fairness of Compliance
Guiding Principles
• Understand and solve problems from taxpayer's point of view
• Expect managers to be accountable - knowledge, responsibility, authority, action
• Use balanced measures of performance
• Foster open, honest communication
• Insist on total integrity
Goals
Service to Each Taxpayer:
• Make filing easier
• Provide first quality service to each taxpayer needing help with his or her return or account
• Provide prompt, professional, helpful treatment to taxpayers in cases where additional taxes may be due
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
Revamped business practices aimed at understanding, solving and preventing taxpayer problems
• Customer education - work with preparers, volunteers and industry groups - tailored services
• Customer service - easier access; clear responsibility for each account; more attractive electronic filing
• Collections; early help for people with payment problems
• Compliance - more focus on identifying and preventing recurring
4 Operating Units
Each dedicated to helping taxpayers with like needs:
Wage and Investment Income
Small Business/Self Employed
Large Business
Employee Plans/Exempt Orgs.
• Services tailored to needs of taxpayers
• Knowledgeable management team who can act to solve problems
• Many fewer layers
• Makes it clear who's responsible
• Pattern similar to private sector
• More independent taxpayer advocates
Management roles with clear responsibility
• Jobs defined in manner similar to private sector
• Broader range of experience, external as well as internal
• Management teams
• Jobs more attractive to internal and external candidates
Balanced measurement of performance
• Tied to goals
• Externally validated
• Financial management tied to plans and goals
New technology
• Central, professional management
• Common standards and architecture
• Partnership among business owners, CIO and private sector contractors
• Flexible evolution driven by business goals


IRS Organization Today (Simplified)
Employee Population:
Districts 47%
Service Centers 31%
Other 23%
100%
National Office
Taxpayer Advocate
Chief Inspector
Commissioner
Deputy Commissioner
Chief Counsel
Branches
NTEU
Chief, Management and Administration
A/C, Support
A/C, Procurement
Misc. Functions
Chief Financial Officer
Accounting
Budgeting
Chief, Operations
A/C, Collections
A/C, Examination
A/C, Customer Svc
A/C, International
A/C, Criminal
A/C, EP/EO
Chief, Appeals
To Regions
Chief Information Officer
Computer Centers
Development/Maint
Chief Communications
Legislative Affairs
Press
Intermediate Management
Reg Counsel
Western Region
Staffs
Mid-states Region
Southeast Region
Northeast Region
Dist. Counsel
33 Districts
District
District
Etc.
All taxpayers in geographic area, with exceptions
Cust Svc Div
Collection Div
Exam Div
Criminal Div
Taxpayer Advocate
EP/EO Div
Mgr Staff
Branches
Groups
Assistors
Rev Officers
Walk-in Sites
Rev Agents
Tax Auditors
Taxpayer Education
Spec Agents
10 Service Centers
Fresno
Austin
Ks City
Memphis
Atlanta
Brkhvn
Ogden
Cincinnati
Phila
Andover
To region for budget
All taxpayers in geographic area
All tax forms
Service Center
Elec Filing
Submissions Processing
Revenue Accounting
Info Systems
Cust Svc Div
Compliance Div
Corres
Phone
Cust Accts
Collection
Tax Examiners
Assistors
Exam
Matching
Criminal
Organized into branches, groups and sections


INTERNAL REVENUE SERVICE
Top Level
Organization Concept
Agency Stakeholders:
• Treasury
• Executive Branch
• Congress
• Tax Professionals & Preparers
• States
• Countries
• Press
NTEU Advisor
CIO
Agency Communications
Commissioner/ Deputy Commissioner
Inspection
NO Fin/Adm
National Taxpayer Advocate
Chief Counsel
Appeals
Wage and Investment Income Taxpayer Service Organization
100 million filers
Small Business and Self-Employed Taxpayer Service Organization
25 million filers
Large Corporate Taxpayer Service Organization
100,000 filers
Employee Plan/ Exempt Organization/ S/L Government Service Organization
1.8 million filers
All line operations conducted by 4 major operating units, each serving a major group of taxpayers with like needs.
These replace 4 regions and part of NO. Technology management is centralized,
but each operating unit is the business owner for systems that support it. NO becomes much smaller corporate
headquarters. Each operating unit is internally organized differently, tailored to specific needs of its market.

Enhance Customer Service

Initiatives:	$ M
Improve clarity of notices, forms, pubs	$ 5
Provide better telephone service	$ 50
Make it easier to get answers in person	$ 6
Expand Electronic Filing	$ 3
Strengthen support for small business	$ 1
Shift how performance is measured	$ 1
Improve customer service training	$ 23
Strengthen Taxpayer Advocate's Office	$ 10
Create Citizen Advocacy Panels	$ 5
Total	**$ 103** [1]

1. Includes $ 42 million contained in the Information Systems Appropriation

Near-Term Technology Investments
($ in Millions)

	FY 1999 Increase* (IS Appropriation)
Business Lines Investments :	
• Integrated Collection System	$ 61
• Field Agent Exam Computers	$ 33
• Integrated Personnel System	$ 14
• Other Systems	$ 17
Subtotal	$ 125
Other Investments:	
• Enhance Customer Service	$ 42
– Includes $19 Million for Call Routers	
• Operational Systems	$ 33
– Includes $ 16 million for Product Assurance	
• Organizational Modernization	$ 6

IRS PRINCIPAL SYSTEMS

Computer Systems	Vintage	Technology Platform
Master Files (Taxpayer Records)	1965	IBM - Tape Files
Integrated Data Retrieval (On-line Access / Customer Service)	1978	UNISYS
Automated Collection System (Telephone Collections)	1985	IBM
Field Agents' Exam Computers	1990 / 1991	DOS Laptops
Revenue Officers' Personal Computers	1/3 Paper 2/3 1996 / 1997	UNIX Laptops
Customer Service Rep Tax Law Information	Paper	3-ring Binders

<u>Telephone System:</u> Manual call routing
No screening voice response unit
Limited voice messaging
Circuitry bottlenecks due to design flaws
Minimal systems management capability
No predictive dialing

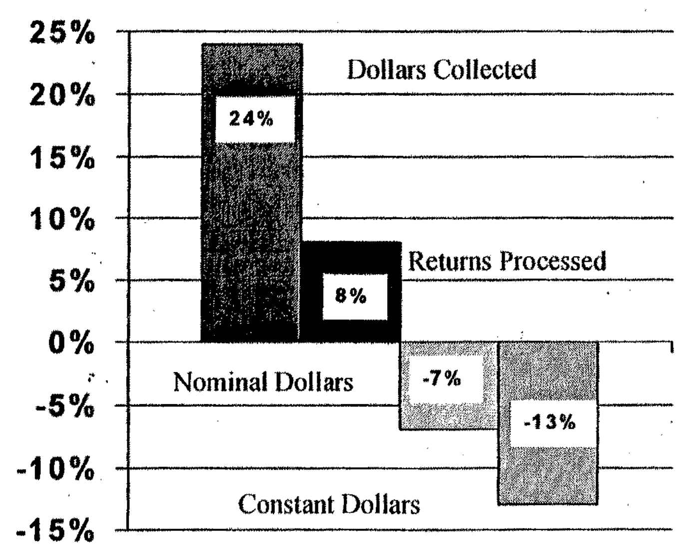
Longer Term Technology Investments

($ in Millions)

	FY 1999 Budget (IS Appropriation)	FY 1999 Increase (IS Appropriation)
Modernization Program:		
• Program Management / Architecture & Engineering	$ 31	$ 0
• Security	$ 17	$ 17
• Systems Life Cycle and Performance Measures	$ 18	$ 18
• Phase I Blue Print Implementation	$ 13	$ 13
• Architecture / Engineering / Infrastructure	$ 21	$ 21
Subtotal	$ 100	$ 69
Investment Account:		
• Information Technology Investment	$ 323	$ 0
Total Longer Term Technology Investment	**$ 423**	**$ 69***

Work Increasing; Resources Decreasing

(FY 1995 - FY 1998)



IRS Budgets
FY 1995 - 1998

	Appropriations			
	FY 1995	FY 1996	FY 1997	FY 1998
Processing, Assistance & Management	$1,704	$1,724	$2,882	$2,926
Tax Law Enforcement	$4,390	$4,097	$3,036	$3,144
Information Systems	$1,388	$1,527	$1,287	$1,272
Total Operating Apprориations	$7,482	$7,348	$7,205	$7,341
Less: Y2K Costs *	----	----	$175	$384
Total Operating Appropriations Less Y2K				
Nominal Dollars	$7,482	$7,348	$7,030	$6,957
Constant Dollars	$7,482	$7,195	$6,716	$6,478
Workload :				
Net Revenue Collected	$ 1.270T	$1.376T	$1.504T	$1.575T
Primary Returns Processed	193.3 M	196.2 M	202.6 M	208.4 M
Information System Investment	----	----	----	$325
Total IRS Appropriations	$7,482	$7,348	$7,205	$7,666
Earned Income Tax Credit	----	----	----	$138

Dollars in Millions
* Includes Mainframe Consolidation, DSP/ RPS and Product Assurance related to Y2K

Internal Revenue Service FY 1999 Budget ($ In Millions)	Processing, Assistance & Mgmt.	Tax Law Enforcement	Information systems	Information Technology Investments	Total
FY 1998 Base	***$2,926***	***$3,144***	***$1,272***	***$ 325***	***$7,667***
1. Maintaining Current Levels (MCL)	91	108	44		242
Less: Non-Recurring costs			-14		-14
Absorbed w/in base	-28	-17	-8		-52
Net MCLs	63	91	23*		*176*
2. Enhance Customer Service	58	3	42**		*103*
3. Information Systems					
Operational Systems			33***		33
(Balance of increases/decreases not included in #1,2,4 & 6)					
Modernization Program			69		69
Business Line Invest.			125		125
Sub-total Information Systems			227		*227*
4. Organizational Modernization	16	3	6		*25*
5. Decrease in Information Technology Investments				-2	*-2*
6. TIMIS (Payroll)Transfer	29		-29		
7. Realignments	70	-70			
Sub-total Increases	236	26*	269*	-2	*529*
FY 1999	***$3,162***	***$3,170****	***$1,541****	***$323***	***$8,196***

Note:

* Totals do not add due to rounding

** Includes $ 19 million for Call Routers

*** Includes $16 million for Product Assurance

Chairwoman JOHNSON. Thank you, Commissioner. I'd like to start with a couple of questions that emanate from preceding hearings and from your testimony.

First of all, in your budget brief, you make the point and you make it in italics, that the investment in technology—this section is entitled, "Inadequate Near-Term Technology Investment Pending Long-Term Solutions Through Modernization Blueprint"—and I understand the difference between the modernization blueprint and the enormous investment in technology that you need to make to comply with the Year 2000 challenge and also to meet some of your service goals in the near-term.

Nonetheless, it is a startling statement. You say here, it will—while this blueprint and the funding that goes with it are essential for the long-term viability of the IRS, it will provide no improvement in support of current operations for at least three more years.

Now, I would assume that your technology investments that you're going to make in the near term to meet the challenge of the Year 2000 and also to meet some of your service goals and to improve management and all the other things that you have laid out in your testimony, I would imagine that they would make, (a), some near-term improvement in operations and in service, but that they are coordinated with your long-term blueprint and, for the most part, would not have to be repeated in 2001, except for software changes. Now——

Mr. ROSSOTTI. Yes, Madam Chairwoman; the point that I made about the three years is that we really are operating on two tracks here because it's just the nature of where we are in the technology in the IRS. The one track which you were mentioning contains some of the things that are in the budget for this year which have immediate impact; like the Call Router and computers for collection agents who don't have any. Those will be useful for some years to come.

The blueprint and the longer-term technology modernization really won't even begin until 1999. We've recently—just within the last week—issued the final version of the RFP. The "Prime Contract" award is designed to be made right at the end of this year in December and then the early stages of that—most of the work will be required to put in some of the sort of management processes—the system's lifecycle, as it's called—that GAO, among others, has noted is necessary in order to really have the management tools to manage a large program like this, along with some relatively limited early releases along the blueprint. By the time those get rolled out, that will be into about the 2001 timeframe, which is, you know, almost three years from now and that will be about the time that we will start to begin to see the impact in terms of practical use of the investment we're making in this long-term blueprint.

Chairwoman JOHNSON. I guess my question went to an issue that has been an issue for the IRS for as long as I've been Chairwoman of the subcommittee. And that is, whether or not your short-term investments are harmonious with your long-term blueprint and whether the investments we're making—recently, you were telling me about the number of computers that have to be replaced to meet the Year 2000 challenge. Now, are those going to be useful?

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON [continuing]. In the new blueprint?

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON [continuing]. Or are we going to have to replace them? That's the kind——

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON [continuing]. That's really——

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON [continuing]. What I'm asking.

Mr. ROSSOTTI. For the most part, they will be useful and that's designed—we call that in the buzzwords of technology the phase zero of the blueprint. In other words, it's sort of the piece that precedes the major piece. But, if you look at these——

Chairwoman JOHNSON. But the technology investments that you're making now are harmonious with your long-term blueprint.

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON. Isn't a stop-gap measure that will then have to be repurchased—different equipment purchased——

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON. In two or three years?

Mr. ROSSOTTI. Yes, that's right——

Chairwoman JOHNSON. I don't——

Mr. ROSSOTTI [continuing]. Although I do have to make one comment and that is when you buy things like personal computers, the average life of these computers in most places is at most maybe four or five years. So, you have a normal cycle of replenishment of these things. The hardware portion of this tends to have a certain defined life and you have to provide for those replacements in the normal course.

Chairwoman JOHNSON. Right. I did use that example of personal computers but in developing your centers and in beginning the process of reducing the number of centers——

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON [continuing]. You're going to be making some——

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON [continuing]. Very big investments——

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON [continuing]. In technology.

Mr. ROSSOTTI. Yes.

Chairwoman JOHNSON. Will those mainframe investments will be compatible?

Mr. ROSSOTTI. Absolutely.

Chairwoman JOHNSON. Okay.

Mr. ROSSOTTI. The mainframe—in fact, that's one of the places that, in the Year 2000, we do get some long-term benefit. That's actually one of the bigger pieces of the investment that we are making and that will absolutely be in the direction that we want to go because we'll be boiling the computing centers down to the two main computing centers which is where we want to be in the long-term blueprint.

Chairwoman JOHNSON. Now, one of the really big problems that came to light in recent years and resulted in various provisions in the Taxpayers Bill of Rights and various requirements that this committee has placed on the IRS for reports of one kind of another was the evidence of uneven behavior among IRS agents and some agents using a very authoritarian and abusive technique.

You have put a good deal of money in this new budget for training. What do you hope to accomplish? Who is going to get trained? What kind of training are they going to get? Is this only sort of top-level management to make your new management program work?

Mr. ROSSOTTI. Oh, no, actually, that's the least of it. I mean, the basic focus of the training that we're proposing in 1999 in this budget—is for the front-line people that are dealing with taxpayers. I've spent many, many hours talking to front-line employees, both on video conferences and around the country, and we recently had a session where we actually had a process to survey front-line workers who are dealing with taxpayers, saying what are the things that you think you need most in order to do a better job.

And the number one thing—actually, there were two that were tied—technology was one which we already noted. The other one was better training and, in particular, simply better training in some of the basics, like the tax law changes. I mean, if there's going to be 800 tax law changes, they say we feel very uncomfortable when taxpayers are pressing us for an answer and we don't get enough training in what has happened in the tax law, we don't get necessarily up-to-date materials. So, when we're talking about this training in Fiscal Year 1999, we're talking about very practical training for front-line employees who are going to be working with taxpayers, either over the phone or in person.

Chairwoman JOHNSON. Yes. Now, this year you've separated out the cost of administering the Earned Income Tax Credit and it's going to cost you, at least you're requesting $143 million for EITC administration next year. What is that cost per return?

Mr. ROSSOTTI. Cost per return? That's a number that I don't have—I'll have to get back to you on that.

[The following was subsequently received:]

Question. What is the cost per return for administering the EITC initiative?

Answer. The IRS is currently developing an Activity Based Costing that will provide the cost per return specifically for administering the operational portion of the EITC Initiative. This costing will cover the cost of processing the return, issuing notices and/or refunds, and any compliance actions. The EITC Initiative Plan includes direct work (processing of return, issuing notices, and compliance actions) as well as items such as taxpayer education and outreach efforts, research project funding, postage and printing, and EITC systems development that are not traditionally captured in cost per return calculations.

Chairwoman JOHNSON. I hope you will get back to us——

Mr. ROSSOTTI. I will.

Chairwoman JOHNSON [continuing]. I think it's very useful to have that——

Mr. ROSSOTTI. I will.

Chairwoman JOHNSON. I also will be very interested to know what the fraud level is in this round of returns, since we've made a number of changes——

Mr. ROSSOTTI. Right.

Chairwoman JOHNSON [continuing]. So, I won't go into that now but I do want to know the cost per return and I think the committee wants to know promptly what your experience is as the season closes in the area of fraud.

[The following was subsequently received:]

Question. What is the fraud level this year on EITC returns?

Answer. The IRS undertook a study of EITC which involved a statistically valid random sample of EITC returns filed throughout the 1995 filing season. The study results showed that EITC claims filed during the 1995 filing season contained errors that required adjustments both upward and downward. The final study results provided a baseline from which to analyze further studies of the effectiveness of our EITC administrative efforts. There are several programs which work with a portion of the EITC returns to determine the correctness of those returns. The largest programs being the math error program which looks for systemic problems, missing or invalid SSNs, and the examination program where questionable returns may be audited to determine the correctness of the EITC claims. A study on EITC for the 1998 filing season is currently in process. A fully developed and reviewed report including an EITC level of compliance measurement is expected to be available in 1999.

Chairwoman JOHNSON. Let me turn to Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman. Commissioner, over the past few years your budget has not been as high as—the amount of money allocated in the President's budget for the coming year and I was just wondering if, as a result of that, there any activities that you were unable to complete or to be involved in as a result of a reduced budget?

Mr. ROSSOTTI. Well, Mr. Coyne, actually one of the most important was that, in the last two fiscal years—meaning Fiscal Year 1998 and Fiscal Year 1997—almost all of the money that would have gone to any investment in technology was deferred, was eliminated. I mean, it was all spent. It was used—it's being used for the Year 2000 conversion but, of course, that's pretty much just something you have to do in order to stay even. So, I think in terms of technology we had a deficit to begin with and it got deeper as a result of this.

The training was another major area—you know, we used all available resources to put people on phones and continue to do the compliance programs but, as reflected in the comments of the employees, the training was cut.

I think those are probably two of the more significant areas. The other thing that has happened is in some of the compliance areas—and I'm trying to do more studies of this—while the compliance programs have been maintained, there's a certain unevenness that's developed, especially geographically and across different segments of the population, because of the fact that where people came off the payroll, they came off where, you know, attrition took place or where they would accept buyouts which generally was in the higher-growth economies geographically speaking. Whereas in some of the economies that were—segments of the country that didn't have as tight a labor market, people didn't take the buyouts, didn't "attrit." So, we ended up with a sort of uneven balance of compliance resources.

So, these are some of the things that have happened over the last three years as a result of the constraint of the budget. Now, I will say this was before I got here that there were some very difficult and painful reorganizations that took place that did cut some administrative overhead which I think was an appropriate thing to do and which I think could be justly characterized as an "efficiency gain" rather than a loss of anything that was necessary. So, there were some hard decisions made by my predecessor and others to do that. But, that was not all of it; there were certainly losses—certainly, the technology, the training, and some of the balance of where the people are.

Mr. COYNE. Did that transfer into a not-so-ideal situation relative to taxpayer services?

Mr. ROSSOTTI. Well, it would have except that, of course, one of the things we've done in the last two years is to dramatically increase the emphasis on taxpayer service. So, I think, you know, the balance was struck to be able to try to improve taxpayer service, even in the face of these other constraints.

Mr. COYNE. Could you give us some sense of what the audit rate might be under the proposed budget that you brought before us today?

Mr. ROSSOTTI. I don't have that number with me but we can get that for you.

[The following was subsequently received:]

What is the audit rate under the proposed FY 1999 budget?

The audit coverage figure is 1.17%.

Mr. COYNE. All right. Thank you very much.

Mr. ROSSOTTI. Thank you.

Chairwoman JOHNSON. Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair, and thank you for your testimony today, Commissioner. We have little time and I have a lot of questions so I'll try to be as brief as I can. I would appreciate your answers being to the point, too, as they always are.

First of all, congratulations on what seems to be a relatively successful and smooth filing season. Following along with Mr. Coyne's question with regard to the audit rates and so on, I just have a general question for you which is, the degree to which the shift to customer service, which I generally support as you know, is enough to offset the kind of revenue that the government is likely to lose from the audit rate which—when you get back to Mr. Coyne—will probably be revealed to be a lower percentage.

And, how do you deal with that? And how do you feel about that? Do you think that there's going to be a payoff from improved customer service that will counter that?

Mr. ROSSOTTI. Yes, well, let me say that that is a complex question and obviously, you know, we don't have quantitatively, verifiable data to say what is going to happen.

I think that if you look at what was happening a few years ago, you know, when the access rates were low and the service was much lower than it is now, I mean you really had an untenable situation.

As I saw it, you were sending out notices to people telling them they owed money or that they had to do certain things to comply and then if they had a question about it, they wouldn't be able to get through on the phone which, to me, is something that is really not a tolerable situation. One has to believe—even though we can't prove it at this point quantitatively—that that's going to hurt compliance.

I think that there have been some things that the IRS has done to try to offset the impact of the way that resources have been allocated. For example, the math error capability that was added which allows certain kinds of checks to be made in the up-front processing of tax returns—to check social security numbers, for example—used to be done under the audit program. It's now built in as part of processing tax returns. I think there was something like a half a million returns that were done under the audit program a couple of years ago that have been built in to processing.

As when I said my original testimony to this committee the last time, is I think if we can get the money for training and technology, we can do what a lot of private sector companies do—we can keep our workforce stable, we can improve the quality of the way it works and still be able to achieve our customer service goals and our compliance goals and, as the Chairwoman noted, increase the volume. I really think we can do that if we can get the investment money and if we can get the time to make those things happen. And I think already there's been some signs of that happening.

Mr. PORTMAN. Let me ask you a specific compliance question. This is one that's always troubled me and I think a lot of members of the committee and that is that the Office of Appeals generally rejects about two-thirds of the revenue agents' post-audit request for additional taxes and I just wondered if you can comment on that briefly. Does this suggest that revenue agents are seeking unreasonable high amounts? Does this suggest they're trying to make themselves look good in front of their superiors? And why would there be a two-thirds rejection rate by the Office of Appeals?

Mr. ROSSOTTI. Well, that's a very good question and I've asked that question. I honestly don't know that we know exactly what the answer is but I will tell you one thing that we are doing that has been suggested by a number of people that may have some impact on this.

As you know, we're in the process of changing the entire measurement system for——

Mr. PORTMAN. The measurements of performance that there may be some reason that——

Mr. ROSSOTTI. It might be. I mean, no one can prove that but—we're definitely changing—the measurement system so that we will not be measuring it in such a way that it would potentially give somebody encouragement to just build up assessments and I don't know that that has actually happened—

Mr. PORTMAN. I would just suggest, as we're talking about compliance and how to make compliance more efficient with limited resources, that may be one area where one could look closely and talk about more targeted use of the resources.

Quickly, on Year 2000—you talked a lot about it today, I know you're very concerned about it, and I guess the question I would have and—not to be negative here—but what are your contingency plans? What if you don't become compliant by the Year 2000? Are you going to be able to revert back to some equipment that is not compliant in terms of the type of equipment or the type of application? Do you have a contingency plan, a back-up plan if we're not there?

Mr. ROSSOTTI. Reverting to old equipment doesn't do it because the old equipment isn't compliant. What we are doing is we are trying to very specifically identify our risks and figure out those places where we need to have—and where it's feasible to have—a contingency plan. That's where we're putting our emphasis on contingency planning and I'll give you an example.

One of the major programs that Madam Chairman mentioned was the consolidation of the mainframe computers at the two sites. In that case, that's a very, very big program, that obviously has a lot of risk to it. The target is to get all of the 10 service centers converted to 2 computing centers before the year 2000.

However, we do have a contingency plan. We don't need to absolutely do that. The contingency plan would be to upgrade some of the computers in the sites that they're already in, and we're preparing that kind of a contingency plan. But——

Mr. PORTMAN. At what point in time do you make that determination?

Mr. ROSSOTTI. Pardon me?

Mr. PORTMAN. At what point in time do you decide that you need to revert to the contingency plan?

Mr. ROSSOTTI. We're deciding these—every month. I mean, I personally have a meeting every month with a high-level group and we go over these kinds of things on each risk-area every month. We made this decision, for example, just this last month, related to these mainframes.

Mr. PORTMAN. I have additional questions on EITC and maybe we'll have time at the end of the session. Thank you.

Chairwoman JOHNSON. Mr. Tanner.

Mr. TANNER. Thank you, Madam Chairman. I want to follow up on the Year 2000, if I could, Commissioner. And thank you for being here today.

I am not as concerned, I guess, about the fact that you all will do, I think, what you need to do to get your computers compliant with whatever technology is available for the purpose intended.

At the moment, what about all of the people who communicate with you and who may not be in the same position? That's, I think, one of jobs facing not only the Congress in terms of education and public awareness but also the service as well. And so, do your contingency plans—could you briefly describe where we are with that? Thank you.

Mr. ROSSOTTI. Yes, that is, in fact, a very good point. When we talk about Year 2000, it's not just converting our own application programs. There's a whole series of areas that we include under our management program. And one of them is the very area you're talking about—we call it "external trading partners." These are people we exchange data with—like the States, the people that send us information returns. We have a whole office of people who are tracking those people, especially the major ones. I don't have the exact number here but I think there's about 67 or some number like that that's the top priority ones and then we've got the next priority ones. And we have a whole program to communicate with them and actually to test at the appropriate time the ability to interchange data with them.

So, I mean, it is a focus area. I will say that based on the reports I've gotten right now for at least the top-priority ones, that is not one of the ones that is in the most cautious status. We seem to be doing pretty well at least for our major trading partners.

Mr. TANNER. Thank you, Madam Chairman, I yield back.

Chairwoman JOHNSON. Congresswoman Thurman.

Mrs. THURMAN. Thank you, Madam Chairman. First of all, I want to take a few moments just to say that in the short period of time that I've been on this committee, we've asked a lot of questions of the IRS in bringing forth information, letting us know how you do communicate with our constituents. Certainly what I think you've brought back to us today says that you have done a much better outreach program than I think I would have anticipated in the two years that I've been here and been listening to some of this. So, first of all, I want to compliment you on that fact. And I want to compliment you because it's an issue that I raised several months ago; and that is the outreach you've done with your front-line people. Those are the people that our offices are talking to, those are the people that we have to go to to get our questions answered, and certainly those are the people that I think are going to need to have the information to best provide for the taxpayers out there. So, I compliment you on recognizing that that front line is an extremely important part of this.

In keeping with that and in the information that I've received over the last couple of years, the EITC and small business seem to be the two areas that we've had the hardest time in compliance, certainly from the electronic filing, possibility of the 16-hour telephone service, the kinds of things that you've done to outreach.

What other kinds of things are you doing or do you anticipate doing to try to bring—I think the number that I heard for sole proprietors, small businesses, is about 40 percent. If you bring in some cash businesses, it might go up as high as 60 percent. EITC, I think, was at one time 25 percent. Is it now down to about 17 percent? Is that somewhere——

Mr. ROSSOTTI. Well, I don't think we're——

Mrs. THURMAN [continuing]. Around those numbers?

Mr. ROSSOTTI. We don't have up-to-date numbers. We're doing a study to find that out. But I think that, you know, it is interesting that you put both of those together.

In these areas where there's noncompliance, I think that the strategy that we're following right now with EITC is generally the strategy we want to follow with all non-compliant areas, which is to have a strong emphasis on preventing the problem in the first place, by such things as what we did with EITC; mailing out notices to people that have previously claimed an EITC they weren't entitled to and tell them, look, you really shouldn't be claiming this or, if you are, you need to provide us with better information. Get the problem resolved upfront. Have education, outreach kinds of activities. Educate the practitioners.

Then, at the back end, you also need to apply your resources to identify those people that, continue to non-comply even after that, and that's why we have these various detection programs, to try to detect and, where possible, prevent the refunds from going out.

I think with all other areas, whether it be small business or elsewhere, that most people, given the right services and the right kinds of education, will comply if they know they're supposed to and if they understand that really is a mandatory requirement. I think better working with some of the small business groups; better support for people that are starting up small businesses—which is something I knew something about in my previous life—those kinds of things will, I think, help.

That's one of the reasons in the long term that we need to organize the IRS into units that are dedicated to understanding those particular kinds of taxpayers. If we get to the point where we have a small business unit that basically services all the taxpayers, they can, then, get to be very, very knowledgeable about all the specific problems—the specific problems for each industry whether it be the construction industry, the software industry, and all the different industries and work with those associations; work with those people, and figure out what do we need to do to help these people understand their obligations; keep them in compliance, and limit our enforcement resources where they should be to those people who really just aren't willing to comply after we've done that. Now, that's, the long-term strategy that we want to go to, and we're pursuing that this year with EITC as much as we can.

Mrs. THURMAN. As you see and start to pull that information and, particularly, as you've kind of singled because you have a special account to work on EITC, do you potentially see something that people complain about the most—and that is the complexity of the forms, the kinds of things that we hear about—do you see that as maybe an offspring of this to the possibility that we'll see some of the paper reduction in these kinds of filings for these particular folks?

Mr. ROSSOTTI. Well, I hope that as we learn more——

Mrs. THURMAN. Beyond what we're doing up here to add 800 pages in new tax laws.

Mr. ROSSOTTI. I think there's potential for that in the sense that if you have people that are working with a particular group of taxpayers and they see problems—and this is what we're trying to do with the Taxpayer Advocate Network—they can come back and they can recommend not just specific cases but how we can systematically improve the system, and one way, of course, is to redesign the forms; to have better education. We are going to be doing that as part of our customer services initiative improving some of the publications. Of course, there are limits based on what the tax law says.

Mrs. THURMAN. I acknowledge that. [Laughter.]

Mr. ROSSOTTI. But I do think there's potential to improve that, yes.

Mrs. THURMAN. Thank you.

Chairwoman JOHNSON. Mr. Rossotti, I'd like to proceed with a couple of more questions myself; I know Mr. Portman does and if my colleagues have other questions, we'll have a short additional round.

There are two things that I want to approach. First of all, in your plans for customer service, you don't mention—you don't advance any interest in reorganizing your very front line personnel.

We had a very, very interesting hearing at which the taxpayer advocates testified, and they were very high on the special tax days that the agency has been doing, the Saturday days, the problem-solving days, but they made a very important point: part of the success of those days was due to the fact that everyone on the team was there, and they could take the taxpayer's problems and all the people they would have to run it through and ask questions of were there, so they could solve it. Now, I thought—and we discussed this at some length—I thought that was a very important bit of testimony, because—and that kind of reorganization needs to be thought through at the local level if you're really going to be a problem solving agency and not one that takes in the problem; runs through a million bureaucratic hoops, and hopes that at the end it comes out solved in a timely fashion. That kind of front line reorganization, I think, is extremely important and is what has made the difference in the private sector.

Mr. ROSSOTTI. I couldn't agree with you more, Madame Chairman. If you look at this organization chart of the whole IRS, by the time you get down to the front line employees, they're divided up into these, what we call, stovepipes, functional areas, that are then under quite of few layers of management.

Chairwoman JOHNSON. Yes, I do think the idea of reorganizing according to the subject matter expertise is very good. This is way below that, and it's probably not something that you can do entirely from the top. It's something that they—each office is going to have to figure out how to do, but just Saturday problem-solving days isn't the only time you need the whole team at the table.

Mr. ROSSOTTI. No, I think that the concept that I've proposed organizing is not just strictly at the top. I think that when we get to the next level of detail which we're currently studying, I think we will find that—the whole point is to deliver what the customer needs, not what is organized according to the IRS.

Chairwoman JOHNSON. Well, I thought that was the most significant comment that was made by the advocates about what they had learned from the problem-solving days, and I'll be interested to watch to see if that's——

Mr. ROSSOTTI. Well, I would agree with that very, very much, and if you diagram the way that the current IRS organization works, it makes it very difficult to do that except on an exceptional basis.

Chairwoman JOHNSON. There is one area in which I have a significant question about how you're going to—about your budget decisions. First of all, it is truly remarkable, the increase in electronic filing, telefiling—electronic filing up 28 percent; telefiling up 68 percent; some other statistics along those lines that are very impressive. From past hearings, while we couldn't exactly agree on how much is saved, there was general agreement that an electronically filed tax return is far cheaper for the agency to process than a paper filed tax return. So, clearly, this level of increase of activity does save the agency some money. Consequently, I find it really hard to understand why you're going to continue to function with only 1,682 cross checkers. Now, you used to have 3,322 employees who cross checked interest and dividends reported on individual tax returns, and you used to collect $3.5 billion just from cross checking. Now, the agency now has 1,600 people, so it has about half the number of employees, but it's only collecting about one-third of the amount of revenue. It's collecting—your prediction next year is that you will collect $1.2 billion from this activity as opposed to $3.5 billion.

Now, first of all, half of the employees ought to be able to collect at least half the money; that's a problem. Secondly, this is clearly an area in which personnel matter. I don't know how you cross check if you don't have the people to do it. It also is clearly an area of high yield. So, there are areas in which outside of the whole "we need more money" issue—and I agree you need more money, and I'll work with you to get more money—nonetheless, are you deploying your resources in the most powerful way when you're clearly reducing people power demands in some areas, and you're not pumping them up in an area where there is an obvious big bang payoff for the taxpayers?

Mr. ROSSOTTI. Well, I'd like to be able to get back to you, perhaps, in writing——

Chairwoman JOHNSON. Yes, I'd appreciate that.

[The following was subsequently received:]

Question: The IRS cut about half of the employees from the document matching program but is only collecting about one third of the revenue. Why aren't employees being moved from areas where demand is reducing to the document matching programs where there is a big payoff?

Answer: IRS is constantly trying to balance scarce resources while prioritizing its program objectives. In the area of our document matching program, we made a program decision to shift some of the resources originally directed towards document matching towards increasing the Service's ability to respond to the more taxpayer telephone inquiries during the past filing season. Although the document matching program's resources were reduced, we believe that our shift significantly enhanced our educational efforts through greater contact with taxpayers and, indirectly may have had a beneficial impact upon taxpayers to avoid future contacts within the document matching program.

Mr. ROSSOTTI. But let me just say that one of the issues here is that the total staffing in the IRS, if you look over the last 3 years, has gone down by 10,000 people. The number of returns processed has gone up by 8 percent in total which is more returns, by far, than—in terms of an increase—than we've saved in terms of how many have gone up through electronic filing, because even though our filing's gone up 25 percent, it's 25 percent of a small base. The whole economy has grown enough to add that many returns, so it's certainly more efficient relatively but in terms of absolute numbers of people, we've got to process more returns. In terms of the specific allocation of people to that specific function in terms of document matching, though, I don't have those numbers in my mind, so I could get back to you in writing?

Chairwoman JOHNSON. Yes, I would like you to get back to me.

Mr. ROSSOTTI. I will.

Chairwoman JOHNSON. In the same sort of context, I was very distressed by a report in the newspaper that we did verify and your people said was accurate—this is in February of this year; it's now March, so this is a recent report, and this Ms. Marvel didn't name any officers but said there's been historically a tendency on the part of some, not all, of the revenue officers who contact taxpayers to start that dialogue with an enormous chip on their institutional shoulder. This creates a level of acrimony and a level of perception of persecution that is really not what the system should convey or intends to convey.

Now, you have mentioned that you are very interested in training, and I know from talking with you in other instances that you fully understand that this training has got to correct this kind of problem, but I think this also goes to the problem that Mr. Portman raised of the number of revenue agent recommendations that are actually rejected on appeal. I have no idea how many are paid that should not have been paid just because people can't tolerate the process of or front the money of an appeal. I think we really do have to be very aggressive about training, and I think when we do that we're going to save some money in some other places, and I would like you to get to me on the cross checkers, because I think that's one area that we need to look at as we move through this budget process.

Mr. ROSSOTTI. On the training, I think that the whole business that we're talking about is how do we convert the whole agency, to an agency that says, "Look, our job here is to assume the taxpayers want to comply; we want to help them comply, and then if they don't, then, and only then, do we apply the more stringent kinds of enforcement tools." That is a big change, okay, and it involves more than one thing; I've laid out a number. One of them is, of course, the measurement issue; another one is the training, and it is somewhat technical training, but it's also some of the practices that you mentioned about how you go about doing an interview. In one of our programs that we're working on, we have one of the people working on specifically that issue with respect to collections about how do we retrain or restructure some of the interviewing process for revenue officers, and it's obvious that there are opportunities to improve in that area. It's just that when you have that many people, it takes a little while to get it done, but I am very encouraged by the response I've gotten from the front line employees. I really think that people are ready to change, and they want to make these kinds of changes. They're asking for help in the form of training and other kinds of tools.

Chairwoman JOHNSON. I appreciate that, and for those who are listening—and there always are some that are interested enough in what we're doing to listen—I do affirm my congratulations to you and the people who work in the IRS and the tremendous effort you've made in the last year to respond to the concerns that have been raised publicly and the many, many, many changes that have been made to make the agency more efficient and more customer friendly and more responsive as a customer service bureau.

There are problems and that's why I wanted to be sure that the record did contain a recent complaint, because it's only if people keep talking to all of us—to you as well as to us—that we can make sure that the statistics not only represent progress but that we are creating a different environment for our employees; a different way of serving the public, and a different style of collecting taxes, and I think it will take awhile to make sure that the statistics represent reform at the kind of human level that we all know is important and are committed to achieving.

I'd like to yield to Mr. Portman.

Mr. PORTMAN. I thank the Chair for the second round, and I'd like to focus a little on the earned income tax credit, if I could. This is something that troubles, again, a lot of us on this committee because of the mispayments. I think this year we're estimating they'll be, what, about $5.4 billion worth of mispayments which is well over half of your budget request today, and we continue to see, as Ms. Thurman mentioned, real compliance problems there.

I guess I would have a couple of comments: one, is having looked at the GAO statement today—I know we're going to hear from Lynda in a moment—but on page 41, it talks about the fact that, at least according to GAO, the IRS is not using the 1995 study the IRS undertook which showed that there was about a 26 percent error rate; about 26 percent of the dollars were being misclaimed, and I wonder if you could respond to that first to be sure that that's not the case; that, in fact, you are using that as part of your baseline?

And then I want to talk a little about your compliance efforts. You've just asked for $143 million for the second year of a 5-year compliance effort. If you're not using that 1995 study as a baseline, that would obviously concern me, and that's the implication from GAO's testimony today.

And then I want to talk to you a little about what you are doing in your study.

Mr. ROSSOTTI. Well, first of all, I wanted to bring my colleague here, Mr. Dalrymple, who's more or less directly in charge of this. On the matter of the baseline—and John will elaborate on this—but I think that it's not that it's not being used, it's just that what we're trying to do is to come up with——a preliminary kind of an informal study that was done by the Criminal Investigation Division and not by the people that normally do compliance studies; research that is more statistically sound. So, it is a useful study, but what we're trying to do is, since we have this 5-year program, to create a more reliable and more statistically-based kind of baseline which we will then use every year.

Let me just ask John to talk about that and also the other issue you talked about, about what we're doing in compliance this year.

Mr. PORTMAN. OK.

Mr. DALRYMPLE. Actually, I'll reiterate part of what——

Mr. PORTMAN. My time is limited, John, as you know.

Mr. DALRYMPLE. Yes, okay. I won't reiterate too much. The CID study that we did, which we shared with this committee last year, actually took place prior to all of the changes that Congress made and allowed us to implement such as math error changes for invalid and missing social security numbers, et cetera, which we expect would have a substantial impact on overclaim rates.

Mr. PORTMAN. Moving it from, what, about 26 percent to 21 percent?

Mr. DALRYMPLE. Well, we're really not sure, actually, I mean, that's really the problem. So, that study, the beauty of it was that it pointed up a significant problem that we had; allowed us to create some additional screens in our screening processes for overclaims and identify schemes, and we followed that up with another study the following year, but both those studies predate the changes in the law. So, what we're doing this year is a very precise research study which we believe will show exactly what the compliance rate is this year, and we will follow that up each year of the compliance initiative, or the EITC Initiative, with another compliance study, and we'll be able to tell from the baseline this year what impact steps we're taking this year have had.

Mr. PORTMAN. So, the funds which were appropriated last year are being used, in part, primarily for a benchmark study that would then be used going forward to see whether your compliance efforts are successful?

Mr. DALRYMPLE. Right. It's not really a huge part of the $138 million, but it is a study that's being done this year. It's going to affect about 2,500 tax returns.

Mr. PORTMAN. And when is that study due?

Mr. DALRYMPLE. That study is being conducted right now. We expect to have preliminary results in time for us to affect next filing season, and I'll have to get back to you with the exact date that we expect the study results.

Mr. PORTMAN. Another point GAO makes—which I know you're very well aware of—was your efforts this year with regard to increased information, public information, and so on, probably won't be affected because, yes, these folks tend to file earlier because they're getting a refund, and so when you say for next filing season, I guess that would mean sometime during this calendar year.

Mr. DALRYMPLE. Yes, it would, and, actually, it's interesting because we did quite a bit of work early this year to try to ensure that folks knew about the credit. For example, we sent information letters to 100 of the top employers most likely to employ taxpayers who would be eligible. We sent 6 million EITC recipients informing them of the advanced EITC credit. We sent a notice to approximately 2.5 million taxpayers who did not claim the credit but we thought were eligible, and took other measures. And our EITC filings are up dramatically this year, and the total rate of examinations is actually down, so we think we hit the right mark there. In addition to that, we've put in a substantial number of new screens, and we've done substantial work, also, in the compliance arena which I'd be more than happy to supply you with.

Mr. PORTMAN. Is one of your major problems social security numbers?

Mr. DALRYMPLE. That is one of the major areas that we're looking at. And the math error legislation that you helped pass has been a significant help to us.

Mr. PORTMAN. What does it cost you to check social security numbers with paper returns?

Mr. DALRYMPLE. I have to get back to you. I don't know that off the top of my head.

Mr. PORTMAN. Just one point I would make—and I appreciate the indulgence of the subcommittee—is that I've heard numbers as high as $60, $70 to check the social security numbers. If that's true, then there certainly would be an advantage to move to electronic filing rather than the paper returns and I wonder whether there are efforts being undertaken on the electronic side to encourage electronic filing?

Mr. DALRYMPLE. Yes, there are, to answer that question. We are highly encouraging that, and, of course, there's huge advantages to us there because we check them up front and then reject them out of the system before they ever come in, so we encourage that highly, and, in fact——

Mr. PORTMAN. They need to be screened.

Mr. DALRYMPLE [continuing]. Our trading partners——

Mr. PORTMAN. But at no cost. Well, I guess, if you could get back to me on the social security issue, specifically, and any detail you could give us as to what you plan to undertake with this money, you started to outline it in general terms—I think we're out of time now—and then the more general question I have is whether you're going to give us a benchmark that we can then use for policy purposes here within the year? It would be very helpful for us.

Mr. DALRYMPLE. I'll get you those dates.

[The following was subsequently received:]

Question: What does it cost to check social security numbers with paper returns for EITC compliance?

Answer. Using 1996 data, the average cost to check social security number per paper return claiming EITC is twenty-two cents. This takes into account all processing and validation costs up to the point it becomes necessary to issue a math error notice.

Question: What does the IRS plant to do with the additional funding requested for the EITC compliance initiative?

Answer. The IRS plans to expand on the FY 1998 EITC inititive in FY 1999. The 1998 initiative includes plans to expand customer service efforts with dedicated toll-free telephone assistance, increase community based tax preparation assistance sites, and develop a marketing and educational campaign. The IRS will also expand compliance research efforts. Enhanced computer capabilities will allow the IRS to identify and select questionable EITC claims prior to refund issuance. Funds also are included to reimburse State vital statistics offices, through the Social Security Administration, for expanded data associated with social security numbers. Finally, expanded examination and criminal investigation staff in the district office and service centers will assist our efforts to address questionable or potential EITC fraud.

Question: Is the IRS going to provide a benchmark for EITC compliance that Congress can use for policy purposes within the year?

Answer. A study on EITC for the 1998 filing season is currently in process. The goal of the study is to establish a baseline for measuring EITC compliance. A fully developed and reviewed report including an EITC level of compliance measurement is expected to be available in 1999.

Mr. PORTMAN. Thank you. Thank you, Madame Chair.

Chairwoman JOHNSON. In addition to that, you'll get the figure that I asked the commissioner for earlier, the cost per filing.

Mr. DALRYMPLE. Right. I have that also.

[The following information was received:]

Question: What is the cost per return for administering the EITC initiative?

Answer. The IRS is currently developing an Activity Based Costing that will provide the cost per return specifically for administering the operational portion of the EITC Initiative. This costing will cover the cost of processing the return, issuing notices and/or refunds, and any compliance actions. The EITC Initiative Plan includes direct work (processing of return, issuing notices, and compliance actions) as well as items such as taxpayer education and outreach efforts, research project funding, postage and printing, and EITC systems development that are not traditionally captured in cost per return calculations.

Chairwoman JOHNSON. We'd like to have that report as soon as you conclude it, that you're doing now, your oversight report.

Mr. DALRYMPLE. Okay.

[The following information was received:]

Question: What is the date the study on current year EITC returns will be available?

Answer. The Compliance Research study on EITC for the 1998 filing season is currently in process. The goal is to establish a baseline with the data. The steps of the study include the selection of returns, examinations of the returns, and analysis of the information. A fully developed and reviewed report, including an "EITC level of compliance" measurement, is expected to be available in 1999.

Chairwoman JOHNSON. Mr. Coyne.

Mr. COYNE. Thank you, Madame Chairwoman. Commissioner, are there any results in yet from the EITC awareness day that was conducted this past Saturday in 150 sites across the country?

Mr. ROSSOTTI. We are going to collect the comments from the taxpayers, but we don't have them in yet; it was just this Saturday.

Mr. COYNE. Nothing you could share with the committee at this point?

Mr. ROSSOTTI. Sure.

Mr. COYNE. The current study that's being done, the EITC study, are you going ask that it distinguish between errors and fraud?

Mr. DALRYMPLE. Well, we're actually looking at what we consider to be overclaim rates. It is extremely difficult in these scenarios—I mean, if we see some really abusive things here, we will make referrals out of this process, but it is a research study, and what we're looking for is, in general, overclaim rates. And it's very difficult to determine willfulness in those kind of situations. Now, it's not to say we may not find some really abusive situations which we would then refer to our criminal investigation units, and if we do that, we consider that there was, potentially, some fraud involved.

Mr. COYNE. Well, don't you think that it would be important to go the extra mile for people who do make innocent errors like we all do on our tax returns; to distinguish that between fraud and innocent errors?

Mr. DALRYMPLE. Well, that's how we do distinguish them, Congressman, I'm sorry. If we see badges of fraud in this study, we will know how many—it's a statistically valid study—and we will send those on to our criminal investigation unit, so, to the extent that we see that, we will be pursuing it.

Mr. COYNE. So, the answer to the question, will we be able to distinguish between innocent errors and fraud, is yes?

Mr. DALRYMPLE. A qualified yes. Innocent errors—I mean, there are all kinds of errors, and whether it reaches the threshold for fraud and the definition for fraud is another issue. Does that make sense?

Mr. COYNE. Yes. Thank you.

Chairwoman JOHNSON. If there are no further questions? Thank you, Commissioner Rossotti. We appreciate your testimony, and we look forward to working with you on the budget issues.

Mr. ROSSOTTI. Thank you very much, Madame Chairwoman.

Chairwoman JOHNSON. I'd like to call next, Lynda Willis, the Director of the Tax Policy and Administration Issues at USGAO, General Accounting Office. Ms. Willis, welcome to you and your staff.

STATEMENT OF LYNDA WILLIS, DIRECTOR, TAX POLICY ADMINISTRATION ISSUES, UNITED STATE GENERAL ACCOUNTING OFFICE

Ms. WILLIS. Thank you, Madame Chairman. I'm very pleased to be here today and with your permission, I'll ask that my written statement be put in the record in its entirety, and I'll just very quickly hit the highlights of what we have to say today.

Chairwoman JOHNSON. Thank you. So, ordered.

Ms. WILLIS. I have with me, today, my associate, Jim White, and also the Assistant Director responsible for our technology modernization work, Randy Hite.

The most critical issue IRS faces this year and next is the need to make its computer systems year 2000 compliant. The goal is to implement all year 2000 efforts by January of 1999 to allow time for testing, and with the IRS, as you are all aware, it is very important to have enough time to test the new systems during a filing season before we go into the year 2000. IRS' latest cost estimates indicate that additional funds will be needed for Fiscal Year 1998 beyond the amount already available. IRS is also refining its budget estimates for Fiscal Year 1999 in light of more current information.

For Fiscal Year 1999, the administration is also requesting an additional $323 million for IRS' information technology investments account. Combined with the $325 million appropriated for 1998, that request would increase the account's total to $648 million. Because we believe that $246.5 million of the request has not been justified on the basis of analytical data or derived using a verifiable estimating method, we believe that Congress should consider reducing the administration's request by that amount.

The administration's request also includes $103 million to enhance customer service. IRS plans, among other things, to provide better telephone service; improve customer service training, as you discussed; and strengthen the Taxpayer Advocates Office. We believe all of these areas are critical to good customer service and need improvement.

Each year IRS submits detailed budget estimates to support the administration's budget request. In our opinion, several factors limit the utility of the budget estimates for oversight purposes. For example, the estimates do not provide the kind of information needed to determine how much of the administration's request is for taxpayer assistance as opposed to enforcement. One aspect of IRS' budget estimates that has improved over the years involves the use of performance measures, however there is still much work to be done in that area and many challenges to overcome. Both of these things are very critical to IRS' successful implementation of the Government Performance and Results Act.

Interim data on the 1998 filing season indicate that IRS is continuing to make progress in two very important areas: electronic filing and the ability of taxpayers to reach IRS by telephone. In addition, although it is too soon to assess the results of the IRS initiative to reduce earned income credit non-compliance, we do have observations on two aspects of the initiative. First, some of the expanded assistance will probably be too late to help many claimants, and, second—as Congressman Portman noted--the baseline 1995 study, according to IRS, cannot be used as a baseline. This raises questions as to whether decisions to develop and fund the initiative were founded on reliable data. We also question, based on the information we have from IRS, whether the results of the new baseline study will be available soon enough to be of any value to the Congress.

Madame Chairman, those are the highlights of our testimony today. I'd be happy to answer any questions you may have.

[The prepared statement follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Oversight, House Committee on Ways and Means

For Release on Delivery Expected at 2:00 p.m. EST Tuesday, March 31, 1998

TAX ADMINISTRATION

IRS' Fiscal Year 1999 Budget Request and Fiscal Year 1998 Filing Season

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

TAX ADMINISTRATION: IRS' FISCAL YEAR 1999 BUDGET REQUEST AND 1998 FILING SEASON

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

The administration is requesting about $8.3 billion and 102,000 full-time equivalent (FTE) staff years for IRS in fiscal year 1999. This is an increase of about $500 million and 1,500 FTEs over IRS' proposed operating level for fiscal year 1998. The most critical issue IRS faces this year and next is the need to make its computer systems century date compliant. The goal is to implement all Year 2000 efforts by January 1999 to allow time for testing. IRS' latest estimates indicate that additional funds will be needed for fiscal year 1998 beyond the amount already available. IRS is also refining its budget estimates for fiscal year 1999 in light of more current information.

For fiscal year 1999, the administration is requesting $323 million for IRS' "Information Technology Investments Account." When combined with the $325 million appropriated for this account last year, that request would increase the account's total to $648 million. Because $246.5 million of the request has not been justified on the basis of analytical data or derived using a verifiable estimating method, GAO believes that Congress should consider reducing the administration's request by that amount.

The administration's request also includes $103 million to enhance customer service. IRS plans, among other things, to provide better telephone service, improve customer service training, strengthen the Taxpayer Advocate's Office, make it easier to get answers in person, and improve the clarity of forms and notices--all areas that are critical to good customer service and that need improvement.

Each year, IRS submits detailed budget estimates to support the administration's budget request. In GAO's opinion, several factors limit the utility of those budget estimates for oversight purposes. For example, the estimates do not provide the kind of information needed to determine how much of the administration's request is for taxpayer assistance as opposed to enforcement. One aspect of IRS' budget estimates that has improved over the years involves the use of performance measures. However, there is still much work to be done in that area and many challenges to overcome.

Interim data on the 1998 filing season indicate that IRS is continuing to make progress in two important areas--the use of electronic filing and the ability of taxpayers to reach IRS by telephone. Although it is too soon to assess the results of IRS' new initiative to reduce Earned Income Credit noncompliance, GAO does have some observations on two aspects of that initiative.

Madam Chairman and Members of the Subcommittee:

We are pleased to be here today to participate in the Subcommittee's inquiry into the administration's fiscal year 1999 budget request for the Internal Revenue Service (IRS) and the status of the 1998 tax return filing season.

This statement is based on (1) our review of the administration's fiscal year 1999 budget request for IRS and supporting documentation, including IRS' February 2, 1998, budget estimates, which provide details behind the administration's request; (2) interim results of our review of the 1998 tax return filing season; (3) our past work on IRS information systems and performance measures; and (4) our ongoing reviews of the Taxpayer Advocate's Office, IRS' efforts to reduce noncompliance associated with the Earned Income Credit (EIC), and IRS' efforts to make its information systems Year 2000 compliant.

Our statement makes the following points:

-- The most critical issue facing IRS this year and next is the need to make its computer systems century-date compliant. IRS received $376.7 million for that effort in fiscal year 1998 and is seeking another $234 million for fiscal year 1999. However, IRS' latest estimates indicate that additional funds will be needed for fiscal year 1998. IRS officials are also refining their budget estimates for fiscal year 1999 in light of more current information.

-- As shown in appendix I, the administration's fiscal year 1999 budget request for IRS totals $8.339 billion and 102,013 full-time equivalent (FTE) staff years, which are increases of $534 million (6.8 percent) and 1,462 FTEs (1.5 percent) over IRS' proposed operating level for fiscal year 1998.[1] Included in the fiscal year 1999 request is $323 million for the information technology investments account. Because $246.5 million of that request has not been justified on the basis of analytical data or derived using a verifiable estimating method, we believe that Congress should consider reducing the administration's request by that amount. We also believe that Congress should consider precluding IRS from obligating funds from the investments account to develop or acquire modernized systems until IRS has defined and implemented mature systems life cycle processes.[2]

-- Also included in the fiscal year 1999 budget request is $103 million and 1,024 FTEs to enhance customer service. Most of the $103 million is to go toward providing better telephone service and improving customer service training; smaller amounts

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[1]The fiscal year 1999 amounts include the second year of an IRS initiative to improve compliance with the EIC. Like the first year, the second year is to be funded outside the spending caps.

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

are for such things as improving walk-in service, strengthening the Taxpayer Advocate's Office, and clarifying forms and notices. Each of these areas are important to good customer service and are in need of improvement.

- Each year, IRS submits detailed budget estimates to support the administration's budget request. The utility of this information for oversight purposes is limited because (1) the intermingling of enforcement and assistance resources within various budget activities precludes an assessment of the balance between those two areas; (2) periodic restructuring of IRS' appropriations and the budget activities within those appropriations hinders long-term trend analyses; and (3) the estimates provide inadequate information on the resources being devoted to critical areas, such as the Year 2000 effort and the Taxpayer Advocate's Office.

- One aspect of IRS' budget estimates that has improved over the years involves the use of performance measures. However, there is still much work to be done and many challenges to overcome. These challenges include (1) developing a reliable measure of taxpayer burden, including the portion that IRS can influence; (2) developing measures that can be used to compare the effectiveness of IRS' various customer service programs; and (3) refining or developing new measures that gauge the quality of the services provided.

- Data on the first 2 1/2 months of the 1998 filing season indicate that IRS is continuing to make progress in two important areas–the use of electronic filing and the ability of taxpayers to reach IRS by telephone. This is also the first year of a planned 5-year initiative to reduce EIC noncompliance. Although it is too soon to assess the results of this initiative, we do have some observations on two aspects of the initiative–special assistance being provided to EIC claimants and IRS efforts to develop a baseline measure of EIC compliance.

YEAR 2000: FISCAL YEAR 1998 FUNDING INCREASES IDENTIFIED; FISCAL YEAR 1999 NEEDS BEING REFINED

IRS, like other federal agencies, has to make its computer systems "century-date compliant." Because IRS' systems, like many others in government and the private sector, use two-digit date fields, they cannot distinguish, for example, between 1900 and 2000 (both years would be shown as "00"). IRS estimates that failure to correct this situation before 2000 could result in millions of erroneous tax notices, refunds, and bills. Accordingly, the Commissioner of Internal Revenue has designated this effort a top priority.

To make its systems Year 2000 compliant, IRS plans to (1) convert existing systems by modifying application software and data and upgrading hardware and system software where needed; (2) replace systems if correcting them is not cost-beneficial or technically feasible; and (3) retire other systems if they will not be needed after the year 2000. IRS' Year 2000 effort includes the following two major system replacement efforts:

- IRS is replacing its primary tax return and remittance input processing systems (i.e., the Distributed Input Processing System and the Remittance Processing System) with a single system, the Integrated Submission and Remittance Processing System (ISRP). This new system is being piloted at the Austin Service Center. If the pilot is successful, IRS expects to begin rolling the system out to other service centers later this year.

- IRS is consolidating its mainframe computer processing operations from 10 service centers to 2 computing centers. This consolidation is to replace the computer hardware, systems software, and telecommunications infrastructure for most of IRS' primary tax processing systems.[3]

IRS' goal is to implement all Year 2000 efforts by January 1999. IRS established this goal so that (1) Year 2000 changes would be implemented before the start of the 1999 filing

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[3]Two parts of mainframe consolidation are critical to Year 2000 compliance: (1) replacing the Communication Replacement System, which provides communications and security management and oversight for on-line account databases, and (2) replacing 16,000 terminals that support front-line customer service and compliance operations. IRS decided to undertake a larger consolidation effort because it concluded that consolidation would (1) satisfy Office of Management and Budget (OMB) Bulletin 96-02, which directs agencies to consolidate information processing centers; (2) be consistent with IRS' planned modernization architecture; and (3) save an estimated $356 million from fiscal year 1997 through fiscal year 2003.

season and (2) IRS could conduct an extensive systemic test of tax data transactions through IRS' mission critical systems in a Year 2000 environment to simulate how systems are likely to function and interact on or after January 1, 2000.[4]

As of March 1998, IRS estimated that the cost of its Year 2000 effort for fiscal years 1997 through 2001 would be about $925 million. IRS received $376.7 million for this effort in fiscal year 1998 and is seeking another $234 million for fiscal year 1999. IRS' latest estimates indicate that additional funds will be needed for fiscal year 1998. IRS officials are also refining their estimates for fiscal year 1999 in light of more current information.

Additional Needs Identified for Fiscal Year 1998

Table 1 shows how the $376.7 million IRS received for Year 2000 efforts in fiscal year 1998 was allocated among various spending categories.

[4]A Year 2000 environment means that system date clocks and tax data being used in the test are given dates of January 1, 2000, or later.

Table 1: IRS' Fiscal Year 1998 Appropriation for Year 2000 Efforts

Spending category	Amount (in millions)
Conversion of existing systems	
Conversion and testing	79.0
Telecommunications	23.0
ADP equipment	13.0
Operating systems software	17.0
Year 2000 project office	9.0
Certification	7.0
Contingency amount	42.0
Offset within IRS' budget[a]	-20.0
Subtotal	**170.0**
Mainframe consolidation	157.7[b]
ISRP	49.0
Total	**$376.7**

Note: Of the $376.7 million, Congress appropriated $289 million and authorized IRS to reprogram the rest from fiscal year 1997 and 1996 Tax Systems Modernization funds.

[a]IRS was to identify $20 million from other programs to cover Year 2000 costs.

[b]This amount includes the costs for all aspects of consolidation, not just the portion that is necessary for Year 2000 compliance. Congress provided an additional $7 million to relocate and retrain employees who might be affected by the mainframe consolidation project.

Source: Except for ISRP, the information in table 1 is from House Conference Report 105-284, September 29, 1997. ISRP information is from IRS' report to Congress on the status of its Year 2000 effort as of October 1, 1997.

As table 1 shows, most of the $376.7 million is to convert existing systems and consolidate mainframes. As discussed below, IRS officials have identified additional funding needs for fiscal year 1998 for the conversion of existing systems and are pursuing options for meeting those needs. Funding needs for mainframe consolidation will be more definite when IRS completes contract negotiations for this project.

Conversion of Existing Systems

IRS' fiscal year 1998 appropriation provided $170 million to convert existing systems. However, IRS officials estimate that an additional $60 to $70 million will be needed for this purpose in 1998. In part, that increase reflects the approach IRS used to assess the scope of its Year 2000 conversion work.

IRS has three tiers of computing operations–mainframe computers, minicomputers and file servers, and personal computers. IRS focused its initial Year 2000 efforts on assessing and converting its mainframe computer operations that are largely controlled by IRS' Chief Information Officer and encompass most of IRS' key tax processing systems. Assessments for the two other tiers and telecommunications systems, not all of which are under the control of the Chief Information Officer, started late and were delayed, in part, because IRS did not have a complete inventory for these areas. Since receiving its fiscal year 1998 appropriation, IRS has been trying to complete its inventory and refine its cost estimates for these information systems areas as well as for non-information systems, such as building facilities and security. Thus far in fiscal year 1998, IRS has (1) reallocated funds among the spending categories identified in the fiscal year 1998 appropriation, (2) identified specific needs for the $42 million initially set aside for contingencies, and (3) identified additional needs of about $60 to $70 million that are not yet funded. IRS notified the Appropriations Committees of these additional needs in its Year 2000 status report for the first quarter of fiscal year 1998.

According to IRS budget officials, IRS anticipates that it can meet most of the $60 to $70 million shortfall from two sources. First, the Department of the Treasury plans to submit a reprogramming letter to Congress, which will include a transfer request for IRS, in accordance with the President's February 20, 1998, supplemental budget request for fiscal year 1998.[5] According to IRS budget officials, IRS' request will call for transferring up to $50 million from unobligated balances from prior fiscal years' expired accounts. Second, according to IRS and Treasury officials, Treasury plans to fund up to $29 million in Treasury-wide telecommunications costs that IRS had previously factored into its base funding of $170 million. As a result, part of the base funding that was allocated to telecommunications costs will be available for other Year 2000 conversion work.

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[5]The President's February 20, 1998, supplemental budget request covers several departments. For the Department of the Treasury, the request asks for authority to transfer up to $250 million among Department accounts as well as authority to extend the availability of unobligated balances existing at the end of fiscal year 1998 to address the challenges associated with the Year 2000 effort. According to IRS and Treasury budget officials, IRS, unlike other Treasury bureaus, already has authority to extend the availability of unobligated balances.

Mainframe Consolidation

IRS' fiscal year 1998 appropriation for mainframe consolidation was $157.7 million. Congress also provided $7 million to relocate and retrain IRS employees who might be affected by the consolidation. According to officials from IRS' mainframe consolidation project office, the contractor's latest cost proposal for fiscal year 1998 is $195.2 million--$37.5 million more than the amount appropriated. However, project office officials said that they do not consider the $37.5 million a funding shortfall because some of the work that is included in the contractor's fiscal year 1998 proposal was started in 1997 and funded with fiscal year 1997 funds. According to documents prepared for the Commissioner's Executive Committee on Century Date Change and the 1999 Filing Season, the fiscal year 1998 budget for mainframe consolidation will remain uncertain until the completion of (1) contract negotiations and (2) the project office's validation of fiscal year 1998 budget requirements.

Fiscal Year 1999 Request Is Being Refined

The budget request for fiscal year 1999 includes $1.42 billion for operational information systems. According to IRS, $234 million of that request is for Year 2000 efforts--about $143 million less than the 1998 appropriation. Most of the $234 million is for Year 2000 work on existing systems ($140 million) and mainframe consolidation ($76 million). The rest ($18 million) is for ISRP. On the basis of information we obtained in mid-March

1998, IRS is refining its allocations of the $140 million for the conversion of existing systems. The funding requirements for mainframe consolidation could increase in light of expanded business requirements and schedule changes.

Conversion of Existing Systems

At the time we prepared this statement, Year 2000 project office officials were refining their allocations of the $140 million included in the fiscal year 1999 budget request for the conversion of existing systems. According to information we obtained in mid-March, the largest spending categories for fiscal year 1999 are testing ($58 million); contractor support to the Year 2000 project office ($20 million); and IRS salary costs ($24 million). Although we cannot comment on the adequacy of these amounts, IRS has allocated a large portion of its request to testing, which is what we would have expected based on IRS' conversion plans and schedule. However, we are concerned that IRS has not fully assessed the impact of not including all mission critical systems in a major test it is to conduct in fiscal year 1999.

IRS' plans call for completing all hardware and software upgrades and the conversion and testing of individual applications by January 1999. Beginning in January 1999, IRS plans to start what it refers to as systemic testing at Year 2000 test facilities. This test is to simulate how various tax data transactions will move through mission critical systems in a Year 2000 environment.

At the time we prepared this statement, IRS officials said that they had received a contractor's cost proposal of about $30 million for a systemic test and that the contractor's proposal is reflected in IRS' budget request for fiscal year 1999. Under this proposal, the test is to include 39 of the 126 mission critical systems IRS has identified. Officials responsible for overseeing this test said that they believe these 39 systems affect the vast majority of taxpayers. IRS officials said that although they are still negotiating with the contractor to increase the number of mission critical systems that will be included in the systemic test, not all 126 will be included.

The century date change project office Director said that those systems that are not included in the systemic test will undergo testing individually in a Year 2000 environment. We did not assess whether in fact the 39 systems that are included in the contractor's proposal affect the vast majority of taxpayers and thus may be more important to include in the test than other mission critical systems. We are concerned, however, that IRS has not fully assessed the impact of not including the other mission critical systems and the associated risks. We are also concerned that IRS has not identified the total resources needed for testing mission critical systems that are not included in the systemic test. The century date change project office Director said total resource requirements for such testing may not be known for another 6 months.

Mainframe Consolidation

The fiscal year 1999 budget request also includes $76 million for mainframe consolidation–about $89 million less than in fiscal year 1998. According to mainframe consolidation project office officials, the $76 million represents IRS' estimate of contractor costs at the time the budget request was prepared. According to the officials, several factors (final contract negotiations, an expanded set of business requirements, ergonomic furniture requirements, and a slippage in the original completion schedule) could increase the fiscal year 1999 funding requirements for mainframe consolidation.

According to mainframe consolidation project officials, IRS has received the contractor's cost proposal, which is about $7.3 million higher than IRS' initial estimate. In addition, IRS has asked the contractor to provide cost estimates for an expanded set of business requirements relating to security, disaster recovery, and testing in response to an ongoing initiative within IRS' Information Systems organization. Those estimates were not available to us when we prepared this statement. Project office officials also said that additional funds will be needed for ergonomic furniture as a result of IRS' February 19, 1998, agreement with the National Treasury Employees Union. The officials estimated that this furniture will cost about $8 million in fiscal year 1999.

In addition to expanded business requirements, additional contractor costs may arise if IRS does not meet its original completion schedule for mainframe consolidation.

According to IRS' plans, all 10 service centers were to be consolidated by December 1998. The Memphis Service Center was consolidated in December 1997. However, because of field office concerns about the ambitious consolidation schedule and pending expanded business requirements, IRS is reassessing its schedule for the other nine centers. IRS is considering the following three consolidation options: (1) three centers in 1998 and six in 1999, (2) four centers in 1998 and five in 1999, or (3) five centers in 1998 and four in 1999. Because IRS has decided not to consolidate any service center during the filing season, consolidations would not start until June. Under this scenario, it is likely that IRS would incur additional costs by having to retain the contractor through most of calendar year 1999.

Thus, the budget for mainframe consolidation will remain uncertain until IRS (1) makes final decisions on which expanded business requirements will be implemented, (2) identifies the number of service centers that will be consolidated in 1998 and 1999, and (3) completes contract negotiations. IRS' goal is to complete negotiations by May 1, 1998.

CONGRESS SHOULD CONSIDER
REDUCING AND RESTRICTING FUNDS
REQUESTED FOR INFORMATION TECHNOLOGY

The administration's fiscal year 1999 budget request includes $1.54 billion and 7,493 FTEs for IRS' Information Systems appropriation. Of this $1.54 billion, $1.42 billion is to fund "Operational Systems" (i.e., the operation and maintenance of existing systems), and $125 million is to fund "Developmental Systems" (i.e., new systems that are intended to sustain IRS' operations until modernization plans are implemented). IRS' proposed categories of spending under this appropriation request are consistent with our recent recommendations and related congressional actions.

In addition to the $1.54 billion, the administration is requesting $323 million for IRS' multiyear capital account for systems modernization investments, referred to as the "Information Technology Investments Account." IRS has not adequately justified $246.5 million of this request. We also question IRS' readiness to obligate funds in this investment account for the purpose of building or acquiring modernized systems because IRS has yet to complete and implement mature systems life cycle processes.

GAO Recommendations and Legislation
Have Successfully Restricted IRS' Spending
and Funding Requests for Information Systems

In June 1996, we reported that although IRS had initiated a number of actions to respond to our recommendations for correcting pervasive management and technical weaknesses in its Tax Systems Modernization (TSM) program, many of these actions were incomplete, and none, either individually or collectively, responded fully to any of our recommendations.[6] Accordingly, we suggested that Congress consider limiting TSM spending to cost-effective efforts that (1) support ongoing operations and maintenance (e.g., Year 2000 efforts); (2) correct pervasive management and technical weaknesses, such as a lack of requisite systems life cycle discipline; (3) are small, represent low technical risk, and can be delivered in a relatively short time frame; or (4) involve deploying already developed systems that have been fully tested, are not premature given the lack of a complete systems architecture, and produce a proven, verifiable business value. The act providing IRS' fiscal year 1997 appropriations[7] and the related conference report limited IRS' information technology spending to efforts consistent with these categories.

In September 1997, we briefed IRS' appropriations and authorizing committees on the results of our assessment of IRS' modernization blueprint. In those briefings and in a

[6] Tax Systems Modernization: Actions Underway But IRS Has Not Yet Corrected Management and Technical Weaknesses (GAO/AIMD-96-106, June 7, 1996).

[7] P.L. 104-208, Sept. 30, 1996.

subsequent report,[8] we concluded that the blueprint represented a good start but was not sufficiently complete to use as the basis for building or acquiring systems. As a result, the conference report accompanying IRS' fiscal year 1998 appropriations act[9] limited IRS' 1998 spending to efforts that were consistent with the aforementioned spending categories.

IRS' fiscal year 1999 request of $1.54 billion for the Information Systems appropriation appears consistent with the spending/funding conditions discussed previously. For example, over 90 percent of the request is for such things as (1) ongoing systems operations and maintenance (e.g., Year 2000 conversion efforts, service center mainframe consolidation, and implementation of recent tax law changes); (2) institutionalization of systems life cycle rigor and discipline; (3) establishment of an organization to manage the modernization contractor; and (4) establishment of an organization to independently ensure system quality. The remainder ($125 million) is for new systems that are either generally small, low risk, near-term projects (e.g., $33.3 million for replacement of 7-year-old laptop computers used by revenue agents) or projects that involve deployment of already developed systems, such as $60.7 million for the Integrated Collection System, for which IRS has analyzed the system's actual performance at pilot locations to validate its expected cost effectiveness.

[8] 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).

[9] H.R. Conf. Rep. No. 105-284 (1997).

IRS Has Not Adequately Justified $246.5 Million of the "Information Technology Investments Account" Request

Key provisions of the Clinger-Cohen Act, the Government Performance and Results Act (Results Act), and OMB Circular No. A-11 and supporting memoranda, require that, before requesting multiyear funding for capital asset acquisitions, agencies develop accurate, complete cost data and perform thorough analyses to justify the business need for the investment. For example, agencies must show that needed investments (1) support a critical agency mission; (2) are justified by a life cycle cost/benefit analysis; and (3) have cost, schedule, and performance goals.

In its fiscal year 1998 budget request for IRS, the administration had proposed an "Information Technology Investments Account" and requested $1 billion to fund it--$500 million in fiscal year 1998 and $500 million in fiscal year 1999. In our testimony last year before this Subcommittee, we questioned the need for this funding because the amounts requested were not based on analytical data or derived using formal cost estimating techniques, as required by OMB.[10] Subsequently, in IRS' fiscal year 1998 appropriations act,[11] Congress provided only $325 million for the investments account and made these funds available through fiscal year 2000. Additionally, Congress conditioned obligation of

[10]Tax Administration: IRS' Fiscal Year 1997 Spending, 1997 Filing Season, and Fiscal Year 1998 Budget Request (GAO/T-GGD/AIMD-97-66, Mar. 18, 1997).

[11]P.L. 105-61, Oct. 10, 1997.

these funds on completion of the modernization blueprint and prohibited IRS from obligating any of the $325 million until September 1998.

For fiscal year 1999, the administration is requesting $323 million for the investments account. When combined with the $325 million already appropriated, this request would increase the account's total to $648 million. According to IRS, these funds are needed to develop and deploy systems under phase 1/release 1 of its modernization blueprint. However, IRS' validated and approved business case justification and associated documentation for phase 1/release 1 specify development costs (derived using a formal cost estimating technique) of $401.5 million.

IRS has not justified the remaining $246.5 million of this $648 million on the basis of analytical data or derived the $246.5 million using a verifiable estimating method. IRS' budget estimates indicate that the $246.5 million will be used to develop business cases for subreleases 1.3 and 1.5 of phase 1/release 1 and to develop plans for releases 2 through 5 of phase 1. IRS officials could not explain how the additional $246.5 million was derived or what it was based on, other than to state that the funds will be used to develop IRS' systems life cycle methodology and future modernization business cases. Additionally, IRS budget documents state that $20 million of this amount would be earmarked for development and integration of the systems life cycle methodology. However, this request for funding lacks analytical support and is contradicted by other information. For example, the phase 1/release 1 business case used to justify the $401.5

million in this account already covers all phase 1/release 1 subreleases. Moreover, the "Information Systems" appropriation request already includes $15 million for systems life cycle development.

For these reasons, we suggest that Congress consider reducing the fiscal year 1999 request for the "Information Technology Investments Account" by $246.5 million.

Congress Should Consider Precluding
Obligation of Investment Account Funds
Until Systems Life Cycle Is Completed and Implemented

In our recent report on IRS' modernization blueprint, we recommended that IRS limit future requests for information technology appropriations to the four categories we mentioned earlier until IRS has implemented mature systems life cycle processes for developing and acquiring systems across the agency.[12] IRS has not yet implemented such processes. The fiscal year 1999 budget request includes funding for accomplishing just this, which we strongly support. However, until this implementation is accomplished, we suggest that Congress consider precluding IRS from obligating "Information Technology Investments Account" funds for the purpose of developing or acquiring systems under its modernization blueprint.

[12]GAO/AIMD/GGD-98-54.

CUSTOMER SERVICE INITIATIVE
ADDRESSES MANY PROBLEM AREAS

The fiscal year 1999 budget request includes a new initiative that, if approved, will provide $103 million to enhance IRS' customer service. This initiative is the result of findings and recommendations by a Customer Service Task Force formed in May 1997.

Although the task force did not issue its report until March 1998,[13] its findings and recommendations were available to IRS several months earlier. In that regard, IRS' operating functions were told to develop cost estimates for implementing numerous changes proposed by the task force. The original estimate of $212.5 million was eventually reduced during the budget review and approval process to the $103 million in the administration's budget request. According to IRS, some of the $109.5 million reduction represented more accurate costing of parts of the proposed initiative, such as the plan to provide better telephone services, while the rest of the reduction was accommodated by either deleting parts of the proposed initiative, such as plans to enhance the appeals process, or revising the scope of other parts, such as plans to strengthen support for small businesses (see app. II).

Under the revised proposal, the greatest shares of the $103 million are to go toward providing better telephone service and improving customer service training ($50.4 million

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[13] Reinventing Service at the IRS, IRS Publication 2197 (March 1998).

and $22.5 million, respectively). Smaller amounts are to be used to, among other things, strengthen the Taxpayer Advocate's Office; create citizen advocacy panels; make it easier for taxpayers to get answers in person; and improve the clarity of notices, forms, and publications. The need for improvement in many of these areas has been apparent for some time, and certain of IRS' proposed actions (such as providing better telephone service, creating citizen advocacy panels, and strengthening the Taxpayer Advocate's Office) are attempts to address some of the problems recently highlighted by Congress and the Commission on Restructuring IRS. Whether the $103 million is a reasonable estimate of the funds needed in fiscal year 1999 to implement this initiative will not be known until more details are available on the various parts of the initiative. Another unknown is how, if at all, the revised organizational concept proposed by the Commissioner earlier this year will affect IRS' plans for improving customer service in fiscal year 1999 or beyond.

VARIOUS FACTORS DIMINISH THE VALUE OF IRS' BUDGET ESTIMATES FOR OVERSIGHT PURPOSES

Each year, IRS submits detailed budget estimates to support the administration's budget request. We have found recent years' budget estimates to be more useful for oversight purposes, primarily because of the inclusion of better performance measures and more narrative information on actual and planned performance. Nevertheless, the utility of IRS' budget estimates for oversight purposes is limited because (1) the intermingling of enforcement and assistance resources within various budget activities precludes an assessment of the balance between those two areas; (2) periodic restructuring of IRS' appropriations and budget activities hinders long-term trend analyses; and (3) the budget estimates provide inadequate information on the resources being devoted to such critical areas as the Year 2000 effort and the Taxpayer Advocate's Office.

Mix Between Assistance and Enforcement Is Not Clear

Achieving IRS' strategic objectives of improving customer service and increasing compliance requires a mix of assistance and enforcement. Finding the appropriate mix is not easy, and we do not claim to have the answer. However, we do think that it is important for effective oversight that Congress know what mix IRS is achieving and what mix it plans to achieve. That information cannot be derived from IRS' budget estimates.

For example, IRS is requesting $891.6 million and 21,147 FTEs for the "Telephone and Correspondence" budget activity within the Processing, Assistance, and Management appropriation. That activity covers all non face-to-face contacts between IRS and taxpayers. Such contacts include typical forms of assistance, such as answering telephone calls and correspondence, as well as several enforcement activities, such as correspondence audits and attempts to collect overdue taxes via the telephone.

Last year, IRS was able to provide a breakdown of the FTEs included in the fiscal year 1998 budget request for Telephone and Correspondence. As table 2 shows, 44 percent of those FTEs were for enforcement-related operations.

Table 2: Breakdown of Fiscal Year 1998 Budget Request for the Telephone and Correspondence Budget Activity

Component	**FTEs**
Toll-free operations	6,459
Adjustments/Taxpayer Relations	4,722
Problem Resolution Program	438
Subtotal--assistance-related operations	**11,619 (56 percent of total)**
Service Center Examination	3,473
Service Center Collection Branch	2,844
Automated Collection System	2,839
Subtotal--enforcement-related operations	**9,156 (44 percent of total)**
Total	**20,775**

Source: IRS response to a question from the Senate Appropriations Committee in conjunction with hearings on IRS' fiscal year 1998 budget request.

This year, because of a change in its accounting structure, IRS could not give us a breakdown of the Telephone and Correspondence budget activity for fiscal year 1999. Thus, we do not know how much of this request IRS expects to devote to assistance as opposed to enforcement.

Similarly, despite its name, the Tax Law Enforcement appropriation is not exclusively for enforcement. The $3.2 billion and 46,130 FTEs being requested for that appropriation include an unspecified amount of money and FTEs for various forms of assistance, including walk-in service, taxpayer education efforts, and problem resolution. The $143 million and 2,184 FTEs being requested for the EIC compliance initiative, which we discuss in more detail later, also involve a mix of assistance and enforcement, but, again, that mix is not apparent in IRS' budget estimates.

Budget Restructuring
Hinders Trend Analyses

It is often useful, in assessing agency operations, to analyze trends over several years. IRS' annual budget estimates are not conducive to such analyses because IRS periodically restructures its appropriations and the budget activities within those appropriations.

The most recent restructuring, done in conjunction with the administration's budget request for fiscal year 1998, involved the merging of various budget activities and the movement of activities between appropriations. According to IRS, that restructuring was done to, (1) match the way IRS manages its programs, (2) facilitate a clean opinion on its financial statements by simplifying account reconciliation and providing an easier audit trail, (3) distinguish capital investments from operations, and (4) provide maximum resource flexibility. Another restructuring seems likely if and when the Commissioner's proposed reorganization becomes reality.

We are not taking issue with the changes IRS made for fiscal year 1998 or with the need to restructure in general. Our intent is to point out how restructuring can hinder the ability to conduct long-term trend analyses. For example, IRS established a new budget activity in fiscal year 1998 called Telephone and Correspondence, which was formed by merging pieces from the Taxpayer Services budget activity, which was discontinued, and the Examination and Collection budget activities, which were retained in reconfigured forms. When IRS restructured its budget activities for fiscal year 1998, it recalculated its fiscal year 1997 accounts to be compatible with the new structure. However, years before 1997 are not compatible with the new structure, making long-term analyses difficult. For example, it would be of little value to compare IRS' request for the Examination budget activity in fiscal year 1999 with the actual figures for that activity in fiscal year 1996 because the 1999 version of that activity includes certain programs (such as Taxpayer Education) that were not part of the 1996 version and excludes programs (such as Service Center Correspondence) that were part of the 1996 version.

Even with restructuring, long-term analysis could still be possible if there was adequate detail behind the various budget activities. However, some key details are no longer available. As discussed earlier, IRS no longer has the level of detail behind the Telephone and Correspondence activity that it had when it first restructured that budget activity in 1998.

Budget Estimates Provide Inadequate Information on the Resources Devoted to Certain Critical Areas

Two IRS activities that are of considerable interest to Congress in the current environment are the Year 2000 effort and IRS' efforts to identify and resolve taxpayer problems. IRS' budget estimates for fiscal year 1999 provide inadequate information on both of those activities.

Year 2000 Effort

As discussed earlier, IRS' Year 2000 effort involves significant resources to convert existing systems, consolidate mainframes, and replace the primary tax and remittance input processing systems. Also, as discussed earlier, IRS has identified additional funding needs for fiscal year 1998 that go well beyond the amount appropriated. Despite the significance of this effort, IRS' fiscal year 1999 budget estimates do not discuss IRS' revised funding needs for fiscal year 1998 or specify how much of the $1.5 billion being requested for information systems in fiscal year 1999 is for Year 2000 activities.

Problem Resolution

During the past year, Congress questioned the independence of IRS' Taxpayer Advocate and the adequacy of resources devoted to the resolution of taxpayers' problems through the Problem Resolution Program (PRP). IRS' budget estimates do not accurately reflect the level of resources being devoted to problem resolution. In addition, concerns about independence may be exacerbated by the way IRS funds the work of the Taxpayer Advocate's Office.

According to IRS, the fiscal year 1999 budget request includes about $38 million and 628 FTEs for the Taxpayer Advocate's Office, an increase of about $14 million and 191 FTEs over the proposed operating level in fiscal year 1998.[14] Those resources are not separately identified in IRS' budget estimates but are included within the Telephone and Correspondence budget activity. Even if those resources were separately identified, they would significantly understate the level of resources IRS has been allocating and plans to allocate to activities of the Taxpayer Advocate's Office. That is because many of the staff who work PRP cases and who participate in Problem Solving Days are funded by other functions, such as Examination and Collection. In that regard, according to a January 1998 report by the Taxpayer Advocate, his resources for fiscal year 1998 are being supplemented by more than 1,000 other field employees, on either a full or part-time basis. We believe that oversight of the operations of the Taxpayer Advocate's Office would be enhanced if (1) the Office were given more visibility in IRS' budget structure and (2) IRS' budget estimates provided complete information on the amount of resources being devoted to those operations.

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[14]Among other things, the increase in resources for the Taxpayer Advocate's Office is intended to help that office handle a growing workload generated, at least in part, by the Problem Solving Days IRS has been holding monthly across the country.

A more fundamental question, however, is whether the Taxpayer Advocate's independence is compromised in any way by the need to rely on other functions for needed staff. While working PRP cases, these employees receive program direction and guidance from the Taxpayer Advocate's Office but are administratively responsible to their functional organizations–oftentimes the same organizations responsible for the problems that led taxpayers to seek the Advocate's help. We are pursuing this and other issues in an ongoing study of the Taxpayer Advocate's Office for this Subcommittee.

IRS FACES MANY CHALLENGES IN DEVELOPING USEFUL PERFORMANCE MEASURES

As mentioned earlier, one aspect of IRS' budget estimates that has improved over the years involves the use of performance measures. The performance measures shown in IRS' budget have become more useful as IRS strives to develop and implement a results-oriented performance measurement system that will meet the requirements of the Results Act. As IRS acknowledges, there is still much work to be done in that area.

IRS' budget estimates for fiscal year 1999 include numerous performance measures, some of which have yet to be developed. The budget estimates include a brief description of each measure and, for those that have been developed, provide such information as the source and reliability of data used to compile the measure. Tracking performance measures over time is not always possible because some are added or dropped each year and others are revised. These kinds of changes are to be expected as IRS gets input from

Congress and other stakeholders and learns more about how to measure its performance. In its fiscal year 1999 budget estimates, for example, IRS lists 16 discontinued performance measures, some of which were dropped in response to congressional concern about an undue emphasis on enforcement results.

IRS has a three-tiered system of performance measures. At the highest (mission) level, IRS has a mission effectiveness indicator intended to measure the agency's overall performance in collecting the proper amount of tax revenue at the least cost or burden to the government and the taxpayer. The second (strategic) level of indicators is intended to gauge IRS' progress in meeting its strategic objectives to improve customer service, increase taxpayer compliance, and increase productivity. According to IRS' fiscal year 1999 budget estimates, for example, IRS has four indicators and plans to develop two others to gauge its progress in improving customer service. The four existing indicators are (1) taxpayer burden cost for IRS to collect $100, (2) initial contact resolution rate for taxpayer inquiries, (3) toll-free telephone level of access, and (4) tax law accuracy rate for taxpayer inquiries. The two indicators IRS plans to develop are (1) customer satisfaction rates and (2) employee satisfaction rate. The third (program) level of indicators is intended to measure the accomplishments of specific IRS programs or operations. For example, IRS' fiscal year 1999 budget estimates include 18 program-level customer service measures, covering such things as refund timeliness, number of telephone calls answered, the quality of PRP cases, and the number of walk-in service contacts. (See app. III for a list of all of the performance measures in IRS' fiscal year 1999 budget estimates and a comparison of those measures for fiscal years 1997, 1998, and 1999.)

IRS faces some difficult challenges as it strives to improve its performance measurement system. We discussed some of those challenges in a recent report to the Subcommittee on measuring customer service.[15] As noted in that report, key challenges facing IRS include (1) developing a reliable measure of taxpayer burden, including the portion that IRS can influence; (2) developing measures that can be used to compare the effectiveness of the various customer service programs; and (3) refining or developing new measures that gauge the quality of the services provided. Measuring burden is especially difficult. IRS currently measures burden by using a model that estimates the time taxpayers spend on each tax form. As such, the measure excludes the burden taxpayers face after they file their tax returns, such as the time and costs incurred in responding to IRS notices and audits. Flaws in the burden measure also limit the usefulness of IRS' mission effectiveness indicator, because burden is a key component of that indicator. IRS recognizes the limitations of its burden measure and is looking for alternatives.

Devising ways to measure the burden that IRS influences and overcoming the other challenges our report identified will not be easy. IRS is faced with devising reliable measures that are useful in improving agency and program performance, improving

[15]Tax Administration: IRS Faces Challenges in Measuring Customer Service (GAO/GGD-98-59, Feb. 23, 1998).

accountability, and supporting policy decisionmaking. At the same time, IRS is faced with making decisions on how to minimize the costs of collecting data and measuring results over time.

INTERIM DATA ON THE 1998 FILING SEASON SHOW CONTINUED IMPROVEMENT IN TWO IMPORTANT AREAS

Despite some problems (e.g., envelopes that were printed with incorrect bar codes and an apparent programming error that caused some incorrect notices), IRS appears to be headed toward another generally successful filing season. Two areas that we have looked at in assessing recent filing seasons for the Subcommittee are the extent to which returns are being filed electronically and the ability of taxpayers to reach IRS by telephone. In a report to the Subcommittee on the 1997 filing season, we said that IRS had made substantial improvements in both of those areas.[16] Data from the first 2 1/2 months of the 1998 filing season indicate continuing improvement. Besides electronic filing and telephone accessibility, another area of IRS emphasis this filing season is EIC noncompliance. This is the first year of a planned 5-year initiative aimed at reducing noncompliance through assistance, enforcement, and research. Although it is too early to assess the results of this year's efforts, we do have some preliminary observations on two parts of the initiative.

[16]Tax Administration: IRS' 1997 Tax Filing Season (GAO/GGD-98-33, Dec. 29, 1997).

Use of Electronic Filing
Continues to Increase

As shown in table 3, as of March 13, 1998, IRS had received 23.4 percent more electronic returns than at the same time last year. This increase is even more significant considering that the total number of individual income tax returns filed as of March 13, 1998, was up less than 1 percent from the same time last year.

Table 3: Individual Income Tax Returns Received

Type of filing	1/1/96 to 3/15/96	1/1/97 to 3/14/97	Percent change 1996 to 1997	1/1/98 to 3/13/98	Percent change 1997 to 1998
Traditional paper	36,258	32,250	-11.1%	29,528	-8.4%
1040PC[a]	2,767	3,195	15.5	2,408	-24.6
Total paper	**39,025**	**35,445**	**-9.2**	**31,936**	**-9.9**
Traditional electronic[b]	9,811	11,570	17.9	14,199	22.7
TeleFile[c]	2,379	3,663	54.0	4,597	25.5
Total electronic	**12,190**	**15,233**	**25.0**	**18,796**	**23.4**
Total	**51,215**	**50,678**	**-1.1%**	**50,732**	**0.1%**

[a]Under the Form 1040PC method of filing, a taxpayer or tax return preparer uses personal computer software that produces a paper tax return in an answer-sheet format. The Form 1040PC shows the tax return line number and the data for that line number. Only numbers for those lines on which the taxpayer has made an entry are included on the Form 1040PC.

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

[c]Under TeleFile, certain taxpayers who are eligible to file a Form 1040EZ are allowed to file using a toll-free number on touch-tone telephones.

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

As table 3 shows, the largest percentage increase last year and again this year is in the number of returns filed through TeleFile. The increase for 1997 was largely attributed to IRS' decision not to include a Form 1040EZ in the tax package sent to taxpayers who appeared to be eligible to use TeleFile–thus encouraging them to use TeleFile. The increase in use of TeleFile for 1998 may be due to a combination of last year's tax package change and a change in IRS' procedures this year. Until this year, persons who had a different address from the one they used on their prior year's return were ineligible to use TeleFile. For 1998, however, IRS updated the address information in its records through use of the Postal Service's National Change of Address File and is now able to accept TeleFile returns from some persons who moved after they filed last year. According to IRS, this new procedure allowed it to mail TeleFile tax packages to about 1.6 million potentially eligible TeleFilers who would not have been given the opportunity to file via TeleFile under the old procedure.

The use of traditional electronic filing had also increased as of March 13--by about 23 percent over the same period last year. There have been a few changes in the program this year that may have contributed to this increase. For example, two more states (Alabama and Arizona) joined the Fed/State electronic filing program, and IRS added two more forms to the list of forms that can be filed electronically. We have insufficient information at this time to determine how much of the increase might be due to those changes rather than to a general growth in the willingness of taxpayers and tax return preparers to use this alternative way of filing.

Telephone Accessibility
Continues to Improve

Another continuing positive trend this filing season is an increase in the ability of taxpayers who need assistance to reach IRS by telephone.` In our report on the 1997 filing season, we noted that the accessibility of IRS' telephone assistance had increased from 20 percent during the 1996 filing season to 51 percent during the 1997 filing season. As shown in table 4, IRS data for the first 2 1/2 months of the 1998 filing season indicate that the level of access to IRS' toll-free telephone assistance has continued to increase. One clear indicator of that increased access is the significant drop in the number of calls receiving busy signals.

Table 4: Toll-Free Telephone Level of Access[a] for the First 2 1/2 Months of the 1998 and 1997 Filing Seasons[b]

	1998[c]	1997
(a) Calls answered	23.2	23.2
(b) Calls abandoned	4.9	5.0
(c) Subtotal - Calls that got into IRS' system	**28.1**	**28.2**
(d) Busy signals	2.9	13.5
(e) Total call attempts	**31.0**	**41.7**
Percent Level of Access[d]	91%	68%
Percent of calls that got into IRS' system but were abandoned[e]	17%	18%

Note: Numbers are in millions.

[a]We recently reached agreement with IRS on measuring accessibility to IRS' toll-free telephone system. The measure, called Toll-Free Telephone Level of Access, reflects the combined level of access for six toll-free numbers that taxpayers can call to, among other things, get answers to tax law questions or get information on their account. Level of Access is computed by dividing the number of calls received by total call attempts. A call is considered received if it reaches IRS' automated call system, whether it is answered by IRS or abandoned by the caller. (In 1998, 17 percent of the calls received were abandoned by the caller before making contact with an assistor.) Total call attempts are all calls received plus any calls that got a busy signal. We calculated the information for both years in table 4 using this methodology except as noted in note "c" below.

[b]Data are for January 1 through March 14, 1998, and January 1 through March 15, 1997.

[c]Although IRS' methodology combines data for six toll-free numbers, we backed out data for one of the numbers (the one for the Automated Collection System) in calculating the results for 1998 because IRS did not include data for that number in computing its results for 1997. With that deletion, data for 1997 and 1998 in table 4 should be comparable.

[d]Computed by dividing subtotal (c) by total (e).

[e]Computed by dividing calls abandoned (b) by subtotal (c).

Source: IRS' Weekly Customer Service Report.

IRS took some steps this year to improve accessibility. For example, it (1) increased the hours assistors are available to answer telephone calls from 10 hours a day, 5 days a week in 1997, to 16 hours a day, 6 days a week in 1998, and (2) increased the number of complex tax topics that are to be handled through a voice messaging system.[17] However, despite these changes, the data in table 4 indicate that the number of calls answered by IRS has remained constant compared to the number for 1997 and that the increase in level of access is due to a decrease in call attempts.

Our Test Confirms Improved Accessibility

To independently check whether the level of access to IRS' toll-free assistance had increased, we conducted a test from February 9 through 26, 1998. Our results, which are not projectable, showed that the level of access we achieved during our test was close to the 91-percent level of access reported by IRS for the first 2 1/2 months of this filing season. We made 384 total calls to IRS and gained access to the telephone system 333 times, a level of access of 86.7 percent. On the other 51 calls, we received busy signals.

Of the 333 times we gained access to the telephone system, we were routed to lines that were to be answered by IRS' assistors 263 times and to lines that were to be answered by a voice messaging system 70 times. Of the 263 times we were routed to an assistor, we

[17]Taxpayers calling with questions about these topics are asked to leave their name, telephone number, address, and best time for IRS to call them back. Staff detailed from IRS' Examination function are to call the taxpayers back within 3 business days.

made contact with an assistor 239 times (90.9 percent). We abandoned the other 24 calls (9.1 percent) without making contact with an assistor after remaining on hold for 7 minutes. For each of the 70 calls that were routed to the voice messaging system, we left a message. In 57 of those cases, (81.4 percent), we received a call back from IRS within 3 business days.

Some Preliminary Observations
on the EIC Compliance Initiative

IRS' fiscal year 1998 appropriation included $138 million for the first year of what is to be a 5-year EIC compliance initiative. IRS' budget request for fiscal year 1999 includes $143 million for the second year of that initiative. IRS has developed a plan for using these appropriated funds that calls for various efforts directed at reducing EIC noncompliance, including expanded assistance, increased enforcement, and enhanced research.

We are gathering data on IRS' efforts as part of two reviews for the Subcommittee: a review of EIC noncompliance and a review of the 1998 filing season. We are unable to comment at this time on the impact of any efforts undertaken this filing season because not enough time has elapsed for us to assess results.

However, we do have some comments on two aspects of IRS' plans for this filing season. First, some of the expanded assistance IRS has planned will probably be too late to help many EIC claimants. In particular, IRS designated March 28 as EIC Awareness Day, and designated April 4 and April 11 as Problem Prevention Days. On those days, IRS staff are to be available at over 150 walk-in sites to help EIC claimants prepare their returns. Although that kind of assistance is commendable, it will come too late to help many EIC claimants, if last year's filing trends hold constant. Of about 19.5 million returns filed last year with EIC claims, about 11.9 million (61 percent) were received by IRS before the end of March.

We also have questions about IRS' baseline measure of EIC compliance. IRS did a study in 1995 involving a sample of taxpayers who claimed an EIC on their tax year 1994 returns. The study showed that EIC claimants were not entitled to about 26 percent of the EIC dollars they were claiming--a noncompliance rate that generated considerable congressional concern, eventually leading to the EIC compliance initiative. However, in response to our questions about the current EIC initiative, IRS officials told us that the results of the 1995 study could not be used as a baseline measure of EIC compliance, although they were unable to satisfactorily explain why. IRS' assertion that the 1995 study cannot be used as a baseline measure of compliance raises the question whether decisions to develop and fund the 5-year EIC initiative were founded on reliable compliance data.

If IRS does a new baseline study, we question whether the results will be available soon enough to be of any value to Congress. Our concern stems from IRS' history in conducting past EIC compliance studies. For example, IRS did not release the results of its 1995 study until April 1997. If data from a new baseline study are not available until 2000, IRS will already be in the third year of the initiative and will have finalized its funding request for the fourth year.

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That concludes my statement. We welcome any questions that you may have.

IRS' FISCAL YEAR 1999 BUDGET REQUEST COMPARED WITH PROPOSED FISCAL YEAR 1998 OPERATING LEVEL

Dollars in thousands

	Fiscal year 1998		Fiscal year 1999		Percent change	
Budget activity	**Dollars**	**FTEs**	**Dollars**	**FTEs**	**Dollars**	**FTEs**
Submission Processing	$850,787	15,105	$888,408	15,113	4.42%	0.05%
Telephone & Correspondence	827,176	20,255	891,648	21,147	7.79	4.40
Document Matching	61,110	1,682	62,629	1,682	2.49	0.00
Inspection	100,963	1,168	106,518	1,179	5.50	0.94
Management Services	511,046	6,850	556,005	6,950	8.80	1.46
Rent & Utilities	574,792	135	657,222	135	14.34	0.00
Subtotal: Processing, Assistance, and Management Appropriation	**2,925,874**	**45,195**	**3,162,430**	**46,206**	**8.08**	**2.24**
Criminal Investigation	367,867	4,103	373,407	4,103	1.51	0.00
Examination	1,726,132	24,934	1,714,520	24,934	-0.67	0.00
Collection	667,356	11,938	692,847	11,995	3.82	0.48
Employee Plans and Exempt Organizations	134,315	2,045	133,520	2,045	-0.59	0.00
Statistics of Income	25,787	471	26,766	471	3.80	0.00
Chief Counsel	222,011	2,582	228,479	2,582	2.91	0.00
Subtotal: Tax Law Enforcement Appropriation	**3,143,468**	**46,073**	**3,169,539**	**46,130**	**0.83**	**0.12**
Operational Information Systems	1,272,487	7,329	1,415,884	7,284	11.27	-0.61
Developmental Information Systems	0	0	125,000	209	NA	NA
Subtotal:Information Systems Appropriation	**1,272,487**	**7,329**	**1,540,884**	**7,493**	**21.09**	**2.24**
Information Technology Investments	**325,000**	**0**	**323,000**	**0**	**-0.62**	**NA**
Earned Income Credit (outside caps)	**138,000**	**1,954**	**143,000**	**2,184**	**3.62**	**11.77**
Total	**7,804,829**	**100,551**	**8,338,853**	**102,013**	**6.84**	**1.45**

Source: IRS' February 2, 1998, budget estimates for fiscal year 1999.

IMPACT OF REDUCTION IN CUSTOMER SERVICE INITIATIVE
FROM $212.5 MILLION TO $103 MILLION

Dollars in millions

Initiative	Original estimate	Revised request	Impact of reduction according to IRS
Improve clarity of notices, forms and publications	$27.7	$5.0	Original plans called for rewriting all tax packages to make them more customer friendly and easier to read; also called for publications for "lifetime events," such as adoptions. Revised plans call for phasing in the rewriting of tax packages; IRS intends to focus in FY 1999 on selected publications for lifetime events.
Provide better telephone services	65.2	50.4	Reductions reflect a more accurate recosting. All original plans can be achieved with the $50.4 million, including increasing service to 24 hours, increasing access rates to 86%, expanding customized services through Voice Response Units, and expanding hours of forms distribution centers.
Make it easier to get answers in person	23.0	5.6	Original plans called for providing funds to conduct problem solving days, expand office hours, and open more convenient locations. Revised plans fully fund problem solving days. However, there will need to be some scaling back on plans to expand office hours, and IRS will not be able to open additional locations.
Expand electronic filing	6.0	2.5	Reductions reflect a more accurate recosting. IRS will aggressively pursue efforts to expand TeleFile and enable paperless filing through electronic signature alternative.
Strengthen customized support for small business	7.0	1.0	Original plans were staff intensive and provided 83 FTEs for both taxpayer outreach and telephone assistance. Revised plans eliminate additional FTEs for the taxpayer outreach programs and handle telephone assistance more efficiently.

Initiative	Original estimate	Revised request	Impact of reduction according to IRS
Upgrade technology to improve customer service	$1.7	$0	The costs for Electronic Federal Tax Payment System, if needed, will be absorbed within the total resource levels for information systems.
Shift how performance is measured	2.1	1.0	Reductions reflect a more accurate recosting. Funding is sufficient for a contract to measure customer satisfaction.
Improve customer service training	32.0	22.5	These resources fund cross training of employees so that the peak workload periods for account and assistance work can be more efficiently handled. Reduction reflects a scaled back version of the original plan and more accurate costing.
Strengthen Taxpayer Advocate's Office	21.0	10.0	Reduction will necessitate scaling back plans to provide greater assistance through the Advocate's office. However, this level of funding increases current staffing levels by about one third. Because of the priority of this program, there may be some need to divert resources from other programs if enhanced service levels cannot be achieved with these resources.
Create citizen advocacy panels	15.0	5.0	Original plans called for providing funds for panels in all 33 districts. Revised plans fund pilots in four test sites, one for each region.
Enhance appeals process	11.8	0	Original plans called for establishing customer service representatives for the Appeals function in each district and speeding case processing to enhance customer service and reduce taxpayer burden. Because of other funding priorities, this initiative was eliminated.

Source: IRS' Office of Budget Formulation.

IRS PERFORMANCE MEASURES

Tables III.1 and III.2 show the mission, strategic, and program-level performance measures included in IRS' February 2, 1998, budget estimates for fiscal year 1999. The strategic and program-level measures are categorized by IRS' three strategic objectives of improving customer service, increasing compliance, and increasing productivity.

Table III.1: IRS' Mission and Strategic-Level Performance Measures

Performance Measure	1997 actual	1998 estimate	1999 estimate
Mission-level measure			
Mission Effectiveness Indicator (percent)	79.5%	79.5%	79.5%
Strategic-level measures			
Improve customer service			
Taxpayer burden cost (in dollars) for IRS to collect $100	$8.52	$8.53	$8.55
Initial contact resolution rate (percent)[a]	78.8%	73%	73%
Toll-free telephone level of access (percent)	65.1%	70%	86%
Tax law accuracy rate for taxpayer inquiries (online) (percent)	96.1%	96%	96%
Customer satisfaction rates: all business lines	NA	NA	TBD
Employee satisfaction rate	NA	NA	TBD
Increase compliance			
Total collection percentage	87.3%	87.4%	87.4%
Total net revenue collected (trillions of dollars)	$1.504	$1.575	$1.642
Increase productivity			
Budget cost to collect $100	$0.48	$0.47	$0.49
Customers successfully served per dollars expended	NA	NA	TBD

Legend: NA = not available; TBD = to be determined.

[a]For 1998 and 1999, this measure includes telephone contacts only; correspondence contacts were included for 1997.

Source: IRS' February 2, 1998, budget estimates for fiscal year 1999.

Table III.2: IRS' Program-Level Performance Measures

Performance measure	1997 actual	1998 estimate	1999 estimate
Improve customer service			
Refund timeliness--paper filing (days)	38	40	40
Refund timeliness--electronic filing (days)	14.5	21	21
Processing accuracy-paper filing (percent)	95.2%	95%	95%
Processing accuracy--electronic filing (percent)	99.3%	99%	99%
Notice accuracy (percent)	98.6%	98.5%	98.5%
Number of TeleFile returns (millions)	4.7	5.5	5.9
Taxpayers gaining access as a percent of demand	NA	NA	TBD
Customer complaint analysis	NA	NA	TBD
Number of calls answered--includes automated (millions)	103.9	120.6	126.6
Correspondence answered	NA	NA	TBD
Problem Resolution Program average processing time (days)			
District office	36.1	35.4	35.4
Service center	31.6	30.3	30.3
Problem Resolution Program quality customer service rate (percent)			
District office	88.8%	89.4%	90.5%
Service center	80.7%	81.6%	83.4%
Currency of Problem Resolution Program inventory (days)			
District office	94	87	87
Service center	96	86	86
Walk-in customer service contacts--includes requests for forms (millions)	NA	9.9	9.9
Technical advice and service assistance per FTE	64	64	64
Private letter rulings and advance pricing agreements per FTE	66	66	66
Regulations, revenue rulings and procedures, and legislation per FTE	9	9	9
Weekend Taxpayer Information File update completion time (percent of timely updates of taxpayers' accounts)	89.6%	85.6%	85.6%

Performance measure	1997 actual	1998 estimate	1999 estimate
Increase compliance			
Service center examination dollars recommended (billions)[a]	$2.635	$2.141	$2.223
Automated Collection System dollars collected (billions)	$4.1	$4.1	$4.1
Document matching dollars assessed (billions)[a]	$1.5	$1.218	$1.218
Internal Audit corrective actions completed (percent)	76.7%	66.3%	69.5%
Internal Security investigations effectiveness (percent)	62.9%	58.3%	61.1%
Background investigations completed timely (percent)	76.3%	81.0%	82.6%
Inspection efficiency (products divided by FTEs realized)	8.91	8.33	8.50
Usefulness of Inspection products to customers[b]	NA	3.06	3.12
Narcotics conviction rate (percent)	90%	88%	88%
Fraud conviction rate (percent)	94%	90%	90%
Field examination dollars recommended (billions)[a]	$26.18	$26.10	$26.40
Alternative treatment revenue	NA	NA	TBD
Appeals nondocketed cycle time (days)	223	217	221
Collection dollars (in billions) collected--includes Collection Field, Special Procedures, and Collection Support functions	$5.99	$6.04	$6.33
Collection average cycles per taxpayer delinquent account or taxpayer delinquency investigation disposition (weeks)	34.1	34.7	34.7
Employee plans determination letter cycle time (days)	132	140	140
Exempt organizations determination letter cycle time (days)	84	87	87
Employee plans examination cycle time (days)	NA	210	210
Exempt organizations cycle time (days)	NA	314	314
Docketed Tax Court closures per FTE	65	65	65
Bankruptcy closures per FTE	228	228	228
Litigation support completions per FTE	87	87	87
Corporate Files On-Line availability to front line personnel (percent)	99.3%	99.0%	99.0%
EIC overclaim rate	NA	NA	TBD

Performance measure	1997 actual	1998 estimate	1999 estimate
Increase productivity			
Individual returns filed electronically (percent)	15.9%	17%	19.5%
Dollars received electronically (percent)	40.6%	48.4%	78.2%
Percent of dollars received via 3rd party processors (lockbox)	70.9%	70.9%	70.9%
Dollars collected per $100 dollars expended	NA	NA	TBD
Service center examination dollars recommended per $100 of cost[a]	NA	NA	TBD
Average dollars collected through Automated Collection System per $100 of cost	NA	NA	TBD
Support services performance index	100	103	104.5
Space utilization rate (square feet)	213	196	180
Field examination dollars recommended per $100 of cost[a]	NA	NA	TBD
Alternative treatment revenue per $100 of cost	NA	NA	TBD
Appeals staff days per disposal	2.04	2.03	2.00
Collection dollars collected per $100 of cost	NA	NA	TBD
Statistics of Income projects delivered on time (percent)	NA	90%	90%
Statistics of Income quality customer service rate (percent)	NA	90%	90%
Integrated Data Retrieval System real time availability (percent)	99%	99%	99%

Legend: NA = not available; TBD = to be determined.

[a]IRS plans to adjust these amounts to remove the portion attributable to penalties.

[b]According to IRS, this measure is computed by dividing the weighted sum of all customer responses to questions on the usefulness of Inspection products by the number of customer responses to Inspection requests for feedback on usefulness.

Source: IRS' February 2, 1998, budget estimates for fiscal year 1999.

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Chairwoman JOHNSON. Thank you. I'd like to enlarge on this issue of the $243 million, was it, that you don't feel is adequately documented.

Ms. WILLIS. Let me allow Mr. Hite to answer that question.

Mr. HITE. Madame Chair, the OMB has put forth guidance directing the agencies as to what they need to do to justify investments in capital assets. This guidance requires that these capital assets be justified on the basis of verifiable data; that the amounts being requested be determined using formal estimating methods.

Now, in the case of IRS' request this year for its investment account of $323 million, if you combine that with the appropriation IRS received last year in the investment account which was $325 million. That provides $648 million in the account. Now, the justification that IRS has put forth in terms of a business case for the first release of the first phase of the modernization, totals $401.5 million. The difference has not been justified on the basis of any verifiable analysis. Therefore, in the absence of that, IRS has not met the requirements of OMB, and that leads us to our recommendation that about $247 million not be funded.

Chairwoman JOHNSON. So, $247 million of the dollars that they already have for capital investment cannot be justified?

Mr. HITE. Two hundred and forty-six point five million of what they are asking for this year, out of that $323 million cannot be justified.

Chairwoman JOHNSON. That's a very high percentage. What are the kinds of problems you're seeing? I mean, that seems like a remarkable statement. What are the failures? What I hear you saying is that $247 million of $323 million can't be justified using the guidelines OMB has issued for capital investment.

Mr. HITE. Correct. And the rationale behind the $323 million that's being requested this year is to show a steady state of funding from prior years. Last year, $325 million was appropriated, and what we were told by OMB was we'll keep the request for funding at a steady rate, therefore, it will be somewhere around $325 million.

Chairwoman JOHNSON. So, your point is that they just keep asking for the same amount of money knowing that they're going to have technology needs, but, actually, they're not spending it well, because they can't justify it?

Mr. HITE. That's correct. The fact that they're not spending it well, I wouldn't necessarily agree with, but they're asking for that steady rate of funding without the associated justification for that amount of money.

Ms. WILLIS. Madame Chairman, this is not dissimilar to the situation we had with this investment account last year when IRS came in asking for $500 million, and we found that they did not have good plans justifying what they were going to buy with that money and what they were going to get in return for it. Congress cut the $500 million request down to just over $300 million, and that's basically the same amount that they've asked for this year, but, again, in our opinion, without having an adequate basis for saying this is how much we need to fund investments in the account even in the future, recognizing that they will not be spending this money in the near term if there are certain requirements on it. In order to know how much you're even going to need, you need to have a better justification for the total.

Chairwoman JOHNSON. Do you mean that while they know they need to replace a lot of front line computers, they can't tell you exactly how many nor what kind?

Ms. WILLIS. Well, now, the front line computers that they're replacing are being funded under the operations part of the budget not the investment account. That's all part of the year 2000 investment, and so none of that money is coming out of the investment account.

Chairwoman JOHNSON. Are the mainframes and the centers coming out of this investment?

Ms. WILLIS. No, no, that, again, is coming out——

Chairwoman JOHNSON. Is this all just blueprint stuff?

Ms. WILLIS. This is all money designed to pay for the investment that will be driven by the blueprint for modernization in the future.

Chairwoman JOHNSON. Is this money actually being spent? It's just being allocated so that they can build it up, and we don't have to do it over one budget here?

Ms. WILLIS. Yes, it's just being placed in a multi-year type of investment account so that when IRS is in a position—we hope in a position—and has the disciplined processes in place to spend the money properly, that this is where they will go to get the money for the new modernized systems. But how much money will be needed and when will it be justified are the open questions.

Mr. HITE. If I could add to that? For Fiscal Year 1999, from that investment account, IRS is planning to obligate, roughly, $81 million.

Chairwoman JOHNSON. Well, since some of this money is clearly being set aside to meet the future costs of the blueprint, of implementing the blueprint, and since they're just now going out for contracting the blueprint, would you assume that they would be able to be justified—that they would be able to justify this, all of this money precisely at this time? It's kind of a question of the overall blueprint plus the detail of the equipment that's going to achieve those goals. Can you really expect at this point that they would know all of that and, therefore, be able to attach specific justification for equipment to these dollars at this time?

Ms. WILLIS. Madame Chairman, I think the issue here is that under OMB guidelines before investment accounts are set up or money is placed in investment accounts, you need to be far enough along the process to have a justification for what you're going to spend that money on. So, no, IRS is not in a position right now to say how much they're going to need overall to modernize and when, but before we start appropriating or allocating money in specific amounts for that, they do need to be farther down the road in understanding what they're going to use it for. Right now, it's just kind of going into a bank account that can be drawn on in the future, and we don't know what they're going to buy with it.

Chairwoman JOHNSON. Interesting. Certainly, one of the problems that we saw in the $4 billion that we've already put into technology modernization.

Mr. COYNE. Congresswoman Thurman.

Mrs. THURMAN. Thank you. Just so I understand it, in that account that we're talking about, are there any guidelines; are there any stipulations; is there anything that would prevent them from spending those dollars or is this just to kind of gather some money recognizing modernization later on? I mean, is there anything that covers that?

Ms. WILLIS. Well, there are certain requirements or fences that have been placed around the money in terms of IRS having a systems life cycle, processes in place, and the blueprint finished, et cetera, but once that basic framework is in place and the money is released, as I understand it, at this point, there are no controls around what and how that money will be spent.

Mr. HITE. One thing I could possibly add to clarify this, is that the modernization blueprint lays out multiple phases; and within each phase, it specifies multiple releases of technology. There are 16 releases in all. What IRS has justified so far is the first of the 16 releases. Now, these releases are going to be brought on incrementally; presumably, they're going to be justified incrementally. Thus far, only release one has been justified.

Mrs. THURMAN. And justified and accepted with the justification. I'm not sure that I understand all of this.

Mr. HITE. Justified in terms of OMB's requirements for business case justification—a case where the estimates, or the monies that you're going to spend for the technology that you want, are arrived at using formal cost estimating techniques; where there is a validated cost benefit analysis justifying those amounts, and the payback—the return on investment from those amounts are worth making that investment. These are the type of things that OMB is requiring.

Mrs. THURMAN. Okay, so they put some kind of limitation on what can happen. And you said that's 1 out of 16? Have there been other ones offered and they just haven't been justified at this point or——?

Mr. HITE. No.

Mrs. THURMAN. No——

Mr. HITE. I'm sorry. There have been no justifications put forward in terms of a business case for any of the releases beyond release one.

Mrs. THURMAN. Do they have a time period in which they can do that with that pot of money?

Mr. HITE. We asked that question and right now they have no time frames for preparing the business cases for the subsequent releases.

Mrs. THURMAN. What did they say back to you when you asked about that? I mean, not having the opportunity to ask them that question because they're no longer a witness. What is their justification to you? I mean, when you talk about this issue. Do they give you any?

Mr. HITE. Justification in terms of why they haven't completed?

Mrs. THURMAN. Why they have that money? Why they need that money? I mean, what have they been telling you?

Mr. HITE. We asked IRS how that amount of money was derived, and they couldn't explain the derivation over and above the $401.5 million that's justified in that business case. We asked OMB and

OMB's reply was the steady rate of funding from year to year in the investment account. So, the presumption is we'll ask for a constant amount of money over a number of years, so you do not see a lot of peaks and valleys in the amount of money that's being asked for in the investment account.

Mrs. THURMAN. So, does this kind of go to the issue that we hear sometimes from Government where if you don't get the money but when you need it to do modernization or you need to do some other updating and that kind of stuff, because you haven't spent that money the year before, so they don't want to give you any more money, but there's no account for them to use later on where something might be more expensive? I don't know if that made a lot of sense.

Ms. WILLIS. As we have looked at IRS' technology programs and modernization over the past 10 years, we have not found a lack of money to be a problem at all. Now, there is the issue of having money to invest as the projects come up in the future, but there's also the issue based on history of making sure that when the money is invested it is invested wisely and consistent with the blueprint, with the architecture, and done in a way that will bring the benefits that you expect to get; and that has not historically happened.

Mrs. THURMAN. Are we—and I don't know that you can answer this—but are we seeing that same problem—I mean as I look at this year 2000 issue that seems to be getting very close to us—are we experiencing this in other parts of budgets in other areas, the same kind of situation?

Ms. WILLIS. Around the year 2000 budget? Yes, I think across the board in Government what you're seeing are increases in the estimates for what it's going to cost to become year 2000 compliant as agencies become more familiar with the inventory of their systems; what they're going to have to do; which systems are going to have be replaced; what that's going to cost. There's also some hypotheses out there that as we get closer to the time and resources get tighter, that the cost of contractors will go up. So, the expectation is that the cost will continue to climb.

Mrs. THURMAN. Okay, thank you.

Ms. WILLIS. And that's not unique to the Federal sector.

Mrs. THURMAN. Thank you.

Mr. COYNE [presiding]. Well, I'd like to thank the panelists, director, for your testimony and call up the next panel.

The next panel is Joseph Lane, EA, Chair, Government Relations Committee from the National Association of Enrolled Agents, and Roger Harris, Federal Taxation Committee, National Society of Accountants.

Mr. Lane.

STATEMENT OF JOSEPH LANE, NATIONAL ASSOCIATION OF ENROLLED AGENTS

Mr. LANE. Thank you, Mr. Coyne. We appreciate the opportunity to visit with the committee again today. If it's all right, I'll submit our written comments for the record and I'll just summarize and then be happy to take your questions afterwards.

We're pleased to be before the committee again this afternoon, and continue to appreciate the opportunity to come in annually to review the preparation for the filing season and the service's performance. We're surveyed our online members in the last two weeks in preparation for this testimony. We received scores of comments from our members who, despite the fact they work 100 hours a week, wanted to comment and have some input on this hearing today.

The overall impression is that the filing season is running very smoothly. More taxpayers than ever are using paid preparers to get their tax returns done this year because of the confusion caused by the tax bill was passed last year. And while we appreciate the work, we probably would recommend that Congress revisit the whole area of tax simplification next year, because we don't really think the intent of last year's bill was to increase our workload. There's a lot of confusion about the Schedule D, the various IRAs that take effect this year, and the childtax credit.

We also want to extend some congratulations to the Service for the way they've taken the criticisms of last year, both at the congressional hearings and from taxpayers. We think they have made a legitimate and concerted effort to try improve responsiveness to taxpayer complaints and problems and to emphasize to their employees the absolute necessity for courtesy in all their dealings. Our members report to us a general improvement across the board in that area.

We also think the institution of the local problem-solving days at the district level was a masterstroke. And the decision to continue these events into the filing season has proved very effective and we support the Service on that.

What we would like to suggest the committee do, however, is to schedule a hearing in the near future to have the Service come in and present to the committee what systemic problems and case-processing problems have been identified across the country in these problem-solving days, and what steps they've taken to ensure that those problems don't continue to recur. We think we could all learn something out of this, and the Service would benefit from having the committee's input and the input of the practioner organizations on those issues.

Another example of improved service is the extended office hours into nights and weekends. We think this is a trend in the right direction, and IRS should be granted with additional budget support. We caution the committee not to expect an immediate payoff. Sometimes it takes a while and a number of years of pump-priming to get people to realize IRS is not open during the usual business hours, but has extended hours and is available on weekends.

Several years ago IRS had a program where they used to take fully-outfitted campers out to shopping centers. They had tax forms and actual assisters on board to help taxpayers. A guy would come to the shopping center not knowing IRS was going to be there, see it there, and come back the next weekend with his stuff. And of course they would have moved to another mall by then. So they had some bad publicity and there was a disconnect. It takes a while and a concerted effort to make sure this publicity gets out. But we praise IRS for their ability to take this these programs out to the public where the public is, as opposed to expecting them to go downtown on a weekday to a Federal building.

Schedule D reporting of capital gains has been a major headache for taxpayers and practitioners and apparently for mutual funds and brokerage houses. We are seeing a tremendous increase in the number of corrections that are coming out late in the year on 1099's because brokerage houses were not able to properly account for and report the capital gains. Some of the mutual funds gave out reports that did not break out what was subject to the 28 percent rate versus the 20 percent rate, so we had problems along those lines. We had many practitioners exercised about that.

Another exasperated practitoner basically said that anybody in Congress who voted for this bill ought to be taken out and hung or shot or whatever, but we'll say we don't blame you folks for designing the form.

One thing that is important, I think, is that any time you have a late-year tax law change, it really is disruptive, not only to the IRS, but to the publishing industry, the software industry, practioners and everybody else. So we would like to see the committee agree that for current year tax law changes, legislation must be ready for a vote by July 1, and any vote on a tax law change that comes after July 1 would have to take effect the following year. It just makes sense to do it on a more rational basis.

One of the other issues we looked at is the electronic filing program. The comments we received from our members were universally supportive of the quality and design of the e-filing program material that the IRS made available this year. They are very happy with that. We would note that was done by an outside agency under IRS contract.

What our members have not noticed are any of the Public Service Announcements on public television. It's been very, very spotty, and so it prompted a lot of our members to be concerned. And so like other government agencies that have legitimate advertising program needs—for example, the volunteer Army, which we understand is somewhere funded in the neighborhoood of $100 million for advertising—that the IRS ought to get some kind of reasonable budget that allows them to go out and actually market this e-filing program appropriately with professional management.

Of course, the caveat is that would have to be handled by an outside advertising agency. We would not recommend that we have IRS engage in running their own advertising campaign. The experience we've had with them in the past has not been entirely positive in that regard, but they certainly deserve a much-enhanced budget to allow them to go out and actually purchase advertising.

We are still receiving complaints from practitioners who would be willing to convert to electronic filing, but can't because not all the tax forms can be accepted electronically. And one of the concerns we have is that we hope the Senate delays in passing the IRS reform bill will not cause a situation where IRS is granted a delay beyond December 31 of this calendar year to have a procedure in place which allows IRS to accept all forms electronically. And that is a major concern of ours because, quite frankly, we think it's not getting the proper amount of emphasis in this budget request.

If you look at that illustration in the Commissioner's testimony you got today, of the additional $103 million that's going for enhanced customer education and customer service, only $3 million is earmarked to go to electronic filing. Now we heard testimony all last year where we had an $800 million cost to process tax returns through the pipeline, and if 50 percent of those tax returns are from practitioners that are in digital format already and get transferred back to paper to send to IRS, it seems to me that there is a substantial budgetary savings that could be derived by just increasing the number of practioners who file electronic returns.

So it's critical, and we believe it ought to be addressed in a specific line budget item, to make sure that that work is done and it is done timely, even if it means going outside and hiring an outside contractor to identify what reprogramming needs to be done to make sure IRS could accept the all existing tax forms. We understand the Service has lots of priorities, and the Year 2000 problem is a major one, but this cannot be allowed to drop through the cracks.

We've also had some complaints about the refund telephone solicitors giving bad advice to taxpayers. All of these examples we're putting up are mentioned to us by our members for purposes of illustrating that the Service has still got some improvements to make in the training area.

One of the real concerns we have is the so-called e-filing educational monitoring visits that are part of the revenue protection strategy. These visits are ostensibly done to assure the practioner is complying with the record-keeping requirements of the e-filing program and maintaining the documentation required of return transmitters. Based on our review of our members' depictions of these events, we can only conclude the Service has re-defined the word "visit"—something akin to the Viking visits of Northern Ireland centuries ago.

We have had incredible complaints from members about revenue agents barging into their offices full of people, insisting on seeing the preparer immediately, asking to see taxpayer records immediately, not calling for appointments, not explaining the purpose of the visit. We understand the need for revenue protection strategies, to make sure you don't have earned income fraud and refund fraud, but the IRS's own study two years ago indicated that Enrolled Agents and CPA's who are covered by Circular 230 were a miniscule percentage of the problem e-filers. I think that these educational visits, if they're allowed to be conducted the way they're being conducted now, are just going to cause more ill-will.

And it's important, we think, for the Service to communicate the criteria they use—when they identify these problem taxpayers—that they're going to be using, that they should share that information with responsible practitioner organizations and the banking industry, in particular, and the software companies, because they have the most to lose from earned income credit fraud.

So we need to address those issues dramatically and quickly, because one of the problems we had this year is the earned income credit criteria that they publicized they didn't put out until mid-March, and the peak refunding cycles had occurred in late January and February. So all of those bad loans had already been made before the criteria that the Service was going to use was disclosed to the people that would have been making the loans.

And part of the problem, as we understand it from the banks that we've talked to and our own members who have lost a fair amount of money so far on this, these people came in, made a commitment to the Service to file electronically. They filed the returns electronically. The Service has selected these tax returns for additional review for purposes of looking at the earned income credit.

And in the cases where the Service subsequently decides that that is an accurately claimed return refund and an accurately claimed earned income credit, even though they have been designated or instructed on the original return that was filed to do a direct deposit of the refund back out—and generally in those cases, that means to a bank that's already advanced the loan to the taxpayer against that refund, they are issuing a paper refund, which means that the very people who are supporting them in the electronic filing arena, trying to get additional tax returns filed electronically, the banks and the preparers that are involved in that program now, are losing. The preparer loses his fee because it doesn't get deducted, and the bank loses the repayment of a loan which they had assumed was a guaranteed repayment because the Service was going to do a direct deposit.

Now, they should be able to get that back into a direct deposit cycle. IRS should not have to issue a paper refund on that. In 1995 when they did that, the bankers we talked to told us that it cost them over $200 million. This year the bankers have told us that they had programmed a 2 percent unfunded refund loss rate, and they're currently running 4 percent. So they're looking at the same type or dimensional losses this filing season. That's outrageous. That's four years that they've been talking about changing that. They should get that back into an automatic deposit cycle. It just creates ill-will among everybody that they're looking to help them improve their processing systems.

And we'd like to suggest that the committee hold hearings on this issue alone this year and invite in the banks. There are only three or four banks that are involved in this, and software people, and some practitioner organizations—to comment specifically on the cost to them to do business with IRS just because of the way they handle these refunds.

As to budget priorities, we reviewed the budget. We think the budget priorities in terms of the design and direction are all getting proper emphasis. It's taxpayer service; it's enhancing the ability of the technology to process the work effectively. The one area we would like to spell out in detail, and we believe you have to stay on top of it, is to make sure that those tax forms are translatable and file able electronically by the end of this year.

The IRS has supported this and said they had supported it for years. The problem is, if you look at that budget request, with $3 million allocated to enhancing electronic filing, I don't think you're going to buy much in terms of moving the rest of the tax forms over. We would be happy to come back and comment at either one of those hearings, should you decide to put those on your schedule.

In summary, we would like to comment that Commissioner Rossotti has made a substantial effort in turning around the morale of that organization and we commend him on that. And we would also like to commend Deputy Commissioner Mike Dolan, who was acting for quite a while before Mr. Rossotti was confirmed, and the IRS employees, who really had to take some pretty substantial hits last year in terms of their own performance and but who took the valid stuff to heart. They have made a legitimate change, and, I think, basically, are going to continue to make positive changes in the way they deal with taxpayers.

So, in general, we're happy to report a much better functioning IRS this year than we have had in the last year or so. So, I'd be happy to take any questions if you have any.

[The prepared statement follows:]

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Prepared Testimony

and

Statement for the Record

of

Joseph F. Lane, Enrolled Agent

on behalf of the

National Association of Enrolled Agents

before the

House Ways and Means Subcommittee on Oversight

on

the 1998 Tax Return Filing Season and the

IRS Budget for Fiscal Year 1999

March 31, 1998

Washington, DC

Testimony of
Joseph F. Lane, Enrolled Agent
on behalf of the
National Association of Enrolled Agents
Before the
House Ways & Means Subcommittee on Oversight
Tuesday, March 31, 1998
Washington, DC

Madame Chair Johnson, Members, staff and guests, my name is Joseph F. Lane and I am an Enrolled Agent engaged in private practice in Menlo Park, California. I have been an Enrolled Agent for nearly 20 years, after spending 10 years with the Internal Revenue Service. I currently serve as Chair of the NAEA Government Relations Committee.

I am pleased to have this opportunity to present testimony on behalf of the more than 9,600 Members of the National Association of Enrolled Agents, all of whom are tax professionals and many of whom are small business owners. As I am required to advise you under House rules, NAEA receives no Federal grants or contracts.

As you know, Enrolled Agents are licensed by the U.S. Department of the Treasury to represent taxpayers before the Internal Revenue Service. Enrolled Agents were created by legislation signed into law by President Chester Arthur in 1884 to remedy problems arising from claims brought to the Treasury after the Civil War. We represent taxpayers at all administrative levels of the IRS, thereby affording us front-line perspective on the administration of our nation's tax laws.

We would like to once again express our appreciation to the Oversight Subcommittee Chair, to the Members and staff for your annual review and evaluation of the IRS budget and filing season. NAEA believes you are making an invaluable contribution to improving our system of tax administration by your practice of regularly scheduled hearings about IRS activities.

1998 Filing Season Report Card: An Overview

In order to prepare for this hearing, NAEA utilized its online surveying capability to reach out to our Members for their views. We received scores of replies from practitioners around the country this past week, despite the fact that this is the height of filing season and most of our Members are working more than 100 hours each week.

The overall impression is that the filing season is running very smoothly. However, more taxpayers than ever are using paid preparers to assist them due to confusion about changes in the tax law enacted last year. For example, many taxpayers, having taken a look at Schedule D, are finding their way to the door of their local Enrolled Agent. There is massive confusion about the various IRAs and child credit provisions -- what they are and when they go into effect. As a result, more and more taxpayers are turning over their tax preparation obligations to tax professionals. We are hearing reports of business increases of 10% to 20% and more. While we certainly appreciate the business, we recommend Congress revisit the issue of tax simplification as we doubt the intent of last year's bill was to increase practitioner business!

This is also the time of year when many nonfilers come to us and request our assistance in getting back into compliance. In addition to these individuals, we are also seeing a number of individuals who have long-standing, unresolved disputes with the IRS. To its credit, the IRS seems to have taken last year's Congressional and taxpayer criticisms to heart and made a noticeable attempt to improve responsiveness to taxpayer complaints and emphasize the absolute necessity for courtesy in all dealings. Our Members report to us that the IRS personnel they have been dealing with have mostly been cooperative in their efforts to iron out taxpayer problems and assist citizens in putting together installment agreements or offers in compromise in order to resolve their cases.

The institution of local District Office Problem Solving Days last year and the decision to continue these events, even during filing season, have, we believe, contributed to improving the taxpayer's perceptions of the Service and allowed problem cases to be elevated to the proper level for resolution. We urge the Subcommittee to consider the possibility of conducting a hearing in the near future focusing on the case processing trends and systemic problems the Service has identified through these Problem Solving Days and what steps have been taken or planned to prevent their recurrence.

Another example of the Service's commitment to improving taxpayer service is the public's welcomed response to extending office hours to nights and weekends. We believe this is a trend in the right direction and ought to be continued and expanded through additional budget support. It is important to remember that changes such as these need several years of "pump priming" to get established as the public begins to realize that the Service is open during nontraditional business hours.

We note for the committee's reference that years ago the Service had a "tax mobile" program of bringing recreational vehicles to shopping centers fully outfitted with tax forms, publications and taxpayer assistors to help the public during tax season. This was an innovative program and one we felt should have been continued at the time but it was discontinued due to budget cut-backs and lack of effective publicity. We support efforts the Service makes to bring their assistance out to the public rather than insisting the public travel into federal buildings - especially on weekends.

Specific Problems Areas Identified by Our Members

While the filing season is generally proceeding smoothly, we have received Member comments on a handful of issues and we would like to share them with you. We would first like to state for the record that these problems are complex, not entirely the result of IRS actions, and at times reflect decisions made prior to Commissioner Rossitti and his team coming on board.

1. Schedule D

A) Complexity and computation problems
Schedule D for reporting capital gains has been a major headache for taxpayers and practitioners, and apparently for mutual funds and brokerage houses as well. Many of our Members commented that taxpayers did not understand why their returns could not be filed earlier (there was a hold on filing Schedule D returns until February 12 when the IRS computers were prepared to accept them). Others complained that brokerage houses and mutual funds sent out inaccurate 1099s -- apparently due to errors in the calculations -- and then sent out corrected ones. This meant that the taxpayer had to either pay for the return to be redone or, if filed, incur additional cost to amend it.

Still others complained that IRS had grossly underestimated the impact of the delay in processing Schedule D returns. A number of our Members said that significant portions of their clients were affected -- and these were not necessarily practitioners from affluent areas. Rather, they represented a cross section of the populace -- a reflection of the increased number of Americans holding shares in mutual funds or who took advantage of the other capital gains reductions last year such as residence sales.

As one exasperated tax practitioner put it, "This has been a nightmare filing season. This was primarily due to the capital gains changes. Many funds issued capital gains and failed to tell what portion was 28%. I had to call each fund manager and get the data. Time to do a return was almost double what it was last year." And yes, that particular EA said he wouldn't mind seeing filing season extended, just so he could get correct information and prepare the return properly.

Another Member commented, "That [schedule D] computation should be considered a crime against the elderly who exist on their dividends. [It was] very cruel."

B) Recommendations

While we do note for the record that Congress itself does not design the forms, we agree that complaints like these are especially valid when late in the year tax law changes are enacted. Then the IRS, the brokerage houses, the software industry, and tax practitioners must rush through their work to properly write, edit and program instructions for computers and taxpayer publications to communicate the changes, retrain staff and revise internal processing procedures. We recommend that the Subcommittee initiate legislation which sets a July 1 "drop dead date" for any tax legislation which would affect a current tax year and that anything passed after that deadline would be required to take effect the following tax year.

Still another Member noted: "More and more taxpayers are investing in mutual funds. They also frequently sell shares in them. The majority of the mutual fund organizations provide average be added to Schedule D that would say something to the effect that: If an average cost method was used for this transaction, please check here." This would not seem to be too difficult for IRS to do and would really help relieve taxpayer burden. We think this is a simple, but good idea and ought to be adopted.

2. E-filing

A) Promotional materials/need for advertising budget
We have received nothing but praise for the IRS promotional materials on the e-filing program. Our practitioners found the materials sent them to be useful and report that taxpayers responded in a very positive manner. They have not seen many of the Public Service Announcements on the program -- which caused many to suggest that IRS be given a real advertising budget to promote e-filing . We endorse this suggestion enthusiastically!

Given the impact widespread e-filing would have on reducing IRS budget needs and the vast improvement to be gained by receiving correct tax data initially, we think it is as important to our nation as other government programs which receive healthy advertising budgets. We understand, for example, that the volunteer Army advertising program has a budget approaching $100 million. Considering the number of taxpayers IRS "reaches out and touches" each year, we think they ought to be given an equally realistic advertising budget to promote e-filing. This budget item ought to be designed to require contracted out professional advertising agency services to actually run the program.

The quality of this year's material underscores this suggestion as it was prepared by outside contractors. From our extensive experience with e-filing promotion for the past thirteen years, we have learned that the Service's core competencies do not include public relations and advertising expertise.

B) E-filing of all forms
We are still receiving complaints from practitioners who would be willing to convert to e-filing but who are still finding that too many forms cannot be filed electronically. The burden placed on practitioners to maintain a two-track system -- paper and e-file -- is a major obstacle to practitioner acceptance of electronic filing.

We hope that the delay in the Senate consideration of the IRS reorganization bill does not lead to granting the IRS more time beyond the established deadline of December 31, 1998 to have procedures in place to accept all tax forms electronically. We believe this is the critical factor delaying wholesale conversion of the practitioner community to e-filing.

C) Teletax

We have lately received complaints about the IRS refund inquiry telephone line assistors giving inaccurate advice to taxpayers. It seems that their data files are contained on two computer screens and many assistors were not bothering to look at the second screen before answering the taxpayer's inquiry. Instead they were improvising answers like "Oh, your tax preparer must have your refund." While this is possible when taxpayers are availing themselves of any of the financial loan products connected with refunds, the lack of precision in the Service employee's answer has caused many problems for e-filers.

To their credit, when we brought this problem to the attention of the IRS National Office Customer Service staff, they immediately communicated a reminder to the field components to follow the correct procedures. However, we are still encountering problems in this area. These procedural glitches must be resolved before practitioners will fully commit to e-filing the majority of their returns as they do not want to lose clients because of IRS miscommunications.

D) Fraud prevention/monitoring visits

Within the past week we have learned that the random "educational monitoring visits" the IRS is performing on e-filing practitioners are also creating problems. These visits are ostensibly done to insure the practitioner is complying with the record-keeping requirements of the e-filing program and maintaining the documentation required of return transmitters.

Based on our review of several Members' depictions of these events, we can only conclude the Service has a new definition of the word visit - something akin to the Viking visits to the coastal areas of Ireland long ago. We have been told of Service employees not following procedures; barging into offices without appointments; demanding immediate access to taxpayer files; demanding practitioners discontinue meetings they are in so they might speak with the agents immediately; threats of "pulling the practitioner's e-filing permit;" not explaining the purpose of visits; and of loud announcements in waiting rooms full of clients as to why they were calling. When our Members complained to local IRS officials, they were told - "Don't ask me, National Office is requiring that we do these inspections."

There is widespread feeling among practitioners that the assigned agents don't want these details and as a result are taking it out on practitioners. We don't know if that is true, but we do know that when they did this same program two years ago, they caused incredible ill will towards e-filing among compliant practitioners. Furthermore, the Service's own analysis showed that practitioners operating under Treasury Circular 230 represented a minuscule percentage of problem e-filers.

We think the Service might better use its limited resources to focus on the refund fraud mills and the people in federal prisons who are filing false returns and stay out of compliant practitioners' offices. We believe the Service needs to communicate its criteria for refund fraud investigations to responsible practitioner organizations for dissemination to members and to consult more widely with software publishers and the banking industry who have the most to lose from this crime.

They are too secretive and their failure to communicate openly breeds distrust and ill will among otherwise compliant and supportive stakeholders and undermines any willingness to engage in e-filing.

3. Earned Income Credit

A) Fraud prevention efforts
Perhaps the most significant problem we have been informed about this filing season concerns the IRS processing of EIC claims. We have been advised by bankers as well as our Members that the Service has a serious credibility problem as a result of their actions in the revenue protection strategy arena. As we pointed out above, tax practitioners, banks and the Service all have the exact same interest in insuring that only valid refunds are issued to taxpayers. Everyone loses when refund fraud is perpetrated.

This year, the Service announced on its Web site and in information sent to the industry that they anticipated holding a maximum number of 150,000 electronically filed returns with EIC claims for additional review. The industry relied on this representation in setting parameters for possible losses resulting from loans made against refunds which would not be fully funded. There are now rumors circulating that the Service pulled between 500,000 and 750,000 returns for review, not 150,000.

This causes tremendous exposure for tax practitioners, banks and lending institutions in two ways. First, the dollar loss percentages may be much higher due to the increased number of refunds questioned. This would have the effect of increasing the cost of e-filing for everyone as these enterprises must cover their losses. Second, despite promising four years ago to do otherwise, the Service is issuing paper refunds directly to taxpayers when it subsequently deems the refund and EIC are properly due on a return it has held up - this despite the presence of a direct deposit indicator on the return when originally filed.

The effect of this action is to leave the bank holding the bag on what was supposed to be a fully paid loan as they have already advanced to the taxpayer the loan proceeds secured by the anticipated refund to be directly deposited by the Service to the bank. Bankers we have talked with have told us they are experiencing an "unfunded refund loss rate" double what they had anticipated for the current filing season. This means the industry in general will lose millions of dollars for supporting the Service this year. This is wrong. We believe it will drive practitioners, who lose their preparer fees when a direct deposit direction is not followed and banks, who lose the loan repayment, away from the possibility of participating in e-filing in the future. The sad part of this is that it is entirely unnecessary. It is in the interest of the American taxpayer, the Service, tax practitioners, and financial institutions to be fully briefed on what refund fraud criteria the IRS is using in combating this crime. The Service cannot continue to insist on holding its criteria close to the vest and pass the losses off to others who they have solicited to help increase the number of returns filed electronically. The Service released some of their criteria for this year in mid-March - way too late to help salvage the loans made during the peak refund cycles of late January and February.

This issue is of such economic consequence that we believe the Subcommittee ought to hold hearings on this issue alone this year and invite testimony from those businesses who have incurred losses as a result of the Service's policies.

B) Due diligence requirements
In addition to the problems outlined above, the Earned Income Credit (EIC) has provided plenty of heartburn for taxpayers and practitioners. The new due diligence requirement significantly increased prep time and paper work. In addition, we have had numerous complaints of the Service holding up the EIC payments until further information is submitted to support the claim, then automatically issuing a denial 30 days later saying the taxpayer didn't respond when, in fact, the taxpayer did respond via fax directly to the Service. The explanation offered to one of our Texas members by the IRS unit issuing the denial was that they were so overwhelmed by the volume of work they didn't have time to associate the responses with the cases- so they were sending the denials out because they had a requirement to resolve the matter within a set time frame! Needless to say, this is ridiculous and we believe needs additional looking into by GAO. We believe the Service should take whatever precautions are necessary to insure against fraud but should adequately fund units charged with doing the work.

IRS Budget Priorities for 1999

We have reviewed the IRS budget priorities for the coming year. There is little there to disagree with in terms of program emphasis and direction. The Service is responding to the publicity of the past year by reemphasizing the need for better customer service and to improve its internal control systems.

A specific area we would like to see spelled out by the Service in detail is how they plan to meet the requirement of accepting all tax forms electronically by the end of the current calendar year. We have raised this issue in so many forums over the years and note that the National Commission on Restructuring the IRS also raised this issue that we believe it needs to be individually addressed by Congress in the IRS budget process to insure its completion. This is an idea the Service has long paid lip-service to but does not really support and it is the one thing which will open the door for drastically increased practitioner participation in e-filing.

The best way to achieve a dramatic increase in the overall number of e-filed returns is to convert the existing practitioner base of 50% of all returns to electronically transmitted ones. This will not be possible until the Service can accept electronically whatever the practitioner would have sent on paper, including "white paper" memoranda and elections. We strongly believe that if the

Subcommittee does not monitor this area with a critical eye we will be here again next year asking for the same thing and the goal of getting to 80% of returns electronically will again be deferred another year down the road.

Summary

We hope our comments here today have provided some ideas for your future action. While we have been critical on some issues, we do want to conclude by praising Commissioner Rossotti's and Deputy Commissioner Michael Dolan's efforts towards moving the Service into the future and to compliment the Service officials and employees for the way they stood up to the criticisms of the past year, took the valid ones to heart, and made a determined effort to affect positive changes in the way the Service deals with taxpayers. We are off to a good start - let's keep working together to keep the momentum going. America's taxpayers will thank us.

Chairwoman JOHNSON [presiding]. Thank you very much, Mr. Lane.

Mr. Harris.

STATEMENT OF ROGER HARRIS, VICE CHAIRMAN, FEDERAL TAXATION COMMITTEE, NATIONAL SOCIETY OF ACCOUNTANTS

Mr. HARRIS. Thank you, Madam Chairman. My name is Roger Harris. I am president of Padgett Business Services and currently the vice chairman of the National Society of Accountants Federal Taxation Committee. We're very pleased to have the opportunity to be here today to comment on the current filing season, as well as the 1999 IRS budget.

I think, as you know, our organizations have been big supporters of the restructuring legislation that the House has passed and the Senate is considering, and certainly we've been supportive of the goal of that legislation, which is to make the IRS a much more customer-responsive agency. I think to be consistent with that support, we must also be supportive of the fact that they need money to do that, and we stand in general support of their budget request.

Specifically, on a few points, Commissioner Rossotti's reorganization plan, I think, is something we agree, certainly in principle, with. I think we know very well that the small business taxpayer is a different person than the individual taxpayer, and when the IRS reorganizes in a business unit format, I think it offers them the opportunity to train their people to understand their customer better, and that what they are dealing with is their customers. I think that this has a tremendous opportunity to improve the customer service of the agency.

Clearly, I think training and equipping personnel is important at all levels of the IRS. I think we have a lot of hardworking people at the IRS that just need to have the training and equipment that they need to do the kind of job that I think they want to do when they come to work every day. And I think to the extent that we can fund that, it certainly is money well-spent.

I don't think that we can—any of us—sit around and question the need for funding for the Year 2000. I think all of us shudder at the idea of what would happen if the system is not functioning as it needs to be in the Year 2000. Perhaps of all the budgetary processes, that maybe is the most important area that we have to address. I think that the system has to work and work indefinitely.

Moving into the filing season, I can agree in large part with some of the things that Joe said, particularly as it relates to the Schedule D and the capital gains rule. I think we would all agree that this has been a relatively smooth filing season, but there is no question that the Schedule D and the capital gains law has added a complexity that many of us didn't anticipate and has been an unintended benefit to the tax practioners. And I know that that legislation was not intended to help us make money, but it has done that.

But there's also been another interesting result of that—that since most taxpayers have benefitted from these changes, it's amazing how complexity, when it saves you taxes, is not nearly as offensive as it is when your taxes go up. [Laughter.]

So, I don't know what the message is there, but we thank you, and I think the taxpayers thank you at this point.

There have been some positive things, obviously, done this year by the IRS, many of which have been mentioned here today with regard to the expanded hours of the phone, the walk-in Saturdays, and the problem-solving days. I don't think we can ignore that those have been well-received and have made a major impact on this smoother tax season. I think we should commend the Service and certainly encourage them to continue to work in those areas.

With regard to electronic filing, we've heard numbers and we've heard comments today that electronic filing has increased, and I think, in fact, it has. But, unfortunately, I don't think it's increasing anywhere fast enough if we're going to try to meet the 80 percent goal of the legislation that has passed the House. There are problems in the current system that have to be addressed if we are going to realistically meet an 80 percent goal.

There are some encouraging things going on, though. One, I think, is Bob Barr joining the IRS—I know they are currently working right now to put together the Electronic Tax Administration Advisory Committee, and I think if we build that committee properly and give Mr. Barr the funds and the people to work with, I think we can devise the system that will help us reach the goal.

I don't think today we know what that system looks like. I'm not sure that we should be restricted by what's happening today. I think we have to be, again, a little creative and give this group the empowerment to design a system that gives incentives both to taxpayers and practitioners so that the 80 percent goal is met very easily and leads into perhaps even better than 80 percent, because it becomes the way everyone wants and chooses to file their tax return.

I see the light is coming on, and in the interest of everybody's time, I will ask you—to include written testimony I have submitted that is in more detail. I certainly, again, welcome the opportunity to be here today. It's also a pleasure to come, and I certainly will look forward to any questions that any of you may have.

[The prepared statement follows:]

National Society of Accountants

TESTIMONY OF

ROGER HARRIS

VICE-CHAIRMAN, FEDERAL TAXATION COMMITTEE

NATIONAL SOCIETY OF ACCOUNTANTS

ON

THE IRS BUDGET FOR FISCAL YEAR 1999

AND

THE 1998 TAX RETURN FILING SEASON

BEFORE

THE HOUSE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

MARCH 31, 1998

1010 N. Fairfax Street, Alexandria, Virginia 22314 (703) 549-6400

The National Society of Accountants is pleased to testify on the status of the 1998 tax filing season and the fiscal year 1999 budget for the Internal Revenue Service. NSA commends Chairman Nancy Johnson and the other members of the Subcommittee on Oversight for holding today's important hearing. In the context of a proposed fiscal 1999 budget for the IRS, we strongly support the Subcommittee's goal of creating a modernized, efficient, and responsive tax agency.

My name is Roger Harris, President of Padgett Business Services and Vice Chairman of the National Society's Federal Taxation Committee. Padgett Business Services, headquartered in Athens, Georgia, provides accounting, tax, and financial advisory services to individuals and small businesses through a network of 400 offices located throughout the United States and Canada.

NSA is an individual membership organization. Through our national organization and affiliates in 54 jurisdictions, we represent the interests of approximately 30,000 practicing accountants. Our members are for the most part either sole practitioners or partners in moderate-sized public accounting firms who provide accounting, tax return preparation, representation before the Internal Revenue Service, tax planning, financial planning, and managerial advisory services to six million individuals and small business clients. The members of NSA are pledged to a strict code of professional ethics and rules of professional conduct.

Internal Revenue Service Budget

The National Society strongly supports H.R. 2676, the Internal Revenue Service Restructuring and Reform Act of 1997, approved by the House of Representatives on November 5, 1997. This excellent bill, which was carefully crafted by the Ways and Means Committee, strives to make the Internal Revenue Service a more customer service oriented agency.

NSA firmly supports the objective of making the IRS a more customer responsive agency, as opposed to an agency solely focussed on carrying out aggressive collection activities. We believe a customer oriented philosophy should yield significant increases in tax revenues for the Treasury over the long-term. In fact, the National Society is so supportive of making the IRS a more customer responsive agency, that we further believe the IRS' fiscal 1999 budget request should also be measured against the benchmark of "putting the customer first."

In terms of the IRS' customers, the agency must implement procedures designed to improve its relations with America's taxpayers and its ability to service the needs of those taxpayers. The National Society of Accountants believes the Internal Revenue Service's budget request for fiscal year 1999 does in fact strive to address these needs.

Consequently, the National Society supports the Internal Revenue Service's request for a net budget increase of $529 million over fiscal year 1998. Under this budget proposal, a net $176 million would be used to maintain current program levels within the agency. Further, as part of its budget request, IRS has proposed a $103 million increase in funding for customer service functions, and an additional $227 million for improving the agency's information systems. As described in more detail below, Commissioner Rossotti has also requested $25 million to support a long-term reorganization plan for the agency.

According to IRS projections for fiscal year 1999, the agency's 100,000 employees will respond to 120 million telephone calls from taxpayers and will examine 1.3 million individual tax returns. These statistics only briefly highlight the critical governmental mission served by IRS employees to our nation. The practitioner community appreciates and understands the heavy burdens placed on IRS employees to improve the agency's work culture from within. We believe IRS employees want to become more customer oriented, as suggested by recent statements by Commissioner Rossotti. To achieve this end, the agency must be allowed to expend the funds needed for employee training and equipment. Funding must be provided not only to maintain current service levels, but to provide additional funds to allow the Service to respond to needs for better customer service identified by Congress, taxpayers and IRS employees.

The National Society of Accountants believes that funding should be allocated for new initiatives to improve customer service. Several such recent initiatives by the IRS have improved both customer service and taxpayers' attitudes toward the Service. The Problem Solving Days are one example of this effort. Held monthly in IRS Districts around the country, Problem Solving Days give taxpayers the opportunity to meet face-to-face with Service personnel to work out tax problems. Another example is the improved telephone access during extended operating hours this filing season. NSA members appreciate the Service's efforts in these areas.

One of the best examples of new, improved customer service is the IRS' Internet Home Page. The newly created Tax Professional's Corner on the website gives practitioners immediate access to just-released IRS rulings, procedures, announcements and notices. Savvy tax professionals who now use the website do not have to phone the IRS for answers to their questions. They can also sign up to receive informative electronic mail via the Digital Dispatch direct from IRS. By using this medium, IRS has the ability to quickly notify tax professionals of processing snags or software glitches at the Service Centers. Problems can be instantly addressed over the Internet, ensuring a smoother filing season. By allocating funding to further development of Internet resources and promoting the availability and use of these assets, the Service will reduce its long-term telephone, processing and mailing costs.

Another excellent product developed by IRS is the 1997 Federal Tax Forms CD-ROM. Efforts by the Service to bring down the price of this product and to distribute it to post offices, libraries, copy centers and corporate human resource departments are to be commended. We applaud the Service for these efforts, and for plans to develop other new CD-ROM products. NSA stresses the need for adequate funding in these important customer service areas.

Two other important areas need to be adequately addressed and funded in the IRS budget. The agency should have the resources to efficiently complete the conversion of its computer systems to accommodate the year 2000 date change. The foundation of the tax system depends on the Service's ability to continue smoothly processing returns into the next century. Also in the technology area, the Service needs to maintain its focus on its long-term effort to modernize computer operations. The IRS currently lags far behind private industry in giving its employees access to and use of modern, efficient computer equipment. This must be changed.

IRS Reorganization Plan

Commissioner Rossotti has proposed a $25 million long-term reorganization plan for the IRS. The plan calls for a reorganization of IRS business practices into four operating units, split into practice areas where IRS employees will be better able to understand and more quickly resolve taxpayer problems. The IRS would be split into individual business units for the purpose of addressing the needs of (1) persons with wage and investment income, (2) small businesses and self-employed individuals, (3) large corporate businesses, and (4) employee plans and exempt organizations.

The National Society of Accountants is in agreement with the conceptual overriding objective of the new reorganization plan. We support the proposed focus on the unique needs of specific types or categories of taxpayers (like the self-employed) as opposed to the current geographical configuration of the management structure of the agency. NSA believes this plan has the potential of significantly improving the IRS' relationship with its customers, America's taxpayers. NSA applauds this effort and we believe Commissioner Rossotti merits our support. The Commissioner should be given the opportunity and the proper tools to implement his ambitious plans for the agency during fiscal year 1999. He should also be given a multi-year, stable budget plan to allow him to proceed with both the reorganization and modernization of the agency. Finally, he should be given the flexibility to bring in qualified personnel from outside the IRS to give the agency new ideas and fresh perspectives on solving old problems.

NSA understands that the details for this business unit concept have not been fully fleshed out by the IRS. For purposes of helping the agency with implementation of the plan, the IRS has hired a consulting firm to evaluate the plan's details. The National Society looks forward to working closely with the IRS on the plan's development. We consider this a top budget priority. We intend to provide constructive comments to the IRS throughout all the review stages for the plan.

Offers in Compromise

Another area which we believe should be given budgetary priority during fiscal year 1999 is reform of the Offer in Compromise program. It is our understanding the IRS began an effort on

January 20, 1998 to review the problems associated with Offers in Compromise. We further understand the agency has set up a task force to review the reasons why a super-majority of offers are determined to be "nonprocessable," as well as to make recommendations for improving the Offer in Compromise program. NSA recommends the Service examine other problem areas in the program including guidance for collections personnel on application of the current allowable expense standards, inordinate delays in processing, delayed notifications and lack of consistency. IRS should allocate funding to studying and improving this important taxpayer program.

The Current Filing Season

The 1998 filing season has proven to be a trying one in some respects for taxpayers and practitioners alike. This in large part is due to the complexity of many of the 1997 tax law changes, particularly the changes involved with the reporting of capital gains on Schedule D, Form 1040. We compliment IRS on solving the problems associated with processing Schedule D according to their pre-announced timetable. The fact that the IRS Electronic Tax Administration notified practitioners and the public in advance of the delay avoided what could have been a public relations nightmare.

The National Society of Accountants testified on February 12, 1998 before the House Ways and Means Committee on the issue of capital gains and tax burden. We raised concerns about the 1997 Schedule D, and how the schedule has grown from 23 lines to 54 lines. Taxpayers have been frustrated by the fact differing capital gains rates apply for different holding periods, as well as being upset about complexities associated with differing capital gains rates applying to different assets.

For purposes of eliminating much of the complexity associated with Schedule D, we concur with Chairman Archer that the beneficial 20 percent long-term capital gains rate should be made effective for capital assets held for at least one year, as opposed to the current holding period of 18 months. Chairman Archer's proposal would serve to reduce much of the recordkeeping burdens placed on mutual fund investors by the 1997 tax law.

Nevertheless, despite the various complexities of the tax law, the feedback NSA has received from practitioners is that the 1998 filing season is proceeding on a relatively smooth track. In this context, the IRS deserves a lot of credit for working hard to ensure a successful filing season. It should be noted that practitioners are reporting an influx of new clients this year. Many of these individuals first tried to do their own tax returns, even going so far as purchasing tax preparation software, only to be stymied by the information reported by their mutual fund company or alternative minimum tax generated from a large capital gain. Many Schedule D glitches faced by these taxpayers are the result of non-standard Form 1099-B reporting by mutual funds. It is extremely difficult for taxpayers to decipher mutual fund statements and even more difficult when each statement reports gain in a different way. These difficulties have resulted in taxpayers seeking help from tax professionals. Based on their experiences this filing season, practitioners have renamed the Taxpayer Relief Act of 1997 the Tax Practitioner Full Employment Act of 1997.

We applaud the IRS for the number of steps it has taken to help ensure a positive filing season. For example, on March 7, the Service announced extended walk-in hours on Saturdays at over 150 locations nationwide. These extended hours enable taxpayers to pick up forms, receive answers to tax questions, and to check their tax account balances. Other positive initiatives include an extension of the agency's Problem Solving Days, held once a month at various locations throughout the country. As mentioned previously, IRS efforts to improve telephone service by focusing on hourly demand and routing calls to staff at remote locations has had a positive effect on taxpayer access to information. Taxpayer use of the Internet and tax forms CD-ROM products has eased pressure on the telephone lines. The fact that this filing season is going so smoothly, despite the complicated law changes, indicates the IRS' success in efforts to facilitate taxpayer service.

Electronic Filing and the Current Tax Season

The IRS Restructuring and Reform Act (H.R. 2676), as passed by the Ways and Means Committee and the full House of Representatives, includes a number of positive provisions designed to encourage more tax professionals and taxpayers to utilize electronic filing. The legislation requires the IRS to develop a plan within 180 days of enactment "to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing gradually over the next 10 years..."

To the credit of the IRS, the electronic filing of tax returns has continued to surge in popularity among taxpayers during the 1998 tax filing season. According to IRS statistics, by early March 1998, about 10.7 million federal returns were filed by paid preparers or by taxpayers over home computers. Further, the agency announced that an additional 3.75 million returns were filed by telephone utilizing the TeleFile program.

NSA applauds the continued growth in the use of the electronic filing program. We also commend the Service for its appointment of Robert B. Barr, a person from outside the government, as Assistant Commissioner, Electronic Tax Administration. Mr. Barr's appointment has sent a very visible and positive signal to the practitioner community that the IRS is serious about making major, long-term improvements in the overall electronic filing program. IRS has also taken very positive steps in terms of implementing an Electronic Advisory Committee which includes representation from critical stakeholder groups and the small business community.

We believe the electronic filing provisions contained in H.R. 2676 should also spur additional growth in the use of electronic filing by taxpayers. However, NSA maintains that other positive initiatives could be implemented by the IRS which we believe would result in even greater rates in the growth in the electronic transmission of returns.

With respect to the 1998 filing season, there continues to be barriers inhibiting electronic filing. The National Society of Accountants recommends that the Subcommittee on Oversight examine inequities currently existing between practitioners who file returns electronically and practitioners who file paper returns. For example, a practitioner who files using the paper method is not prohibited from continuing to file paper returns if he or she is assessed a tax penalty or preparer penalty. However, a practitioner enrolled in the electronic filing program is prohibited from filing any returns electronically once he or she, for any reason, is assessed with any kind of tax penalty. The assessment of a preparer penalty is more damaging to an electronic return originator than to a preparer who does not participate in the electronic filing program. This is a strong disincentive to use of the electronic filing program for many professional preparers.

Another example of inequities between electronic filing and paper filing may come to the forefront next year when the IRS plans to accept electronically transmitted payments in conjunction with electronically transmitted returns. An electronic payment will be debited from the taxpayer's bank account on April 15. A check included with a paper return postmarked April 15 could take up to two weeks or more to clear the taxpayer's bank. This presents taxpayers who might have temporary cash flow difficulties a clear advantage for filing a paper return rather than using electronic filing. If the IRS wants to encourage more taxpayers and tax professionals to use electronic filing, these inequities must be addressed.

According to previous surveys of our membership, it is our understanding that only about 35 percent of NSA members transmit electronically filed returns on behalf of their clients. Reasons for not using electronic filing cited by NSA members include the additional staff time and keystrokes required to input W-2 and Form 1099 data necessary for electronic transmission; the requirement for filing paper Form 8453 and W-2 after a return has been filed electronically; dealing with electronic rejects for incorrect Social Security numbers or other reasons; extra costs involved in electronic transmissions through a software provider; costs and time involved in learning the procedures and IRS regulations on electronic filing; and the prospect of compliance audits during the filing season. None of these concerns apply to practitioners who file only paper returns.

Tax practitioners who file complicated tax returns are the least apt to use electronic filing because certain forms, statements, elections and allocations cannot be electronically transmitted. The IRS electronic filing program to date has principally focussed on the filing of simple returns by taxpayers expecting a refund. The IRS restructuring legislation clearly attempts to rectify these problems by making significant attempts to reach out to the practitioner community. As the IRS works to implement the provisions in the restructuring bill by make more forms transmittable via e-file and proceeding with other improvements, such as development of an electronic signature, the practitioner community will become more supportive of electronic filing. NSA commends the Service for reaching out to the practitioner community for suggestions and cooperation in making the transition to an electronic environment.

When the National Society of Accountants testified before the Ways and Means Committee last fall on the IRS restructuring legislation, we made a number of other recommendations associated with the electronic filing program. These included a recommendation involving the acceptance of digital signatures by the IRS under the electronic filing program. Another NSA recommendation was for the regulation of all preparers of tax returns. According to the National IRS Commission report, uniform requirements of this kind "will increase professionalism, encourage education, improve ethics, and better enable the IRS to prevent unscrupulous tax preparers from operating."

NSA's tax research desk, which operates as an aid to our members all year long, has found that some of the questions asked suggest a lack of needed familiarity with new tax laws and procedures. This has been exacerbated this year by the complexities of the 1997 Act. Our active members are credentialed as enrolled agents, certified public accountants, public accountants, accredited tax advisors and accredited tax preparers. As such, they must comply with our continuing professional education program. The fact that a certain lack of knowledge may exist among credentialed practitioners gives us great concern about the knowledge and skills of the countless paid return preparers who are not credentialed and /or who have no oversight within a structured environment to give them assistance.

The National Society of Accountants appreciates the efforts of the IRS to listen to the concerns of practitioners regarding electronic filing. It is our belief that electronic filing can become a very valuable and time saving tool for practitioners during filing season. To reach that point, the Service must actively work to deal with the current roadblocks to full participation by the tax professional community. By reaching out to that community to establish an Electronic Tax Administration Advisory Committee, the Service is moving in that direction. By allowing practitioners to participate in the evolution of the program, the Service will be able to achieve a result that is agreeable to all participants.

Earned Income Credit Due Diligence Requirements for Paid Preparers

The Taxpayer Relief Act of 1997 includes a provision which prohibits taxpayers from claiming the earned income tax credit (EIC) for certain disallowance periods to the extent the taxpayer previously made a fraudulent or erroneous claim involving a reckless or intentional disregard of rules and regulations. The 1997 Act also imposes due diligence requirements on tax return preparers with respect to determining a taxpayer's eligibility for, or the amount of, the earned income tax credit. Under this penalty, the preparer is subject to a $100 penalty for each such failure. Further, the due diligence penalty is imposed in addition to any other penalty which may otherwise be assessed against the preparer.

On December 22, 1997, the IRS released Notice 97-65, 1971-51 I.R.B. 14. In general, the Notice sets out the due diligence requirements that a preparer must follow in order to avoid assessment of the penalty associated with the EIC. According to this Notice, the preparer must complete the "Earned Income Credit (EIC) Checklist" or a comparable, alternative checklist. The IRS requires that the preparer's completion of the checklist be based on information provided by the taxpayer or otherwise reasonably obtained by the preparer.

Preliminary feedback from NSA members indicates practitioners view the "Earned Income Credit (EIC) Checklist" as an effective tool. The form seems to act as an effective safe harbor for any practitioner who is conscientious about avoiding the assessment of the EIC due diligence penalty.

Removal of Preparer's Social Security Number from Tax Returns

While the 1998 filing season has proceeded relatively smoothly, the practitioner community remains concerned with the current requirement that a paid preparer's Social Security number appear on returns. Revenue Ruling 79-243 states that under Section 6109(a)(4) of the Internal Revenue Code, "any return or claim for refund prepared by an income tax return preparer must bear the identifying number of the preparer, the preparer's employer, or both...(and) that the identifying number of an individual shall be the individual's Social Security number." Revenue Ruling 78-317 gives some relief by stating that "an income tax return preparer is not required to sign and affix an identification number to the taxpayer's copy of a federal income tax return," being required only to affix his or her Social Security number to the copy of the tax return filed with the Internal Revenue Service.

Practitioners feel that the requirement they include their Social Security number on returns violates their privacy, as it could provide access to certain records that would not otherwise be available. NSA suggests that the Subcommittee on Oversight review this requirement with the Internal Revenue Service and develop a separate system for identifying tax practitioners.

Conclusion

The National Society of Accountants is pleased to provide these comments on the IRS' fiscal year 1999 budget and the status of the 1998 tax filing season. NSA stands ready to work with the Subcommittee on Oversight on solutions to these important issues for taxpayers and practitioners.

Chairwoman JOHNSON. Thank you very much.

Mr. Lane, your comments about the need to complete work on making all the forms of the IRS compatible with the electronic filing system is a very important point. The Commissioner didn't speak to that, and certainly from last year's work we know how important it is to get more people into that system, both to save money, improve accuracy, service, and so on. Is anything going on to move forward on accommodating the forms to the electronic system?

Mr. LANE. We had a meeting yesterday afternoon with Commissioner Rossotti to just chat with him, meet him, and talk about what his plans were, and I brought this up with him as well. We had given him an advance copy of our testimony. And he obviously shared with us the concerns he has in terms of the number of problems he's dealing with over there, and clearly the Y2K problem is a major preoccupation of the Service right now.

Our concern is exactly as we outlined in the testimony, that the Service has always said that they support that process, but we don't see the support given in the budgetary requests. And I think if you look at the Commissioner's exhibit, it shows, I think, $3 million out of $103 million going for enhanced electronic filing. I can sympathize with their situation. They have a unique problem with the Y2K issue, given the age of their equipment. I mean, they're unlike almost any other corporate business, because most corporate businesses have much more current equipment to work with.

So, we can sympathize with that and recommend to the committee that if the Service feels they cannot meet that goal this year, then they ought to let a contract out and have an outside group do that piece of it because that has nothing to do with Y2K. Let an outside group of programmers come in and get all those tax forms moved over.

Right now they have the ability to enter the data from those forms digitally because when they keypunch the return, they put it in. So it's not like they have to reprogram everything. They just have to give us the ability to load that data electronically, basically, if they are in fact keying that information.

Chairwoman JOHNSON. Do you have reason to believe that this will cost more than $3 million?

Mr. LANE. You know, I would assume that it does. I don't have the data in my possession to determine what their cost factors are, but $3 million is a paltry sum when you consider that just the amount of money that would have to go into advertising promotion alone to expand electronic filing beyond 20 percent to 25 percent of tax returns to get up to 80 percent—that's an admirable goal.

Chairwoman JOHNSON. Is is worth, though, putting the money into a big marketing effort when you can't yet let everyone who could file electronically, file electronically?

Mr. LANE. I agree with you. There's no question the priority ought to be on getting as many of those forms moved over.

Chairwoman JOHNSON. How big a job is that? How long do you think it would take? I mean, if you really committed yourself to getting all those forms in there, what are we talking about? Six months, a year, three years?

Mr. LANE. You know, I don't have the expertise to respond to that. I'm sure the Service has looked at it and could do it, but—and I would like to see the answer to that because we've been raising that issue, and I noticed the National Commission on Restructuring focused on that issue intently and tried to get an answer of what that would cost.

The key thing—and I think that the National Commission has understood it when we got finished, and I think your staff people here understand it from the discussions we've had with them in the committees—the key thing to getting practitioners to move into electronic filing is to allow them to file. They will not set up two separate processing pipelines in their office during tax season. They have to have one processing—and as long as 40 or 50 or 60 percent of the tax returns can't be filed electronically, they're going to keep 100 percent of the volume out, and that's critical.

Chairwoman JOHNSON. Right, and I think that point has been very well made, and I appreciate your calling us back to something that is very fundamental to the whole cost structure of the IRS and its ability to use its resources in the future in the way that will be most effective for the taxpayers in the long run.

Mr. LANE. Absolutely.

Chairwoman JOHNSON. We will look into some of these questions about how long this project would take and what the resources are and what they're planning, as certainly this is a key component of customer service.

Also, I just wanted to ask you briefly—you heard the discussion about the cross-checkers?

Mr. LANE. Yes.

Chairwoman JOHNSON. What is your opinion of that process and the need for more people in that function? Will that need decline as electronic filing increases?

Mr. LANE. It's interesting. Part of the reason you've had a drop-off in yield from that program is because of the fact that they have gotten so much more corrective. Initially, the reason you got a lot of yield on that program is that people didn't know that there was a cross-check between the 1099 data that came in, so a lot of stuff didn't get put on tax returns or it got put on tax returns erroneously or taxpayers didn't know that they got it and should have put it on. So, I think what's happened is an education level as this IRP program has matured—taxpayers and practitioners are doing a better job of making sure the information is on the return.

Chairwoman JOHNSON. Interesting. So would you interpret, then, the fact that the personnel has been cut in half but the collections have been cut by two-thirds, to indicate greater compliance out there in the community and therefore may not be a case for adding more people back and doing more of that function?

Mr. LANE. I would say that you've had a significant increase in compliance with the tax return data matching the 1099 data. There's no question about that compared to 5 or 10 years ago, absolutely no question about that. Roger?

Mr. HARRIS. Oh, I would agree completely. I think most people now are aware of the fact that the cross-checking does go on, and I think you're seeing a much higher compliance.

Chairwoman JOHNSON. So actually increasing personnel in that function might not make any difference to the yield?

Mr. LANE. No, because the vast majority of the 1099 data you get, what they call the IRP data—the information returns data—comes in electronically, so those people—those checkers—are only looking at the stuff that's dropping out of the other system because of a mismatch, and I think what we're saying is that a lot less stuff is mismatching.

Now, it's going to be interesting to see, because as more requirements get ladeled-in to require 1099's—for example now, this year, every check written to a lawyer—whether he's a corporation or not—for $600 or more needs a 1099. So you're going to increase dramatically the number of small paper 1099's you get. So, I can see a need if you're going to generate a lot of that stuff in the future to have to increase those checkers back up again, because the paper documents don't get the degree of verification that the electronically filed documents do.

Chairwoman JOHNSON. Thank you.

Mr. LANE. Sure.

Chairwoman JOHNSON. Mr. Coyne. Mr. Portman.

Mr. PORTMAN. I first want to thank both of these gentlemen. Roger and Joe, this is like deja-vu all over again. You've testified so many times before this subcommittee and the Commission.

I sort of agree with you that to get to the 80 percent goal in electronic filing you almost have to have that quantum leap that Joe talked about. And I guess one question I would have for you is, as you look at the restructuring bill that is now over in the Senate, and with any luck will be back for a House-Senate conference within a month, is there anything that you think should be changed with regard to electronic filing to create more incentives? As you know, we took that legislation—this subcommittee took the legislation and the recommendations—changed them somewhat, dropped out a couple of things, added a couple of things. Do you have any comment on that? We have a window of opportunity here.

Mr. LANE. Yes; I would like to see—we made a recommendation to the Restructuring Commission at some point in our testimony—quite frankly, I don't remember which one it was, but it's in there. I would like to see a provision that if a person files electronically and there is an accurate match on the IRP data with what's on the tax return—so, in other words, the 1099 dividend and information and the W–2 data was correct—that the statute for audit on that tax return be 24 months instead of 36 months.

Mr. PORTMAN. Yes; I remember that recommendation.

Mr. LANE. I think what that will give you is taxpayer motivation to file electronically, and practitioners will always respond to client demand before they're going to respond to anything else. And so if practitioners get a taxpayer ground-swell that says, "I want this filed electronically because I want to limit my audit exposure," their malpractice insurers are going to be telling them the same thing: "You better justify why you're not filing everything electronically because we don't want to have another year of exposure if we don't need it," I think you'll get that 80 percent number relatively quickly, if not within a year or two.

Mr. PORTMAN. Interesting. Roger, do you have some thoughts?

Mr. HARRIS. You know, I think what we've got is a lot of things that move a small number of people. I don't think there's any one magical change we're going to make that's going to all of a sudden have the whole marketplace demand electronic filing, so I think anything—what Joe suggested, what's in the legislation, incentives we've talked about were taken out——

Mr. PORTMAN. What about the signature?

Mr. HARRIS. Signature—I think all of those things are important. I think that's why the Commission that I know the bill had set up and now the IRS is setting up is so important that we not be bound by what we know today, that we're able to look, not only with what's out here today, but what can happen over the next three or four years—not get in a hurry to hit 80 percent, but get there the right way.

Mr. PORTMAN. Yes; therefore the advisory committee could be very helpful. You know one thing—this is a far-fetched idea, but I thought I'd throw it out anyway—EIC is one area where I think you could see some increase in electronic filings, as I mentioned earlier, and that there are some advantages to that in terms of cost and compliance. Anybody who wants a refund, obviously there's an incentive there now. For people who owe taxes, there, in a sense, is a disincentive. We can knock down all the barriers in the world, and we can create, therefore, some more incentives, but there will be that disincentive for somebody who files on paper, and because it processes more slowly it is going to be a disadvantage. Can you address that?

Mr. LANE. But the taxpayer who owes money typically has the more complex return and is the one who has the most audit exposure. So where you do get that guy, where you incentivize him is you say, "Well, limit your own exposure."

Mr. PORTMAN. Going back to your idea.

Mr. LANE. And why it's important to make sure that the provision has to be, not only is it filed electronically, but all the IRP data matches, is because the delay time in IRS getting the confirmation back from Social Security on the wage data and getting all the IRP data processing could take anywhere from 12 to 14 months. So, if only in cases where that's a 100 percent match is the 24-month statute in there; if it's not a match, they should have the additional 12 months to pursue examination.

Mr. HARRIS. Well, and we mention in our testimony that right now if you file electronically and owe this year, that it will be debited on your account on the 15th. If you mail your tax return, then you've got a certain float. Why not give the people who file electronically until May 1? You know, put an incentive in there to file electronically; your payment will be made later.

Mr. PORTMAN. Yes. I say it's far-fetched because it will cost something, and we're running into that problem with this bill already.

Mr. HARRIS. That's why I think we've got to be creative and think of all of these, and see what the effect will be.

Mr. PORTMAN. Yes.

Mr. LANE. You know, I'd like to suggest one other thing. It seems to me every year we're having problems on this earned income credit, and it really isn't a tax issue. I can see an argument to say, "Hey, give this to Social Security; give it to Health and Human Services, but it doesn't belong on a tax form."

There are a lot of people who are entitled to that that aren't getting it because they're not even filing. You know, the guy working for minimum wage and he's making $4,000 to $5,000 a year, and he's got a couple of kids—he's going to be qualified, and he's not even filing a tax return. So, I think one of the issues you might want to address is whether IRS ought be handling this at all. And why create all of this tension and aggravation over this issue?

Mr. PORTMAN. I can't believe you said that, Joe.

Chairwoman JOHNSON. We're working up to that one.

Mr. PORTMAN. That's exactly the question that needs to be proposed, and the answers need to come more from us.

Thank you very much.

Mr. LANE. Thank you.

Chairwoman JOHNSON. Thank you. Congresswoman Thurman.

Mrs. THURMAN. Mr. Harris, just very quickly, because I know this is an issue that our chairperson and Mr. Portman and others of us—with the electronic filing, and we were certainly encouraged by some of the statistics, I think, that we heard today of the more compliance on this—and I can't remember for the life of me who said this to me, but somebody said, "Well, we don't do electronic filing because we don't have enough clients to really do that." Help me with that statement. I mean, in the fact that you represent accountants—and I don't know how many accountants there are in the country—but what do you think the percentage of accountants that are actually in the situation or have the ability, or would, how many are doing it electronically?

Mr. HARRIS. Currently, to the best estimates of our organization, about one-third are doing it today.

Mrs. THURMAN. And in that, can you tell us why they don't? Maybe it's because of what I just said, but there are other stumbling blocks that would prevent them from wanting to get into the electronic filing?

Mr. HARRIS. We've talked about some of them today; I think the fact that you can't file all returns electronically. You know, there are the checks that you must go through during the filing season that contribute to some. But as a business person, I think it's that the demand in the marketplace is not that great yet—again, unless you're right now in the business of filing a lot of returns due refunds early and you can speed that process up. If your practice is geared towards business people who maybe don't have refunds, there's no demand, certainly not to pay extra to file a return electronically when you owe money. It's very hard to sell that idea to a business person.

Mrs. THURMAN. But this year would be different because they're getting money back, right? [Laughter.]

Mr. HARRIS. Yes.

Mr. LANE. I'd like to add something on that, if I could. I think, as Roger said, there are lots of issues that impact that, particularly from a member's behavior standpoint. Some of it's education, some of it's a perception of a lack of technical competence, technical competence in the terms of the technology as opposed to the technical tax stuff. And actually it's much simpler than they really believe it is, and once you show them how easy it is they go, “Oh, my God; I could have been doing this.”

Mrs. THURMAN. “Why haven’t I been doing this?”

Mr. LANE. Part of it is a perception that they have to go out and buy a whole bunch of expensive equipment to do it, and they’re very happy with the DOS machine they have in their office and they don’t want to upgrade; they don’t realize you can use that machine to do it.

So, part of it is the way the whole program has been packaged and sold. Quite frankly, some of it is also a kind of a hangover of the bad reputation electronic filing got early on when it was basically viewed as a way of gouging clients by charging them outrageous fees for doing refund anticipation loans. They don’t realize that the whole market has really transformed, and there is a whole array of financial products that really help taxpayers—and they’re not right for every taxpayer, but they’re right for some taxpayers.

And so we’re going through this whole re-education effort in both of our memberships in terms of the benefits of that. Quite frankly, the IRS causes themselves a lot of problems by doing exactly what we talked about in our testimony today. They don’t share the information; they change procedures in mid-stream, and it catches the guy unaware.

This whole paper refund issue—I mean, in 1995 they pulled 7 million returns that had EIC credits on them out of the line that were supposed to go direct deposit and did nothing with 6 million of them and put them back 12 months later, all on paper refunds, and cost people all of the fees on those returns and the banks all of the loan repayments. I mean, it’s just appalling, and this is supposed to be the partner you’re working with—to give him the information. And, we would hope they would have learned from that, but now we’re back into the same problem this year. So you look at people and say, well, if they’re going to lose that kind of money, what’s the business reason for them to do it? There isn’t any.

Mrs. THURMAN. But we can fix this, right? I don’t know—what kind of an answer was that? [Laughter.] Thank you.

Mr. LANE. A qualified “yes.”

Chairwoman JOHNSON. Before we go to vote on this current problem of the IRS not doing direct deposits, is that elective or a matter of law?

Mr. LANE. We tried to get an answer on that yesterday. The thing that’s got our members so upset about this is this is a problem that IRS has said for four years that they would correct, and it hasn’t yet been corrected. My personal view—we were told when we inquired about this that there is a technical problem in terms of being able to put the refunds that were now held up back into an electronic deposit stream as opposed to a paper check. I don’t know if that’s accurate or not.

My belief is that probably when you get down to the bottom of it, that what the advice that is being given, because it’s coming out of a criminal investigation, they’re looking at the potential for fraud there. What I would be willing to hazard a guess as to what the advice is is make it a paper refund, because if we were right and it subsequently develops that there was fraud there, we have a better case if we have a taxpayer’s signature on a cancelled check as opposed to a bank deposit that went in straightforward. And so my concern is if that is what they're looking for—to have a better paper trail in the event one of these things gets prosecuted—I mean it is at an extremely high cost to the people who are participating in this program.

And what we tried to point out in our testimony is that everybody loses with refund fraud, not just the Government. The banks are the biggest losers, and the preparers and software companies lose because they don't get their fees paid. If the IRS was more forthcoming in their criteria for identifying refund fraud, the software companies and banks would be happy to act as the first couple of screens for that because they don't want to make that loan.

Chairwoman JOHNSON. And are their new screens, even though they came out a little later—are they helpful?

Mr. LANE. Yes, yes. But mid-March, when 95 percent of the business is done by February 15, mid-March doesn't help them.

Chairwoman JOHNSON. No; I appreciate that. But as you reflect on this—what to try to do now versus next time we go through this, now with a better system in place. I would be interested in hearing any thoughts on that.

Mr. LANE. What I would hope, and I think Roger could agree with me on this, is that this new ETAAC, or advisory board for electronics—I would hope that when that gets funded and put together this year that the whole revenue protection strategy is discussed at great detail with those folks and then shared with the practitioner organizations like NSA and NAEA and AICPA, so we can disseminate that information to our people——

Chairwoman JOHNSON. That's a very good suggestion.

Mr. LANE [continuing] And also to the banks and software companies.

Chairwoman JOHNSON. We have three minutes left, so thank you for your input. I appreciate your testifying today.

Mr. LANE. Thank you.

Mr. HARRIS. Thank you.

Chairwoman JOHNSON. The hearing is closed.

[Whereupon, at 4:06 p.m., the hearing was adjourned subject to the call of the Chair.]

[A submission for the record follows:]

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STATEMENT

on behalf of

THE SECTION OF TAXATION

of the

AMERICAN BAR ASSOCIATION

submitted to

SUBCOMMITTEE ON OVERSIGHT

of the

COMMITTEE ON WAYS AND MEANS

of the

U.S. HOUSE OF REPRESENTATIVES

on the subject of

1988 TAX RETURN FILING SEASON

and the

IRS BUDGET FOR FISCAL YEAR 1999

March 31, 1998

The following comments reflect the views of the American Bar Association and of its Section of Taxation.

The Section's 21,000 members typically work with the tax law as their full time profession, most of them representing taxpayers. Accordingly, we have a particularly large stake in the proper functioning of the Internal Revenue Service as well as experience that bears on many (but not all) of the pending budget issues. In the area of technology, for example, we recognize the importance to the Service of having a far better overall information system, the necessity of the Century Date Change, and the necessity of providing Service personnel with better equipment, yet we do not have the expertise to suggest how these things should actually be done. Similarly, we cannot evaluate the dollar estimates in the budget or the specific effects on compliance with the law from particular expenditures.

On other points, our experience and concerns for the tax system are relevant. In particular, we are concerned by the unprecedented intensity of the hostility that has been directed at the Service by some members of the public and Congress. To the extent that extended scrutiny of the Service leads to constructive changes in its operations, perhaps the controversy engaged in will be judged necessary. If what develops, however, is a permanent war between the taxpayers and the Service, everyone will lose. No tax system in a country as large and complex as ours can expect to operate without some kind of government organization to collect taxes. If, however, the tax collection organization and its employees are constantly attacked and ridiculed, the tax system will lose the confidence of the American people, and it will be increasingly difficult to attract and retain qualified employees.

For these reasons, we have supported the appointment of a Commissioner who could restore the public's and the Congress' confidence in the Service. It is critically important that the Commissioner be supported through the budget in the great effort he must make to improve the Service and its public respect. Accordingly, without meaning to pass on specific technical issues, we hope and urge that the budget finally adopted by Congress will give his program a real opportunity to succeed and restore the Service to an appropriate level of performance and respect.

Another very important issue exists that we would like to emphasize, since it has not received much public attention. It has been well demonstrated that there are taxpayers who have sincerely attempted to comply with the law but have nevertheless been improperly treated. This problem must be promptly addressed. We are confident that it could also be demonstrated, however, that there are other taxpayers who have demonstrated little or no intention of complying with the law. We cannot ourselves compute, and perhaps no one can compute, the full amount of tax due under current law that is neither reported nor collected. Clearly, however, billions of dollars of taxes do have to be collected every year from honest taxpayers because of amounts that were due from, but not paid by, less than honest taxpayers.

Public reluctance to accept higher tax rates has increased pressure on the Service to increase revenues through increased compliance. In view of the stress on tax compliance, we recommend against further reducing the already very low percentage of returns that are actually audited by a human being. We, therefore, oppose directing fewer resources to the sometimes unpleasant functions of auditing tax returns and of collecting taxes that have already been determined to be due. The statement from the Budget in Brief, "With the shift to improving Customer Service, the impact of the workforce will be significant," should not reflect any lesser commitment to collecting the taxes due under laws already passed by Congress. In our view, it would be totally inappropriate for the Service to become less effective in collecting taxes justly due. We would not want a tax system in which compliant taxpayers would come to be seen not as honest but as naïve. That kind of a change in taxpayer attitude, if it should occur, might take years to reverse.

Finally, the whole premise for enforcing the tax laws by auditing only a small number of returns depends upon effective selection of the returns chosen for audit. For a number of years that selection was based on having a certain number of returns audited in depth, as opposed to auditing only a few items. Because the Congress has denied the Service the funds to carry out these so-called TCMP audits, however, the data bank on which the Service bases these critical decisions is becoming increasingly obsolete. It may be that the prior intensive audit program imposed an unacceptable level of burden on the taxpayers affected, but the program generated information essential to the operation of a serious compliance effort. Consideration should be given to authorizing a compromise form of audit that would impose less burden, but still give the Service the information needed.

In conclusion, the question of compliance has been a continuing concern of the American Bar Association. In 1983 it formed a Commission on Taxpayer Compliance, and the Section of Taxation sponsored an Invitational Conference on the subject. We would be pleased to submit the report of the Commission or to provide any other assistance the Committee believes would be helpful.