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TREASURY, POSTAL SERVICE, AND GENERAL
GOVERNMENT APPROPRIATIONS FOR
FISCAL YEAR 2001

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HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

SUBCOMMITTEE ON THE TREASURY, POSTAL SERVICE, AND GENERAL
GOVERNMENT APPROPRIATIONS

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NOTE: Under Committee Rules, Mr. Young, as Chairman of the Full Committee, and Mr. Obey, as Ranking
Minority Member of the Full Committee, are authorized to sit as Members of all Subcommittees.

MICHELLE MRDEZA, JEFF ASHFORD, KURT DODD, and TAMMY HUGHES,
Staff Assistants

PART 6

	Page
IRS-Electronic Tax Administration	1
ATF-YCGII	225
Executive Residence Budget Justification	283



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TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2001

TUESDAY, OCTOBER 3, 2000.

IRS-ELECTRONIC TAX ADMINISTRATION

WITNESSES

CHARLES ROSSOTTI, COMMISSIONER, INTERNAL REVENUE SERVICE
PAUL D. HARRISON, PRESIDENT & CEO, FREETAXPREP.COM, INCORPORATED
EDWARD BLACK, PRESIDENT & CEO, COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION
CHARLES LACIJAN, THE IMPLEMENTATION GROUP

Mr. KOLBE. Good afternoon. The Subcommittee on Treasury, Postal Service and General Government will come to order.

Commissioner, we welcome you here. We are happy to have you once more before the subcommittee on this oversight hearing, and we look forward to hearing from you today.

Let me just set the tone for what we are trying to do here today by giving a little bit of overview for this hearing. The purpose is to talk about electronic tax administration, where we are and where we are going. It is a very timely issue. The country, indeed the world, is becoming very adept at using electronic media in daily life. Every day we find more services that are being offered electronically, and more transactions that are being conducted through the use of electronic means.

As people become more comfortable using digital technology, as the technology itself improves and becomes more widely available, the development and implementation of the Federal electronic tax administration has to proceed appropriately and with all due speed. So while this is a timely issue it is certainly not an entirely new issue to the Internal Revenue Service. Indeed, the IRS Restructuring and Reform Act of 1998 has a whole title on this area that talks about electronic filing and provides for the establishment of the electronic commerce advisory group.

Industry is offering a wide range of electronic tax services to tax filers, including no-cost filing options under certain circumstances. The IRS, through its Office of Electronic Tax Administration, has been working for a long time now to develop and implement aspects of electronic tax administration.

In the tax season that has just ended, 27 percent of all the tax returns that were filed, that is 35 million out of 130 million, were filed electronically. But we still have some issues that need to be looked at, and that is the purpose of the hearing today.

Some of the issues involving electronic tax administration, particularly Internet interactions, appear to break some new ground for the IRS and impact fundamental concepts regarding the relationship of the IRS to the American people. These concepts include the establishment of rules and pricing policy for tax services, the voluntary compliance system on which our tax system is founded, the relationship between the IRS and the tax preparation industry and, of course, issues of privacy.

The IRS has made recent announcements regarding its plans and expectations for moving forward with electronic tax administration. Our purpose is to get a better understanding of these plans and expectations, to provide a forum for hearing concerns and perspectives from outside groups that include members of the tax preparation industry.

So we will have two panels here. We will begin with Mr. Rossotti, a panel of one here, who will be followed by a panel of three outside witnesses. We will hear from Charles Lacijan, a former chairman of the Electronic Tax Administration Advisory Committee; Edward Black, President and CEO of the Computer & Communications Industry Association; and Paul Harrison, who is President and CEO of FreeTaxPrep.Com.

Before I turn to you, Mr. Rossotti, for your opening statement, let me ask Mr. Hoyer if he has any comments that he would like to make. Mr. Hoyer.

Mr. HOYER. No. I welcome the Commissioner to the hearing room, and we look forward to his testimony and the testimony of others.

Mr. KOLBE. Thank you very much.

Mr. Rossotti, we will let you begin with your statement. As always, we will put the full statement in the record, if you would prefer to do it that way, or however you want to proceed here.

Mr. ROSSOTTI. I have submitted the full statement.

Mr. KOLBE. The full statement will be put in the record.

Mr. ROSSOTTI. As you noted, Mr. Chairman, the IRS Restructuring Act had a whole section concerning electronic filing. Probably one of the most prominent parts of that was to establish a goal that 80 percent of returns be filed electronically by 2007.

More broadly, I think we have, as you noted, Mr. Chairman, defined electronic administrations to be all of our transactions with the public; and our overarching goal is to really convert most of those to electronic means. To meet this objective, we not only have to make it technologically possible, we have to make it attractive to the public for them to change from their traditional paper way of doing business to electronic.

Now, while our goal, I think, is clear as laid out in the Act and in spite of the fact that we, I believe, have made some very significant progress over the last two years, I have to say we do not have all the answers yet as to how we are going to achieve this goal. We keep finding new and complex issues, as you noted in your opening statement, as new technology comes about, but also as we learn more about what taxpayers need and want. So given this kind of changing, dynamic environment, we are constantly seeking advice from the Congress, from industry and especially from the Elec-

tronic Tax Administration Advisory Committee, which was established for this purpose.

I want to thank you, Mr. Chairman, for holding this hearing. I think it is very timely to lay out these issues.

Now let me briefly and with the help of this chart, which is also in the back of the testimony, just give a very short overview of how this system works. Taxpayers can file electronically in one of three ways: through tax practitioners, directly from a home computer or over the telephone. A number of private companies that are shown on the chart play a role.

For all forms of electronic filing it is important to note that a return must be prepared electronically in order to be filed electronically. It is really a combination of those two, and that creates a lot of the benefit. And just three options—the first option on the top there, which is currently used by 25 million taxpayers, is the one in which a taxpayer goes to a tax professional, a tax preparer, to file their return. In our jargon these are known as electronic return originators, and last year 25 million returns were filed by this method.

I think, as shown on the chart, most of the tax practitioners who electronically file returns for taxpayers actually transmit their returns through bulk transmitters that collect the forms. Usually, these are the same firms that provide the practitioner the tax software; and last filing season there were about 77,000 active practitioners and/or EROs and all but about 5,300 of them filed through their software provider, their bulk transmitter. About 5,300 of them actually filed with us directly.

The IRS does not charge any fees for electronic filing or receiving these returns, but many of the electronic return originators do charge a fee to their taxpayers for that service. Some of them do bundle that in the tax preparation fee.

The second option, which is becoming prevalent more rapidly, is the one in which the taxpayers file directly from their home computer. They put the software on the home computer and use that commercial software to prepare the return and then transmit it. This software can actually either reside on their own personal computer or it can reside on a Web site, which is a newer option. The taxpayer accesses the software through the Web site. When the return is completed, the taxpayer can transmit that information by modem to the software provider who, in turn, transmits it to the IRS; and last year there were about five million taxpayers who did it that way.

We do not receive tax returns directly from individual taxpayers from their home computers. We receive that from the software providers who provide the software. The tax software providers sometimes charge the taxpayers a separate fee for transmitting it, but, more commonly, they bundle that with the software that they provide either through the Web site or for purchase cost.

Then there is a third option which is called TeleFile, which is for really very simple returns, 1040 EZ, in which some taxpayers can simply pick up a Touch Tone phone, dial in some numbers, and then it actually computes the tax and transmits it to us. Last year, we had 5.2 million taxpayers do it that way.

Those are the three ways to electronically file.

I think, going back again into the RRA to determine how we get from where we are right now, 35 million, 27 percent, as you noted, to the 80 percent, the Congress wrote in both some guidance for us and a process as to how we should go about working in this market process.

One is they encouraged us to work in partnership with the private sector to improve the offerings of filing services that were available; and it mentioned three kind of things, reduce barriers, provide incentive and, to quote the conference report, press for robust private sector competition. Those were the words from the Act. I think we have tried to act on those suggestions from taxpayers and the industry and practitioners to make filing more attractive and remove barriers.

One of the key barriers is to make it possible to actually file all the individual returns through this electronic means. Up until now that has not been possible because we could not accept certain kinds of schedules and forms. We are solving that problem rapidly for this upcoming filing season 2001. We are adding 23 more forms to the program, and we will roll out the remaining 40 forms and schedules in 2002. So that means by 2002, which is the season after next, we will have solved that problem. All of the forms and schedules will be able to be filed electronically with some very, very minor exceptions; and the importance of that is it does open up about four million more potential taxpayers.

But I think, more importantly, the practitioners tell us they want to do business one way. They do not want to do some with paper and some electronically. So that problem is rapidly being solved, and by 2001 it will be solved.

The second key barrier that we are eliminating is the fact that up until now electronic filing has not been truly paperless. In some cases—in most cases, it was required to send a signature document in by paper, even though you filed electronically. That problem will be solved in this coming filing season. Working with chief counsel and the Justice Department we have come up with a way, having tested it for a couple of years, to use a personal identification number as the taxpayer's signature, with a few exceptions, in this coming season. This will now be extended to taxpayers nationwide who will be able to select their own pin, provide some additional data to us and file electronically without any paper. That would be true for all three methods.

The third important point is, traditionally, most electronically filed returns were those where the taxpayer received a refund and they got them faster, and that is one of the attractions. But we would also like to encourage taxpayers who actually have a balance due, as we call it, in other words, they owe the IRS money instead of the other way around, to be able to file electronically. In order to make that possible we are accepting more electronic payment mechanisms, debit payments through TeleFile, accepting credit cards for Form ES, which are the estimated tax payments, and also for taxpayers who have extensions of time to file. So, essentially, through either debit cards or credit cards, taxpayers will be able to pay balances due in most cases electronically rather than through paper.

The fourth thing, which is still in the prototype stage and is more of a longer term effort, is that especially for our electronic return originators, we would like to extend our electronic communication not only for the filing process, but through other forms of communication that we have. We have a pilot that is working on resolving account-related issues in a secure way through the Internet. It will be one of our major goals through our technology modernization.

Finally, in terms of marketing, with the authorization of the Restructuring Act and the funds that this committee has provided, we do have a marketing campaign which has been quite successful; and next year—we will show you the chart after that—there is some new marketing that we will be doing that revolves around the idea of stressing that over 30 million Americans are already using e-file. We are now beginning to promote not just awareness of it but the specific values to the taxpayer. Those are some pretty important steps that are taken that we have heard from the industry are needed.

Having taken those steps, or when we will have taken them over the next 15 to 18 months, there is one additional hurdle, however, that we—or barrier, if you will—that we have heard from taxpayer practitioners and others, which is the cost to the taxpayer. As it is now, taxpayers must either pay a fee to a preparer or pay a fee to buy or use software to prepare and file their returns. It was to try to address this issue that the President included two provisions in the fiscal 2001 budget proposal. One was a proposed tax credit for electronic filing. The second was a provision requesting the IRS to find ways to allow taxpayers to file over the Internet at no cost to themselves.

Since there has been some confusion about it, especially this latter proposal, I would like to clear up a couple points, or at least attempt to right now, that have been I think points of confusion or concern about this.

One is, it was not and is not intended that this provision is related to the IRS itself offering tax software preparation or filing services in any form. That was not the intent. We can elaborate on that, but I believe that would not be a wise thing for the IRS to do.

Secondly, with respect to confidentiality of taxpayer data, it is clear that this must be assured under all circumstances as is required by law; and there was no implication or intention in any form that any of the protections for taxpayer confidentiality would be modified or compromised in any way, shape or form.

Finally, I think it is the IRS' intent to try to follow the provisions of the law concerning the promotion of robust competition in the industry and potential use of incentives to make e-filing more attractive and to reduce the cost to the taxpayer. Our approach here was to ask the industry for suggestions on how to accomplish this objective, which we have done by putting out a request for them to tell us what their ideas are. We think this approach is consistent with the thoughtful advice that we have received from the advisory committee.

Mr. Chairman, I just want to conclude here and say that we believe there is a challenge to meet these goals, but we are working closely with Congress and the industry to try to achieve them.

[The information follows:]

*Electronic
Commerce*

Statement of

Charles O. Rossotti

**COMMISSIONER
INTERNAL REVENUE SERVICE**

Before the

**SUBCOMMITTEE ON
TREASURY, POSTAL SERVICE,
AND GENERAL GOVERNMENT
HOUSE APPROPRIATIONS COMMITTEE**



Department of the Treasury
Internal Revenue Service

www.irs.gov

October 3, 2000

**TESTIMONY OF
COMMISSIONER OF INTERNAL REVENUE
CHARLES O. ROSSOTTI
BEFORE THE
HOUSE APPROPRIATIONS SUBCOMMITTEE ON
TREASURY, POSTAL SERVICE AND GENERAL GOVERNMENT
HEARING ON
ELECTRONIC COMMERCE
OCTOBER 3, 2000**

Introduction: Meeting the Challenge

Mr. Chairman, the IRS Restructuring and Reform Act of 1998 (RRA 98) set forth the mandate that at least 80 percent of returns be filed electronically by 2007. Reaching this and the other Electronic Tax Administration (ETA) goals is an enormous challenge, but well worth the effort. A strong ETA system provides many potential benefits to taxpayers, practitioners and our tax administration system. Increased electronic filing of returns can improve service and the efficiency of tax administration by speeding refunds to taxpayers, providing positive acknowledgment that a return has been received and reducing the need to correct errors.

On a broader scale, improved electronic exchange of information with taxpayers and practitioners advances all three of the IRS' strategic goals: service to each taxpayer, service to all taxpayers and productivity through a quality work environment.

A robust ETA program will reduce time spent by taxpayers dealing with the IRS. We will reduce the number of phone calls we have to answer and because of these two factors we will free up our compliance employees to focus on real compliance issues, rather than just retrieving or correcting information.

The first and most visible ETA initiative was allowing taxpayers to file 1040 returns electronically. This year, 35 million individual taxpayers took advantage of this option. However, we are expanding our reach. There are also major opportunities we can exploit in virtually every aspect of tax administration by converting from paper-based to electronic methods of doing business. The Internet, in particular, offers exciting new opportunities. The IRS web site, the *Digital Daily*, has already received almost 1.3 billion hits this year. Our business systems modernization program will provide the essential technological foundation for this major transformation of the way the IRS does business.

Mr. Chairman, the IRS' overarching goal is to conduct most of its internal and external transactions by electronic means. To meet this objective, we must make it not only technologically possible, but also attractive to the public to make a permanent change from paper to electronic means.

However, while our goal is clear, and in spite of the important progress we have made in our ETA program, we still have much to learn. Our ETA strategic plan does not contain all of the answers we need to achieve our goals. The rapidly changing market and technology environments create more opportunities, but also raises significant questions. Indeed, RRA 98 recognizes that the achievement of the overall goal of converting most transactions from paper to electronic is an on-going process that constantly brings up new and complex issues.

Given this environment, we are constantly seeking advice from Congress, industry, and especially from our advisory committee, the Electronic Tax Administration Advisory Committee (ETAAC), as we formulate our plans and programs. Mr. Chairman, I thank you for holding this hearing at such a critical moment and we welcome this opportunity to explore with the committee this important subject and some of the issues and challenges we face.

Electronic Filing for Individuals

Taxpayer can file electronically in one of three ways: through tax practitioners, directly from a home computer, or over the telephone. A number of private companies play a role in this process, as shown on the attached chart. One thing that is common to all forms of electronic filing is that a return must be prepared electronically in order to be filed electronically and it is the combination of the electronic preparation and filing that creates much of the benefit of the process.

In the first option, the taxpayer goes to a tax professional who is authorized by the IRS to file returns electronically. This individual is also known as an Electronic Return Originator (ERO). In most cases, these tax professionals prepare the taxpayer's return using software they purchase from a variety of software vendors and then transmit it to the IRS on the taxpayer's behalf. In the last filing season, 25.2 million individual returns were filed by this method.

As shown in the chart, most tax professionals who electronically file returns for taxpayers send their returns to bulk transmitters. These bulk transmitters are defined as companies who transmit over 1,000 returns to the IRS. Usually, it is the same firm that provided their tax preparation software. There are 20 such firms who act as bulk transmitters nationwide. Last filing season, there were over 77,000 active EROs, and of these, 60% (over 46,000) utilized bulk transmitters and the rest (31,000) utilized over 5,300 direct transmitters to get the returns to the IRS.

The IRS does not charge a fee for electronic filing. However some EROs charge a fee for this service to taxpayers, while others offer it free of charge or include it in their tax preparation fee. Most companies who provide software and transmission services to practitioners charge a fee to the practitioner for the transmitting their returns to the IRS.

In the second option, taxpayers prepare returns on a personal computer using commercial tax preparation software. When the return is completed, the taxpayer

transmits the information by modem to a bulk transmitter, usually the company who provided the tax preparation software, who in turn transmits it to the IRS.

In a recent variation of this process, some providers now offer tax preparation services over the Internet. In this process, the tax preparation software resides on a web site. The taxpayer signs onto the web site, uses the software to prepare the return, and then requests that it be sent to the IRS. The operator of the web site collects the returns and transmits them to the IRS.

Last year approximately five million taxpayers filed their returns through their home computer, almost double the previous year's volume

Tax software providers sometimes charge a separate fee for transmitting a return to the IRS, but increasingly these fees are being included with the purchase cost of the software or the fee for use of the software on the web site.

The third option is TeleFile. This is an interactive program that allows qualified taxpayers to file simple Federal returns (Form 1040EZ) electronically using the TeleFile toll-free number and a touch tone phone. A personal computer is not necessary. Only those taxpayers receiving a TeleFile booklet in the mail are eligible to use this option. Last season, almost 5.2 million taxpayers filed through TeleFile.

Overall, 12 million taxpayers also chose to file both their federal and state tax returns simultaneously in a single electronic transmission. This year, 35 states and the District of Columbia participated in the program.

Mr. Chairman, let me also note that paper and electronic return preparation and filing are also offered through IRS local offices as well as Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites. Taxpayers may go to local IRS offices to have their returns prepared because they do not choose, or cannot afford, to either pay a professional tax preparer or buy a personal computer and tax software. The tax software we use in our offices is competitively procured in the open market. Through this method, the IRS both electronically prepares and files simpler returns for lower-income taxpayers at the taxpayer's request.

RRA 98: Charting ETA's Course

Mr. Chairman, as I mentioned in the opening of my testimony, RRA 98 set forth the mandate that at least 80 percent of returns be filed electronically by 2007. To help meet this goal, Congress required that the "Secretary of Treasury establish a strategic plan to eliminate barriers, provide incentives and use competitive market forces to increase taxpayer use of electronic filing."

Congress further encouraged the IRS to work in partnership with the private sector to improve electronic filing services. The RRA 98 conference report further states: "The provision on private sector cooperation is clarified to provide that the IRS should cooperate with and encourage the private sector by encouraging competition to increase

electronic filing of returns. The intent of the conferees with respect to this provision is for the IRS and Treasury to press for robust private sector competition.”

In order to achieve RRA 98’s ETA mandates, the IRS has listened to taxpayers, industry and practitioners. We heard that we must make electronic filing more attractive and remove barriers. Let me briefly discuss our ongoing efforts to address these concerns.

One, the IRS must address the frustration that taxpayers and practitioners experience when they cannot file some forms electronically. For the 2001 filing season, we are adding 23 additional forms to the 1040-*e-file* program. These include Form 2106-EZ for un-reimbursed employee business expenses; the Form 2688 application for additional extension of time to file and Form 8379 for injured spouse claims.

We plan to roll out the remaining 40 forms and schedules for the 2002 filing season. This means we will open *e-file* eligibility to 99.1 percent of all taxpayers, potentially adding 3.8 million new *e-filers* to the growing rolls. Equally important, it means that preparers will be able to go essentially 100 percent electronic for all of their customers by 2002.

Two, the IRS will make electronic filing paperless by eliminating the requirement for a separate paper document with the *e-file* return. The IRS has tested the use of a Personal Identification Number (PIN) code as the taxpayer’s signature, eliminating the need to file the paper *jurat*. The tests have been a resounding success.

- 5.4 million taxpayers participated in the Practitioner PIN pilot compared to 499,606 taxpayers for all of 1999. Taxpayers were able to select a PIN when filing through 18,000 participating preparers.
- Use of the on-line filing Customer Numbers also increased significantly from 660,209 to 1.4 million this year. Under this pilot, the IRS distributed Customer Numbers to taxpayers who prepared their own returns using tax preparation software to file from their home computers.

Next year’s program will extend this option to taxpayers nationwide, with some exceptions, who will be able to select their own PIN, then file electronically without any paper.

Three, this filing season, more electronic payments options have been made available to taxpayers, such as accepting debit payments through TeleFile and accepting credit cards for Forms 1040ES, estimated tax payments, and Forms 4868, extensions of time to file. As of September 2nd, 209,424 payments averaging \$2,935 were made via credit card and another 237,281 payments averaging \$1,614 were made by Automated Clearing House (ACH) Direct Debit where taxpayers can authorize either their checking or savings account to be debited.

Four, we are prototyping a Secure Messaging System that will provide

participating practitioners with a web-based means for resolving account-related issues. The pilot will involve a limited number of practitioners and will involve the resolution of notices, account problems, transcript requests and installment agreements. A major priority of our Business Systems Modernization Program is to build a secure infrastructure that will permit authorized practitioners to exchange information with the IRS through the Internet.

Five, contributing to this year's successful e-filing season was IRS' new marketing campaign, "30 Million Americans Use IRS *e-file*." In conjunction with its advertising agency, and as authorized by RRA '98, the IRS developed a fully integrated campaign with TV, radio and print advertising. Let me point that as the *e-file* program matures, our data- and market-driven marketing campaign is shifting away from merely promoting awareness of *e-file* to emphasizing its value, such as saving taxpayers time.

I also want to applaud our practitioners' efforts to expand *e-filing* through innovative programs such as H&R Blocks' Refund Rewards. H&R Block also distributed hundreds of public service announcements to TV stations to promote *e-filing* in 2000.

Remaining Barrier

By the year 2002, the barriers and obstacles I discussed will be largely solved. However, one hurdle remains to be surmounted: cost to the taxpayer. Taxpayers must either pay a fee to a preparer, pay a fee to buy software or to use software over the web. In some cases, a fee for filing is combined with a fee for software and some vendors have offered lower-cost or even no-cost filing through web sites.

Nevertheless, in most cases today, there is a cost to the taxpayer which is greater than simply taking the IRS paper forms, filling them out with pen and pencil and mailing them in with a stamp. Notwithstanding the advantages of preparing and filing electronically, some taxpayers are deterred by the cost. As you are aware, Mr. Chairman, some even write letters to the IRS and Congress complaining about the cost.

To help address this problem, the President included two provisions in the Administration's FY 2001 budget proposal: a tax credit for *e-filing*, and a provision requesting that the IRS find ways to allow taxpayers to file over the Internet at no cost to the taxpayer. There has been some confusion concerning the latter proposal that I hope I can clear up today.

One, it was not, and is not intended that the IRS would offer preparation or filing services itself in any form.

Two, confidentiality of taxpayer data must be assured under all circumstances. The IRS has no authority to allow anyone to use taxpayer data for any purpose other than transmission to the IRS except as provided for under specific regulations.

Three, it is the IRS' intent to follow the provisions of the law concerning promotion of robust competition in industry and the potential use of incentives to make *e-filing* more attractive and to reduce the cost to the taxpayer. Our approach is to ask industry for suggestions as to how to accomplish this objective. At this time, we have no plans beyond soliciting input from the industry on this matter.

Since the ETAAC also plays an important role in this process, it is appropriate to quote from their recent report, which I believe contains some very wise counsel:

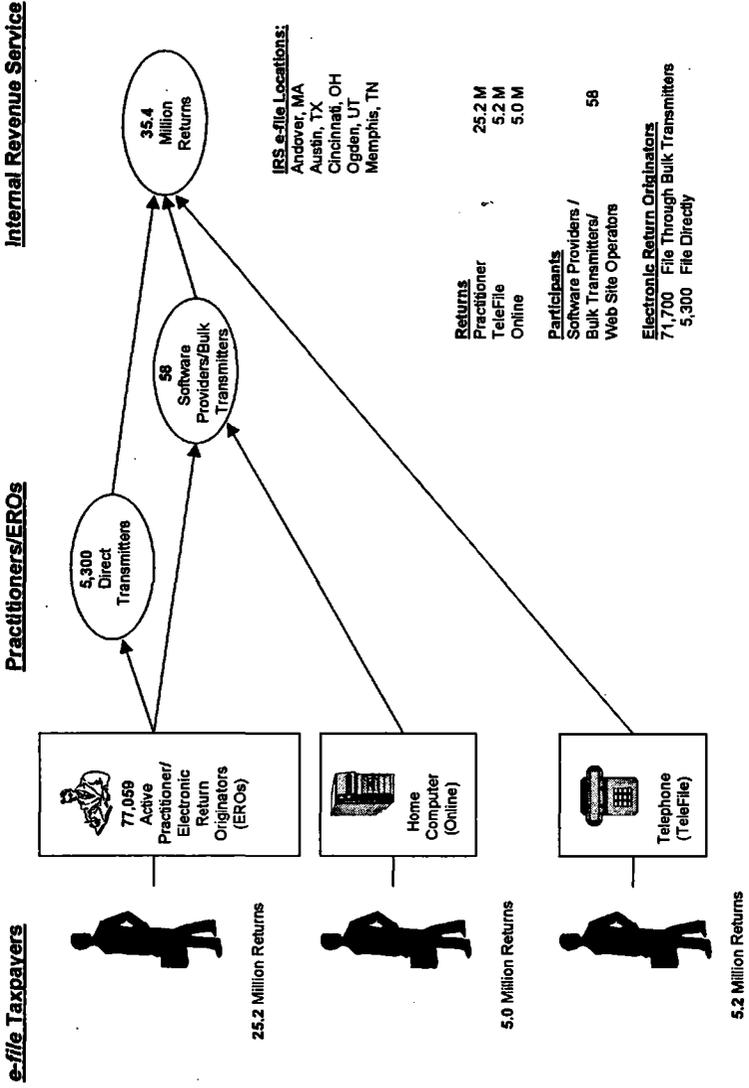
"In support of the goal of no-cost e-filing and tax preparation over the Internet, the ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of low-cost and no-cost tax preparation and filing options over the Internet are to continue to: 1) encourage competition, 2) seek industry views on which barriers inhibit lower-cost to no-cost private sector supplied options, and 3) stimulate electronic filing through its creative advertising campaign and make electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper.

"The ETAAC also recognizes that the Internet changes rapidly and business models are in constant evolution, and even revolution. The ETAAC believes that a re-assessment of the marketplace should be made in two years to assess whether the range of choices for electronic filing over the Internet includes no-cost options for taxpayers. If no-cost choices do not exist, the ETAAC believes the IRS would then be justified in evaluating, in conjunction with ETAAC, whether an electronic template, or other approach, is an appropriate and needed tool to promote no-cost e-filing over the Internet...."

Conclusion

Mr. Chairman, the Restructuring Act clearly recognizes that Electronic Tax Administration is a fundamentally important aspect of modernizing the IRS and one of the cornerstones of efficient and effective tax administration. However, meeting the mandates and challengers of RRA 98 will not be easy. It will require changing the way nearly all business is conducted – shifting all of our practices from paper to electronic means. Although we have a clear direction from RRA 98, we are also in unexplored territory. This is a rapidly changing field, and we do not have all the answers. However, we are working closely with Congress and our stakeholders, including industry, to get the answers and then implement the best ETA program we possibly can.

1040 ELECTRONIC FILING PROCESS - 2000 FILING SEASON



Mr. KOLBE. Good timing. We have our 5-minute warning here on the vote. We will go take it. We have two votes, and then we will be right back and begin our questions.

Mr. ROSSOTTI. Sure. Thank you.

Mr. KOLBE. The subcommittee will stand in recess temporarily. [Recess.]

Mr. KOLBE. The subcommittee will come to order again.

At the suggestion of two of our members that it might be—and I think it is a good suggestion—that it might be useful to have the private sector panel speak so that we could get—the questions for the Commissioner might come out of the things that are said by them. If that is acceptable to you, Commissioner, why don't we go ahead and ask you to step aside a moment? We will ask the second panel to come up here, if you would—all three of you, yes.

Let me, if I might, welcome this panel of outside witnesses here to the hearing.

We have, first, Mr. Charles Lacijan, who has chaired the Electronic Tax Administration Advisory Committee during the production of the most recent report, the one in June. We will submit a copy of this report for the record here and place it in the record; and we thank you very much, Mr. Lacijan. We found it very helpful to us in preparation for this hearing.

Mr. KOLBE. We also have Mr. Edward Black, who is President and CEO of the Computer & Communications Industry Association. The members of that association include a variety of companies that are engaged in electronic tax preparation and filing.

Finally, we have Mr. Paul Harrison, who is President and CEO of FreeTaxPrep.Com, a relatively new company, who has a strong interest in electronic tax administration.

We thank you for being with us today. All of you represent different aspects of electronic tax administration issues, and I think we look forward to hearing your testimony and views on this topic.

Your full statements can be placed in the record, and if you preferred, if you would—and I would hope you would—each summarize it so we can go directly to questions.

Mr. KOLBE. We will begin with you, Mr. Lacijan, if you might.

Mr. LACIJAN. Thank you, Mr. Chairman.

My name is Chuck Lacijan. I am the Senior Technical Advisor for The Implementation Group, a Washington, D.C., based consulting firm. I also served as chair of the Electronic Tax Administration Advisory Committee from September, '98, to June 2000, and have also evaluated electronic filing issues while serving on the staff on the National Commission on Restructuring the IRS. I will summarize my written statement as you requested.

I would like to acknowledge that in 1995 this committee initiated the formation of the IRS restructuring commission. Its final report and the subsequent legislation has led to a number of new directions at the IRS, including that of electronic tax administration.

Certainly, as we heard today, electronic tax administration is one of the most important elements of IRS business systems modernization. If you take that, combined with the development of the new data engine which will provide timely and accurate tax data and post-filing applications, that is really the heart and soul of the modernized IRS.

My written statement provides some background on the importance of electronic tax administration and how it can help the whole tax administration process run more smoothly, and I would certainly refer you to my statement to get some of the details of that.

I have also included in the written statement the role of ETAAC and its membership; and I certainly want to stress that the June, 2000, report from ETAAC was a consensus among the 22 members who serve on the committee and who represent a very broad spectrum of electronic tax administration stakeholders.

But let me quickly go to the issue at hand and that is how to best use the Internet to achieve low- and no-cost tax prep and e-filing. Certainly, the ETAAC supports this objective because it believes that no-cost e-filing encourages more taxpayers to e-file.

My written statement identifies several approaches that the ETAAC evaluated. The option that involves an IRS offering of its own product either directly or through working with a few selected providers was thought to be inappropriate at this time in favor of letting the private sector continue to provide this capability. This position was based on the belief that the clear choice of public policy should be to let the private sector provide the capability for this no-cost electronic filing tax prep, with the Federal Government only stepping in if the private sector does not meet the need.

The reason for this recommendation was simple. It is that competition works. I think ETAAC believed that competition is the most effective way to provide taxpayers with the widest range of tax prep and e-filing services. The marketplace has made considerable progress towards this goal in the last few years; and I think my fellow panelist, Mr. Paul Harrison, is proof positive that competition works and can deliver taxpayer options for both low-cost and no-cost electronic filing for tax prep.

The ETAAC also recommended that the marketplace be assessed in two years to determine if competition is having the desired effect. If not, ETAAC believed that the IRS would then be justified in evaluating, in conjunction with the ETAAC, if an electronic template or other approach was an appropriate needed tool to promote no-cost e-filing over the Internet.

However, ETAAC is not advocating that the IRS should do nothing. I would say quite the contrary. ETAAC believes there are some appropriate actions that the IRS can take. That is, one, to continue to foster competition; two, to seek industry reviews on which barriers lower or inhibit lower and no-cost private-sector-supplied e-filing options; and, three, to stimulate e-filing through creative advertising and making it more convenient to use.

I would like to now discuss an issue that has arisen after ETAAC submitted its report on June 30, 2000; and here I am getting into the area of personal opinion as opposed to ETAAC consensus, as the ETAAC has not had an opportunity to meet as a group to form the consensus since our June 2000 report was submitted. In July of 2000 the IRS issued the Request for Information or an RFI that I think has caused some confusion in the marketplace. The stated purpose of the RFI was for the IRS to seek comments and input from the public and private industry concerning IRS providing free tax prep and filing of individual tax returns over the Internet.

At the heart of the issue was the following statement taken out of the President's 2001 budget request. No later than tax year 2002 the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer. If the IRS offered such options through contract arrangements with authorized IRS e-file providers, it would be with the assurance that the taxpayer's tax return information would not be used by the provider without the taxpayer's permission for any purpose other than submission to the IRS.

I think, despite denials by the IRS in several forums that it did not intend to get into the tax prep business, a number of private sector firms believe that the RFI was actually the first step to do just that. I think the resulting confusion concerning the IRS's true intentions has caused some turmoil in the marketplace.

Congress is now being asked to articulate a public policy to address the perceived threat of IRS entry to the marketplace that previously has only been occupied by the private sector. I think that several recommendations from the ETAAC June 2000 report can serve as guiding principles in formulating such a policy; and I have four items I would like to mention.

First, the clear choice of public policy should be let the private sector provide the desired capability, with the Federal government only stepping in if the private sector is not meeting the need. Second, for the next 2 years, do not pursue the public policy that would require the IRS to offer no-cost e-filing over the Internet. Third, the IRS, with the support from ETAAC, should assess the marketplace in 2 years to evaluate whether the Internet includes no-cost e-filing options for taxpayers and make the judgment whether an IRS entry in the marketplace is needed. Lastly, the IRS should be encouraged to take the appropriate steps, as I just mentioned earlier.

In closing, I just want to make one observation. Congress has laid ambitious goals for the IRS for e-filing—80 percent by 2007; and these goals only can be met by partnering with the private sector. However, partnerships require a sense of trust if they are to work; and, unfortunately, the current situation—gives little evidence that the trust needed to succeed is actually present.

I am not here to assess blame to any one organization. I think it is really a question of deciding where we go from here. That is the real challenge, and I hope that the guiding principles that I laid out will be effective in helping the committee reach a decision.

That concludes my testimony.

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

[The information follows:]

Statement of Charles A. Lacijan
The Implementation Group, Sr. Technical Advisor
Chairman, Electronic Tax Administration Advisory Committee
1998-2000

Testimony Before the Treasury, Postal Service and General Government Subcommittee
of the House Appropriations Committee

Chairman Kolbe, Ranking Member Hoyer, and Members of the Subcommittee, my name is Chuck Lacijan, and I am the Senior Technical Advisor for The Implementation Group, a Washington, D.C. consulting firm. Since September 1998 I have served as chairman of the Electronic Tax Administration Advisory Committee (ETAAC). I also have prior relevant experience as Senior Policy Advisor on the staff of the National Commission on Restructuring the IRS, in which capacity I was responsible for technology and electronic filing issues.

In 1995 this committee initiated the formation of the National Commission on Restructuring the IRS. The Commission's final report, and the resulting IRS Restructuring and Reform Act of 1998 (RRA 98), set a new direction for the IRS in many areas, including electronic tax administration. Title II of the Act established a Congressional policy that paperless filing should be the preferred and most convenient means of filing Federal tax and information returns, and set a goal for the IRS of having at least 80 percent of these returns filed electronically by the year 2007.

Electronic tax administration, and electronic filing in particular, is one of major elements of IRS modernization. Two other critical elements include the development of a modern data engine that creates a single source of timely and authoritative data, and modernized post-filing applications that eliminate dozens of stovepipe systems and take advantage of the modernized database to deliver both customer service and compliance improvements.

Electronic filing introduces productivity savings by shifting resources away from the labor intensive processing of paper returns into customer service. Taxpayers benefit directly also, as electronic filing has a much lower error rate than paper filing. In a broad sense, electronic filing makes the entire tax administration system run far more smoothly. Electronic filers generally prepare their tax returns using software, reducing errors. Errors are further reduced by avoiding error-prone manual processing by the IRS. These two types of errors exceed 20 percent for paper returns, but are only about one percent for electronic returns. Although many of these errors are detected and corrected by the IRS, those that go undetected place burdens on both taxpayers and the IRS in the post-filing environment. This burden is compounded by the archaic nature of legacy databases at the IRS.

Recognizing that the electronic filing goals established in RRA could only be achieved through cooperation between the IRS and the private sector, RRA 98 required the IRS to create an electronic tax administration advisory group and gave it two missions. The first mission is to help the IRS meet its electronic filing goals by providing it with private sector input. The second mission is to provide Congress with an annual report that describes the IRS' progress in meeting

its electronic filing goals, the status of its strategic plans, any legislative changes necessary to assist the IRS in meeting the goals, and the effects of electronic filing on small businesses and the self-employed.

This past year, ETAAC had 22 members representing a broad spectrum of stakeholder interests, including:

- tax preparers, including some who operate small businesses
- tax preparation software companies serving both individual and business filers
- payroll services
- the financial community
- big business
- the academic community
- state government
- individual taxpayers

A list of the ETAAC members and their positions is attached to this statement. The broad base of interests represented by these members ensured we gave thoughtful consideration to our recommendations. The following perspectives and recommendations are based on the ETAAC's June 2000 report to Congress.

The ETAAC sees electronic tax administration playing a critical role in a modernized IRS, and believes the underlying purpose of electronic tax administration is to be an enabling mechanism that transforms the IRS into a modern financial institution offering taxpayers world-class service. The electronic filing goals established in RRA 98 represent one metric to evaluate IRS progress towards achieving this transformation, but the underlying objective remains to improve service to taxpayers by providing them with electronic means of conveniently interacting with the IRS.

In using electronic tax administration to transform itself, the IRS must overcome these critical challenges:

1. Continuing to develop a strategic planning process to achieve goals.
2. Encouraging all professional tax preparers to become Electronic Return Originators (EROs) and convincing them that filing and communicating with the IRS electronically is preferable to other methods.
3. Increasing electronic filing among self-preparers.
4. Increasing electronic interactions between the IRS and businesses, including filing, payment, and communication activities.
5. Forming strategic alliances with businesses, federal government agencies, states, and other organizations to facilitate and promote the growth of electronic tax administration.

Of particular interest to this subcommittee is the role that the Internet can have in electronic tax administration. The Internet has changed many aspects of our culture, and the ETAAC's vision is that it can revolutionize tax administration as well. As the IRS develops more strategies for

interacting with taxpayers electronically, the ETAAC believes that the Internet must be an important part of those strategies.

The Internet will be a revolutionary tool for the facilitation of all tax administration activities. The IRS is in the process of enabling Internet payment and communication systems and ETAAC is very supportive of these efforts. However, for the preparation process there is a highly developed private sector activity encompassing tax preparers, accountants, software providers and outsourcers. Filing is the outcome of the preparation process, and to some extent it is not possible to supply filing without some aspects of preparation. This fact raises a number of issues in regard to how involved the IRS should be in the preparation process given its role as an auditor and reviewer of whether or not taxpayers have complied with the tax code in determining their taxes. In addition to the appropriateness of the IRS' role, there is also the question of whether the IRS should provide a service that the private sector is already providing.

The ETAAC has been most interested in the use of the Internet to provide low- and no-cost Form 1040 tax preparation and e-filing options to taxpayers. The ETAAC supports this objective because it believes it will lead to an increase in e-filing, but recognizes there are several ways to achieve it. The IRS should carefully consider marketplace conditions in developing its plans for achieving no-cost Internet tax preparation and e-filing.

There are several approaches the IRS could adopt to achieve no-cost Internet tax preparation and e-filing. One approach is entering the marketplace with its own product, either by developing a software product internally or acquiring it through a competitive procurement. This approach would represent a significant change in current policy. Currently, the IRS does not provide or approve tax preparation software and the risk for the use of these products lies with the individual taxpayer. A more appropriate variation of this approach may be to offer an electronic template or form that allows taxpayers that have already computed their taxes manually to transmit their returns to the IRS electronically. This approach would try to create a distinction between electronic filing and preparation with electronic output.

A second approach to entering the marketplace would be for the IRS to align itself with a limited number of "authorized e-file providers" that offer no-cost e-filing. This approach would have the effect of limiting competition and reducing the likelihood of new competition in the marketplace. Ultimately, this approach could have the effect of limiting competition and reducing taxpayer choices.

These two approaches are both characterized by having the IRS enter the marketplace in some way. A third approach is to achieve this objective through the private sector, which is the intent of RRA 98. The ETAAC believes that the clear choice of public policy should be to let the private sector provide the desired capability, with the federal government stepping in if the private sector does not meet the need. The ETAAC believes it is inappropriate at this time to pursue a public policy that would require the IRS to offer no-cost electronic filing over the Internet.

This position is based on the belief that the marketplace has made noticeable progress towards achieving no-cost electronic filing over the Internet in the past two years, and additional progress towards this goal is expected next year based on publicly announced plans. My fellow panelist, Mr. Paul Harrison, is proof positive that competition works and the marketplace is developing taxpayer options for low- and no-cost electronic tax preparation and filing. Would the type of innovation shown by Mr. Harrison occur if the IRS was offering its own product for free tax preparation and e-filing?

The ETAAC's recommendations on the use of the Internet for electronic filing are grounded in the belief that competition is the most effective way to provide taxpayers with the widest range of performance and price options for tax preparation and electronic filing. Promoting the most intense competition among private sector companies and pursuing policies that allow these companies to reduce unnecessary costs is the best action the IRS can take in pursuit of the goal of no-cost electronic filing for taxpayers.

The ETAAC is not advocating that the IRS should do nothing. Quite the contrary. In support of the goal of no-cost e-filing and tax preparation over the Internet, the ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of low-cost and no-cost tax preparation and filing options over the Internet are to continue to: 1) encourage competition, 2) seek industry views on which barriers inhibit lower-cost to no-cost private sector supplied options, and 3) stimulate electronic filing through its creative advertising campaign and making electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper.

The ETAAC also recognizes that the Internet changes rapidly and business models are in constant evolution, and even revolution. The ETAAC believes that a re-assessment of the marketplace should be made in two years to assess whether the range of choices for electronic filing over the Internet includes no-cost options for taxpayers. If no-cost choices do not exist, the ETAAC believes the IRS would then be justified in evaluating, in conjunction with ETAAC, whether an electronic template, or other approach, is an appropriate and needed tool to promote no-cost e-filing over the Internet. The IRS and ETAAC should track progress in meeting this objective on an annual basis.

I would now like to discuss an issue that has arisen since the ETAAC submitted its report on June 30, 2000. I am now venturing into the area of personal opinion, rather than ETAAC consensus, as the ETAAC has not met since June 2000, and, more importantly, when the next ETAAC meeting occurs in the fall, the two-year terms of 17 of last year's 22 members, including mine, will have expired.

In July 2000 the IRS issued a Request for Information (RFI), TIRNO-00-H-00007, that has caused a great deal of confusion in the marketplace. The stated purpose of the RFI was for the IRS to seek comments and input from the public and from private industry concerning IRS providing free tax preparation and filing of individual tax returns over the Internet. At the heart of the issue was the following statement, taken from the President's FY 2001 budget request, that appeared in the RFI:

"No later than tax year 2002, the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer. If the IRS offered such options through contract arrangements with Authorized IRS e-file Providers, it would be with the assurance that the taxpayer's tax return information would not be used by the Provider without the taxpayer's permission for any purpose other than submission to the IRS."

Despite denials by the IRS in several forums that it did not intend to get into the tax preparation business, a number of private sector firms believed that the RFI was the first step in doing just that. The resulting confusion concerning the IRS' true intentions has caused turmoil in the private sector marketplace.

Congress is now being asked to articulate a public policy to address the perceived threat of the IRS entry into a marketplace that previously has only been occupied by the private sector. I believe that several recommendations from the ETAAC June 30, 2000 report can serve as guiding principles for Congress in formulating such a policy:

- the clear choice of public policy should be to let the private sector provide the desired capability, with the federal government stepping in if the private sector does not meet the need
- Because the marketplace has made noticeable progress towards achieving no-cost electronic filing, it is inappropriate at this time to pursue a public policy that would require the IRS to offer no-cost electronic filing over the Internet.
- There are appropriate actions the IRS can take to provide taxpayers with a wide choice of low-cost and no-cost tax preparation and filing options over the Internet, such as encourage competition, seek industry views on which barriers inhibit lower-cost to no-cost private sector supplied options, and stimulate electronic filing through creative advertising and adding additional convenience features
- The IRS, with support from ETAAC, should assess the marketplace in two years to evaluate whether the range of choices for electronic filing over the Internet includes no-cost options for taxpayers and make a judgement whether an IRS entry in the marketplace is needed.

In closing I would like to make an observation. The ambitious goals the Congress has placed on the IRS can only be met by partnering with the private sector. Partnerships require a sense of trust if they are to work. Unfortunately, the current situation gives little evidence of having the trust needed to succeed. I don't believe it's productive to try to find fault or place blame on any one organization. The real challenge is figuring out where we go from here. The guiding principles I have enumerated will only be effective if both sides work together.

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

**ETAAC Members
1999/2000**

Name	Title
Sandy Abalos	Owner, Abalos & Associates
Fran Bartlett	President & CEO, Federal Liaison Services, Inc.
Michael P. Boyle	Chief Tax Counsel & General Auditor, Microsoft Corp.
Margaret Drescher	National Advisor, Chair National Technology Committee, AARP
Keith T. Dusenbery	Professor of Accounting and Information Systems, Johnson State College
Edward B. Feinstein,	AVP, Electronic Commerce, H&R Block Tax Services
Theron Gilden	President, T.Gilden, Inc.
Connie L. Grimes	President, Grimes Income Tax, Inc.
Mary B. Harris	Jackson Hewitt Tax Service, franchise owner in Arkansas
Peter Hosokawa	President, First Data Corporation – Cash Tax Inc.
Yvonne D. Kirkendall	Co-owner, W. R. Kirkendall, EA
Charles A. Lacijan	Sr. Technical Advisor, The Implementation Group
Frank L. Lanza	Director, Processing Services, California Franchise Tax Board
Robert O. Lewis	President, Tax Back, Inc.
Susan W. Martin	Professor of Accounting & Taxation, Grand Valley State University
Issac A. Nooe, III	Administrator, Information Resources Management Division, South Carolina DOR
Helen O'Planick	Partner, HELJAN Associates
Bette Rice	Director, Enterprise Technology Services, Merrill Lynch
Elizabeth M. Seymour	Vice President, Wachovia Bank, N.A
William C. Shepard	VP & General Manager, Professional Products Group, Intuit, Inc.
John A. Stauffer	Sr. VP of Product Planning, Ceridian Corporation/Ceridian Tax Service
John Stoller	President, John D. Stoller, CPA

Mr. KOLBE. We will hear from Mr. Black.

Mr. BLACK. Mr. Chairman and members of committee, I am Ed Black, President and CEO of Computer & Communications Industry Association. I am very pleased to be here today to testify on behalf of the high technology industry regarding the future role of the U.S. Government in electronic commerce and specifically as it pertains to electronic tax services.

CCIA is an industry association representing Internet, computer, telecommunications, software and electronic commerce companies ranging from small entrepreneurial firms to some of the largest in the industry. Our member companies employ well over half a million people and generate annual revenues exceeding \$300 billion. We believe technology policy issues currently before Congress are critical to the future health and growth of the American economy.

Although the instant question is whether the IRS should get into the role of providing electronic tax preparation services to the public, the real public policy question at stake is much larger and more profound.

In 1997, President Clinton issued a report that declared, "For electronic commerce to flourish, the private sector must lead."

We believe it is this principled approach that has helped the U.S. technology industry to grow dramatically to the distinct benefit to American consumers and workers.

Other governments have heavily regulated e-commerce, managing and directing competition or offering government-sponsored goods and services, distorting their economies and stunting their economic growth, which brings us to the matter before the committee, the Internal Revenue Service's offering of free electronic tax preparation services over the Internet.

The Congressional mandate of achieving 80 percent electronic filing of individual income tax returns by the year 2007 is a worthy goal and one the private sector enthusiastically supports. However, the Congressional mandate for electronic filing applies only to the filing of tax returns. Congress has not mandated or even provided authority to the IRS to offer tax preparation services.

Private sector innovation and competition has enabled the American taxpayer to prepare and file their income tax returns electronically at very low cost or at no cost. The options available to consumers are numerous, and a number of market leaders even donate their Internet-based services to low- and middle-income taxpayers at no charge.

It is difficult to understand, therefore, why the Federal government would seek to interpose itself in this robust marketplace. Given the success of free market competition in electronic financial services, it is difficult to understand why the IRS would contemplate setting price controls on the products and services of this industry or try to regulate its commercial business and revenue models, as IRS officials have discussed doing this spring.

We believe that such regulation would be a fundamental mistake that would actually endanger our ability to achieve the electronic filing objectives that Congress has brought forth as the national policy by impeding the development of a competitive market for such services.

There appears to be no identified justification, no unmet need in the marketplace to justify IRS entry into electronic tax preparation and to offer it to the public as a new Federal service. Our economic system does not countenance the injection of the government into competitive private markets in this manner. Internet-based electronic financial services are a core competency of the private sector. Most importantly, this approach runs counter to a sound economic and public policy, including the administration's own position on electronic commerce.

As my colleague has mentioned, even the IRS's ETAAC committee, its own advisory committee, strongly recommends against pursuing this policy.

The Office of Management and Budget's Circular A-76 provides a strong policy foundation for decision making in this area. That presidential directive was formulated during the Eisenhower administration, but it has been forcibly and effectively reissued and formulated ever since by every President.

It says, "in the process of governing, government should not compete with its citizens." It further provides that "a commercial activity is not a governmental function."

A number of Members of Congress have proposed an immediate, government-wide moratorium suspending those activities that would duplicate or compete with established private sector electronic commerce businesses. We believe this is a thoughtful approach that will enable Congress to determine the proper government role in the emerging new economy.

We believe Congress and the Administration should act now to implement this recommendation. We look forward to participating in the policy review that lies ahead and to contributing the expertise and insight of high technology to this dialogue.

In the meantime, however, we think it is vital that the subcommittee step into the breach, uphold the Administrative Procedures Act and OMB Circular A-76 by declaring the simple fact that no authorization or appropriation exists for the IRS to undertake its announced electronic tax preparation services project and that further activity should cease in order to permit Congress to perform its lawful constitutional function.

We think the assessment of every President since Eisenhower, Kennedy, Johnson, Nixon, Ford, Carter, Reagan, Bush and Clinton—was correct that it is not a proper function for the government to do this and that a competitive enterprise system characterized by individual freedom and initiative is the primary source of national economic strength.

I appreciate the opportunity to appear before the committee today, and I look forward to working with you.

[The information follows:]



TESTIMONY OF

EDWARD J. BLACK, PRESIDENT & CEO

ON BEHALF OF THE

**COMPUTER & COMMUNICATIONS INDUSTRY
ASSOCIATION**

BEFORE THE

**SUBCOMMITTEE ON TREASURY, POSTAL
SERVICE AND GENERAL GOVERNMENT
OF THE
HOUSE COMMITTEE ON APPROPRIATIONS**

ON

**IRS Plans and Industry Perspectives Concerning
Electronic Tax Administration**

OCTOBER 3, 2000

Chairman Kolbe, Members of the Subcommittee, I am Ed Black, President and CEO of the Computer & Communications Industry Association (CCIA). I am pleased to be here today to testify on behalf of the high-technology industry regarding the future role of the United States Government in electronic commerce, and specifically as it pertains to electronic tax services.

CCIA is the industry association representing Internet, computer, telecommunications, software, and electronic commerce companies ranging from small, entrepreneurial firms to some of the largest in the industry. CCIA's member companies employ well over a half-million people and generate annual revenues exceeding \$300 billion.

We appreciate the opportunity to join you here today because we believe the technology policy issues presently before Congress are critical to the future health and growth of the American economy. The matter before the Subcommittee today is an excellent example. Although the instant question is whether the IRS should get into the role of providing electronic tax preparation services to the consuming public, we believe the real public policy issue at stake is much larger and more profound.

In 1997 President Clinton and Vice President Gore promulgated a report entitled "A Global Framework for Electronic Commerce." This Presidential Directive to the heads of Executive agencies declared that:

"Governments can have a profound effect on the growth of electronic commerce. By their actions, they can facilitate electronic trade or inhibit it. Knowing when to act and – at least as important – when not to act, will be crucial to the development of electronic commerce."

"For electronic commerce to flourish, the private sector must lead."

* * *

"In some areas, government involvement may prove necessary to facilitate electronic commerce and protect consumers. Where governmental involvement is necessary, its aim should be to support and enforce a predictable, consistent, and simple legal environment for commerce."

We believe this principled approach to electronic commerce is a significant reason why the technology industry in the U.S. has grown so dramatically and robustly in the last several years, to the distinct benefit of American consumers and workers.

Indeed, the United States has become the world's dominant provider of Internet-based services, including electronic financial services. Some governments have been far less enlightened in the governance of e-commerce and have pursued a heavy-handed, regulatory role, or even sought to manage and direct competition in the industry. Other governments have continued to intrude into their domestic commercial markets by offering government-sponsored goods and services, thus distorting their economies and stunting their economic growth.

But that has not happened here in the United States. Here, our policymakers have employed a rational, limited approach to government intervention in e-commerce that has been extraordinarily beneficial to the performance of our economy, allowed dramatic growth in jobs, and facilitated our global economic leadership.

In addition to the Administration's progressive policy position on e-commerce, the President also made an extraordinary declaration in his State of the Union Address on January 23, 1996 about the role of government in this country. On that day he professed that "the era of big government is over" in our nation. That declaration reflected the belief that government can no longer afford to try to be all things to all people, and has learned the lesson that it does not do all things well.

Instead, in a drive to reengineer and reinvent government, Congress and the Administration set about the task of setting realistic and achievable goals and objectives for Federal agencies, enacted legislation to restructure and reform critical parts of our government, sought to establish performance-based management models, created chief information and chief financial officers to enhance management discipline, and set in motion a national movement to modernize the public sector, implementing electronic government and seeking to improve service to the citizen.

Part of this effort involved turning to voluntary alliances with the private sector to address some societal needs -- seeking to create public-private partnerships by which the public good can be advanced without rigid government control or excessive intervention. Such a model emphasizes cooperation, self-restraint, and mutual respect to facilitate government and industry working together, collaboratively, in the public interest.

Public-private partnership holds great promise for this country if we can learn to embrace it and utilize it effectively, but what does it really mean? It does not refer to government contracting-out for its needs instead of building its own solutions, which is merely a make-or-buy decision in government procurement. Public-private partnership means something altogether different.

The Progressive Policy Institute has done some seminal work in this area, and it merits our serious consideration. In their landmark "New Economy Task Force Report: Rules of the Road" they note that:

In the old economy, bureaucracy was how we addressed many major public policy problems. In the New Economy, we must rely on a host of new public-private partnerships and alliances.

In the New Economy, boundaries of all sorts have blurred. . . . [R]ather than acting as the sole funder and manager of bureaucratic programs, New Economy governments need to co-invest and collaborate with other organizations -- networks of companies, universities, non-profit community organizations, churches, and other civic organizations -- to achieve a wide range of public policy goals."

Compared to government, these organizations have a number of advantages. They are usually closer to the customer and tend to have greater capacity to solve problems because they can be more flexible, leverage additional resources, and face bottom-line pressures to boost performance. Yet public policy has only begun to explore the potential of bottom-up, decentralized networks assuming the lead role in solving pressing societal problems.

The Institute built on this important work with a new study issued just this spring entitled "Digital Government: The Next Step in Government Reengineering." That report lays out twelve principles for implementing digital government. Of particular interest in the context of today's

hearing is Principle Eleven: "Federal Efforts Should Complement, Not Duplicate Private Sector Efforts."

The study went on to note:

In some instances, government agencies have recently pursued strategies where good electronic government ideas have evolved into electronic commerce initiatives, where the Government took on a role of providing commercial products or services to consumers in competition with the private sector. Whether the subject is the [U.S. Postal Service] and electronic bill presentment and payment, or a state agency with electronic tax preparation services, or a federal department wanting to commercially sell its electronic payroll services, these forays cross the line into Electronic Commerce.

* * *

[D]igital government efforts should be focused on those innovations and initiatives which are necessary to fundamentally improve service to the citizen in inherently governmental functions, and to provide significantly better access to public information resources. Public funds, whether appropriated by Congress or generated through systems such as the Postal Rate Base, should not be used as venture capital to launch governmental agencies into competition with the private sector. There are too many necessary functions of Government which are either going unfulfilled or are being poorly performed in outmoded ways, to be able to justify in an era of limited budgets spending taxpayer dollars on activities which fundamentally change the role of government in our economy.

House Majority Leader Dick Armey has stated similar concerns regarding the government's entanglement in e-commerce:

Unfortunately, as the industry matures and the competitive stakes get higher, it can be easy to lose sight of the principles of freedom that have led to such success. Government solutions can be a tempting alternative to a competitive marketplace, but as they say, 'if you lie down with dogs you may wake up with fleas.' So far the industry has achieved its great success primarily because government has not been involved.

Which brings us to the specific case with which the Appropriations Committee has been grappling: the proposal for the Internal Revenue Service to offer one or more free electronic tax preparation services over the Internet to American consumers.

The congressional mandate of achieving 80% electronic filing of individual income tax returns by the year 2007 is a worthy goal, and one the private sector enthusiastically supports. The private sector invented and developed electronic tax preparation, and is annually transmitting millions of tax returns electronically to the government. The volume of these transmissions is growing dramatically every year. However, we must be clear that the congressional mandate for electronic filing applies only to the filing of tax returns -- Congress has not mandated or even provided authority for the IRS to offer tax preparation services.

The marketplace today, through private-sector innovation and competition, has made it possible for the American taxpayer to prepare and file electronically their income tax returns at very low cost or at no cost. The options available to consumers are robust, and a number of market leaders even donate their Internet-based services to low- and middle-income taxpayers at no charge.

In this environment it is difficult to understand why the Federal government would be seeking to interpose itself in this marketplace in order to offer electronic tax preparation and filing options directly to consumers. And more than that, given the success of free market competition in this industry, it is difficult to understand why the IRS would contemplate setting price controls on the products and services of this industry, and regulate the commercial Internet business and revenue models for these electronic financial services, as was discussed by IRS officials this spring

These ideas seem to be reestablishing Big Government all over again as the preferred method of any pressing public policy matter. It almost appears as if the Federal government is saying to us that if we are going to achieve the goal of 80% electronic filing, the government is just going to have to go and do it itself, as well as expand into the offering of tax preparation services. We believe that would be a fundamental mistake and would actually endanger our ability to achieve the electronic filing objectives the Congress set forth as national policy by impeding the development of the competitive market for such services.

There appears to be no identified justification -- no unmet need in the marketplace -- to validate any proposal to absorb electronic tax preparation as a service to be offered to the public under the auspices of the Federal government. While that strategy may have allure to some, it is fraught with many serious and insurmountable flaws. In addition, our economic system does not countenance the interjection of the government into competitive private markets in this manner -- Internet-based electronic financial services are a core competency of the private sector.

In March of 1998 the IRS announced that it would be developing and launching its own products and services for electronic tax preparation. That announcement was highly controversial at the time, and the plan did not proceed. However, in the two and one-half years since then, the plan has reemerged in a number of new forms.

In January of this year, language appeared in the President's Fiscal Year 2001 Budget directing the IRS "to provide taxpayers with [] one or more no cost options for preparing and filing individual income tax returns over the Internet beginning no later than tax year 2002."

In February the agency announced plans for a competitive procurement of these services. In May, when he was asked whether the government would enter the market for tax preparation services with their own product if industry didn't respond as hoped, the Assistant Commissioner for Electronic Tax Administration declared that the agency "hope(s) it doesn't come to that." Likewise, in May, Assistant Commissioner Barr publicly pronounced an objective of lowering national pricing for electronic tax preparation services to "zero", and that the agency was carefully reviewing the Internet business models of the industry to determine "what revenue model makes sense." While other statements by the agency have disavowed such intentions, these statements are very troublesome to those of us in the private sector.

We believe American consumers would not be well served by the government seeking to manipulate markets and establish for itself a role as a purveyor of commercial goods and services to the public, or as an FCC-style regulator of electronic financial services. These are not the core missions and objectives of the Internal Revenue Service, either in its original charter or even in its revised form under the 1998 Restructure and Reform Act.

Most importantly, in the context of good government, such an approach runs counter to sound economic and public policy, including the Administration's own position on electronic commerce.

It does not serve the taxpayer well for the government to neglect the changes and innovations necessary to make electronic government a reality, and instead to focus on trying either to duplicate the services the private sector is already offering, or to try to manage competition, revise business models, and run the industry.

Similarly, the intentions of the IRS procurement strategy, as described in multiple news interviews, is to use possible changes to the existing Use of Tax Data rules, and how they might be applied in the future, as an incentive to get private companies to drop their product prices to government-set price levels. The fact that such an idea would even be seriously contemplated underscores how anxious some in the IRS have been to make a role for the agency in this electronic commerce marketplace. But the fact that the IRS would use a procurement vehicle as the preferred methodology for changing the application of these regulations is completely inappropriate.

The President's 1997 e-commerce policy directive to agency heads required that old paper-era regulations be updated and modernized to facilitate electronic commerce. We wholeheartedly support that presidential mandate, and believe the IRS should comply with it. The 30-year-old Use of Data regulations do require updating, but the Administrative Procedure Act is clear about the lawful methods and procedures for conducting a public rulemaking that would respect the interests and rights of the citizens of this country.

In terms of the broader issue we are addressing at this hearing, we believe there is clearly a better way to advance the public interest than the path that has been followed in this matter to date. The innovative thinking of political scientists, economists, and experts in public administration have concluded that public-private partnership can provide the opportunity to advance significantly our public interest goals without government control and intervention. Even the IRS' own Federal advisory committee, the Electronic Tax Administration Advisory Committee (ETAAC), has strongly recommended against the IRS pursuing its declared strategy in this area in its recent Annual Report to Congress.

What is truly unfortunate about the strategy the agency appears to be pursuing is the degree to which it has dismissed the extensive private-sector efforts to bring these important services within the reach of all Americans, regardless of means. Voluntary Digital Divide initiatives of the private sector have already made commercial electronic tax preparation and filing services available to lower income Americans for free. These public service initiatives have existed for several years, and have demonstrated dramatic year-to-year growth in usage. Citizens do not need a computer or software, or a credit card, to take advantage of these Digital Divide initiatives. Instead, lower-income taxpayers can go to any public Internet access location, go online, and prepare and file their tax returns at no charge. These public service offerings are also provided without expenditure of public funds, in the form of either government budget or staff resources. We believe these types of voluntary public-private Partnership initiatives should be encouraged, not supplanted, by the IRS.

If no other policy direction or guidance has been adequate for the IRS to formulate its planning on these matters, Office of Management and Budget Circular A-76 ought to have provided the strong policy foundation with which to make the right determination. That presidential directive, formulated by the Eisenhower Administration and renewed by every President since, clearly

states: "In the process of governing, Government should not compete with its citizens." Circular A-76 further provides that a "commercial activity" is not a "governmental function."

This presidential directive, in place for half a century, would seem to remove any lingering uncertainty about our national policy. However, as some agencies have pointed out in the face of scrutiny, a presidential directive like Circular A-76 is not "legally enforceable." That simple fact leads us to the conclusion that further action by Congress and the Executive Branch is necessary.

Congress needs the time to deliberate the complex issues presented in this very significant policy dispute. A number of Members of Congress have proposed an immediate government-wide moratorium, suspending those government activities that would duplicate or compete with established private sector electronic commerce services. This thoughtful approach would enable the exercise of congressional oversight to determine the right law and policy for the United States going forward, and what the proper role should be for our government in the emerging New Economy. We believe Congress and the Administration should act now to implement this recommendation.

To assist in the necessary analysis and review of the issues surrounding this debate, CCIA has commissioned an independent economic policy study, to be released later this month, which will review the implications for our economy, and for public policy, of this developing trend. As part of this analysis, nationally recognized economists will propose guidelines for helping to determine when government should intervene and insert itself in these circumstances, and when sound economics and prudent policy dictates governmental restraint.

We look forward to participating in the policy review that lies ahead, and to contributing the expertise of the high-technology industry to this dialogue. In the meantime, however, it is vital that this Subcommittee step into the breach, and uphold the Administrative Procedures Act and OMB Circular A-76, by declaring the simple fact that no authorization or appropriation exists for the IRS to undertake its announced electronic tax preparation services project, and that further activity must cease in order to permit Congress to perform its lawful constitutional function. Instituting such a moratorium will permit both the Congress and Executive Branch to make measured, thoughtful determinations about what policy best serves the American taxpayer and the American economy.

In that assessment, we believe Presidents Eisenhower, Kennedy, Johnson, Nixon, Ford, Carter, Reagan, Bush, and Clinton were correct when they declared in OMB Circular A-76 that:

"The competitive enterprise system, characterized by individual freedom and initiative, is the primary source of national economic strength."

CCIA appreciates the opportunity to appear before the Subcommittee, and we appreciate your interest in and attention to this extremely important matter. I would ask the Chairman if I might be permitted to submit for the record several informational documents.

Mr. BLACK. I do have some relevant documents that I would like to submit for inclusion in the record, if I could.

Mr. KOLBE. Those documents will be placed in the record at this point—at the point of your testimony, Mr. Black. Thank you very much. We will get those from you.

Mr. Harrison.

Mr. HARRISON. Thank you, Mr. Chairman. My name is Paul Harrison, and I am the founder, CEO and President of FreeTaxPrep.com. FreeTaxPrep is a venture capital-backed company which was founded in December of 1999, and starting with the 2000 tax season we will be offering free tax preparation and free electronic filing over the Internet.

I would like to assure everyone here that the management of this company is both experienced and very serious about this initiative. The management alone has over 60 years of experience in the tax technology software and electronic filing business.

We also understand how critical preparing and assisting people with the preparation of their taxes is, and we take that responsibility very seriously in the way we approach this industry.

In responding to the IRS' 80 percent initiative, I think there are some things that we all need to understand when we look at how difficult it is going to be to achieve that goal. First and foremost, tax software and electronic filing have been around for 15 years. I have been involved with tax software from the consumer side since 1990.

To date, only 20 percent of the people who prepare their own returns use tax software, and only 10 percent file their returns electronically. That leaves 55 million individuals who prepare their own returns who do not file electronically. Getting those people to file electronically is going to be very large hurdle to achieve by the year 2007.

We believe there are three impediments to achieving that goal that need to be overcome. The first one is awareness. We applaud the IRS for the advertising campaigns that they are undertaking. We applaud the fact that there have been budget dollars allocated toward creating awareness with consumers regarding e-filing. But we are concerned that that is not the most effective way to drive consumer usage of products and services that allow them to file their returns electronically.

The research that we have done with consumers, reveals that consumers hear the ads for e-filing, but they don't know what it is and they don't know how to do it. So we feel what is required is a much more directed campaign, which tells consumers what are the options you can use to file your returns electronically. This approach would be much less expensive than the current method, which is very expensive, for creating a brand for e-filing.

The second impediment to the 80 percent goal is access. Not everyone has access to a computer. Not everybody has access to computers with modems. I believe there is good news there. All of the recent research shows that the highest area of growth in both computer usage and in Internet usage, is in the middle- to lower-middle-income demographic. That is the demographic that is currently least involved with electronically filing their tax returns from a

self-preparation standpoint. So there will be access. Access is moving very quickly into those segments.

The last impediment to the 80 percent goal is price. This is a very, very serious impediment to achieving this goal.

We are a consumer products company, and as a consumer products company, we always look at things from the viewpoint of our customer, the consumer.

Filing your taxes is not a discretionary event; it is something that you have to do. Most people do not view it as an enjoyable event; it is a chore. When people are being requested to file their returns electronically, their first question is, what is in it for me. What people see at this point in time is that electronic filing benefits the IRS, it makes the IRS' handling of paperwork easier; and there is no benefit to the consumer, because they don't understand that electronic filing is easier, and they have to pay for it.

Let me give you a very similar example. Prior to forming FreeTaxPrep.com, I spent the last five years implementing online banking systems for the largest banks in North America. When we started doing this work for banks like Bank of America, and several others, the banks—wanted more customers doing banking online. We did research with consumers, and consumers said "You are nuts; we are not going to go online and pay you for the privilege to make your life easier and to allow it to be less costly for you to process a transaction." Citibank finally jumped the hurdle and said, It is free.

Guess what? In a 6-month period of time, Citibank added more customers for online banking than the whole industry combined. Every other bank got in line and followed, and they are all happy they did it, because it broke the logjam and created millions and millions of consumers who are on online banking now.

The challenge that we are facing here is very similar. If we don't provide a free option for consumers, there are going to be some people who are willing to pay, there are going to be people who want a more branded type of solution. But for the masses, it is going to have to be free to achieve this 80 percent.

We are very committed to this model, and we will succeed in this model. And we will succeed upholding the highest standards of security and privacy for the consumer.

I can assure this committee that we have no intention of using any consumer data without total approval of the consumers. We will always ask consumers to opt in to letting us use their data. We will not try to trick them by having the box checked on the screen. We will always ask them to opt in.

We will give full disclosure to consumers. We will never sell the data, we will never rent the data, and we will not solicit these customers without their approval for products and services. We want to be the poster child of how you can do this and how you can do it right without compromising the goodness of the consumer and the privacy of the consumer.

We do believe the IRS can help companies like us succeed. We would like to see the IRS have advertising campaigns that are a little more focused on the solutions in the industry.

We brought to the IRS earlier this year a very extensive marketing plan on how we felt they could help us. That marketing plan

did not include one budget dollar that the IRS would have to expend to help us in our efforts. Quite honestly, we are disappointed that we have not received any response to those recommendations. We think we understand why that is, but to date there hasn't been a lot of progress and we have essentially taken some different courses with our marketing efforts.

The whole issue of resisting the entry to a market of companies like ourselves is really based on a simple fact. In 1998, tax preparation software for our citizens was an oligopoly. There were two companies providing that service. In 1993, I was on the wrong end of the Justice Department blocking a merger of those two tax companies, and it was still in oligopoly in 1994.

In the year 2000, tax preparation software is an oligopoly. There are economic interests that the two companies that control this market have right now to prevent free tax preparation from being successful. We have been very disturbed that there have been articles in some of the major newspapers throughout the country trying to strike fear in the hearts of consumers that free is bad, suggesting that if someone is offering free tax preparation, they are going to misuse your data.

There have been articles written that the IRS is going to sell the consumer data in return for its free tax preparation. We don't believe that, we don't advocate that and that doesn't need to happen for this to be successful. We plan on proving that in our efforts in the industry.

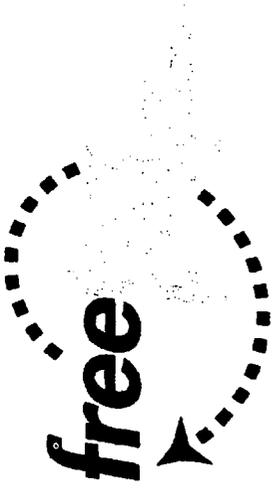
The biggest risk here is that these efforts to try to taint free tax preparation on the Internet are going to slow down the process. We believe this is what has caused the IRS to be unresponsive to our request for marketing programs and working with them. And quite honestly, companies like ourselves are dependent upon raising money in the venture capital community, and they ask us the question, does the IRS support what you are doing.

We would like to see some more support from the IRS.

In closing, I can assure you, we will adhere to the highest standards possible. We will be good partners of the government, we will be good partners of our customers, and we will be good partners of the IRS. We want to make this work. We are committed to making it work. And we will provide the taxpayers of this country a secure private online solution which is free for both preparing their taxes and electronically filing them.

And I thank you for the opportunity of speaking today.

[The statement of Mr. Harrison follows:]



*Subcommittee on Treasury, Postal Service and
General Government*

Oversight Hearing – October 3, 2000 10:00 AM

*Presentation/Opening Remarks
Paul D. Harrison, President & CEO
FreeTaxPrep.com, Inc.*



Introduction – About FreeTaxPrep.com

- FreeTaxPrep.com, Inc.
 - Venture funded
 - Will offer free tax preparation and e-filing starting tax year 2000
- Management
 - Over 60 years combined experience in tax preparation and e-filing technology
 - Understand the industry and responsibilities associated with this business sector
 - Appreciate, and confirmed with research, consumers' desire for easy and free tax preparation and e-filing solutions

2



IRS's 80% e-file Initiative

- Electronic tax preparation (software) been available to consumers for 15 years
- Only 20% of those who prepare their own returns use software
- Just over 10% e-file (self prepared)
- 55 million self prepared returns are not e-filed



Awareness, access and price

Impediments to 80% goal

- Awareness
 - IRS \$14 million promoting e-file
 - Good start – long way to go
 - Assumes consumer knows what e-file is and how to access the service
 - Access
 - Good news: Growth of PC and Internet usage is highest in the middle/lower middle income demographic - this demographic represents the largest growth potential for self prep e-filing



Awareness, access and price are impediments to 80% goal (continued)

- Price (is a big issue)
 - Filing taxes is not discretionary
 - Consumers view e-file benefit accrues to IRS
 - Why should I pay?
 - Similar Example - *Evolution of on-line banking*
 - Banks wanted to charge, growth was slow
 - Consumers felt benefit accrued to the bank
 - Citibank forced free; usage exploded



FreeTaxPrep.com will succeed with a free model

- FreeTaxPrep.com will:
 - Use highest standard for “opting in” or gaining approval
- FreeTaxPrep.com will not:
 - Use data without approval
 - Rent or sell data
 - Solicit without approval



IRS Can Assist “Free” Model

- Create awareness — tax preparation and e-filing
 - Let consumers know free exists
- Soft dollar marketing
 - Public relations
 - IRS Mailings
 - Postage
 - Tremendous benefit to the IRS with no real cost



Why is this an Issue?

- Today's oligopoly depends on software license fees and resists the FREE model to protect their own economic interests
- Effort to paint FREE model as bad by suggesting possible misuse of data
- This effort to slow progress and the resultant (risk of) lack of IRS direction will inhibit the investment of capital required to promote competition and innovation



FreeTaxPrep.com will:

- Adhere to the highest standards
 - Be a good partner
 - Earn the trust of government
 - Earn the trust of the Country's taxpayers
 - Help IRS achieve its goals
 - Provide the taxpayers of this country with a high quality, free tax preparation and e-filing option



Mr. KOLBE. Thank you very much. I think the testimony of all of you has been very helpful.

Could I get the three of you to kind of roll your chairs to the side so we can get the Commissioner up here. There we go.

Now, if we could just get everybody to slide down a little bit, we will get the Commissioner up there at the table. Everybody, thank you.

I think this is very useful information for us to have, and it raises some real questions. I am not on the authorizing committee, of course, which crafted this language about electronic filing; and so maybe among all of you, you can help me understand this a little bit. It is important for us and the Appropriations Committee because we have the responsibility to be sure the IRS is doing its job of implementing congressional intent.

On the one hand, we have the idea of the goal of the 80 percent filing. We have the idea of providing free filing on the Internet, free filing through the IRS. On the other hand, although that may be—although Mr. Harrison has told us it is not to some, it might sound like this is inconsistent in the marketplace—how do you do something free? I think I know the answer that Mr. Harrison would give to us.

So let me begin by asking the Commissioner whether you believe it is possible to have free filing to the IRS and have it done through the private sector?

Mr. ROSSOTTI. I think it is possible because it is being done now. Even last year there were some offers—as I think Mr. Black noted, there are some companies that offer free filing to people that file certain kinds of returns, usually lower-income returns, and those are potentially fairly significant.

In addition to that, there is at least one company that I am aware of, maybe others, that offer either no-cost or low-cost filing through the Internet; and Mr. Harrison has noted that he is going to be offering some services.

So I think the market is developing much as ETAAC noted, and I think, contrary to what you may have heard, the IRS is simply trying to foster that trend. I mean, the act itself simply says that we are supposed to—I think words are “reduce barriers,” “provide incentives” and “provide for robust competition.” Those are the three pieces in the act.

We have not used any financial incentives which were authorized, because the industry told us they would rather have us work on reducing barriers rather than do that—although that possibility could exist. But we have asked, through the RFI. And again we may have unintentionally caused some confusion here, but the purpose of the RFI was to solicit—gee, it would seem I didn’t know “on” from “off.”

Mr. KOLBE. That is one of those computers that handles all of those.

Mr. ROSSOTTI. But really our intent was simply to solicit from the industry and our representatives of the industry here what ideas they had as to what we could do to basically try to support this trend, which is already happening to some degree, but we would like to support it as much as possible. And, you know, we don’t know really all the possibilities that exist out there.

I mean, the Internet especially is a fast-changing market. We don't know all the business models that people have. So we would like to get as much input as we can from the industry and use that to see if there are some things that we could do.

Mr. KOLBE. Does the idea of making it possible for people to do free electronic filing mean that the IRS needs to provide a software program to make that happen?

Mr. ROSSOTTI. I don't believe that that is true. I really—having been a part of the software business myself, and now having been in the IRS, I think we have enough to do with developing software for the things that we have to do internally, that it is not good sense for us to get—that is not necessary.

But I think you know the access that we should support or—

Mr. KOLBE. So you believe you can meet the terms of the act without actually getting into the software business?

Mr. ROSSOTTI. I believe that we can. I mean, I obviously won't know everything we can do, but I think that there is enough going on in the industry that if we do what the act says—press for competition, provide incentives—we need to find out more from the industry, what kind of support they need.

Mr. Harrison said he would like to get more support from us, you know, in some form. I am not sure exactly what that means, but we would like to find out from companies like his what it is that they would want. We have links on our Web site for example. Maybe we could do more links on our Web site to refer people to companies that offer these services.

Mr. KOLBE. Let me turn now, if I might, to the industry people here and ask them the response to that question. I take it, the concern you have, or at least what we heard certainly from Mr. Black as a concern, is that you are not at all sure that the IRS really does intend to meet the requirement of the reform act without developing its own software.

Would that be a fair recapitulation of your statement?

Mr. BLACK. Partly, Mr. Chairman, yes. The IRS can get into the marketplace by them actually writing their own software or by trying to pick winners and losers by perhaps identifying one firm, and making an exclusive contract. So they could do it through a contract.

Mr. KOLBE. Do you see that happening? What is your—are you concerned that this is a potential problem, or is this something that you see some—

Mr. BLACK. There have been a number of statements made by IRS officials, ETA officials, that have indicated that was the intent. There was an indication during deliberations on authorizing legislation, in fact, to obtain certain authority that moved in this direction. I think the Commissioner has made a very articulate statement about not wanting to move in this direction, but I am not at all sure that that is universally shared within all parts of the agency, and we constantly sense that there is such a desire.

I should also add that while we fully support the goal of electronic filing at 80 percent, we do not think there is any national mandate to move towards zero-cost, free filing. If the private market can get there—and it is clearly moving to lower costs, and people that provide these services have great public services in pro-

viding low- and middle-income taxpayers that opportunity—we think that is great. If the market moves there, so be it.

Mr. KOLBE. You do not think—let me just see if I understand.

You do not think there is a mandate. Is that a goal, though, a public policy goal that we should be moving towards, of no-cost filing?

Mr. BLACK. I don't think that there has been such a goal established by either Congress or the executive branch. If that is a goal that we should perhaps consider pursuing, then, the policy process of the U.S. Government ought to make that decision. But that has not been a decision that has been made, so far as we can tell, by any statutory authority, nor any presidential directive. So we think that, if this is a public policy decision people want to make, we will debate it. We think the arguments are yet to be made on both sides.

Mr. KOLBE. If I am filing, not electronically, if I can figure out all the forms and get them filled out myself on paper, the cost of filing is the stamps to mail it. So it can be done free other than the postage cost.

Mr. BLACK. The cost of filing entails tremendous man hours, huge cost. That is what software, through logarithms, in essence replaces. There is a huge cost to the private sector in technological development research to, in fact, create it and an ongoing need to update those logarithms to do the tax preparation. So there is a savings—

Mr. KOLBE. There is a savings in time. There is no question that time is dollars, time is money. But in actual cash outlay, you are saying there is a difference.

Commissioner, do you see that as accurate, that there is no mandate in the legislation to move to—

Mr. ROSSOTTI. No, I don't think there is a mandate in the legislation to reduce the cost of filing to zero. I think the mandate in the legislation or the goal in the legislation is to find a way to get to 80 percent, and we are supposed to do that by three means. One is—you know, again I go back to “reduce barriers,” “provide incentives” and “press for robust competition.” I think that is what we should do.

That is a perfectly reasonable set of guidelines. It also provides a process for us to consult with ETAAC, which has been designated to be set up under the legislation. And we have been consulting with ETAAC. I think their advice in the June 30th report is pretty wise advice; I certainly accept that advice.

I think the idea of the RFI we put out was an attempt, although there might have been confusion about this, to simply solicit industry views about how we could do what it is, who is to press for robust competition and support the industry in the direction it seems already to be moving, which is to provide more services at less cost.

I think, as I said in my prepared testimony, that based on what I have heard—and I think Mr. Harrison's research showed this—that there are a number of barriers that stand in the way of getting beyond the level we are at now. Not all of them are costs, but one of them is cost.

We do certainly hear from taxpayers that they—some taxpayers are concerned about the fact that they have to pay a fee to elec-

tronically file their tax return, and if they can use a stamp not to—whether that is rational on their part, based upon how much time they would save or not, it nevertheless is certainly something that we believe is a view held by some taxpayers.

Mr. KOLBE. Mr. Black.

Mr. BLACK. Mr. Chairman, I think what is lost here is there has been a recent request for information that is, in essence, a procurement to provide this service.

Mr. ROSSOTTI. It is simply a request for information.

Mr. KOLBE. There seems to be some dispute about this.

Mr. ROSSOTTI. In our information, it is just a request for people to provide views. There is no procurement involved. There is no specific proposal. There is no more contemplated. All we have asked is for people to give us views and answers to some questions.

I am afraid I have to correct that. That is not an accurate statement.

Mr. KOLBE. Mr. Black, I would be interested in hearing your thoughts about that. A request for information is very different from an RFP, which is a request for a proposal which is a specific contractual obligation at that time IRS intends to enter into upon completion of that. Is that not correct?

Mr. BLACK. It is not an RFP, that is correct. But as we view it, in essence what it really is doing is requesting that kind of connection to the private sector and asking for private-sector participation; and we see that what can go on here is in essence picking somebody in the private sector to be the arm of the IRS in providing this service.

Actually, that is what we think is happening.

Mr. KOLBE. I take it your real concern at this point, as I hear—what I heard in your testimony—what you have said again, Mr. Black, is the idea of the IRS picking and choosing winners here; is that it?

Mr. BLACK. That has certainly been part of it.

If I may make reference to the cover letter of the RFI itself, it does say that “the IRS plans to issue a subsequent solicitation for the purposes of identifying organizations who are willing to offer free tax preparation, and electronic filing via the Internet.” It says “this RFI is for planning purposes only. Responses to this RFI are not offers and cannot be accepted by the Government to form a binding contract,” but they do plan a general solicitation. It is the first step in a procurement process.

It is not an RFP itself, but it appears to be a step in the procurement process.

Mr. KOLBE. Well, I don’t want to get into the “he said, you said,” but let me ask the Commissioner to respond to that statement.

Then I will ask Mr. Price for some questions.

Then I want to go to some other areas and involve the other people here.

Commissioner, that statement about subsequently seeking proposals—

Mr. ROSSOTTI. I think what we intend to do is look at the responses we have gotten. By the way, we have gotten about 150 responses so far. So therefore we presume there are a lot of different

views as to what could be done and what should be done, and until we look at that, we are not going to have—

Mr. KOLBE. Where are these coming from? Are these coming from—

Mr. ROSSOTTI. Industry.

Mr. KOLBE. From Internet as well as software and—

Mr. ROSSOTTI. There is a wide variety of people that have responded. I am afraid that—you know, it is possible that we contributed to the confusion, but I think I should make it clear that there isn't anybody in the IRS that is going to do anything, to put it very bluntly, that I don't agree they should do, because that is why I am the Commissioner.

I have stated on the record here to the committee that we are not doing a procurement, so if there is someone that has told Mr. Black that we are doing a procurement, let me know who it is, because that is not going to happen, Mr. Black.

Mr. KOLBE. Once again, we are going to get interrupted. I am going to see how far we have to go before we go.

This is the vote on the continuing resolution.

Mr. Price, I will ask you for some questions.

Mr. PRICE [presiding]. Thank you, Mr. Chairman. Let me echo my thanks to the entire panel, both panels for your testimony here today.

I would like to concentrate on the Commissioner's testimony mainly, although I do want to say, Mr. Harrison, I am intrigued by what you say and that—what you said and some other services that I have learned about are the pretexts for the question I would like to pose to the Commissioner.

The Commissioner has said more than once that the hurdle to be surmounted, cost to the taxpayer, is a significant barrier to the 80 percent goal we all want to reach. This morning, actually, I reviewed a tax return and it was not a return from a particularly low-income taxpayer, a tax return that was filed electronically for free this year via H.D. Vest Online, and I have a little information about this service.

This—I don't mean to single out this company particularly; I am interested in how typical this is, or how feasible this is to become more widespread.

H.D. Vest—this article from E-Commerce Tax News by David Harray, June 25th of this year, says H.D. Vest has a plan to provide free tax return preparation services. Services include both Federal and State individual income tax returns, as well as free electronic filing. According to the company, from January 28th to April 17th, there were more than 1.5 million unique visitors to the H.D. Vest site; of these, more than 260,000 prepared and e-filed their 1999 income tax returns free of charge.

How does this work? Where is the profit in this? Well, the article goes on that when an individual comes to the H.D. Vest site for free tax return preparation, the site provides information on other services that are available from local affiliates. The hope is that users of free services will eventually become buyers of premium services.

Now, I assume that there is already evidence, pretty convincing evidence, that free filing via the Internet is possible, is feasible, is

electronically workable. Is this something the IRS, Mr. Commissioner, is in any way encouraging? Are there aspects of it that you are concerned about? Is this, in fact, the wave of the future?

Mr. ROSSOTTI. Well, I think it is certainly something that we are observing carefully. I think it points to the fact that the industry is responding with new and creative options as to how we can improve the services that are available.

Mr. Harrison noted that he is starting up a company. I think what we simply are trying to do, notwithstanding maybe some of the confusion that we may have caused inadvertently, is to simply support these—you know, these trends which seem to be moving in the right direction.

There may well be things that we can do in the way of supporting or encouraging or advertising or marketing or working with companies that are offering services that are going in the direction that I think we all want, which is to offer more services at less cost to the taxpayer.

Mr. PRICE. There are other hurdles to taxpayer acceptance, some of which you have referred to—data security, personal privacy, the prospect of being put on some kind of e-mail mailing list—and then the problems this could pose, I suppose, for dispute resolution down the line.

You, of course, have testified very strongly that confidentiality of taxpayer data must be assured under all circumstances. Do these online services pose particular challenges in that regard? Has the IRS's role in overseeing these services and working with these providers in offering greater assurance to taxpayers that their data is secure, their privacy is protected?

Mr. ROSSOTTI. I think that our role is actually spelled out in the statute or in the regulations. There is a specific regulation, known as Regulation 7216, which actually deals with tax people who are tax preparers. And although the Internet is new, it has been determined that companies who offer tax preparation software over the Internet are considered tax preparers, and they are governed by this particular regulation. And it really spells out pretty concretely, with some very strict limitations as to the privacy of taxpayer data, the confidentiality of taxpayer data, including the issue of use, or reuse, of any information on the return.

So what our goal is, or our—I guess our need is to make sure that we administer that regulation, get questions as they come up, if there are new issues that haven't been considered before; and try to get industry input or industry questions about any new questions that might come up.

But fundamentally the standard is set by law. It is our job to administer that and to provide any new answers that might be coming up as a result of the new technology.

I think more broadly, you know, protection of confidential tax information, that is one of the most fundamental aspects of the whole tax administration system. There are many, many things, you know, that the IRS would like to do with technology which we are being very cautious about simply because of the paramount need to protect the security and confidentiality of taxpayer data. We have no interest and no authority to relinquish or in any way weaken that standard.

So our role is to administer the standards that exist in the protection of taxpayer data. Clearly, there could be some novel issues that come up as the result of new technology which, with the help of our counsel, we have to react to. But the policy, I think, is quite clear and it is set by law.

Mr. PRICE. And you seem to have little doubt that the IRS's proper role can be clearly delineated.

You have some interest—I think, some responsibility—to promote and encourage the provision of these services, to consult with those providing the services, to make certain that it is meeting your specifications, to make certain that there are consumer protections involved.

You are satisfied that there is not a problematic gray area there, where the agency might go into a more overtly promotional mode?

Mr. ROSSOTTI. Well, I think that there is not a gray area in the sense that the IRS should be getting into, or would intend to get into, the business. I think that would be very unwise, either by contract or in any form.

I think, though, where it comes into the question, to provide incentives and promote robust competition there is certainly a question and there may be differences of view as to how we should do that. I mean, ETAAC said we should continue to press for competition; the law says we should press for robust competition, and it also says we could provide incentives, working with companies to do cooperative advertising perhaps.

We don't know what the requests are, or the ideas are, that the industry has come up with in response to our RFI.

So there isn't any question about the protection of taxpayer data. That is set by law and it is of paramount value and importance in the tax system. I don't think, at least from my point of view, there is any gray area in terms of the IRS either by—in any form, really, getting into the tax preparation or tax—even the tax filing business.

I think where you get into the question is, what does it mean, you know, and what are the appropriate things to do when it says "provide incentives" and "press for robust competition." That is what we are trying to find out. The purpose of the RFI was really to find out what views we might receive from the industry about how we could proceed there. And there could be disagreements about that.

But I think that is really the question: what should we be doing to provide incentives and press for robust competition?

Mr. PRICE. I appreciate that answer. It does seem to me that the industry complains notwithstanding the fact that the industry is going to depend on the IRS to promote electronic filing if they are to succeed, and that this should not be an adversarial situation.

Mr. ROSSOTTI. I don't think it should be. I think, for the most part, our interests coincide. That doesn't mean there couldn't be, you know, disagreements about some specific item.

It is also the case, though, that the law provided, I think, an interesting process. It said where there is any disagreement, we should consult through ETAAC, which is what we would intend to do. So, I mean, before we could do anything of any significance—there would not be anything that we could do on our own—we

would consult with ETAAC as the designated advisory group to work with us on any initiatives that we might take.

Mr. PRICE. Thank you. We have a vote on. What is our process here?

Mr. HOYER. We are going to recess pretty soon.

Following up, I understand this question wasn't asked. I am sorry that I wasn't here for all the testimony, but I am going to read all the testimony. I was on the House floor discussing the next continuing resolution bill.

There is some concern expressed by the fact that the IRS would align itself with certain e-authorized vendors. Do you have any plans to align yourself with any vendors?

Mr. ROSSOTTI. We have no plans. Well, we have all the electronic return originators, about 77,000; we are not aligned with any one of them.

I think that—you know, the question that may come up as we receive input to this RFI is, what proposals do people have to work with us in a cooperative way. We certainly would not be authorized through this RFI process to pick, you know, one company or a small set of companies or any subgroup of companies. But the question that we are asking for is what are their ideas about how we could effectively work with them—you know, whichever ones are interested in working with us—and before we would be able to do anything on that, we would certainly consult with ETAAC. That is what is described by the statute.

Mr. HOYER. Thank you, Mr. Commissioner, and gentlemen. The chairman is going to be back. I can't come back because I have a 3:30 meeting, which will obviously be pushed back. But the chairman indicated he would be back. So we will recess the hearing until the chairman returns. Thank you.

[Recess.]

Mr. KOLBE. The subcommittee will resume. I apologize. That was the last interruption for the day, so at least we don't have to do this again. I apologize—all of you, I suspect, have testified before—or certainly been around hearings here enough to know how votes tend to interrupt these hearings. But sorry that this has happened.

Let me go back to a couple of other things that I wanted to talk about.

First, Commissioner Rossotti, the plans you are talking about for reducing the barriers, the things that you need to do to enhance the electronic filing, to what extent is this dependent on your modernization plans, your technology modernization plans; and I might add, your reorganization perhaps?

Mr. ROSSOTTI. Well, I think that, as with all the things, you know, Mr. Chairman, we tried to segment things we can do immediately from things that will take longer.

The immediate things—

Mr. KOLBE. I think your button is off.

Mr. ROSSOTTI. The immediate things that we are doing over the next filing season and the following filing season are largely being done by upgrading the existing legacy systems, because that is the only way we can get those done in that period of time; and those are well under way.

However, some of the longer-term things are dependent entirely on the technology modernization and, in particular, to be able to convert our ability to do business with taxpayers and practitioners beyond just filing; in other words, to be able to do other kinds of transactions—to do the whole tax administration process, to provide them access to taxpayer accounts, to do electronic messages—those things are entirely dependent on our technology modernization.

And, in fact, the request that, you know, we have been working with your committee on for the 2002 release has steps in that direction. So that would allow, for example, electronic originators to communicate with us in a secure way over the Internet for such things as applying for applications and eventually exchanging account data.

So those things are very important, and they will fit into the overall process of creating a greater incentive for people to do business with us electronically.

But the immediate steps that I specifically mentioned of eliminating the need for the paper form and extending the filing option to all the forms and schedules, those are more tactical initiatives that we need to get done right away through our existing legacy systems.

Mr. KOLBE. By the way, your mentioning the additional forms raises just one thing in your testimony I just wanted to ask—this is kind of an aside. You said with that it would then be possible for 99.1 percent of people who file electronically. What is the nine-tenths—what is the 1 percent that gets left out?

Mr. ROSSOTTI. There are some, honestly—we have lots of little schedules that are used by people in very limited circumstances.

Mr. KOLBE. So there are some of the forms that will not be—

Mr. ROSSOTTI. Just a few things. I don't frankly know what is limited; I don't think it is technical. I think there are some legal requirements, but effectively they affect a very small number of people. We consider that will be as close as we need to get.

Mr. KOLBE. One of your modernizations is the Security and Technology Infrastructure Release, as it is called, STIR, which provides the security infrastructure foundation necessary for conducting the business functions, such as electronic services. Would you comment on the GAO conclusion that this project needs to go through a rigorous assessment of security threats and vulnerabilities?

Mr. ROSSOTTI. We agree with that. It does need to and it will because that is the sort of core infrastructure project that will provide appropriate security mechanisms for essentially all of our technology modernization. So it is literally the critical component in terms of security. And we will—through a rigorous security assessment, we have a number of resources available to us to do that. One of them is our own internal security office, which we built up considerably; the other one is MITRE Corporation that has a great deal of expertise.

We will be using all the resources, as well as that of the prime contractor, to assess the threats and issues that will arise. That will be an ongoing process. We will be doing that as part of the development process, but also as we move through it and we learn more about threats that might exist.

So we concur with that recommendation, and we intend to pursue that vigorously.

Mr. KOLBE. Okay. Let me turn back to some of the testimony that we heard from the other panel.

Mr. Harrison spoke about the concerns that have been expressed on the privacy issue. I think some of the others alluded to that, as well.

Commissioner, you did too.

Let me just ask this question as a kind of a—in terms of being provocative, not necessarily expressing my view of it, but just to take an extreme position, what difference should the privacy issue make before the information gets to the IRS?

If I want to go out with some private company—with Mr. Harrison's company or somebody else—sell it, let him use it, if I know that he is using it, if he wants to tell me that that is my business, or my problem, perhaps, but until it gets to you, until it is transmitted through the Internet or electronically to you, what concern do you have about that?

Mr. ROSSOTTI. Well, I think that is definitely a broad policy issue that has been probably thrashed out over the years. But in that policy-making process which is incorporated in, you know, Section 7216, which is the part of the regulation that regulates tax preparers—this is way before there was an Internet; this deals with tax preparation business—I think the policy decision was made—and this is long before I was here—that in this sense, the people that prepare tax returns are part of the tax administration process and that there are some protections that need to be established for the taxpayer as to how their data would be used or not used. And those policy decisions were incorporated in—you know, and they have been long-standing policy decisions that have been in place in business for a considerable period of time.

And I think—you know, it is interesting that those were made before. You know, I think in recent years the issue of privacy has become a greater public concern, or at least it has been expressed more vocally; and yet, you know, even prior to this time, there was a reasonably strict regulation—actually quite strict regulations that were established to protect taxpayer data even while it was in the hands of people who prepare the data.

In a sense, the tax preparation industry is, I guess, viewed in that sense as part of the broader tax system. And certainly we view it that way. We view tax preparers as very important partners; the tax system wouldn't work without them. But there is a balancing act there that has been established in the form of this policy. As I see it, our role at the IRS is simply to administer that policy the best way we can. And certainly if there are those issues that arise because of technology, we would have to try to find answers to those.

So the policy is pretty well established.

Mr. KOLBE. So the policy is that tax preparers are guided by certain requirements of protecting the privacy even though they are in the private sector and that is before the information is transmitted to you.

So, Mr. Harrison—now, the others can comment on this as well—did you agree with that? And if you do, it is pretty obvious how a

tax preparer that does it not electronically, or even electronically now, and I walk into their office—just use a name—an H&R Block, when I walk into their office, it is pretty obvious how they get their compensation; they charge me a fee for preparing my return.

You are talking about a system where you don't do that, where it could be done free, which means that you have got to get your financial reward in some other fashion. How do you do that and protect the privacy at the same time?

Mr. HARRISON. Well, first off, we agree with the assessment that the Commissioner has stated regarding the privacy provisions. I would say that there is a question—while we plan fully on following those, there is a question as to—it is wrong for us to say, It is our data; and I think it is wrong for the IRS to say, it is their data, because in the end it is the individual's own data and we must not to lose sight of that.

However, in our business model, we really are focused on the fact that there are \$146 billion of tax refunds that are issued each year. And the consumer is very concerned with convenience and very motivated by convenience. We want to make it convenient for the consumer to put those refunds to their intended use whether that is putting them in touch with a merchant where they can buy a product from that merchant, whether it is putting those funds into an investment account of some type, whether it is getting a loan against those funds. Whatever it may be, that is how we are focused on our business model.

We do not need to use taxpayer's individual data to do that. We are not going to be looking at how much money they make. We are not going to be looking at what type of deductions they have, how many children they have, anything of that nature.

I would say that if there is one thing I would request that the IRS look at, it is the use of electronic signatures. The regulations are currently written to require an actual written signature, assuming that people are in tax preparation offices. That does not work in the electronic world.

The IRS has made great strides in allowing taxpayers to file paperless returns. I think the next thing they need to be able to do is to allow the individual to use that code that they create electronically to allow companies like ourselves to use that data for other means.

Mr. KOLBE. I don't want to lose the thread of what I was talking about here about—according to your testimony, you are well on the way to solving that problem; are you not?

Mr. ROSSOTTI. I think what Mr. Harrison is saying, we are well on the way to solving it with respect to the things that have been of most concern in the past, up to now, which is having taxpayers file their return electronically and having to send in a separate piece of paper with a signature. That problem is going to be stopped as soon as this current season.

Mr. KOLBE. So they will not have to send in a separate piece?

Mr. ROSSOTTI. They will not have to for the purpose of filing their return.

But what I think Mr. Harrison might be referring to—correct me if I am wrong—is what would be required for a taxpayer to give

a firm permission to, for example, market some other service or use their name in some other way.

Mr. KOLBE. Directly to the individual?

Mr. ROSSOTTI. In other words, the taxpayer under the rules—the tax preparer is not allowed to use the taxpayer's information in any way, shape or form to market without their permission, without a physical signature—

Mr. KOLBE. Oh, without a physical signature.

Mr. ROSSOTTI [continuing]. For that purpose.

Mr. KOLBE. Okay. And, Mr. Harrison, you are saying that that is the area where the signature issue has to be addressed?

This is in the rules governing tax preparers, I gather.

Mr. HARRISON. Yes. We believe that is the main thing that needs to be addressed.

We believe there are ways over the Internet of ensuring that it is a legitimate signature. We would sign up for all of the audit provisions where people come in and audit, that we are actually receiving these signatures, before we use the data; but clearly that hurdle does have to be overcome.

Mr. KOLBE. So this is the kind of signature you would get at the time somebody comes in or comes through the Internet, contacts you to do their return, you prepare the return and file it. You would get it, and that is the way basically you get the compensation for your company; once you have that signature on file, you can then market the information not about their tax return, but only about making available information about how they could use their refund; is that right?

Mr. HARRISON. Right. We have ways now, we have a revenue model that is not totally dependent on that signature. There are things we can do within the rules that do not require that signature. However, not being able to get that signature electronically is actually going to force misuse of that data.

Earlier there was a reference to H.D. Vest. They wanted to use the personal data to help people do financial planning and to turn them over to a real-person financial planner. Because of these regulations, what they did—and we don't approve of what they did, but what they did was, they had a taxpayer go to their site and they said, We would like to collect your personal financial information; and they did that up front in the context of a financial planner.

Then they said, by the way, we will use that data to fill out your tax return. So they somewhat sidestepped that regulation by collecting the data first and doing the tax return second.

We don't think that should have to be the case. We just feel there needs to be a way to facilitate a signature in the electronic world.

Mr. KOLBE. The business you are doing seems to be posing some very interesting questions. And I have no objections to it; I think it is very good for the consumer. But it is interesting, I would not—if I were XYZ Investment Company, Brokerage House, I would not be able to go to the IRS today and say, hey, I would like to buy a list of everybody that is getting a refund, just so I could do a mailing to them. I don't want any other information about their return; I just want a list of everybody who is getting a refund, but

I would like to contact them about a way in which they could put that money to good use here.

Mr. HARRISON. That clearly is not our intent. What we will do at the end of a tax return is tell the taxpayer that there are various things you can do with this refund. If you would like, you can get a check from the IRS. If you would like, we have a relationship with X Brokerage Company; we can electronically deliver that money directly to an investment account.

But consumers will always be given the option of what they want done. We will not supply the names in that context.

Mr. KOLBE. Mr. Lacijan, you spoke a couple times in your testimony about the problem of trust. And I wonder if you would talk about that a little bit, in what you see as the relationship between the electronic tax preparation industry and the Internal Revenue Service.

Is trust an ongoing problem that we haven't solved or figured out yet, or how are we doing in that regard?

Mr. LACIJAN. Just a little side comment first: If the IRS could sell the names of everybody getting a refund, the need for future appropriations would go way down.

I think the discussion at the table has confirmed my testimony that the RFI has caused some confusion in the marketplace, and we are not quite up at the partnership level yet. Certainly, I think there are things we need to work together on to overcome that. I think there needs to be very open communication on both sides of the issue from IRS to industry and industry back to IRS. ETAAC certainly is one way to do that.

There are industry groups that exist in addition to ETAAC. But clearly industry dislikes uncertainty. You can't expect someone to invest millions of dollars in a concept for a product and then find out 6 months after that the IRS is going to offer the same product for nothing. So there clearly needs to be a sense of openness in terms of what IRS is planning to do and what they expect the private sector to do.

Mr. KOLBE. Is the IRS making good use of ETAAC, of the Electronic Tax Administration Advisory Committee? How do you feel the relationship between, if not the whole industry and IRS, between at least your advisory committee and the IRS has been?

Mr. LACIJAN. I think among some of the members the issuance of the RFI after we made our report caused some concern that their advice, the advice we gave in the June 2000 report, wasn't being followed; that they would have expected that IRS would not have issued the RFI in light of the recommendations in the ETAAC report not to pursue a public policy to have IRS offer its own e-filing product.

This was in the belief that the RFI was leading to the IRS offering its own product. So I think that is part of the confusion of which I spoke.

Mr. KOLBE. Commissioner, I gather you would say this is a misunderstanding?

Mr. ROSSOTTI. I have acknowledged—first of all, I believe that—as I have tried to do very diligently, I think, with almost all of our stakeholders, all of our stakeholders, I do believe there is an important relationship in trust and open communication.

Every once in a while, I have to concede, it breaks down for whatever reason; then we have to repair it.

But with respect to this RFI, there has been a miscommunication. It was not our intent, you know, to do anything other than solicit industry views about how we could promote the objective of reducing the cost and making electronic tax preparation more available over the Internet. It is not, I think, anything more than that.

There are certainly things some people probably said that could be interpreted that way. My purpose—one of my purposes here today was to try to clarify that and to make it clear that was not the intent.

I think that we do have to acknowledge that while we have to have a good relationship and an open relationship, that there are different views within the industry. I think we have heard some of them here today. And there is a question, I think when you were just coming back, that Mr. Hoyer asked me: Is there a gray area?

I don't think there is a gray area about what the IRS' role is in terms of providing services, because I don't believe that we should provide tax preparation services or tax software.

I think where the question might arise is with respect to the part of the law that says we should provide incentives and encourage, quote, "robust competition"; you know, what it means, what that means exactly, is open to some interpretation. And I think that we do have a commitment to work with ETAAC to get their input and their advice that, I think, has been very good in the past. I don't see anything in their June 30 report that I don't agree with. As a matter of fact, they indicated, in two years they might reconsider and get into some sort of a product. I think that could happen.

But that is a thing that they propose. I would be very skeptical of even that, because I don't really see that that kind of an approach. I think that would be getting the IRS further even than I would want to see us get into.

So I do believe that there is a need to, every once in a while, improve communication where it breaks down. I think there might have been some confusion that we created here. But, you know, one of the advantages of this hearing is that it helps to clear that up.

Mr. KOLBE. If we can do at least that I would appreciate that. Yes, Mr. LaciJan.

Mr. LACIJAN. As a the follow-up, I think in the three years that Commissioner Rossotti has been commissioner external stakeholders would give him very high marks for outreach.

Mr. BLACK. Mr. Chairman, first, I would like very much to associate myself with the comments of Mr. LaciJan. I think it is important we remove the cloud. We want the trust. We very much want to work in partnership with the IRS. Right now, we do have this cloud of uncertainty hanging over us, and while you were gone we talked about how the language—

Mr. KOLBE. Excuse me for interrupting. But do you see that cloud as being created by this RFI?

Mr. BLACK. Tremendously so. There were statements made by IRS officials which were reported in the press that basically used the terms RFI and RFP interchangeably over the course of a whole industry conference. In addition to that, with the President's budg-

et submission, the fact sheet of the IRS itself for this year's budget said, "the IRS could implement this option by issuing a Request for Proposal to the industry requesting vendors to submit proposals that would meet these requirements." So there are out on the record indications that indicate there is some intent of the IRS to move this way.

But the Commissioner made some very useful, strong statements today; and if we can take some of that, in essence, as a pledge they are not moving in that direction and if, frankly, the committee would adopt the ETAAC recommendation to signal in its language accompanying Treasury-Postal appropriations that there should be a two-year moratorium on the IRS moving into this area, that would remove the cloud.

We would say that it is not going to happen. They will have been told it will not happen. There is a moratorium.

Now let's sit down together and work and really make electronic filing, make e-government work well and smoothly for the taxpayer and not worry about this issue, whether they will compete directly or indirectly with the private sector. I think you would provide a great service by clarifying that, removing for everybody that issue from the table.

Mr. KOLBE. I want to follow up. It looked like, Commissioner, you wanted to make a response.

Mr. ROSSOTTI. No.

Mr. KOLBE. Let me ask the three people from the private sector, if this happens and if we can remove these doubts or uncertainties here, do you think the market is much greater even than what we have seen today? The Commissioner said 150 responses to the RFI so far. I think some of you have indicated there was low industry response to the RFI.

Mr. ROSSOTTI. At the time I think of the original date it may have been too tight a date, and we didn't get that many. We just extended that a little bit, and we got a lot more responses.

Mr. KOLBE. So you are getting a lot more responses. Do you think this field—we haven't even touched the field yet in terms of the amount of competition that is possible out there in the marketplace. Mr. LaciJan.

Mr. LACIJAN. I think that is true. Let me give you one example. I don't know of anything specific in the works, but in my much younger days I can remember when banks gave away free toasters for signing up an account. The new economy version of that would be for a bank that is offering online banking saying, if you bank with us, As a competitive edge, we will allow you to access a tax prep product for nothing and facilitate technology just as part of our normal service. That is kind of a normal model that could easily be just around the corner. That is one example of how the marketplace might react to provide more e-filing for nothing.

Mr. BLACK. Mr. Chairman, if I could, a robust private sector is I think what we have, what we all say we want, and I think it is important to remember when we talk about competition with the IRS I think we interpret the language of promoting robust competition slightly differently. Because in our mind that means let the dynamic of the marketplace work, and if the marketplace's dy-

dynamic is really working well you will have competition, you will have innovation. That is what really does it.

What hurts the marketplace is an attempt to artificially jump in and interfere with it, and that is where there may be some worry that, in an attempt to help it, you can have collateral damage in the different dynamic in the marketplace. We see lots of examples—it's not just taxes. It is a whole package of financial services offered on the Internet electronically, many other companies who don't care about the IRS. But, in fact, we see a lot of different people, lots of people packaging different kinds of services in a wide range of ways. But people will not be anxious to create and investors will not be anxious to invest in companies if they think they will be competing against a branch of the U.S. Government. That stifles the dynamic marketplace, not helps it.

Mr. KOLBE. Thank you.

Mr. Harrison.

Mr. HARRISON. I would just question the assertion that there is dynamic competition that exists today.

Mr. BLACK. You are it.

Mr. HARRISON. As I previously stated, for 12 years there has only been two companies that have survived in this sector. I know of at least three companies that entered the online tax preparation business last year that will not be coming back this year because of how difficult it is to survive. I would say the biggest cost associated with this business is acquiring the customers.

Mr. KOLBE. I am sorry. Is what?

Mr. HARRISON. Acquiring the customers. And the IRS can play a significant role in helping us acquire the customer while they are achieving their goal of the 80 percent electronic filing. That is where we really believe the effort has to be in helping people in the industry succeed, and that is going to require the IRS be proactive and not just sitting on the sidelines and watching people come into this industry and fail because they can't provide an economic model that works.

Mr. KOLBE. Why is it that difficult to acquire customers? I mean, unlike some other things, we know that every April 15 or somewhere between January and April every single one of us who is out there working is going to file a return. It should be a nice market base to work from.

Mr. HARRISON. Well, we live in this industry, and it is amazing, until you do consumer research, you don't realize how little people know about what we do every day. But if you get a focus group together and you sit down and talk to people, most people don't even know that financial software exists for doing their taxes, and it has been around for 15 years, let alone do they know that there is an option of electronically filing it. And surely they don't know there is an option for doing that for free.

So there is an awareness capability here, and the IRS has the credibility and ability of creating that awareness very quickly because they touch every one of those 125 million homes that has to file a tax return. I can guarantee you that a mailing from the IRS explaining this to consumers will get a lot more attention than a mailing from freetaxprep.com.

Mr. KOLBE. Let me turn to Commissioner Rossotti.

Commissioner, what do you see as the IRS role in terms of educating your filing public about the options that are available to them?

Mr. ROSSOTTI. I think this is really the essence of it. Because, as I see it, I don't see any value or benefit to us either by directly or by contract actually offering these services. On the other hand, I do see a value potentially. We need to get people's ideas of how this should be best done, of letting them know what the options are and helping to educate them, perhaps through our Web site, perhaps through our marketing program. That is what we really were asking for, as I see it, through this RFI: What can we do?

I would categorize that under the category of providing incentives and pressing for robust competition. I would not think that just standing by is consistent with the mandate we have that says to press for robust competition. We could do that, and we could just stay and say we'll see what happens. I think the ETAAC report said we should—part of the recommendation was that we should promote competition, which is the same thing that the law says.

There might be some disagreements about what that consists of. People could say that interfering with the private sector, if we do anything, to even let people know that there are options out there—and I don't think I would go that far. I think that wouldn't be consistent with our mandate.

That is a long way of us getting into the business of either providing software directly or through contracts. That is why I have no hesitation in saying that is not our intent. There is potentially, I would say, some disagreement that could arise about what it would mean for us to take any initiative based on whatever input we got from the industry to actively inform the public or let them know what the options are that they would have to get better services at lower costs.

Mr. KOLBE. So you do see marketing the options as one of your functions, one of your roles.

Mr. ROSSOTTI. I could see that would be one of our roles. I think that is what it says we are supposed to do. We already do that now, but in a very, very general way. I think Mr. Harrison said maybe there is some more targeted or concrete way. We are not the experts on figuring out how to market products or how to let the public know. We are interested in getting the industry's views on that.

Mr. KOLBE. Mr. Black.

Mr. BLACK. We think there is a lot of benefit in making more people aware of the benefits of electronic filing, and I think the very fact that Mr. Harrison stated that there is such a large number of people who don't avail themselves of this service is a great indication that there are great market opportunities for companies to market to that. But I do think we have to be careful how we will support going out educating consumers. It is important that the government—again, there is a winner-and-loser issue—not do it in a way that is not balanced and fair and evenhanded.

If all of sudden they say we are going to highlight a couple of companies over other companies or a certain kind of service over another service, we can get into very dangerous territory. But, yes,

I think as long as it is truly, evenly balanced I think there is a great role in promoting the benefits of electronic filing.

Mr. KOLBE. Final question—at least I think this is my final one. Mr. Harrison, you spoke about the need for doing something about changing the rules, regulations with regard to the signature that allows you to be able to have access to the market information, from a marketing standpoint, the information that you have about tax, the tax preparation and the filing that you are doing. I would like all of you to comment on whether or not there are other areas where—and the Commissioner as well—where we need to make changes in either the rules or regulations or in the law to make this work better than it is right now. In other words, what can you tell us that we should be looking at here in Congress to make sure that we are moving towards a world of electronic tax filing that we are not now doing?

Mr. HARRISON. The only other thing I would add—and I would say it is a gray area right now—but it is very difficult especially to build a business plan for a new company when there is this gray area that you are trying to work around. We don't think there is a huge amount of advertising revenue associated with this business, but there is some. Right now, it is not even clear if you can run an advertisement on a Web site that does tax preparation. That is no different than telling someone that has an H&R Block office that the person next door to them can't have an advertisement outside because someone will walk past it to get to the tax store. We are a store, a virtual store but we are a store. And not being able to have advertisements that are not driven by the consumer data—not just general purpose advertisements—not being able to have that on your site—

Mr. KOLBE. You are not talking about advertising about your business. You are talking about other kinds.

Mr. HARRISON. Other kinds—third-party advertising—for example an advertisement on our site that shows someone doing a tax return and drinking Coke instead of Pepsi.

Mr. KOLBE. The regulations now prohibit that or you are not sure?

Mr. HARRISON. It is a gray area.

Mr. ROSSOTTI. This is what I meant before. I think the regulations are out there. We certainly have the obligation to enforce those and administer those. There are some new questions as to exactly how to interpret them in the light of Internet that we probably need to work on.

Again, we need to get some questions from the industry. This is another point. Any conclusions that the IRS would come to with the help of counsel would in all cases, as is required by law, be public inclusions that we would put out in the appropriate forum, not in the forum of any particular company, giving advice to any particular company. They would be public statements that would answer questions for everybody to know what the answers were. That is the way the process works.

Mr. KOLBE. Mr. Black or Mr. Lacián, anything we are missing here that we should be looking at from either a regulation or law change?

Mr. BLACK. Mr. Chairman, I think it is an excellent question. And to follow up on the Commissioner's comments, we think that updating rule 7216 is exactly what we have been advocating, that in fact the IRS should conduct a public rule making process to update and modernize the rule to deal with the e-commerce era. Public rulemaking would permit full public comment, sunshine, and let consumers' rights really be aired. We need to modernize the rule. It needs to be done in a way consistent with the President's e-commerce policy directive for all agencies, and that is what we have been asking for. We think that is the way to go. Not requests for information and quasi procurements, but let's go through a formal, public, sunshine rulemaking.

Mr. KOLBE. Mr. Lacijan.

Mr. LACIJAN. To avoid repeating what some of the other panel has said, let me take it to an entirely different area.

The ETAAC strongly endorsed the President's proposal for a \$10 tax credit. Now that has some expense associated with it, but clearly, in terms of public policy, we are talking in terms of potential tax cuts in the billions and almost a trillion dollars. This would cost about half a billion a year. But, in essence, the repeat rate among e-filers is very high. The satisfaction rate as measured by public surveys of e-files compared to other files is also in the 70s, compared to around 50 percent. It would build up a tremendous demand for e-filing that would allow practitioners to build up infrastructure, and I think it would have a tremendous impact on making the whole tax administration system run far more smoothly by getting all this information in electronically. In the end, I think actually it would be worth the expense of the half a billion dollars it would cost.

Mr. KOLBE. That leads to an—I said final question, but it leads to an interesting thought, Commissioner. Have you done any cost-benefit studies of this to say for every 1 percent additional electronic filing what the IRS can save, what taxpayers can save? Do we know?

Mr. ROSSOTTI. What taxpayers can save, no, we have not done that, but what we can save, yes.

Mr. KOLBE. I am sorry. When I said taxpayers I meant through the IRS, not individually.

Mr. ROSSOTTI. In terms of direct cost, we have estimated what that would be on a per-term basis. There is short-term cost savings for every return next year, just in terms of the labor. But then there is a bigger cost saving if we get to the point where we have a sufficient volume that we can consolidate some of our activities. So we do have that information, and it is attractive. It is one of the things we are counting on to be able to deliver all of the services that taxpayers want within the limits of the appropriations because we know there is going to be limited appropriations and so we have to make technological improvements. So that is one of the things we are counting on to be able to deliver over the next years.

Of course, it happens year by year. It does not happen all at once. It happens as we gradually convert people from paper to electronic.

Mr. KOLBE. So the \$10 tax credit really ends up being a cost savings.

Mr. ROSSOTTI. You aren't going to save \$10 per return. I think the \$10 tax credit was intended for a limited period of time. I think it was for five years. I characterized it lightly as kind of an introductory offer. As Mr. LaciJan said, once they do it electronically they will probably not go back to paper. I think the thought was to get people into the electronic system with this incentive for the \$10 to offset whatever transitional costs they have might have; and then once they got on, and especially if the cost to the taxpayer after that were to come down, then it would make it attractive for them to stay. So I don't think it was intended as one for one.

Clearly, we are not going to save \$10 directly in internal appropriations, but I think that would be a one-time kind of a thing for just a few years to get people into it. Then once you got them there—but I really think the problem is getting them. Once they get there, and assuming the cost to them is reasonable, they are probably not going to go back to filing on paper.

Mr. KOLBE. Mr. LaciJan.

Mr. LACIJAN. What the Commissioner said is very true. But the real cost savings might not just be the few dollars per return that the IRS saves. It has been well publicized that the error rate for paper return is about 20 percent and for electronic returns is 1 percent. So some of those 20 percent of the errors that paper returns introduce that don't get caught filter into notices downstream, and a lot of man hours get spent resolving notices and people going to practitioners. So the real cost savings, which probably are undocumented, are downstream after filing occurs.

Mr. KOLBE. Gentlemen, thank you. Is there anything I haven't asked that I should have asked? Is there anything you would like to say in closing that I have not given you an opportunity to say?

If not, I would like to thank all of you. I think this has been, for me, extraordinarily enlightening. I hope this has been one of those hearings where we actually contributed something in a tangible way to maybe clearing the air a bit between the industry and the IRS, and I hope we have helped to stimulate the communications. I want to thank all of you again for coming and participating today.

Mr. BLACK. We appreciate your leadership. Thank you.

Mr. KOLBE. The subcommittee stands in recess.

**QUESTIONS FOR THE RECORD SUBMITTED BY
CONGRESSWOMAN ANNE NORTHUP
TREASURY/POSTAL SUBCOMMITTEE
Hearing on the Electronic Tax Administration
October 3, 2000**

Internal Revenue Service

Question 1: You have stated that the IRS has no plans to provide or offer electronic tax preparation services to the public. However, in the IRS language in the FY01 Budget, and in your own procurement announcement earlier this year, the agency specifically states that its objective is to "provide" free electronic tax preparation and filing services to the public and to "offer" one or more such options to consumers by no later than 2002. Since those words are from the agency's own official documents, is it your testimony that the agency's meaning has changed, or that those words mischaracterized the agency's intent from the outset?

Answer: The IRS does not intend to offer Internet preparation or filing services itself in any form, nor do we plan to contract with a limited number of private companies to provide these services indirectly. In fact, the IRS is planning to work closely with the private sector to find ways to achieve the free electronic filing objective. In particular, we will consult extensively with the Electronic Tax Administration Advisory Committee (ETAAC) on any policies we may be considering before we implement them.

It is also important to note that we have not begun any sort of procurement. We used the Request for Information process to solicit and obtain information -- to ask industry for suggestions on how the private sector might offer low-cost or free tax preparation and electronic filing over the Internet. This action was consistent with the provisions of the IRS Restructuring and Reform Act of 1998 (RRA 98) concerning promotion of robust competition in the industry and the potential use of incentives to make *e-filing* more attractive and to reduce the cost to taxpayers.

Question 2: You have stated that the agency "plans" no further action after this RFI procurement process you have just conducted. However, the RFI document itself tells the public that:

The IRS plans to issue a subsequent solicitation for purposes of identifying organizations who are willing to offer free tax preparation and electronic filing via the Internet in exchange for some combination of monetary or non-monetary consideration.

Should we interpret your comments today to mean that the IRS previously had plans to

go further, but that you have abandoned those plans and now will take no further action on this?

Answer: Our plan was and is to solicit input from the industry on this matter and then, based on those comments and in careful coordination with ETAAC, consider appropriate next steps. In fact, we are currently analyzing the responses we received from the RFI and intend to share that analysis with the ETAAC at its December meeting and make it public after that. Any action we take based upon the responses to the RFI will be designed to encourage and facilitate the availability of electronic filing options and ensure that all taxpayers have access to electronic filing options.

Question 3: The Congress has received a letter today from a large number of current and former members of the Electronic Tax Administration Advisory Committee. That letter states that they repeatedly advised the Electronic Tax Administration not to pursue their E-Commerce agenda, but that they were ignored as the ETA went ahead with their procurement anyway. Why do you believe the ETA ignored this advice and do you feel the advisory committee should continue to exist or be dissolved?

Answer: The ETAAC, which was established by RRA 98, plays a vital role in Electronic Tax Administration and should be continued. We have every intention of acting in concert with ETAAC as we seek ways to reduce barriers to electronic filing. We take ETAAC's advice very seriously. In fact, Commissioner Rossotti quoted from its June 30, 2000 Annual Report to Congress as evidence of the sound guidance that the Committee gave the IRS on this matter:

"In support of the goal of no-cost e-filing and tax preparation over the Internet, the ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of low-cost and no-cost tax preparation and filing options over the Internet are to continue to 1) encourage competition, 2) seek industry views on which barriers inhibit lower-cost to no-cost private sector supplied options, and 3) stimulate electronic filing through its creative advertising campaign and make electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper.

"The ETAAC also recognizes that the Internet changes rapidly and business models are in constant evolution and even revolution. The ETAAC believes that a re-assessment of the marketplace should be made in two years to assess whether the range of choices for electronic filing over the Internet includes no-cost options for taxpayers. If no-cost choices do not exist, the ETAAC believes that the IRS would then be justified in evaluating, in conjunction with the ETAAC, whether an electronic template, or other approach, is an appropriate and needed tool to promote no-cost e-filing over the Internet...."

Consisting of representatives from various groups including, tax practitioners and preparers, transmitters of electronic returns, tax software developers, small and large businesses, employers and payroll service providers, individual taxpayers, state governments, and financial industry members, the ETAAC provides valuable and continuing input on the development and implementation of IRS' strategic plan for Electronic Tax Administration. We will continue to work closely with ETAAC in the coming years.

It is also important to point out that the IRS is seeking information, not conducting a procurement. The IRS issued an RFI to solicit industry opinions on how the private sector might offer low-cost or free-tax preparation and filing over the Internet. This was not the first step in a procurement process. It was an effort to get the best information possible to enable us to develop productive ways of reducing barriers to electronic filing and promote robust competition as required by RRA 98.

**QUESTIONS FOR THE RECORD SUBMITTED BY
CONGRESSWOMAN JO ANN EMERSON
TREASURY/POSTAL SUBCOMMITTEE
Hearing on the Electronic Tax Administration
October 3, 2000**

Internal Revenue Service

Question 1: If at least four private companies now provide or will provide in 2000 free online tax preparation and free e-filing of some or all 1040 forms, why is there any need for additional government-sponsored services? How many providers of free services are needed for "robust" private-sector competition?

Answer: "Robust private-sector competition" cannot be defined solely in terms of the numbers of providers. The IRS believes that it also involves additional factors such as:

- taxpayer segments that are served and the choices available to these various segments;
- access to the service, or in other words, a taxpayer's ability to take advantage of the service;
- quality of the service;
- relative size of the competitors within the market; and
- trends in the marketplace.

It is also important to note that the IRS has no preconceptions about whether additional government sponsored services are needed. That is why we plan to work closely with the ETAAC to develop any policy recommendations in this area.

Question 2: Does OMB Circular A-76 offer any useful guidance in defining those services which are appropriate for government and those which are appropriate for the private sector? Is there a principled way to draw such lines?

Answer: OMB Circular A-76 and associated implementing instructions give general guidance to agencies in determining which specific activities are commercial (and can be contracted out) or governmental (and cannot be contracted out). There is no specific guidance directly bearing on the subject of tax preparation software or electronic filing. Agencies have the authority to determine which activities are "inherently governmental." A principled way to make such a decision requires careful judgment on the applicability of OMB's general rules to the IRS' specific activity.

Question 3: A recent poll by the Council on Excellence in Government reported by the *Washington Post* (9/29/00) found that 66% of 1,003 adults were "extremely concerned"

about hackers breaking into government computers and 55% were "very concerned" about government employees misusing personal information. Given a recent GAO study that found privacy deficiencies in government web sites, what assurances can you provide that a government web site for online tax return filing won't be a risk?

Answer: The privacy of taxpayers is of utmost importance to the IRS. We are devoting considerable resources to evaluate security and privacy concerns in every aspect of electronic tax administration and to ensure that taxpayer information receives the highest levels of protection. It is also important to note that the IRS does not plan to offer individual tax preparation or filing services over the Internet in any form. In addition, the current IRS web site, the "Digital Daily," does not contain confidential taxpayer information. That being said, the IRS is committed to developing systems and processes that comply with stringent government security standards to adequately protect the confidentiality of taxpayer data. At this point in time, however, the confidentiality of information transmitted over the Internet cannot be guaranteed, which the IRS informs its visitors through its web site privacy notice. The privacy notice also advises web site visitors that the IRS will not use the Internet to transmit personal information such as account-related or refund information. To provide confidential information over the Internet in its current state would place such information at risk and therefore the IRS will not do so.

Question 4: If the IRS sponsors online filing, do you believe that will lead to comparative advertising in which a bare-bones government program is contrasted with a value-added private sector product, and in which IRS difficulties in reliably answering the phone, protecting taxpayer privacy, and being on the side of the taxpayer will all be called into question? Would such comparisons hurt the IRS' image that you've worked so hard to repair?

Answer: Because we do not intend to compete with the private sector, it is very unlikely that comparative advertising of this nature will occur. Working with ETAAC, we intend to follow the provisions of RRA 98 concerning promotion of robust competition in industry and the potential use of incentives to make *e-filing* more attractive and to reduce the cost to the taxpayer.

QUESTIONS FOR THE RECORD SUBMITTED BY
CONGRESSMAN STENY H. HOYER
TREASURY/POSTAL SUBCOMMITTEE
Hearing on the Electronic Tax Administration
October 3, 2000

Internal Revenue Service

Question 1: What message, if any, is the IRS getting from taxpayers or members of Congress who represent constituents who e-file or want to e-file? Specifically, are there complaints about the cost?

Answer: Taxpayers are concerned that they cannot use e-file for free. Since March 1999, we have received approximately 15 letters from constituents of members of Congress that complain specifically about the cost of electronic filing.

Question 2: In the written testimony, it states that the IRS has no plans to enter the marketplace with its own product. If competition in the marketplace does not yield a "no-cost" option for taxpayers, would you reconsider entering the marketplace? What type of resources would the IRS need to do this?

Answer: At this point in time, no-cost options do exist and therefore, we see no need to even consider such an option.

Question 3: Please explain why the IRS issued a Request for Information (RFI) concerning electronic filing on the internet? What has been the response to this RFI?

Answer: It is the IRS' intent to follow the provisions of the law concerning promotion of robust competition in industry and use of incentives to reduce the cost of electronic filing and make e-filing more attractive to taxpayers. The IRS is seeking information, not conducting a procurement. The IRS issued an RFI to solicit industry opinions on how the private sector might offer low-cost or free-tax preparation and filing over the Internet. This was not the first step in a procurement process. It was an effort to get the best information possible to enable us to develop productive ways of reducing barriers to electronic filing and promote robust competition as required by RRA 98. We asked industry for suggestions as to how to accomplish this objective. We received approximately 160 responses to the RFI which are currently being evaluated.

**QUESTIONS FOR THE RECORD SUBMITTED BY THE
TREASURY/POSTAL SUBCOMMITTEE
Hearing on the Electronic Tax Administration
October 3, 2000**

Internal Revenue Service

Question 1: Please summarize what electronic methods are currently available for filing tax returns with the Internal Revenue Service?

Answer: Taxpayers can file electronically in one of three ways: through tax practitioners, directly from a home computer, or over the telephone. A number of private companies play a role in this process, as shown on the attached chart. One thing that is common to all forms of electronic filing is that a return must be prepared electronically in order to be filed electronically and it is the combination of the electronic preparation and filing that creates much of the benefit of the process.

In the first option, the taxpayer goes to a tax professional who is authorized by the IRS to file returns electronically. This individual is also known as an Electronic Return Originator (ERO). In most cases, these tax professionals prepare the taxpayer's return using software they purchase from a variety of software vendors and then transmit it to the IRS on the taxpayer's behalf. In the last filing season, 25.2 million individual returns were filed by this method.

As shown in the chart, most tax professionals who electronically file returns for taxpayers send their returns to bulk transmitters. These bulk transmitters are defined as companies who transmit over 1,000 returns to the IRS. Usually, they are the same firms that provided the tax preparation software to the preparer. There are 58 firms who act as bulk transmitters nationwide. Last filing season, there were over 77,000 active EROs, and of these, 60% (over 46,000) utilized bulk transmitters and the rest (31,000) utilized over 5,300 direct transmitters to get the returns to the IRS.

The IRS does not charge a fee for electronic filing. However some EROs charge a fee for this service to taxpayers, while others offer it free of charge or include it in their tax preparation fee. Most companies that provide software and transmission services to practitioners charge a fee to the practitioner for transmitting their returns to the IRS.

In the second option, taxpayers prepare returns on a personal computer using commercial tax preparation software. When the return is completed, the taxpayer transmits the information by modem to a bulk transmitter, usually the company that provided the tax preparation software, which in turn transmits it to the IRS.

In a recent variation of this process, some providers now offer tax preparation services over the Internet. In this process, the tax preparation software resides on a web site. The taxpayer signs onto the web site, uses the software to prepare the return, and then requests that it be sent to the IRS. The operator of the web site collects the returns and transmits them to the IRS.

Last year approximately five million taxpayers filed their returns through their home computer, almost double the previous year's volume

Tax software providers sometimes charge a separate fee for transmitting a return to the IRS, but increasingly these fees are being included with the purchase cost of the software or the fee for use of the software on the web site.

The third option is TeleFile. This is an interactive program that allows qualified taxpayers to file simple Federal returns (Form 1040EZ) electronically using the TeleFile toll-free number and a touch tone phone. A personal computer is not necessary. Only those taxpayers receiving a TeleFile booklet in the mail are eligible to use this option. Last season, almost 5.2 million taxpayers filed through TeleFile.

Question 2: What are the next steps the IRS plans to take to further facilitate the electronic filing of tax returns and when do you anticipate those steps occurring?

Answer: There are two components of our plan. One is to continue to solicit feedback from tax practitioners, software companies and taxpayers about electronic filing and respond to that feedback by modifying existing products and adding new ones. The ETAAC assists us in evaluating that feedback and the resulting product plans are described in our strategic plan "A Strategy for Growth." The second component is to continue to use our marketing resources to increase tax practitioner and taxpayer awareness of the advantages and value of electronic filing.

Question 3: Do your electronic tax administration plans envision the IRS directly receiving tax returns from taxpayers via the Internet?

Answer: The IRS has no plans to receive tax returns directly from individual taxpayers over the Internet.

Question 4: To what degree are the Internet plans of the IRS dependent upon its computer modernization effort?

Answer: IRS currently offers informational services through our public web site, *The Digital Daily*. These services are not dependent on the modernization effort, and we will continue to offer them in the future. However, the IRS cannot develop Internet

applications today that use taxpayer data because we do not have the appropriate secure infrastructure to support those applications. Plans for increasing the use of the Internet as a tool to provide service to taxpayers is dependent on expanding our e-services capabilities and a secure infrastructure. Both of these projects are underway in IRS' Business Systems Modernization (BSM) program. IRS has committed the appropriate talent and management resources to these projects. They are dependent, however, on available funding from the Information Technology Investment Account.

Question 5: One of the modernization projects, the Security and Technology Infrastructure release (STIR) project, is to provide the security infrastructure foundation necessary for conducting business functions such as electronic services. Please comment on the GAO conclusion that this project needs to go through a rigorous assessment of security threats and vulnerabilities?

Answer: GAO was concerned that STIR should go through a rigorous security assessment. We are aggressively addressing its concern. STIR did not go through a formal Milestone 2 process that would have required the delivery of preliminary work products to include the Preliminary Security Risk Assessment and the Preliminary Business Case. Instead, the Business Systems Modernization Office determined STIR should focus on Milestone 3, which delivers the Baseline Business Case and the Intermediate Security Risk Assessment. The Final Security Risk Assessment is delivered at Milestone 4

The Security Risk Assessment is a living document that matures through the project's life cycle. At the time of GAO's assessment, these products were being developed; however, we have put increased focus on the quality, maturity and completeness of these documents for our upcoming Milestone 3 review. An important part of our focus is ensuring the products are consistent with the Enterprise Life Cycle and adequately address the most up-to-date architectural guidance. Additionally, as part of the normal Milestone 3 Readiness review, key stakeholders in the IRS Office of Security and the Chief Financial Officer's Office will review the contents of the documents to validate the requirements and reflection of the findings of the Security Risk Assessment in the business case. We will obtain our security certification prior to becoming operational.

Question 6: Staff from the Treasury Inspector General for Tax Administration recently informed the Committee of computer demonstrations, prototypes, and pilots being conducted by the Office of Electronic Tax Administration outside of the business systems modernization effort and the e-Services modernization project. Should these electronic tax administration efforts be incorporated into the larger business systems modernization effort?

Answer: Not necessarily. Comprehensive oversight and project management controls can be accomplished by implementing a modified Enterprise Life Cycle (ELC)

methodology for pilots and prototypes. The full ELC process is highly effective for large-scale, multi-year development projects, but would stifle the development of small-scale projects, such as demonstration projects, prototypes, and pilots.

The funding of Business Systems Modernization (BSM) projects comes from the Information Technology Investment Account (ITIA). A small amount of funding should be allocated to perform Research and Development (R&D) outside of BSM for computer demonstrations, prototypes, and pilots. Small-scale R&D projects that demonstrate system functionality, before investing large dollar amounts on production systems, are effective at capturing customer needs and determining technology viability, while having a small impact on budget.

Question 7: The Committee on Appropriations has responsibility for identifying those programs and projects under its funding jurisdiction that are not authorized. It is also the responsibility of the Committee on Appropriations to provide oversight to ensure that agencies are managing their projects efficiently and fulfilling Congressional intent. What are the Internal Revenue Service authorizations with respect to electronic filing?

Answer: Title II of the IRS Restructuring and Reform Act of 1998 is the IRS' principal authorization with respect to electronic filing.

Question 8: The report accompanying RRA 98 states that the IRS should continue to offer and improve its TeleFile program and make available a comparable program on the Internet. Do you envision the Internet proposal contained in the President's budget request as resulting in an Internet program that is comparable to your TeleFile program or will this Internet program extend beyond the TeleFile program?

Answer: Until we analyze the results of the RFI and review our findings with the ETAAC, it would be difficult to speculate on what approach should be taken.

Question 9: I note that the proposal to require the IRS "to offer one or more options ... for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer" is contained in the analytical perspectives volume accompanying the FY 2001 President's budget request rather than the IRS budget justification. Is the IRS seeking Congressional approval before it proceeds with the Internet proposal contained in the President's budget request? For what purpose was this proposal included in the President's budget request?

Answer: Some methods of facilitating free Internet filing through reduced private sector barriers do not require legislation. The proposal was included in the President's budget request as further indication of the Administration's efforts to press for robust private sector competition. In addition, we will work closely with ETAAC and the industry before developing any kind of policies or initiatives in this area.

Question 10: Why was this proposed action included in the analytical perspectives volume of the President's budget request rather than either the FY 2001 IRS budget justification or the accompanying FY 2001 IRS performance plan?

Answer: This proposal was not included in the budget justification or performance plan because it is a tax policy issue, not a budget request. Policy issues are not included in the budget justification, but do appear in the analytical perspectives because the Office of Tax Policy within the Treasury Department is the only party allowed to offer tax policy initiatives on behalf of the President of the United States.

Question 11: Why in the President's budget request was the Internet proposal linked to a proposed tax credit, which does require additional legislation?

Answer: The proposals were linked in the President's budget request because they were both intended to make electronic filing of income tax returns more attractive to taxpayers.

Question 12: The conferees of RRA 98 stated that the IRS should cooperate with and encourage competition within the private sector and that when disputes arise between the IRS and the private sector on the question of whether services offered by the IRS inhibit competition or are appropriate, the electronic commerce advisory group shall recommend to the Commissioner an appropriate course of action. Do you feel that the proposal to require the IRS to offer by no later than tax year 2002 one or more no-cost options for filing tax returns over the Internet promotes competition?

Answer: Yes, because the IRS planned to work closely with the private sector to accomplish this objective. We used the RFI process to ask the industry for suggestions on how the private sector might offer low-cost or free tax preparation and electronic filing over the Internet. As demonstrated by the over 150 responses that have been received, we believe that the RFI has stimulated interest within the private sector.

Question 13: At the end of July, the IRS issued a request for information to analyze the public and private sector's reaction to its Internet proposal. What type of response have you received from industry to your request for information?

Answer: Thus far, we have received more than 150 responses to the RFI. Some of these were very lengthy and so we are still in the early stages of the analysis. Our plan is to share the analysis with the ETAAC at their December meeting and make it publicly available shortly thereafter.

Question 14: What further actions are you considering with respect to your Internet proposal?

Answer: At this time, we have no plans beyond soliciting input from the industry on this matter. It is our hope that the responses will generate ideas for encouraging free electronic filing options and ensuring that they are accessible to all taxpayers.

Questions 15: What new information privacy impacts or concerns, if any, will result from using the Internet to communicate or transmit information?

The privacy of taxpayers is of utmost importance to the IRS. The IRS web site, the Digital Daily, does provide vast amounts of non-confidential information to taxpayers, such as the downloading of tax forms. At this point in time, however, the confidentiality of information transmitted over the Internet cannot be guaranteed, which the IRS informs its visitors through its web site privacy notice. The privacy notice also advises web site visitors that the IRS will not use the Internet to transmit personal information such as account-related or refund information. The web site discourages Internet visitors from providing personal information by stating that if the visitor does transmit such information, he or she is assuming the risk that an unauthorized person will learn his/her email address and any other personal information provided. For this reason the web site provides alternative avenues for sharing information. To provide confidential information over the Internet in its current state would place such information at risk and therefore the IRS will not do so.

Questions 16: Do you believe differences in data privacy requirements between commercial and government websites will affect IRS' ability to enter into or appropriately manage arrangements with the private sector for Internet tax filing?

The IRS is subject to Federal security laws and directives that do not apply to private industry. However, the differences in these requirements do not preclude private sector firms from providing secure tax-related services for the IRS. The government's privacy and security requirements may limit the number of private sector firms offering Internet filing to those providing or investing in the required safeguards (e.g., physical security including restricted access to facilities and computer rooms; personnel security including background investigations with fingerprint checks; and systems security features that prevent, detect and react to unauthorized accesses to taxpayer records by employees and others).

Question 17: What authority or responsibility does the IRS have over the privacy of taxpayer information gathered and held by the tax preparation industry?

Provisions of the Internal Revenue Code and Treasury Regulations that limit the disclosure and use, by all persons in the tax return preparation business, of information taxpayers provide to them in connection with tax return preparation and filing. (I.R.C. § 7216(a); Treas. Reg. § 301.7216-1). There are criminal and civil penalties for violations

of these limitations.

The Internal Revenue Code provides certain exceptions to such limitations on the use and disclosure of information provided by taxpayers in connection with tax return preparation and filing. See I.R.C. § 7216(b). The Code permits the use of such information to prepare, or to assist in preparing, the taxpayer's tax return. I.R.C. § 7216(a). The Code also permits disclosures of such information made pursuant to other provisions of the Code or pursuant to court order. I.R.C. § 7216(b)(1).

The limitations in the Code also do not apply to disclosures or uses permitted by regulations promulgated by the Secretary of the Treasury. I.R.C. § 7216(b)(3). Such regulations permit, for example, a tax return preparer who is a lawyer or accountant to use information provided by a taxpayer in connection with tax return preparation and filing to render other legal or accounting services. Treas. Reg. § 301.7216-2(e). The regulations permit certain uses of such information, within strict limitations, to solicit business unrelated to tax return preparation and filing. Treas. Reg. § 301.7216-3. The regulations also permit certain other limited uses and disclosures.

The Internal Revenue Code imposes criminal and civil penalties on persons in the tax return preparation business who violate the limitations on use and disclosure of information provided by taxpayers in connection with tax return preparation and filing. The criminal penalty for a knowing or reckless unauthorized disclosure or use consists of a fine of not more than \$1,000, imprisonment for not more than one year, or both, along with the costs of prosecution. I.R.C. § 7216(a). The civil penalty is \$250 per unauthorized disclosure or use, with a maximum penalty for each such person of \$10,000 per calendar year. I.R.C. § 6713(a).

Question 18: Would the IRS support "loosening" taxpayer privacy interests were that to be necessary in order to support its no-cost Internet proposal?

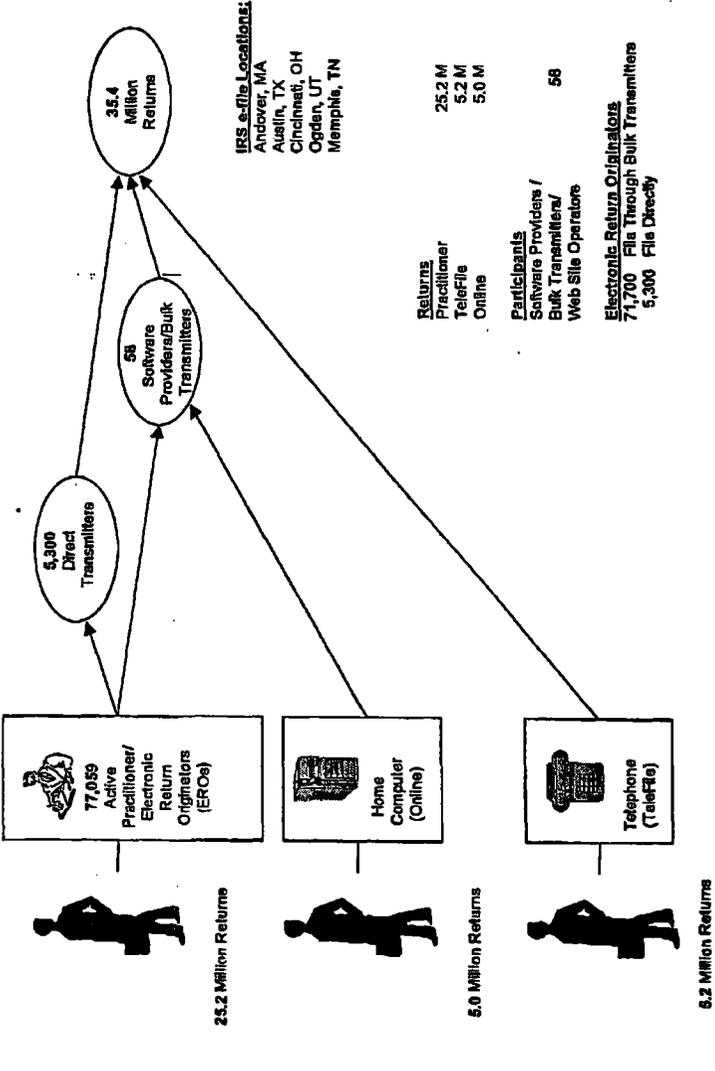
No. The Internal Revenue Code and the Privacy Act prohibit access to taxpayer information without the consent of the taxpayer, unless these statutes explicitly authorize the sharing of such information.

1040 ELECTRONIC FILING PROCESS - 2000 FILING SEASON

Internal Revenue Service

Practitioners/EROs

e-file Taxpayers



**Concerned Group comprised of Alumni and Current Members of the
Electronic Tax Administration Advisory Committee**

September 27, 2000

The Honorable James Kolbe
Chairman, Subcommittee on Treasury, Postal Service and
General Government
Committee on Appropriations
B-307 Rayburn House Office Building
United States House of Representatives
Washington, DC 20515

Dear Chairman Kolbe:

In response to the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA), the IRS established the Electronic Tax Administration Advisory Committee (ETAAC) in September 1998. The mission of the ETAAC, as defined in the RRA, is to provide the IRS with private sector input in the development and implementation of the strategic plan that eliminates barriers, provides incentives, and uses competitive market forces to increase electronic filing. Additionally, the ETAAC has the obligation to report to Congress. The seven undersigned are a subgroup of either currently appointed or past members of the ETAAC, each serving a term of two years.

The Conference Report for the RRA contains the following. "The intent of the conferees with respect to this provision is for the IRS and Treasury to press for robust private sector competition. When disputes arise between the IRS and the private sector on the question of whether services offered by the IRS inhibit competition or are appropriate services not reasonably available to taxpayers or tax preparers, the Electronic Commerce Advisory Group [ETAAC] shall recommend to the IRS Commissioner an appropriate course of action. Those recommendations shall also be made available to the Congress."

On May 1, 2000, the ETAAC sent the IRS a letter, addressed to Robert Barr, Assistant Commissioner of Electronic Tax Administration, regarding the subject of the IRS offering "one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer." The ETAAC took this action because of the increasing controversy between the private sector and the IRS on this matter and the ETAAC's view that this was not good public policy.

In its May 1st letter ETAAC recommended "... that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of no cost tax preparation and filing options over the Internet are to: 1) let the competitive market continue to progress, and 2) continue stimulating electronic filing through its creative advertising campaign and making electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper." The letter further stated that "The ETAAC strongly recommends against the IRS developing its own tax preparation software program, either internally or through acquisition. The ETAAC also believes that the IRS should not follow an approach where the IRS

ETAAC Alumni Congressional Letter
September 25, 2000
Page 2

issues an RFP or RFA to select a limited number of "Authorized IRS e-file providers" to IRS specifications." This recommendation and opposition to IRS entering tax preparation through an Internet-based service was communicated to Congress in the ETAAC's June 2000 Annual Report.

Voluntary compliance has been a keystone of our income tax system from its outset. With voluntary compliance came both the responsibility and the right for an individual to independently and privately prepare and file a statement of their income and tax liability. Put another way, under the American income tax system, it is the citizen who takes the first step in the tax transaction, telling the government what they earned and what they owe. The burden is then on the government to challenge the citizen's independent tax return, and only about 1% of the American people are so challenged through the audit process. For 99% of the American taxpaying public, when they submit their tax return, and either make a payment or receive a refund, that is the end of the transaction. However, the present strategy of the Electronic Tax Administration threatens to reverse the presumption of the American tax system – ultimately imposing on all of our citizens the necessity of having to challenge the government's determination of their earnings and tax liability. Introducing such a fundamental change to the system, by bringing the preparation of individual and business income tax returns under the auspices of the government, should be the subject of full public debate, and happen only as the result of Congressional decision with the concurrence of the President.

Today some 55% of individual taxpayers choose the assistance of a paid tax professional in preparation of their return. The remaining self-preparers either use paper and pencil or have chosen, in increasing numbers, to use personal computer software. As a matter of public policy, we believe that tax preparation should remain the independent right and responsibility of the taxpayer. Consequently, we strongly oppose any action by the IRS to further enter into income tax preparation, including the IRS offering the public an Internet-based preparation service, either developed internally or obtained through contract, or through regulation of private sector companies providing computerized and Internet tax preparation software and services. We believe that the IRS plans to insert itself into this arena are ill conceived and represent fundamentally flawed public policy.

The private sector invented electronic tax preparation services, and annually invests many tens of millions of dollars in ongoing technology and service innovations. The marketplace is robustly competitive, and has demonstrated civic responsibility by already making many Internet-based tax preparation and filing services available to lower and middle income citizens at no charge. The strategy of IRS' ETA group to insert itself into this market risks both continuing investment and innovation as it seeks to make this a government service sector of the economy.

In its letter to Mr. Barr, the ETAAC commented: "The IRS Restructuring and Reform Act of 1998 states that 'The IRS should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns.' This approach is working well. Existing marketplace competition has already led to a wide number of options that individual or business taxpayers can choose, including very low or no cost tax services on the Web for individual

ETAAC Alumni Congressional Letter
September 25, 2000
Page 3

taxpayers from a wide variety of providers—the very trend you indicated in your letter. The number of providers, now over 20, is dramatically increasing every year, forcing strong product development and causing prices to fall dramatically.”

Further emphasizing this point, the ETAAC included this statement in its June 2000 Report to Congress. “The ETAAC believes that the clear choice of public policy should be to let the private sector provide the capability, with the federal government stepping in if the private sector does not meet the need. The ETAAC believes it is inappropriate at this time to pursue a public policy that would require the IRS to offer no-cost electronic filing over the Internet. The marketplace has made noticeable progress towards achieving no-cost electronic filing over the Internet for individual taxpayers in the past two years, and additional progress towards this goal is expected next year based on publicly announced plans. The ETAAC believes that any effort by the IRS at this time to enter the marketplace itself, either by developing its own software or aligning itself with a limited number of “authorized e-file providers” that offer no-cost e-filing for individual or business taxpayers, would have the effect of limiting competition and would ultimately limit taxpayer choices.”

“In support of the goal of no-cost e-filing and tax preparation over the Internet, the ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of low-cost and no-cost tax preparation and filing options over the Internet are to continue to: 1) encourage competition, 2) seek industry views on which barriers inhibit lower-cost to no-cost private sector supplied options, and 3) stimulate electronic filing through its creative advertising campaign and making electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper. The ETAAC’s recommendations on the use of the Internet for electronic filing are grounded in the belief that competition is the most effective way to provide taxpayers with the widest range of performance and price options for tax preparation and electronic filing. Promoting the most intense competition among private sector companies and pursuing policies that allow these companies to reduce unnecessary costs is the best action the IRS can take in pursuit of the goal of no-cost electronic filing for taxpayers.”

On July 20, 2000, the IRS’ Electronic Tax Administration proceeded with its plans and initiated a procurement action by releasing a Request for Information (RFI) seeking comments on an Internet-based preparation service by which taxpayers could prepare and file their tax returns directly with the IRS, at no cost to the taxpayer. As a justification, the President’s FY2001 Budget Request is cited: “No later than tax year 2002, the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer...” We were surprised and shocked that the IRS is continuing with this effort after all of the discussions and recommendations on the part of the ETAAC and the industry. We are deeply concerned that the *check and balance* that Congress sought to create when the ETAAC was created through the RRA is not working. It appears that the ETA group is pursuing an independent course of direction without regard to any other consideration.

ETAAC Alumni Congressional Letter
September 25, 2000
Page 4

The content of the RFI raises a related concern. Why is the IRS entering the e-commerce market by attempting to set market prices for private sector products and services, and dictating e-commerce business models? The IRS has no corollary authority to the FCC's Communications Act under which it can play such a role in the marketplace. Indeed, we know of no statutory basis by which the IRS should be attempting to establish policies for or regulate software, Internet, financial services, accounting, and tax preparation services whatsoever. We believe this latest initiative is far outside of the mission of the IRS.

Accordingly, we strongly recommend the IRS rescind their current procurement action, the electronic tax RFI, and discontinue all other efforts to further expand their mission and role into tax preparation on the Internet and elsewhere. We request that Congress address the cited budget provision with an explicit denial, and conduct necessary Oversight on ETA's ongoing plans, activities and role in the IRS organization.

We appreciate your consideration of our comments and are prepared to answer any questions you may have.

Sincerely,



Signed with consent of and on behalf of
current and former ETAAC members listed below:

Fran Bartlett
Connie Grimes
Mary Harris
Susan Martin
Helen O'Planick
Bill Shepard
John Stauffer

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Congress of the United States
House of Representatives
Committee on Appropriations
Washington, DC 20515-6015

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CLERK AND STAFF DIRECTOR
 JAMES W. DYER
 TELEPHONE:
 (202) 726-1771

August 7, 2000

Charles O. Rossotti
 Commissioner
 Internal Revenue Service
 1111 Constitution Avenue, NW
 Washington, DC, 20224

Dear Commissioner Rossotti:

We have spoken several times regarding IRS electronic tax administration. I appreciate the straightforward answers you gave me at the IRS budget hearing on March 16. Your statements that IRS is not going to go into the tax preparation software business, that IRS is not getting into a position of competing with industry in software preparation, and that IRS wants to work with industry were clear indications to me of your intent to form partnerships with the tax preparation software industry in fostering the use of electronic filing.

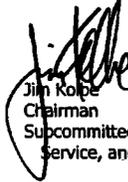
Nevertheless, some confusion remains regarding specific IRS plans and expectations for electronic tax administration, particularly with respect to a proposal to provide a no-cost option that would allow taxpayers to submit (perhaps prepare and submit) individual tax returns over the Internet. Part of the confusion may be semantic; part of the confusion may be tied to the rapidly changing technological environment. Another part of the confusion may be related to differing visions with respect to IRS authorities and responsibilities for helping foster the use of electronic tax preparation and filing.

This confusion has caused concerns among industry groups regarding the degree to which (if any) the IRS may compete with the private sector or possibly influence if not control taxpayer preparation software pricing, products, and services. Some of these concerns were raised orally at the May 9 meeting of the

Council for Electronic Revenue Communication Advancement. Concerns were also raised by the Computer & Communications Industry Association, American Electronics Association, and Software & Information Industry Association in a June 23 joint letter to the House Majority Leader, the Chairman of the Commerce Subcommittee on Telecommunications, and a Co-Chairman of the House Internet Caucus. Related concerns are contained in the Annual Report to Congress of the Electronic Tax Administration Advisory Committee.

I fully support the goal of increasing the percentage of individual tax returns that are filed electronically. I also firmly believe that cooperation and coordination between the IRS and the tax software preparation industry is critical to achieving this goal in the most efficient and effective manner possible. I recognize that the future of electronic tax administration strikes a very deep chord in the IRS, is closely tied to fundamental authorization issues, and strongly impacts system modernization requirements as well as improvements to core business services. To help settle some of the confusion and reassure those who continue to express concerns about this matter, I request that you answer as soon as possible, preferably no later than August 28, 2000, the questions contained on the attachment regarding IRS electronic tax administration.

Sincerely,



Jim Kolbe
Chairman
Subcommittee on Treasury, Postal
Service, and General Government

Attachment

Questions on IRS Electronic Tax Administration

1. How does IRS define (and differentiate between) the phrases "electronic tax return preparation," "Internet tax return preparation," "electronic tax return filing," and "Internet tax return filing?" Please be specific.
2. What are the current roles of the IRS with respect to electronic tax return preparation and electronic filing?
3. How does this current role differ from the current IRS role with respect to traditional paper tax return preparation and filing?
4. What should be the future role of the IRS with respect to Internet tax return preparation and Internet tax filing?
5. How would this future IRS role with respect to Internet tax return preparation and filing differ from the current IRS role with respect to traditional paper tax return preparation and filing?
6. What is the appropriate industry role with respect to Internet tax return preparation and Internet tax return filing?
7. What is the appropriate industry role with respect to traditional paper tax return preparation and paper tax return filing?
8. According to a February 4 IRS fact sheet on Electronic Tax Administration, the President's FY2001 Budget contains a provision that would require the IRS to provide taxpayers with one or more no cost options for preparing and filing individual income tax returns over the Internet beginning no later than tax year 2002. Please provide the full citation (including page number) of this provision in the President's Budget.
9. The February 4 fact sheet broadly describes the intention of two provisions contained in the President's FY2001 Budget "to make electronic filing of income tax returns more attractive to taxpayers;" one of the provisions is described as being aimed at providing "one or more no cost options for preparing and filing individual tax returns over the Internet." Are there any differences between these two statements (one mentions electronic filing while the other mentions Internet preparing and filing)? If so, please explain.
10. The February 4 fact sheet implies that legislation must be enacted before IRS implements its proposed free Internet filing provision. Please provide a status of this proposed legislation.

11. The implication contained in the February 4 fact sheet of the need for this legislation suggests that IRS does not currently have the authority to implement its proposed free Internet filing provision. Please comment on the validity of this observation.
12. The February 4 fact sheet, in citing the proposed free Internet filing provision, mentions potential contract arrangements with "Authorized IRS e-file Providers." Do all "Authorized IRS e-file Providers" currently offer electronic tax preparation services as well as e-filing services? What is the rationale behind proposing to offer these options through contract arrangements with "Authorized IRS e-file Providers" versus a wider pool of potential providers? Please describe these authorized providers, how an entity becomes an authorized provider, authorized provider limitations (if any), the current number of authorized providers and future projections of the number of providers.
13. Could these types of contract arrangements be construed as resulting in the IRS entering into the tax software business (perhaps not directly through the tax software development business but indirectly through subcontracts with tax software businesses)? Could these types of contract arrangements create the potential for or the perception of the IRS causing or influencing unfair price competition in the private sector between "Authorized IRS e-file Providers" and everyone else? Would you anticipate that eventually only "Authorized IRS e-file Providers" would remain in the tax preparation software industry?
14. The February 4 fact sheet states that, "The IRS does not currently provide tax preparation software and is not equipped to enter this business, nor does it plan to do so." Through the proposed contract arrangements with "Authorized IRS e-file Providers," the IRS seems to be at least 'arranging for' the provision of tax preparation software. This might give the appearance of the IRS 'entering' an aspect of or 'influencing' competition within the tax preparation software business. Please comment on the validity of this observation.
15. Since the IRS has stated that it has no intention or plans to provide tax preparation software, on what basis, if any, would the IRS object to this concept being captured in appropriations report language (i.e., "The conferees have provided no funds for the IRS to provide tax preparation software.")?
16. An article on pages 880-884 of *Tax Notes*, volume 87, number 7, May 15, 2000, states that the IRS Assistant Commissioner for Electronic Tax Administration engaged the IRS Office of Chief Counsel to look into advertising and incentive issues regarding IRS electronic tax administration arrangements with private sector companies. The article suggests that an internal opinion by the IRS Office of Chief Counsel would be completed by the end of June. Is this

article correct on this point? Has the internal opinion (or a summary of the opinion) been publicly released or will the internal opinion (or a summary of the opinion) be publicly released? If not, why not?

17. The same article mentions fears on the part of some members of the Council for Electronic Revenue Communication Advancement that the Administration believes the IRS should interfere with the market in the quest to give taxpayers a free online or electronic filing option and that the Administration might use this first experiment in setting market prices on tax services – in this case, setting the price at zero – as a springboard for doing so routinely in the future. Please comment on the validity of these concerns.

18. The IRS recently released Request for Information No: TIRNO-00-H-00007, a request for information to analyze the public and private sector's reaction to a proposed electronic opportunity via the Internet. The first item in its Requested Comments section asks for a discussion of the possibility of offering free tax preparation and electronic filing, while the next two items and item 13 focus on a free Internet filing opportunity. Is there any difference in the substance of the first item and the other items?

19. The mailing address for written responses to the request for information identifies a "Free Internet Filing Project." Is this an accurate description of the project or is IRS also seeking free Internet tax preparation?

20. The deadline for receiving comments based on this request for information is August 21, 2000. What actions will the IRS take upon receipt of this information? Will this information be used to fashion a request for proposals? If so, what would be the timeframe for issuing such a request and selecting proposals that might result from such a request? Does the IRS require additional statutory authorities before issuing a request for proposals?



COMMISSIONER

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

September 13, 2000

The Honorable Jim Kolbe
Chairman, Subcommittee on Treasury,
Postal Service, and General Government
Committee on Appropriations
U.S. House of Representatives
Washington, DC 20515-6015

Dear Mr. Chairman:

Thank you for your letter dated August 7, 2000, regarding the Internal Revenue Service's plans to foster the use of electronic filing. You asked about our plans to provide a no-cost option that would allow taxpayers to submit, or prepare and submit, individual income tax returns over the Internet.

I hope the enclosed information will address your concerns and those of the tax preparation industry groups. If you have further questions please contact me at (202) 622-9511.

Sincerely,

Charles O. Rossotti

Enclosure

Questions on IRS Electronic Tax Administration

1. How does IRS define (and differentiate between) the phrases "electronic tax return preparation," "Internet tax return preparation," "electronic tax return filing," and "Internet tax return filing?" Please be specific.

Answer:

The IRS defines "electronic tax preparation" as using computer software on a PC, from a web-site, or accessed over a touch tone phone to capture tax information and prepare a form for submission to the IRS. This submission may occur on paper or electronically. "Internet tax return preparation" is using computer software resident at a web-site to capture tax information and prepare a form for submission to the IRS. "Electronic tax return filing" is submitting a tax return that has been prepared electronically to the IRS through electronic means using formats and communication protocols set by the IRS. This electronic transmission may be made directly to the IRS or through a private sector third party. "Internet tax return filing" is submitting a return electronically that has been prepared electronically on an Internet web-site.

A tax return may not be filed electronically without having been prepared electronically.

2. What are the current roles of the IRS with respect to electronic tax return preparation and electronic filing?

Answer:

First and foremost, the IRS publishes format specifications and communication protocols and administers a program whereby tax software vendors may format and electronically file tax returns on behalf of their customers. The IRS also permits all tax software vendors to test their software for adherence to IRS format and communication standards. The IRS does not develop tax software nor approve tax software for tax preparation quality except for TeleFile. In addition, at IRS local offices, IRS prepares and files returns for low income taxpayers who request this assistance. The IRS also assists various volunteer programs that help needy taxpayers and the elderly.

As noted, TeleFile is an exception. In this instance, the IRS hired a private sector contractor through a competitive procurement to build a system for taxpayers with very simple returns to both prepare and file their tax returns electronically over a touch tone phone directly to the IRS for free. Typical users of this system have been students and individuals new to the workforce.

To support electronic tax return preparation and filing, Congress enacted the Restructuring and Reform Act of 1998 (RRA '98). Conference Language from Title II of the Act reads:

"The provision on private sector cooperation is clarified to provide that the IRS should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of returns. The intent of the conferees with respect to this provision is for the IRS and Treasury to press for robust private sector competition. When disputes arise between the IRS and the private sector on the question of whether services offered by the IRS inhibit competition or are appropriate services not reasonably available to taxpayers or tax preparers, the Electronic Commerce Advisory Group shall recommend to the IRS Commissioner an appropriate course of action. Those recommendations shall also be made available to Congress. Notwithstanding the previous sentence, the conferees also intend that the IRS should continue to offer and improve its TeleFile program and make available a comparable program on the Internet."

3. How does this current role differ from the current IRS role with respect to traditional paper tax return preparation and filing?

Answer:

Paper and electronic return preparation and filing are offered through IRS local offices, Volunteer Income Tax Assistance (VITA), and Tax Counseling for the Elderly (TCE) sites. Strictly through word of mouth, taxpayers will go to local IRS offices to have their returns prepared because they do not choose, or cannot afford, to either pay a professional tax preparer or buy a personal computer and tax software. The tax software we use in our offices is competitively procured in the open market. The IRS both electronically prepares and electronically files simpler returns at taxpayer request.

The IRS also facilitates electronic tax preparation and filing through the VITA and TCE programs. We facilitate these programs by competitively acquiring tax software and computer hardware in the open market to supply these sites. Volunteers for these clinics are recruited from surrounding communities and are not compensated by the IRS in any way. The IRS acquires tax software training in the open market for these volunteers.

The IRS works cooperatively with tax software companies and professional tax preparation organizations. We provide format specifications for both paper and electronic returns. We also provide tax preparation instructions and publications in electronic format, which are used as features of their products. The IRS also holds various tax software developer conferences to: discuss record layout and file specification changes, provide technical support and specialized bulletin boards to software developers and electronic return originators, and provide testing services for electronically filed returns. All these services are provided at no cost to the software vendors. In addition, the IRS provides

technical support to electronic return originators during the filing season, again, at no cost to the tax software industry. The IRS also spends close to \$14 million per year promoting electronic filing to raise the awareness of electronic filing.

4. What should be the future role of the IRS with respect to Internet tax return preparation and Internet tax filing?

Answer:

The IRS' role is to follow the guidance of Congress as summarized in the section from the Conference Report quoted in answer to Question #2 above.

Since the Electronic Tax Administration Advisory Committee (ETAAC) has a role in this process, it is also helpful to quote their recent report:

"In support of the goal of no-cost e-filing and tax preparation over the Internet, the ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of low-cost and no-cost tax preparation and filing options over the Internet are to continue to: 1) encourage competition, 2) seek industry views on which barriers inhibit lower-cost to no-cost private sector supplied options, and 3) stimulate electronic filing through its creative advertising campaign and make electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper. The ETAAC also recognizes that the Internet changes rapidly and business models are in constant evolution, and even revolution. The ETAAC believes that a re-assessment of the marketplace should be made in two years to assess whether the range of choices for electronic filing over the Internet includes no-cost options for taxpayers. If no-cost choices do not exist, the ETAAC believes the IRS would then be justified in evaluating, in conjunction with ETAAC, whether an electronic template, or other approach, is an appropriate and needed tool to promote no-cost e-filing over the Internet...."

Secondly, as noted in the answer to Question #2, the Conferees for RRA '98 "intend(ed) that the IRS should continue to offer and improve its TeleFile program and make available a comparable program on the Internet."

Finally, the IRS needs to ensure that taxpayer privacy is a high priority in creating an eventual solution for internet filing.

5. How would this future IRS role with respect to Internet tax return preparation and filing differ from the current IRS role with respect to traditional paper tax return preparation and filing?

Answer:

The principle difference is that in RRA '98, Congress established a goal that 80% of all tax returns should be filed electronically by 2007. Further, it authorized the IRS to promote electronic filing through mass communication and other means as well as pay incentives as appropriate. As noted above, it indicated that the IRS should "press for robust private sector competition."

6. What is the appropriate industry role with respect to Internet tax return preparation and Internet tax return filing?

Answer:

The role of the industry is to provide competitive products and services that are responsive to the needs of the public.

7. What is the appropriate industry role with respect to traditional paper tax return preparation and paper tax return filing?

Answer:

The role of the industry is to provide competitive products and services that are responsive to the needs of the public.

8. According to a February 4 IRS fact sheet on Electronic Tax Administration, the President's FY2001 Budget contains a provision that would require the IRS to provide taxpayers with one or more no cost options for preparing and filing individual income tax returns over the Internet beginning no later than tax year 2002. Please provide the full citation (including page number) of this provision in the President's Budget.

Answer:

This proposal is found on Page 64 of the Analytical Perspectives volume of the Fiscal Year 2001 President's Budget. It reads:

"Provide tax credit to encourage electronic filing of individual income tax returns. Under current law, tax return preparation costs of individuals, including any costs of electronic filing, may be deducted only by taxpayers who itemize deductions and then only to the extent that such costs, in combination with most other miscellaneous itemized deductions, exceed two percent of AGI. The proposal would provide a temporary, refundable tax credit for the electronic filing of individual income tax returns. The credit would be for tax years 2001 through 2006 and would be \$10 for each electronically filed return, and \$5 for each TeleFile return (which are filed by entering information through the keypads of

telephones). The credit would encourage taxpayers to try electronic return or TeleFile submission, which reduces taxpayer errors and the need for subsequent contacts between the taxpayer and the IRS and which permits taxpayers to receive their tax refunds faster. The credit would help the IRS achieve the goal set in the 1998 IRS Restructuring and Reform Act of having 80 percent of 2006 returns filed electronically. No later than tax year 2002, the IRS would be required to offer one or more options to the public, through contract arrangements with the private sector, for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer."

As further described in the Treasury General Explanations of the Administration's Fiscal Year 2001 Review Proposals, "If the IRS offered such options through contract arrangements with Authorized IRS E-file Providers, it would be with the assurance the Provider would not use the taxpayer's tax return information without the taxpayer's permission for any purpose other than submission to the IRS."

9. The February 4 fact sheet broadly describes the intention of two provisions contained in the President's FY2001 Budget "to make electronic filing of income tax returns more attractive to taxpayers;" one of the provisions is described as being aimed at providing "one or more no cost options for preparing and filing individual tax returns over the Internet." Are there any differences between these two statements (one mentions electronic filing while the other mentions Internet preparing and filing)? If so, please explain.

Answer:

Yes. One proposal, the refundable tax credit, would be given to all electronic filers. The second proposal is for free Internet preparing and filing.

10. The February 4 fact sheet implies that legislation must be enacted before IRS implements its proposed free Internet filing provision. Please provide a status of this proposed legislation.

Answer:

A refundable tax credit for all electronic filers would require legislation. Facilitating free Internet filing through reduced private sector barriers does not require legislation.

11. The implication contained in the February 4 fact sheet of the need for this legislation suggests that IRS does not currently have the authority to implement its proposed free Internet filing provision. Please comment on the validity of this observation.

Answer:

RRA '98 Section 201(c) gives the Secretary the authority to promote the benefits of and encourage the use of electronic tax administration programs, as they become available, through the use of mass communications and other means.

12. The February 4 fact sheet, in citing the proposed free Internet filing provision, mentions potential contract arrangements with "Authorized IRS e-file Providers." Do all "Authorized IRS e-file Providers" currently offer electronic tax preparation services as well as e-filing services? What is the rationale behind proposing to offer these options through contract arrangements with "Authorized IRS e-file Providers" versus a wider pool of potential providers? Please describe these authorized providers, how an entity becomes an authorized provider, authorized provider limitations (if any), the current number of authorized providers and future projections of the number of providers.

Answer:

To date over 108,000 individuals and businesses are recognized as Authorized IRS e-file Providers. To our knowledge, all income tax software vendors are Authorized IRS e-file Providers or have contracted with one to serve their customers. Any individual or business preparer service that is compliant in their taxes and not convicted of any felonies can become an Authorized IRS e-file provider. We want to enroll as many Authorized IRS e-file Providers as we possibly can. We hope to double the number of Authorized IRS e-file Providers in the next several years. Only authorized Providers may offer electronic filing to taxpayers. The rationale behind this proposal is to prevent tax refund fraud by requiring applications and background investigations for providers.

13. Could these types of contract arrangements be construed as resulting in the IRS entering into the tax software business (perhaps not directly through the tax software development business but indirectly through subcontracts with tax software businesses)? Could these types of contract arrangements create the potential for or the perception of the IRS causing or influencing unfair price competition in the private sector between "Authorized IRS e-file Providers" and everyone else? Would you anticipate that eventually only "Authorized IRS e-file Providers" would remain in the tax preparation software industry?

Answer:

No. To our knowledge, all income tax software providers are already Authorized IRS e-file Providers or have contracted for one to serve their customers. As demand for electronic filing has increased from taxpayers seeking faster refunds, acknowledgements, and more accurate processing, tax software vendors have had to respond to market forces. These

vendors have been competitively compelled by their customers to offer the ability to electronically file as a feature of their software. Computer software typically declines in price over time. One strategy employed by software vendors to keep their prices buoyed is to add new features. Electronic filing is just such a feature. Increasingly, the cost of electronic filing is bundled in the price of the software.

14. The February 4 fact sheet states that, "The IRS does not currently provide tax preparation software and is not equipped to enter this business, nor does it plan to do so." Through the proposed contract arrangements with "Authorized IRS e-file Providers," the IRS seems to be at least 'arranging for' the provision of tax preparation software. This might give the appearance of the IRS 'entering' an aspect of or 'influencing' competition within the tax preparation software business. Please comment on the validity of this observation.

Answer:

As noted in the answer to Question #13, to our knowledge all income tax software providers are already Authorized IRS e-file Providers or have contracted for one to serve their customers. In addition, well over 108,000 professional tax preparers are "Authorized IRS e-file Providers." If you are not a convicted felon nor delinquent in your taxes, you may apply and will be accepted as an "Authorized IRS e-file Provider." We seek as many "Authorized IRS e-file Providers" as we can recruit. As noted in the answer to Question #12, the rationale behind engaging Authorized IRS e-file Providers is to help prevent tax refund fraud in the IRS e-file Program. The IRS was explicitly charged by the Congress in 1995 through a series of hearings to take every precaution to prevent and eliminate fraud from the IRS e-file Program. The Congress and GAO explicitly endorsed the Authorized IRS e-file Provider Program as one of a number of measures being taken by the IRS to prevent fraud.

15. Since the IRS has stated that it has no intention or plans to provide tax preparation software, on what basis, if any, would the IRS object to this concept being captured in appropriations report language (i.e., "The conferees have provided no funds for the IRS to provide tax preparation software.")?

Answer:

In RRA '98, Congress has already provided legislation and guidance concerning Electronic Tax Administration as noted in the answer to previous questions. This includes a forum, the ETAAC, for discussing such issues. This legislation recognizes that the achievement of the overall goal of converting most transactions from paper to electronic is an on-going process that constantly raises new and complex issues. For example, the rapid growth of the Internet provides important new opportunities for reaching the electronic filing goals set by Congress, but also raises new issues such as electronic tax

preparation and filing through web sites. Other programs, such as the Congressional mandate that partnerships with over 100 partners must file their 1065 and K-1 returns electronically, present many questions as to how we can accomplish this mandate.

We have not yet implemented the specific authorization by Congress to offer a program comparable to TeleFile over the Internet. In this fast changing and complex environment, a separate provision attached to an appropriations bill is not in the best interest of taxpayers nor would it help us achieve the Congressional mandate for electronic tax administration.

Such language could put many of our most important programs at risk, such as Voluntary Income Tax Assistance (VITA), TeleFile, and software development for tax forms and schedules that the industry has chosen not to develop.

16. An article on pages 880-884 of Tax Notes, volume 87, number 7, May 15, 2000, states that the IRS Assistant Commissioner for Electronic Tax Administration engaged the IRS Office of Chief Counsel to look into advertising and incentive issues regarding IRS electronic tax administration arrangements with private sector companies. The article suggests that an internal opinion by the IRS Office of Chief Counsel would be completed by the end of June. Is this article correct on this point? Has the internal opinion (or a summary of the opinion) been publicly released or will the internal opinion (or a summary of the opinion) be publicly released? If not, why not?

Answer:

IRS Revenue Procedure 98-51 (recently strengthened by 2000-31) declares businesses engaged in electronic filing as tax preparers are governed in their behavior by Internal Revenue Code Section 7216. The new technology of tax preparation and filing through software resident on web sites has raised some new questions as to the interpretations of these sections and regulations. The IRS has asked the Office of Chief Counsel to study these issues so that we can better understand the legal implications. The IRS met with the tax software companies recently to discuss these questions in general terms. Individual private sector companies may submit specific questions on interpretation through the private letter ruling process. We are attempting to understand the issues raised by the industry and to arrive at answers consistent with the law.

17. The same article mentions fears on the part of some members of the Council for Electronic Revenue Communication Advancement that the Administration believes the IRS should interfere with the market in the quest to give taxpayers a free online or electronic filing option and that the Administration might use this first experiment in setting market prices on tax services - in this case, setting the price at zero - as a springboard for doing so routinely in the future. Please comment on the validity of these concerns.

Answer:

These concerns are completely unwarranted. No such discussions have ever occurred. In fact, the IRS has routinely gone out of its way to offer new products and services for the tax software vendors to, in turn, offer to their customers. The IRS agrees with the ETAAC that the IRS should "seek industry views on which barriers inhibit lower-cost to no-cost private sector supplied options" for Internet tax preparation and e-filing

18. The IRS recently released Request for Information No: TIRNO-00-H-00007, a request for information to analyze the public and private sector's reaction to a proposed electronic opportunity via the Internet. The first item in its Requested Comments section asks for a discussion of the possibility of offering free tax preparation and electronic filing, while the next two items and item 13 focus on a free Internet filing opportunity. Is there any difference in the substance of the first item and the other items?

Answer:

No. All three items are intended to reference free tax preparation and electronic filing over the Internet.

19. The mailing address for written responses to the request for information identifies a "Free Internet Filing Project." Is this an accurate description of the project or is IRS also seeking free Internet tax preparation?

Answer:

We are interested in getting industry views on all aspects of this issue.

20. The deadline for receiving comments based on this request for information is August 21, 2000. What actions will the IRS take upon receipt of this information? Will this information be used to fashion a request for proposals? If so, what would be the timeframe for issuing such a request and selecting proposals that might result from such a request? Does the IRS require additional statutory authorities before issuing a request for proposals?

Answer:

By Friday, August 18, 2000, we had received only one response, so we extended the response date an additional month. We will not take any action until we review all responses and meet with the Electronic Tax Administration Advisory Committee later this year. We will keep Congress informed of any plans in this area.



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October 17, 2000

The Honorable Jim Kolbe
 Chairman, Subcommittee on Treasury, Postal
 Service and General Government
 B307 Rayburn Building
 Washington, DC 20515

Dear Chairman Kolbe:

Thank you for the opportunity to submit this letter for inclusion in the hearing record regarding Internal Revenue Service ("IRS") electronic filing initiatives. Since our firm, H.D. Vest¹, was specifically discussed during the October 3 hearing, we would like to provide comments on tax e-file issues addressed at the hearing, data security, use of PIN numbers and related e-sign issues, as well as privacy and confidentiality.

History of hvest.com e-file project:

H.D. Vest Financial Services was founded in 1983 on the philosophy that the best financial planning advice a consumer can receive is from his or her tax professional. We believe tax professionals are uniquely qualified to provide valuable financial planning advice based on their understanding of the client's affairs and the tax implications associated with various financial planning recommendations. Today, H.D. Vest is the largest provider of financial planning services through tax professionals in the country. We are

¹ H.D. Vest Technology Services, Inc., maintains hvest.com and its related web sites, and is responsible for providing our free online tax preparation service. H.D. Vest Technology Services is a wholly-owned subsidiary of H.D. Vest, Inc. (d/b/a H.D. Vest Financial Services). H.D. Vest Financial Services is publicly traded on NASDAQ (symbol: HDVS), and is also the owner of H.D. Vest Investment Securities, Inc., a broker/dealer registered in all 50 states and H.D. Vest Advisory Services, Inc., a registered investment advisor, likewise doing business in every state. In addition, H.D. Vest Financial Services is affiliated with H.D. Vest Insurance Agency and related companies which provide insurance products in 49 states. H.D. Vest Financial Services, through its affiliated entities, is one of the largest providers of financial planning services through a nationwide network of over 8,000 certified public accountants, Enrolled Agents, attorneys other tax professionals.

Securities Offered Through:
 H.D. VEST INVESTMENT SECURITIES, INC., Member:



Advisory Services Offered Through:
 H.D. VEST ADVISORY SERVICES, INC.

committed to providing full service, one stop shopping to fulfil the myriad of tax and financial needs of the consumer.

We recognize that many taxpayers prefer to complete their tax returns themselves. In many cases, these taxpayers enjoy the capability of getting on-line and using web-based tax preparation software to prepare and e-file their tax returns. Our website, hdvest.com, was created, among other things, to fulfil the needs of do-it-yourselfers by allowing them to prepare and e-file their tax returns in a secure and private environment while also providing them with the same opportunities that other H.D. Vest customers enjoy: one stop shopping for all of their tax, financial planning, insurance, and mortgage needs.

In January 2000, we launched a website where all Americans can go to prepare and e-file their tax returns free of charge regardless of income level or complexity of tax return. Hdvest.com was also awarded the opportunity to become an IRSe-file partner. As an IRSe-file partner, we were afforded the opportunity to have a hyperlink to hdvest.com from the IRS Partner's Web Page. In our inaugural year, we had 1.5 million unique visitors to our website. Sixty percent (60%) of those hits were from taxpayers hyperlinked to us via the IRS Partner's page. Additionally, as noted by Congressman David Price during the hearing, over 263,000 tax returns were completed utilizing our free service and over 180,000 returns were e-filed through our web site. We applaud the efforts of the IRS to reach out to the private sector and look forward to continuing our relationship with the IRS in the filing seasons to come. Ultimately, we hope to make a substantial contribution to the IRS' effort to achieve its congressionally mandated goal of having eighty percent (80%) of all federal tax returns e-filed by 2007.

How hdvest.com works:

As noted above, privacy and security is the number one priority at our firm. Our company's privacy policy provides that we will not share personally identifiable information (including tax information) with any non-affiliated third parties. As with any on-line site handling sensitive information, we believe it is imperative that accounts are password protected and the transmission of information is accomplished utilizing high bit encryption. We believe a clearly stated privacy policy is appropriate to

notify consumers how they can expect their information to be gathered and used.

Once taxpayers enter our site and have been informed of our privacy statement, we seek to provide consumers with a one-stop shop for tax preparation and financial services. The major component of the site is a user-friendly questionnaire that enables the taxpayer to complete federal tax returns and select state tax returns online and e-file them with the IRS at no charge. There are no income limits for consumers. Common schedules and forms for federal returns are available.

It is important to point out that our firm's policies and procedures have been carefully reviewed and tested by regulatory authorities and independent auditors for compliance with laws, regulations, and privacy and security issues. Our site's privacy policies have been reviewed and approved by TRUSTe and BBBOnLine as well as reviewed and approved through the AICPA's WebTrust^{SM/™} program. Further, we voluntarily comply with OMB 1545-0962 *Security Guidelines for Federal State, and Local Agencies*. We are committed to providing the best services for users of our site in a secure environment while also ensuring that our users are well informed as to use of information.

E-filing issues in the upcoming tax year:

H.D. Vest would like to continue to build on the strong relationship we developed with the IRS in our first year in the on-line preparation and e-filing arena. We believe we are offering the public a valuable service and, at the same time, are assisting the IRS to meet the congressionally mandated goal that eighty percent (80%) of all tax returns be e-filed by 2007.

We would like to see the IRS expand its promotion of on-line services providing *free* preparation software and e-filing. The IRS e-filing partner program has been successful and, where appropriate, would want the IRS to expand its promotion of e-filing partners. We noted, for example, that of the 1.5 million unique visitors who clicked on our tax site last tax season, sixty percent (60%) came from the hdvest.com hyperlink which appeared on the IRS e-file Partner's page. We would appreciate the opportunity to discuss in an open forum with the IRS how the public and private sector can work together to take advantage of additional marketing and educational opportunities in the next tax filing year.

Additionally, we would like the IRS to continue to explore methods to reduce the amount of paper and signatures involved in the completion of a tax return. Ultimately, we believe the public will benefit from a streamlined, paperless preparation system relying in large part on the completion and processing of returns through the Internet. We appreciate the efforts of the IRS to eliminate the need for signatures on tax returns in lieu of PIN numbers for the next filing season. By allowing taxpayers the selection and utilization of a PIN number in place of printing, signing, and mailing in a form, taxpayers enjoy a quicker, easier way to prepare and e-file their returns.

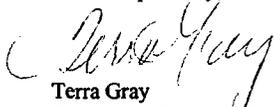
We would also like the IRS to consider making available to taxpayers an electronic download of last year's tax information as well as current year information received by the IRS (W-2, 1099 information, etc.) as of the date of a requested download. In this way, taxpayers may populate tax forms without having to type the information into the computer. We believe that "populating" the tax form will reduce input errors on the tax return and make the tax preparation process easier for the taxpayer. We understand that the IRS has already been approached regarding "electronic mailboxes" through which the taxpayer may pick up prior/current year's tax information and that the main concern of the Electronic Tax Administration is the privacy and security of taxpayer information as well as authenticating who is requesting/receiving the information. We would appreciate the opportunity to work with the IRS on transmission of tax information in a secure environment in an attempt to further reduce the errors on tax forms as well as to provide an easier method of tax preparation for the taxpayer.

Finally, we agree with several of the comments made at the hearing with regard to regulations and statutes governing tax preparation in an on-line world. We too believe that issues surrounding use of taxpayer information and privacy and security need to be carefully reviewed to ensure that taxpayers are protected, but not hindered from taking advantage of tax preparation and e-filing opportunities. Please keep in mind that most of the regulations governing tax preparation were enacted long before the creation of the Internet. Currently, we, like many companies, are trying to interpret these regulations in light of an entirely new medium not contemplated by these regulations: We would appreciate the opportunity to speak to some of these issues with respect to updating rules and regulations in light of the electronic environment. As emphasized during the hearing, input from the private sector is imperative so as to ensure the privacy and security of the consumer while likewise encouraging the expansion of valuable consumer services.

Conclusion:

We commend you and the Subcommittee for holding a hearing on some of these very important issues concerning tax preparation software and e-filing in an online world, and we appreciate the opportunity to submit these comments. We also look forward to participating in any future discussions between the private sector, the IRS, and Congress. Should you have any questions or need additional information, please do not hesitate to contact me.

Yours respectfully,



Terra Gray
Director of Government Affairs
H.D. Vest Financial Services

cc: The Honorable Charles Rossotti, Commissioner, Internal Revenue Service
The Honorable Steny Hoyer, Ranking Subcommittee Member
The Honorable David E. Price, Member of Congress

Presidential Directive - Electronic Commerce**THE WHITE HOUSE
Office of the Press Secretary**

For Immediate Release

July 1, 1997

**MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS
AND AGENCIES**

The invention of the steam engine two centuries ago and the subsequent harnessing of electricity for communications ushered in an industrial revolution that fundamentally altered the way we work, brought the world's people closer together in time and space, changed the way we organize our economies, and brought us greater prosperity.

Today, we are on the verge of another revolution. Inventions like the integrated circuit, the computer, fiber optic cable, and the Internet are changing the way we work, learn, and communicate with each other.

Students and teachers can have immediate access to the world's information from their classrooms; doctors can administer diagnoses to patients in remote parts of the globe from their offices; and citizens of many nations are finding additional outlets for personal and political expression.

As the Internet empowers citizens and democratizes societies, it is also changing the way business is conducted: entrepreneurs are able to start new businesses more easily by accessing the Internet's worldwide network of customers; world trade involving computer software, entertainment products, information services, professional consulting, financial services, education businesses, medical diagnostics, advertising, and technical services is increasing rapidly as the Internet dramatically lowers costs and facilitates new types of commercial transactions; engineers, product developers, and managers thousands of miles apart can collaborate to design and manufacture new products more efficiently; businesses can work more efficiently with their suppliers and customers; consumers have greater choice and can shop in their homes for a wide variety of products from manufacturers and retailers all over the world, and they will be able to view these products on their computers or televisions, access information about the products, and order and pay for their choices, all from their living rooms.

According to several estimates, commerce on the Internet will total tens of billions of dollars by the turn of the century and could expand rapidly after that, helping fuel economic growth well into the 21st century.

For this potential to be realized, governments must adopt a market-oriented approach to electronic commerce, one that facilitates the emergence of a global, transparent, and predictable environment to support business and commerce.

Government officials must respect the unique nature of the medium and recognize that widespread competition and increased consumer choice should be the defining features of the new digital marketplace.

Many businesses and consumers are still wary of conducting extensive business over the Internet because of the lack of a predictable legal environment governing transactions. This is particularly true for international commercial activity where concerns about enforcement of contracts, liability, intellectual property protection, privacy, security, and other matters have caused businesses and consumers to be cautious.

Many companies and Internet users are also concerned that domestic or foreign governments will impose extensive regulations on the Internet and electronic commerce including taxes and tariffs, restrictions on the type of information transmitted, control over standards development, licensing requirements, and extensive regulation of Internet service providers. Indeed, signs of these types of commerce-inhibiting actions already are appearing in many nations.

Governments can have a profound effect on the growth of electronic commerce. By their actions, they can facilitate electronic trade or inhibit it. Knowing when to act and -- at least as important -- when not to act, will be crucial to the development of electronic commerce.

Today I have approved and released a report -- "A Framework For Global Electronic Commerce" -- outlining the principles that will guide my Administration's actions as we move forward into the new electronic age of commerce. This report articulates my Administration's vision for the emerging digital marketplace by declaring a set of principles, presenting a series of policies, and establishing an agenda for international discussions and agreements to facilitate the growth of electronic commerce. I expect all executive departments and agencies to review carefully the principles in this framework and implement appropriate policies.

Accordingly, I am hereby directing that executive department and agency heads should be guided in any future actions they take related to electronic commerce by the following principles:

-- For electronic commerce to flourish, the private sector must lead. Therefore, the Federal Government should encourage industry self-regulation wherever appropriate and support private sector efforts to develop technology and practices that facilitate the growth and success of the Internet.

-- Parties should be able to enter into legitimate agreements to buy and sell

products and services across the Internet with minimal government involvement or intervention. Therefore, the Federal Government should refrain from imposing new and unnecessary regulations, bureaucratic procedures, or taxes and tariffs on commercial activities that take place on the Internet.

-- In some areas, government involvement may prove necessary to facilitate electronic commerce and protect consumers. Where governmental involvement is necessary, its aim should be to support and enforce a predictable, consistent, and simple legal environment for commerce.

-- The Federal Government should recognize the unique qualities of the Internet including its decentralized nature and its tradition of bottom-up governance. Existing laws and regulations that may hinder electronic commerce should be revised or eliminated consistent with the unique nature of the Internet.

-- The Internet is emerging as a global marketplace. The legal framework supporting commercial transactions on the Internet should be governed by consistent principles across State, national, and international borders that lead to predictable results regardless of the jurisdiction in which a particular buyer or seller resides.

I also direct the relevant agencies as identified in "A Frame-work For Global Electronic Commerce" to pursue the following policies:

1. I direct the U.S. Trade Representative to work with foreign governments to secure agreement within the next 12 months that all products and services delivered across the Internet will not be subject to tariffs and that all equipment from which the Internet is built will also not be subject to tariffs.

2. I direct the U.S. Trade Representative to work with foreign governments to enforce existing agreements and secure new agreements to make electronic commerce a seamless global marketplace. This will include enforcing provisions of the recently concluded World Trade Organization (WTO) Telecommunications Services Agreement; ensuring that product testing, certification, and approval processes do not unnecessarily restrict trade; ensuring that service providers have nondiscriminatory access to customers worldwide; and other measures that ensure a free flow of commerce.

3. I direct the Secretary of Commerce to seek the protection of copyright in the digital environment by working to achieve ratification in the United States and overseas within the next 12 months of the World Intellectual Property Organization (WIPO) Copyright Treaty and the WIPO Performances and Phonograms Treaty.

4. I direct the Secretary of Commerce to update and make more efficient our system for protecting patentable innovations to meet the needs of the fast-moving electronic age and to seek agreements with other governments to protect patentable innovations worldwide.

5. I direct the Secretary of Commerce to support efforts to make the governance of the domain name system private and competitive and to create a

contractually based self-regulatory regime that deals with potential conflicts between domain name usage and trademark laws on a global basis.

6. I direct the Secretary of the Treasury to work with State and local governments and with foreign governments to achieve agreements that will ensure

that no new taxes are imposed that discriminate against Internet commerce; that existing taxes should be applied in ways that avoid inconsistent national tax jurisdictions and double taxation; and that tax systems treat economically similar transactions equally, regardless of whether such transactions occur through electronic means or through more conventional channels of commerce.

7. I direct the Secretary of Commerce to work with the private sector, State and local governments, and foreign governments to support the development, both domestically and internationally, of a uniform commercial legal framework that recognizes, facilitates, and enforces electronic transactions worldwide. I further direct the Secretary of Commerce within the next 12 months to seek to gain agreement with the private sector, State and local governments, and foreign governments, both domestically and internationally, on common approaches for authentication of electronic transactions through technologies such as digital signatures.

8. I direct the Secretary of Commerce and the Director of the Office of Management and Budget to encourage private industry and privacy advocacy groups to develop and adopt within the next 12 months effective codes of conduct, industry developed rules, and technological solutions to protect privacy on the Internet consistent with the Privacy Principles issued by the Information Infrastructure Task Force (IITF) Privacy Working Group. I further direct the Director of the OMB to develop recommendations on the appropriate role of government consistent with "A Framework For Global Electronic Commerce." I further direct the Secretary and the Director to ensure that means are developed to protect the privacy of children.

9. I direct the Secretary of Commerce to encourage the development and adoption within the next 12 months by industry of easy to use and effective rating systems and filtering technologies that empower parents, teachers, and other Internet users to block content that is inappropriate for children.

10. I direct the Secretary of Commerce to support private sector development of technical standards for the Internet and the U.S. Trade Representative to oppose efforts by foreign governments to impose standards or to use standards for electronic commerce as non-tariff trade barriers.

11. I direct the Secretary of the Treasury to cooperate with foreign governments to monitor newly developing experiments in electronic payment systems; to oppose attempts by governments to establish inflexible and highly prescriptive regulations and rules that might inhibit the development of new systems for electronic payment; and as electronic payment systems develop, to work closely with the private sector in order to keep apprised about policy development and ensure that governmental activities flexibly accommodate the needs of the

emerging marketplace.

12. I direct all executive departments and agencies to promote efforts domestically and internationally to make the Internet a secure environment for commerce. This includes ensuring secure and reliable tele-communications networks; ensuring an effective means for protecting the information systems attached to those networks; ensuring an effective means for authenticating and guaranteeing confidentiality of electronic information to protect data from unauthorized use; and providing information so that Internet users become well-trained and understand how to protect their systems and their data.

13. I direct the Administrator of General Services to move the Federal Government into the age of electronic commerce by expanding "GSA Advantage," its online shopping service for the Federal community to cover four million items by 12 months from now.

I am asking the Vice President to lead an interagency group coordinating the U.S. Government's electronic commerce strategy. Further, I am directing that executive department and agency heads report back to the Vice President and me through this interagency group every 6 months on their progress in meeting the terms of this directive.

WILLIAM J. CLINTON

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**Electronic Tax Administration Advisory Committee
Charles A. Lacijs, Chairman**

May 1, 2000

Robert E. Barr
Assistant Commissioner
Electronic Tax Administration
Internal Revenue Service
1111 Constitution Ave., NW
Washington D.C. 20224

Dear Bob:

Your letter of February 22, 2000, distributed to ETAAC members at our March 2 meeting in Washington, elicits our reaction to two proposals in the President's FY 2001 proposed budget:

- 1) a temporary, refundable tax credit of \$10 for e-filing of individual income tax returns; and
- 2) one or more no cost options for preparing and filing individual income tax returns over the Internet.

In particular, you requested our views on how the free Internet filing option could best be achieved and cited the provision in its entirety:

"No later than tax year 2002, the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer. If the IRS offered such options through contract arrangements with Authorized IRS e-file Providers, it would be with the assurance that the taxpayer's tax return information would not be used by the Provider without the taxpayer's permission for any purpose other than submission to the IRS."

Your letter stated that "This proposal does not mean that the IRS will be entering the tax software business. However, it does mean that the IRS will be required to build on the trends that already exist in the industry, which are to offer very low cost or even no cost tax services over the Web. One way that the IRS could implement this provision is by issuing a Request for Proposal (RFP) to the industry requesting vendors to submit proposals" to meet a number of IRS requirements.

At its March 2 meeting, ETAAC discussed the proposed \$10 refundable tax credit proposal and decided to support this proposal for taxpayers who e-file individual income tax returns.

Letter to Bob Barr
May 1, 2000
Page 2 of 3

In response to your letter, we have subsequently considered the proposal for free Internet preparation and filing for individual tax returns. The ETAAC believes that free tax preparation and electronic filing over the Internet for individuals would benefit taxpayers and lead to an increase in electronic filing. Therefore, ETAAC supports this objective, but is concerned that the IRS might attempt to achieve the objective either by competing with the private sector or eliminating robust competition from the private sector.

The IRS Restructuring and Reform Act of 1998 states that "The IRS should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns." This approach is working well. Existing marketplace competition has already led to a wide number of options that taxpayers can choose, including very low or no cost tax services on the Web from a wide variety of providers—the very trend you indicated in your letter. The number of providers, now over 20, (see the attached list for details) is dramatically increasing every year, forcing strong product development and causing prices to fall dramatically.

The ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of no cost tax preparation and filing options over the Internet are to: 1) let the competitive market continue to progress, and 2) continue stimulating electronic filing through its creative advertising campaign and making electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper. These actions will result in increased taxpayer demand for electronic filing which will in turn stimulate the marketplace to create improved and less expensive, even no cost, products, as it has already done in the last several years. The ETAAC applauds Commissioner Rossotti's testimony to the House Ways and Means Oversight Subcommittee on March 28, 2000 whereby he endorsed this approach.

There are two approaches that the ETAAC believes the IRS should not take. The ETAAC strongly recommends against the IRS developing its own tax preparation software program, either internally or through acquisition. The ETAAC also believes that the IRS should not follow an approach where the IRS issues an RFP or RFA to select a limited number of "Authorized IRS e-file providers" to IRS-specifications. Your letter suggested IRS might use this approach, which ETAAC believes would lessen competition that currently exists in the private sector. If the IRS selects a limited number of providers that will be effectively "co-branded" with it for e-filing, the IRS will indirectly be entering the software business. This situation will result in a huge competitive advantage and perhaps even a monopolistic position for those selected. The IRS should not lessen competition by entering the market and choosing which of the current providers gets the advantage of an "IRS brand". The ETAAC believes more competition, not less, is important to lowering the price of e-filing and cannot support any implementation that limits or stifles competition in the private sector. The ETAAC would be pleased to work more

Letter to Bob Barr
May 1, 2000
Page 3 of 3

with the IRS to develop approaches the IRS might take to stimulate the market and increase competition.

The ETAAC supports the goal of a no dollar cost Internet e-filing for all taxpayers and believes it is being achieved currently through free market forces, with even more no cost options available in the future. The marketplace will be further stimulated towards no cost tax preparation and e-filing by enactment of the \$10 tax credit. The key to achieving no cost tax preparation and electronic filing over the Internet is to increase marketplace competition rather than decrease competition by offering IRS software or selecting a limited number of e-file providers for co-branding. If the private sector does not progress to free tax preparation and e-filing in the next several years, as expected, the ETAAC believes the IRS would then be justified in evaluating whether an electronic template is an appropriate and needed tool to promote free e-filing over the Internet. The IRS and ETAAC should track progress in meeting this objective on an annual basis.

The IRS must also recognize that the goal of the private sector is to make a profit and free enterprise does not mean that the private sector must offer its products and services for free. Establishing a goal of no-cost tax preparation and electronic filing ultimately means private sector companies engaging in this practice must obtain something of value, such as exposure to advertising or offers to perform other services, in exchange for free tax preparation and electronic filing. The IRS should ensure that taxpayer privacy rights are not violated, but should not restrict the ability of a consensual exchange between the taxpayer and private sector company to occur in a totally electronic environment with appropriate security safeguards.

The committee has addressed in this letter the two issues you asked it to consider. We are also evaluating a number of other issues that we believe have strategic impact, and will be making recommendations on these issues in our June report to Congress.

Sincerely,

Charles A. Lacijan, Chair
Electronic Tax Administration Advisory Committee (ETAAC)

Attachment

Appendix A: Circular A-76

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

CIRCULAR NO. A-76 (REVISED 1999)

August 4, 1983

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Performance of Commercial Activities

1. **Purpose.** This Circular establishes Federal policy regarding the performance of commercial activities and implements the statutory requirements of the Federal Activities Inventory Reform Act of 1998, Public Law 105-270. The Supplement to this Circular sets forth the procedures for determining whether commercial activities should be performed under contract with commercial sources or in-house using Government facilities and personnel.
2. **Rescission.** OMB Circular No. A-76 (Revised), dated March 29, 1979; and Transmittal Memoranda 1 through 14 and 16 through 18.
3. **Authority.** The Budget and Accounting Act of 1921 (31 U.S.C. 1 *et seq.*), The Office of Federal Procurement Policy Act Amendments of 1979. (41 U.S.C. 401 *et seq.*), and The Federal Activities Inventory Reform Act of 1998. (P. L. 105-270).
4. **Background.**
 - a. In the process of governing, the Government should not compete with its citizens. The competitive enterprise system, characterized by individual freedom and initiative, is the primary source of national economic strength. In recognition of this principle, it has been and continues to be the general policy of the Government to rely on commercial sources to supply the products and services the Government needs.
 - b. This national policy was promulgated through Bureau of the Budget Bulletins issued in 1955, 1957 and 1960. OMB Circular No. A-76 was issued in 1966. The Circular was previously revised in 1967, 1979, and 1983. The Supplement (Revised Supplemental Handbook) was previously revised in March 1996 (Transmittal Memorandum 15).
5. **Policy.** It is the policy of the United States Government to:
 - a. *Achieve Economy and Enhance Productivity.* Competition enhances quality, economy, and productivity. Whenever commercial sector performance of a Government operated commercial activity is permissible, in accordance with this Circular and its Supplement, comparison of the cost of contracting and the cost of in-house performance shall be performed to determine who will do the work.

When conducting cost comparisons, agencies must ensure that all costs are considered and that these costs are realistic and fair.

- b. *Retain. Governmental Functions In-House.* Certain functions are inherently Governmental in nature, being so intimately related to the public interest as to mandate performance only by Federal employees. These functions are not in competition with the commercial sector. Therefore, these functions shall be performed by Government employees.
- c. *Rely on the Commercial Sector.* The Federal Government shall rely on commercially available sources to provide commercial products and services. In accordance with the provisions of this Circular and its Supplement, the Government shall not start or carry on any activity to provide a commercial product or service if the product or service can be procured more economically from a commercial source.

6. Definitions. For purposes of this Circular:

- a. A *commercial activity* is one which is operated by a Federal executive agency and which provides a product or service that could be obtained from a commercial source. Activities that meet the definition of an inherently Governmental function provided below are not commercial activities. A representative list of commercial activities is provided in Attachment A. A commercial activity also may be part of an organization or a type of work that is separable from other functions or activities and is suitable for performance by contract.
- b. A *conversion to contract* is the changeover of an activity from Government performance to performance under contract by a commercial source.
- c. A *conversion to in-house* is the changeover of an activity from performance under contract to Government performance.
- d. A *commercial source* is a business or other non-Federal activity located in the United States, its territories and possessions, the District of Columbia or the Commonwealth of Puerto Rico, which provides a commercial product or service.
- e. An *inherently Governmental function* is a function which is so intimately related to the public interest as to mandate performance by Government employees. Consistent with the definitions provided in the Federal Activities Inventory Reform Act of 1998 and OFPP Policy Letter 92-1, these functions include those activities which require either the exercise of discretion in applying Government authority or the use of value judgment in making decisions for the Government. Services or products in support of inherently Governmental functions, such as those listed in Attachment A, are commercial activities and are normally subject to this Circular. Inherently Governmental functions normally fall into two categories:

(1) The *act of governing*, i.e., the discretionary exercise of Government authority. Examples include criminal investigations, prosecutions and other judicial

functions; management of Government programs requiring value judgments, as in direction of the national defense; management and direction of the Armed Services; activities performed exclusively by military personnel who are subject to deployment in a combat, combat support or combat service support role; conduct of foreign relations; selection of program priorities; direction of Federal employees; regulation of the use of space, oceans, navigable rivers and other natural resources; direction of intelligence and counter-intelligence operations; and regulation of industry and commerce, including food and drugs.

(2) *Monetary transactions and entitlements*, such as tax collection and revenue disbursements; control of the Treasury accounts and money supply; and the administration of public trusts.

- f. A *cost comparison* is the process of developing an estimate of the cost of Government performance of a commercial activity and comparing it, in accordance with the requirements of the Supplement, to the cost to the Government for contract performance of the activity.
- g. *Directly affected parties* are Federal employees and their representative organizations and bidders or offerors on the instant solicitation.
- h. *Interested parties* for purposes of challenging the contents of an agency's Commercial Activities Inventory under the Federal Activities Inventory Reform Act of 1998 are:

(1) A private sector source that (A) is an actual or prospective offeror for any contract or other form of agreement to perform the activity; and (B) has a direct economic interest in performing the activity that would be adversely affected by a determination not to procure the performance of the activity from a private sector source.

(2) A representative of any business or professional association that includes within its membership private sector sources referred to in (1) above.

(3) An officer or employee of an organization within an executive agency that is an actual or prospective offeror to perform the activity.

(4) The head of any labor organization referred to in section 7103(a) (4) of Title 5, United States Code that includes within its membership officers or employees of an organization referred to in (3) above.

7. Scope.

- a. Unless otherwise provided by law, this Circular and its Supplement shall apply to all executive agencies and shall provide administrative direction to heads of agencies.
- b. This Circular and its Supplement apply to printing and binding only in those agencies or departments which are exempted by law from the provisions of Title 44 of the U.S. Code.
- c. This Circular and its Supplement shall not:

- (1) Be applicable when contrary to law, Executive Orders, or any treaty or international agreement;
 - (2) Apply to inherently Governmental functions as defined in paragraph 6.e.;
 - (3) Apply to the Department of Defense in times of a declared war or military mobilization;
 - (4) Provide authority to enter into contracts;
 - (5) Authorize contracts which establish an employer-employee relationship between the Government and contractor employees. An employer-employee relationship involves close, continual supervision of individual contractor employees by Government employees, as distinguished from general oversight of contractor operations. However, limited and necessary interaction between Government employees and contractor employees, particularly during the transition period of conversion to contract, does not establish an employer-employee relationship.
 - (6) Be used to justify conversion to contract solely to avoid personnel ceilings or salary limitations;
 - (7) Apply to the conduct of research and development. However, severable in-house commercial activities in support of research and development, such as those listed in Attachment A, are normally subject to this Circular and its Supplement; or
 - (8) Establish and shall not be construed to create any substantive or procedural basis for anyone to challenge any agency action or inaction on the basis that such action or inaction was not in accordance with this Circular, except as specifically set forth in Part 1, Chapter 3, paragraph K of the Supplement, "Appeals of Cost Comparison Decisions" and as set forth in Appendix 2, Paragraph G, consistent with Section 3 of the Federal Activities Inventory Reform Act of 1998.
- d. The requirements of the Federal Activities Inventory Reform Act of 1998 apply to the following executive agencies:
- (1) an executive department named in 5 USC 101,
 - (2) a military department named in 5 USC 102, and
 - (3) an independent establishment as defined in 5 USC 104.
- e. The requirements of the Federal Activities Inventory Reform Act of 1998 do not apply to the following entities or activities:
- (1) the General Accounting Office,
 - (2) a Government corporation or a Government controlled corporation as defined in 5 USC 103,
 - (3) a non-appropriated funds instrumentality if all of its employees are referred to in 5 USC 2105(c), or
 - (4) Depot-level maintenance and repair of the Department of Defense as defined in 10 USC 2460.
8. **Government Performance of a Commercial Activity.** Government performance of a commercial activity is authorized under any of the following conditions:
- a. *No Satisfactory Commercial Source Available.* Either no commercial source is capable of providing the needed product or service, or use of such a source would cause unacceptable delay or disruption of an essential program. Findings shall be supported as follows:

(1) If the finding is that no commercial source is capable of providing the needed product or service, the efforts made to find commercial sources must be documented and made available to the public upon request. These efforts shall include, in addition to consideration of preferential procurement programs (see Part I, Chapter 1, paragraph C of the Supplement) at least three notices describing the requirement in the *Commerce Business Daily* over a 90-day period or, in cases of *bona fide* urgency, two notices over a 30-day period. Specifications and requirements in the solicitation shall not be unduly restrictive and shall not exceed those required of in-house Government personnel or operations.

(2) If the finding is that a commercial source would cause unacceptable delay or disruption of an agency program, a written explanation, approved by the assistant secretary or designee in paragraph 9.a. of the Circular, must show the specific impact on an agency mission in terms of cost and performance. Urgency alone is not adequate reason to continue in-house operation of a commercial activity. Temporary disruption resulting from conversion to contract is not sufficient support for such a finding, nor is the possibility of a strike by contract employees. If the commercial activity has ever been performed by contract, an explanation of how the instant circumstances differ must be documented. These decisions must be made available to the public upon request.

(3) Activities may not be justified for in-house performance solely on the basis that the activity involves or supports a classified program or the activity is required to perform an agency's basic mission.

b. *National Defense.*

(1) The Secretary of Defense shall establish criteria for determining when Government performance of a commercial activity is required for national defense reasons. Such criteria shall be furnished to OMB, upon request.

(2) Only the Secretary of Defense or his designee has the authority to exempt commercial activities for national defense reasons.

c. *Patient Care.* Commercial activities performed at hospitals operated by the Government shall be retained in-house if the agency head, in consultation with the agency's chief medical director, determines that in-house performance would be in the best interests of direct patient care.

d. *Lower cost.* Government performance of a commercial activity is authorized if a cost comparison prepared in accordance with the Supplement demonstrates that the Government is operating or can operate the activity on an ongoing basis at an estimated lower cost than a qualified commercial source.

9. **Action Requirements.** To ensure that the provisions of this Circular and its Supplement are followed, each agency head shall:

- a. Designate an official at the assistant secretary or equivalent level and officials at a comparable level in major component organizations to have responsibility for implementation of this Circular and its Supplement within the agency.
- b. Establish one or more offices as central points of contact to carry out implementation. These offices shall have access to all documents and data pertinent to actions taken under

the Circular and its Supplement and will respond in a timely manner to all requests concerning inventories, schedules, reviews, results of cost comparisons and cost comparison data.

- c. Be guided by Federal Acquisition Regulation (FAR) Subpart 24.2 (Freedom of Information Act) in considering requests for information.
 - d. Implement this Circular and its Supplement with a minimum of internal instructions. Cost comparisons shall not be delayed pending issuance of such instructions.
 - e. Ensure the reviews of all existing in-house commercial activities are completed within a reasonable time in accordance with the Federal Activities Inventory Reform Act of 1998 and the Supplement.
10. **Annual Reporting Requirement.** As required by the Federal Activities Inventory Reform Act of 1998 and Appendix 2 of the Supplement, no later than June 30 of each year, agencies shall submit to OMB a Commercial Activities Inventory and any supplemental information requested by OMB. After review and consultation by OMB, agencies will transmit a copy of the Commercial Activities Inventory to Congress and make the contents of the Inventory available to the public. Agencies will follow the process provided in the Supplement for interested parties to challenge (and appeal) the contents of the inventory.
11. **OMB Responsibility and Contact Point.** All questions or inquiries should be submitted to the Office of Management and Budget, Room 6002 NEOB, Washington, DC 20503. Telephone number (202) 395-6104, FAX (202) 395-7230.
12. **Effective Date.** This Circular and the changes to its Supplement are effective immediately.

Attachment A
OMB Circular No. A-76

EXAMPLES OF COMMERCIAL ACTIVITIES

Audiovisual Products and Services

Photography (still, movie, aerial, etc.)
 Photographic processing (developing, printing, enlarging, etc.)
 Film and videotape production (script writing, direction, animation, editing, acting, etc.)
 Microfilming and other microforms
 Art and graphics services
 Distribution of audiovisual materials
 Reproduction and duplication of audiovisual products
 Audiovisual facility management and operation
 Maintenance of audiovisual equipment

Automatic Data Processing

ADP services - batch processing, time-sharing, facility management, etc.
 Programming and systems analysis, design, development, and simulation
 Key punching, data entry, transmission, and teleprocessing services
 Systems engineering and installation
 Equipment installation, operation, and maintenance

Food Services

Operation of cafeterias, mess halls, kitchens, bakeries, dairies, and commissaries
 Vending machines
 Ice and water

Health Services

Surgical, medical, dental, and psychiatric care
 Hospitalization, outpatient, and nursing care
 Physical examinations
 Eye and hearing examinations and manufacturing and fitting glasses and hearing aids
 Medical and dental laboratories
 Dispensaries
 Preventive medicine
 Dietary services
 Veterinary services

Industrial Shops and Services

Machine, carpentry, electrical, plumbing, painting, and other shops
 Industrial gas production and recharging
 Equipment and instrument fabrication, repair and calibration
 Plumbing, heating, electrical, and air conditioning services, including repair
 Fire protection and prevention services
 Custodial and janitorial services
 Refuse collection and processing

Maintenance, Overhaul, Repair, and Testing

Aircraft and aircraft components
 Ships, boats, and components
 Motor vehicles

- Combat vehicles
- Railway systems
- Electronic equipment and systems
- Weapons and weapon systems
- Medical and dental equipment
- Office furniture and equipment
- Industrial plant equipment
- Photographic equipment
- Space systems
- Management Support Services**
 - Advertising and public relations services
 - Financial and payroll services
 - Debt collection
- Manufacturing, Fabrication, Processing, Testing, and Packaging**
 - Ordnance equipment
 - Clothing and fabric products
 - Liquid, gaseous, and chemical products
 - Lumber products
 - Communications and electronics equipment
 - Rubber and plastic products
 - Optical and related products
 - Sheet metal and foundry products
 - Machined products
 - Construction materials
 - Test and instrumentation equipment
- Office and Administrative Services**
 - Library operations
 - Stenographic recording and transcribing
 - Word processing/data entry/typing services
 - Mail/messenger
 - Translation
 - Management information systems, products and distribution
 - Financial auditing and services
 - Compliance auditing
 - Court reporting
 - Material management
 - Supply services
- Other Services**
 - Laundry and dry cleaning
 - Mapping and charting
 - Architect and engineer services
 - Geological surveys
 - Cataloging
 - Training - academic, technical, vocational, and specialized Operation of utility systems (power, gas, water steam, and sewage)
 - Laboratory testing services

Printing and Reproduction

- Facility management and operation

- Printing and binding – where the agency or department is exempted from the provisions of Title 44 of the U.S. Code

- Reproduction, copying, and duplication

- Blueprinting

Real Property

- Design, engineering, construction, modification, repair, and maintenance of buildings and structures; building mechanical and electrical equipment and systems; elevators; escalators; moving walks

- Construction, alteration, repair, and maintenance of roads and other surfaced areas

- Landscaping, drainage, mowing and care of grounds

- Dredging of waterways

Security

- Guard and protective services

- Systems engineering, installation, and maintenance of security systems and individual privacy systems

- Forensic laboratories

Special Studies and Analyses

- Cost benefit analyses

- Statistical analyses

- Scientific data studies

- Regulatory studies

- Defense, education, energy studies

- Legal/litigation studies

- Management studies

Systems Engineering, Installation, Operation, Maintenance, and Testing

- Communications systems - voice, message, data, radio, wire, microwave, and satellite

- Missile ranges

- Satellite tracking and data acquisition

- Radar detection and tracking

- Television systems - studio and transmission equipment, distribution systems, receivers, antennas, etc.

- Recreational areas

- Bulk storage facilities

Transportation

- Operation of motor pools

- Bus service

- Vehicle operation and maintenance

- Air, water, and land transportation of people and things

- Trucking and hauling



2000 TNT 92-3

MAY 11, 2000 THURSDAY

2713 words

#3 2000 TNT 92-3 BY CLICKING WEB AD, DOES TAXPAYER CONSENT TO DISCLOSURE OF TAX DATA? (Release Date: MAY 09, 2000) (Doc 2000-12970 (8 original pages))

DEPARTMENT: News, Commentary, and Analysis; News Stories

ABSTRACT: The IRS Office of Chief Counsel is preparing to issue within the next month an internal opinion on the myriad issues surrounding advertising by private-sector vendors on the IRS Web site, said Robert E. Barr, assistant commissioner for electronic tax administration.

SUMMARY:

Could a private-sector vendor prepare an banner ad that pops up on a computer screen when a taxpayer is filling out a form online through the IRS Web site, and if so, to what level of consent would the taxpayer be agreeing to marketing from the vendor if the taxpayer clicks on that ad and enters in personal information? Going further into this scenario, what types of customized information or data, if any, could vendors request taxpayers to give them with that click? Would this information include, for example, the taxpayer's name? The taxpayer's industry affiliation? The type of form the taxpayer is filling out when he or she clicks on that ad?

These are among the many questions the IRS Office of Chief Counsel will address in an internal opinion expected to be issued within the next month. Robert E. Barr, the IRS's assistant commissioner for electronic tax administration, engaged Chief Counsel to look into the myriad issues surrounding advertising by private-sector vendors on the IRS Web site, as well as questions raised by possible incentives the IRS might use to encourage businesses to offer free online electronic filing. And yes, according to Barr, these two subjects are linked. These are also questions raised in the marketplace by regulations written a quarter century ago.

On May 9 Barr cut short prepared remarks to the Council for Electronic Revenue Communication Advancement in favor of an open exchange. He did so because by the time he took the podium there was mass confusion among CERCA's members about where the IRS is heading in its quest for free online or electronic filing alternatives. President Clinton's fiscal 2001 budget proposal includes language that has led business leaders to believe the IRS was considering "relaxing" taxpayer privacy rules and regulations to allow vendors that provide free online or electronic filing access to valuable taxpayer personal or financial data. That is, the business leaders believed the administration was suggesting the IRS might use access to such data as an incentive for vendors to give their filing services away for free.

IRS officials clarified that the Service is not considering "relaxing" privacy standards to provide incentives to businesses to offer free electronic filing. However, according to Barr, there is a link between the issue of incentives and vendor access to certain taxpayer data — provided the taxpayer consents to disclosure of the data and vendors enter into agreements with the IRS spelling out how that data will be protected. This is why Barr brought Chief Counsel into the equation; the IRS's attorneys are looking into what the IRS can and cannot do under current regulations and statutes.

AUTHOR: Hamilton, Amy

Tax Analysts

GEOGRAPHIC: United States

INDEX: disclosure;

compliance, examinations

REFERENCES:

Subject Area:

Electronic commerce tax issues;

Information disclosure;

Practice and procedure

Industry Group:

Computers and software

TEXT:

Release Date: MAY 09, 2000

Could a private-sector vendor prepare a banner ad that pops up on a computer screen when a taxpayer is filing out a form online through the IRS Web site, and if so, to what level of consent would the taxpayer be agreeing to marketing from the vendor if the taxpayer clicks on that ad and enters in personal information? Going further into this scenario, what types of customized information or data, if any, could vendors request taxpayers to give them with that click? Would this information include, for example, the taxpayer's name? The taxpayer's industry affiliation? The type of form the taxpayer is filing out when he or she clicks on that ad?

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Mass Confusion

CERCA's membership includes virtually every business working in partnership with the IRS or otherwise publicly associated with some aspect of the tax business. For example, American Express and Discover Novus Network are members of the organization, as are H&R Block, Microsoft, and Intuit. The list also includes firms whose tax work is well-known in the tax world, but not necessarily among the general public, including both Computer Sciences Corporation, the company that heads the consortium that was awarded the IRS's prime contract for technology modernization, and Andersen Consulting.

The confusion about where the IRS is heading in terms of providing incentives to businesses to provide free online or electronic filing became evident in questions CERCA's members posed to earlier panels. For example, former IRS Chief Operations Office John Dalrymple appeared stunned when several CERCA members indicated they were under the impression the IRS was considering "relaxing" privacy standards protecting taxpayer information as an incentive for vendors to offer free online or electronic filing. Dalrymple, who was recently named the first commissioner of the IRS's wage and investment division, responded by saying he believes that if anything, the IRS would come down harder on ensuring taxpayer privacy is protected should vendors be allowed access to any taxpayer information. "Relaxing the privacy regulation — I'm not even sure what that means," Dalrymple said.

CERCA members got their information from language in President Clinton's fiscal 2001 budget request. The budget request contains two provisions intended to make electronic filing more attractive to taxpayers. The one that has received a great deal of publicity is the proposal for a temporary, refundable \$ 10 tax credit for returns filed electronically for tax years 2002 through 2006. (This provision excludes Telefile, for which the administration is proposing a \$ 5 temporary, refundable credit.) It is the administration's second proposal at issue here. That provision states:

No later than tax year 2002, the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer. If the IRS offered such options through contract arrangements with Authorized IRS e-file Providers, it would be with the assurance that the taxpayer's tax return information would not be used by the Provider without the taxpayer's permission for any purpose other than submission to the IRS.

CERCA members provided Barr with a copy of this language for the IRS's interpretation of what it means. One CERCA member asked specifically, "Does the language mean the administration believes there is a link between private taxpayer data and incentives the IRS might provide to vendors who agree to offer free electronic or online filing services?"

"What it basically says is that there is in fact a connection here," Barr said. "Essentially what the president has said here is that the administration is interested in pervasive, free electronic filing over the

Internet with the assurance that information would not be used without the taxpayer's permission." Barr later added that "clearly it intimidated" the taxpayer could opt in to marketing.

Earlier, another CERCA member had asked Barr whether the IRS is considering giving vendors "click-through" as opposed to written consent from a taxpayer giving the vendor authorization to solicit the taxpayer directly or to use certain elements of the taxpayer's data (for constructing market analyses, for example, or building targeted mailing lists). It was during this earlier exchange that Barr discussed Chief Counsel's work on this matter, giving examples of the many issues and scenarios he asked the IRS attorneys to consider.

In addition to the questions listed in the first paragraph of this article, Barr asked Chief Counsel to address questions like the following: If solicitation occurs, would it be on an "opt-in" or "opt-out" basis for the taxpayer? That is, would the taxpayer "opt-in" for solicitation when they answer affirmatively to a vendor's specific request to provide more information. Or, for example, would all taxpayers who file through the IRS Web site be the potential recipients of solicitation unless they specifically "opted-out" of that possibility?

Also, Barr said, if solicitation occurs would the taxpayer's consent be automatic, or would a human being be required to respond to verify that the taxpayer has given consent before solicitation can occur? In either case, would the taxpayer subsequently be solicited by mail or through another means? What assurances would the IRS and taxpayers have that the taxpayer information is not specialized if vendors in the end turn out not to have authorization for certain pieces of the taxpayer data?

"All of those questions are on the table right now," Barr said.

Another CERCA member wondered about the timing of solicitation, noting that the only part of this issue the IRS addresses in written form right now states that vendors can offer their services to taxpayers only at the time the taxpayer is picking up a return. "I think the expiration of the authorization (for solicitation), and is the taxpayer specifically asked to deal with the time frame -- if you ask, 'Can we use your data to solicit you?' the taxpayer will say 'get outta here.' I think expirability is a fair question," Barr said.

After Barr's exchange before the audience, Tax Analysts presented Barr with a few questions raised by CERCA members that were either not discussed during the forum or not fully clarified during that discussion. One of the concerns CERCA members had expressed to Tax Analysts was a fear that the Clinton administration's budget language suggests the administration believes the IRS should interfere with the market in the quest to give taxpayers a free online or electronic filing option. One CERCA member had suggested as much to Barr in a question about whether the Clinton administration would use this first experiment in setting market prices on tax services -- in this case, setting the price at zero -- as a springboard for doing so routinely in the future.

"No," Barr said in his comments to Tax Analysts. "That's not it. What the administration believes is that taxpayers should be offered a free alternative. So what the administration has asked us to do is check out some of the opportunities we can leverage through the [Internal Revenue Service Restructuring and Reform Act of 1998] to discover whether this can be done." The administration absolutely wants to protect taxpayer information, Barr added.

Another concern brought to Tax Analysts' attention by one CERCA member is that taxpayer data is the only thing the IRS has to barter when it comes to providing incentives to businesses to provide free online or electronic filing. "That's not really true though," Barr said. "I want to ask businesses, is this a case where you can only get a couple of dollars per return? I want to just open it up," Barr said. "I want businesses to tell us the kinds of things they think we can do."

Barr told Tax Analysts his sense is that a "click-through" consent option could work. "But then the question is, to what level of consent is the taxpayer agreeing?" Barr said. "As you dig deeper into this it gets more problematic." Barr noted that Counsel is coming out soon with the internal opinion he requested.

"Then we'll better understand what the current statutes and regs say we can and cannot do," Barr said. "Then we'll invite feedback from the vendors. Maybe you should call it a 'request for information' instead of a request for proposal," Barr told Tax Analysts.

In fact, what exactly the IRS will be requesting from vendors within the next two months proved to be another source of confusion among CERCA members. One CERCA member expressed concern that the IRS is using the "request for proposal" procedure to determine the boundaries that will be set on which, if any, taxpayer data can be made available to vendors. That is, instead of using traditional procedures by which the government spells out how the tax law will be administered, businesses will direct the government through the "request for proposal" procedure. Also, the CERCA member said, businesses fear that under this procedure only select vendors -- in other words, those vendors that provide free electronic filing services to taxpayers -- would have access to the valuable taxpayer data.

That is not the case, Barr told Tax Analysts. After the Chief Counsel's office issues its internal opinion, the IRS wants input from businesses on whether the conclusions of Counsel support -- in any way, shape,

or form -- a marketplace where it is feasible for businesses to offer free online or electronic filing services.

Barr said that what the IRS wants is information. What the IRS needs right now, in this entirely new area, is a new vehicle -- a vehicle or forum for obtaining information from businesses on these issues that can be published and sifted through. And then, perhaps, after all of this, the IRS would be able to take elements of several different ideas that have come in through this forum and build a system that supports free electronic filing as a viable service for businesses to offer. What the IRS will be seeking after Counsel issues its opinion is a "request for information," Barr told Tax Analysts.

Barr had not been that explicit with CERCA members, instead using the phrases "request for proposal" and "request for information" interchangeably.

No Free Lunch

During his open session with CERCA members, Barr noted "I have heard from some of you that you'd like cash" in exchange for providing free electronic filing services. "I have no intention of doing that." But, he said, the new "request for information" procedure described above will be a place where businesses can resubmit this proposal for widespread consideration.

"I think we all believe there's no such thing as a free lunch," one CERCA member said to Barr. "Is there any view in the administration that this could be anything other than free? I think \$ 9.95 is a very reasonable price for the service."

Barr replied by first mentioning the administration's proposal for a \$ 10 temporary, refundable tax credit, which he said has not been widely discussed by vendors. He then noted that the fate of the proposed credit is now in the hands of Congress.

"From my perspective, I clearly understand there are no free lunches per se," Barr stated. "What we're interested in understanding is what revenue models make sense." Also, the IRS wants to know how the agency and businesses can work together on this front to make free electronic filing a viable alternative.

"There is another voice not represented here today," Barr said, "and that's the taxpayers." Increasingly, Barr said, members of Congress are getting letters from taxpayers asking why they have to use somebody's tax software and pay a fee to file their taxes, when filing and paying taxes is not an option? And increasingly, members of Congress are writing to Barr, forwarding these letters and demanding a response from the IRS to comments from taxpayers like, "I don't have a choice when it comes to filing my taxes. Why can't you guys go build the software yourselves?"

Tax Analysts later asked Barr what would happen if the marketplace cannot support offering free electronic filing to taxpayers? "We'd have to look at other alternatives," Barr said.

"I wouldn't declare we'd build our own software, for two reasons," Barr continued. "One, I seriously doubt we'll get to that point. Two, I sincerely hope we don't get to that point."

The State Side

According to the Federation of Tax Administrators, an association representing all of the state tax officials in the nation, 12 state tax departments already offer their taxpayers free online filing through the state tax Web sites. All but one of those states have built their own software systems for providing this free electronic filing option.

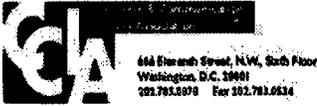
Only Oklahoma partners with a business to provide a free electronic filing service to the state. And, it turns out, Oklahoma pays Intuit \$ 6.50 per return for this service.

According to Paula Ross, the Oklahoma Tax Commission public relations director, Oklahoma launched its free Web-based filing option two years ago after awarding Universal Tax Systems the contract for this work. In that first year, 10,000 Oklahoma filers chose this option. Then Intuit bought Universal Tax Systems and absorbed the state contract; in the second year, 33,000 Oklahoma filers chose the free Web-based option.

Ross said Oklahoma's Tax Commission assigns the cost of paying Intuit for this service to its processing budget. "We feel it is cost-effective for us," Ross told Tax Analysts. Plus, she said, the state wants to encourage electronic filing, which she noted already appears to be growing in popularity with the state's taxpayers.

Most privacy experts contacted by Tax Analysts were unable by press time to comment on the specifics described in this article. However, Sarah Andrews, a policy analyst at the Washington-based Electronic Privacy Information Center, did venture to make one general comment. "There is sort of an ethical question when you've got government agencies collaborating with these advertisers, which are renowned privacy offenders," Andrews said.

***** End of Document *****



September 22, 2000

Ms. Michelle Lane
Contracting Officer
Free Internet Filing Project
Internal Revenue Service OP:ETA:I:CM
NCFB C4-322
5000 Ellin Road
Lanham, Maryland 20706

RE: Electronic Tax Administration (ETA) "Free e-file" Request for Information (RFI)
No: TIRNO-00-H-00007

Dear Ms. Lane:

The Computer & Communications Industry Association (CCIA) hereby submits this Response to the Electronic Tax Administration (ETA) "Free e-file" Request for Information (RFI) No: TIRNO-00-H-00007.

CCIA is an association of electronic commerce, Internet, telecommunications, computer and software companies ranging from small, entrepreneurial companies to some of the largest in the industry. CCIA's members include equipment manufacturers, software developers, telecommunications and online service providers, resellers, systems integrators, and third-party vendors. Its member companies employ well over a half-million employees and generate annual revenues exceeding \$300 billion.

The future of electronic government and service to the citizen is vitally important to our country, and so too is the continued health, vitality, investment, and innovation of the high technology and electronic commerce sectors of the American economy. U.S. citizens will benefit greatly from both, but it is exceedingly important that public policy seeks to balance the requirements and needs of our public and private sectors, so that the success and growth of the former is not at the expense of the continued success and growth of the latter.

Nine Presidents of the United States have embraced a national policy that declares: "In the course of governing, Government should not compete with its citizens. The competitive enterprise system, characterized by individual freedom and initiative, is the primary source of national economic strength." The continued validity of that simple truth, expressed so clearly in OMB Circular A-76, is the central issue at stake in the IRS'

pending Request for Information (RFI). The outcome of the current national debate over the appropriate role of the U.S. Government in the emerging New Economy will impact investment, job formation, and innovation in this country for years to come.

The ultimate decisions made by the Government in its ongoing effort to competitively enter electronic commerce markets will either advance or set back American economic growth. We are therefore pleased to submit the attached comments in this important policy debate.

Sincerely,

Edward J. Black
President and CEO
Computer & Communications Industry Association

Attachments

Request for Information No: TIRNO-00-H-00007

**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ELECTRONIC TAX ADMINISTRATION**

REQUEST FOR INFORMATION

The Office of Electronic Tax Administration (ETA) within the Department of Treasury's Internal Revenue Service (IRS) is issuing this Request for Information (RFI) to analyze the public and private sector's reaction to a proposed electronic opportunity via the Internet. The IRS requests comments on various aspects of the implementation of this opportunity.

Background

The mission of ETA is to revolutionize how taxpayers transact and communicate with the IRS. Strategies to fulfill this mission include:

- Making electronic filing (*e-file*), payments, transactions and communications so simple, inexpensive and trusted that taxpayers will prefer these to calling and mailing;
- Providing additional taxpayer access methods to products and services centering on electronic filing, payment, transaction, and communication products and services;
- Aggressively protecting transaction and information integrity and quality;
- Seeking the best people, ideas and partners to assure IRS success; and
- Delivering the highest quality products and services as promised.

These strategies include the development and implementation of an aggressive IRS *e-file* awareness campaign and the solicitation of assistance and support from the tax professional and software development community within private industry. Collectively, all efforts will help the IRS strive to achieve the overriding goal of receiving 80% of all tax and information returns electronically by 2007. As provided by the IRS Reform and Restructuring Act of 1998, such bold and innovative steps are necessary to continue the previously mentioned revolution - which to date, is gaining momentum. For example, per IRS statistics, during the entire 1999 income tax filing season, the IRS received and processed almost 30 million income tax returns electronically. Through June 1, 2000 of the 2000 income tax filing season, the IRS had already received and processed over 35 million tax returns electronically - a significant increase from the previous year. However, additional efforts and/or partnerships are needed to reach set objectives.

Request for Information No: TIRNO-00-H-00007**Current Opportunities for Taxpayers**

Currently, taxpayers desiring to self-prepare and electronically file an individual income tax return must use third party tax preparation software. Such software is available for purchase over-the-counter and/or is available on-line or via download from the Internet. In most cases, the industry charges a fee to use the software for tax preparation and/or for electronic filing. Taxpayers have increasingly notified the IRS that they want to prepare and file their tax return electronically but at no cost to them. Many have indicated that they would prefer to file directly with the IRS instead of using a third party.

Presidential Budget Provision

Per the President's FY2001 Budget Request:

"No later than tax year 2002, the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer. If the IRS offered such options through contract arrangements with Authorized IRS e-file Providers, it would be with the assurance that the taxpayer's tax return information would not be used by the Provider without the taxpayer's permission for any purpose other than submission to the IRS."

The IRS is hopeful to build on the trends that already exist in industry, which are to offer very low cost or even no cost tax services over the web. Individuals interested in learning more about such trends in industry may visit the IRS *e-file* Partnership Page located within the Electronic Services section of the IRS web site at <http://www.irs.gov>.

Security Requirements

One of the most important requirements of any ultimate offering will be for the private sector to maintain the confidentiality and security of the taxpayer's data. Although this information is supplied to the private sector at the taxpayer's consent, the IRS will require that all information received through this program meet the following stringent security requirements:

- (1) Tax return information will be kept confidential
- (2) Tax return information will be used solely for the purpose directed by the taxpayer
- (3) Tax return information will not be further disclosed, traded, bartered or sold without the express authorization of the taxpayer (i.e., the contractor will be required to obtain another authorization from the taxpayer for further disclosures).

Comments of the Computer & Communications Industry Association

The declared desire by the Internal Revenue Service to competitively offer electronic tax preparation services to American consumers has been the subject of a growing national debate for the last three years. However, the first known public announcement of that intent was in March 1998 at the IRS' Software Developers Conference in Landover, Maryland, by the Assistant Commissioner for Electronic Tax Administration. That conference, attended by upwards of a hundred representatives of the technology industry, was stunned to hear the IRS announcement that it planned to offer online electronic tax preparation services to consumers as part of its strategic plan for the future of the agency.

Since that time there have been many developments in this debate. Senior IRS officials have been asked repeatedly in congressional hearings either to confirm or deny the electronic tax plans of the agency. The Commissioner of Internal Revenue has stated in multiple such hearings that the agency has no plans or intent to develop, provide, or offer electronic tax preparation software or services -- and yet the efforts of the Electronic Tax Administration (ETA) have somehow continued undeterred and the debate has gone on. It is difficult to account fully for this seeming disconnect. However, it has been clear that as the debate has intensified, the method and modality of the ETA plans has evolved. Some of the recent evidence of the continued adherence of ETA to its plan is the advancement this year of the ETA's latest concept of government-sponsored, free online tax preparation, represented by the publicly released Request for Information to which these comments are submitted in response (No: TIRNO-00-H-00007).

The denials of the intent of the IRS to enter this market in competition with commercial service offerors for consumers are belied by the insertion into the President's FY2001 Budget by the IRS of the declared objective of having free online tax preparation and filing services to be provided to the public by the Government not later than 2002. Page 64 of the Analytical Perspectives volume of the President's FY2001 Budget proposal states: "the IRS would be required to offer one or more options to the public, through contract arrangements with the private sector, for preparing and filing individual income tax returns over the Internet at no cost to the taxpayers". Whether the Government enters the electronic tax preparation services business with its own product or utilizes the products of others is irrelevant to the debate, as that is merely a "make or buy" decision. What does matter is the declared intent of the Government to enter the market.

While the language the IRS succeeded in inserting into the President's Budget may have the patina and appearance of policy, it is actually anomalous and significantly deviates from many other electronic commerce policy declarations by this President and Vice President over the last eight years, which have previously followed a consistent and rational logic grounded in sound economic theory. Indeed, in 1997 the White House completed its groundbreaking "Global Policy Framework for Electronic Commerce". Led by Ira Magaziner, the development of the Administration's policy for electronic commerce set the standard for the world by relying on a progressive economic philosophy and the vitality of free enterprise as the bedrock for the emerging American

model for the New Economy. The U.S. e-commerce policy announced by the President and Vice President in the summer of 1997 changed the national and international debate when it declared:

"Governments can have a profound effect on the growth of electronic commerce. By their actions, they can facilitate electronic trade or inhibit it. Knowing when to act and – at least as important – when not to act, will be crucial to the development of electronic commerce...."

IRS RFI No: TIRNO-00-H-00007 is completely inconsistent with the above national policy directive by the President of the United States.

The President's e-commerce policy directive to the heads of Executive Agencies further states:

"In some areas, government involvement may prove necessary to facilitate Electronic Commerce and protect consumers. Where governmental involvement is necessary, its aim should be to support and enforce a predictable, consistent, and simple legal environment for commerce."

Again, IRS RFI No: TIRNO-00-H-00007 is completely inconsistent with this policy directive by the President of the United States.

IRS RFI No: TIRNO-00-H-00007 reflects unwillingness by a major federal agency to restrain itself from competitively interfering in a healthy American electronic commerce market. This first stage of the ETA's announced public procurement for electronic tax preparation services attempts to substitute procurement processes for public rulemaking, demonstrating a desire by a division of the agency to try to transform itself into a commercial market offeror of e-commerce goods and services to American consumers. The attempt to do so through the exercise of invented regulatory authority over an industry it is not empowered to manage is particularly egregious. Rather than facilitating electronic commerce and protecting consumers as the President directed, ETA would manipulate the existing open, competitive marketplace in order to insert itself between private offerors of electronic commerce services and their American consumers. Rather than conducting a public rulemaking to protect consumers while facilitating electronic commerce, with sunshine and the full involvement of the public, ETA is attempting to utilize procurement processes to make a place for itself in the competitive commercial market, putting the protections of American consumers on an auction block to the lowest bidder. This is not service to the citizen.

ETA attempted to secure regulatory authority over the tax preparation services industry in 1998 by seeking to insert language at that time into the IRS Restructure and Reform Act. Congress reviewed the ETA proposal that it be given authority to "stimulate and manage competition by writing rules" for the industry. Congress rejected the proposal and those words appear nowhere in the Act or accompanying Conference Report. Nevertheless, IRS has moved ahead as if so empowered, declaring in May 2000

at a conference of the Council for Electronic Revenue Communication Advancement (CERCA) that it was implementing a national price-setting objective of driving the transaction cost of electronic tax preparation services to "zero" for all Americans. Moreover, in that same announcement, the agency declared that it would determine "what revenue model makes sense" for the electronic commerce with regard to electronic tax preparation industry. (Tax Notes, May 11, 2000)

The ETA's industrial policy agenda has no basis in federal law, and neither the division nor the agency is empowered to serve as the regulator of commercial enterprise. The IRS' core statutory mission of revenue collection and enforcement did not contemplate the agency's current attempt to transform into an "FCC" over the electronic commerce and tax preparation services industry.

American consumers will not be well served by the Government seeking to manipulate markets and establish for itself a role as a purveyor of commercial goods and services to the public. The excesses of the ETA's activities and plans over the past three years in its effort to insert itself into the commercial electronic tax preparation services industry must be reviewed and reversed before serious damage is done. Likewise, the ETA attempt to utilize procurement processes as a substitute for a public rulemaking to modernize the agency's rules governing access to and use of tax return information is completely inappropriate, and must be reversed by Executive action and directed into lawful and appropriate procedures as stipulated by the Administrative Procedure Act.

It is also profoundly disappointing that the ETA is completely ignoring the input and advice it nominally sought from the private sector in the formulation of its current plans. The 2000 Annual Report to Congress by the Electronic Tax Administration Advisory Committee details the opposition and contrary advice of the ETAAC to the course of action being pursued by the ETA with regard to offering electronic tax preparation services to the public. That Report, a copy of which is attached here to be a part of the record in this RFI, should be seriously reconsidered by the agency.

Attached are additional documents submitted as part of the record of this RFI. Among these are a CCIA abstract detailing our concerns with various Government actions in electronic commerce, and an multi-trade association letter submitted to the Secretary of the Treasury and Commissioner of Internal Revenue in June 2000 addressing the subject of this RFI and the actions and plans of the Government for electronic tax preparation services.

Also attached here is a policy monograph published in the spring of 2000 by the Progressive Policy Institute, outlining a thoughtful policy approach to Digital Government. The white paper presents twelve principles for electronic government. Principle Eleven declares "Federal efforts should complement, not duplicate, private sector efforts", and goes on in the paper to discuss examples of both what the government should and should not do. We agree with the Digital Government blueprint set forth in this constructive policy proposal and strongly urge its adoption by the Administration and the IRS. Following these principles would provide a rational approach that would not

compete with, duplicate or seek to supplant the role of the private sector in Electronic Commerce, but would give a full agenda of constructive direction and initiative for Government to appropriately pursue.

Likewise, the Progressive Policy Institute published an earlier monograph in 1999 on guidelines for the New Economy, also attached here. That paper details a thoughtful model for Public-Private Partnership between government and the private sector, which while dramatically different from that being pursued by the IRS and ETA today, would point the way to a constructive and cooperative relationship that could be appropriately leveraged to advance and serve the public interest significantly. We strongly urge the agency to study closely the recommendations of this study as a thoughtful approach to moving away from the counterproductive and confrontational situation of the last several years.

What is truly tragic about the driven agenda of the ETA to duplicate private sector service offerings and take on electronic tax preparation as its new mission and role, is the degree to which this strategy has dismissed the extensive private sector efforts to bring these services within the reach of all Americans, regardless of means. Voluntary Digital Divide initiatives of the private sector have already made commercial electronic tax preparation and filing services available to lower income Americans for free. These public service initiatives have existed for several years, and have demonstrated dramatic year-over-year growth in usage. Citizens do not need a computer or software, or a credit card, to take advantage of these Digital Divide initiatives. Instead, lower income citizens can go to any public Internet access location, go online, and prepare and file their tax returns at no charge. These public service offerings are also provided without expenditure of public funds, either in the form of budget or staff resources.

It is profoundly disappointing that in the face of these voluntary industry initiatives the preferred strategy for the ETA would be for the government to step into this space in the marketplace and insist on being the provider of free electronic tax preparation services to the public. No compelling public need has been identified. No unfilled gap in the marketplace exists. We strongly believe, as the Progressive Policy Institute recommended, that federal efforts should complement, not duplicate, private efforts. Nor should federal efforts seek to supplant private efforts. Voluntary public-private partnership should be encouraged, not supplanted, by the IRS.

In conclusion, it would be highly desirable for the IRS and ETA to turn the page and begin anew to establish a collaborative and productive working relationship between the agency and the high-technology and electronic commerce industry, in pursuit of a public interest agenda of better serving the interests and needs of the taxpaying public. Voluntary public-private partnership, not public-private competition, should be the standard for this relationship. It is an objective that can be achieved, and the Computer & Communications Industry Association would be pleased to assist and participate in the advancement and realization of that vision. To do so requires abandoning the contrary agenda set forth in RFI No: TIRNO-00-H-00007.



June 23, 2000

The Honorable Lawrence H. Summers
Secretary
U.S. Department of the Treasury
Washington, DC 20220

The Honorable Charles O. Rossotti
Commissioner
Internal Revenue Service
Washington, DC 20224

The Honorable Bruce N. Reed
Assistant to the President for Domestic Policy
The White House
Washington, DC 20500

The Honorable David Beier
Chief Domestic Policy Advisor
Office of the Vice President
The White House
Washington, DC 20500

Gentlemen:

The undersigned industry associations representing the high technology community are writing at this time to express grave concern about an apparent new direction in government, away from sound policy principles for the future of electronic commerce. This developing trend has disturbing implications for the role of government in the New Economy and requires your personal attention.

In 1997 the Administration issued a directive to Executive Agencies entitled "A Global Framework for Electronic Commerce", which set forth policy with regard to Internet commerce. That directive from President Clinton and Vice President Gore states in part:

"Governments can have a profound effect on the growth of Electronic Commerce. By their actions, they can facilitate electronic trade or inhibit it. Knowing when to act and – at least as important – when not to act, will be crucial to the development of electronic commerce....

"For Electronic Commerce to flourish, the private sector must lead....

"In some areas, government involvement may prove necessary to facilitate Electronic Commerce and protect consumers. Where governmental involvement is necessary, its aim should be to support and enforce a predictable, consistent, and simple legal environment for commerce."

Despite this clear direction, the Administration's Fiscal 2001 Budget includes the following e-commerce initiative:

"No later than tax year 2002, the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer."

On February 4, 2000 the Internal Revenue Service released a statement that declared:

"The IRS could implement this option by issuing a Request for Proposal (RFP) to the industry requesting vendors to submit proposals that would meet such requirements as:

Allowing any taxpayer to prepare 1040 series tax returns through access to a vendor maintained Web site at no cost to the taxpayer.

Providing related customer support to the taxpayers using the site.

Providing acceptable transmission security using industry standards such as SSL.

Agreeing not to use the tax data transmitted by the taxpayer for any purpose other than transmission to the IRS without explicit permission from the taxpayer.

Agreeing to IRS-specified compliance procedures to ensure compliance with this commitment. Prominently displaying these commitments on the site.

The RFP could request the vendors to quote what terms, financial or otherwise, the vendor would require from the IRS to provide the service. Under this approach, the IRS could accept as many proposals as it felt were responsive and useful in serving the public. The number accepted could range from one to many."

On May 9 of this year, senior officials of the Internal Revenue Service addressed the Council for Electronic Revenue Communication Advancement (CERCA). In those comments on behalf of the agency, the following announcements were made:

- * the Government has set a national policy objective of reducing the pricing of Internet-based electronic tax preparation services in the United States to zero;

- * the Government's zero price objective is not a Digital Divide initiative, but is intended to establish pricing for electronic tax preparation services for all Americans;
- * the agency is examining areas of possible incentives to motivate companies to drop their prices to zero, and would conduct a procurement action to solicit recommendations about what such incentives should be;
- * the industry's Internet business model for electronic tax preparation services is being closely examined by the agency to determine what that model should be in the future, including, for instance, whether continued banner advertising on such websites will be permitted;
- * in response to a series of questions posed by the Electronic Tax Administration regarding the requirements and flexibility of rules in an Internet environment, the IRS privacy regulations governing the use of citizen tax data are being actively reviewed by the agency's General Counsel,;
- * there is a direct connection or linkage between the future requirements of the privacy rules governing the use of taxpayer data, and the incentives the IRS might offer to vendors to drop their market prices to zero.

Press accounts of the IRS explanation of its plans include a May 9 article by Tax Analysts' *Tax Notes Today* (enclosed). With regard to the specific IRS proposal in the President's budget and future privacy regulations, the article quotes IRS officials as follows:

"What it basically says is that there is in fact a connection here," Barr said. "Essentially what the president has said here is that the administration is interested in pervasive, free electronic filing over the Internet with the assurance that information would not be used without the taxpayer's permission." Barr later added that "clearly it intimated" the taxpayer could opt in to marketing."

This same article quotes spokesmen for the agency as stating that:

"From my perspective, I clearly understand there are no free lunches per se," Barr stated. "What we're interested in understanding is what revenue models make sense." Also, the IRS wants to know how the agency and businesses can work together to make free electronic filing a viable alternative...."

"Tax Analysts later asked Barr what would happen if the marketplace cannot support offering free electronic filing to taxpayers? 'We'd have to look at other alternatives,' Barr said."

"I wouldn't declare we'd build our own software, for two reasons," Barr continued. "One, I seriously doubt we'll get to that point. Two, I seriously hope we don't get to that point." "

It is unclear to us on what statutory basis the IRS would set national pricing for services in the electronic commerce industry or seek to regulate the Internet business model for

electronic financial services, including making determinations about what revenue models make sense for electronic commerce in the United States. Neither do we find legal authority for the IRS to link consumer privacy regulations to specific price levels for services in private sector markets. We certainly do not believe that the IRS' threats to enter the tax preparation software and Internet commerce business if the private sector fails to adopt IRS-set price levels and revenue models for e-commerce services have a basis in law.

The agency is correct that the "bricks and mortar"-era IRS privacy regulations governing the use of tax data need to be updated for the e-commerce era, as do many other paper-era government regulations. The President's 1997 e-commerce policy directive clearly directs that such regulatory modernization be undertaken as a necessary element of ensuring an environment that facilitates e-commerce and meets consumer needs. However, it is clearly inappropriate for the Government to in any way link the application, or modernization, of privacy regulations to the pursuit of particular market pricing objectives that the Government may be seeking. To the contrary, the Administrative Procedures Act provides the established process for such a regulatory modernization initiative, and the IRS should follow those requirements accordingly.

The desire by the Government to attempt to either regulate or compete with the electronic commerce industry in offering Internet tax preparation services appears, on its face, to conflict with the President's e-commerce policy directive in every respect. The reality is that the private sector invented and is offering multiple Internet-based tax preparation services to consumers today at low cost and often at no cost. This innovation is happening in an intensely competitive electronic financial services market. Multiple companies also have created Digital Divide initiatives by which they donate Internet tax preparation services to low- and middle-income citizens; these programs, in place for the last several years, are now nearing one million free transactions per year and are growing at a dramatic pace.

The need for the Government to insert itself into this industry in the manner it is now proposing is inexplicable. The natural forces of the free marketplace are serving taxpayers well, providing multiple choices and alternatives for consumers. In addition, the electronic filing of tax returns has grown enormously over the last several years, and it is expected that this dramatic growth will continue.

If the Administration's electronic commerce policy is being modified along the lines of the activity being now proposed by agencies such as the IRS, it is vital that such a significant change in policy direction be fully and openly put forward for debate and dialogue – with the involvement of the high technology industry, Congress, and the general public. The range of issues raised by the IRS proposals and plans go to the very core of determining what should be the appropriate role of Government in the emerging New Economy, and what should be the scope of agency missions for the future.

The high technology community strongly supports the need for *e-government*, including the modernization of government infrastructure, the electronic accessibility of

government to its citizens, and digitizing governmental functions. However, commercial activities -- such as price-setting and making determinations about business revenue models -- are only considered to be governmental functions in highly regulated industries, and only when Government agencies have statutory authority and a defined charter for setting industrial policy. Such activity is not generally understood to be the mission of the IRS.

Likewise, offering commercial products and services to the consuming public, including the marketing and distribution of the same, are among the most basic of commercial activities. However, under long-established U.S. policy, commercial activities are not supposed to be governmental functions. In the course of governing, government is not supposed to compete with its citizens. Similarly, Presidential policy has long declared that the Government shall not start or carry on any activity to provide a commercial product or service if such services are available from the private sector. OMB Circular A-76 makes this clear.

Given all of the above, the undersigned high technology industry associations are deeply concerned by the developing trend of public agencies inappropriately trying to insert themselves, or seeking to compete, in private sector e-commerce markets. President Clinton and Vice President Gore were correct when they directed in their 1997 e-commerce policy that the private sector should lead, and that Government needed to restrain its contrary impulses:

Governments can have a profound effect on the growth of Electronic Commerce. By their actions, they can facilitate electronic trade or inhibit it. Knowing when to act and -- at least as important -- when not to act, will be crucial to the development of electronic commerce.

We strongly urge that you reevaluate the electronic commerce plans of the IRS in the context of the Administration's overarching policy directives, before the agency's mission enlarges significantly beyond that which was intended, and a major policy disconnect develops that adversely affects the continued growth of e-commerce in this country.

Sincerely,



Edward J. Black
President and CEO
Computer & Communications
Industry Association (CCIA)



William T. Archey
President and CEO
American Electronics
Association (AEA)



Ken Wasch
President
Software and Information
Industry Association (SIIA)

Enclosure

**Concerned Group comprised of Alumni and Current Members of the
Electronic Tax Administration Advisory Committee**

September 27, 2000

The Honorable James Kolbe
Chairman, Subcommittee on Treasury, Postal Service and
General Government
Committee on Appropriations.
B-307 Rayburn House Office Building
United States House of Representatives
Washington, DC 20515

Dear Chairman Kolbe:

In response to the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA), the IRS established the Electronic Tax Administration Advisory Committee (ETAAC) in September 1998. The mission of the ETAAC, as defined in the RRA, is to provide the IRS with private sector input in the development and implementation of the strategic plan that eliminates barriers, provides incentives, and uses competitive market forces to increase electronic filing. Additionally, the ETAAC has the obligation to report to Congress. The seven undersigned are a subgroup of either currently appointed or past members of the ETAAC, each serving a term of two years.

The Conference Report for the RRA contains the following. "The intent of the conferees with respect to this provision is for the IRS and Treasury to press for robust private sector competition. When disputes arise between the IRS and the private sector on the question of whether services offered by the IRS inhibit competition or are appropriate services not reasonably available to taxpayers or tax preparers, the Electronic Commerce Advisory Group [ETAAC] shall recommend to the IRS Commissioner an appropriate course of action. Those recommendations shall also be made available to the Congress."

On May 1, 2000, the ETAAC sent the IRS a letter, addressed to Robert Barr, Assistant Commissioner of Electronic Tax Administration, regarding the subject of the IRS offering "one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer." The ETAAC took this action because of the increasing controversy between the private sector and the IRS on this matter and the ETAAC's view that this was not good public policy.

In its May 1st letter ETAAC recommended "... that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of no cost tax preparation and filing options over the Internet are to: 1) let the competitive market continue to progress, and 2) continue stimulating electronic filing through its creative advertising campaign and making electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper." The letter further stated that "The ETAAC strongly recommends against the IRS developing its own tax preparation software program, either internally or through acquisition. The ETAAC also believes that the IRS should not follow an approach where the IRS'

ETAAC Alumni Congressional Letter

September 25, 2000

Page 2

issues an RFP or RFA to select a limited number of "Authorized IRS e-file providers" to IRS specifications." This recommendation and opposition to IRS entering tax preparation through an Internet-based service was communicated to Congress in the ETAAC's June 2000 Annual Report.

Voluntary compliance has been a keystone of our income tax system from its outset. With voluntary compliance came both the responsibility and the right for an individual to independently and privately prepare and file a statement of their income and tax liability. Put another way, under the American income tax system, it is the citizen who takes the first step in the tax transaction, telling the government what they earned and what they owe. The burden is then on the government to challenge the citizen's independent tax return, and only about 1% of the American people are so challenged through the audit process. For 99% of the American taxpaying public, when they submit their tax return, and either make a payment or receive a refund, that is the end of the transaction. However, the present strategy of the Electronic Tax Administration threatens to reverse the presumption of the American tax system – ultimately imposing on all of our citizens the necessity of having to challenge the government's determination of their earnings and tax liability. Introducing such a fundamental change to the system, by bringing the preparation of individual and business income tax returns under the auspices of the government, should be the subject of full public debate, and happen only as the result of Congressional decision with the concurrence of the President.

Today some 55% of individual taxpayers choose the assistance of a paid tax professional in preparation of their return. The remaining self-preparers either use paper and pencil or have chosen, in increasing numbers, to use personal computer software. As a matter of public policy, we believe that tax preparation should remain the independent right and responsibility of the taxpayer. Consequently, we strongly oppose any action by the IRS to further enter into income tax preparation, including the IRS offering the public an Internet-based preparation service, either developed internally or obtained through contract, or through regulation of private sector companies providing computerized and Internet tax preparation software and services. We believe that the IRS plans to insert itself into this arena are ill conceived and represent fundamentally flawed public policy.

The private sector invented electronic tax preparation services, and annually invests many tens of millions of dollars in ongoing technology and service innovations. The marketplace is robustly competitive, and has demonstrated civic responsibility by already making many Internet-based tax preparation and filing services available to lower and middle income citizens at no charge. The strategy of IRS' ETA group to insert itself into this market risks both continuing investment and innovation as it seeks to make this a government service sector of the economy.

In its letter to Mr. Barr, the ETAAC commented: "The IRS Restructuring and Reform Act of 1998 states that 'The IRS should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns.' This approach is working well. Existing marketplace competition has already led to a wide number of options that individual or business taxpayers can choose, including very low or no cost tax services on the Web for individual

ETAAC Alumni Congressional Letter

September 25, 2000

Page 3

taxpayers from a wide variety of providers—the very trend you indicated in your letter. The number of providers, now over 20, is dramatically increasing every year, forcing strong product development and causing prices to fall dramatically.”

Further emphasizing this point, the ETAAC included this statement in its June 2000 Report to Congress. “The ETAAC believes that the clear choice of public policy should be to let the private sector provide the capability, with the federal government stepping in if the private sector does not meet the need. The ETAAC believes it is inappropriate at this time to pursue a public policy that would require the IRS to offer no-cost electronic filing over the Internet. The marketplace has made noticeable progress towards achieving no-cost electronic filing over the Internet for individual taxpayers in the past two years, and additional progress towards this goal is expected next year based on publicly announced plans. The ETAAC believes that any effort by the IRS at this time to enter the marketplace itself, either by developing its own software or aligning itself with a limited number of “authorized e-file providers” that offer no-cost e-filing for individual or business taxpayers, would have the effect of limiting competition and would ultimately limit taxpayer choices.”

“In support of the goal of no-cost e-filing and tax preparation over the Internet, the ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of low-cost and no-cost tax preparation and filing options over the Internet are to continue to: 1) encourage competition, 2) seek industry views on which barriers inhibit lower-cost to no-cost private sector supplied options, and 3) stimulate electronic filing through its creative advertising campaign and making electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper. The ETAAC's recommendations on the use of the Internet for electronic filing are grounded in the belief that competition is the most effective way to provide taxpayers with the widest range of performance and price options for tax preparation and electronic filing. Promoting the most intense competition among private sector companies and pursuing policies that allow these companies to reduce unnecessary costs is the best action the IRS can take in pursuit of the goal of no-cost electronic filing for taxpayers.”

On July 20, 2000, the IRS' Electronic Tax Administration proceeded with its plans and initiated a procurement action by releasing a Request for Information (RFI) seeking comments on an Internet-based preparation service by which taxpayers could prepare and file their tax returns directly with the IRS, at no cost to the taxpayer. As a justification, the President's FY2001 Budget Request is cited: “No later than tax year 2002, the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer...” We were surprised and shocked that the IRS is continuing with this effort after all of the discussions and recommendations on the part of the ETAAC and the industry. We are deeply concerned that the *check and balance* that Congress sought to create when the ETAAC was created through the RRA is not working. It appears that the ETA group is pursuing an independent course of direction without regard to any other consideration.

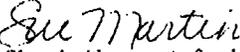
ETAAC Alumni Congressional Letter
September 25, 2000
Page 4

The content of the RFI raises a related concern. Why is the IRS entering the e-commerce market by attempting to set market prices for private sector products and services, and dictating e-commerce business models? The IRS has no corollary authority to the FCC's Communications Act under which it can play such a role in the marketplace. Indeed, we know of no statutory basis by which the IRS should be attempting to establish policies for or regulate software, Internet, financial services, accounting, and tax preparation services whatsoever. We believe this latest initiative is far outside of the mission of the IRS.

Accordingly, we strongly recommend the IRS rescind their current procurement action, the electronic tax RFI, and discontinue all other efforts to further expand their mission and role into tax preparation on the Internet and elsewhere. We request that Congress address the cited budget provision with an explicit denial, and conduct necessary Oversight on ETA's ongoing plans, activities and role in the IRS organization.

We appreciate your consideration of our comments and are prepared to answer any questions you may have.

Sincerely,



Signed with consent of and on behalf of
current and former ETAAC members listed below:

Fran Bartlett
Connie Grimes
Mary Harris
Susan Martin
Helen O'Planick
Bill Shepard
John Stauffer

Congress of the United States

Washington, DC 20515

The Honorable William Jefferson Clinton
 President of the United States
 The White House
 Washington, DC

Dear President Clinton:

We bring to your attention our concerns about a growing and troubling trend in which federal agencies are seeking to duplicate, or compete with, private sector innovation in electronic commerce. It is critical for the continued growth of the New Economy that this trend be reversed.

The Internal Revenue Service included, in the FY2001 budget request, language enabling the Service to provide Internet-based electronic tax preparation services for consumers by 2002. At the same time that this initiative was moving forward, the U.S. Postal Service announced that it would begin offering an even wider range of electronic financial services, including electronic bill payment and presentment. These initiatives directly compete with an existing robust private sector electronic commerce economy and are contrary to Presidential policy directives. As you know, OMB Circular A-76 tells us that "commercial activities are not a governmental function" and that "in the course of governing, government should not compete with its citizens". That fifty-year-old Presidential policy directive is sound policy for the American economy for many reasons, and these current forays by the federal government conflict with that direction.

There has been significant concern expressed about this provision. In March of this year, the Progressive Policy Institute ("PPI") published a major report entitled "Digital Government: The Next Step to Reengineering the Federal Government". The study detailed Twelve Principles as key guidelines for the success of Digital Government including Principle # 11: "Federal Efforts Should Complement, Not Duplicate, Private Sector Efforts". The PPI points out in their study that "digital government efforts should be focused on those innovations and initiatives that are necessary to fundamentally improve service to the citizen in inherently governmental functions . . . [t]here are too many necessary functions of government which are either going unfulfilled or are being poorly performed in outmoded ways to be able to justify in an era of limited budgets spending taxpayer dollars on activities which fundamentally change the role of government in our economy."

In addition, the Electronic Tax Administration Advisory Committee (ETAAC), a Congressionally established Federal Advisory Committee, issued its Annual Report to Congress. The ETAAC, representing a broad cross section of views, strongly recommended that the government not proceed with the IRS' plan to offer electronic tax preparation services over the Internet to the public. Aside from significant questions about preserving individual citizen privacy from government intrusion, and about conflicts of interest with the IRS' existing multiple roles, the IRS plan is troubling for another very practical reason. The ETAAC points out in their report that there already exist multiple low-cost and no-cost electronic commerce services available in a very competitive marketplace where citizens can privately obtain electronic tax preparation and electronic filing over the Internet without the involvement of the government.

Finally, the governmental incursion into commercial services is contrary to the Administration's 1997 Global Policy Framework for Electronic Commerce. In this policy outline, the Administration

correctly observed that government by its actions can encourage electronic trade or inhibit it, and concluded that government "knowing when to act and - at least as important - when not to act, will be crucial to the development of electronic commerce." The Administration was, and remains, correct in that judgment.

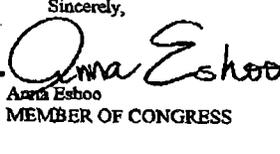
While electronic government is critically important for our country, electronic commerce is critically important for our economy, and the two are not, and should not be, the same. A number of e-commerce firms have sought to address public policy needs including donating the use of their electronic tax preparation and filing services for lower and middle income citizens as a Digital Divide initiative. These efforts should be encouraged by the efforts and actions of government rather than discouraged by government competition. There are many other areas for potential electronic government innovation which have yet to be pursued, to improve Service-To-The-Citizen and enhance public sector efficiency, without venturing into or interfering with private sector electronic commerce.

It is critically important that the Administration and Congress closely examine the Government's developing trend of stepping beyond Electronic Government to insert itself into Electronic Commerce, and seek to understand the significant policy and economic implications. To make such an Executive Branch review and Congressional Oversight possible, it is essential that a moratorium be instituted immediately, suspending those government agency initiatives which would duplicate or compete with established private sector electronic commerce services. To otherwise permit these activities to continue, in contravention of the Administration's own E-Commerce policy, runs the serious risk of damaging emerging private sector New Economy markets, and would create a momentum inside the Government which would be much more difficult to stop and reverse at a later point in time.

We strongly urge you to look very closely at this developing trend, and specifically at the particular government initiatives described here, and assert leadership to rein in the government's appetite for expansion of its mission.

Sincerely,

 Jim Moran
MEMBER OF CONGRESS

 Anna Eshoo
MEMBER OF CONGRESS

 Zoe Lofgren
MEMBER OF CONGRESS

cc: The Honorable Albert Gore
Vice-President of the United States

The Honorable Lawrence Summers
Secretary, United States Department of the Treasury

The Honorable Charles Rossotti
Commissioner, Internal Revenue Service

Key Document | The New Economy Task Force | September 13, 1999
New Economy Task Force Report: Rules of the Road
Governing Principles for the New Economy

Introduction

The U.S. economy has undergone a profound structural transformation in the last decade and a half. The information technology revolution has expanded well beyond the cutting-edge high-tech sector. It has shaken the very foundations of the old industrial and occupational order, redefined the rules of entrepreneurship and competition, and created an increasingly global marketplace for a myriad of new goods and services. In short, a New Economy has emerged. Yet while economic reality is fundamentally changing, much of our public policy framework remains rooted in the past.

This mismatch between public policy and economic reality is not sustainable. On one side of the political spectrum, policymakers advocate across-the-board tax cuts, a dramatically reduced role for government, and elimination of social regulations. This does nothing to support the *underlying factors propelling growth in the New Economy*: technological innovation, e-commerce and digital transformation, higher education and skills, open trade, and a balanced budget. An every-man-for-himself ethos risks leaving behind Americans who are struggling to cope with the dynamism of the New Economy. On the other side of the political spectrum, policymakers advocate increased spending on top-down social programs geared toward income redistribution, coupled with a focus on command-and-control regulation through bureaucratic institutions, ignoring just how entrepreneurial, fast moving, and flexible our economy has become. Furthermore, resistance from both ends of the political spectrum to open trade, global integration, and technological and organizational change threatens to slow the economic changes that hold great potential to yield higher standards of living for American workers.

Over time, policy frameworks must adapt to changing underlying economic and social realities. Turn-of-the-century industrialization triggered the development of new institutions and policies in the Progressive Era. Likewise, the rise of a national mass production,

industrial economy in the 1940s led to the emergence of the post-New Deal, Keynesian policy framework. But during the rocky and turbulent transitional period from the mid-1970s to the mid-1990s -- when the old economy was collapsing but the New Economy had not yet emerged -- that consensus broke down. Too often, one side devoted its energies to preserving rather than reforming existing policies and programs, while the other side fought to tear down the institutions of government entirely, guided largely by economic views that made more sense in the pre-mass production economy of the turn of the 20th century.

Now that the New Economy has emerged, we must foster a new consensus around a new framework for government and public policy. This framework must be consistent with the unique properties and logic of the New Economy. These characteristics include an increase in knowledge-based jobs, higher levels of entrepreneurial dynamism and competition, reduced delays between design and production, faster times to market, increased product and service diversity, constant technological innovation, the advent of the Internet and the information technology revolution, globalization, the replacement of hierarchical organizational structures with networked learning organizations, and relentless economic churning. These are more than economic fads or passing trends; they go to the heart of how the New Economy works.

The Progressive Policy Institute formed the New Economy Task Force to weigh these issues and to develop a set of guiding principles for rethinking the role of government in the Information Age. Here, the New Economy Task Force lists ten key "rules of the road" to guide policymakers. These rules should not be seen as absolute injunctions that cannot be breached in any situation. These rules are not tailored to suit any particular technology, nor should they have to evolve to keep pace with each new innovation. Rather, they are signposts intended to guide policymakers at the local, state, and federal levels as they craft a policy framework for the New Economy.

Rule #1: Spur Innovation to Raise Living Standards

New economic research shows that innovation plays a central role in productivity growth in the New Economy. Innovation and productivity are the prerequisites for higher wages and expanded opportunity for American workers and are critical to addressing a host of social needs,

from averting a future Social Security crisis, to improving human health, to solving global warming. As a result, government must be on the side of policies that boost innovation and foster higher productivity and against policies that seek only to divide a slowly growing pie, protect or reward special interests at the expense of overall economic progress, or slow down the process of change. But at the same time, government must play a key role in providing workers and communities with the skills and tools they need to successfully navigate turbulent waters and prosper.

Innovation and change are disruptive. They displace workers; they cause firms, and even entire industries, to fail; they lead to industrial and economic restructuring in cities and sometimes even whole regions; and they upset traditional ways of doing things, making some skills obsolete. There is every reason to believe that this will be just as true, if not more so, in the New Economy. Because innovation and change are disruptive, they tend to spark strong political demands to insulate affected segments of the economy and slow down economic change.

Such demands, while understandable, inherently deny opportunities to less politically powerful interests in the guise of "protecting" those with clout. As a result, to effectively promote growth in the New Economy, government must facilitate, rather than resist, the processes of economic change and modernization as these changes create new opportunities and increased incomes for all Americans. A key lesson of American economic history is that the broad benefits of innovation and change vastly outweigh the short-term costs associated with disruption. This is particularly true in the New Economy, where innovation and change are creating more jobs than they are eliminating and are driving productivity and wage growth.

Rule #2: Expand the Winners' Circle

Ensuring that the benefits of innovation and change are spread broadly will require that all Americans, including those not yet engaged in or benefitting from the New Economy, have access to the tools and resources they need to get ahead and stay ahead.

As the economy has become increasingly volatile and knowledge-based, success for people, organizations, and entire communities is more than ever determined by the ability to learn and adapt. Government needs to

counterbalance the tendency toward a new division of society around learning and skills.

As the economy churns--destroying some jobs while creating others-- government needs to ensure that employee benefits are portable, that workers can access a state-of-the-art system of rapid re-employment, and that all workers have expanded opportunities for capital ownership. In a skill and knowledge-based economy, government must provide every American with access to continuous and affordable life-long education.

As information technology becomes an increasingly important driver of the economy (and a determinant of worker skill requirements), and as it becomes an increasingly vital tool for accessing information and participating in civic life, government needs to enable widespread access by ensuring that public libraries, schools, job centers, community centers, and all regions of the nation are connected to the Internet and that individuals have the skills they need to use these technologies.

Rule #3: Invest in Knowledge and Skills

To spur innovation and equip citizens to win in the New Economy, government should invest more in the knowledge infrastructure of the 21st century: world class education, training and life-long learning, science, technology, technology standards, and other intangible public goods. These are the essential drivers of economic progress today.

In the new knowledge-based economy, over two-thirds of economic growth stems from technological innovation. But the knowledge economy is not only about expanding the frontiers of knowledge; it is about more effective use and implementation of all kinds of knowledge in all kinds of economic activity. In short, our competitive success stems from our capacity to innovate. Moreover, skills and learning not only drive economic growth, they increasingly determine individual opportunity.

But a global, hyper-competitive, fast-paced economy has made it increasingly difficult for the private sector to maintain its investments in these kinds of public goods, especially training and mid- to long-term research. Moreover, publicly supported research is a key driver of economic growth. (Over 30 percent of U.S. patents are based on research supported by the public sector, and that share is increasing.) Therefore,

government investments in science and technology should be increased, and private sector research should be encouraged through the R&D tax credit and support for collaborative R&D. In addition, in an economy where competitive success stems increasingly from shared industrial standards, government needs to support standards setting.

Finally, investments in education and training, including science and engineering education, are critical to ensuring that companies have the skilled workers they need to be productive, and that workers have the skills they need to navigate, adapt, and prosper in the New Economy.

Rule #4: Grow the Net

The Internet is a critical component of the emerging digital economy. In the old economy, the key driver of economic growth was mechanization of production, particularly in manufacturing and agriculture. In the New Economy, the key driver will be digitization (using digital information technologies to produce goods and services), particularly using the Internet and other information technologies in the service sector, which employs more than 80 percent of working Americans. The information technology revolution is transforming virtually all industries and is central to increased economic efficiency and productivity, higher standards of living, and greater personal empowerment.

Governments must avoid policies and regulations that would inhibit the growth of the Internet or slow progress by protecting business interests threatened by the digitization of the economy. Policymakers should craft a legal and regulatory framework that supports the widespread growth of the Internet and high speed "broadband" telecommunications, in such areas as taxation, encryption, privacy, digital signatures, telecommunications regulation, and industry regulation (in banking, insurance, and securities, for example). However, they must do so in ways that are fair and responsible. Government can also help spur future growth of the Internet by co-investing in the information infrastructure, including the Next Generation Internet (NGI), a collaboration among more than 100 U.S. universities to develop networking and advanced applications for shared learning and research. The importance of the Internet also means that we must expand its reach to all Americans.

Rule #5: Let Markets Set Prices

In the old economy, government often regulated prices when national markets were dominated by oligopolies or monopolies. In those cases, the economic costs of government intervention were manageable, and sometimes necessary. But in the new, more competitive global economy, distorted prices are much more likely to lead to economically inefficient decisions by consumers and producers and to unfair, politically driven resource allocation. Therefore, in the absence of clear market failures, markets, not governments, should set prices of privately provided goods and services.

In this critical transition period, as the old economy gives way to the New Economy, policymakers must embrace forward-looking, innovation-producing investments (e.g., industry-university collaborative R&D) while at the same time, distinguishing between programs that address legitimate market failures and industry subsidies that foster economic inefficiency. Government must focus on increasing investment in the foundation areas of the New Economy: technological innovation, education, and skills. At the same time, government must strive to reduce or eliminate the tariffs, unnecessary price regulations, and the array of government protections that protect entrenched interests without increasing the economy's innovative or productive capacity.

Markets are a means, not an end in themselves, and they do not always work as intended. Government has a responsibility to address the problems stemming from market failures, through such mechanisms as emissions taxes to reduce pollution or the R&D tax credit to boost research. Government must also safeguard democratic values of equal opportunity. Along with establishing rules to ensure fair competition, it must also support policies to ensure citizens have access to the information they need to make informed choices.

Rule #6: Open Regulated Markets to Competition

Economists have long acknowledged that competition keeps prices down. The New Economy creates another critical reason for competition: competition drives innovation, and ultimately provides the greatest benefits to consumers and citizens. Of course, government must continue to provide commonsense health, safety, and environmental regulations. However, government should move away from regulating economic

competition among firms and instead promote competition to achieve public interest goals of lower costs, new products and greater consumer choice. For example, competition in the long distance telecommunications market has driven down costs and improved the quality of service for consumers. Likewise, the Federal Communications Commission's goal is to set rules to open telecommunications markets to robust competition and then step back and ensure network interoperability, universal service, and consumer protection. Through minimalist, yet consistent rules, public policy should also ensure that consumers have the information they need to make educated choices and provide a backstop to protect consumers and citizens from abuse in markets.

Rule #7: Let Competing Technologies Compete

In the New Economy, technology is not just the province of Silicon Valley; it is the catalyst for profound change throughout the economy and society. Technological innovation has now become central to addressing a wide range of public policy goals, including better health care, environmental protection, a renewed defense base, improved education and training, and reinvented government. For example, technology provides doctors and patients with state-of-the-art health information systems that improve the quality of care. Similarly, new generations of cleaner technologies can dramatically reduce pollution generated by industrial processes.

We should look for technology-enabled solutions to public problems, but not so that today's winners are frozen in place at the expense of tomorrow's innovators. As a case in point, in the 1980s the French government decided to provide free "Minitel" terminals to all French households. However, because the Minitel systems are incapable of supporting modern Internet technology, France now lags significantly behind in Internet usage. Similarly, some U.S. states have passed legislation locking in particular technical standards for the digital signatures that allow individual authentication in electronic commerce. Given today's rapidly changing technological capabilities, locking in any particular technology through regulation or massive public investment would run similar risks.

Rule #8: Empower People

With Information In the old economy, information was a scarce resource to which few outside of large corporations and governments had access. In the New Economy, constant innovations in ever-lower-cost information technologies have enabled increasingly ubiquitous access to information, giving individuals greater power to make informed choices. Governments should encourage and take advantage of this trend to address a broad array of public policy questions by ensuring that all Americans have the information they need as consumers and citizens.

For example, policymakers have required TV manufactures to install technology such as the V-chip to give parents tools to block objectionable programming from children. But the application of the principle of providing people with tools and information to make informed choices goes far beyond gadgetry. Policymakers could improve the quality of the health care in the United States by enabling consumers to have ready access to their own health records and more information about health care providers' track records. That type of transparency has long been one of the core strengths of our financial markets, where the Securities and Exchange Commission requires publicly traded companies to open their books so people can make educated investment decisions. Publishing on-time airline performance data has spurred an increase in airline efficiency, while requiring long distance telecommunications companies to publish information on pricing plans has helped consumers make better choices in a competitive telecommunications market. Similarly, publishing real-time environmental emissions information could lead to reduced pollution. Finally, making a wide range of government information available over the Internet could lead to more open and accountable government.

Rule #9: Demand High-Performance Government

Government should become as fast, responsive, and flexible as the economy and society with which it interacts. The new model of governing should be decentralized, non-bureaucratic, catalytic, results-oriented, and empowering. In some cases government agencies should be transformed into Performance-Based Organizations (PBOs) that have both the accountability and flexibility to achieve publicly defined goals. In other cases, governments should let organizations, both public and private, compete to deliver public services.

When designing solutions to compelling public concerns, such as reducing industrial pollution or delivering world-class public education, government should hold organizations and individuals accountable for meeting goals, while allowing them flexibility to achieve those goals. In many cases, industry self-regulation can achieve public policy goals in ways that are more flexible and cost effective than traditional command-and-control regulation, while also enabling technological innovation.

For example, in the case of pollution, the government should set clear standards that protect health and the environment, but where appropriate, government should encourage companies to devise their own ways of meeting prescribed standards while maintaining credible monitoring to ensure that standards are indeed being met. Similarly, to improve the quality of public education, government should create incentives for schools to set high standards of achievement. But it should also give schools flexibility in how they implement programs and hold schools accountable for reaching standards, while encouraging parental and community involvement in the education process.

Procedurally, governments should use information technologies to fundamentally reengineer government and provide a wide array of services through digital electronic means to increase efficiency, cut costs, and improve service. Digitizing government is the next step in re-engineering government.

Rule #10: Replace Bureaucracies With Networks

In the old economy, bureaucracy was how we addressed many major public policy problems. In the New Economy, we must rely on a host of new public- private partnerships and alliances.

In the New Economy, boundaries of all sorts have blurred. In what has been described as "coopetition," companies are entering into partnerships and alliances of all forms. Direct competitors in one market may well collaborate on research and development in another market. Similarly, rather than acting as the sole funder and manager of bureaucratic programs, New Economy governments need to co-invest and collaborate with other organizations -- networks of companies, universities, non-profit community organizations, churches, and other civic organizations -- to achieve a wide range of public policy goals.

Compared to government, these organizations have a number of advantages. They are usually closer to the customer and tend to have greater capacity to solve problems because they can be more flexible, leverage additional resources, and face bottom-line pressures to boost performance. Yet public policy has only begun to explore the potential of bottom-up, decentralized networks assuming the lead role in solving pressing societal problems.

In short, many problems in the New Economy cannot be solved without government, but government alone can't solve problems. Relying on collaborative networks does not mean that government should abdicate its policy responsibilities. It is dangerously naive to hope that private sector voluntary efforts alone will emerge in a sufficient scale to meet public needs. Rather, government needs to co- invest in these efforts and foster continuous learning through the sharing of best- practice lessons. Most importantly, the collaborative network model requires government to relax its often overly rigid bureaucratic program controls and instead rely on incentives, information sharing, competition, and accountability to achieve policy goals.

Digital Government
***The Next Step to Reengineering
the Federal Government***

Progressive Policy Institute
Technology & New Economy Project

Robert D. Atkinson and Jacob Ulevich

March 2000

About the Progressive Policy Institute

*“One person with a belief is a social power
equal to ninety-nine who have only interests.”*

—John Stuart Mill

The mission of the Progressive Policy Institute is to define and promote a new progressive politics for America in the 21st century. Through its research, policies, and perspectives, the Institute is fashioning a new governing philosophy and an agenda for public innovation geared to the Information Age.

This mission arises from the belief that America is ill-served by an obsolete left-right debate that is out of step with the powerful forces re-shaping our society and economy. The Institute advocates a philosophy that adapts the progressive tradition in American politics to the realities of the Information Age and points to a “third way” beyond the liberal impulse to defend the bureaucratic status quo and the conservative bid to simply dismantle government. The Institute envisions government as society’s servant, not its master—as a catalyst for a broader civic enterprise controlled by and responsive to the needs of citizens and the communities where they live and work.

The Institute’s work rests on three ideals: equal opportunity, mutual responsibility, and self-governing citizens and communities. Building on these cornerstone principles, our work advances five key strategies to equip Americans to confront the challenges of the Information Age:

*Restoring the American Dream by accelerating economic growth,
expanding opportunity, and enhancing security.*

*Reconstructing our social order by strengthening families,
attacking crime, and empowering the urban poor.*

*Renewing our democracy by challenging the special interests and
returning power to citizens and local institutions.*

*Defending our common civic ground by affirming the spirit of
tolerance and the shared principles that unite us as Americans.*

*Confronting global disorder by building enduring new international
structures of economic and political freedom.*

The Progressive Policy Institute is a project of the Progressive Foundation. For further information about the Institute or to order publications, please call or write:

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Introduction

*"I have in general no very exalted opinion of the virtue of paper government."
Edmund Burke*

Imagine a future in which citizens can log onto one Internet site, easily find the government services they are looking for, and use that site to conduct an online transaction; a future in which businesses fill out one Internet form for all their local, state, and federal environmental regulatory compliance requirements; a future in which government officials make all purchases and payments electronically, saving millions of dollars. The technology for all these applications and others is here today, waiting to be adopted by the federal government.

Indeed, these technologies are rapidly spreading in the commercial sector. The economy is evolving to the point where a significant share of economic transactions will soon be conducted through electronic means. Digital technologies are fundamentally transforming our economy and society, and have the potential to transform government. In fact, a key next step in reinventing government involves the widespread application of information and communications technology to the delivery of government services—in short, fostering digital government.

Among the potential benefits of digital government are savings in money and time for the government, consumers, and businesses. If banks can cut their transaction costs by 90 percent through online banking, similar savings for gov-

ernment are likely.¹ Moreover, users of government services will benefit by greater 24x7x365 access to higher quality services. Most importantly, the relationship between government and citizens can evolve from its traditional hierarchical and arms-length one to a more reciprocal one where citizens are genuine stakeholders in their government.

Done right, digital government promises to transform Industrial Age big government into Knowledge Age smart government. Old economy government was organized around agencies and bureaucracies that operated like "stove pipes" with little information flowing between them, and with operations developed to meet the requirements of agencies, not the needs of citizens. New Economy government will be organized around the functions and the needs of citizens; with information and communication technologies a key enabler of this reinvented government.

Moving to digital government will speed the transition to a digital economy. Part of why this transition is not proceeding even faster is because of "chicken or egg" issues. For example, smart cards have diffused slowly through society, in large part because consumer value is limited as long as few merchants accept them, and few merchants accept them as long as few consumers have them. Similar issues exist with regard to digital authentication, educational software, and to some

Digital Government

extent the Internet itself.² These impasses will be broken, but if the federal government became a leading-edge, or even "middle-edge," user of information technology (IT), it would enhance the value of being online and speed the transition.

Despite the obvious promise of digital government, it has not yet become a priority of most policy makers. Congressional committees have largely ignored the issue. And while the Administration has articulated goals and begun projects, much more can be done. In the meantime, the issue has remained the province of technologists focused on technically complex issues not readily understandable to policy makers, much less to citizens in general.

In part because of this technocratic focus, digital government progress to date has been slow and not linked to government reinvention. Rather, most IT applications have focused on improving

the efficiency of existing operations or providing one-way information dissemination, instead of on fundamentally changing the way businesses and citizens interact with government. As a result, another kind of digital divide is emerging—between government, which is only moving tentatively into digital operations, and the commercial sector, which is moving at "web-speed" into e-commerce.

This report lays out the overall direction the federal government should take to foster digital government and describes how the government can use IT to transform its operations. It first discusses the factors that have slowed progress to date and then describes 12 key principles to follow in implementing digital government. It then lists four major policy recommendations for implementing digital government. Finally, it examines what government is doing now and what it should be doing.

Impediments to Faster Progress Toward Digital Government

At the federal level, considerable progress has been made toward establishing a vision for digital government and providing information to the public through agency web sites. But, relative to the capabilities of the technology, much more can be done. There are least four factors that have hindered progress: 1) lack of top-level agency and government-wide leadership; 2) lack of funding and flexibility to implement digital government projects; 3) the prevalence of a traditional "agency-centric" government paradigm, rather than a customer-centric one; and 4) lack of pressure for change.

A Lack of Political Support for Digital Government

Congress and the Administration have issued broad and generalized mandates regarding digital government. However, congressional committees have largely ignored the issue. While the Administration has articulated progressive goals and begun projects—including innovative efforts from the Vice-Presidents' National Performance Review dating back as far as 1995—more can be done. In fact, the NPR is a center for creative thinking on these issues, but their initiatives have not always received the high-level support needed to translate them into results. Cabinet secretaries in particular have generally not made digitizing government a top priority and see it as separate from their core mission (for an exception, see Box A, p.4). Nor has OMB been a strong advocate of digital government. Within agencies, Chief Information Officers (CIOs) normally do

have the authority and budget to implement significant digital government applications.

However, there are signs that digital government is receiving increased attention, both in Congress and the Administration. President Clinton issued an executive memorandum on the subject in December 1999, and the President's Management Council has adopted the issue of digital government as one of their three top priorities for 2000. And in Congress, Senator Joseph Lieberman (D-CT), and ranking Democrat of the Senate Governmental Affairs Committee and Congressman Jim Turner (D-TX), ranking Democrat on the Government Management, Information, and Technology Sub-committee of the House Committee on Government Reform are both exploring the issue of electronic government with an eye toward introducing legislation this congressional session.

Notwithstanding recent efforts, it has up until now been hard to make needed progress, particularly to develop cross-agency applications. Currently, each federal agency has an individual information technology plan, usually created without regard to the need to develop cross-agency applications. Compatibility on a government-wide scale was not the original aim of government IT use and has resulted in a cacophony of systems—proprietary, and non-proprietary; and common and rarely used software and hardware.

While inter-agency IT compatibility issues are important, so is the incompatibility of systems within individual agencies. For example, some employees at the State Department have to use up to

BOX A: Success with Digital Government and the Federal Geographic Data Committee³

Anyone who has ever looked for anything on the Internet knows the frustration of trying to whittle down a search to get to the useful information. Now imagine searching the Net to find a particular map and its underlying data with the right scale and features for your application. Without a common means of describing geographic data, the search could be long and fruitless. Fortunately, an obscure federal interagency committee—aided by academics, states, businesses, and local government representatives—developed in 1994 a common way to describe geographic (sometimes called "spatial") data like land elevation, population, vegetation, waterways, political boundaries, soils, and many other features. This "metadata standard", recently revised, helps turn single-use data sets into widely used publicly available assets. It is an example of how government, working on the edge of technological development, can add significant value to private and other public sector investments in information.

Back in 1990, the Office of Management and Budget had the wisdom to establish the Federal Geographic Data Committee (FGDC) to oversee the coordinated development of common standards for map-making by 16 federal agencies like the Census Bureau, the U.S. Geological Survey, the Forest Service, the National Defense Mapping Agency, and the Transportation Department among others. As geographic information system (GIS) software developed in the early 1990s, FGDC focused its efforts on developing standards and protocols for just about every kind of data that could be represented on a map. While extraordinarily tedious to develop, these standards enable millions of users of geographic data to search and find information on the Internet, use data sets assembled by others, and make their own work widely accessible to others. A 1994 Clinton Executive Order further broadened FGDC's mission and links to state, local, and tribal governments and the private sector under the banner of the National Spatial Data Infrastructure.

The Federal Geographic Data Committee is a story of how political leadership at the highest levels can transform an obscure bureaucratic backwater into a leading edge model of digital government. In 1993, soon after taking the helm of the Department of the Interior, Secretary Bruce Babbitt decided to become chair of the FGDC. (The previous chair had been the Deputy Director of the Geological Survey.) When he announced this decision at a senior staff meeting, he was greeted with hoots of laughter. Few of the political staff thought he was serious about delving into this most arcane—and boring—government activity.

In fact, Secretary Babbitt knew exactly what he was doing. He had seen with his own eyes during the negotiations on the Northwest Forest Plan in early 1993 that none of the dozen or so government agencies worked off the same map. Nor could the maps be made compatible with one another: land ownership boundaries didn't match, and measures of scale and elevation were inconsistent, making a difficult policy and political issue even worse.

Secretary Babbitt understood the value of standard setting and coordination among federal agencies and their partners in state and local government. These partners, in fact, were often at the front line of tracking land use and fine-scale geographic features that can be so important in resource management. Because of the Secretary's interest in the mission of the FGDC, all the other agencies had to revisit their representation on the Committee. By the next meeting, under secretaries and assistant secretaries were attending instead of GS-14 and GS-15 employees.

FGDC now directs a widely used, net-based clearinghouse of 188 spatial data servers, making access to geographic data possible in ways that text-based search engines could not. FGDC offers modest seed grants to states and local agencies to develop their own nodes for the NSDI. In addition, FGDC leads in the development of a nationally consistent "framework" data set, upon which virtually all map products in the future will be based. Finally, FGDC continually develops and revises the core data standards for making maps of population density, forests, soils, waterways, highways, biological resources, pollutant sources, and many other kinds of information that can be displayed on maps. With a modest budget of about \$3.4 million each year, FGDC more than pays its freight in adding value to hundreds of millions of public and private dollars invested in data gathering and map making.

The lessons for digital government from the FGDC are the following: involve cross-agency and intra governmental collaboration, focus on the end user customer, be web enabled, and drive it from the highest levels of political leadership.

three computer terminals to accomplish tasks, because of incompatible applications and systems.⁴

Concerted top-level leadership in both Congress and the Administration is necessary to harness contemporary technology to bring government into the 21st century. Leadership is also needed to foster inter-agency solutions. A number of committees and organizations work to foster government IT coordination. The National Partnership for Reinventing Government (NPR) has attempted to develop a number of cross-agency applications, and the Government Information Technology Services Board was created in 1993 to help implement NPR's recommendations. Similarly, the Chief Information Officer Council, made up of 54 CIOs or deputy CIOs from federal agencies, meet as an interagency forum to direct the implementation of federal IT resources. The Office of Intergovernmental Solution's Intergovernmental Advisory Board and the General Services Administration have also worked to develop innovative cross-governmental technology systems.⁵

But these interagency groups suffer from several distinct limitations. First, they lack the resources to implement government-wide efforts. Second, they are largely a meeting of equals, and lack the authority to impose central direction on individual agencies. Moreover, their primary focus remains on their individual agencies, not on government-wide reinvention. Third, without strong cabinet-level support, CIOs are limited in what they can get done, especially if it involves reengineering government. Fourth, because OMB itself is organized by stovepipe it has done little to promote cross-agency, enterprise-wide initiatives.

A final reason why elected and appointed officials have not done more to promote digital government until recently is because the private sector has done little to push for it. Unlike their support for important issues such as encryption export control reform, copyright protection, and digital signatures, business has been virtually silent when it comes to advocating digital government. Without the strong support of the technology business community, it is easy for policy makers to put this issue on the back burner, or to treat it simply as a narrow technical issue affecting government alone. The technology business community needs to educate Congress and the Administration as to why moving to a digital government is a critical step in the overall evolution to a fully networked, digital economy.

Lack of Funding and Flexibility

Government is being asked to manage paper and face-to-face government while at the same time creating a new digital government, but often without additional resources to do the job. While it is true that digital government saves money, there are short term costs for technology and project management. Moreover, agencies are limited by Congress and OMB in the amount of flexibility they have to reprogram funds toward digital government initiatives.

When funding is provided, it is usually to individual agencies. There is a conspicuous lack of funding for cross-agency applications and agencies are not apt to use their limited funds for them. Yet to effectively implement many digital government functions, government must take an enterprise-wide management perspective (whether it's delivering monetary benefits to the public, organizing cross-agency or individual agency databases, or developing government portals). This unwillingness to fund cross-agency projects is a principal reason why the development of the International Trade Data System has stalled, as the Customs Service has lobbied for funds for its own proprietary system (see Box B, p.6). Similarly, when the Small Business Administration sought to develop a single point of entry where small businesses who interact with numerous federal agencies could enter their data just once and have it shared with the various agencies, resistance by individual agencies scuttled the initiative.

An "Agency-centric" Rather Than a "Customer-centric" Paradigm Prevails

Government services are funded on an agency-by-agency basis. Congressional committee jurisdiction and OMB agency budget allocations sustain this stovepipe focus. Within Congress, committees and subcommittees focus on individual agencies, as does the oversight system. There are few means in Congress to take an enterprise-wide perspective.

However, the IT revolution provides the opportunity to reengineer government and to allow government services to be organized in ways that fit the needs of customers rather than the requirements of bureaucracies. Yet, because government officials usually view the world through an agency, or even bureau perspective, developing the will to create and implement digital government solutions organized around customers' needs has proven difficult.

Digital Government

As President Clinton stated in his recent memorandum on electronic commerce: "There has not been sufficient effort to provide government information by category of information and service—rather than by agency—in a way that meets people's needs."⁶ For example, many of the required forms for exporting can be downloaded from the Internet, printed, and mailed to the respective offices. While the online forms expedite the process considerably, it would be much more efficient if all of the pertinent information from various agencies were available in one form and automatically routed to the correct agencies at the push of the "submit" button.

This is not unique to the United States. A recent survey of UK citizens on digital government reported, "There is . . . a strong belief that [government] services have traditionally been developed from the producer rather than the user perspective and this has induced a feeling of powerlessness in dealing with government."

Just as the Internet threatens to disintermediate large sectors of our economy (for example, it has put out of business some brick and mortar retailers, middlemen, stockbrokers, etc.) it also threatens to disintermediate some government

functions. For instance, some in government have justified their positions by controlling and doling out information. Yet, by providing information freely on demand, digital government makes these functions obsolete. Only top-level leadership can overcome the resistance of government bureaucrats to potentially disruptive changes.

Lack of Competitive Pressures Forcing Change

Commercial e-commerce companies face enormous pressures to innovate, to be the first to commercialize applications, and to gain market share as rapidly as possible. As a result, in the frenetic Internet economy people talk about technological and commercial evolution in "Web years" (three months time) because the rules seem to change that often. In contrast, the federal government does not face these pressures, and because of this, has not operated with anywhere near the same speed and intensity as e-commerce companies. As a reflection of this, one federal official recently stated, in an informal context, that the federal government could afford to go slow because the Internet marketplace just wasn't big enough to justify an aggressive pace.

Box B: ITDS and the Challenge of Overcoming Stove-Pipe Government

In an effort to reinvent the system by which exporters and importers deal with regulations reporting requirements, the National Partnership for Reinventing Government proposed the creation of the International Trade Data System (ITDS). ITDS was intended to be a partnership of the Customs Service and a number of other regulatory agencies, including the Food and Drug Administration, the Environmental Protection Agency, and the Department of Agriculture, to accomplish a variety of trade-oriented tasks without the traditional hindrances of agency boundaries. The proposed system would allow importers and exporters to essentially fill out one master form that would combine all of the information all of the various agencies may need. This process would lead to cheaper, more accurate, and more timely exchange and recording of information, and expedite the physical movement of trade by reducing the time goods are kept at the border for inspection.

Yet, the ITDS story illustrates just how hard it is to develop true customer-centered government. From the beginnings of the process, the Customs Services viewed ITDS with suspicion. ITDS represents a cultural shift, one that would require Customs to share power and authority over trade with other agencies, something they are presently able to avoid. Because of this, Customs has resisted the development of a true interagency partnership. Customs was able to funnel funds toward its own proprietary system, which has meant that the inter-agency ITDS has been slow to get off the ground. Most recently, the Customs Service has gained jurisdiction over ITDS, taking it away from a joint-agency working group housed in Treasury. It is not clear that the system will now be implemented, or if it is, implemented as originally intended.

If implemented properly, these multi-agency systems could provide both information and services in a more streamlined and cohesive manner and make government run more effectively and cheaply. Yet, without new institutional means and leadership to support and promote these efforts, they are likely to be stillborn.

12 Principles for Implementing Digital Government

The Progressive Policy Institute offers the following 12 principles for implementing digital government.

1) Think Customer, Not Government Agency

Digital government both enables and requires rethinking how government is organized from the perspective of the citizen and the functions government performs to serve the needs of its citizens. A system based on functionality rather than agency jurisdiction, will lead to a more intuitive and efficient process of government-customer interaction where information is collected once and government functions are integrated. To do this, government must focus on customer requirements first and then work backwards to design systems that best meet those needs. The strategy should support the streamlining and integration of processes across the boundaries between government departments and agencies, so that those boundaries are invisible to the customer. This also means streamlining the processes between levels of government—federal, state, and local—so that cross-government applications are developed. Doing this will begin to reinvent the government's relationship with the public and will recognize citizens as real stakeholders. It will also raise citizen expectations of their government. Some nations have begun to use IT to reorient their gov-

ernment this way. For example, Australia called its report on digital government: *Clients First: The Challenge For Government Information Technology*.

2) Reinvent Government, Don't Simply Automate It

If digital government is viewed simply as a technology solution and is used to merely automate routine tasks, it will have failed to live up to its potential. Digital government must be part and parcel of government reinvention. The technologies need to be used to simplify government processes, drive internal change, and reorganize government.

For example, the Environmental Protection Agency is experimenting with allowing companies to file compliance forms online. But if the technology only makes the shift from scores of paper forms to scores of electronic forms it will not have taken advantage of the opportunity to use IT to reengineer government and move toward multi-media regulation (such as focusing on air, water, and solid waste emissions collectively).

3) Set An Ambitious Goal

In order to transform the federal government to a digital government, it is necessary to set an ambitious goal to be met in the near future. For example, Australia seeks to deliver all appropriate services on the Internet by 2001. British Prime Minister Tony

BOX C: Principles for Implementing Digital Government

1. Think Customer, Not Government Agency
2. Reinvent Government, Don't Simply Automate It
3. Set an Ambitious Goal
4. Invest Now to Save Tomorrow
5. Focus on Digital Transactions Between Citizens and Government
6. Make Government Applications Interoperable with Commercial Ones
7. Pass on a Portion of Savings From Electronic Transactions Back to Citizens
8. Promote Access to Information on the Internet, Do Not Restrict it
9. Respect the Rights of Americans for Information Privacy
10. Online Access to Government Should Not Eclipse Traditional Means
11. Federal Efforts Should Complement, Not Duplicate Private Sector Efforts
12. Take Action Now, and Learn From Mistakes

Blair declared in October 1997 that "within five years, one quarter of dealings with government can be done by a member of the public electronically—through their television, telephone, or computer." The 1998 Government Paperwork Elimination Act requires each federal agency to make its forms available for electronic submission by 2003 (through use of a digital signature when necessary).

4) Invest Now to Save Tomorrow

Investment in digital government will yield high returns as more time- and cost-efficient systems

are developed. However, Congress and the OMB too often view digital government appropriations simply as one expenditure competing against others. Moreover, appropriators usually expect immediate staff reductions from digital government, which are not possible until new systems are online and debugged, and the user community has switched. Expenditures on digital government need to be viewed as investments with positive returns in the near term.

5) Focus on Digital Transactions Between Citizens and Government

Internet enabled services should be the driver of digital government reengineering for the next five years. The growing popularity and availability of the Internet provides an unparalleled opportunity for the government to vastly improve contact with the American public. Government should ensure that all possible government-citizen and government-business interactions that can be transacted online are available.

6) Make Government Applications Interoperable with Commercial Ones

The driving force of information technology is interoperability—the basic foundation of the Internet. In embracing digital government, the government needs to make its systems interoperable with commercial ones rather than force the public to develop two separate systems—one for government use and one for private use. Interoperability makes the process of interaction more efficient, easier, less confusing, and cheaper for all parties involved. It also helps to resolve the chicken and egg problems slowing deployment of these technologies in the commercial marketplace.

7) Pass on a Portion of Savings From Electronic Transactions Back to Citizens

Digital government will save government money and these savings should be reflected in the "price" people pay for interacting with government. For example, Massachusetts offers a five dollar rebate on their driver's licence fee for those who register online, since it saves the state much

more. Providing rebates and discounts will encourage citizens to choose these lower cost forms of interaction. A United Kingdom survey found that a large proportion of the population is willing to use information technologies in interacting with government irrespective of their current knowledge or familiarity, provided that it offers benefits—including cost savings—to them.

Yet, the U.S. Government has not done this. For example, the U.S. Postal Service (USPS) will not give discounts to users of "electronic stamps" or postal meters, even though they cost the Postal Service less than purchasing stamps at a post office.⁷ Similarly, the IRS will not give a rebate for electronic tax filing.

Some argue that providing discounts will only benefit the affluent since they are now more likely to be on the Internet. Yet by lowering the actual cost of Internet access, rebates and discounts for online transactions (both government and commercial) will probably do more to get low-income Americans online than any other factor.

8) Promote Access to Information on the Internet, Do Not Restrict It

Moving to digital government will lead to issues regarding security and privacy. But if handled properly, these issues should be no more problematic than those faced in the current era of paper government. Yet, in the face of privacy concerns, elected and Administration officials can overreact, stymying progress. For example, a bill was introduced in the last Congress (HR1330) to prohibit government from providing information over the Internet. Rather than restricting online access to information, government should promote it and ensure that adequate security and privacy measures are in place.

9) Respect the Rights of Americans for Information Privacy

Some government entities have treated personal citizen information as belonging to the state, and have engaged in the practice of selling such information to the highest bidder, without citizen permission or knowledge. Examples have included prominent cases involving state driver's license lists and databases which have been sold

to third parties. The Supreme Court has ruled that such activity is unlawful, rejecting the defense by government that it ought to have the latitude to continue such practices.

As we make the transition to digital government, policies need to be put in place which ensure the privacy of the personal information of individual citizens. These issues are being addressed in the private sector through self-governance initiatives, including detailed "best practices" certifications by groups as Trust-E and BBB-OnLine. Governments should do no less to ensure that their own practices respect the privacy of citizens. In addition, as the federal government becomes more digital, it needs to ensure that it has top-quality security systems in place which protect the integrity of information against hackers and other threats. Specific policies of this sort, and funding to support them, are necessary to help instill public confidence in governments' intentions in the evolving Information Age.

10) Online Access to Government Should Not Eclipse Traditional Means

All services that can be provided digitally should be. However, at least for the foreseeable future, federal services should remain accessible through all forms of communication, including mail, phone, and in person, for those who cannot or do not wish to communicate digitally. For example, an individual should still be able to call the Social Security Administration office to find out how to apply for benefits, even when the information and application process is online.

11) Federal Efforts Should Complement, Not Duplicate Private Sector Efforts

In OMB Circular A-76, nine successive American presidents, beginning with Dwight Eisenhower, have set forth a policy regarding the relationship of government to the performance of "commercial activities." That policy is well-summarized in one sentence: "A commercial activity is not a governmental function."

As the federal government ventures into digital government it needs to remember the A-76 guidelines. In some instances, government agencies have recently pursued strategies where good

Digital Government

electronic government ideas have evolved into electronic commerce initiatives, where the government took on a role of providing commercial products or services to consumers in competition with the private sector. Whether the subject is the USPS and electronic bill presentment and payment, or a state agency with electronic tax preparation services, or a federal department wanting to commercially sell its electronic payroll services, these forays cross the line into electronic commerce.

For example, it is one thing for government to provide tax forms in electronic format (as they already do in paper format), it is quite another to provide tax preparation software that mimics the functions of tax preparers. Similarly, it is one thing for the USPS to use information technologies to support its mission of delivering physical mail. It is quite another to become an Internet Service Provider. For example, the USPS has announced an interest in entering the market for electronic bill presentment and payment services. Yet, it is not appropriate for the USPS to unilaterally expand its charter beyond the delivery of physical mail and packages and to compete with private sector companies already providing such services as e-mail, electronic carrier services, electronic certificate authorization, or electronic bill presentment and payment.

The justification government agencies often make for such efforts is that they are simply acting more like private corporations, and after all, isn't this the goal of government reinvention? Yet, when reinventing government advocates argue that government should operate more like a business, they mean that it should become effi-

cient, faster, and more customer-oriented in its delivery of services—not that it should effectively go into business and use public funds to competitively provide commercial goods and services in private markets.

As a result, digital government efforts should be focused on those innovations and initiatives which are necessary to fundamentally improve service to the citizen in inherently governmental functions, and to provide significantly better access to public information resources. Public funds, whether appropriated by Congress or generated through systems such as the Postal Rate Base, should not be used as venture capital to launch governmental agencies into competition with the private sector. There are too many necessary functions of government which are either going unfulfilled, or are being poorly performed in outmoded ways, to be able to justify in an era of limited budgets spending taxpayer dollars on activities which fundamentally change the role of government in our economy.

12) Take Action Now, and Learn From Mistakes

The IT revolution is changing so rapidly that waiting until the "perfect" comprehensive system can be developed will mean that any solution will be out of date by the time it is implemented. Government needs to move forward with smaller projects that, if successful, can be scaled up. Moreover, failure should be seen as an opportunity to learn what does not work, and not necessarily something to be penalized.

Policy Recommendations

To accelerate the pace of transformation we recommend that the Congress and the Administration do four major things to foster digital government:

1. Establish the Position of a Chief Information Officer for the Federal Government
2. Establish a \$500 Million Annual Digital Federal Government Fund to Invest in Cross-Agency Digital Government Projects
3. Give Agencies the Flexibility in the Use of Funds for Digital Government and Let Them Keep the Savings Generated by It
4. Expand Funding for Agencies to Develop Digital Government Applications

Establish the Position of a Chief Information Officer for the Federal Government

Currently, 54 federal agencies have CIOs, but the federal government as a whole does not. Current coordination efforts are just that, meetings among equals without the budget or authority to implement government-wide digital government solutions. A federal CIO would report directly to the President and direct the process of developing a concerted digital government conversion plan. He

or she would have a budget independent of individual agencies to help drive the next generation of digital government, much of it involving cross-agency applications. The CIO would head inter-agency and cross functional IT councils. The office would also take the lead in shaping the Administration's policy regarding the Internet, oversee issues of computer and network security for the government, and work with state and local governments to promote digital government. Just as the Y2K "tsar" was able to assert strong leadership in dealing with a potential Y2K crisis in government, a federal CIO and a comprehensive plan will foster digital government in a faster, more effective, and more comprehensive manner.

A number of states and nations have moved in this direction, appointing technology directors. For example, British Prime Minister Tony Blair has appointed an e-minister to coordinate the various departments involved in developing digital government as well as carry out e-commerce initiatives to improve service to the citizens.

Establish a \$500 Million Annual Digital Federal Government Fund to Invest in Cross-Agency Digital Government Projects

Agencies generally have not funded interagency digital government projects. Similarly, appropriations by both Congress and OMB is organized by

Box D: Ten Digital Government Applications

There are literally hundreds, if not thousands, of applications that could be developed to allow businesses, citizens, and other governments to interact with the federal government digitally. Here are 10 examples of things that could be done today.

1. Businesses and individuals could file tax returns directly with the IRS at no cost.
2. Exporters could fill out just one electronic form that is automatically routed to all government agencies involved in export issues.
3. Individuals could bid on government surplus items online.
4. Companies could file environmental compliance forms online.
5. Individuals could apply for Social Security benefits online.
6. Businesses could query a computerized "expert system" to find out what regulatory requirements their particular facility faces.
7. Individuals could store and access their medical information on a "smart card."
8. Individuals could search for federal employees through a centralized and integrated online database.
9. Government officials could purchase goods using electronic catalogs.
10. Companies could access and bid for government procurements on the Internet.

department, not function, so finding allocations for cross-agency projects is difficult. Only a small amount of funds for agency pilot projects has been allocated. But while pilot projects can get programs launched, they are not able to sustain them or develop them on the scale needed.⁸ Providing a pool of funds specifically targeted at implementing significant cross-agency projects would not only provide the resources to implement such projects, it would provide the organizational direction to get them done. However, to ensure agency buy-in, agencies should be required match these funds. And Congress should allocate funds to agencies specifically targeted to joint projects.

Give Agencies Flexibility in the Use of Funds for Digital Government and Let Them Keep the Savings Generated by It

Digital government will save money, but where will the government get the money to implement this

innovation? There is a model from the private sector. A number of computer/IT service firms, led by IBM and EDS, contract for these services with companies and, in effect, guarantee productivity gains to the firm. In return, companies are compensated out of a portion of the client firm's productivity gain.

Current law allows federal agencies to contract for energy efficiency technologies that will lower energy costs, with the contractor being paid out of the agency's energy cost savings. In this way, the agency doesn't have to invest up-front appropriated monies in efficiency saving technologies. Rather, it can pay for them over time with a part of the cost savings. The Clinger-Cohen Act of 1996 similarly allow federal agency pilot experiments with such "shared savings" contracting in the information technology area.

The information technology provision hasn't been used yet, probably because there is no "up side" for the agency—it has to return any savings to the Treasury, and can't use savings to enhance

its mission responsibility. But if that provision were fixed, and if broader demonstrations were permitted (rather than just the two pilots the law currently allows), this might be a significant way to expand digital government.⁹ In particular, agencies should be allowed to earmark the savings from digital government to their own innovation funds to finance further digital government initiatives.

In addition, governmental agencies should be given increased flexibility regarding digital government-related procurement. The Administration should identify pilot digital government projects that meet certain requirements, and develop new acquisition and procurement methods for them that are faster and more flexible. For example, in 1999 Congress gave the Central Intelligence Agency the authority and funding to create a \$28 million "venture capital fund" to help generate and procure advanced information technologies to help the agency carry out its mission.

Expand Funding for Agencies to Develop Digital Government Applications

Federal funding for information technology has grown every year since 1996, but the rate of growth has slowed, while the amount going to new applications has declined. In FY96, federal funding for information technology grew almost 8 percent, while in FY2000, it grew less than 2 percent, increasing slightly more than 4 percent in the President's 2001 budget.¹⁰ Moreover, this growth has not kept pace with growth in private sector information technology expenditures which have averaged over 8 percent growth per year through 1999.¹¹ In addition, much of the increase in funding for IT has gone to maintaining existing systems (increasing 24 percent between FY99 and FY01), while funding for modernizing and developing new systems has actually decreased 2 percent.¹²

What Government Is Doing Now, What Government Should Be Doing

There are at least three distinct aspects of digital government: information dissemination, interactive service delivery, online monetary transactions. This section details what the government is doing in each of these areas and suggests what government policy makers and managers should be doing.

Information Dissemination

What the Government is Doing

Government has begun to embrace the Internet, but most applications still focus on information dissemination from the government to the user. The information dissemination capabilities of the Internet and the low cost of maintaining and updating web sites has helped substitute for a shrinking government budget. Every federal agency from the statistics-rich Department of Commerce to the secretive National Reconnaissance Office maintains news updates, background information, and other data accessible through the Internet.

However, the lack of coordinated IT policy has resulted in disparities and duplication in the trans-

fer of online information between agencies. While some agencies stand out as innovative service providers, most do not utilize the Internet to its full capability—often viewing the Internet as a tool simply for *information dissemination*, and not a means of carrying out complex transactions. Moreover, agencies vary significantly in how online information is organized and the web site designed, making finding information confusing. While most agency web sites maintain individual search engines, they are of varying capability and efficiency, some allowing advanced searches while others have few customizing capabilities.

Most government web sites are designed with an agency-centric focus, not a customer-centric focus. For example, the typical agency web site home page features a picture of the department secretary, and lists press releases and other recent news about the department. This is equivalent to the *Amazon.com* home page featuring a picture of its CEO Jeff Bezos, along with press releases on how well Amazon's stock is doing, instead of immediately seeing how to buy books, CDs, etc.

Information is often quite difficult to find unless one is lucky enough to know what agency or bureau to look at.¹³ In response, the federal gov-

ernment has developed some "portal" sites that aggregate a variety of information. Sites such as *business.gov* do a reasonable job of organizing government-related information that businesses may need. However, while they provide numerous resources from obscure technical information to general knowledge information, most federal portals (e.g., *webgov.net*, *fedworld.gov*) are confusing, difficult to use, and do not comprehensively and accurately search all online government documents. More importantly, most are simply collections of many disparate web sites, as opposed to means to truly organize federal information in logical and accessible ways. In this sense, these sites are currently pointers to agency-centric organizations and their services, not real vertical and horizontal portals organized according to how customers view and seek government services and capabilities.

Moreover, because individual agencies and programs develop their own web sites, there is duplication of efforts. For example, both Access America's student web site (*students.gov*) and the Department of Education's Easy Access for Students and Institutions (EASI) web site¹⁴ focus on students, but the EASI web site does not link to the Access America site and its online student loan application function. The proliferation of agency and program-specific web sites is a reflection of the stovepipe nature of the federal government and the inability to organize information and services around the customer. As the federal CIO Council states, IT has been "used in pockets of isolation to accomplish separate and distinct tasks."¹⁵

Several agencies are beginning to combine resources to better carry out tasks, record transactions, and benefit the consumer. As stated earlier, Vice President Gore's National Partnership for Reinventing Government (NPR) has been at the center of the efforts to reform government and traditional agency practices. Specifically, NPR's Access America program has worked to coordinate government-wide resources into a more user-friendly structure, namely in the form of gateways (web sites pertaining to a particular topic) focused on seniors and students. The resources are primarily links to online information such as Social Security benefits, educational resources regarding scholarships, and federal loans. But there are few

innovative services available on either gateway and a number of links seem to be quite dated.

What Government Should be Doing

- **Develop an enterprise-wide information architecture:** In an attempt to make web sites more easily accessible, the Australian and Israeli governments have developed design and content standards for their web sites.¹⁶ Simple baseline standards on design, file architecture, and information display for federal web sites will make it easier for users to navigate sites and retrieve information. This should be part of a broader effort to develop a shared information architecture for the federal government that addresses issues of data sharing, telecommunications usage, and standards for web design.

- **Implement a standardized information tagging system.** Most indexed information cataloged by an Internet search engine is retrieved using search programs (called spiders or robots) which explore the World Wide Web by tunneling through web pages and categorizing the information contained therein. The degree and depth to which the robots search differs from engine to engine. The process is time consuming (considering the billion-plus web pages) and results in an index of web sites which are often not accurately organized according to relevance. Increasingly, web developers have begun adding metatags, or short descriptions of the web page content, for use by search engines in cataloging web pages. However, there is currently no standard for Internet metatagging.

The most effective solution for categorizing information on government web pages would be to develop a database-driven system, where all information is automatically listed in databases as it is placed online. Implementing this type of system would allow more accurate and efficient searches. Extensible Markup Language (XML), a newly approved Internet standard for developing highly interactive and flexible web pages, will allow a more accurate and efficient categorization for improved indexing and searching.

Digital Government

However, while XML is a viable solution to information organization, it will take time to implement and does not solve the current problems associated with indexing. In the interim, a metatagging standard should be developed that will more accurately index immediately forthcoming and currently available web pages. The standard should be applied to all government web sites to improve government-wide search agents, and should be available to commercial search engines to better enhance their search capabilities.¹⁷

The federal government should consult with several organizations currently working on metatagging initiatives and either support one standard or develop one for government use. Combining metatagging with the capabilities of XML will allow expert systems, intelligent agents, and next generation search engines to use semantics and concept association to search and index information.¹⁸ For example, this type of technology could be used by the Department of Health and Human Services and others to establish health information networks; where people could get state of the art health information online despite not knowing complex medical terminology and jargon (see Box E, p.18).

- **Create an entryway/portal to government services.** Web sites need to be categorized by the function of the service rather than the agency (or most likely, agencies) administering them. A well designed portal to all online federal information will make citizen-government interaction more efficient and effective. But a portal needs to be more than simply a mega-link to government web sites. Rather, it needs to completely bypass agency stovepipe organization and be organized by information and type of interaction.

Australia¹⁹ has organized a central web site by bringing together eight different government programs into one web site interface for the citizen, called Centrelink. The Israeli government completed a similar process and created a portal to Israeli government services.

- **Expand the amount of information acces-**

sible on searchable databases. The federal government has an enormous amount of information in databases, but most are not searchable online. For example, citizens should be able to search Bureau of Land Management land records to identify land parcels. In fact, there are a host of potential database functions that could be developed.

- **Use "information on request" to provide people with government information.** This notification technology automatically sends information to individuals based on criteria that they have submitted which is unique to their interests. For example, companies should be able to answer a questionnaire and automatically receive an e-mail informing them of each federal procurement solicitation that matches the criteria they entered. Similarly, this technology could inform businesses of new regulations that might affect their particular facility or company.
- **Develop "expert systems" to access information.** Expert systems are software programs that let individuals enter information and receive back expert advice based on the data programmed into the software. For example, the Occupational Safety and Health Administration has developed a series of online "adviser" expert systems to help business people to identify safety problems in the work place—from cadmium to mercury to asbestos—and determine an appropriate course of action.²⁰
- **Make the Web the first place to put information, not the last.** Too many federal web sites are "stale," only slowing adding new information and in many cases containing information that is months and often years out of date. For example, one agency site describes its efforts to use Electronic Data Interchange (EDI) protocols to allow companies to file regulatory information, even though the information is years old and the agency is now planning on using Internet-based systems. Agencies need to post information on the web even before they publish it in other forms.

BOX E: Creating Health Information Networks²¹

As purchaser of about half of the nation's health care (through Medicare, Medicaid, the VA etc.), the government is in a unique position to catalyze greater adoption of information technology throughout the health care system. Indeed, in the Information Age, affecting the change outside your organization is as important as the change inside it. And nowhere is this more apparent than the health care system.

Consider how many times patients must fill out medical histories. Each doctor and hospital has their own form and no system for checking the accuracy of the records. Yet such information can literally be a life and death matter for patients. As one business leader put it, an ATM knows more about your finances than the average doctor knows about your medical history.

The Department of Veterans' Affairs has taken the lead in catalyzing adoption of information technology for health records. The leaders of the VA have come to realize that any information system that works only in their own system won't do them any good. Even VA patients do not stay in the VA system, so if doctors are to track their patients, they need a system that everyone can use.

The VA's goal is much like the DOD's in building the Internet. The DOD needed a communication system that couldn't be shut down by the enemy because it was widely used yet controlled by no one. The VA realizes that any system for exchanging health information must be similarly diffuse in order to operate between the highly fragmented elements of health care, and cannot be controlled by any one element of the health care system, which few people would trust.

As VA health care consultant Tom Munnecke puts it, everyone should be able to have a personal health space that allows for the secure, private, and confidential exchange of health information from their medical history to the payment for health services. It might take the form of a personal web site where consumers could keep and control access to their health records, communicate confidentially with their doctor or other patients with similar health problems, and shop for health care services that are best matched to their needs and preferences.

The key to creating a personal health space is an organization that reflects the diversity of the health care system and yet comes together around a common purpose of giving people control of their health and health care. Along with the VA, other federal agencies and private sector organizations like the American Hospital Association have launched the "Vvaleo" project. Vvaleo is from a Latin word, "to be in good health." While it is still in the very early stages, this organization or another like it is needed to address the systemic problems in health care that otherwise slip through the cracks because no one is directly responsible for them.

The government must also assure that personal health information is not abused. Incredibly, there are no national laws or even national standards on health information privacy and confidential use. While a national regulatory process is underway as part of the Health Insurance Portability and Protection Act, it covers only electronically stored information and not written records, which could potentially create an uneven playing field and effectively discourage using information technology to replace written records.

- **Measure customer satisfaction.** Just as its possible to get data on the number of times private web sites have been visited, it would help assess the usefulness of federal web sites by tracking and reporting this information. Usage metrics should be built into the site maintenance process. In addition, all web sites should have standardized ranking forms built into them where citizens can rank a web site (1 to 5, with 1 being extremely useful, and 5 being not useful) on how useful it is to them and to what degree it met their needs. These will help government customize its efforts to meet citizen needs.

Interactive Service Delivery

It is one thing to simply provide information on a web site, it is another to allow businesses or citizens to engage in transactions with the government. Creating an agency web site is relatively easy. But government must do more than this, it must enable citizens to interact and transact business with government. But this is harder, both technically and organizationally. It is not good enough to simply build a fancy web site with online forms for people to fill out and submit if the forms are printed out (on the government end) and go into the same old bureaucratic system. The government must reinvent itself the same way companies have had to reinvent themselves in the private sector: use the technology to replace bureaucracy with more efficient systems and more flexible human organizational structures. Online transactions are the next major challenge to implementing digital government.

What the Government is Doing

The online form has become one of the preeminent Internet-age tools for web-based communication; a fundamental step toward improving online services. Using an online form, a person can submit information which is deposited directly into a database, saving both the person and the organization time and money. The range of applications and the cost savings and quality improvement (reduced errors) are immense.

Many agencies allow individuals to obtain forms online, print them, and then mail the paper copies, where the information is then either entered by hand or scanned into a computer.²² A few agencies are beginning to allow citizens and businesses to file forms online. For example, the Postal Service allows residents to file change-of-address forms online, while 18 year-old American males can register with the Selective Service online to immediately obtain a Selective Service number. The Social Security Administration also maintains an online benefits calculation service (however, the information is mailed to the applicant). The National Park Service allows people to make registrations online. In addition, some federal agencies, such as the Securities and Ex-

change Commission, the Federal Communications Commission, and the Federal Energy Regulatory Commission allow companies to submit regulatory filings online.

What Government Should be Doing

- **Expand and standardize the number of applications for online forms.** All government forms should be publicly available and searchable on a central federal web site. The 1998 Government Paperwork Elimination Act requires each federal agency by 2003 to make its forms available for electronic submission (through the use of a digital signature when necessary). President Clinton recently issued an executive memorandum to all executive departments and agencies calling for the availability of online forms needed for the top 500 government services by December 2000.²³ There are a host of potential applications including: applying for Social Security benefits, veterans benefits, passports, and federal jobs; allowing businesses to pay Social Security and other regularly recurring taxes; allowing people to respond to government surveys (e.g. Census); and letting attorneys file federal court documents electronically.
- **Whenever possible, use Web-based technology.** In the private sector, e-commerce applications are evolving toward the web, and away from proprietary electronic data interchange (EDI) protocols managed by fee-based vendors. Yet some federal applications have been slow to move toward web-based applications, even though they do not require costly subscriptions to EDI Value Added Networks and are more accessible to small businesses and individuals. Forms packages should also have open standards so that they all tie into back-end legacy systems.
- **Online forms should use shared information about the submitter.** One of the frustrations many individuals experience with e-commerce is the requirement to fill in personal information every time they order something online. E-commerce vendors are working on solutions that would allow indi-

viduals to only enter personal information once, saving them time and effort. Directory technology such as Lightweight Directory Access Protocol (LDAP) is used to maintain one information resource that is queried by multiple systems. This system should be used in conjunction with XML or other advanced and flexible Internet-related formats. The federal government needs to adopt the same system so individuals can streamline their interactions with government.

- **Integrate forms.** Putting forms online is one thing, streamlining and consolidating information collection is another. For example, EPA has been slow to shift to one-stop reporting whereby companies fill out one form, ideally for both state or federal compliance reporting. The proposed International Trade Data System is an example of this (see Box B, p.6).
- **Focus on intergovernmental solutions.** Many online applications require citizens and businesses to deal with multiple levels of government. For example, companies must file local, state, and federal environmental regulatory compliance forms. Digital government efforts need to be integrated at all levels of government to streamline these processes.

Online Monetary Transactions

Monetary transactions increasingly rely on electronic funds transactions (EFT). This process significantly reduces transaction costs and improves the timeliness of interaction. The federal government is the largest issuer of checks and is the largest procurer of goods and services in the world. Virtually all of these activities could be done electronically, replacing paper.

What the Government is Doing

Government has begun to embrace online monetary transactions. For example, the IRS encourages online filing of tax returns for both citizens and businesses. Online filing reduces instances of data error from an average of 21 percent (in paper) to less than 1 percent, and significantly reduces the transaction costs of processing returns and checks.²⁴ In 1998, 24.6 million Americans—

an increase of 28 percent from the year before—filed their tax returns electronically.²⁵ However, due to a lack of digital signature protocol, the user is required, via mail, to return a signed confirmation sheet to the IRS. The IRS also uses direct deposit of refunds, saving substantial costs. The costs of issuing a paper check are \$2-\$3.50 per check, compared to roughly \$0.15-\$0.55 with direct deposit and EFT.²⁶ Despite the convenience and cost savings of e-filing, it was not until January 2000 that the first business tax return was submitted online; and even then, only one company has been authorized to process electronic tax returns for businesses.²⁷

Today, a large share of federal payments (except tax returns) are carried out through EFT, as required by the 1996 Debt Collection Improvement Act.²⁸ In FY99, 68 percent of government payments, including benefit payments, were transacted through EFT; additionally, 96 percent of salary and allotment payments were carried out using EFT.²⁹ Savings after full conversion to EFT could reach roughly \$100 million per year.³⁰

The government is also embracing electronic benefits transfer (EBT) to convey medical, food, and other government-to-citizen benefits. Increasingly, electronic benefits are placed on debit cards or smart cards. Like EFT, EBT replaces the need for checks and allows people receiving government support to have it automatically transferred to debit cards. This is especially useful for the 20 percent of benefit recipients who do not have bank accounts. Today, 39 states—29 of which are state-wide programs—use EBT systems with benefits going to 4.25 million families (\$1.35 billion per month in food stamp benefits alone).³¹ The National Partnership for Reinventing Government has proposed putting all (federal and state) benefit-related information on one card, to reduce confusion and cost, and increase convenience.³² One of the most innovative pilot programs, which incorporates state, local, and federal government benefits, has been the Health Passport, a project developed by the Western Governors' Association. This program places all medical benefit information on one smart card and can be used to redeem a variety of benefits—from medical care, to pharmaceutical products, to food benefits.³³

As the world's largest purchaser, the U.S. Government spends large sums on procurement.

Digital Government

E-commerce cuts the costs of procurement and acquisition for government and for vendors. The majority of government agencies have unique procurement and electronic catalog systems, utilizing non-web based proprietary accounting and data basing software. Department of Defense is perhaps farthest along, having established a goal of an entirely paperless contracting system for major weapons systems by January 2000.³⁴ The Federal Electronic Commerce Program Office and the Interagency Acquisition Internet Council are working with CommerceNet,³⁵ an electronic commerce industry membership organization, to develop interoperable electronic catalogs which allow agencies to post notifications of their needs online for public bidding by contractors. The catalogs would also allow companies to list goods and prices for government purchasers. Currently, vendors can go to the electronic posting system (*eps.gov*) where agencies post their procurement requirements for purchases above \$25,000. The General Services Administration (GSA) hopes to have this system in place on a government-wide basis by early 2001. Similarly, *fedcommons.gov* is a gateway to a large share of government grants that are awarded.

The government is also beginning to experiment with allowing individuals to purchase items from the federal government online. For example, in its first month online, the U.S. Mint averaged sales of \$2 million per day of numismatic sets and coins. Savings bonds can be purchased online. Individuals can also buy stamps, postal products, and savings bonds online.

The government is also beginning to use smart cards to fulfill an increasing number of functions including EBT and procurement. Integrated circuit chip cards, or smart cards, enable the centralization of information, tools, and identification on one small plastic card. The cards are being used by the private sector, and increasingly by the government in pilot programs, as a means of organizing several card-based tools onto a single card.

The Department of Defense (DOD), especially the Navy, has begun to implement smart card technology for American servicemen. Smart cards make obsolete the multiple forms and papers servicemen are required to keep. The Navy uses smart cards for identification, ATM-at-sea cash re-

trieval systems, medical and dental records, retrieval of classified documents, and accountability tracing of government tools and clothes by Navy personnel. Proposed improvements will include tracking mess line attendance, debit card capability with the ship's store, and recording mail room pick-ups.³⁶

The private sector has been anxious to work with government on the development of smart cards. Citibank, IBM, Visa, 3G International, CTE, the Sandia National Labs, and the Federal Technology Service have created a 500-card pilot project for Federal Technology Service employees in Virginia. The 16KB card includes the basic utilities of smart cards: ID, building access, procurement ability, calling card, access to LAN and applications, as well as direct access to airplane boarding.³⁷

What Government Should be Doing

- **Use EFT in all monetary transactions.** Electronic fund transfer will save government, citizens, and businesses both time and money. This process also automatically creates an accurate record of transactions.
- **Implement the use of electronic checks.** Electronic checks involve not just the transfer of funds but also the transfer of an electronic record to the recipient. The Treasury Department is in the initial stages of a trial program using this technology; this should be expanded government-wide.³⁸
- **Develop government-wide electronic procurement systems.** A standardized electronic procurement system would reduce costs and increase competition and convenience. The process would include bidding by companies for government contracts, as well as search engines and virtual assistants which will help government employees find desired goods at the lowest possible prices. The "Channel Convergence in a Delivery to the Citizen Model Pilot" with the Social Security Administration is focusing on this area.
- **Issue government benefits through EBT.** Automatic allocation of benefits will reduce pa-

perwork, cut costs, and allow government to keep better track of benefit use for data and studies. States that have not yet implemented EBT programs should work with both the federal government and the private sector to develop systems.

- **Expand the number of items citizens can purchase online.** To the extent that federal agencies sell items, citizens should be able to purchase them online. CommerceNet is working with the federal government to allow citizens to find online government surplus items. In addition, the government should develop an online auction for disposing of surplus government property. Other applications should be developed.
- **Make it easier for citizens and businesses to directly file their taxes online.** Simply continuing the current system of regulating the certification of data transmitters who batch income tax returns and submit them by proprietary tax agency electronic protocols is not adequate. Governments should instead invest in the 'back room' infrastructure necessary to permit direct electronic transmission to the government of completed tax returns by individual citizens using their private sector software. The creation of such electronic portals will also facilitate direct electronic communication between citizens and tax agencies, allowing citizens to access general government information, information on tax return status, and individual income tax "accounts." Digital government in the income tax environment
- cannot move forward in robust ways until the government invests in modernizing the infrastructure underlying the entire tax system.
- **Expand federal smart card applications.** Currently, smart cards are in use in pilot programs. Pending successful outcomes, these card applications should be expanded. For example, the Veterans Administration could issue smart cards to veterans to obtain prescriptions. In addition, the smart card can also house the veteran's medical history and other information. In fact, there is no reason why this could not be extended to all Americans who could have their medical history on one card. The government should explore how to extend benefits and services to all Americans through the use of smart cards.
- **Ensure that government smart cards are interoperable with private sector applications.** At minimum, government smart cards need to be interoperable with other cards in government. Ensuring that government smart cards can be used in non-governmental applications will help jump start the introduction of smart card technology and smart card readers throughout society, making it a more useful tool for government use.
- **Attach digital signature functions.** Attaching digital signature (i.e. online authentication) abilities to smart cards (along with a password) would allow verification for forms and transactions and would help jump start the use of digital signatures.³⁰

Conclusion

The U.S. economy is going digital. This information technology revolution provides the opportunity for the federal government to transform itself and the way it provides services to citizens. Doing so would not only cut the cost and improve the quality of government, it would improve the trust citizens have in their government. Yet, real progress in a timely manner depends upon digital government rapidly becoming a priority of Congress and the Administration, both in terms of funding and leadership.

Endnotes

- ¹ The IRS reports that it costs \$3.50 to mail out a tax form, compared to 2 cents on the web. Hewlett Packard reports that it would save \$1 million per year for filing just one form electronically: the W-4 (dependent declaration tax form for taxes). Press Release from the Office of Congresswoman Anna Eshoo, "Congress Passes Eshoo's Landmark Digital Signature Legislation" October, 28, 1999 (<http://www.house.gov/eshoo/digsigw.htm>).
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- ³ This box was written by Debra Knopman, director of the Progressive Policy Institute's Center for Innovation and the Environment.
- ⁴ Thomas W. Lippman, "U.S. Diplomacy Behind the Times, Studies Say," *Washington Post*, (10-28-98).
- ⁵ There are numerous smaller committees and organizations such as the Federal Communicators Network and the Federal Webmasters Forum which tackle more focused IT issues.
- ⁶ President William Jefferson Clinton, "Memorandum for Heads of Departments and Agencies: Electronic Commerce" (December 17, 1999).
- ⁷ Similarly, while the Postal Service gives discounts to businesses who bar code mail, they do not give them to consumers who mail bar coded envelopes (e.g., return envelopes of bills).
- ⁸ Currently, the GITS board oversees a small Information Technology Innovation Fund to fund cross agency projects, but at less than \$7 million per year, the funding does not go very far. The funds come from a small agency "tax" on their FTS2000 long distance telecommunications budgets.
- ⁹ William B. Bonvillian, Speech given to the National Academy of Sciences/National Research Council Symposium on Government-Industry Partnerships in Biotechnology and Computing (October 25, 1999).
- ¹⁰ Tom Hewitt, Federal Sources, Inc. *Virtual Government 2000*, Presentation to the AFCEA Virtual Government 2000 Conference, Washington, DC: February 23, 2000.
- ¹¹ *Ibid.*
- ¹² *Ibid.*
- ¹³ For example, the National Science Foundation maintains scores of studies and reports on scientific issues as well as on aspects of the science and technology sectors. From education to employment, the CIA maintains a huge database of country-specific information. *Fedworld.gov*, an online federal information resource (maintained by the Department of Commerce) lists over 20 databases maintained by various federal agencies.
- ¹⁴ <http://easi.ed.gov/>.
- ¹⁵ Chief Information Officers Council. *Strategic Plan, Fiscal Year 2000*, p. 2.
- ¹⁶ Australia: <http://www.fed.gov.au/>. Israel: <http://www.info.gov.il/eng/mainpage.htm/>.
- ¹⁷ Malcolm MacLachlan, "Meta-Tagging May Improve Web Searches," *TechWeb* (April 17, 1998) (<http://www.techweb.com/news/story/TWB19980417S0018>).
- ¹⁸ Laurie Ann Toupin, "Software That Does Your Research For You," *Design News* (September 20, 1999) (<http://www.manufacturing.net/magazine/dn/archives/1999/dn0920.99/18f1907.htm>).
- ¹⁹ <http://www.centrelink.gov.au/>.
- ²⁰ <http://www.osha-slc.gov/dts/osta/oshasoft/>.
- ²¹ This box was written by Dave Kendall, senior fellow for health policy, Progressive Policy Institute.
- ²² For example, the U.S. Copyright Office allows individuals to download registration forms and submit them by mail (<http://www.loc.gov/copyright/forms/>).
- ²³ The White House, "Memorandum for the Heads of Executive Departments and Agencies: Electronic Govern-

Digital Government

ment." (December 17, 1999).

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²⁵ *A Strategy for Growth*. The Electronic Tax Administration (December 17, 1998) (http://www.irs.ustreas.gov/prod/elec_svs/eta-plan.html).

²⁶ Larry Carnes. *Electronic Delivery of Government Systems*. General Services Administration (June 1998) p. 23.

²⁷ "The Tax Man Takes It Online." *National Journal's Technology Daily*, (February 10, 2000).

²⁸ <http://ec.fed.gov/efi.html/>.

²⁹ <http://www.fms.treas.gov/efi/agency/VFY99.html/>.

³⁰ <http://www.fms.treas.gov/efi/>.

³¹ <http://ec.fed.gov/ebfacts.html/>.

³² <http://ec.fed.gov/ebfacts.html/>.

³³ <http://www.westgov.org/wga/initiatives/hpp/>.

³⁴ <http://www.acq.osd.mil/pcipt/>.

³⁵ <http://www.commerce.net/>.

³⁶ <http://www.doncio.navy.mil/focusareas/smartcard/index.html/>.

³⁷ <http://smart.gov/section04e.html/>.

³⁸ <http://www.echeck.org/>.

³⁹ Marc Strassman and Rob Atkinson. *Jump Starting the Digital Economy* (Washington, DC: Progressive Policy Institute, 1999) (<http://www.dlcppi.org/texts/tech/privacy.html/>).

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**Electronic Tax
Administration
Advisory Committee**

Annual Report to Congress



June 30, 2000

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Contents

<u>Executive Summary</u>	iv
<i><u>Progress in meeting electronic tax administration strategic goals</u></i>	iv
<i><u>Continuing the Strategic Planning Process</u></i>	iv
<i><u>Encouraging all Tax Preparers to be EROs</u></i>	v
<i><u>Increasing Electronic Filing by Self Preparers</u></i>	v
<i><u>Increasing Electronic Tax Administration for Business</u></i>	vi
<i><u>Alliances</u></i>	vi
<u>1.0 Introduction</u>	1
<i><u>1.1 ETAAC's Vision of Electronic Tax Administration</u></i>	1
<i><u>1.2 The Most Critical Strategic Electronic Tax Administration Challenges Facing the IRS</u></i>	2
<i><u>1.3 ETAAC Members</u></i>	2
<u>2.0 IRS Progress in Meeting Strategic Goals</u>	3
<i><u>2.1 Individual Filing Season Results</u></i>	3
<i><u>2.2 Other Significant Accomplishments During 1999-2000</u></i>	4
<i><u>2.3 Progress Towards Meeting Strategic Goals</u></i>	5
<i><u>2.4 ETAAC's Assessment of the 2000 Filing Season</u></i>	6
<u>3.0 Critical Challenge 1: Developing A Strategic Planning Process to Achieve Goals</u>	7
<i><u>3.1 ETAAC's Vision of IRS' Strategic Planning Process</u></i>	7
<i><u>3.2 Public Policy</u></i>	7
<i><u>3.3 IRS Strategic Planning</u></i>	10
<i><u>3.4 IRS Systems Modernization</u></i>	11
<i><u>3.5 IRS Marketing Strategy & Outreach to e-File Market</u></i>	13
<u>4.0 Critical Challenge 2: Encouraging All Professional Tax Preparers to Become Electronic Return Originators</u>	15
<i><u>4.1 ETAAC's Vision of Professional Tax Preparers</u></i>	15
<i><u>4.2 The Importance of Professional Preparers to Achieving E-Filing Goals</u></i>	15
<i><u>4.3 Professional Incentives</u></i>	15
<i><u>4.4 Creating Parity Between EROs And Paper Return Preparers</u></i>	16
<i><u>4.5 Mentoring</u></i>	16
<i><u>4.6 Practitioner Association Consortium</u></i>	17
<i><u>4.7 Debt Indicator Expansion</u></i>	17

<u>4.8</u>	<u><i>Using Other Organizations to Drive e-File Demand</i></u>	17
<u>5.0 Critical Challenge 3: Increasing Electronic Filing Among Self-Preparers</u>		18
<u>5.1</u>	<u><i>ETAAC's Vision of Self Preparers</i></u>	18
<u>5.2</u>	<u><i>Attracting Self Preparers to e-File</i></u>	18
<u>5.3</u>	<u><i>State Participation</i></u>	19
<u>5.4</u>	<u><i>Other Initiatives to Consider</i></u>	20
<u>6.0 Critical Challenge 4: Increasing Electronic Interactions Between The IRS And Businesses, Including Filing, Payment, And Communication Activities</u>		21
<u>6.1</u>	<u><i>ETAAC Vision of Business-Related Electronic Tax Administration</i></u>	21
<u>6.2</u>	<u><i>Business Income Tax Returns</i></u>	21
<u>6.3</u>	<u><i>Information Returns</i></u>	22
<u>6.4</u>	<u><i>Electronic Employer & Financial Institution Statements</i></u>	22
<u>6.5</u>	<u><i>TIN Matching</i></u>	22
<u>6.6</u>	<u><i>Retirement Plans</i></u>	23
<u>6.7</u>	<u><i>Electronic Records and Communication</i></u>	23
<u>6.8</u>	<u><i>Electronic Payments</i></u>	23
<u>7.0 Critical Challenge 5: Forming Strategic Alliances with Businesses, Federal Government Agencies, States, And Other Organizations to Facilitate And Promote the Growth Of Electronic Tax Administration</u>		25
<u>7.1</u>	<u><i>ETAAC Vision for the Alliance Programs</i></u>	25
<u>7.2</u>	<u><i>Embracing Private Sector Partnerships</i></u>	25
<u>7.3</u>	<u><i>Use of the RFA Process</i></u>	26
<u>7.4</u>	<u><i>Managing "Pilots" To Engage Potential Alliances</i></u>	27
<u>7.5</u>	<u><i>Transitioning from Pilots to Production</i></u>	27
<u>7.6</u>	<u><i>Community Alliance Initiatives</i></u>	28
Appendix A ETAAC Members 1999/2000		A-1
Appendix B ETAAC Letter to Robert E. Barr		B-1

Executive Summary

This report defines a vision for electronic tax administration. The ETAAC sees electronic tax administration playing a critical role in a modernized IRS, and believes the underlying purpose of electronic tax administration is to be an enabling mechanism that transforms the IRS into a modern financial institution offering taxpayers world-class service. The electronic filing goals established in the Internal Revenue Restructuring and Reform Act of 1998 (RRA 98) represent a meaningful metric to evaluate IRS progress towards achieving this transformation, but the underlying objective remains to improve service to taxpayers by providing them with electronic means of conveniently interacting with the IRS.

In using electronic tax administration to transform itself, the IRS must overcome these critical challenges:

1. Continuing to develop a strategic planning process to achieve goals.
2. Encouraging all professional tax preparers to become Electronic Return Originators (EROs) and convincing them that filing and communicating with the IRS electronically is preferable to other methods.
3. Increasing electronic filing among self-preparers.
4. Increasing electronic interactions between the IRS and businesses, including filing, payment, and communication activities.
5. Forming strategic alliances with businesses, federal government agencies, states, and other organizations to facilitate and promote the growth of electronic tax administration.

The ETAAC has developed a vision of what meeting each critical challenge will look like, evaluated the IRS' progress in meeting its electronic tax administration strategic goals, and identified what the IRS must do to reach this vision.

Progress in meeting electronic tax administration strategic goals

The IRS experienced a large growth in electronic filing in 2000, with a 20.5 percent increase in e-filed returns. Other aspects of the electronic filing program showed excellent improvement in 2000 as well.

RRA 98 set a goal for IRS to achieve 100 percent electronic filing of all returns prepared on computer by both tax professionals and taxpayers alike by 2003. While progress is being made, the ETAAC believes that much work remains to be done to even approach this goal, and it will not be achieved by 2003.

The 80 percent goal for 2007 can be achieved if a growth rate of 19 percent or better is maintained, but the ETAAC does not know if this rate is sustainable. The ETAAC believes new initiatives will be needed to maintain the growth rate at this level, and recommends that the IRS monitor closely the total growth rate for electronic filing in future years.

Continuing the Strategic Planning Process

The ETAAC envisions that the IRS strategic planning process will clearly establish the IRS electronic tax administration strategy with sufficient milestones and performance measures for both the IRS and external stakeholders to evaluate its progress, and envisions that electronic tax administration strategic plans will become part of an agency-wide master plan that seamlessly integrates electronic tax

administration plans into broad agency strategic plans, establishes meaningful performance measures for each goal, and ties resource planning into achievement of strategic objectives.

An effective strategic plan will align the elements of Public Policy, Strategic Planning, Systems Modernization, and Marketing Strategy and Outreach into a single plan. Public policy in particular should support achievement of the electronic filing goals established by Congress in the RRA 98 and be aligned with IRS strategies. Accordingly, the ETAAC makes the following public policy recommendations to Congress:

- The ETAAC strongly supports the administration's proposed \$10 tax credit for taxpayers that e-file because surveys of tax practitioners indicate this will make a difference in e-filing levels. Congress is encouraged to enact this legislation.
- The Internet can revolutionize tax administration and must be part of the IRS' strategies for interacting with taxpayers electronically. These strategies should stress partnership, not competition, with the private sector to achieve its objectives. The ETAAC believes that the private sector is progressing towards offering taxpayers a range of convenient, low- and no-cost e-filing options, and the best action for IRS to take is to promote the most intense competition among private sector companies and pursue policies that allow these companies to reduce unnecessary costs.
- Congress must appropriate adequate resources and authority for pilots and prototypes, enabling a quick response to rapid changes in the electronic commerce marketplace.

The ETAAC envisions that business systems modernization will provide the technology infrastructure necessary to support electronic tax administration business plans, and that technology infrastructure projects will be funded and scheduled in time to support strategic objectives. Developing technology that facilitates the transition to a fully paperless e-filing process is critically essential to the success of using electronic tax administration to transform the IRS to a customer service-based agency.

Encouraging all Tax Preparers to be EROs

The advantages of e-filing should be so overwhelming that professional tax preparers will consider e-filing the preferred way of doing business. To achieve this condition, the IRS needs to pay closer attention to the tax practitioner market, and understand the factors that motivate various types of practitioners to continue or become an ERO. The account management program has strong potential, and could go far in improving its relationship with tax practitioners.

All incentives that apply to professional preparers should be aligned in favor of e-filing. Of particular concern is that the IRS has set standards for EROs that do not apply to professional preparers that file using paper, thus encouraging professional preparers to remain with paper. The ETAAC recommends this inequity be resolved by applying similar standards for all professionals, regardless of filing mechanism. Preparers should not be able to escape standards by filing only paper returns.

Increasing Electronic Filing by Self Preparers

The fastest growing segment of the e-filing population is online filing by self preparers. The ETAAC believes that based on current market trends, taxpayers will soon have several options to prepare and e-file taxes over the Internet at no cost, and that private sector competition will continue to drive prices down. The ETAAC vision is that the formation of business alliances in the private sector will increase competition and provide many options for convenient and free filing for self preparers, and most of these options will be via the Internet as opposed to buying tax software from a traditional retail outlet.

The ETAAC vision of federal and state cooperation is that a single filing transaction can suffice for both federal and state purposes. The current Fed/State e-filing program enables this type of seamless experience for individual filers in a majority of states, and ETAAC commends the IRS for cooperating with state agencies to continue operating a successful Fed/State program. .

Increasing Electronic Tax Administration for Business

The ETAAC believes that a business should be able to conduct tax administration functions electronically as easily as it conducts business functions with another business. Electronic interaction with the IRS should be at the election of the business. To make this vision a reality, the IRS must improve electronic interactions between itself and businesses in a number of areas, including business income tax returns, information returns, electronic employer and financial institution statements, TIN matching, retirement plan requirements, electronic records and communications, and electronic payments.

The ETAAC recommends the necessary enabling legislation and subsequent establishment of IRS and SSA regulations to permit employers and financial institutions to send forms W-2 and 1099 to taxpayers electronically.

Alliances

The ETAAC envisions a cooperative environment between the IRS and external stakeholders that encourages the formation of alliances to achieve objectives. The ETAAC recommends that the IRS adopt a clear strategy for incorporating alliances with the private sector in order to successfully achieve its electronic tax administration objectives.

1.0**Introduction**

This report defines a vision for electronic tax administration—electronic interaction between the IRS and taxpayers for tax filing, payment, and related communication. The National Commission on Restructuring the IRS established a vision for the IRS in 1997 in its report, *A Vision for a New IRS*. In 1998, much of that vision was codified into law in the IRS Restructuring and Reform Act of 1998 (RRA 98). Electronic filing, which the IRS has extended to electronic tax administration, was an important part of that vision. Title II of the RRA 98 provided the IRS with the following policy statement with respect to electronic filing:

- (1) paperless filing should be the preferred and most convenient means of filing Federal tax and information returns
- (2) it should be the goal of the Internal Revenue Service to have at least 80 percent of all such returns filed electronically by the year 2007, and
- (3) the Internal Revenue Service should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns.

Recognizing the importance of receiving private sector input to achieving this goal, the legislation further required that the IRS establish an advisory group to provide it with private sector input, and further required that this advisory group report to Congress annually on the following subjects:

- the progress of the IRS in meeting the goal of receiving electronically 80 percent of tax and information returns by 2007;
- the status of the strategic plan to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing gradually over the next ten years;
- the legislative changes necessary to assist the IRS in meeting such goal; and
- the effects on small businesses and the self-employed of electronically filing tax and information returns.

The Electronic Tax Administration Advisory Committee (ETAAC) satisfies the requirement of RRA 98 to establish a private sector advisory group on electronic filing matters. This report responds to the reporting requirements specified in the RRA 98, and can be valuable to Congress by providing it with private sector insight on:

- progress made by the IRS in achieving the goals established by Congress;
- a vision of how electronic tax administration can transform the IRS into a customer service organization;
- strategic challenges facing the IRS in electronic tax administration; and
- electronic filing impact on self-employed and small business.

1.1 ETAAC's Vision of Electronic Tax Administration

The ETAAC sees electronic tax administration playing a critical role in a modernized IRS, and believes the underlying purpose of electronic tax administration is to be an enabling mechanism that will transform the IRS into a modern financial institution offering taxpayers the type of services they have come to expect from private sector institutions. The electronic filing goals established in the RRA 98 represent a meaningful metric to evaluate IRS progress towards achieving this transformation, but the

underlying objective remains to improve service to taxpayers by providing them with electronic means of conveniently interacting with the IRS.

1.2 The Most Critical Strategic Electronic Tax Administration Challenges Facing the IRS

The ETAAC focused its attention during the past year on identifying the most critical challenges the IRS must overcome to meet its electronic tax administration objectives, and providing private sector advice on defining strategic approaches to meet these challenges. As a result, the ETAAC identified the following critical challenges, and organized itself into subgroups to develop strategies to meet them:

1. Developing a strategic planning process that optimizes the probability of goal achievement.
2. Encouraging all professional tax preparers to become Electronic Return Originators (EROs) and convincing them that filing and communicating with the IRS electronically is preferable to other methods.
3. Increasing electronic filing among self-preparers.
4. Increasing electronic interactions between the IRS and businesses, including filing, payment, and communication activities.
5. Forming strategic alliances with businesses, federal government agencies, states, and other organizations to facilitate and promote the growth of electronic tax administration.

Section 2 contains an assessment of IRS' progress in meeting its strategic goals. Sections 3 through 7 contain ETAAC's recommended strategies for meeting the critical challenges.

1.3 ETAAC Members

The members of the ETAAC were selected by the IRS to represent a broad spectrum of the private sector, including tax preparers, tax software developers, payroll companies, financial institutions, small businesses, state governments, and taxpayers. Appendix A contains a list of ETAAC members.

2.0 IRS Progress in Meeting Strategic Goals

This section evaluates the results of this year's filing season from an electronic tax administration perspective and provides an assessment of IRS' progress in meeting its strategic goals.

2.1 Individual Filing Season Results

Electronic filing growth for 2000 is shown in Table 1. The IRS experienced a large growth in electronic filing in 2000, with a growth of 20.5 percent. This growth is above IRS' projections for the year and requires a re-evaluation of future projections in *A Strategy for Growth*.

Table 1. Electronic Filing Growth for 2000

Electronic Returns	2000 Projected returns in millions (for CY2000)	2000 Actual returns in millions (through 5/18/00)	1999 Actual returns in millions (through 5/21/99)	Percent Actual Change
Practitioner	23.7	25.0	21.1	18.7
TeleFile	5.9	5.2	5.7	-8.9
Online	4.0	5.0	2.4	104.4
Totals	33.6	35.1	29.2	20.5

To put the growth achieved in 2000 in better perspective, Table 2 presents the growth of individual electronic tax returns for 1995 through 2000.

Table 2. Five Year Growth of Electronic Filing for Individual Tax Returns

Year	Total Returns in millions	Practitioner Returns in millions	TeleFile Returns in millions	On-line Returns in millions	Total Electronic Returns in millions	Percent Change- Electronic Returns	E-file Percent of Total Returns
2000	127.4	25.2	5.2	5.0	35.3 (note 1)	21	27.7
1999	124.9	21.1	5.7	2.4	29.3	19	23.4
1998	122.5	17.6	5.9	0.9	24.4	26	19.9
1997	120.8	14.4	4.7	0.4	19.5	29	16.1
1996	118.8	12.1	2.8	0.2	15.1	28	12.7
1995	116.5	11.1	0.7	0.001	11.8	N/A	10.1

Note 1: Projected number of returns

Also encouraging was the growth of more complex returns. Table 3 shows that more complex returns such as Form 1040 and Form 1040 with complex schedules experienced higher growth rates than simpler return types.

Table 3. Growth in Complex Returns for 2000

	1040EZ	1040A	1040	1040 with Schedule C/F
1999	8.4	7.5	13.3	1.8
2000	8.7	8.7	17.8	3.0
Percent change	3.6	16.0	33.8	66.7

Electronic payments are also increased over last year. This year more balance due filers chose IRS *e-file* than ever before and more payments were made electronically. Nearly 2.3 million balance due returns were filed electronically; a 51.3 percent increase over last year. Table 4 shows the growth of electronic payment as of June 2000. Expanded electronic payment options during the 2000 filing season also included accepting credit cards for estimated tax payments and extensions of time to file and direct debit for TeleFile. Direct deposits of refunds made by the IRS were also up 24 percent in 2000.

Table 4. Electronic Payment Growth for 2000

	1999			2000		
	Volume	Average \$	Total \$	Volume	Average \$	Total \$
Direct Debit	75,000	\$1867	\$140 million	234,600	\$1616	\$379 million
Credit Card	53,000	\$3448	\$183 million	190,400	\$2871	\$547 million

Finally, EFTPS continues to grow aggressively with 36 million transactions and more than \$986 billion being processed through the system since the beginning of the FY through June 17, 2000. This is a 15 percent increase over the same period last year bringing total EFTPS transactions and dollars since inception to 161 million transactions and 4.0 trillion dollars.

2.2 Other Significant Accomplishments During 1999-2000

In addition to the overall 20 percent growth in e-filed returns, the 2000 tax filing season included several noteworthy events that reflect positively on the abilities of the IRS to successfully administer a growing electronic tax administration program.

The IRS updated its electronic tax administration strategic plan, *A Strategy for Growth*, incorporating a number of recommendations made by ETAAC and other private sector sources to enhance the document, and established it as a leading strategic planning document within the IRS.

The IRS mailed more than 11.5 million postcards with E-file Customer Numbers (ECNs) to people who did their taxes on a computer last year, whether they filed a paper or electronic return. Approximately 1.4 million taxpayers used the ECN when they e-filed, up 112 percent over last year. The IRS also enrolled 18,000 Electronic Return Originators (EROs) in the Practitioner PIN Pilot, more than twice as many preparers as last year. The result was a resounding success with 5.4 million taxpayers participating in the program compared to only 499,606 for all of last year.

The debt indicator pilot project, which provided an offset indicator for e-filed returns requesting a bank product in exchange for closer scrutiny of potential fraudulent returns by EROs, was successful in driving down the cost of bank products and increasing the number of e-filed returns in that market segment.

The number of e-filed returns through the AARP Tax Aide program increased. The number of EROs participating in this program more than doubled from 618 to 1288, submitting a total of 145,733 returns compared with 44, 815 in 1999.

Fed/State *e-file* also continued to grow with 11.9 million taxpayers in 35 states and the District of Columbia filing both their Federal and state tax returns in a single electronic transmission.

In order to better coordinate the electronic tax administration approaches in each Business Operating Division, the IRS has established an e-Business Executive Steering Committee to involve all of the Operating Divisions in the planning and execution of the ETA program across all market segments. The steering committee will be responsible for ensuring that consistent strategy, plan and resource allocation decisions are made for the ETA program on a Service-wide basis. The ETAAC regards this as a positive step in unifying the strategic planning efforts of each operating division and the agency as a whole.

Other accomplishments include:

- The marketing campaign to taxpayers was significantly better.
- The Nationwide Tax Forums, aimed at the tax preparer community, were much improved. By introducing an ERO recognition program, the IRS adopted a business standard that will serve them well in the future. This should be considered a beginning, as much more does need to be done.
- The IRS has implemented the new Form 941 On-Line filing program for employers this spring
- The ETAAC recognizes and endorses the efforts to improve the internal systems. Clearly, the effort is only at its beginning, but the consolidation of 11 e-mail systems into one is commendable progress.
- The IRS is beginning to establish an Account Management program including designating National Account Managers as well as piloting Account Management in two district offices
- The IRS has made significant progress in issuing guidance to employers on the use of electronic technologies for administering tax-qualified retirement plans. Specifically, the IRS issued Notices in 1999 and 2000, and a series of regulations in 2000, that provide flexible standards for the use of electronic technologies in a variety of situations.

2.3 Progress Towards Meeting Strategic Goals

The RRA 98 established a goal for the IRS that 80 percent of all tax and information returns should be filed electronically by the year 2007. The act further requires that the IRS strategic plan for reaching the 80 percent goal provide that all such returns prepared electronically should be filed electronically by the 2003 tax filing season.

Strategic Goal for 2003

The 2003 goal aims to reach 100 percent electronic filing of all returns prepared on computer by both tax professionals and taxpayers alike. While progress is being made, the ETAAC believes that much work remains to be done to even approach this goal, and ETAAC believes this goal will not be met because it would require virtually all professional tax preparers to e-file returns by 2003, as well as all self-prepared returns prepared using computers to be filed electronically. ETAAC believes that insufficient incentives are in place or planned to achieve this magnitude of change in the professional tax preparer community, and recognizes not all home computers have communication capability. In some respects, the goal for 2003 is more difficult than the 80 percent goal in 2007. It is possible, and even likely, that even in 2007 not all returns prepared electronically will be filed electronically, even if the 80 percent goal e-filing goal is achieved.

Strategic Goal for 2007

Although it is unlikely that the goals for 2003 will be met, developing an electronic filing strategy that attracts all professional tax preparers to become Electronic Return Originators (EROs) is an extremely important goal, and is one of ETAAC's five critical issues that must be addressed to meet the 2007 goal.

The question should not be whether the IRS will meet its 2007 goal, but rather, what types of initiatives and incentives are required to change taxpayer and tax preparer behavior so this goal can be achieved.

The ETAAC believes that more new initiatives and incentives are needed to achieve the 2007 goal. Moreover, it is critical that the IRS develop new initiatives quickly together with a program to evaluate results against established milestones and expectations. The ETAAC is concerned that *A Strategy for Growth*, alone or in conjunction with other IRS planning documents, does not present a complete strategy for achieving the goal. IRS projects that between 49.4 and 70.4 million e-filed 1040 returns in the year 2007. This is far short of the 80 percent goal. However, recent e-filing trends, including the growth of e-filing in the 2000 tax season, give hope that these projections may be understated. The IRS is already working on updating its e-filing projections based on recent filing season results.

The tables in Appendix E of the *A Strategy for Growth* do not show the complete picture. A number of significant returns are missing, including 990, 1120 and 5500. ETAAC recommends all forms of significant quantities be added to the tables, along with a total number of returns, presenting a complete picture of progress.

The two-year request and approval process for Request for Information Services (RIS) and for budgetary resources must be considered in planning to achieve the 80 percent goal by 2007. All final plans and resources for 2007 must be initiated and requested no later than 2005. Hence, from a budget and planning perspective, we are only four years away from the final goal. The IRS must carefully and critically select projects, define information system changes, and budget in each of the five remaining years.

2.4 ETAAC's Assessment of the 2000 Filing Season

This is the second consecutive year that the number of TeleFile returns has decreased. The IRS has not determined the specific causes for this decrease. The ETAAC recommends that the IRS perform an analysis of the factors causing the decrease. Not only should the IRS factor the decrease into future projections, it must determine the future direction of the program.

The growth rate of 20.5 percent is an increase over the growth rate of 19 percent experienced in 1999. The ETAAC does not know if this rate is sustainable, and recommends that the IRS monitor closely the total growth rate for electronic filing in future years. The 80 percent goal for 2007 can be achieved if a growth rate of 19 percent or better is maintained, but ETAAC believes new initiatives will be needed to maintain the growth rate at this level.

Although electronic payments did experience growth, the number of taxpayers using electronic payment options is low. The ETAAC is concerned that electronic filing is still perceived by many taxpayers and professional tax preparers as a filing mechanism for refund taxpayers. The number of balance due e-filers should be monitored closely by IRS, but the ETAAC believes that additional incentives are needed to attract balance due e-filers. Both credit card and ACH payments cost more than their paper counterpart, the former because of processing fees credit card companies charge taxpayers, and the latter because of the time value of money.

3.0

Critical Challenge 1:**Developing A Strategic Planning Process to Achieve Goals****3.1 ETAAC's Vision of IRS' Strategic Planning Process**

The ETAAC's vision of the IRS strategic planning process for electronic tax administration is that *A Strategy for Growth*, the IRS's strategic plan for electronic tax administration, clearly establishes the IRS strategy for achieving its electronic tax administration goals, with sufficient milestones and performance measures for external stakeholders to evaluate IRS' progress.

The objective of the ETAAC's strategic planning effort is to review, with a private sector perspective, the IRS' strategic plan and planning processes relating to electronic tax administration and to assess progress toward achieving the e-filing goals specified in the 1998 IRS Reform and Restructuring Act. The following four sections summarize ETAAC's assessment, accompanied by appropriate recommendations:

- Public Policy
- IRS Strategic Planning
- IRS Systems Modernization
- IRS Marketing Strategy & Outreach to e-File Market

3.2 Public Policy

The ETAAC's vision is that public policy should support achievement of the electronic filing goals established by Congress in the RRA 98 and be aligned with IRS strategies. Accordingly, it makes the following recommendations for public policy aligned in support of this objective.

Taxpayer Incentives

The ETAAC strongly supports the administration's proposed \$10 tax credit for taxpayers that e-file their tax returns. Surveys of professional tax preparers, such as that conducted by the Council for Electronic Revenue Communications Advancement (CERCA) in 1999, show that over 50 percent of tax practitioners believe that a tax credit for a client's e-filed return would have substantial influence in convincing professional tax preparers to e-file. Moreover, the tax credit, if enacted as proposed by the Administration, would put the Congress behind this method of filing tax returns, demonstrating its commitment to using electronic tax administration as a mechanism for providing taxpayers with customer service from the IRS.

Meaningful incentives, such as the \$10 tax credit, will promote e-filing both among taxpayers that use professional tax preparers and self preparers. Tax incentives create customer demand for e-filing that professional tax preparers cannot afford to ignore if they want to retain their clients' business. Incentives also motivate self preparers to e-file. In both cases, the value of e-filing goes beyond savings realized by IRS in processing costs. E-filing gets taxpayers away from manual computation of taxes, an error-prone process at best. E-filing also results in more accurate data in the tax administration system, as error-prone data entry processes are avoided. As a result, far fewer errors are introduced into IRS data files, and the entire tax administration process runs more smoothly from both the taxpayer's and IRS' perspectives.

Internet Strategy

The Internet has changed many aspects of our culture, and the ETAAC's vision is that it can revolutionize tax administration as well. As the IRS develops more strategies for interacting with taxpayers electronically, the Internet must be an important part of those strategies. The Internet has potential for four tax administration functions—preparation, filing, communication, and payment, and for

all four customer segments—wage and investment; small business and self-employed; large and medium business; and tax exempt and government entities.

In order to provide some additional clarity, the four tax administration functions are defined as:

- Preparation—the interpretation of the tax laws and regulations as they apply to the situation of the individual taxpayer and the completion of the forms required by the IRS. This process results in the actual calculation of the taxpayer's tax liability.
- Filing—the process of supplying the results and information from the preparation process to the IRS. Electronic filing is the process of supplying this information in an electronic form.
- Communication—the exchange of information and dialog between taxpayers or their representatives and the IRS.
- Payment—the transmission of money to or from the IRS to satisfy liabilities or process refunds.

The Internet will be a revolutionary tool for the facilitation of all of these activities. The IRS is in the process of enabling Internet payment and communication systems and ETAAC is very supportive of these efforts. However, for the preparation process there is a highly developed private sector activity encompassing tax preparers, accountants, software providers and outsourcers. Filing is the outcome of the preparation process, and to some extent it is not possible to supply filing without some aspects of preparation. This fact raises a number of issues in regard to how involved the IRS should be in the preparation process given its role as an auditor and reviewer of whether or not the taxpayer has complied with the tax code in determining their taxes. In addition to the appropriateness of the IRS' role, there is also the question of whether the IRS should provide a service that the private sector is already providing.

In developing electronic tax administration strategies for the four customer segments and four functional areas noted above, the ETAAC believes the IRS should stress partnership, not competition, with the private sector and state and local governments to achieve its objectives.

The ETAAC has been most interested in the use of the Internet to provide low- and no-cost Form 1040 tax preparation and e-filing options to taxpayers. The ETAAC supports this objective because it believes it will lead to an increase in e-filing, but recognizes there are several ways to achieve it. The IRS should carefully consider marketplace conditions in developing its plans for achieving no-cost Internet tax preparation and e-filing.

The ETAAC believes that the Internet has already increased competition in the individual tax software marketplace. Although there are primarily two products available to consumers through traditional retail channels, there are considerably more options available to consumers through the Internet. Appendix B, a letter from the ETAAC to the IRS on e-filing over the Internet, contains a list of various web sites that offer e-filing. The ETAAC also sees competition in the Internet tax software marketplace increasing in the next several years. One newly formed company has announced plans to offer free tax preparation over the Internet starting next year, and at least one other already offers it.

Alternatively, the IRS could choose to achieve the goal of no-cost e-filing and tax preparation over the Internet by entering the marketplace with its own product. It could accomplish this either developing a software product internally or acquiring it through a competitive procurement. This approach would represent a significant change in current policy. Currently, the IRS does not provide or approve tax preparation software and the risk for the use of these products lies with the individual taxpayer. A more appropriate approach may be to offer an electronic template or form that allowed taxpayers that already

computed their taxes manually to transmit their returns to the IRS electronically. This approach would try to create a distinction between electronic filing and preparation with electronic output.

A second approach to entering the marketplace would be for the IRS to align itself with a limited number of "authorized e-file providers" that offer no-cost e-filing. This approach would have the effect of limiting competition and reducing the likelihood of new competition in the marketplace. Ultimately, this approach could have the effect of limiting competition and reducing taxpayer choices.

The ETAAC considered the question of how to best meet taxpayer needs. Congress has already established a policy for the IRS that electronic filing should be the preferred and most convenient method of filing tax returns. As more taxpayers use the Internet in their daily lives, some taxpayers seem to want no-cost tax preparation and e-filing over the Internet. The ETAAC believes it is consistent with good public policy to encourage the use of the Internet to provide a complete range of options, including low- and no-cost options, for taxpayers to perform tax preparation and e-filing.

The ETAAC believes that the clear choice of public policy should be to let the private sector provide the capability, with the federal government stepping in if the private sector does not meet the need. The ETAAC believes it is inappropriate at this time to pursue a public policy that would require the IRS to offer no-cost electronic filing over the Internet. The marketplace has made noticeable progress towards achieving no-cost electronic filing over the Internet in the past two years, and additional progress towards this goal is expected next year based on publicly announced plans. The ETAAC believes that any effort by the IRS at this time to enter the marketplace itself, either by developing its own software or aligning itself with a limited number of "authorized e-file providers" that offer no-cost e-filing, would have the effect of limiting competition and would ultimately limit taxpayer choices.

In support of the goal of no-cost e-filing and tax preparation over the Internet, the ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of low-cost and no-cost tax preparation and filing options over the Internet are to continue to: 1) encourage competition, 2) seek industry views on which barriers inhibit lower-cost to no-cost private sector supplied options, and 3) stimulate electronic filing through its creative advertising campaign and making electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper. The ETAAC's recommendations on the use of the Internet for electronic filing are grounded in the belief that competition is the most effective way to provide taxpayers with the widest range of performance and price options for tax preparation and electronic filing. Promoting the most intense competition among private sector companies and pursuing policies that allow these companies to reduce unnecessary costs is the best action the IRS can take in pursuit of the goal of no-cost electronic filing for taxpayers.

The ETAAC also recognizes that the Internet changes rapidly and business models are in constant evolution, and even revolution. The ETAAC believes that a re-assessment of the marketplace should be made in two years to assess whether the range of choices for electronic filing over the Internet includes no-cost options for taxpayers. If no-cost choices do not exist, the ETAAC believes the IRS would then be justified in evaluating, in conjunction with ETAAC, whether an electronic template, or other approach, is an appropriate and needed tool to promote no-cost e-filing over the Internet. The IRS and ETAAC should track progress in meeting this objective on an annual basis.

Budgetary Support for Pilots and Prototypes

Once an integrated strategic and modernization plan is completed, the ETAAC recommends that the IRS be given adequate resources and authority for pilots and prototypes, enabling a quick response to rapid

changes in the electronic commerce marketplace. This year, a number of planned pilot projects were delayed one year. Pilots and prototypes have an important role in the strategic plan for electronic tax administration. Because of the rapid advances in technology, pilots and prototypes represent an effective method for IRS to test the effectiveness of new technology in tax administration applications, and validate requirements on a small scale for future full-scale development.

Effective Dates for New Tax Laws

When new tax laws are enacted, the ETAAC encourages Congress to give careful consideration to the proscribed effective dates and the impact these dates have on electronic tax filing. A significant amount of time is needed by tax software developers to rewrite their tax software programs to be in compliance with federal law. In addition, changes at the federal level typically require tax software developers to modify their state tax software programs as well. Otherwise, tax software developers may not be able to timely rewrite their programs and the number of taxpayers that may file electronically may be significantly reduced.

3.3 IRS Strategic Planning

ETAAC's vision is that electronic tax administration strategic plans become one part of an agency-wide master plan that seamlessly integrates electronic tax administration plans into broad agency strategic plans, establishes meaningful performance measures for each goal, and ties resource planning into achievement of strategic objectives. Accordingly, it makes the following recommendations for public policy aligned in support of this objective.

Master IRS Strategic Plan

The ETAAC strongly encourages the IRS to develop an overall Master IRS strategic plan that incorporates the transition to electronic business management and electronic filing. During its development, the plan should then be synchronized with *A Strategy for Growth*, the IRS Modernization plan, and the plans of the IRS operating divisions into an integrated whole with common goals, objectives and strategies. The ETAAC recommends that each of the operating divisions develop strategic objectives, strategies and operational plans for achieving their component of the electronic filing goals.

IRS Strategic Planning Process

The ETAAC recommends the IRS begin a process of integrated strategic planning, encompassing ETA, Business Systems Modernization, and business planning for the four operating divisions. The ETAAC believes the planning process should be consistent with the best industry practice for strategic planning.

Integrated Program Management

The ETAAC recommends that an integrated program management function be established to aid in the effective management, communication and tracking of the modernization efforts, the transition to electronic tax administration, and the reorganization. Additionally, the program management group is seen as assisting in the overall prioritization of initiatives and strategies to achieve the electronic tax administration goals. The ETAAC recognizes that recently established E-Business Executive Steering Committee is a step in this direction.

Operational Planning

An important element of the planning process is implementation planning. *A Strategy for Growth* contains comprehensive time lines for each identified project; however, there is no discussion of the operational steps, major segments and overall timing. Although operational plans need not be part of a strategic planning summary, having such information is an important step before implementation. The ETAAC recommends the IRS develop the operational plans corresponding to the electronic tax administration projects and share these with the ETAAC.

Resource Commitment

Adequate resources for the projects required to transition the IRS to electronic tax administration by 2007 have not been addressed. It is important for the IRS strategic plan to commit to providing sufficient resources to ensure the necessary systems and services will be implemented on the required schedule. Further, identifying a multiple year resource plan and budget would be a valuable tool in assisting achievement of the overall goal.

3.4 IRS Systems Modernization

The ETAAC's vision is that IRS systems modernization efforts provide the technology infrastructure necessary to support electronic tax administration business plans. Technology infrastructure projects that support electronic tax administration goals must be funded and scheduled in time to support strategic objectives. The ETAAC makes the following recommendations for IRS business systems modernization.

Vision

ETAAC recommends the IRS develop and publish a comprehensive vision of the modernized systems taxpayers will use to interact with the IRS as a result of modernization. This vision should describe how information will be electronically presented, transmitted, received, routed, acknowledged and accessed by individuals, businesses, and their representatives. This vision document would serve as a road map in developing implementation plans and in communicating with the public and private sector partners.

All Forms & Schedules

The ability for the IRS to receive nearly all forms and all schedules for all income tax and information returns, including the ability to receive supplemental statements is required for achieving the goal—particularly for those returns currently prepared electronically. Emphasis here is on all forms and schedules, not just schedules of form 1040.

- The ETAAC recommends the IRS develop a time table identifying when each form and schedule (or group of forms and schedules) will be receivable electronically.
- *A Strategy for Growth* places emphasis on 1040 e-filing. While priority rightly is placed on the largest volume returns, including forms 1040, 1099 and W-2, coverage should be extended to other large volume returns, such as corporate, partnership, and non-profit returns.
- The plan currently leaves the implementation of business tax returns (corporate and partnership income tax, and related information returns) until later in the implementation period. If this timing is maintained, neither the 2003 nor the 2007 goals will be achieved. ETAAC recommends acceleration with initial emphasis being placed on those returns currently being prepared electronically.

Electronic Authentication—The Importance of Paperless

Transitioning to a fully paperless e-filing process is critically essential to the success of using electronic tax administration to transform the IRS to a customer service-based agency. The ETAAC is fully supportive of the alternative signature initiative undertaken by the IRS, including the use of Electronic Control Numbers (ECNs), and recommends that IRS develop an ECN program, whether self-selected or assigned, for all taxpayers that can be used universally for electronic tax administration functions. This action would extend customer service to higher levels.

An alternate to a paper signature has been implemented for individual tax returns, but not for a large number of returns and documents required by the IRS. The ETAAC recommends the IRS enable electronic alternatives for taxpayers to sign all tax documents that now require paper signatures, and

further recommends the IRS place high priority on adopting a comprehensive authentication, security, and privacy policy. In evaluating alternatives, the ETAAC recommends the IRS:

- Complete a risk analysis that weighs potential non-compliance and fraud, for a small number of tax cases, against the benefit to the IRS and the burden reduction for millions of e-filing taxpayers.
- Apply equivalent levels of security, privacy and fraud protection to both e-filing and paper filing.
- Define the appropriate and acceptable levels of security and privacy.
- Establish the degree of certainty that is required for signatures and authentication.

Business Systems Modernization

The ETAAC recognizes that systems modernization is essential to meeting the electronic filing goals, and is concerned with the one-year delay in planned pilots, including Secure Extranet, Secure Messaging, Taxpayer Identification Number (TIN) Matching, Power of Attorney, Transcripts, and Authentication. Together these represent key incentives in attracting the preparer community that prepares over half of the 1040 returns and a significant number of business and information returns.

The "Building the Foundation" section of *A Strategy for Growth* identifies six areas as priorities for infrastructure development—Authentication, Processing System Consolidation, Performance Analysis, Internet Capabilities, Fraud Prevention and Control, and Annual Maintenance. These priorities are important, but ETAAC believes that other items of equal importance should be added to the list. Some of these are:

- Making the taxpayer tax account database accessible in real time to IRS business application.
- Establishing the strategies for completing the necessary technology development.
- Implementing a common system capability that enables the filing of all types of returns, with all of their forms and schedules, over the Internet.
- Modernizing correspondence with electronic transmission.
- Enabling account access through the Internet for taxpayers, their EROs and other professional representatives.
- Developing and implementing processing systems that can handle substantially higher volumes of transactions.

Although the current modernization plan makes a case for architectural principles, it provides only general guidelines. The timely introduction of a governance process that includes architectural principles and standards (information, data, application, technology and knowledge) should be addressed. The speed with which IT governance and new architectural standards can be introduced is critical to the success of every strategic objective, and needs to be addressed in the context of the technology infrastructure strategy.

IRS & SSA Partnership

The ETAAC's vision is that the IRS obtain all information returns in electronic form prior to processing income tax returns, enabling the IRS to match tax and information returns prior to issuing refunds, while maintaining or improving the present refund issuance cycles. Implementing this vision requires a number of changes to tax administration systems, and will take many years to achieve. Under the current system,

Social Security Administration currently accepts the W-2 information from employers, using a method of batch processing information that is now outdated. After this information is compiled, usually sometime in August, all this information is submitted to IRS. Other information returns, such as dividend and interest reporting, go directly to the IRS. Using its own antiquated system, it takes IRS months to process all of the information and match the information returns against tax returns.

As an initial step, the ETAAC recommends that the IRS develop the capability to receive all information returns electronically, and that the IRS implement a program for taxpayers and employers to electronically file forms W-2, 940, 941 and 1099 over the Internet. The ETAAC also recommends that IRS and Social Security Administration work together to design and implement a single database system for use by both agencies, as well as any other government agencies having authorized access to this information. The long-range objective should be to achieve a database that is available during the filing season to accomplish document matching in real time. Ultimately, after the Master Files are updated, the IRS can safeguard income tax returns from refund fraud by matching payroll data with the return prior to making refunds. GAO recently reported that IRS inability to perform document matching costs the government \$15 billion per year, only about \$9 billion of which is recovered.

Differentiated Service

The ETAAC's vision is that taxpayers will perceive clear benefits to e-filing over paper filing. To achieve this vision, it is important to make e-filing preferable to paper filing in all respects, including taxpayer's perception of compliance checking of paper vs. e-filed returns. The ETAAC recommends that all incentives for filing preference be aligned to provide taxpayers with advantages for e-filing over paper filing, and incentives for paper filing be eliminated. Currently, there are still incentives for taxpayers to file by paper, such as the following examples.

- Data is required on e-filed returns that are not required with paper returns. This can be corrected by requiring the same information on paper returns and e-filed returns.
- The IRS accepts paper returns with SSN errors, although e-filed returns with the same errors are rejected. The IRS should suspend processing of the paper returns with these errors and contact the taxpayer. The current process provides an incentive for taxpayers to file on paper.
- Document Retention—e-filing taxpayers are asked to retain paper copies of their tax returns. ETAAC recommends this requirement be modified allowing taxpayers the option of keeping copies electronically.

Generally, the ETAAC recommends that the modernization efforts in products and services be focused on those that use electronic communications rather than making parallel investments in improving electronic and legacy, paper-based and paper supporting systems.

3.5 IRS Marketing Strategy & Outreach to e-File Market

The ETAAC vision is that the IRS continues to build on current marketing success to make all taxpayers in all market segments aware of the advantages of e-filing. The following recommendations support achievement of this vision.

Advertising and Marketing

Although the marketing budget for ETA has increased over the past few years, it still remains inadequate. If corporate America were told that it needed to target every taxpayer in America and get each taxpayer to change lifetime habits, eleven million dollars annually, or \$220,000 per state, would not begin to do the job. During the 2000 filing season, the IRS had a great marketing campaign to promote electronic filing. However, it had to severely limit the markets playing the message due to budget constraints. The

ETAAC recommends increasing the electronic tax administration marketing budget so more taxpayers become aware of the benefits of e-filing, and that the IRS look to the private sector for models to determine the appropriate levels of funding for advertising campaigns.

Effecting the Transition

Based on industry data, the IRS has achieved its goal of making taxpayers aware of electronic filing. What remains is the more difficult task of getting the multiple taxpayer segments to e-file.

- Tax preparers must be convinced that e-filing is effective for their practice and good for their clients.
- Individuals already self-preparing their returns using computer software must be convinced it is in their best interest to e-file, and not just a cost savings for the IRS.
- Individuals who prepare their own returns manually will be the most difficult segment. Convincing them to shift to an electronic method of preparation, and then to an electronic method of filing, will be difficult.
- Specific marketing efforts should be directed at small businesses, identifying the benefits to them for e-filing and inducing them to make the transition.

To be successful, the marketing program must overcome taxpayer suspicions about e-filing, including the security and privacy of e-filing, likelihood of audit, and the disclosure of information not included in the paper return.

Marketing Services

- Current aggressive marketing strategies for individual taxpayers should be expanded and continued with the emphasis on getting them to actually e-file rather than just creating awareness.
- The marketing plan for businesses should be further developed.
- The marketing plan for attracting the preparer market should be developed. Professionals prepare over 50 percent of individual returns. Attracting this segment is critically important.

Marketing plans should be developed in a process that involves private and public sector stakeholders throughout the planning process so the IRS, states, and companies can work together to define the most effective marketing messages that can be leveraged off each other to maximum benefit.

Distribution Channel Management

The IRS has placed heavy reliance on Distribution Channel Management as the tactic to getting professional preparers to transition their clients to e-filing. While this approach shows promise, performance measures should be developed to establish its effectiveness in transitioning professional preparers to e-filing. Comparisons should be made with other approaches to motivating the professional and their clients.

The impact of Distribution Channel Management on the effort to transition to electronic filing has not been estimated in IRS plans. The ETAAC recommends this be accomplished.

4.0

Critical Challenge 2:**Encouraging All Professional Tax Preparers to Become Electronic Return Originators****4.1 ETAAC's Vision of Professional Tax Preparers**

Virtually all professional tax preparers use tax software today because of the conveniences and efficiencies these products provide. Use of tax software is a business decision most tax preparers make automatically. The vision of ETAAC is that the advantages of e-filing should be so overwhelming that professional tax preparers will consider e-filing the normal way of doing business. The recommendations below discuss strategic approaches the IRS can use to achieve this vision.

4.2 The Importance of Professional Preparers to Achieving E-Filing Goals

The ETAAC recognizes the IRS has a challenging task of promoting e-filing to many different "user" groups. From large business to financial and investment companies to small business and individual self preparers, there are many different strategies and incentive programs needed to attract its users to adopt e-filing as the preferred method of filing.

In no single group is there a bigger need for the IRS to attract to e-filing than the tax practitioner market segment. Many tax practitioners still are not registered as EROs. At present, the IRS exercises tighter scrutiny and control over EROs, including the ability to exclude EROs from the e-filing program. The IRS does not have such control over non-EROs.

While the IRS is busy implementing strategies to serve other segments, tax practitioners often feel that their tax businesses are being threatened. For example, the free Internet filing promotion to the self-preparer market intimidates many tax practitioners. They see clients moving to the Internet and e-filing. Real or not, many practitioners view this action as an effort to take their clients away from them.

The ETAAC firmly believes that the IRS needs to pay closer attention to the tax practitioner market, to evaluate their needs and to allay their fears, real or perceived, about continuing as or becoming an ERO. The account management program is an excellent program, and could go far in firming up the relationship with tax practitioners. The delay in expanding the account management program could delay the conversion of tax practitioners to EROs.

Until this relationship with tax practitioners is at least improved, it is extremely unlikely that the IRS can meet the 80 percent goal, as professional practitioners prepare 56 percent of all individual tax returns. Therefore, the ETAAC strongly recommends the following recommendations be implemented.

4.3 Professional Incentives

Two years ago, the IRS proposed a concept for a step-incentive program to get professionals to e-file their tax returns. The ETAAC strongly recommends that the IRS move forward with this strategy at the earliest possible date to start delivering value-added services to the EROs based on e-filing participation.

The ETAAC vision of this program is consistent with the IRS vision. ETAAC believes that such a program would have multiple categories or levels of participation, with higher levels earned through achievement of performance and linked to additional benefits. Category titles for various levels have already been suggested by the IRS: Bronze, Silver, Gold, and Platinum. At the basic (Bronze) level of participation, there would be no minimum requirements, and all EROs would enter at this level. Providing an entry level removes any barriers to joining the e-file program. Higher levels would be achieved through years of service and percentage of eligible returns e-filed.

ETAAC believes that all new e-services should only be available through the e-file system for returns that are e-filed. Benefits at the higher level would include features that the professional tax preparer community regards as desirable, such as limited power of attorney and electronic account resolution. Linking benefits such as these to the upper levels of the step-incentive program would encourage professionals to e-file their returns and provide incentive to start e-filing now to meet the requirements when these benefits are finally available.

4.4 Creating Parity Between EROs And Paper Return Preparers

The ETAAC believes that to make e-filing the preferred method of filing for all professional tax preparers, all incentives that apply to professional preparers should be aligned in favor of e-filing. With regard to regulation of preparers, the IRS has actually set standards for EROs that do not apply to paper return preparers. The ETAAC recommends this inequity be resolved by applying similar standards for all professional, regardless of filing mechanism. The standards that protect both the IRS and taxpayers alike should be extended to all preparers.

The IRS sets regulatory standards for EROs through Publication 1345, but there is no equivalent standard for preparers of paper returns. The ETAAC recommends that the IRS close the gap between standards for preparers of paper and e-filed returns. In order to help close this gap, a complete revision of Publication 1345 is needed, with a goal of bringing all practitioners into compliance with federal tax law and ethics practices. Preparers should not be able to escape standards by filing only paper returns.

Under the current regulations, practitioners fear that they can be deprived of their livelihood because they choose to embrace e-filing. If regulations are extended to all professional preparers as recommended by ETAAC, EROs will not be subjected to higher standards just because they are EROs. In any case, ETAAC recommends that suspension handling for any preparer should be timely and equitable.

4.5 Mentoring

As part of the ETAAC's future vision of universal acceptance of e-filing by tax preparers as the normal way of doing business, the ETAAC recommends that the IRS establish a voluntary mentoring program to assist tax preparers to institute electronic filing procedures into their practices. There are many barriers to becoming a new ERO, and getting a grasp of e-filing procedures is a major hurdle to cross. Current EROs have overcome the "learning curve" and incorporated office procedures to facilitate efficient processing of electronic returns. New EROs would greatly benefit from the experience of these professionals through a mentoring program.

An incentive consideration for an ERO to assist in taking the time to assist a new business could include continuing education credit, an additional "step-up" in the step-incentive program, a link on the Digital Daily, or other incentives as IRS may identify in the future.

Many tax preparers are still unaware of the mechanics of e-filing. The ETAAC's concept is that mentors would be available on a one-on-one basis before the filing season, helping the new ERO understand the process, working with the staff in learning e-filing procedures, as well as helping via telephone or e-mail during the tax season to troubleshoot problems or answer questions. The success of the mentoring program will work well, as experienced e-filers will be showing others how it is done. This program would take advantage of the wealth of knowledge that IRS officials cannot give, and publications cannot explain.

4.6 Practitioner Association Consortium

The 1040 e-file program has been successful, largely due to practitioner involvement, and promises to be one of the prime factors in e-file's continued growth in the future. Practitioners desire to have input into the evolution of the e-file program, relating to both the individual and business filing programs.

In the past, IRS has sought practitioner input through advisory groups such as the ETAAC, as well as at IRS seminars and utilizing focus groups. While this effort is to be commended, it also needs to be recognized that not all practitioners have the same needs and desires. It is important that the IRS continue seeking practitioner input and even expand its ability to obtain input from a wider subset of practitioners.

One of the best mechanisms to obtain practitioner input is through practitioner associations that represent their members. There are four national associations that represent a significant number of practitioners with diverse practices and backgrounds—the American Institute of Certified Professional Accountants, the National Association of Enrolled Agents, the National Association of Tax Practitioners and the National Society of Accountants, with each association representing a segment of the professional tax preparer community. These associations and their membership represent a broad spectrum of practitioners including those who are governed by Circular 230, as well as those practitioners who are not. It is important to the success of future IRS e-file programs and enhancements that all practitioners are heard and their advice sought.

The ETAAC encourages the formation of a tax practitioner alliance to speak to the IRS with a single voice. Since tax practitioner associations regularly survey their members to obtain information regarding various topics, this relationship could also provide data to the ETAAC and the IRS in significant numbers to provide guidance on new proposals, programs and enhancements relating to e-filing. The ETAAC believes that it would be a great benefit to future ETAAC committees to have a liaison from the ETAAC attending the consortium meetings who would report back to the ETAAC committee as a whole.

4.7 Debt Indicator Expansion

The ETAAC recommends IRS expand the debt indicator that was piloted this year to include returns that do not include a bank product. EROs could be proactive with their clients if they received this information of a refund offset at the same time as the acknowledgment of the return. This would enable taxpayers to immediately contact the respective agency and resolve debt issues. The ETAAC believes this would be a value-added client service and incentive for paid preparers to e-file returns.

4.8 Using Other Organizations to Drive e-File Demand

The ETAAC recommends there be a check box included on electronic 1040 returns by which the filer could authorize other government agencies to obtain information from the IRS directly. This authorization would reduce the taxpayer burden associated with filling out other government forms, such as the FAFSA form that needs to be filled out for college students. Including a FAFSA check-box would get all colleges, universities, and technical schools to promote e-filing, as it would vastly improve correctness of the FAFSA forms.

Similarly, if e-transcript delivery were only available to banks and others desiring credit information for loans if the return were e-filed, all financial institutions would promote e-file. The IRS could then avail itself of free advertising and promotion with definite value-added service to the taxpayer, with no appreciable cost. These types of alliances could result in financial and learning institutions actively promoting e-file with their customers.

5.0

**Critical Challenge 3:
Increasing Electronic Filing Among Self-Preparers****5.1 ETAAC's Vision of Self Preparers**

The fastest growing segment of the e-filing population is online filing by self preparers. The ETAAC believes this growth is indicative of an increasingly higher number of taxpayers using computers to prepare their taxes. The ETAAC believes that based on current market trends, in several years taxpayers will have a multitude of options to prepare and e-file taxes over the Internet for free. By 2007, the ETAAC vision is that the formation of business alliances will provide many opportunities for convenient, low- and no-cost filing for self preparers, and most of these opportunities will be via the Internet as opposed to buying tax software through a traditional channel.

This section recommends strategies to the IRS aimed at increasing electronic filing among self-preparers to at least 70 percent. Based upon calendar year 1999 filing data, the self-preparer population represents 55 million returns from which just 8.2 million (14 percent) were e-filed, which includes 5.6 million TeleFile returns. None-the-less, the self-preparer segment is today and will continue to be a significant population the IRS must consider.

Projecting out to 2007, IRS estimates 60 percent of the nearly 139 million returns expected will be prepared by paid practitioners leaving about 64 million returns to be self-prepared. To achieve 70 percent e-filing by this population, 45 million returns will be required. The upward trend in the use of paid practitioners has been experienced for the past several years and is expected to continue. The ETAAC believes this is based in part on the complexity of the tax code as well as a convenience for time-challenged taxpayers.

5.2 Attracting Self Preparers to e-File

The number of taxpayers that prepared and e-filed their own returns grew dramatically this year. Not surprisingly, the program remains most attractive to refund filers. A variety of payment options for balance due filers will encourage this population (estimated at 25 percent of taxpayers) to use e-file.

The question the IRS must answer is why people still mail in paper returns? A survey by International Data Corporation (IDC) shows that there is no single strong reason for not filing online. Of those still mailing returns, 18.7 percent don't want to pay for electronic filing, 13.3 percent don't know how to do it or their tax preparer doesn't offer the option, 8.0 percent don't want the IRS to get it sooner, 7.2 percent don't know electronic filing is an option, and the remainder just don't see the need to do so. Interestingly, in the IDC survey, security concerns were minor compared to the reasons above.

However, in a poll conducted for the AP by ICR of Media, PA, 36 percent suggest privacy concerns are a worry. Younger filers (18 to 34 years old) tend to worry less but even among this population of taxpayers, the concern is high. Attracting self-preparers to e-file will be assisted:

1. a temporary, refundable tax credit of \$10 for e-filing of individual income tax returns, and
2. one or more low- or no-cost options for preparing and filing individual income tax returns over the Internet

The ETAAC supports the \$10 tax credit for taxpayers who e-file individual income tax returns.

The ETAAC believes that low- or no-cost tax preparation and electronic filing over the Internet for individuals would benefit taxpayers and lead to an increase in electronic filing. Therefore, ETAAC supports this objective, but is concerned that the IRS might attempt to achieve the objective either by competing with the private sector or reducing competition from the private sector. See Section 3 and Appendix B for a fuller discussion of these issues.

As to the other issues surfaced in the IDC survey, ETAAC believes the IRS commitment to aggressive marketing to taxpayers and practitioners will continue to show positive results. The ETAAC supports these initiatives and encourages the Congress to appropriate sufficient funds to allow IRS marketing campaigns to continue and expand.

5.3 State Participation

The ETAAC vision of federal and state cooperation is that a single filing transaction can suffice for both federal and state purposes. The current Fed/State e-filing program enables this type of seamless experience for individual filers in a majority of states, and ETAAC commends the IRS for cooperating with state agencies to continue operating a successful Fed/State program. Of the few states that operate independent e-filing systems, most work closely with software developers and online filing service companies so that state calculations typically are integrated into a single tax preparation experience even though separate e-filing transactions are required. Thus, from a technology perspective, taxpayers in virtually all states where income taxes must be paid enjoy the benefits of a seamless and convenient e-filing program.

Consistent with the objective to evaluate and recommend strategies that can be used by the IRS to increase e-filing among taxpayers that prepare their own returns, in early 2000 the ETAAC enlisted the assistance of the Federation of Tax Administrators (FTA) to survey state revenue agencies. More than 20 such agencies responded to a FTA questionnaire that asked states to describe initiatives implemented to attract self-preparers to e-file. Most responding states indicate that the percentage of taxpayers who self-prepare returns is within a few points of the federal percentage of 44 percent. However, a few states have observed that self-preparers constitute as many as two-thirds of their filing population.

Most state revenue agencies are part of the IRS Fed/State e-filing program; only 5 states operate independent e-filing programs with some states offering both options. Thus, the vast majority of states are closely tied to the broad strategies used by the IRS to attract taxpayers to e-file. However, according to the FTA survey administered on behalf of ETAAC, the efforts in some states to attract self-preparers to e-file go beyond those used by the IRS. These include:

- “broadcasting” (mass mailing) of e-mail messages directly to various taxpayer segments, especially college students;
- hosting “mall days” in major shopping centers to inform the public about e-filing options;
- offering free State-sponsored or State-operated web-based tax preparation and e-filing;
- providing a state PIN to authenticate the e-filing transaction;
- inserting “stuffers” in utility bills, state employee pay warrants and other targeted taxpayer segments;
- building of an Internet filing portal for self-preparers who use commercial tax preparation software to calculate their return and who prefer to transmit directly to the state via the Internet (instead of through a commercial online filing company); and

- A few state revenue agencies have allocated budget resources to purchase radio, television, highway billboard and other advertising to attract taxpayers to e-file. There is growing interest on the part of some states to explore cooperative marketing and advertising campaigns with the IRS so that federal and state campaigns do not overlap.

The ETAAC commends the IRS for its innovative Fed/State e-file program that makes it possible for states to conveniently obtain taxpayer information, e-filed via the IRS system. At the same time, the ETAAC encourages the IRS to expand its efforts to cooperate with state agencies in the design and implementation of marketing campaigns designed to attract more self-preparers to e-file. One specific initiative of potentially high value to state agencies is the use of the Electronic Customer Number (ECN) that taxpayers may use to authenticate their federal e-filing transaction. For 2001 the IRS has indicated it will not provide ECNs to state agencies for use in state e-filing programs. Other cooperative Fed/State efforts could include co-funded advertising campaigns.

Other tax programs

Beyond filing transactions for individuals, federal-state cooperation on electronic tax administration matters has been very limited, with few "experimental" efforts to point to in the examinations (audit) and collections arenas. In addition, as yet there is no plan on the part of the IRS to develop and implement Fed/State corporate, partnership and employer tax filing programs. Given the wide variety of business tax programs that operate at the state level, it is reasonable to defer development activity in this area until the IRS is better prepared to move forward with plans to institute business tax filing programs at the federal level.

5.4 Other Initiatives to Consider

Approximately 25 percent of all form 1040 tax returns filed are prepared by hand. Of these only a small percentage are prepared by a paid preparer. Special attention and programs need to be developed to transition the self preparer with a pencil to e-filing. The following recommendations all provide additional help to self preparers that are not aware of the benefits of e-filing:

- At least during the tax filing season, the IRS should improve its Digital Daily homepage or establish a separate e-file website to make it easier for taxpayers to hyperlink to commercial online services. Current navigation on the Digital Daily requires too many "clicks" to find useful information targeted to self-preparers, and linkage to commercial sites is not as seamless as it should be to attract increasing numbers of self-preparers to initiate and complete an online filing transaction.
- The IRS should revamp its tax booklets that are sent to self-preparers, especially those who qualify for low/no cost e-filing through commercial online services, to more aggressively promote the advantages of e-filing. Booklets should be designed primarily to induce self-preparers to e-file, rather than promoting paper filing. The ETAAC recommends the IRS study state experiences in modifying or eliminating tax booklets sent to taxpayers, such as the elimination of paper forms in the tax booklet, making these forms available only upon request.
- The IRS should increase efforts to establish its outreach program to employers who are considering offering e-filing services to employees. Especially for large employers, the IRS could play the role of a catalyst broker bringing together employers and tax preparation/e-filing companies.

6.0

Critical Challenge 4:**Increasing Electronic Interactions Between The IRS And Businesses, Including Filing, Payment, And Communication Activities****6.1 ETAAC Vision of Business-Related Electronic Tax Administration**

Many businesses have already begun using e-commerce to conduct business with other businesses or consumers. The Internet has sparked a business revolution that many observers believe is just beginning. The ETAAC's vision for electronic tax administration is simply this—a business should be able to conduct tax administration functions over the Internet as easily as it conducts business functions with another business.

The ETAAC reviewed, within the context of the private sector business community, the IRS' initiatives and progress relative to the electronic tax administration objectives and e-filings goals specified in the RRA 98. The importance of electronic tax administration in this context includes the following:

- From the standpoint of revenue collected and returns filed, the business community represents a large proportion of the taxpayer community. In the most recent *ETA Strategy for Growth*, several of the Business goals for 2007 were highlighted:
 - 7.4 million forms 941 and 1.2 million forms 940 received electronically or on magnetic media
 - 1.5 billion information returns received in non-paper form
 - All of the top 22 payroll service providers file Forms 941 and 940 electronically
 - All of the top 1,000 financial institutions file Forms 1099 electronically
 - 75 percent of the Fortune 1000 file their business tax returns electronically
- Accuracy and automation of business returns and some reporting, for example, greatly improves the overall timeline and efficiency of the individual return process.
- Recognition that from a taxpayer perspective the business returns are an important prerequisite to the individual tax filing.

In order to achieve the vision of making electronic tax administration as easy as electronically interacting with another business, the ETAAC has made recommendations in the following areas:

- Business Income Tax returns
- Information Returns
- Electronic Employer & Financial Institution statements
- TIN matching
- Retirement Plan Requirements
- Electronic records and communications
- Electronic Payments

6.2 Business Income Tax Returns

Electronic filing of corporate income tax returns is one of the last items that the IRS is going to undertake. Since businesses tend to be, on average, more technologically sophisticated than other taxpayers, this may be an opportunity for the IRS to receive a significant portion of this type of tax return in electronic format. Therefore, it may be worthwhile for the IRS to reconsider when it can undertake the

challenge of receiving electronic filing of corporate income tax returns and permit this type of filing at an earlier date.

6.3 Information Returns

With the recent implementation of the Filing Information Returns Electronically (FIRE) system in November 1999, the IRS has made great strides in the ability to electronically process information returns. The Martinsburg Computing Center (MCC) has received 185 million records via the new system and should finish the year with approximately 200 million records, representing a 66 percent increase over last year's returns. Many benefits are derived, including accuracy and timeliness for IRS/MCC processing and notices of acceptance within two workdays.

While these upgrades have provided a foundation for reaching the business goals for information returns, the ETAAC recognizes that more needs to be done, particularly for the large filers of Forms 1099. The ETAAC encourages further development of the FIRE system such that larger transmissions can be accommodated via a secure, higher speed interface. Utilizing Internet-based protocols as developed in the secure messaging pilot, and leveraging the IRS work to date in authentication (1040 PIN and ECN pilots), a secure, higher-capacity system capability is recommended. Section 3 presents a fuller discussion on the need to receive information returns electronically as a first step in improved document matching.

6.4 Electronic Employer & Financial Institution Statements

The ETAAC recommends the necessary enabling legislation and subsequent establishment of IRS and SSA regulations to permit employers and financial institutions to send W-2, and 1099 forms to taxpayers electronically. Taxpayers should provide prior consent to the electronic delivery, and this consent should be permitted to be provided electronically with "click-through" acknowledgement of the consent.

Two benefits will be derived. First, employers will derive a substantial burden reduction with the elimination of paper handling. Secondly, and equally important, supplying tax return related information to employees electronically would facilitate the employee's own electronic filing.

6.5 TIN Matching

The ETAAC supports and encourages the creation of an IRS TIN matching system. Such a system will provide filers of information returns a means to verify taxpayer name and identification number combinations prior to reporting that information to the IRS. Having access to a TIN matching system will enable filers to file more accurate information returns and will lower the overall cost of payer compliance. In addition, Form 1099 recipients (payees) will also benefit by receiving more accurate information returns that will properly reflect revenues received and funds withheld.

The IRS TIN matching system should be consistent with the Social Security Administrations (SSA) "EVS" system (i.e., user interface, security, name matching logic). A submission of a name and TIN for an individual to the IRS system should produce the same result as if the record were submitted to SSA system. The ETAAC believes that coordination and consistency between the IRS and SSA will provide both immediate and long-term benefits to all, leveraging the SSA work in progress, including a solution that takes advantage of a secure, Internet based interface.

With an online TIN matching system, payers will incorporate the matching process into their account set-up or modification procedures as a way to verify TIN are received from payees. With an instantaneous notification through the TIN matching system, payers can pursue and correct name/TIN problems prior to issuing an incorrect Form 1099 and thereby avoid the later receipt of a B-Notice.

6.6 Retirement Plans

The IRS has made significant progress in issuing guidance to employers on the use of electronic technologies for administering tax-qualified retirement plans. Specifically, the IRS issued Notices in 1999 and 2000, and a series of regulations in 2000, that provide flexible standards for the use of electronic technologies in a variety of situations. In addition, the IRS business plan for 2000 anticipates guidance for the use of electronic technologies in administering plan loans and distributing "notices to interested parties" of IRS determination letter filings.

The ETAAC recognizes the benefits that electronic technologies provide to both employers and employees, and recommends that the IRS continue to facilitate the use of electronic technologies in retirement plan administration. Specifically, the ETAAC recommends the IRS provide guidance on recordkeeping requirements, the electronic distribution of participant notices required under section 204(h) of ERISA, and the applicability of previous guidance to plans established under sections 403(b) and 457 of the IRS Code.

6.7 Electronic Records and Communication

The ETAAC envisions that in the future all communications between the IRS and business could be electronic if elected by the business. The ETAAC recognizes that electronic delivery of notices would provide benefits to the taxpayer community, protect transaction and information integrity and quality and accelerate overall delivery time. Taxpayers and service providers would be able to identify problems and take corrective action within one day of a tax filing, instead of several weeks in today's environment. This would reduce IRS notices significantly.

The ETAAC also recommends expansion of on-line access to authorized taxpayer return information. Many letters to the IRS are necessary only because the service provider must rely on IRS personnel information retrieval, and further economies and benefits will be derived by direct online availability of account information.

6.8 Electronic Payments

The IRS has made substantial progress in creating an electronic money movement system (EFTPS) for business tax payments and some individual payments. This system currently moves approximately 93 percent of all the funds collected by the IRS. The IRS has also done an excellent job of shifting this program from a mandated activity to a voluntary one, and demonstrating that taxpayers will use an electronic system voluntarily if it offers convenient and efficient features. As part of this shift, the IRS has learned the value of focusing on the benefits to the taxpayer and the IRS versus a more rigid regulatory requirement approach. The IRS is to be commended for this change.

The ETAAC recommends that the IRS take EFTPS to the next level of sophistication by focusing their efforts on how this system can be used more effectively by the tax preparation and filing infrastructure community. This community is composed of accounting firms, service bureaus, banks, and software providers. These are the businesses that will create the tools for electronic filing.

This community is very familiar with the need for systems that can deal with both data and dollars. Today EFTPS is a dollars only system and filing is primarily a data collection and calculation application. This community has already experienced the problems and the time and effort that has to be expended when data and dollars have to be merged and reconciled. As the IRS focuses on filing systems (data), the opportunity exists for a public private collaboration to ensure that the data and the dollars are handled in an all-encompassing process versus multiple systems. For example, prior to EFTPS, the IRS provided a means for payroll services to estimate and overpay tax deposits on behalf of their clients, so

that minor post-deposit date adjustments could be made without penalty. Just as thousands of businesses routinely overpay tax deposits to establish a "buffer" for anticipated adjustments, payroll service providers were able to overpay lump-sum final tax deposits for each quarter, and utilize a five-day adjustment window to reconcile taxpayer deposits and data. EFTPS has no similar mechanism. To protect taxpayers from unnecessary penalty notices, EFTPS should be enhanced to restore this capability.

The ETAAC recommends that the IRS establish a joint task group with representatives of the filing community to address how the IRS can couple EFTPS with the commercial sector's filing and preparation processes to create a collaborative system that will effectively handle both data and dollars. In addition, the task force could consider solutions for account resolution capabilities, such as confirmation of non-filing for seasonal businesses, and corrected taxpayer information to resolve un-postable EFTPS deposits.

7.0

Critical Challenge 5:**Forming Strategic Alliances with Businesses, Federal Government Agencies, States, And Other Organizations to Facilitate And Promote the Growth Of Electronic Tax Administration****7.1 ETAAC Vision for the Alliance Programs**

The ETAAC envisions a cooperative environment between the IRS and external stakeholders that encourages the formation of alliances to achieve objectives. The ETAAC recommends that the IRS adopt a clear strategy for incorporating alliances with the private sector in order to successfully achieve its electronic filing objectives. The strategy must be clear to all participants and offer fair compensation for all participants who make an investment in assisting IRS meet its goals. In the technology field, it is customary to have many alliances to achieve the desired result. The ETAAC recommends the IRS develop its alliance strategy using a similar approach. The following are some of the elements that should be considered for incorporation into the strategy:

- Documented Alliances programs that outline the expectations for each program
- Certification program for Alliances
- Testing lab for Alliances who have built interface programs to the IRS
- Recognition program to honor those Alliances who achieved the desired result
- Shared co-development efforts with Alliances (such as early release of planned projects and scope of such projects).
- Approved Alliance partners to be listed on the IRS web page so that taxpayers would know that they were certified to do business with the IRS.
- Co-branding certification emblems (such as the e-file logo, only with more significance).

The IRS should make an effort to find and align itself with firms that could act as a distribution channel for its electronic filing programs. This would help IRS reach a massive taxpayer audience quickly. IRS needs to recognize that the private sector already has relationships with the taxpayers and this should be capitalized on.

7.2 Embracing Private Sector Partnerships

The ETAAC envisions a future where the IRS embraces partnership with the private sector to achieve its objectives. The IRS has expressed more interest in partnering with the private sector in recent years, and the ETAAC encourages continued emphasis on partnership with external stakeholders such as the private sector.

Criteria for Success

The ETAAC believes that the 2007 goals established by Congress can only be achieved if the IRS adopts a policy of embracing private sector participation in the solution. The importance of private sector involvement was further stated in Congressional policy, "The Internal Revenue Service should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns." To date, the IRS has not identified its vision of the private sector's role in electronic filing specifically, or generally in the transition to electronic tax administration. The ETAAC recommends this be accomplished.

Establishing Guidelines and Defining Responsibilities

To enable individual and business taxpayers to conduct their tax filing and related business activities electronically, all IRS systems must be modernized. As the process continues for redefining taxpayer services, the ETAAC recommends that the IRS establish and publicly announce a process and guidelines for determining which modernization services and projects will be:

- Developed by the IRS at taxpayer expense, either internally or through contracting.
- Left to the private sector at private sector expense and investment.

At the earliest reasonable time, the currently identified services and projects should be placed into one of these categories and publicly announced. Further, the IRS should develop and communicate a comprehensive schedule for the planned availability of each new service.

Armed with this information independent private sector providers and potential partners would be able to plan their investment activities, complimenting the IRS plans. To the extent practical, the private sector should be encouraged to respond with private investment and control in preference to internal control and funding.

Encouraging Private Sector Participation

The ETAAC recommends the IRS expand its plans to effectively engage the private sector in the modernization effort. Some of the key areas include the following.

- Expand the techniques used to achieve additional participation by the private sector in enabling e-filing.
- To the greatest extent possible, participation by those interested should be encouraged. Standards adoption is an essential element.
- Create an Internet strategy that stimulates the private sector to develop and expand filing alternatives for taxpayers and that does not stifle private sector competition and development.
- Establish and publicize the roles the software industry, tax processors and preparer community are envisioned to be asked to play in the implementation of the strategies and initiatives.
- Fully describe the evolving mechanisms for identifying new projects for pilot implementation and evaluation.
- Adopt national and public sector standards for electronic transmission of tax, financial and information data to encourage and facilitate private sector development and support. With the growing broad acceptance of XML as the preferred data encapsulation standard, serious consideration should be given to the adoption of XML as the data standard.

7.3 Use of the RFA Process

In part, the benefit of the RFA process is that it allows for innovative solutions in a non-monetary manner that provides additional flexibilities than the government's traditional procurement process. At the same time, the IRS has been criticized by industry for an RFA process that is viewed with some skepticism. At issue are matters of fairness, clarity of objectives and expected outcomes, ambiguity surrounding future opportunities and protection of intellectual properties.

For an RFA process to succeed, it must take the following into account:

- There must be standardization of the RFA notification process including response time frames, communication of modifications to the original RFA, and selection methodology.
- The IRS must offer industry clear and concise information regarding the future expectations for the program that encourage participation by industry. This information includes such issues as exclusivity, duration, use, and ownership of the developed systems and procedures.

The ETAAC recommends the IRS develop and adopt regulations for RFA creation, administration, award and review that encompass these elements for success.

7.4 Managing “Pilots” To Engage Potential Alliances

Consistent with the goal to partner with the private sector in achieving e-filing goals, the ETAAC recommends that the IRS expand its current RFA process to:

- annually solicit conceptual proposals from prospective partners to address specific business objectives;
- engage with partners in the creation of partner selection criteria that encourages broad participation while respecting the potential proprietary nature of conceptual proposals;
- develop and define pilot programs based on conceptual proposals;
- select more partners to participate in pilot programs;
- establish success factors and performance measures that are agreed upon by selected partners; and
- evaluate pilots quickly to determine potential for expansion.

Furthermore, as the Service continues to “stand up” its four organizational divisions and further defines the process for incorporating ETA expansion efforts in those divisions, pilots should be undertaken in several divisions annually. Overall management of the pilot programs will require the IRS to devote a greater focus and perhaps additional resources to ensure successful transition from the pilot phase to full-scale production. This investment is closely aligned with research and development efforts in the private sector, and holds the potential for faster and more creative ETA expansion efforts.

7.5 Transitioning from Pilots to Production

The ETAAC recognizes that many of the systems and approaches for electronic tax administration will originate from small scale pilots designed for a) proof of concept, b) validation of market acceptance, or c) real world experience on issues involving scalability, feasibility, cost effectiveness and security. The ETAAC recommends that the following guidelines be used in managing pilots and transitioning them to production.

- Pilots should run no longer than one tax-filing season.
- Immediately after the end of the pilot phase, the IRS should meet privately with the service provider(s) participating in the pilot. Jointly the IRS and the service provider(s) will evaluate the success of the pilot versus the criteria that were established at the beginning of the pilot.
- If the pilot were deemed to be successful, the service provider(s) and the IRS would jointly develop a high level description of the service configuration. Heavy emphasis in the document should be placed on the interface between the service provider and the IRS (e.g., file formats, transmission protocols). The document should also outline any minimal requirements for service provider qualifications.

- Prior to rollout, the document would be circulated to potential providers and interested parties seeking recommendations that will make the specifications acceptable to the broadest group feasible. These recommendations would then be considered for incorporation into the final specifications.
- It will be understood that the service provider may consider some of the details regarding the taxpayer interface to the system proprietary and therefore this information may not appear in the document.
- The service description document should then be circulated to possible providers of the service for comment and input.
- The document would then be presented to all interested parties for national roll out. It is our belief that service providers will then be able to build systems that will meet a minimal level of functionality as specified in the document while at the same time providing value added proprietary functionality.

7.6 Community Alliance Initiatives

The ETAAC sees considerable participation from a broad spectrum of taxpayers and tax practitioners needed to achieve the electronic filing goals established by Congress. Simple wage and interest returns account for the majority of electronically filed returns to date. The future growth and success of electronic filing will largely depend on the increased participation of the tax preparer community and the sanction of the small business community.

The tax preparer community is extremely diverse in tax practice procedures and client profile. For some preparers, electronic filing provides efficiencies and incentives. For other preparers, electronic filing presents a burden. There are tremendous opportunities for tax preparer associations to provide constructive input, opinion, and direction into electronic filing process and procedures as they specifically relate to divergent preparer practices and taxpayer profiles.

The small business community, on the other hand, is very sensitive to change, complexity and cost. A seemingly simple initiative will emerge as a compliance nightmare within the small business community.

The advance input and endorsement of the small business community will ensure a successful program. Furthermore, it will provide public assurance the developments of the business electronic filing capabilities are resources well directed.

The ETAAC recommends the formation of two community alliance coalitions or consortiums for the express purpose of working with the practitioner and small business communities via organized agencies and associations who have a vested interest in electronic filing. IRS appointed directors would organize and facilitate the exchange among a consortium of organizations in an effort to obtain valuable input and develop alliances with the IRS. The small business community consortium should include representatives from organizations such as the National Federation of Independent Business, the National Association of Women Business Owners, the National Association of Self-Employed and National Small Business United. The tax preparer community consortium, as noted in Section 4, should include participation from organizations such as the American Institute of Certified Public Accountants, the National Association of Enrolled Agents, the National Association of Tax Practitioners, and the National Society of Accountants. In addition, a representative member of the ETAAC should participate in each alliance consortium.

The ETAAC envisions the tax preparer and small business community consortiums as being the liaison link between the IRS and the organization participants. Anticipated results of consortium communications include:

- identify and eliminate the roadblocks associated with electronic filing;
- implement awards/incentives program to encourage new and continued participation;
- identify and suggest areas of program improvement and application;
- coordinate electronic filing initiatives with respective state and local agencies;
- communicate e-filing initiatives through the consortium organizations; and
- conduct surveys to obtain direct participant feedback regarding e-filing.

The ETAAC believes a community alliance approach to working with the practitioner and business community will go far in advancing electronic filing participation. The participating organizations will applaud such an opportunity for input and direction. Government and community working together will give e-filing strength, momentum, and credibility. Simply being "part of the process" encourages participation and ownership. The endorsement of these organizations will go far in increasing e-filing confidence and participation.

The consortium directors should be employees of the IRS and would be a critical component in the success of such an initiative. The position requires strong public relations and facilitation skills. The business objectives of this position should be specifically defined and appropriate performance measures incorporated. The ETAAC believes the public relations outreach and communicated goodwill via the consortium organizations will produce increased e-filing participation well beyond any public relations campaign communicated directly from the IRS.

**Appendix A
ETAAC Members
1999/2000**

Sandra Abalos, Owner, Abalos & Associates*

Fran Bartlett, President & CEO, Federal Liaison Services, Inc.

Mike Boyle, Vice President, Tax & Audit, Microsoft Corporation

Margaret Drescher, National Advisor, AARP

Keith Dusenbery, Professor of Accounting & Information Systems, Johnson St. College

Edward Feinstein, Vice President, Electronic Filing, H&R Block Tax Services, Inc.

Theron Gilden, President, T.Gilden, Inc.*

Connie Grimes, President, Grimes Income Tax, Inc.

Mary Harris, Jackson Hewitt Tax Service

Peter Hosokawa, President, First Data Corporation – Cash Tax Inc.*

Yvonne Kirkendall, EA, Co-owner, W.R. Kirkendall, EA

Charles Lacijan, Senior Technical Advisor, The Implementation Group

Frank Lanza, Director, Processing Services, California Franchise Tax Board

Robert Lewis, President, Tax Back, Inc.

Sue Martin, Professor of Accounting & Taxation, Grand Valley State University

Ike Nooe, Administrator, Info. Resources Mgmt. Div., South Carolina Dept. of Revenue

Helen O’Planick, Partner, HELJAN Associates*

Bette Rice, Director, Enterprise Technology Services, Merrill Lynch

Elizabeth Seymour, Vice President, Wachovia Bank, N.A.

Bill Shepard, VP & General Manager, Professional Products Group, Intuit, Inc.

John Stauffer, Sr. VP of Product Planning, Ceridian Corporation

John Stoller, President, John D. Stoller, CPA*

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*First year member

**Electronic Tax Administration Advisory Committee
Charles A. Lacián, Chairman**

**Appendix B
ETAAC Letter to Robert E. Barr**

May 1, 2000

Robert E. Barr
Assistant Commissioner
Electronic Tax Administration
Internal Revenue Service
1111 Constitution Ave., NW
Washington D.C. 20224

Dear Bob:

Your letter of February 22, 2000, distributed to ETAAC members at our March 2 meeting in Washington, elicits our reaction to two proposals in the President's FY 2001 proposed budget:

- 1) a temporary, refundable tax credit of \$10 for e-filing of individual income tax returns; and
- 2) one or more no cost options for preparing and filing individual income tax returns over the Internet.

In particular, you requested our views on how the free Internet filing option could best be achieved and cited the provision in its entirety:

"No later than tax year 2002, the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer. If the IRS offered such options through contract arrangements with Authorized IRS e-file Providers, it would be with the assurance that the taxpayer's tax return information would not be used by the Provider without the taxpayer's permission for any purpose other than submission to the IRS."

Your letter stated that "This proposal does not mean that the IRS will be entering the tax software business. However, it does mean that the IRS will be required to build on the trends that already exist in the industry, which are to offer very low cost or even no cost tax services over the Web. One way that the IRS could implement this provision is by issuing a Request for Proposal (RFP) to the industry requesting vendors to submit proposals" to meet a number of IRS requirements.

At its March 2 meeting, ETAAC discussed the proposed \$10 refundable tax credit proposal and decided to support this proposal for taxpayers who e-file individual income tax returns.

Letter to Bob Barr
May 1, 2000
Page 2 of 3

In response to your letter, we have subsequently considered the proposal for free Internet preparation and filing for individual tax returns. The ETAAC believes that free tax preparation and electronic filing over the Internet for individuals would benefit taxpayers and lead to an increase in electronic filing. Therefore, ETAAC supports this objective, but is concerned that the IRS might attempt to achieve the objective either by competing with the private sector or eliminating robust competition from the private sector.

The IRS Restructuring and Reform Act of 1998 states that “The IRS should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns.” This approach is working well. Existing marketplace competition has already led to a wide number of options that taxpayers can choose, including very low or no cost tax services on the Web from a wide variety of providers—the very trend you indicated in your letter. The number of providers, now over 20, (see the attached list for details) is dramatically increasing every year, forcing strong product development and causing prices to fall dramatically.

The ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of no cost tax preparation and filing options over the Internet are to: 1) let the competitive market continue to progress, and 2) continue stimulating electronic filing through its creative advertising campaign and making electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper. These actions will result in increased taxpayer demand for electronic filing which will in turn stimulate the marketplace to create improved and less expensive, even no cost, products, as it has already done in the last several years. The ETAAC applauds Commissioner Rossotti’s testimony to the House Ways and Means Oversight Subcommittee on March 28, 2000 whereby he endorsed this approach.

There are two approaches that the ETAAC believes the IRS should not take. The ETAAC strongly recommends against the IRS developing its own tax preparation software program, either internally or through acquisition. The ETAAC also believes that the IRS should not follow an approach where the IRS issues an RFP or RFA to select a limited number of “Authorized IRS e-file providers” to IRS-specifications. Your letter suggested IRS might use this approach, which ETAAC believes would lessen competition that currently exists in the private sector. If the IRS selects a limited number of providers that will be effectively “co-branded” with it for e-filing, the IRS will indirectly be entering the software business. This situation will result in a huge competitive advantage and perhaps even a monopolistic position for those selected. The IRS should not lessen competition by entering the market and choosing which of the current providers gets the advantage of an “IRS brand”. The ETAAC believes more competition, not less, is important to lowering the price of e-filing and cannot support any implementation that limits or stifles competition in the private sector. The ETAAC would be pleased to work more with the IRS to develop approaches the IRS might take to stimulate the market and increase competition.

Letter to Bob Barr
May 1, 2000
Page 3 of 3

The ETAAC supports the goal of a no dollar cost Internet e-filing for all taxpayers and believes it is being achieved currently through free market forces, with even more no cost options available in the future. The marketplace will be further stimulated towards no cost tax preparation and e-filing by enactment of the \$10 tax credit. The key to achieving no cost tax preparation and electronic filing over the Internet is to increase marketplace competition rather than decrease competition by offering IRS software or selecting a limited number of e-file providers for co-branding. If the private sector does not progress to free tax preparation and e-filing in the next several years, as expected, the ETAAC believes the IRS would then be justified in evaluating whether an electronic template is an appropriate and needed tool to promote free e-filing over the Internet. The IRS and ETAAC should track progress in meeting this objective on an annual basis.

The IRS must also recognize that the goal of the private sector is to make a profit and free enterprise does not mean that the private sector must offer its products and services for free. Establishing a goal of no-cost tax preparation and electronic filing ultimately means private sector companies engaging in this practice must obtain something of value, such as exposure to advertising or offers to perform other services, in exchange for free tax preparation and electronic filing. The IRS should ensure that taxpayer privacy rights are not violated, but should not restrict the ability of a consensual exchange between the taxpayer and private sector company to occur in a totally electronic environment with appropriate security safeguards.

The committee has addressed in this letter the two issues you asked it to consider. We are also evaluating a number of other issues that we believe have strategic impact, and will be making recommendations on these issues in our June report to Congress.

Sincerely,

Charles A. Lacijan, Chair
Electronic Tax Administration Advisory Committee (ETAAC)

Attachment

Attachment On-line Filing Software Companies

Note: The Internal Revenue Service (IRS) has provided links to these companies' web sites. The IRS and the United States Government do not endorse or warrant these companies or their products or services. The decision to use or not to use any of these products and services will not result in any special treatment from the Internal Revenue Service.

On-Line Filing Software	Software Developer	Is Product on Internet?	State On-Line Filing?	Customer Service Telephone Numbers and/or Email Addresses
Preptax.com*	Preptax.com	www.preptax.com	KS, PA, ID, NE, MD, NC, NY, WI, ND, CA, IA, MS, LA, MA, RI, DC, WV, CT, IN, GA, KY, OR, OH, NJ, AL, MO, DE, MI, MT, NM	support@preptax.com , 1-918-499-3000
ZapTax*	PDP Tax Service	www.zaptax.net		nm23@aol.com
Automated e1040*	e1040.com	www.e1040.com		1-877-404-1040, cs425@e1040.com
FileYourTaxes.com	Atilla M. Taluy	Yes - www.FileYourTaxes.com	CA	1-805-984-0248, service@FileYourTaxes.com
CompleteTax*	CCH, Incorporated	www.CompleteTax.com	ID, KS, LA, MD, NE, NY, PA, WI, CA, NC, IA, MI, SC, CT, OR, AL, GA, IN, VA	support@completetax.com
Taxslayer	RCS Rhodes Computer Services	Software available for download www.taxslayer.com	KS, LA, MD, NC, PA, MI, NY, IA, MS, SC, DC, IL, WV, CT, MO, AL, KY, MS, NJ, IN, DE, VA, NM	www.taxslayer.com
esmart TAX*	C & S Technologies	www.esmarttax.com		1-408-935-8468, support@esmartforms.com

On-Line Filing Software	Software Developer	Is Product on Internet?	State On-Line Filing?	Customer Service Telephone Numbers and/or Email Addresses
Quicken MacInTax, MacInTax Deluxe, MacInTaxHome & Business	<u>Intuit, Inc.</u>	Software available for download www.macintax.com	ID, KS, LA, MD, NC, NE, NY, PA, UT, CA, IA, MS, ND, MI, MA, RI, SC, DC, IL, WV, CT, CA, OR, MO, AL, IN, DE, MT, VA, NM	1-520-901-3240
Quicken TurboTax, TurboTax Deluxe, Turbo Tax Home & Business	<u>Intuit, Inc.</u>	Software available for download www.turbotax.com	ID, KS, LA, MD, NC, NE, NY, PA, UT, CA, IA, MS, ND, MI, MA, RI, SC, DC, IL, WV, CT, CA, OR, MO, AL, IN, DE, MT, VA, NM	1-520-901-3240
Quicken TurboTax for the Web and TurboTaxEZ	<u>Intuit, Inc.</u>	Yes - www.turbotax.com	ID, KS, LA, MD, NC, NE, NY, PA, UT, CA, IA, MS, ND, MI, MA, RI, SC, DC, IL, WV, CT, CA, OR, MO, AL, IN, DE, MT, VA, NM	1-520-901-3240
H.D.VESTONLINE*	<u>H.D.Vest Technology Services</u>	www.hdvest.com		webmaster@hdvest.com
eTaxsimple*	<u>AJV/Taxsimple</u>	Yes - www.taxsimple.com , support@taxsimple.com		1-973-989-0013
TaxCut	<u>Block Financial Corp</u>	Yes - www.taxcut.com	KS, WI, NC, MI, MA, ID, RI, SC, OR, MO, IN, CA, DE	1-816-504-1500
H & R Block Online Tax Program	<u>Block Financial Corporation</u>	www.hrblock.com/tax_center/doing_my_taxes/index.html	KS, WI, NC, MI, MA, ID, RI, SC, OR, MO, IN, CA, DE	1-816-504-1500

On-Line Filing Software	Software Developer	Is Product on Internet?	State On-Line Filing?	Customer Service Telephone Numbers and/or Email Addresses
FileSafe	<u>Tax Systems, Inc</u>	Yes - www.filesafe.com, www.filesafe.net		1-281-895-7014
Microsoft TaxSaver Federal Deluxe, * Microsoft TaxSaver Federal Standard, * Microsoft TaxSaver Federal Trial*	<u>Microsoft</u>	Software available for download - tax saver.msn.com		1-425-454-2030, 1-800-936-5700, http://support.microsoft.com
Tax1	<u>Etax Corporation</u>	Yes - www.Tax1.com		1-301-912-3450, epa@etaxonline.com
AutoTax	<u>TaxLink, Inc.</u>	Software available for download www.autotax.com		1-614-538-5497, www.autotax.com
TaxACT	<u>2nd Story</u>	Software available for download www.taxact.com	IA, NY	1-800-573-4287
Nelco Tax Wizard	<u>Nelco</u>	Yes - www.nelcoinc.com, pefsupport@nelcomail.com		920-337-2034
AMTax	<u>AM Software</u>	Order - www.amtax.com, support@amtax.com		1-800-859-8537
Tax Preparer 2000 by HowardSoft*	<u>HowardSoft</u>	www.howardsoft.com, support@HowardSoft.com		1-858-454-0121
UDS ELECTro TAX Individual	<u>UDS ELECTro TAX LLC</u>	Yes - www.udstax.com		1-410-730-8460, hondo@udstax.com
NetTax-on-line	<u>Full Duplex Systems, Inc.</u>	Yes - www.nettaxonline.com	MD	1-877-892-8470

* New for filing season 2000

Monday, 13-Mar-2000 09:02:01 EST

THURSDAY, OCTOBER 5, 2000.

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

WITNESSES

BRADLEY BUCKLES, DIRECTOR, BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

DENNIS SCHINDEL, OFFICE OF INSPECTOR GENERAL (TREASURY)

ROBERTA RICKEY, TREASURY, INSPECTOR GENERAL

Mr. KOLBE. The Subcommittee on Treasury, Postal Service and General Government will come to order. Thank you very much for being here. Mr. Price, thank you for joining us.

This afternoon we are going to have this hearing to focus on the implementation of what has been called the Youth Crime Gun Interdiction Initiative. I understand that Treasury, the Bureau, refers to it as "Yogi." At least until recently, here on Capitol Hill we have always called it "Yiggi." So Yogi or Yiggi; that is what we are talking about here today.

The Bureau of Alcohol, Tobacco and Firearms, following the direction of the President, initiated this program in 1996 to focus enforcement efforts against gun traffickers whose weapons are used by or against youth, particularly those in the age group of 18 to 24.

Today, to talk about this program and how it has worked, we have two witnesses. First, we will be hearing from Mr. Dennis Schindel, the assistant inspector for audit of the Office of the Inspector General in the Department of the Treasury, and he is joined at the table here by his assistant, Ms. Roberta Rickey.

After that, we will hear from the ATF director, Mr. Bradley Buckles.

Mr. Schindel recently supervised a series of audits of the Youth Crime Gun Interdiction Initiative, "YCGII," the YCGII program, including one of particular interest to us today that examined the implementation and performance measurements. He will be talking today about the findings of the OIG and their recommendations.

Director Buckles will then be asked to respond to those OIG reports as well as tell the subcommittee the steps that ATF is taking with regard to improving the YCGII performance and implementations and what plans he might have for this program or ideas for it for the future.

First, before we ask for Mr. Schindel's remarks here, let me observe that without question, YCGII is a program that has grown. It has grown, in fact, from around \$300,000 in Fiscal Year 1996 to \$51 million in Fiscal Year 2000, covering 38 cities. Even by Washington standards, that is a hefty growth rate.

With the \$76 million increase in funding expected for Fiscal Year 2001, or at least what is in the bill, the budget of the conference report, this would increase it to about 50 cities, the coverage of YCGII to 50 industries, and would account for over a tenth, or 10

percent, of all ATF salaries and expenses in their budget. YCGII, in Fiscal Year 2001, will also have staffing levels that are associated with it of 500 full-time equivalents for agent, administrative, or technical positions.

So I would say that even by Washington standards, we can say this is a big program and certainly, as I just suggested by growth, it is tremendously big.

But it is a program that has been a priority for ATF and the administration, and I should emphasize the Congress has agreed with this so far. They have agreed that this level of effort is justified by the need to reduce gun violence that involves our children and youth. However, from the beginning I think we all expected ATF to carry out a consistent effort in the participating YCGII cities, with clear program guidance, standard data, minimum level of effort reflected both in the processing of trace information as well as in providing strategic analysis and investigative reports to the cities that are participating.

What we have seen instead, at least as outlined in the inspector general's report, is a program that varies very significantly from city to city. There is not really a coherent, overall program. It often has very unclear lines of communication, to the extent that both local ATF field offices and city police departments cannot always describe the organization or the level of efforts for YCGII, let alone characterize or give any clear indication of the impact that it is having on youth or the reduction of guns or juvenile crimes involving guns.

In my own city of Tucson, for example, one of the cities that is involved in this, I found that local law enforcement agents were completely unaware, for the most part, of the program's existence. Given the high profile and scale for this program, such obscurity does not inspire confidence that funding for the program has really been targeted in any meaningful way.

So I hope today that the subcommittee can learn in more detail the inspector general's findings about the program and then hear from ATF on the current program and the actions they plan to pursue, since ATF has indicated its agreement with all of the findings by the OIG. I believe it is fair to say that this subcommittee is going to look carefully for answers to these questions as we consider future funding requests for the program, especially the plan to expand it to 75 cities in Fiscal Year 2003.

So I think this is a timely hearing for us before we get into the nitty-gritty of considering next year's budget to focus on this one very major, fast-growing, program in ATF with substantial growing pains.

Before I hear from my witnesses, let us see if, Mr. Price, you have any opening comments that you would like to make.

Representative PRICE. Thank you, Mr. Chairman. I have no comments except to welcome our witnesses and to look forward to their testimony.

Mr. KOLBE. Thank you. And with that, we will turn to Mr. Schindel for his statement. Of course, the full statement will be placed in the record. You are welcome to summarize it. Give part of it, or however you wish to do it here.

Mr. SCHINDEL. Thank you, Mr. Chairman, Mr. Price. I am pleased to appear before you today to discuss the results of the audits that we conducted at the Bureau of Alcohol, Tobacco and Firearms on their implementation of the Youth Crime Gun Interdiction Initiative. We do refer to it as "Yogi," and that is how I will refer to it throughout the rest of my statement.

With me today is Roberta Rickey, who is the director of program audit in Chicago, and her team performed this audit.

This program brings together federal, state, and local law-enforcement officials to improve information about and investigation of the illegal sources of guns recovered from juvenile and adult criminals, and to use that information to strengthen the enforcement of the nation's firearms laws.

Our office did conduct three separate reviews addressing ATF's implementation of YCGII. My testimony will focus on our most recent audit, which looked at ATF's effectiveness in implementing YCGII in the field offices and whether participating local law-enforcement agencies implemented activities designed to identify and investigate illegal firearms trafficking to juveniles and youths.

YCGII is a component of ATF's overall, illegal-firearms-trafficking project. The program targets juveniles and youths involved in gun crimes. "Juveniles" are defined as those ages 17 and under, and "youths," those ages 18 through 24. Through YCGII, ATF seeks to address a fundamental question in youth gun crime: How are they getting the weapons?

As you mentioned, the program has grown. It started out with 17 cities. It has grown to 38 cities in 2000, and plans are to expand it to 75 cities in the next four years. There are two components that we feel are crucial to the success of the YCGII program. First, there are the YCGII coordinators in the ATF field offices. Second, there are the police departments in the YCGII cities.

Our review of ATF's implementation of the YCGII program looked at the initial 17 cities that were put into the program because they had been in the program the longest, up to two years at the time we did our review. We found that ATF needs to do a better job of implementing YCGII so that the full benefits of the program can be realized. YCGII was not consistently implemented in all cities, and not surprisingly, this has produced mixed results. Whereas some cities have a very active program; others do not.

The results of our work identified four areas that should be improved for the program to be successful. First, existing guidance for ATF field-office YCGII coordinators needs to be updated, expanded, and include best practices that have been gained over the past three years of experience with the program. This is especially needed because of a high turnover of coordinators in some field offices.

We found that ATF field offices did not consistently implement activities that are critical to the program's success. These activities included, one, reconciling trace requests received with police-department records of crime guns recovered—this is important to ensure that all crime guns are traced; second, conducting comprehensive or end-to-end traces of a sample of crime guns—this is important to obtain a more complete picture of the illicit firearms market; and, third, ensuring that ATF special agents work actively with ATF inspectors to target firearms dealers with a high number

of crime guns traced to them. We found that all three activities were performed in only two of the 17 initial cities in the program.

Second, ATF needs to develop a formal methodology for allocating special-agent resources in support of field-office YCGII investigations. For Fiscal Year 1999, Congress appropriated ATF \$16 million for 81 full-time, equivalent-special-agent positions. ATF field offices were directed to assign a minimum of six experienced, special agents to YCGII. These agents were to spend most of their time on YCGII cases. Field offices were then to hire six special agents each to back fill for the experienced agents assigned to YCGII.

We found that while 86 new agents were hired in the initial 17 cities, only 49 experienced agents were reassigned to YCGII cases. More importantly, ATF's decision to assign six experienced agents to YCGII in each field office was not based on an analysis of firearms-trafficking problems in the respective cities. In fact, YCGII coordinators from two field offices told us that they did not believe that the trafficking problem was significant enough in their respective cities to justify six agents being assigned to YCGII. A coordinator from a third field office told us that there were not enough experienced agents in the field office to assign to YCGII cases without jeopardizing arson or explosive investigations.

Third, ATF needs to better communicate and partner with local police departments to improve the level of their participation. Only five of 17 police departments in the initial cities has the means to electronically submit trace requests to ATF's National Tracing Center. Other police departments had to use less-efficient, more time-consuming means involving at least some manual processing. One impact of this is that four police departments did not request traces on all recovered crime guns.

Electronic transmission of requests is essential to make the tracing of a large volume of crime guns manageable. In that regard, ATF needs to continue to help participating cities develop electronic-transmission capabilities.

We also found that police departments were not always aware of or could not access ATF analytical tools to develop strategies to combat illegal firearms trafficking to juveniles and youths. These tools include ATF's on-line lead system, which provides leads to special agents by analyzing data on crime gun traces, stolen guns, and multiple gun sales, and the capability to map the location of recovered guns. With respect to on-line lead system, representatives from six police departments were not aware of the system, and representatives from five other police departments told us that the information was not readily available to them.

Fourth, ATF needs to develop YCGII performance measures that gauge its actual impact on gun traffickers who supply firearms to juveniles and youths. ATF has not developed specific performance measures to show what impact YCGII has had in the participating cities. For example, ATF has been reporting as its principal program measure the number of trace requests submitted by participant cities. While trace requests are certainly important for ATF's analysis of trafficking trends, this statistic does not by itself measure whether trafficking of firearms to juveniles and youths has decreased as a result of YCGII.

In summary, we found a number of areas that need to be improved to ensure the success of the program, specifically implementation has been inconsistent on the part ATF. The level of participation by city police departments has been mixed. The resources appropriated have not been effectively allocated or fully utilized in support of YCGII, and also, after two years of operation in the original 17 cities, ATF cannot show the true impact of the YCGII program. All together, we made nine recommendations to improve the implementation and management of YCGII in the 17 cities and in the additional cities that have been added.

As YCGII continues to grow, it is important that ATF take immediate action to improve its management of the program. The good news is that this appears to be happening. In response to our draft report, ATF provided a comprehensive, corrective-action plan. They have agreed to implement all of our recommendations, and they have already completed or have under way a number of actions. I will just mention a few.

ATF indicated in its response that new guidance and training have been delivered to ATF field agents as well as state and local police departments, and a best-practices pamphlet is being developed. ATF has reevaluated the six-agent-per-city strategy for its 2001 budget submission and has processes in place to monitor changing field-office work loads. Efforts are also under way to develop more meaningful performance measures.

Mr. Chairman, this concludes my remarks, and I will be happy to answer any questions you or Mr. Price may have or other members of the committee.

Mr. KOLBE. Thank you.

I think I am going to do what we did yesterday, which it worked extraordinarily well in this kind of oversight hearing, and ask you just to step aside for a minute and let Mr. Buckles give his testimony, and then do the questions with both of you up there because I think we are going to find ourselves going back and forth now, if that is acceptable with you.

Mr. SCHINDEL. That is fine.

Mr. KOLBE. So we will do that. We will ask Mr. Buckles to come up to the table here, and we can bring up more chairs here in a minute. Mr. Buckles, we welcome you and are prepared to hear your testimony. As we suggested to Mr. Schindel, we will put the full statement in the record here, but you are welcome to go ahead and summarize.

Mr. BUCKLES. Thank you, Mr. Chairman, Mr. Price, Mr. Goode. I thank you for providing me this opportunity today to address you on one of the most important firearms initiatives by ATF, the Youth Crime Gun Interdiction Initiative. As you pointed out, I have submitted a long statement for the record, so I will be brief this afternoon in my comments.

The Youth Crime Gun Interdiction Initiative was developed in response to chilling statistics that gun homicides among young people nearly tripled between 1985 and 1995. Easy access to crime guns by this most vulnerable segment of our society was clearly an important component to the shocking increase in violence. Successfully reversing this culture of violence requires action on all fronts.

As you are aware, our firearms-enforcement efforts directed specifically at armed criminals, as well as ATF's work with youth crime-gun prevention through the G.R.E.A.T. program, are part of ATF's main strategies on dealing with youth violence.

The Youth Crime Gun Interdiction Initiative is designed to complete that coverage by attacking the sources of crime guns. Virtually all crime guns begin as legal commodities. Therefore, developing a better understanding of how firearms move from legal to illegal commerce is essential.

The first three years of the Youth Crime Interdiction Initiative focused on tracing of crime guns. Comprehensive tracing of all crime guns in selected cities, with special emphasis on those possessed by youth, gave us a more precise picture of the problem. The number of firearms traced by ATF climbed from under 100,000 in the early nineties to over 200,000 by the end of the decade. In Fiscal Years 1999 and 2000, the committee supported an increase in ATF investigative personnel to enable us to take enforcement action at these sources of crime guns.

Your investment in the Youth Crime Gun Interdiction Initiative has been significant. Rightfully, you must be convinced that the return on your investment is actually significant in terms of protecting the American people and particularly our youth from the ravages of gun violence.

We believe the early results demonstrate that the Youth Crime Gun Interdiction Initiative is a valuable program. Through this program we have dramatically enhanced our ability to analyze crime-gun information and apply this knowledge strategically to combat violent crime and illegal trafficking. In the first two quarters of Fiscal Year 2000 we initiated 874 illegal-firearms-trafficking investigations involving over 14,600 firearms.

While gun homicides by juveniles and youths have declined, they remain at an unacceptable level, and there is much to be done. But even the best of programs require careful scrutiny to ensure that they are executed in the most efficient and effective manner possible. What brings us here today is a series of examinations by the Treasury Department's inspector general into ATF's implementation of the youth crime gun initiative.

The inspector general has helped us identify a number of areas where we need to improve, and their recommendations have proven invaluable as we have moved from a rather modest tracing initiative to a more strategic effort to systematically attack illegal sources of firearms to our youth and children. We have accepted each and every recommendation, the majority of which have already been implemented, and all of the rest are in some stages of implementation.

With the support and careful oversight of this committee, the Youth Crime Gun Interdiction Initiative is making a difference. As it develops, I am committed to the continued scrutiny of the management of this program and accountability to youth for the results. I am convinced that our effectiveness in reducing armed violent crime is increasing, making our communities safer for our children and all Americans. And I thank you for your commitment to this important goal. That concludes my statement. I would be pleased to answer any questions you have.

Mr. KOLBE. Thank you very much. Yes, Mr. Schindel, if you would come back up here. Ms. Rickey, if you would like to join us, too, that is fine.

Let me begin with kind of a basic question here. Is this youth program really a youth program? I guess my question is directed to this. You really trace all guns, do you not, Director Buckles? This is not a criticism, but it is not a youth program, is it? It is a tracing of all guns.

Mr. BUCKLES. It is a tracing of all guns, and it is identifying traffickers on all levels. [Agency note: To adequately assess the role played by, or impact to, the age groups at hand, it is imperative to not only trace all crime guns in a YCGII city, but to use that information in an analytical sense with offense data.]

Mr. KOLBE. What is the concentration on the youth, then?

Mr. BUCKLES. The reason that we were concentrating on youth when we began this program is, looking at the overall universe of violent firearms crimes, the single age group with the highest incidence in many categories was the ages 17 to 24. Almost 41 percent of all firearms homicide were being committed by people in that age range. It is also a situation where we believe that it is probably an area that is most susceptible to changing that pattern and affecting the access of younger people to firearms. Older criminals may have different access to firearms. They are adults; how they can purchase firearms, what crimes are involved are different, but quite often the youth are involved in crimes of opportunity, and if we can interrupt and make it more difficult for people in that age range to acquire firearms, we have a much greater possibility of impact through that trafficking interdiction.

Mr. KOLBE. Is there a mission statement for the YCGII program? Is it laid out in a manual someplace?

Mr. BUCKLES. Well, we put out documents to our field describing the program and setting forth exactly what the objectives are. Part of the criticism or findings with the inspector general was that there was confusion even within the agency as to exactly what the overall goals and objectives to the program were. I think that that is a result of the fact that it was a program that grew.

It started off, as I said, as kind of a modest tracing initiative early on, when we received some money from the asset forfeiture fund to make improvements in our tracing center, and as it grew incrementally, unfortunately, we did not pull everything back together so that the field and everyone in the agency and others dealing with us had that comprehensive view of what we were doing.

Mr. KOLBE. Mr. Schindel, I think that was one of the criticisms you made as to whether or not it is really clear, the focus of this program. In your view, are there adequate performance measurements here, goals for this program? We are spending \$50 million on this now. Are we getting our money's worth out of that? I guess that is the bottom line of what I am looking at here. I know it is popular to talk about youth crime and doing something about it, but I do not advocate just throwing money at a program if we are not getting something from it here.

Mr. SCHINDEL. That was another one of our findings, was that we do not feel there are adequate performance measures. Certainly, getting all guns submitted for tracing is an important part

of the program, but there are, as I mentioned, other activities that have to take place after guns are submitted for tracing.

Many of the activities, such as the end-to-end tracing, which really tries to follow the gun all the way back to when it was first sold by a federal firearms licensee, helps to identify the trafficking aspect of it, which helps to answer partially the question, how are youths and others who are not entitled to these firearms getting them? If that activity takes place effectively, then the program has the opportunity to do what it is intended to do, and you get your money's worth. But there have to be, I think, some measures that show that those types of things are taking place and that there is a bottom-line impact that, in fact, it is reducing the trafficking of firearms to juveniles and youths.

Mr. KOLBE. But in order to measure that, you have to develop some kind of a baseline, do you not?

Mr. SCHINDEL. Yes. I do not know if there are statistics out there, crime statistics, that already exist, that can be used, but obviously we are beyond the start of the program, so baseline measures have not been established at this point, and it would be difficult, unless if you just do it now—

[Agency note: Baseline measures used to this point were ones previously established for the two major aspects of this initiative, firearms tracing and related trafficking measures. My statement for the record explains measures that are in development to assess outcomes unique to this combination of enforcement tactics.]

Mr. KOLBE. It is kind of hard to establish them after the program has been operating for four years. Mr. Buckles.

Mr. BUCKLES. Well, we are looking at baselines that we can work from, and I think there are a number of them out there. If we talk about the program being there for four years, early on one of our most important performance measures was the number of firearms being traced, because that was the focus of the initiative.

As we move beyond that, we need more result-oriented performance measures, and we are looking at a variety of things. Reduction in the time to crime. We have now, with the study we have done, have some ideas on the time to crime between a firearm being sold and ending up in the hand of a youth. If we are affecting that and slowing down the time to crime, then it means it is harder for people to get a hold of firearms. If we are impacting the number of youths who are being arrested in possession of illegal possession of a firearm. We have baselines now on the cities that we have looked at so far. So I think we have things that we can work off of as we move ahead.

Now, we are also entering into some work with the National Institute of Justice to come out with some even broader ways to look at our program and to determine how it is affecting youth violence overall. So we are exploring all sorts of different ways that we can come up with measures that can show you some tangible results that are coming out of this program.

Now, there are a lot of things. It flows in many directions, and let me give you an example. As we learn and understand more about what the trafficking problem or what the firearms sources are in a particular area, what that does, it allows us to take a

number of steps that in the past, frankly, would have been shots in the dark.

If we determine that one of the principal areas of firearms showing up in a city is from stolen firearms from FFLS, it allows us to work with the dealer community to improve security requirements. Some areas, we find that straw purchasers are the biggest problem. We recently entered into a program with the National Shooting Sports Foundation to work on areas to deal with straw purchasers.

By knowing what the various sources are—it is not always going to lead to a criminal case—it also allows us to engage and address each problem up front through a variety of other measures as well.

All of these have to be pulled together so that when we come before you we can tell you what this information was that we were able to collect, how we were able to use it, and then see if it has resulted in a reduction of firearms thefts from dealers, a reduction in straw purchasers, et cetera.

Mr. KOLBE. Well, you have jumped ahead and answered at least some of the questions I had ongoing as to how this information is used, and you referred to the pronoun, "we," and I gather that means ATF. If I look at this report here—it has got a section here for my city of Tucson. If I go out to the city of Tucson, am I going to find law-enforcement people there that are going to be intimately familiar with the information that is in here? What use is made of this?

Mr. BUCKLES. Well, that was the one of the criticisms from the inspector general's report, that in some cities it was being used, and in other cities it was not. I cannot speak directly to Tucson, but what—

Mr. KOLBE. I am not asking you to speak directly to Tucson.

Mr. BUCKLES. But what we have done as a result of that is instituted very clear guidelines as to how we are supposed to be using those reports in each case, in terms of what ATF can use from them to develop a strategy and also what the local police and law-enforcement authorities can do and how they can use that. So we are taking steps to make sure that the best practices that we are using in some communities are also being used in all of the communities as well because that is what it is designed to do.

Mr. KOLBE. I want to go to my colleagues for some questions. I have a series of others, and I especially want to come back to Mr. Schindel, but let me see if Mr. Price has some questions here and Mr. Goode.

Representative PRICE. Thank you, Mr. Chairman. I want to thank both of you for your testimony, and I would like to start, Mr. Schindel, with the activities that you identified as being critical to the program's success on page four of your testimony.

You are talking about, first, reconciling trace requests received with the records of crime guns recovered; secondly, conducting sample, end-to-end traces to get a more complete picture of the illicit-firearms market; and finally, and this is the one I want to concentrate on, ensuring that ATF's special agents work actively with inspectors to target firearms dealers with a high a number of crime guns traced to them. Presumably, that is the bottom line. Presumably, that is the end goal.

You say that of these 17 cities you looked at, all three activities were performed in only two, which, of course, does not sound very good. With respect to that third activity, though, which in some ways is the culmination of the effort, what would the success rate be on that criteria? I think that one was actually the most successful of the three. I think only two out of 17 cities were not performing that activity.

Representative PRICE. So that changes the picture a bit if you break down those three activities in that way. I really did not anticipate that answer. So you are saying that there would be 15 out of the 17 on that last criterion.

Mr. SCHINDEL. Right.

Representative PRICE. Well, presumably, the other two are somehow leading up to that third activity. Right? The tracing program leads you to identify these high-volume dealers. Is that right? How can the third activity succeed or be implemented without the first two?

Mr. SCHINDEL. It would be difficult. You have to have the tracing first to get the information to start leading back to the FFLs, firearm-licensing dealers.

Representative PRICE. Does that imply, then, that the targeting of these high-volume dealers is somehow based on inadequate data somehow or inadequate tracing information?

Mr. SCHINDEL. Well, I think that there could be more targeting in some of these other cities who are doing that who were not getting all of their guns traced. So while they were performing that activity where there was information that they could develop that lead back to FFLs, there were probably some missed opportunities because not all of the guns were being traced in those cities.

Mr. PRICE. Well, I must say, it does change the picture somewhat if there is such radically different performance rates with these three activities. Simply to lump them together and say all three are being performed in only two out of 17 cases gives a somewhat misleading picture, would not you think?

Mr. SCHINDEL. Well, again, the idea was that there should be some consistent application of the program, and obviously that is not taking place.

Representative PRICE. But you also seem to be saying here in your oral testimony that in terms of that third activity, targeting firearms dealers with a high a number of crime guns traced to them, that is taking place in most of these cases. Now, do you have anything further to say about how thoroughgoing or how effective that targeting is? What does that entail? Mr. Buckles, if you want to chime in here, I welcome your thoughts as well.

Mr. BUCKLES. Well, I think that the information that we gleaned from the inspector general report was that while we were using that data, and we have accumulated—make no doubt about it—regardless of what the performance was, a tremendous amount of information on crime-gun data and sources of crime gun.

What we learned from the inspector general report was that we were not getting all of that, and maybe there were still opportunities we were missing. Not that we were not using the information we had to deal with possible sources of guns, crime guns, but that there may be more sources out there that we are missing because

things were not reconciled, because there were not complete traces in every situation. That was the way I understood the inspector general's report, there weren't issues with making the most of what we had, but that we might be missing additional opportunities because we were not getting everything we might possibly get out of this information.

Representative PRICE. I see. So the deficient performance in these early stages would then compromise your ability at the final stage, or it could.

Mr. BUCKLES. Well, I think, if I am speaking correctly for the inspector general, it suggests that we may yet be missing opportunities.

Representative PRICE. What exactly does it mean to target these dealers? What kind of specific efforts are you carrying out with respect to these dealers once you identify them, once you have the patterns established?

Mr. BUCKLES. What we are doing is conducting a focused inspection on dealers that have high numbers of gun traces to them, short-time-to-crime guns coming from that dealer. We recently conducted a study of a thousand or so of these dealers to determine the factors influencing the source of crime guns. In some cases we are finding out that there are dealers that have a very high volume of business, and they have been in business for a long time, and the number of traces coming back to them are not inordinate, and that their businesses are in good shape.

In other cases we are finding people who have sloppy record keeping, and guns may be going to the wrong people simply because of the way in which they manage their business, and still in other cases we may find dealers that are intentionally violating the law and selling firearms off book, for example. So we are finding the range. What this information is doing is it is leading us to the sources of crime guns so we can, again, be able to sort through that data further and refine our focus on where the problems are.

Representative PRICE. That is a tip-off as to where further investigation might pay off and where you might find criminal activity that you need to zero in on.

Mr. BUCKLES. That is correct. And we are not assuming it is criminal activity. If you notice, this is turning information over to our compliance inspectors, who are first looking at these dealers from the point of view, "are they complying with the law?;" If they do find that there are problems at that dealer, then it can be turned into some kind of investigation, or we can correct the situation with regulatory sanctions, but we are using this information as a way to target our very limited inspector resources.

Representative PRICE. The chairman referred to the quality of the liaison with local police departments, and both of you have spoken to that briefly. Of course, that is an important criticism, I think, in this report and an important thing to be working on, and apparently you are doing that. To what extent, Mr. Schindel, or how much weight are you placing on the efficiency you found in technical capability?

You talked about the fact that four police departments did not request traces on all recovered crime guns. You seem to be tracing that back to the absence of a capacity to do that electronically, to

process this information electronically. Is that your main explanation, or is this failure to undertake this kind of thoroughgoing tracing activity, is it traceable maybe to other causes as well?

Mr. SCHINDEL. Well, I think we found that this is probably the main obstacle. It is less efficient to submit that information. If you cannot do it electronically, in some cases when they inventory these crime guns they take time to record all of this information, and if they cannot submit it to ATF or to the tracing center at the same time, then they have got to go back and kind of duplicate their effort. They are on to other things, and in some cases even where it was being submitted, it may not have been submitted timely. It may not have been submitted accurately so that even when the information was submitted, the trace could not be done. In some cases the information would be submitted to an ATF field office through fax or through a disk, and then the ATF agents would have to spend their time filling out the trace request to send to the National Tracing Center, so it is a very inefficient process.

Representative PRICE. Well, Mr. Buckles, to the extent that that is the problem, to the extent that this lack of a technical capability is the problem, to what extent are you in a position to address that, to deal with it?

Mr. BUCKLES. Well, we are addressing that problem now. We have a variety of different initiatives going on trying to provide ways in which police departments can supply this information in a more efficient manner. The difficulty that we have run into is with every police department you run into a different computer system, a different data base, a different structure, and trying to come up with a solution that will either extract or submit that data so they do not have to keep reentering it every time, that can pull out of their system and place it in the tracing system, has proven to be a somewhat larger challenge than we thought it might be. We are looking for Internet-based solutions that will allow a better interface with that data as one of the solutions on dealing with it.

Representative PRICE. Thank you very much.

Mr. KOLBE. Thank you, Mr. Price. Mr. Goode.

Mr. GOODE. Thank you, Mr. Chairman. Let me ask, I guess, Mr. Buckles first. I need to be familiarized with current law. You know, a juvenile, by definition, and I believe in one of your testimony is 16 or under.

Mr. BUCKLES. It is 17.

Mr. GOODE. Seventeen and under. Now, can a 17 year old possess a handgun legally?

Mr. BUCKLES. Well, I believe a juvenile can possess firearms under certain circumstances, and we are not making every possession by a juvenile to be illegal. We are interested in these—

Mr. GOODE. I know, but what is the law?

Mr. BUCKLES. I know they can possess a rifle.

Mr. GOODE. A shotgun.

Mr. BUCKLES. I believe they can possess a handgun if it is—

Mr. GOODE. Is it federal law? Do you enforce a state law for violation?

Mr. BUCKLES. No. We do not enforce a state law.

Mr. GOODE. So what is the federal law?

Mr. BUCKLES. Well, I used to be the chief counsel, and you are going to catch me not knowing exactly what that is, but federal law generally sets age standards on who can buy a firearm from a licensee, so a juvenile cannot go to a licensed premises. I am from Wyoming, and I know youngsters have rifles that are given to them by their parents, and it is perfectly legal under federal law. You could not go into a dealer yourself if you are under 18 and buy one, but you can certainly have one if it is given to you by your parents.

[The information follows:]

[CLERK'S NOTE.—agency adds that under Federal law, it is unlawful for a Federal firearms licensee (FFL) to transfer a rifle or shotgun to anyone who they know or have reasonable cause to believe is less than 18. Federal law does not place an age or restriction on the possession of rifles or shotguns. Under Federal law, it is unlawful for an FFL to transfer a handgun to anyone they know or have reasonable cause to believe is less than 21. In addition, under Federal law it is generally unlawful for any person less than 18 to possess a handgun. There are exceptions to the prohibition on juvenile possession, for example, target shooting with parental permission.]

Mr. GOODE. Okay. I believe you mentioned 200,000 firearms you confiscated from those under 24. Is that right?

Mr. BUCKLES. No. I said that the total number of traces at our tracing center had increased from under 100,000 earlier to over 200,000 by the end of the decade. Now, that would be all crime-gun traces, not just out of this program. I believe the number out of the Youth Crime Gun Interdiction Initiative cities is somewhere around 60,000 of that. But those are not all confiscated from juveniles. These would be firearms that are in some way involved in a crime.

Mr. GOODE. All right. The 200,000 involved in a crime, then, and these are federal crimes. These are federal or state.

Mr. BUCKLES. No, sir. In most cases they are going to be state violations. The vast majority of trace requests we get are from local authorities who are enforcing state laws.

Mr. GOODE. In those 200,000 situations, and in how many instances was someone arrested or charged with that crime?

Mr. BUCKLES. Well, I could not tell you—

Mr. GOODE. Just ball park.

Mr. BUCKLES. Well, I would imagine in most of those cases there has been some kind of crime involved. Whether someone was charged with a crime, it could be a firearm recovered at a crime scene, and whether anybody is ever charged with that, I do not know. Generally, the firearms that come into police departments' custody is where they have arrested someone for any kind of crime. It may be a breaking and entering, and they were carrying a firearm. It could be a robbery, but generally there is some kind of state violation that went on that led the police to be able to have that firearm, then, in their custody.

Mr. GOODE. Of those charged and arrested, and you are pursuing prosecution, do you have any records of what you are doing with those persons?

Mr. BUCKLES. We do not have a record of what we are doing because the vast majority of those are for state violations, and we performed a trace on behalf of local authorities who are asking us to trace the source of that firearm. [Agency note: ATF uses this information to interdict sources of crime guns.]

Mr. GOODE. As a novice, tell me what you do when you trace a firearm.

Mr. BUCKLES. What we would be doing, for example, and let us use something from your state. For example, we have got the Exile program in Richmond, which is a different kind of firearms initiative that has to do with the use of firearms generally in a crime. The Richmond Police arrest someone. They have got a firearm on them. Perhaps they arrest them for a drug violation, and they are possessing a firearm.

What we do with that is they provide us the information on the make, model, and serial number of that firearm, and we trace that firearm to the first retail purchaser to tell where that firearm came from and where it was last known to be in legal commerce. In some cases that firearm may trace back to the person who was arrested. They may have bought it in a gun store. In another case we may find that the firearm was reported as stolen from a gun store; there was a break-in. There could be any variety of things that we might find when we trace that firearm.

Mr. GOODE. Well, let me ask you this. If I bought—I do not have one, but if I bought my 17-year-old son a rifle, and that was used in a crime, you would just know that I purchased it. Is that right?

Mr. BUCKLES. Yes, sir.

Mr. GOODE. Project Exile has done very well in Richmond, in my opinion. Do you think you would reduce crime more by expanding that rather than worrying about tracing the guns as much?

Mr. BUCKLES. Well, we believe that we have to do both of those. It is important to find out where all of those guns in Richmond are coming from so that every firearm that is recovered from a suspect in an Exile case is traced through our National Tracing Center, and we find out where, if there are any common sources for the firearms that are showing up, and quite often we will find out that there is.

A large percentage, surprisingly enough, of gun traffickers also happen to be violent felons themselves, so tracing the firearm can lead us back to somebody who is not only a violent felon, but also somebody who is being a multiplier on their conduct by providing firearms to others in the community. By being able to trace the firearm and focus in on that trafficker, we believe, is also a key component to successfully combating gun violence.

Mr. GOODE. But you concur, though, that putting the violent felons in prison, state or federal, is certainly a key way in reducing crime and has been.

Mr. BUCKLES. Yes, and it has been an important component of our enforcement strategy all along, yes.

Mr. GOODE. Thank you, Mr. Chairman.

Mr. KOLBE. Thank you, Mr. Goode. Mr. Hoyer.

Representative HOYER. Thank you, Mr. Chairman. Let me apologize for being late.

John Kluge gave \$60 million to the Library of Congress, as you have probably read in the paper this morning. There was a brief ceremony today and there will be a dinner tonight, today's brief ceremony honored him, and at that sum, I thought I would show up, so I apologize for being late, Mr. Chairman.

I did not hear the testimony and, frankly, have not read the testimony either. My staff has prepared some questions, and I am sorry if I am redundant. If I am redundant, simply say we have answered that, and we will go to the record.

Mr. Price asked some questions pertaining to the three criteria that the two out of 17. I think you have cleared up that perception a little bit.

You may have answered this Mr. Buckles, but perhaps you could say something, or perhaps the IG, if he has any information, on the additional cities that were not looked at, what progress are we making. Now, was that asked, David? What progress is being made in light of the IG's observations with reference to the first 17 cities?

Mr. BUCKLES. Well, that is why we have found the IG's report so helpful in making sure as we move on that any stumbling blocks we had from the original 17 cities is not repeated in the program as we go forward. So we are using the same suggestions that the IG found with the original 17 cities to ensure that we are not repeating those mistakes with the newer cities.

I believe one of the things that the IG recommended to us was to update the agreement with the original 17 cities signed, as to what the program is and what everybody's responsibilities were. At the time of the original 17, the program was fairly limited. What happened when we expanded it to other cities and we had more details as to what we were going to require of the cities and what was expected in terms of joint enforcement programs; the original 17 had never been updated. So with their suggestion, we went back to the original 17 and actually gave them the more complete description of what the program should be. So I think that we are in better shape with the newer cities, and we have actually left the older ones unfortunately behind with what we had asked them to do.

Representative HOYER. Well, I suppose that is good news.

Mr. BUCKLES. That is good news.

Representative HOYER. That is good news. Let me ask you, and, again, I know that Mr. Price was getting into some of these issues in terms of—I think Mr. Goode a little bit as well. The trace analysis of the program cites 96,747 traces between 1998 and 1999. What are the number of firearms traced compared with firearms recovered? Now, you have mentioned that a little bit with respect to—there has been some discussion about that, but do you have that relationship?

Mr. BUCKLES. I am not sure what you mean by firearms recovered.

Representative HOYER. Firearms recovered in the course of police work, that they get firearms.

Mr. BUCKLES. Do you mean the total number nationwide?

Representative HOYER. Yes.

Mr. BUCKLES. We do not know exactly what that number is. It is kind of like the total number of firearms in society.

Representative HOYER. Right.

Mr. BUCKLES. There are various estimates. We believe that there is probably somewhere between a universe of four to 500,000. If we had universal tracing by all police departments the way you have universal reporting under the uniform crime reporting, I think that

is probably the ball park of what we think we would see. So we are seeing probably less than half, being able to trace less than half, of the firearms that are currently being recovered by police as having been involved in crime.

Representative HOYER. Now, Mr. Price, I think, did ask about resources available. What is your capacity at this point in time?

Mr. BUCKLES. Well, the capacity of our tracing center has expanded rapidly, and we are probably in a better position than perhaps police departments would be to supply all of that information. Some of the questions that we addressed earlier were problems that some police departments have in manually pulling this information out and submitting the traces. But with the recent improvements to our computer system, we have established electronic connections with a number of firearms dealers that allow them to automatically trace a firearm for us so that it is less labor intensive for the firearms industry. We have been able to expand our capacity without putting a great new burden on the legal firearms industry.

[The information follows:]

[CLERK'S NOTE.—agency adds that it could handle gradual increases in the tracing workload with commensurate increase in staffing and contract support; generally in increments of 10,000 traces. That is tracing only, not analysis.]

Representative HOYER. So if the universe is in the neighborhood of 400,000, what percentage of those, if we were covering the universe, could we handle?

Mr. BUCKLES. I would have to get back to you on that to see exactly what we might be able to do today.

[The information follows:]

[CLERK'S NOTE.—agency adds that there is no mandatory reporting system for requiring state and local law enforcement agencies to submit firearms crime information such as is the case with the Uniform Crime Reports (UCR).]

Representative HOYER. Now, it is our understanding that ATF has created a model of best practices that is going to be used as a guide in the program by your coordinators. It is my understanding you have also had several conferences on this issue with your field representatives. Are you reasonably confident that the best practices and best performances are being applied in all of our field offices?

Mr. BUCKLES. With the steps that we have taken as a result of the IG's recommendation, I am very confident that we have corrected almost all of the problems we saw from before. We have still got a ways to go. We are still training state and locals, but we have the training programs now in place that will help bring them along. We do have clearer instructions to our people in the field as the program becomes more ingrained.

As a core part of what we do, the systems within ATF are making sure that things get done in the normal course of things rather than always trying to force those efforts. But I think we have made tremendous progress, and I am confident that we are on the right track now.

Representative HOYER. You referenced this as well, and, again, this may be repetitive, but with respect to the 38 departments that we are dealing with now around the country and their level of participation and cooperation; how would you characterize that? Are

half participating fully or two-thirds participating fully or all participating fully?

Mr. BUCKLES. The vast majority are participating fully when it comes to the tracing, and we are having fewer and fewer problems with the departments not following through on that. Just to digress, we have had some departments that initially wanted to get involved in the tracing program but as their resources and other priorities change, it is something they cannot consistently sustain at this time. But most of the police departments are eager to stay involved in this kind of approach and to find new ways to deal with gun violence.

I think they all know that the only way we are going to successfully deal with these problems is by working smarter, not just working harder, and this is a way in which we can all work smarter to deal with the gun problem. Nonetheless, it is going to be a consistent struggle and constant effort on our part to make sure that everybody is carrying out what they need to do.

There is the situation that on a very immediate level tracing a handgun by a particular detective does not seem very important because he has already arrested the person, the person has the gun. Solving his crime is not dependent upon where that firearm gets traced to. [Agency note: But the initiative seeks to exploit that crime gun information further, past its obvious value, so having all traces conducted continuously is essential.] There are always going to be situations in any system that unless you are forcing issues, it is easy for the tracing to drop off in particular cases. So what we have learned from the IG report is we have to remain vigilant with the departments, and they have to remain vigilant to make sure firearms are being consistently traced.

Representative HOYER. I am sure we have a list, and I probably should have looked at it, but of the 38 departments, can you give me the range of those departments in terms of their size? I do not necessarily mean the number necessarily of sworn officers, per se, but size of jurisdictions.

Mr. BUCKLES. Well, we would have everything from New York City to Bridgeport, Connecticut, probably, and that might be a range of the sizes you would look at.

Representative HOYER. Bridgeport is pretty large. I do not know what Bridgeport is. What is it, somewhere in the neighborhood of 125 to 150,000 people?

Mr. BUCKLES. Probably.

Representative HOYER. Here is the list of cities. For the most part, we are talking about large metropolitan areas.

Mr. BUCKLES. Yes. And as we move forward this year in the 2001 budget to additional cities, we are obviously moving to smaller cities each time, and those create additional problems sometimes and additional potentials.

Representative HOYER. And I asked that in the context of your response that some police departments' resources are obviously limited, and I presume the smaller the department, the less able they are, although they have a much smaller volume, the less able they are to participate. Would that be a correct conclusion or not?

Mr. BUCKLES. Well, I think we will find that, but I can tell you that moving in the direction we have into 2001, with up to 50 cit-

ies, we are not finding any problem having cities that want to be involved in this program and take advantage of it.

Representative HOYER. Thank you, Mr. Chairman.

Mr. KOLBE. Let me ask you a series, Mr. Schindel, a series of questions based on your report, and then I am going to turn to Mr. Buckles and ask him to respond to some of these. Mr. Schindel, does the ATF headquarters have a full-time, department or organizational position that oversees this program?

Mr. SCHINDEL. Not consistently. For some of the field coordinators it is a collateral or part-time duty.

Mr. KOLBE. But that is within each agency. I said at the national level.

Mr. SCHINDEL. Oh, I am sorry. I did not hear that. Yes. They have a director for the Yogi program and, I think, one assistant.

Mr. KOLBE. Okay. And an assistant there, and you agree with that.

Mr. SCHINDEL. Yes.

Mr. KOLBE. Okay. Is there a set of published guidelines, a manual that is available to the field offices, and did you find that it was out there and available? Is it updated regularly?

Mr. SCHINDEL. There is not a manual, per se. There was a series of memos issued. There is the agreements that have been signed with the newer cities, "statement of participants," they call it, which outlines the basic activities of the city—of the participants, but for the coordinators I would not say—

Mr. KOLBE. I am sorry. Outlines what?

Mr. SCHINDEL. Outlines—

Mr. KOLBE [continuing]. Activities? The responsibility of the cities in terms of participating in this?

Mr. SCHINDEL. I do not believe it necessarily has that.

Mr. KOLBE. Who is it signed by? Is it signed by usually the police chief?

Mr. SCHINDEL. The police chief and the YCGII—

Mr. KOLBE. And the YCGII coordinator in that city. Is that correct, Mr. Buckles?

Mr. BUCKLES. Yes.

Mr. KOLBE. Is that how it would normally be done?

Mr. BUCKLES. But there is not a manual.

Mr. KOLBE. So there is no manual. There is just a whole series of little memos and notes. How does your YCGII coordinator in the city, Mr. Buckles, know what they are supposed to be doing on this?

Mr. BUCKLES. Well—

[The information follows:]

[CLERK'S NOTE.—agency provided the following: We have information available on CD-ROM that provides all they need to know about the essential elements and requirements of this program as it concerns the basic goals. Those agents involved as coordinators are in regular communication with the Crime Gun Analysis Branch for guidance on their cities' tracing and analysis efforts. They are also brought together with program managers for workshops, and many are also trained to deliver associated YCGII instruction for state and locals.]

Mr. KOLBE. Do you have a regular training? Do you have a formal training for these people?

Mr. BUCKLES. Yes, we do now. Again, we have to talk about the difference between when the inspector general looked at this, which

was a period of July 1999, I think, through December 1999, and where we are today. So the answer is different depending on what time period.

When the inspector general looked at it, they found a program that had grown incrementally with a series of memos or policy statements and that nothing had actually brought all of this stuff together into one package. We do have that now with the training that we provide both to our coordinators in the field division and the state and locals who participate in this so that they get very clear instructions as to what the goals of the program are, what the responsibilities of each of us would be as we move forward on this. So we have made considerable improvement in that.

Mr. KOLBE. You are looking at going from 38 to 50 cities with the additional funding you are going to get. What is the criteria for adding new cities to this program?

Mr. BUCKLES. The criteria—I will tell you roughly, because I may miss something here, but it is generally it has to do with the amount of violent crime in the city, crime involving youth. There are about five factors detail of which is found in my statement for the record.

For 2001, we have identified a range of cities that we are looking at right now. We have contacted cities to see who wants to be involved and who would be committed to the program, and once our appropriation is approved for this fiscal year, we are prepared to move forward with adding the additional cities.

Mr. KOLBE. Mr. Schindel, I know you looked at the 17 original cities, but is there any evidence that the local field offices play some role in making the recommendations for evaluating this criteria?

Mr. SCHINDEL. Not in the original 17 cities. I think that was in part based on the criteria of cities that had expressed an interest in participating, had a concern about youth gun crime in their city, and I think a number that were participating in a program called COPS.

Mr. KOLBE. Yes. I think that was one of the criteria. Mr. Buckles, when you went from 17 to 38, did you have more applications than that? Did you have to say yes to some cities and no to others? Was there a formalized review of this?

Mr. BUCKLES. I could not answer that specifically. I would have to supply that for the record. [Agency note: Based on where those cities fell in our ranking guidelines, we tried to address those with more critical problems first. The balance were moved to the list of potential candidates for the next year.]

Mr. KOLBE. I would appreciate it if you would.

Mr. BUCKLES. I have been told that we have had more cities that want to participate than we can bring in each year.

Mr. KOLBE. Mr. Schindel, in your report you say that there are four police departments not submitting trace requests. Two told you—this is the original 17—two told you that because they do not have a computerized system for trace-requests submission, third was submitting some trace requests, but not all due to problems with the computer system, but then there was a fourth one that did not participate at all, did not submit trace requests, did not have

a YCGII representative, and yet it still included an ATF budget request and statistical reports on YCGII. Is that correct?

Mr. SCHINDEL. Yes. That is correct.

Mr. KOLBE. Mr. Buckles, what has been done by ATF about this city that does not participate? Why has not it been replaced?

Mr. BUCKLES. They have been dropped.

Mr. KOLBE. They have been dropped?

Mr. BUCKLES. Yes, and replaced by another city.

Mr. KOLBE. So it is no longer one of these 17. Was that recently?

Mr. BUCKLES. Yes. [Agency note: Inglewood, CA, was dropped and replaced by San Jose, CA. Likewise, Bridgeport, CT, and Salinas, CA, are also under review to determine their continued participation.]

Mr. KOLBE. In the last year or two? Do you rely on the evaluations from your local field office about the criteria about recommendations for cities that might be included in the next round?

Mr. BUCKLES. As we get the proposed cities through our system, we consult with our own field divisions about their sense of the police departments involved and their commitment to be able to work with us as we move forward.

Mr. KOLBE. Last question so I can go back to another round for everybody else here. In March, Mr. Buckles, you told this subcommittee that "personnel may be called upon to provide assistance." You have talked about now the YCGII personnel in the cities, "called upon to provide assistance in other activities, if available, and on a case-by-case basis." But isn't it really kind of the opposite? Isn't YCGII just kind of an add-on activity for your agents, and it is kind of the last thing that gets assigned to people?

Mr. BUCKLES. Well, I do not believe that that is the case. YCGII is something that is an expansion on quite often things that some of the agents may already have been doing, but in order to make it really within the YCGII program, you have to follow it up and cover all of the bases.

We have been doing trafficking cases for years, for example, but to make that trafficking case truly part of the Youth Crime Gun Interdiction Initiative, we have to follow up with additional steps and analysis of the data and make sure we are working properly with the locals. So I think we are requiring a more complete effort to make it fit within this program, but it is not add-on work, as such. Some of it is the same kind of case, but as we get more resources, it is the ability to do more of those cases as well.

Mr. KOLBE. Mr. Schindel, did you find in your analysis of the 17 cities that the personnel turnover in ATF on this program was fairly high?

Mr. SCHINDEL. In some cities they were on their third coordinator, for example.

Mr. KOLBE. Did you find that it is a corollary duty in some cases?

Mr. SCHINDEL. Yes.

Mr. KOLBE. So it was not really a full-time assignment for them.

Mr. SCHINDEL. Right.

Mr. KOLBE. Did you find that there were a lot of junior agents that were assigned to this?

Mr. SCHINDEL. No. I think we found that mostly they adhere to that requirement to assign experienced agents where they had them.

Mr. KOLBE. Okay.

Mr. BUCKLES. Mr. Chairman, I may have misunderstood your question before if we are talking about add-on duties. If you were asking me about the YCGII coordinator, that would have been probably an additional duty placed upon a member of the division staff who had other responsibilities of program monitoring responsibilities within that division. So if I misunderstood your question the first time, I apologize.

Mr. KOLBE. Mr. Hoyer.

Representative HOYER. I am prepared to have you go on and ask questions. I am finding you have it pretty well organized there. I have got some other questions, but I will submit them for the record. I would like to hear the answers to questions you are asking.

Mr. KOLBE. Well, let me just try a couple more, then. I think I am coming close to the main ones that I wanted to get through here.

Mr. Schindel, the report, your report, indicates that the ATF headquarters guidance describes critical activities that the field offices really need to be performing, reconciling the trace requests with the actual crime guns that are recovered, conducting the end-to-end traces of a sample of routine cases, and working closely with industry operations to target the licensees that have the highest number of guns traced to them.

But I think you found that really of the 17 cities only two of them—and that goes back to that criteria that Mr. Price was talking about—in only two cases they were doing it in all of the three that you labeled there. Did you analyze as to why they were doing some of the things and not all of them there?

Mr. SCHINDEL. I think in some cases—

Mr. KOLBE. Manpower, or was it simply a misunderstanding?

Mr. SCHINDEL. I think in some cases they were not fully aware of what all of the requirements were. In some cases I think that they felt that they had too many other duties to handle.

Mr. KOLBE. So partly manpower, partly that there was not any clear direction.

Mr. SCHINDEL. A number of them had their own case load. They were investigating cases as well as handling this responsibility.

Mr. KOLBE. I have the impression that there is really not a clear focus for this program and that it is kind of—you get a sense from reading Mr. Schindel's report that it is kind of—maybe this is too harsh, but it is kind of an seat-of-the-pants, fly-by-night kind of program, and that in each city the agents kind of interpret it in their own way here as to what they are supposed to be doing. I do not see a lot of national direction to this as to what they are supposed to be doing.

Mr. BUCKLES. Well, you would not see that now, but let me back up to that question, because the perspective and function of this initiative has indeed evolved. You have to remember that the first time we received any FTE for our field component of the Youth Crime Gun Interdiction Initiative, was in the Fiscal Year 1999

budget. We had received funds before, but most of that was related to increasing the capacity of the tracing center and other technology changes. And, quite frankly, we were trying to push that out and be as aggressive as we could.

At the same time we really did not have any more people on board than we did before. You are talking about the middle of Fiscal Year 1999 before additional FTE were brought on. We were losing as many people as we were bringing on. We had not started really getting ahead in terms of the amount of resources we had, but we were still committed to make the youth crime gun initiative work.

And seat of your pants; I do not know. That has a lot of different implications, but I will tell you, we were doing it as a stretch. We had people who were working very hard to try to keep this going and to get it up and running without, at that particular point in time, mid-1999, any big boost in the resources. That has come since then.

And I think that you would find a very different situation today as you look at it. We have been able to hire people. We have had difficulty in almost every program we have in management of offices and of having people in place a long time. We are a young agency. We have had a lot of people retire, and we have been pushing people up through the ranks and changing jobs, but these are issues we are working through, and we are determined to address them and make sure that we have got systems in place that are not just relying upon having an old salt there that knows what to do and is used to dealing with people. We will have systems in place and measurements in place so that when we meet with you again you will see a very, very different picture, and we will be able to paint out exactly what it is we are getting of this program.

Mr. KOLBE. Well, I guess what I meant when I said "seat of the pants" is—I will put the question another way. If I were an ATF agent today and working for us, and I was named the YCGII coordinator in my own city of Tucson, would I know what the heck I am supposed to do?

Mr. BUCKLES. Well, you would be brought in for a training.

Mr. KOLBE. You have a formalized training program now—

Mr. BUCKLES. Yes, we do.

Mr. KOLBE [continuing]. For the coordinators?

Mr. BUCKLES. Yes.

Mr. KOLBE. How long is that training?

Mr. BUCKLES. I think we had a week-long workshop where we had all of the YCGII coordinators in and state and local counterparts, and we have continued training planned into the future so that we have a constant effort there with both our people and our partners to know what everyone's responsibilities are, what we have all agreed to do, because those agreements can get put, either at a police department or ATF, in a folder somewhere, and it requires additional efforts to make sure everybody continues to be aware of what their responsibilities are.

Mr. KOLBE. A conference of field coordinators and their local counterparts does not sound exactly like training to me. You would have an annual conference of your YCGII coordinators maybe to go over what you have done, but do you have a training process of

when I am named the coordinator that I am going to be brought in for a training process, or do I just wait for the annual conference and come in and learn it at that time?

Mr. BUCKLES. Well, let me provide for you for the record, if I could, what we have done to make sure that our coordinators know what the programs are and know what their responsibilities are and also that the people we deal with. If I try to get too specific on this, I will probably stumble, but I will give you the specifics on it for the record. [Agency note: Training now being provided is itemized in the statement for the record and in ATF's response to the IG report.]

Mr. KOLBE. Mr. Schindel, did you find that the YCGII structure was consistent from city to city, or did it vary quite a bit?

Mr. SCHINDEL. I do not think there is really necessarily a structure. The YCGII coordinators could be in different functions in the different SAC offices, in some cases in the intelligence function and in other cases in a different function, so there is no structure. I do not think there are YCGII teams, per se, of all of the folks that work YCGII cases all in one group. They can be agents scattered into different groups who get assigned YCGII cases. So there is not a structure, per se.

Mr. KOLBE. What I am hearing is that YCGII is just kind of an overlay of a program and picks agents. For an hour a day they might be working some YCGII cases, but then they are back over here to other assignments here. They are doing other things.

Mr. SCHINDEL. Other than the coordinator, who should have more—

Mr. KOLBE. Other than the coordinator.

Mr. SCHINDEL [continuing]. Of a full-time post.

Mr. KOLBE. That is your understanding of the way the structure of it is?

Mr. BUCKLES. It varies, actually, in cities. If you have a large city, a large field office, one of the groups will be a trafficking group, and almost all of what they do would be trafficking cases that would fall within the YCGII program. If you talk about a smaller office, such as Tucson, where we have got an office with a small number of agents, those same agents have to be working a trafficking case if that comes up, or if there is a bombing, they have got to be prepared to deal with that. So in smaller offices, frankly, the agents have to do a little bit of everything. Trafficking and ways that help focus on youth is one of their main responsibilities.

The extent to which we can work on these cases has to really be viewed on a macro level because every case, even if I take a trafficking case, a youth-crime-gun case in Chicago, some of the work on that case, or maybe a lot of the work that comes out of that, will be in Mississippi because that is the source state. So we will have agents in Mississippi who will be working on a particular investigation that is actually a YCGII case out of Chicago but deals with a source state in Mississippi. Inspectors associated with the youth crime gun initiative may well be placed in Mississippi to deal with the Chicago problem. We have one inspector for the entire state of Mississippi, but it is a major source state of firearms going to Chicago.

So when we assign inspectors, we tried to come up with this as a model and not a cookie cutter that Chicago is going to get six agents and two inspectors. We have got to look at it as a model of what we need on a macro level. We are a nationwide organization. Trafficking problems cross state lines in most cases, and we have to have resources in every state that are prepared to step in and contribute when it comes to working on these cases. [Agency note: The statement for the record elaborates on how we have recognized geographic patterns that affect work load and resource management.]

What we will have to do in terms of monitoring the amount of resources we are putting into this program and making sure we are committing what we need to is look at overall records of where we are expending our resources. We have time- and case-management systems that demonstrate to us where our work is being conducted, the kinds of cases that are being worked that are managed by field offices, that have YCGII as something they have got to accomplish, that is, in their performance evaluation, and then monitored on a macro level at headquarters.

Mr. KOLBE. Okay. Finally, let me just ask about the cities that enlist in this program. I am concerned about the coordination with them, the amount of inspection that they have and the cooperation level. You mentioned also that there was a conference where your coordinators come in, and you bring in the counterparts from the cities. Does part of the change of your YCGII coordinators include training the person in the city that is going to be the coordinator?

Mr. BUCKLES. I do not know if training would be the proper word, but, yes, I think that that is part of the responsibility—

[Agency note: Each office has now in place an agent who is tasked with training State and local partners. We also maintain a roster of all agents designated as coordinators, so that we keep any agents new to the program properly informed.]

Mr. KOLBE. The key to this program, this program does not work if they do not provide all of the information for gun traces. Is that not right?

Mr. BUCKLES. Correct.

Mr. KOLBE. And we have already seen that in some cases we did not get all of that, and some cities are not providing all of that. So I would assume from the very beginning the emphasis has got to be on the city. We are going to have to do this. We are going to help you with this. We are going to give you this information. You in return have to give us the raw data.

Mr. BUCKLES. Yes. All of these are things that we have addressed that came out of the inspector general's recommendations, and we have taken steps to implement every one of the recommendations made by the inspector general's office. That is why maybe there is a disconnect here.

He can describe what the problem was, and I am trying to make it sound like there is not a problem, but it is largely because we have recognized the problem that existed and that we have taken a whole series of steps in each one of these areas to address the problem of making sure that our partners know their responsibilities, that we set up systems where we are monitoring whether or not the police department is actually sending in the traces so that

we will get sooner feedback if there is a problem. So we have set up systems now to try to address all of these issues.

[The information follows:]

REPORT NUMBER: OIG-00-119 TITLE: Implementation of YCGII (Final Report issued August 21, 2000)

(GRAY SHADING INDICATES A COMPLETED ACTION)

FINDING 1: FIELD OFFICES NEED ADDITIONAL GUIDANCE

OIG RECOMMENDATION: Existing guidance be updated to include a model of best practices			Due Date
Exception Noted/ Action Item	Assigned to	Status	Due Date
Updated guidance, including seminars, conferences briefing for Div. Dir./field coordinators/prosecutors and State and local officials for training and educational purposes.	FEA	Combined workshop with S&L LEO's approved and being coordinated, tentative for November	Nov 2000
		Best practices pamphlet is in draft	Nov 2000
OIG RECOMMENDATION: A formal methodology is developed and records maintained for allocation S/A resources and where to place the coordinator in each Field Office's organizational structure			
ATF is now using an average number of s/a per city instead of requiring a specific number. Appropriate.	FEA/FO	Workload study on firearms enforcement to be expanded using demographics and new geographic trafficking info for formulaic approach. Need to articulate formally.	Jan 2001
Placement of coordinators in Field Offices		Recommendation to place function in Intel unit made, workable for some; need to meet with Field Ops to discuss flexibility, expectations, articulate and document role	Jan 2001
OIG RECOMMENDATION: Field Offices appropriately implement the revised guidance and S/A resource allocation methodology <i>Among items which answered this to their satisfaction:</i>			
Contract is let and employees are in place for a 10 city pilot program using contract employees for FIA trace process (now with Treasury FBA. Original solicitation pulled)			
Presentation to Division Directors on relevant workload requirements by SAC Resource Management, continued reinforcement also provided at various management meetings			
YCGII Director provides input to evaluations of Division Director on program efforts (in place)			

REPORT NUMBER: OIG-00-119 TITLE: Implementation of YCGII (Final Report issued August 21, 2000)

FINDING 2: BETTER COMMUNICATION NEEDED BETWEEN ATF AND POLICE DEPARTMENTS

OIG RECOMMENDATION: Specific guidance for cities to use to determine what activities are important and what resources are needed			
Exception Noted/ Action Item	Assigned to	Status	Due date
Certain field offices have not initiated regular communication with PDs to determine whether cities were submitting trace requests as a result certain PDs aren't performing activities ATF considers important	FEA	Requirement reiterated at previous workshop; next to include S&L's, YCGII training delivery started; reinforces same again.	
OIG RECOMMENDATION: Implement procedures to terminate the statement of participants with cities withdrawing from YCGII, and exclude them from future statistical reports on the program			
Exception Noted/ Action Item	Assigned to	Status	Due date
One city continued to receive ATF support after stopping participation in YCGII	FEA	City has been removed and replaced by another; replacement will be announced with the 12 new cities	Oct. 2000
OIG RECOMMENDATION: Continued efforts to help cities implement electronic trace submission systems			
Exception Noted/ Action Item	Assigned to	Status	Due date
Revisit early member cities	FEA	Planned re-assessment of all participants; replace hardware as needed	Spring 2001
OIG RECOMMENDATION: ATF field offices should facilitate police department access to analytical tools.			
Exception Noted/ Action Item	Assigned to	Status	Due date
Police department representatives were not aware of on-line LEAD	FEA	ATF personnel have visited new YCGII cities; ATF provided firearms related training to PD personnel, including capturing firearms information needed for tracing	

REPORT NUMBER: OIG-00-119 TITLE: Implementation of YCGII (Final Report Issued August 21, 2000)

TITLE: FINDING 3: Performance Measures and Data Verification Needed

OIG RECOMMENDATION: Development of performance measures			
Exception Noted/ Action Item	Assigned to	Status	Due date
Performance Measures: continued development	FEA	New measures based on YCGII tables need to be reviewed, best items articulated; awaiting replacement of program managers, group to work with outside academic	FEB 2001
Assessment: ways to measure performance unique to this initiative	FEA	Following the Gm published June 2000, New instructions issued defining a YCGII case and capturing additional information, NIJ MOU signed	
OIG RECOMMENDATION: Procedures for data verification are developed to ensure the validity and accuracy of the performance measures			
Exception Noted/ Action Item	Assigned to	Status	Due date
Quality of Data	FEA/NTC	Assess additional ways to improve overall data quality of NTC: need to assemble and task a diverse user group which will make recommendations	March 2001
Errors in data verification process; raise concerns about reliability of and method of gather YCGII statistics	FEA/NTC	Process established to review completion rates in annual extract for each calendar year report; submit to field for correction; utilize contract assistance in field for comprehensive data; revise quarterly reports	

Mr. KOLBE. There again, what kind of assistance do you give the city in making use of this data when you have compiled it?

I just opened it randomly to Minneapolis, and there is page after page here of juveniles, youth, adults, age unknown, percentages of crimes with firearms, homicide, kidnaping, and so forth. What kind of use do you make of this data for the city, and how do you help them make use of it?

Mr. BUCKLES. Well, one of the commitments we have is that we will work together to review those reports and identify where the information can help us develop a strategy for addressing gun violence in their community.

Mr. KOLBE. You say that is a goal that you have now?

Mr. BUCKLES. Yes.

Mr. KOLBE. Okay.

Mr. BUCKLES. I think it was our goal before, but the IG pointed out that we were not always following through on that, but that was a stated goal earlier on in the program, and they found that there was a deficiency in that, that in some cases we had local partners who were saying they give me the information, but they do not do anything to tell me what to do with it. In other places we would find that that is a very actively used document for defining strategies, but the IG made it clear that in other places it was not being used as intended.

Mr. KOLBE. Mr. Schindel, you are finding that local law-enforcement agencies simply did not know how to use this data?

Mr. SCHINDEL. In some cases that was the situation. They were not aware of things, like I said, the on-line lead. I think on-line lead is an issue that ATF needs to figure out how to address because it is not available to police departments on line. I do not think ATF wants to make it available on line because there are some issues associated with that, but some of the police departments said it is not readily available to them, and in some cases they felt it was inconvenient to get at the information. They have got to actually go into an ATF office and use their system. So that needs to be addressed a little more. I think they are addressing it with some of the actions that they are taking.

The coordinator role is probably in some sense a marketing role, too. They have got to market this program to the local city police departments, to some extent, because it is voluntary on their part, and they have to see a benefit to it. So being able to provide that information, for example other information that some police departments were looking for was the ability to use mapping data to be able to identify pockets of areas where crime guns are being recovered. They wanted that information, and it was not always readily available to them.

Mr. KOLBE. I would agree with you. I think that is a key part of this, and maybe what was missing, and hopefully we are correcting that, is the marketing aspect of this thing. It only is going to be as valuable to the local law-enforcement agencies as the cooperation they have with ATF, and they know how to make use of this data. I will probably have some additional questions for the record, but let me see if Mr. Goode has some additional questions.

Mr. GOODE. A couple of questions.

Mr. BUCKLES. It is not another legal question, is it?

Mr. GOODE. No, sir. You get these firearms that are committed in crimes. Are all of them confiscated, or do you ever turn any of them—if they are stolen, I guess you give them back to the owner. What do you all do with the ones that were illegally obtained, the ones that do not go back to the—

Mr. BUCKLES. There is a very specific procedure in federal law as to what we have to go through to forfeit those firearms. There are time periods we have to comply with. There is notice—

Mr. GOODE. Do you resell them, or do you just usually destroy them?

Mr. BUCKLES. They have to be destroyed. Under GSA regulations—

Mr. GOODE. I can resell—I mean, you know, a sheriff's office can resell.

Mr. BUCKLES. That is right. Many local jurisdictions, they do. Federal-property rulings published by GSA require all surplus or forfeited firearms to be destroyed. They can be converted to official use if they were something susceptible to that.

Mr. GOODE. If you call up a manufacturer and say, "Hey, we have got—this is a Colt serial number this and make this," do you keep any record of guns in crimes with regard to manufacturer source?

Mr. BUCKLES. Yes. Do you mean would we be able to tell you how many from each manufacturer or type of firearm was traced? Yes, we would.

Mr. GOODE. Okay. That is all I have, Mr. Chairman.

Mr. KOLBE. One last question, I guess, and we have got a good wrapup kind of a basis. Looking at the YCGII funding history, going from \$300,000 to the request for this year, and I believe our budget gives it all to you, \$76 million, as I listened to the answers to these other questions, it sounds to me like the key to this program is the cooperation and the involvement of the local law-enforcement agency, that they have to participate in giving you this data, that you would be doing this anyhow. You would be doing these gun traces now, with or without the YCGII program, YCGII program funding for it. Is not that essentially accurate?

Your job is doing this kind of tracing. You would be doing this whether or not we have formally called it a YCGII program. And I guess I am wondering what the funding really enables you to do that you are not able to do today if you did not have this. It is more additional personnel, I gather, although we heard the personnel were not assigned specifically to this task except for the coordinator.

Mr. BUCKLES. Right. The significance of this is twofold. One, it is essentially a trafficking and firearms source project that is trying to give us information that we can use both to make trafficking cases and find other ways that we can impact violent crime. That is something that ATF has always done to some degree or other, and that has expanded our ability to do that.

In terms of it being a youth crime gun initiative, it is centered around youth and crime guns because of the figure I told you earlier, with 41 percent of all of the violent firearms crime being committed by people in this age range, that provided a focus, both of where the biggest problem was and also potentially where we could

make the greatest difference in and change people's lives. If youth did not get involved in firearms, if they did not commit firearms crimes, you have a chance to make the biggest impact in terms of the future of violent crime as well.

So the program itself is part of what the Gun Control Act was designed to do. It makes dealers keep records so that people can find out where crime guns came from. That is the whole purpose of the Act, going back to 1968. This is just a way in which we are highlighting exactly how we are trying to take those authorities and tools and deal both with the larger issues of source guns on crime with a slant on it that allows us to look at probably the most vulnerable and potentially most affected section.

Mr. KOLBE. If you did not have all of this funding, you would not be able to do all of the tracing or this empirical data, collecting this empirical data.

Mr. BUCKLES. No, sir. Our tracing system before was used primarily as a service. If you had a law-enforcement agency where they recovered—

Mr. KOLBE. Came to you with a specific gun.

Mr. BUCKLES. They recovered a crime gun at a scene. They wanted to see if they could get a lead on finding out who committed the murder. They would trace the firearm. We would tell them who purchased it.

This allows us actually to be more carefully focused on what we are doing on the sources of crime guns.

Mr. KOLBE. Mr. Buckles, Mr. Schindel, I thank you very much both for being here. Ms. Rickey also. Thank you for your testimony. I think you have helped add some light, at least, on this program and certainly given us additional food for thought as we go into the next budget cycle. We appreciate the frankness with which you gave your answers today, and I think you have helped this subcommittee do its work. So thank you both very much for participating in this. And without objection, the subcommittee stands adjourned.

YOUTH CRIME GUN INTERDICTION INITIATIVE

Questions for the Record

Issue: Headquarters Implementation of the YCGII Program

The OIG report indicated field offices have not always performed YCGII activities, in part, because either the field office was unaware of existing guidance, or existing guidance did not sufficiently describe how to implement YCGII in their communities.

1. What is ATF policy regarding the staffing of a YCGII field office in terms of the number of personnel and experience levels that should be assigned to the program? Are field office supervisors in compliance with YCGII staffing policies?

We should note that the OIG report, based on the first 17 cities, is a snapshot in time, and our responses to the OIG indicate the progress made in this area. The majority of the special agents, as noted in the report, are of a journeyman level. Other agents are assigned based on their ability to handle certain facets of this project. We have made a conscious effort to develop new agents with these priorities in mind. There is great utility in assigning junior agents to participate in this effort where appropriate, and this actually suggests an increased priority to involve junior agents in these investigative techniques. All new ATF special agents and inspectors who have been hired since 1998 have received three days of "firearms trafficking training." This places strong emphasis on YCGII, firearms tracing, and the detection and investigation of firearms trafficking and preventing firearms violence. The base tool of the initiative, the comprehensive trace, is needed to develop competence in firearms investigations, and new agents must realize the value in use of the crime gun information and associated offense data. We are also concerned with the apprehension of those under the age of 24 who unlawfully possess firearms from the standpoint of prosecuting those who fit the local guidelines, and this type of work again is basic and should be undertaken by newer agents. Those instances where a more complex trafficking scheme is apparent are handled by the veteran investigator, notably with the junior agent in an apprentice role.

YCGII is one of the Bureau's highest firearms enforcement priorities. We are aware of the bipartisan commitment of this Committee to eliminate youth and juvenile firearms violence and we are equally committed to stopping the senseless violence. As stated, we have used YCGII as an opportunity to have focused enforcement become a standard, articulating an overall goal or increased sense of purpose to the enforcement work.

2. Where should the YCGII program fit in a field office's organizational structure?

In general, the YCGII Coordinator would be located where it best meets the needs of the Field Division and many have an agent tasked at that level, either in an Intelligence Group or otherwise reporting to the Division Director's staff. Many have integrated this function into either a YCGII squad or the Firearms Trafficking squad. However, a coordinator's placement will depend on many factors, such as the location of the YCGII city in relation to the Field Division. The special agents and support personnel involved in case work would most appropriately be located in a field office or group.

Issue: YCGII Policy Implementation

1. What is ATF doing to ensure a minimum level of training and participation by local law enforcement?

We have conducted seminars and workshops to include ATF Division Directors, ATF field coordinators, field agents, U.S. Attorneys and State and local officials for training and educational purposes. We have planned a combined workshop with State and local law enforcement and are completing the agenda and site selection. We have also produced several training aids and courses to assist State and local law enforcement personnel in developing competence and expertise in firearms enforcement. Our Crime Gun Analysis branch, as a matter of course, briefs local law enforcement during their city assessment. The following are examples of our efforts:

Firearms Identification and Tracing. In 1999, ATF developed a training protocol to train in firearms identification and tracing procedures for Federal, State, and local law enforcement officers participating in YCGII. ATF field agents who trained on the use of the YCGII Instructor CD-ROM delivered it locally. Specifically, ATF designed two separate blocks of training, "Characteristics of Armed Persons" and the "YCGII Firearms Identification and Tracing Procedures," that could be presented together, separately, or combined with other related blocks of training, cafeteria style. To date, ATF has delivered this training to more than 2,387 law enforcement officers. Hundreds more are scheduled in the next few weeks.

The aforementioned training of 2,387 law enforcement officers is just the beginning of this training. ATF has recently completed the development of a CD-ROM that contains all of the audiovisual and support materials needed by an instructor to deliver "YCGII Firearms Identification and Tracing Procedures" class. ATF subsequently trained 37 special agents in the use of this CD-ROM and the presentation of this material in July and August, 2000. The Office of Training and Professional Development (TPD) developed this training program and the YCGII

CD-ROM to enhance accurate firearms identification and successful tracing procedures for State and local police officers, Federal law enforcement officers and ATF personnel in support of the Youth Crime Gun Interdiction Initiative.

Illegal Trafficking Investigation. Due to the important role of firearms trafficking investigations in the reduction of violent crime, the International Association of Chiefs of Police, in a program funded by the Department of Justice's Bureau of Justice Assistance, continued to provide training for police departments interested in starting comprehensive crime gun tracing and trafficking enforcement programs. ATF offers a week long Firearms Trafficking Techniques course for ATF special agents, inspectors and other ATF employees, as well as State and local law enforcement officers who are proactively involved in firearms or firearms related investigations. This course provides the students with the knowledge, skills, contacts and materials needed to identify, investigate and prosecute those persons who are trafficking guns, making them available to juveniles and youth. This course was recently delivered in Tucson, Arizona (June 14 through June 19, 1999) to more than 75 participants, including two Assistant U.S. Attorneys and several Arizona police officers, and more recently in Chicago (November 28 through December 3, 1999) to 97 participants, including 64 State and local officers and one Assistant U.S. Attorney.

Training in Restoration of Obliterated Serial Numbers. ATF continues to work with police departments and law enforcement laboratories to restore the obliterated serial numbers on crime guns, and to develop local coordinated enforcement efforts to trace and proactively target leads derived from recovered crime guns with obliterated serial numbers. ATF has developed a three-day session of instructional and hands-on training for State and local investigators and firearm examiners covering the importance of restoring obliterated serial numbers and tracing those firearms. Thirteen schools were held in fiscal year 2000, five in YCGII cities.

NTC Firearms Identification Guide. To address the problem of uncompleted traces due to faulty information on the trace request form, the NTC is developing a CD-ROM that will train the law enforcement community in firearms identification. The CD will contain graphic illustrations, historical data and specifications on the 100 most frequently traced firearms. The CD is intended to be a stand-alone training aid that can be utilized by everyone from entry level personnel to senior investigators to crime laboratories. The CD can also be used to print hard copy material for handouts and presentations.

National Firearms and Toolmark Examiners Academy. The mission of the National Firearms Examiner Academy is to provide training for apprentice/entry level firearm and toolmark examiners from Federal, State and local law enforcement agencies. The curriculum is composed of the fundamentals of firearms and toolmark examinations and will serve as the basis for the trainee, under supervision, to develop into a qualified firearm and toolmark examiner. This is a unique, one of a kind program, with a year-long protocol, to which YCGII city members are given preference.

2. Given the variation in agent resources being used in the different communities, could you provide the subcommittee with actual figures for the costs and staffing per city?

The attached field chart addresses field agent resources for solely the firearms enforcement areas exclusive from other mission areas. As you can see, this YCGII effort ranges from specific dedicated squads to groups with YCGII as a major part of their enforcement focus. Actual expenditures for both hours worked and funding expended are not yet available. We are currently in the process of closing the fiscal year and won't have documents posted for a few weeks. We would be happy to provide preliminary numbers as soon as they are available.

Issue: YCGII Performance Reporting**Questions:**

The latest tracing report for YCGII on the ATF website covers the period of August 1997 to July 1998. In March testimony ATF reported that the "the next report on the YCGII cities will be issued in the next three months and will cover information based on the calendar year instead of the Federal fiscal year."

1. When is that report going to be released?

The report is completed and is planned for release in November 2000.

2. The OIG report noted that the tracing data raised questions about the accuracy of YCGII statistics.

⇒ What is ATF doing to ensure accuracy and comprehensiveness in such reporting?

The Director of YCGII held a workshop last fall in West Virginia which all ATF field coordinators were requested to attend. YCGII, along with the core concepts of handling and using firearms information were explored in great detail. The YCGII coordinators were provided with a flat file disk and instructions for updating their cities trace information. Comprehensive tracing is monitored by the NTC and the results are produced on a quarterly basis. These quarterly reports are provided to the Division Directors who have YCGII cities located in their field division and to senior management personnel of the Office of Firearms, Explosives and Arson.

Another significant change which resulted from this planning meeting was a total revamp of reporting instructions, to include clear instructions on identifying the appropriate investigative work to be associated with this initiative. These reporting instructions and the accompanying formats were issued at the end of the calendar year, with requirements to capture FY-00 data in this new format.

We also have underway a pilot with contract employees to facilitate the tracing process, with an eye toward expanded tracing demands. This will address those cities with weakness in their tracing process.

- o To the extent that all crime guns are NOT being traced, will the statistics reflect that?

We have changed the make up of the annual YCGII reports, to accommodate both a national overview and one for each participating city. Incorporated into the "city specific" reports, are several tables which measure the adequacy of the firearms information being obtained, a "report card" of sorts for local management.

3. What is the value of tracing information as a measure of success of YCGII?

ATF established the YCGII in 1996 to focus special agent and inspector resources on reducing youth gun violence. To increase our effectiveness, we resolved to equip our agents and inspectors and their State and local counterparts with more information about how violent youth obtained guns. We asked our colleagues in State and local law enforcement to help us systematically "follow the guns" used in crime to identify gun criminals and their illegal suppliers by tracing all crime guns with the National Tracing Center.

These individual crime gun traces, which use a gun's serial number to track its transfers from manufacturer to retail purchase by a gun owner, lead law enforcement to sources of illegal diversion, gun traffickers, and violent criminals, and contribute to successful prosecutions. In the past, the first case an agent made with trace information would likely have been the last use of that information. Every investigator would start a new case relying on new leads. As the *Crime Gun Trace Reports* demonstrate, that era is over in law enforcement. Today, the criminal investigator can access, search, and analyze investigative and case information contributed by hundreds of his or her colleagues, to gain additional facts and strategic perspective.

Collecting and analyzing information from thousands of crime gun traces supplied by Federal, State, and local law enforcement is helping us gain a more precise picture of the crime gun market, and provide investigative and strategic direction to enforcement aimed at youth gun crime. This year's reports, the third annual publication of *Crime Gun Trace Reports*, include a *National Report*, and a series of *Individual City Reports*, that will provide complete information on the trace results in those cities.

Of great value to law enforcement are the lists of guns that are repeatedly showing up in crimes, and that do so rapidly after purchase, which may indicate a possible criminal intent associated with the original transaction. Every city has its own crime guns and patterns, reflecting local conditions, but certain national patterns are evident. All of law enforcement can use this information to tailor investigative strategies to the most violent criminals and to juveniles, local "hot spots", and illegal sources of guns. Knowing the changing trends in crime guns is also vital to protecting officer safety. Law enforcement officials also benefit from knowing the geographic sources of crime guns. New county-level information will facilitate task force organization.

Crime gun tracing, analysis and its complementary tool, ballistics identification, are rapidly transforming firearms enforcement. We cannot completely stop violent criminals from using illegal means to acquire guns, but we can track their methods with greater precision than ever before, intervene to stop trafficking schemes, investigate both the illegal supplier and their criminal buyers, and fully enforce our Nation's firearms laws to deter and hold accountable those who misuse firearms. But we are only at the beginning of the new era of using available crime gun and ballistics information to solve and prevent gun crimes.

As we have shown with the annual trace analysis, following the gun to the criminal and the criminal supplier, and using the variety of information at our disposal provides a wide range of beneficial indicators for immediate use. Law enforcement officials use crime gun characteristics (possessor's age, firearm type, the time-to-crime, the geographical source of traced crime guns, and obliteration information) alone and in combination, as likely indicators of illegal diversion of firearms, which can be investigated to find illegal traffickers, gun thieves, illegal gun possessors and armed violent criminals. Other indicators include ballistics images, multiple sales information, reports of lost and stolen firearms, and background check denial information. This information assists law enforcement officials at the Federal, state and local levels in assessing the local crime gun problem and deciding how best to deploy limited criminal and regulatory enforcement resources against gun criminals. Knowledge of what crime guns criminals are using is also an important consideration for officer safety.

- ⇒ Should ATF be implementing other performance measures, such as specific crime statistics, health statistics, adjustments for demographic or other trends?

The current performance standards used are consistent with the major areas from which this Initiative evolved: firearms tracing and firearms trafficking investigations. Both are considered to ascertain if the level of comprehensive tracing is being achieved, and if investigative follow-up is being done on the trafficking end. ATF, as stated, published, "Following the Gun", which looked at all trafficking investigations from 1996 to 1998. This report provides some truly exceptional insight into the intricacies of these cases, but more importantly, gave us direction on additional work that could be done to more adequately measure the effectiveness of our work.

Recently, we examined our firearms investigative docket and learned that over a quarter of ATF's investigations into the illegal diversion of guns involved felons. This allowed us to confirm what ATF agents and their State and local colleagues have known but not previously documented -- there is a sizable illegal market in firearms that felons, juveniles and other illegal possessors of firearms use to obtain guns. It includes corrupt Federally licensed dealers who ignore the results of background checks, straw purchasers, unlicensed sellers, and traffickers in stolen firearms, among others.

Listed below are other areas which we intend to examine and consider as possible indicators of the performance of this program. We have convened a working group that will study and provide recommendations:

- Reduction in the "time to crime" of firearms possessed by violators, as this can tell us if we are forcing the illegal market buyers further away from legal commerce.
- Reduction in the average number of guns trafficked per investigation, as this is indicative of ATF's ability to interdict trafficking schemes early on in their development, mainly through our advances in information technology.
- Reduction in the percent of the population illegally possessing guns comprised of persons under the age of 24.

There is currently underway a joint assessment demonstration project with the National Institute of Justice (NIJ) which is in the formulation stage. This will develop relevant, longitudinal measures. A copy of the relevant draft documents and tentative agreements has been previously supplied to Government Accounting Office.

⇒ Is ATF considering using a case classification system to separately track YCGII investigations?

We have a project underway to make modifications to our electronic reporting systems, "N-Force" and "N-Spect" so that we can accurately capture time expended and investigative data relevant to this initiative. We recently transitioned from the previous case management system and are making improvements to facilitate accurate reporting. The OIG indicated during their review that they felt there was an undercount of YCGII activity. Currently, the system does not allow for reporting under multiple profiles. Personnel also have the capability to report time directly into the Simplified Time and Attendance System (STATS), which is done routinely, identifying the specific project to which their time has been committed. We relied upon statistics during the last fiscal year to facilitate our oversight of the level of field implementation.

**Issue: Next Steps
Questions:**

1. Improved policy guidance:

- o What is the schedule of field seminars and similar communication efforts?

We currently have planned seminars that would bring in people from both ATF and police department representatives, which will be held in two locations to accommodate everyone geographically. Due to a turnover in personnel, this was postponed from its intended dates this past spring. A new program manager is scheduled to report and assist in coordinating the seminar. The tentative dates are in December 2000 and January 2001.

- o What is the status of your development of a "best practices" document for field offices?

This document is in draft and being finalized. We expect to be completed in November 2000.

- o Is YCGII performance formally incorporated into performance ratings for field division directors?

The YCGII Director has been given authority to provide input to Division Directors' evaluations. There is already a standing section to evaluate field managers on their performance in implementation and execution of enforcement programs.

2. For your methodology for sizing program resources:

- o What methodology was used to determine that the level of effort requires average of 6 agents and 4 other positions?

Agents report hours by case specific project codes. We used a combination of case time, review of local commitments by field offices, geographic and demographic factors to arrive at this average, which was actually closer to 8 special agents per project.

- For non-personnel costs, does ATF distinguish between NTC gun tracing for YCGII and other support provided by NTC and the ATF field offices? Is there an identifiable component of the YCGII program unique to such support, such as software or hardware for participating cities?

The YCGII has concentrated from its inception in laying a strategic information cornerstone of crime gun information to address this unique enforcement problem. Although the improvements have benefited the overall information capability, the YCGII cities get an even higher level of support, from equipment and, if required, specialized software projects to obtain crime gun information, to the advanced analysis of that information unique only to them. An individual assessment is also conducted to ascertain the needs that each of the cities needs to accomplish this Initiative.

3. For communicating with participating cities, including establishing expectations:

- ⇒ How does ATF ensure that communications are kept up-to-date with existing YCGII cities, which may experience significant turnover?

Part of the instructions given to the coordinators, and also to the field managers at various meetings this past year was the importance of staying in contact with their key police department contact. At a minimum, the trace information quality should be the subject of regular meetings to increase or confirm its quality. Many field offices have standing firearms task forces with the local departments, so this has not been a recurring problem. We also plan to revisit each YCGII project city this spring to re-assess their trace capability and make modifications or improvements where needed.

- What is the status of renewing MOUs with participating cities?

We are planning to renew MOUs annually. Based on recommendations from the OIG the current MOU is under review. As mentioned, if a city is not participating in comprehensive tracing and after discussions still does not wish to support the effort we would terminate the MOU upon mutual agreement.

- What initiatives are in place to help cities electronically submit trace requests, or improve coordination with ATF field offices?

YCGII cities made a commitment to trace all crime guns recovered in their jurisdictions in order to maximize investigative leads and permit analysis of local crime gun patterns by age group. While other law enforcement agencies are making similar commitments and meeting them successfully, the annual Crime Gun Trace

Reports currently include only YCGII cities. ATF makes a special effort to ensure the accuracy of the information collected for these reports.

- **Electronic Trace Submission System (ETSS)** is a stand-alone database, which enables ATF field offices and other law enforcement agencies to store crime gun trace information. It can then be exported from ETSS and the transferred electronically to the NTC for processing. In 1999, the NTC made ETSS available to all ATF Field Offices, by downloading the software from the NTC page on the ATF IntraWeb. Upon request, police departments can upload ETSS by CD-ROM. Currently 35 of the 38 YCGII cities have ETSS access, which requires information systems capability. ETSS can be installed to a local server, which will allow it to be installed on numerous computer sites while at the same time capturing all trace request data in one centralized database. There is also a corresponding user's guide for ETSS.
- The NTC is now using multiple sales records to speed up tracing. FFLs are required by law to record multiple sales transactions of handguns and to forward those records to the NTC. To facilitate crime gun tracing, the NTC began maintaining multiple sale information in a Multiple Sale Database linked to the Firearms Tracing System (FTS). When a crime gun trace request is received, the serial number is entered into the FTS. If the serial number entered matches a serial number in the Multiple Sale Database, the crime gun trace request can be closed immediately with the multiple sale purchaser information without time-consuming telephone calls to FFLs.
- The NTC is also using FFL Out of Business records to speed up crime gun tracing. When an FFL discontinues business, the FFL is required by law to forward business records within 30 days to the Out-of-Business Records Center (OBRC) located at the NTC. OBRC receives and microfilms the acquisition and disposition records and ATF Form 4473s from all firearm transactions completed by FFLs who have discontinued business.
- **Imaging OOB:** To speed up and increase traces completed through out-of-business records, the NTC is shifting from a microfiche to an imaging system that can link serial numbers to the FTS. When a crime gun serial number is entered into the FTS, the serial number will bounce off of the Out of Business records as well as the Multiple Sales Database and previously entered crime gun trace information. If there is a match on the imaged serial number, the 4473 can be immediately pulled from the microfiched Out-of-Business Records to complete the firearm disposition to either a FFL or a final retail purchaser. The NTC expects this improvement to enable the completion of many more older crime gun traces.

- To reduce trace response time, the NTC in 1999 began development of Electronic Trace Returns (ETR) to provide ATF field offices and police departments with electronic trace results in addition to printed trace reports. Currently, Federal, State and local law enforcement can submit trace requests electronically, but can only receive individual trace responses on paper. (Upon request by law enforcement agencies, the NTC will extract all a jurisdiction's trace requests from the Firearms Tracing System and provide them on disk.)
- To speed up tracing, ATF will dedicate additional resources to encourage more manufactures, importers and wholesalers to respond to NTC trace queries electronically through Access 2000, allowing 24 hour trace response by these major industry components. ATF expects an additional 7 to 10 manufactures, importers and wholesalers to join the system by October 2001.
- The NTC Crime Gun Analysis Branch (CGAB) has been increasingly active in responding to requests from law enforcement agencies for assistance in developing strategic overviews of the local crime gun problem and in law enforcement investigations and regulatory inspections. The CGAB provides law enforcement agencies with trace analysis studies and mapping of crime gun recoveries in their area, supports all of the 38 YCGII cities, maintains stolen firearms records, updates the Online LEAD crime gun information system used by agents, inspectors, and other law enforcement officials, submits custom queries to the Firearms Tracing System (FTS), and prepares the annual Crime Gun Trace Reports.
- Online LEAD is the current version of Project LEAD, ATF's crime gun trafficking information system. In 1999, the number of investigators using Online LEAD increased from less than 100 to approximately 1,400 users. In November 1999, Online LEAD was deployed to all ATF field offices, to enable ATF agents, inspectors, and local task force officers to access crime gun trace and related multiple sales information directly.
 - ⇒ What mechanisms does ATF have in place to assess the adequacy of analytic tools being made available by ATF and its field offices, including use of OnLine LEAD and participation in firearms examination training?

We are making every effort to ensure that personnel in YCGII cities are fully informed about the improvements and basic protocols of the systems available to them. ATF coordinators are meeting with local personnel to discuss technological and demographic issues, and any local police assigned to work with ATF have access to OnLine LEAD. The coordinators are also providing reports and trafficking analyses to the local law enforcement and working with local law enforcement staffs to assist in items that will allow the trace requests to be processed in the least

amount of time. As previously mentioned, 37 agents have attended the instructor's Course and have started giving presentations directly to local law enforcement on firearms identification.

4. For improving performance measurement and evaluation:

- ⇒ Are ATF statistics on investigations consistent across field offices, and are they equivalent to classifying cases as "YCGII" cases for record purposes?

Yes, these statistics are uniform for all field divisions, and result in the classification of cases as "YCGII".

- ⇒ What is the status of formalizing other outcome measures, such as "time to crime", reduction in trafficked guns seen in investigations, prosecution success, and, importantly, the larger outcome questions of illegal possession in the population?

As previously cited, we have a number of items that are generated from the current data tables for YCGII that appear to be worth considering as outcome measures. This fall, we will convene a group of program management personnel in consultation with academic experts to determine the most valuable new measures.

The agreement we previously discussed with the Committee planned with NIJ for a demonstration project was signed in September, and will be advertised for proposals to the research community.

- ⇒ What is the status of your Carnegie-Mellon study on geographic coding of data for mapping purposes, and in developing a youth/juvenile gun trafficking market analysis?

This is currently contracted as part of the "LEAD 2002" contract to perform geocoding, mapping, automated data analysis and research of the Bureau's Firearms Tracing System (FTS). The proprietors and key personnel of TruNorth Data Systems Inc. are Wilpen Gorr, Professor of Public Policy and Management Information Systems, and Andreas Olligschlaeger, Systems Scientist, Computer Science Department; of H. John Heinz III School of Public Policy and Management, Carnegie Mellon University, Pittsburgh, Pennsylvania. Gorr and Olligschlaeger are nationally recognized experts in both automated analysis and data mapping. They have done extensive work for the Justice Department's Crime Mapping Research Center.

In this contract, TruNorth has to date:

- Geocoded the entire FTS database.
- Developed address cleaning algorithms or rules specifically designed to automatically geocode and map address information contained in the FTS.
- To assist the YCGII Program, all 1998 and 1999 firearm recoveries for all 37 YCGII cities have been geocoded and mapped and will soon be available on a single CD for distribution. The CD will demonstrate the "change map" functionality, which allows the CD user to see changes over time in crime gun recoveries. Sections of a city that have experienced increases in gun recoveries from 1998 to 1999 will appear in red on the map. Areas experiencing decreases will appear in blue. Police agencies are often criticized for being slow to identifying shifts in crime areas. Using change map functionality to analyze firearm traces will allow agencies to more quickly identify shifts in crime hot spots.

One of the goals of the LEAD 2002 project is to create a system utility that will automate the geocoding and mapping processes used by TruNorth to prepare the 37 YCGII Cities Firearm Recovery CD. Such a system will provide immediate Global Information System (GIS) mapping of trace records as soon as they are in the FTS.

By geocoding address information found in firearm traces distance relationships between firearms dealers, purchasers, possessors and recovery locations can be quantified. Geocoding coupled with automated analysis can, for example: identify those traces where the firearm purchaser and possessor live in close proximity to each other; or identify those purchasers who reside a substantial distance from where the FFL is located; or identify patterns where a group of purchasers residing in one area have a high incidence of their firearms being recovered in a specific town or neighborhood.

There are many ways in which distance relationships can be used as firearms trafficking indicators, and this is a new indicator that holds great promise. The Bureau has long considered the proximity in time between when a traced firearm was purchased and when it was recovered or "time to crime" as an indicator of illegal firearms trafficking. This same concept needs to be applied to trace address information. Geocoding of address information and the use of automated analysis will provide "distance to crime" indicators which will prove to be a powerful tool in the identification and interdiction of illegal firearms sources. The LEAD 2002 Project's geocoding of FTS data seeks to do more than place dots on a map.

Geocoding of trace data also allows for the spatial overlay of trafficking patterns on top of other crime related data such as drug arrests or the FBI uniform crime reporting statistics. This functionality is particularly usefully to cities participating in the YCGII program.

Issue: Field office Implementation of the YCGII program

The OIG report cited a 1997 ATF memorandum advising its Division Directors to tell YCGII participants that YCGII funding will allow ATF to provide their departments/agencies with needed software and hardware to establish a direct link to ATF to submit trace requests.

1. To what extent has ATF provided YCGII city law enforcement with such technical support to assist in gathering this crime gun data, and what steps have been taken to assist communities in submitting crime gun information for tracing?

ATF has provided technical support in the form of hardware and software to perform firearms tracing by either ETSS or data extraction. Currently in development is a prototype for electronic trace return capability to law enforcement. Local police departments also have access to OnLine LEAD through ATF offices. Additionally, contract support, with law enforcement experience, is being provided to facilitate input of trace requests by local law enforcement.

2. What feedback does ATF provide to local law enforcement concerning its analysis of recovered crime gun traces? Is it sufficient? Is it accessible?

ATF provides highly detailed annual trace analyses of all crime guns recovered for all YCGII cities. This information provided crime weapons of choice, illegal firearms activity hotspots and more. This year, we have taken two years of tracing data, and generated a CD to be used with a mapping program, as discussed in the "Tru-North" contract results previously. The information is very sufficient, is supplied directly to the cities, and has been quite well-received.

3. Are "Gun Trace Analysis Reports" utilized by local law enforcement to effect arrests, and if so, how often?

The reports used with other information and local experience allows the localities to develop law enforcement strategies that meet their specific needs. Some departments rely heavily on this packaged assessment, and have successfully used it in conjunction with other crime data as a "pointer" to identify problem areas and the appropriate resource deployment.

Issue: YCGII Field Office Structure**Questions:**

- The OIG reported that many ATF field offices lack a formal YCGII program structure.

This Subcommittee funds numerous task forces such as HIDTA or OCEDTF where the participating law enforcement agencies and departments assign personnel to the task force and are physically located together as a team. Our feedback on this type of structure indicates that it is an efficient way to share information as well as way to develop positive working relationships between Federal and Local law enforcement.

- Allowing for variation for different size cities, what is the typical structure / make-up of an ATF field office YCGII program? Is it a separate squad?

As previously discussed in the statement for the record, the enforcement of the Federal firearms laws, and particularly the trafficking aspect, present one of the most unique challenges we have in our mission. As you know, the conduct of criminal behavior is unpredictable, but with the trafficking of firearms, there are even more factors that influence this activity. Our current research and historical knowledge shows that there are many geographical trends to the illicit movement of firearms, always subject to change, as those involved always take the path of least resistance.

We have found, as you saw in our staffing charts, that a high degree of flexibility is needed. There are cities that various division directors have established entire dedicated groups to handle solely the YCGII aspects of trafficking and possession violations. In many other cities, the responsibility for this focus has been placed with the firearms trafficking groups and joint task forces. The joint task forces have had, as you mentioned, substantial success in many enforcement areas, and this is certainly no exception. Indeed, one of the main requirements to be successful in this initiative is the involvement of the police departments.

As you saw in the example of our revised reporting requirements, there has been an onus placed on the field to identify not just the trafficking work, but entire range of firearms violations if there is involvement of anyone under the age of 25. This serves as subtle guidance to direct agents attention to "following the gun", even in a possession case. We plan to institute increased use of the investigative or end-to-end trace on a larger percentage of the possession incidents, so that this resultant information can provide further empirical information on the sources of youth and juvenile firearms.

There have also been special projects instituted in relation to YCGII cities, such as the identification of areas of Phoenix, Arizona experiencing inordinate firearms crime in these age groups, and the articulation of enforcement plans to address it. The Chicago YCGII project has resulted in the temporary assignment of a squad of agents working in Mississippi and other places to shut down sources of youth crime guns which have flowed north to Illinois.

- How many support personnel or analysts are actually performing YCGII activities in the YCGII field office?

Our field divisions have not had the analyst and support staff that would be ideally required to make a viable contribution to this effort. One of the additional requirements that was transmitted in the current submission for FY01 addressed that situation, with support resources outlined for field offices. In the meanwhile, we have instituted contracts with the Treasury Office of Franchise Business Activity to supply retired law enforcement personnel on a temporary basis to assist in comprehensive tracing and the subsequent evaluation of data, along with clerical support for data input into ETSS.

- Where does the Field office YCGII coordinator fall into the offices' organizational structure?

In general, the YCGII Coordinator's role is located where it best suits the needs of a particular Field Division, and many have an agent tasked at that level, either in an Intelligence Group or otherwise reporting to the Division Director's staff. Many have integrated this function into either the YCGII squad or the Firearms Trafficking squad. However, coordinator's location will depend on many factors, such as location of the YCGII city from the Field Division. The special agents and support personnel involved in case work would most appropriately be located in a field office or group.

- Is there a consistent relationship or regular exchange of information between the ATF field office and local law enforcement coordinators? What does Headquarters policy require in terms of outreach?

Yes, after the workshop last fall with the coordinators covering the 37 cities, this requirement was specifically stressed, and they were also required to take the data disks with those cities trace information to their counterparts so that reconciliation could be done. The CGAB is also in regular contact with the coordinators, not to mention many police departments, in an institutionalized effort to have the highest quality data available.

Supervisor	Special Agent (SA)	Special Agent Under/over	Percent needed for full staff	SA to FBI	Criminal Enforcement Strategy/Program
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WEST

DALLAS					
Division					
Dallas II (Arson)	1	8	2	20%	0 Arson
Dallas III (FA Traff)	1	6	4	40%	2 YCGMFA Trafficking
Dallas IV (Achilles)	1	5	3	38%	1 Operation Egg House/Achilles
El Paso	0	5	5	60%	4
Fort Worth	0	7	3	30%	1 SaleCity
Lubbock I	1	6	4	40%	4
Oklahoma City II	1	6	4	40%	0 SAFE/OKCity Liaison Triggerlock
Tulsa	1	7	1	10%	1 Operation Safe Home
Tyler	1	7	3	30%	1
	7	57	29		14

LOS ANGELES

LOS ANGELES					
Division					
Los Angeles Metro	1	8	1	10%	3 Computer Project
Los Angeles II (Achilles)	1	6	2	20%	4 Achilles
Los Angeles III (Arson)	1	7	3	30%	1 Arson
Riverside	1	8	2	20%	5
San Diego I	1	7	3	30%	2 Operation RapidFire
San Diego II	0	11	-1	-10%	2 Operation RapidFire
Santa Ana I	1	8	2	20%	4 WIT
Van Nuys	1	8	3	30%	2
	7	64	15		23

SEATTLE

SEATTLE					
Division					
Anchorage	1	4	4	50%	1 Juvenile Guns from Adults
Boise	0	3	5	63%	2
Guam	1	2	3	60%	1
Honolulu	1	5	1	17%	0
Portland I (A&E)	1	6	2	25%	0 Arson & Explosives
Portland II (FA & Achilles)	1	7	3	39%	1 Strct Appr to Comm Brvc/YCGI
Seattle I	1	8	2	0	4 YCGI
Seattle III (Arson)	1	4	4	50%	1 Arson & Explosives
Spokane I	1	7	3	30%	2 TF on Juvenile Violence
Yakima	1	3	1	25%	
	8	49	28		12

HOUSTON

HOUSTON					
Division					In Service Training
Austin	1	6	2	20%	1
Waco Satellite		2	0		
Beaumont	1	5	6	50%	1
Corpus Christi	1	6	0	0%	1
Houston I	1	0	4	40%	2 Stolen Firearms Program/YCGI
Houston II (Achilles)	1	6	4	40%	3 Stolen Firearms Program/Achilles
Houston III (Arson)	1	6	3	36%	2 Stolen Firearms Program/Arson
Houston V (CDE)	1	6	4	40%	1 Stolen Firearms Program/CDE
McAllen	1	6	4	40%	3
San Antonio I	1	9	1	10%	YCGI
	8	57	27		13

NOTE: Locations in red identify firearms groups in YCGI cities.

FY 2000 SPECIAL STAFFING AND STAFFING RECOMMENDATIONS

Supervisor	Special Agent(S/A)	Special Agent Undercover	Percent needed for full staff	BIA to FR	Criminal Enforcement Strategy/Program
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SAN FRANCISCO

Division	Supervisor	Special Agent(S/A)	Special Agent Undercover	Percent needed for full staff	BIA to FR	Criminal Enforcement Strategy/Program
Primo I	1	6	3	30%		
Bakersfield Satellite		1				
Las Vegas	1	7	3	30%		1 Project Exile/YCGII
Oakland	1	5	5	50%		3 Project Exile/YCGII
Reno	0	6	2	25%		1
San Jose I	1	7	3	30%		1 Project Exile/YCGII
Sacramento I	1	6	2	20%		2
San Francisco I (F/A)	1	6	4	40%		1 Project Exile/FIA Trafficking
San Francisco II (Arson)	1	5	3	30%		1 Project Exile/Arson
	7	51	26		10	

PHOENIX

Division	Supervisor	Special Agent(S/A)	Special Agent Undercover	Percent needed for full staff	BIA to FR	Criminal Enforcement Strategy/Program
Albuquerque	1	6	2	20%		2
Cheyenne	1	5	2	25%		
Colorado Springs	1	8	0	0%		1 Gun Interdiction
Denver I	1	8	2	20%		2 YCGI
Denver II (Arson)	1	6	2	20%		3 Arson
Phoenix I	1	11	-1	-10%		3 YCGI
Phoenix II (Achilles)	1	7	3	0		1 Valley Metro FIA Traff TF/Ach
Salt Lake City	1	10	0	0%		1 School Violence Prevention
Tucson	1	10	0	0%		YCGI
	9	75	10		13	

KANSAS CITY

Division	Supervisor	Special Agent(S/A)	Special Agent Undercover	Percent needed for full staff	BIA to FR	Criminal Enforcement Strategy/Program
Des Moines	1	7	1	10%		1 First Track to Federal Prosecution
Kansas City I (Arson)	1	7	3	30%		1 Arson
Kansas City II	1	6	2	8		1
Omaha	1	6	4	40%		4 CeaseFire/Operation Night LR/YCGI
Springfield	1	8	1	14%		
Cape Girardeau	1	4	4	60%		1
St. Louis I	1	7	3	30%		1 CeaseFire/YCGI
St. Louis II	1	5	5	50%		1 CeaseFire
Wichita	1	5	5	63%		2
	9	53	29		13	

EAST

BOSTON

Division	Supervisor	Special Agent(S/A)	Special Agent Undercover	Percent needed for full staff	BIA to FR	Criminal Enforcement Strategy/Program
Albany	1	8	-1	-14%		3
Boston I (Arson)	1	6	2	20%		1 Youth Violence Task Force/Arson
Boston II (Achilles)	1	9	1	10%		3 Youth Violence Task Force/YCGI/Ach
Boston IV	1	6	1	10%		Youth Violence Task Force
Buffalo I	0	6	2	77%		1
Rochester Satellite		2				2
Burlington	1	6	1	77%		2 JOs and Kops
New Haven	1	8	2	20%		2 FIA & Narcotics TF/YCGI
Portland	1	6	2	20%		
Concord Satellite		2				
Providence	1	5	3	39%		3
Syracuse	0	6	2	25%		1
Worcester	1	6	-3	-50%		
Springfield Satellite		3				West Miss. Gang TF
	8	63	12		17	

FY 2000 SPECIAL STAFFING AND STAFFING REQUIREMENTS

Supervisor	Special Agent (S/A)	Special Agent Undercover	Percent needed for full staff	SUA to fill	Criminal Enforcement Strategy/Program
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NEW YORK					
Division					Reg Gun Crime Ctr/Transfer Case/Obliterated Serial # restoration
New York I	1	9	1	10%	2
New York II	1	11	-1	-10%	3
New York III (Arson)	1	10	0	0%	Arson
New York IV (Proj Lead)	1	10	0	0%	YCGII/Project LEAD
New York V (HDTA)	0	8	2	20%	HDTA
Melville Satellite					
White Plains Satellite					
New Jersey I	0	12	-2	(0)	YCGII
New Jersey II (Arson)	1	8	2	20%	Arson
Melville	1	6	2	25%	
	6	74	4		6

TAMPA					
Division					
Tallahassee	1	5	5	50%	1 LE Liaison Program
Orlando	1	6	2	25%	5
Jacksonville	1	10	0	0%	
Pensacola	1	9		0%	Chief Judge's TF Gangs/Violence Red
Tampa I	1	7	1	10%	4 YCGII
FL Myers		2			
	5	39	8		10

MIAMI					
Division					CARGO, Pawnshop, NICS, Gun Show TF
Miami I	1	9	1	10%	2 Violent Offenders
Miami II	1	8	2	20%	2
Miami IV	1	8	2	20%	1 YCGII/Achieves
Miami V	1	9	1	10%	1CDE/HDTA
FL Lauderdale	1	8	2	20%	2
West Palm Beach	1	8	2	20%	2 Violence Reduction Alliance
Puerto Rico I	1	5	5	50%	3 Violent Offenders
Puerto Rico II	1	5	5	50%	2 Violent Offenders
	8	60	20		14

CHARLOTTE					
Division					
Charlotte	1	11	-1	-10%	1 Achilles
Charlotte I	1	12	-2	-20%	1 Rock Hill Violent Crime TF
Charlotte II	1	8	2	20%	1 Rock Hill Violent Crime TF
Columbia	1	6	2	25%	Midlands Area VCTF
Fayetteville	1	8	1	10%	Project GOOSE
Wilmington		4			
Greensboro I	1	7	3	30%	2 High Point
Greenville	1	8	0	0%	
Raleigh	1	7	3	30%	3 Project GOOSE
	8	60	8		8

FY 2000 SPECIAL STAFFING AND STAFFING REQUIREMENTS

Supervisor	Special Agent(S/A)	Special Agent Uniformer	Percent needed for full staff	S/A to Fill	Criminal Enforcement Strategy/Program
PHILADELPHIA					
Division					Cases/Fire/Project Carps
Philadelphia I	0	8	5	50%	4 YCGB/FA Trafficking
Philadelphia II	1	8	4	40%	1 Arson & explosives
Philadelphia III	1	6	4	40%	2 HIDTA
Philadelphia VI	1	8	4	40%	1 Cases/Fire
Pittsburgh I	1	8	2	20%	2 PA Trafficking
Pittsburgh II	1	8	6	60%	3 Target/FYRS/Arson & Explosives
Trenton	1	8	1	11%	
Camden	1	8	-1	-10%	2
Allentown City		3			
Harrisburg	1	8	1	10%	1
Reading		1			2
	8	64	25		18
WASHINGTON					
Division					Operation 1X/Arson TF/Mod Red Unit
Washington I	0	8	2	20%	1 HIT/A/Archives
Washington II	1	7	3	30%	3 Cases/Fire
Washington III	1	7	3	30%	3 HIDTA
Washington IV	1	6	4	40%	1 Arson
Falls Church I	1	3	7	70%	Arson
Falls Church II		6	4	40%	3
Richmond I	1	8	2	20%	3 Project Ex/IE/YCGB
Roanoke	1	4	8	60%	
Norfolk	1	8	4	40%	5
Bristol	1	6	2	25%	0
	8	61	37		18
BALTIMORE					
Division					
Baltimore I	1	7	3	30%	3 Arson
Baltimore II	1	8	2	20%	1 HIDTA
Baltimore III	1	7	3	30%	3 Achilles
Wilmington	1	7	3	30%	2 Del. P/A Trafficking TF
Hyttsville	1	6	4	40%	1
	5	35	15		10
CENTRAL					
ATLANTA					
Division					
Atlanta I	1	8	2	20%	2 FACES/FA Trafficking
Atlanta II	1	7	3	30%	4 FACES/Arson
Atlanta III	1	6	4	40%	2 FACES/YCGB/Achilles
Atlanta IV	1	7	3	30%	2 FACES/YCGB
Atlanta SEBYF	1	4	6	60%	
Savannah	1	8	2	20%	1
Nacost	1	9	1	10%	
	7	49	21		9
DETROIT					
Division					Michigan Safe Schools Initiative
Detroit I	1	8	1	10%	
Detroit II	1	8	5	50%	1 Achilles/FYRS
Detroit III	1	11	-1	-10%	1 Arson
Detroit IV	1	10	0	0	1 Operation Countdown/YCGB
Flint	1	11	-1	-10%	
Grand Rapids I	1	11	-1	0	
	8	37	3		3

FY 2000 SPECIAL STAFFING AND STAFFING REQUIREMENTS

	Supervisor	Special Agent (SIA)	Special Agent Under/over	Percent needed for full staff	SIA to Fill	Criminal Enforcement Strategy/Program
NEW ORLEANS						
Division						
New Orleans I	1	8	1	10%	1	Safe/Force/FIA Enforcement Progr
New Orleans II	1	8	2	20%	0	FIA Enf Program/YCGM/FVRS
Shreveport	1	6	2	25%	4	
Little Rock	1	9	3	25%		
FL Smith		1				
Biloxi	1	5	3	30%	1	
Baton Rouge	1	7	3	30%	1	FIST/Exile
Jackson	0	5	2	20%	1	
Oxford I		3				
	6	63	16		8	
CHICAGO						
Division						
Chicago I	1	8	1	10%	3	SureFire/COE
Chicago II	1	8	4	40%	2	SureFire/FIA Trafficking
Chicago III	1	11	-1	-10%	2	SureFire/YCGM
Chicago IV	1	11	-1	0	2	SureFire/Arson
Oak Brook I	1	11	-1	0		
Oak Brook II	1	9	1	0		Explosives
Parkview Heights	1	6	4	40%	4	
Springfield I	1	5	3	30%	2	
	8	68	10		11	
LOUISVILLE						
Division						
Louisville I	1	9	1	10%	1	TF to end Gun Viol/Coop Eff to Pros Career Crim
Charleston	1	6	2	25%	2	
Ashland	1	4	2	33%		
Bowling Green	1	7	1	15%	2	
Lexington	1	5	1	15%	5	
London		2				
Wheating	0	6	0	0%	1	
Marionburg		3			0	
	5	41	7		11	
COLUMBUS						
Division						
Columbus	0	8	2	20%	1	
Cincinnati I	1	9	1	10%	1	YCGE
Indianapolis	1	7	3	30%	2	Indy VRP
Cleveland I	1	9	1	10%		Customized Gun Trace
Cleveland II	1	19	0	0%	1	Customized Gun Trace
FL Wayne	1	6	3	30%	1	Koalasus Death Youth
Merittville	1	9	1	10%	1	MeoFire
Toledo	1	8	2	25%	2	Customized Gun Trace
Youngstown	1	7	3	30%		Customized Gun Trace
	8	70	16		8	

FY 2000 SPECIAL STAFFING AND STAFFING REQUIREMENTS

Supervisor	Special Agent(BIA)	Special Agent Undercover	Percent needed for full staff	BIA to FBI	Criminal Enforcement Strategy/Program
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NASHVILLE					
Division					School Viol Preparedness
Nashville I	1	10	0	0%	6 Gunclippers Hotline
Knoxville	1	7	3	30%	0 FT/FP/YCS
(Johnson City HOTA)		2	0	0%	(separate authorization)
Memphis	1	6	4	66%	1 YCS/TV/Spurlock
Chattanooga	1	3	3	60%	2
Mobile	1	6	4	66%	FIST/PA Training
Montgomery	1	6	4	66%	1 FT
Birmingham I	2	6	2	6	4 Project ICE/YCS
Huntsville		2			
Birmingham II	0	4	6	60%	1 Project ICE/YCS
	8	54	28		15

ST. PAUL					
Division					
St. Paul I	1	8	2	25%	2 HEALS/Violence Red Initiative/YCS
Minneapolis I	0	8	2	0	YCS
Minneapolis II	1	5	5	50%	2 Caselife
Fargo I	1	4	1	15%	Red Leds Initiative
Sioux Falls		3			
Billings	1	4	1	10%	1
Helena		6			1
	4	37	11		6

**Questions for the Record Submitted by
Congressman Hoyer**

1. The objective of the YCGII program is to strengthen enforcement efforts against firearms traffickers who supply firearms to youths by helping police departments trace crime guns to their source.

Statistics show that ATF agents conduct more than 200,000 crime gun traces for local law enforcement each year, and since 1996, ATF has launched hundreds of trafficking investigations related to youth crime. In light of these statistics, are you making progress in stopping the problem dealers and traffickers? What indicators are you putting in place to measure the success of the program? When will they be fully in place?

Yes. What we have experienced as we use crime gun information to identify trafficking patterns, is that criminal schemes have come to light that were not previously identified. In New York, for example, referrals of trafficking information have been made to over 20 different states. In Chicago, we have identified a significant number of cases now under active investigation involving numerous individuals. Some of these investigations involve complicit licensees, who have been active for long periods of time. Our regulatory inspection activity has also benefited from use of this information, by allowing us to target our investigative resources to achieve greater results.

As discussed earlier, the current performance standards used are consistent with the major areas from which this Initiative evolved, firearms tracing and firearms trafficking investigations. Both are considered to ascertain if the level of comprehensive tracing is being achieved, and if follow-up is being done on the trafficking end. We have taken several steps to expand upon these basic measures.

Recently, we examined our firearms investigative docket and learned that over a quarter of ATF's investigations into the illegal diversion of guns involved felons. This allowed us to confirm what ATF agents and their State and local counterparts have known but not previously documented -- there is a sizable illegal market in firearms that felons, juveniles and other illegal possessors of firearms use to obtain guns. It includes corrupt Federally licensed dealers who ignore the results of background checks, straw purchasers, unlicensed sellers, and traffickers in stolen firearms, among others. As a result, we published: Following the Gun, which provides exceptional insight into the intricacies of these cases, but more importantly, gives us direction on additional work that should be done to more adequately measure the effectiveness of our work.

Listed below are other areas which we intend to examine and consider as possible indicators of the performance of this program. We have convened a working group that will study and provide recommendations on the following:

- Reduction in the "time to crime" of firearms possessed by violators, as this can tell us if we are forcing the illegal market buyers further away from legal commerce.
- Reduction in the average number of guns trafficked per investigation, as this is indicative of ATF's ability to interdict trafficking schemes early on in their development, mainly through our advances in information technology.
- Reduction in the percent of the population illegally possessing guns comprised of persons under the age of 24.

There is currently underway a joint assessment demonstration project with the National Institute of Justice (NIJ) which is in the formulation stage. This will develop relevant, longitudinal measures. A copy of the relevant draft documents and tentative agreements has been previously supplied to GAO.

2. The IG report noted that not all police departments submitted trace requests on every firearm recovered. The trace analysis for YCGII cities cited 96,747 traces between 1998 and 1999. What is the number of firearms traced compared to firearms recovered? or percentage? Are you making progress in tracing all firearms recovered?

At this time, based on Uniform Crime Reports, (UCR), we can only provide very rough estimates of the number of firearms involved in crimes that are recovered, and that is from 400,000 to 500,000 annually. We have two strategies to expand upon the collection and use of crime gun information, the first of course being via the YCGII. In budget for FY01, we have an initiative to expand the use of comprehensive tracing to 250 cities, as a means to make use of this invaluable law enforcement tool.

3. The IG report cited the program On-Line LEAD. This program can be very helpful to ATF agents in terms of investigative leads. The report stated that some police departments were not aware of this information system. Your response stated that you are supportive of providing the system to the departments through the ATF field offices. Are the local Department's becoming more aware of the system? What efforts are you making to provide it to them?

We have conducted seminars and workshops to include ATF Division Directors, ATF field coordinators, field agents, U.S. Attorneys and State and local officials for training and educational purposes. We have a combined workshop with State and local law enforcement that we are completing the agenda and site selection for. We have also produced several training aids and courses to assist State and local law enforcement personnel in developing competence and expertise in firearms enforcement, to include OnLine LEAD. Our Crime Gun Analysis branch, as a matter of course briefs local law enforcement during their city assessment. Through this variety of means, and judging from the requests we receive from other agencies to avail themselves of these tools, we are confident that many more local law enforcement officials are making greater use of their ATF partnerships.

We are making every effort to ensure that personnel in YCGII cities are fully informed about the improvements and basic protocols of the systems available to them. ATF coordinators are meeting with local personnel to discuss technological and demographic issues, and any local police assigned to work with ATF have access to OnLine LEAD. The coordinators are also providing reports and trafficking analyses to the local law enforcement and working with local law enforcement staffs to assist in items that will allow the trace requests to be processed in the least amount of time. As previously mentioned, 37 agents have attended the Instructor's Course and have started giving presentations directly to local law enforcement on firearms identification.

EXECUTIVE RESIDENCE AT THE WHITE HOUSE
FY 2001 Appropriation Language
Operating Expenses

For the care, maintenance, repair and alteration, refurbishing, improvement, heating and lighting, including electric power and fixtures, of the Executive Residence at the White House and official entertainment expenses of the President; \$10,900,000 to be expended and accounted for as provided by 3 U.S.C. 105, 109, 110, and 112-114.

Reimbursable Expenses

For the reimbursable expenses of the Executive Residence at the White House, such sums as may be necessary: *Provided*, That all reimbursable operating expenses of the Executive Residence shall be made in accordance with the provisions of this paragraph: *Provided further*, That, notwithstanding any other provision of law, such amount for reimbursable operating expenses shall be the exclusive authority of the Executive Residence to incur obligations and to receive offsetting collections, for such expenses: *Provided further*, That the Executive Residence shall require each person sponsoring a reimbursable political event to pay in advance an amount equal to the estimated cost of the event, and all such advance payment shall be credited to this account and remain available until expended: *Provided further*, That the Executive Residence shall require the national committee of the political party of the President to maintain on deposit \$25,000, to be separately accounted for and available for expenses relating to reimbursable political events sponsored by such committee during such fiscal year: *Provided further*, That the Executive Residence shall ensure that a written notice of any amount owed for a reimbursable operating expenses under this paragraph is submitted to the person owing such amount within 60 days after such expense is incurred, and that such amount is collected within 30 days after the submission of such notice: *Provided further*, That the Executive Residence shall charge interest and assess penalties and other charges on any such amount that is not reimbursed within such 30 days, in accordance with the interest and penalty provisions applicable to an outstanding debt on a United States Government claim under section 3717 of title 31, United States Code: *Provided further*, That each such amount that is reimbursed, and any accompanying interest and charges, shall be deposited in the Treasury as miscellaneous receipts: *Provided further*, That the Executive Residence shall prepare and submit to the Committees on Appropriations, by not later than 90 days after the end of the fiscal year covered by this Act, a report setting further the reimbursable operating expenses of the Executive Residence during the preceding fiscal year, including the total amount of such expenses, the amount of such total that consists of reimbursable official and ceremonial events, the amount of such total that consists of reimbursable political events, and the portion of each such amount that has been reimbursed as of the date of the report: *Provided further*, That the Executive Residence shall maintain a system for the tracking of expenses related to reimbursable events with the executive residence that includes a standard for the classification of any such expenses as political or non political: *Provided further*, That no provision of this paragraph may be construed to exempt the Executive Residence from any other applicable requirement of subchapter I or II of chapter 37 of title 31, United States Code.

EXECUTIVE RESIDENCE AT THE WHITE HOUSE

Justification for Appropriation, Fiscal Year 2001
(in thousands of dollars)

Activity:	1999 ACTUAL	2000 ESTIMATE	2001 ESTIMATE	INCREASE DECREASE
Operating Expenses				
Operating Expenses	8,691	9,225	10,900	+1,675
Full-Time Permanent Positions (FTE)	91	91	95	+ 4

Authorization: 3 U.S. Code 105, 109-110, 112-114

Objective: To provide for the care, maintenance, repair, alteration, refurbishing, improvement, air conditioning, heating and lighting (including electric power and fixtures) of the Executive Residence at the White House, and Official and Ceremonial functions of the President.

Program: The Executive Residence staff provides for the operation of the Executive Residence. A staff of 40 domestic employees accomplishes general housekeeping, prepares and serves meals, greets visitors, and provides services as required in support of official and ceremonial functions. A staff of 33 tradespersons, including plumbers, carpenters, painters on a single shift, electricians on a double shift, and operating engineers on a 24-hour basis, maintain and make repairs, minor modifications, and improvements to the 132 rooms and the mechanical systems and provides support for official and ceremonial functions.

A staff of 12 specialized employees provides services necessary to the operation of the White House and official and ceremonial functions. This staff includes 4 florists, 4 curators and 4 calligraphers.

An administrative staff consists of the Chief Usher, 4 Assistant Ushers, 1 Executive Grounds Superintendent, 1 Operating Accounting, 1 Accounting Technician, 1 Computer Network Engineer and 1 Administrative Officer. The staff is charged with management and administrative functions of the Executive Residence. This requires coordination with the Executive Office of the President, the National Park Service, the Military, the United States Secret Service, the General Services Administration and other agencies.

During larger events, the Executive Residence staff is assisted by contracted personnel under personal services contract agreements ("Services by Agreement") to provide additional help as required for official and ceremonial functions.

**Executive Residence at the White House - Fiscal Year 2001
Current Accomplishments**

The White House is maintained as a home for the President and his family and serves as a facility for Official and Ceremonial functions. Several projects are underway and progress has been made in the past year.

Exterior Window Project - In FY-1990, \$800,000 was appropriated for replacement of the exterior windows at the Executive Residence. This project entails replacement of both the window glass and the wood window components that were last restored during the 1948-52 Truman Renovation of the White House. Historically accurate window glass has been delivered and is authentic to the original glass in quality, color, optical clarity, and method of manufacturing. Working in conjunction with a Secret Service project, actual window replacement is taking place.

Kitchen Renovation - In FY-1991, \$500,000 was appropriated for renovation of the White House kitchens. Work on the staff and pastry kitchens has been completed and these two facilities are fully operational. The remaining work to be completed on the main kitchen has begun. The work is being accomplished as the schedule permits.

Public Tours - The White House is open for public tours Tuesday through Saturday each week in addition to some national holidays, the evening Candlelight Tours at Christmas, the Easter Monday Egg Roll, and Garden Tours. In 1999, more than one million people visited the White House. During 1999, an average of 4,101 visitors toured the White House during each of the 227 open days. Other special public events at the White House for 1999 include: Spring Garden Tours, 2 days (April 17 & 18) with 18,270 visitors; Fall Garden Tours, 2 days (October 9 & 10) with 15,860 visitors; the Easter Egg Roll which was held on April 13 was attended by 32,577 visitors; and the Candlelight Tours, held for 2 nights, December 21 and 27th, brought in a total of 12,095 visitors.

End of Year Spending - As directed by the House of Representatives Subcommittee on the Treasury, Postal Service, and General Government Appropriations, the Executive Residence at the White House, in cooperation with the National Park Service's Finance Office, will ensure that necessary procedures are in place to review end-of-year spending. The Executive Residence routinely conducts a rigorous review of year-end spending to insure that funds are obligated only for necessary items.

**Executive Residence at the White House
Major Budget Considerations — Agency Request - Fiscal Year 2001**

The proposed program at the Executive Residence in FY 2001 accommodates the following fixed-cost increases:

1. Administration policy calls for a 3.9 percent pay raise effective January 1, 2001, as well as annualization of the FY00 pay raise, and FY00 step and merit pay raises. Funding is required to meet this need +\$257,382
2. Funding is required for regular personnel step increases and merit pay raises based on job performance and personnel evaluations in FY01 +\$224,400
3. Funding is requested to meet the 3.9 percent pay raise to occur in January 2001, as it pertains to premium pay, as well as annualization of the FY00 pay raise pertaining to premium pay +\$236,188

Funding for the following projected increases is requested:

1. Funding is requested for a projected increase in utility costs \$62,000
2. Funding is requested for an increase in contractual services. The new heating and air conditioning system is functioning and requires continuing highly technical maintenance; there have been increases in the elevator maintenance contract, curatorial conservation services contract, water filtration maintenance, computer maintenance contract, as well as an increase in contractual services required for non-reimbursable Presidential functions\$271,500
3. Funding is requested for an increase in supplies and materials. This will cover the cost of employee uniforms, kitchen supplies, carpentry, electrical and paint supplies, engineering supplies and materials needed for non-reimbursable Presidential functions. \$278,500
4. The cost of acquisition of Historic Furnishings has escalated in recent years. Therefore, we request a modest increase in this object class \$10,000
5. An addition of four (4) FTE's is requested. These proposed FTE will assist the current domestic staff as follows: NIGHT DOORMAN: The Executive Residence Usher's Office is open from 6:00 am until the First Family retires for the night. During the daytime the Usher's office is staffed by the Duty Usher, Administrative Assistant, Day Doorman, and the Chief Usher who can facilitate the movements of the First Family and guests, as well as manage the efforts of the staff. In the evening the Usher's Office is staffed only by the Duty Usher to perform the duties required to manage the Executive Residence and facilitate the movements of the First Family and their guests. For many years this position has been filled on a temporary basis. This position has direct contact with the First Family and their guests. The importance of the duties they perform, and the level of security required, justify this increase. BUTLER: A staff of six full-time

**Executive Residence at the White House
Major Budget Considerations—Agency Request - Fiscal Year 2001**

butlers (one designated a First Butler) and Maitre d'Hotel serves the First Family and guests from 6:00 am until the evening shift ends at 10:30 pm seven days a week. The volume of Official and Ceremonial functions requires the presence of all the full-time butlers working on overtime, augmented by Service by Agreement contractors. A First Butler is required to assist the Maitre d' in his administrative duties and is therefore unable to fulfill his shift duties. This adds to the burden and overtime of the remaining butlers. The butlers work a tremendous number of overtime hours and due to the staffing requirement it is often difficult to meet leave requests.

LAUNDRY ATTENDANT: The new Laundry Service Center, a larger and better equipped facility with modernized machinery will require one full-time laundry assistant to staff the facility.

HOUSEKEEPER: The Housekeeping staff is responsible for cleaning the entire Executive Residence. The Residence is open to public visitation 5 days per week, Tuesday through Saturday from 7:45 am until approximately 1:00 pm and requires cleaning before tours begin and directly following the end of tours allowing these areas to be used by the First Family, and for Office and Ceremonial Functions. The staff is augmented by Service by Agreement contractors, although the areas in which the contractors can be used is limited for security reasons. The staff is required to work a tremendous number of overtime hours. The staffing requirements of events make it difficult to meet leave requests and schedule lieu days. \$300,030

TOTAL INCREASES REQUESTED.....\$ 1,640,000

SF-300
02/07/00

EXECUTIVE RESIDENCE AT THE WHITE HOUSE			
Total* Operating Program & Multi Year Projects			
IDENTIFICATION CODE	1999	2000	2001
11-0210-0-8-802	actual	estimate	estimate
Obligations by program activity:			
00.01 Direct Program	8,732	9,360	10,925
01.01 Reimbursable Program	3,321	3,515	3,639
10.00 Total Obligations	12,053	12,875	14,564
Budgetary resources available for obligation			
21.40 Unobligated balance, SOY	174	125	25
22.00 New budget authority (gross)	12,004	12,775	14,539
23.95 New obligations (-)	(12,053)	(12,875)	(14,554)
24.99 Unobligated balance, EOY	125	25	10
New Budget Authority (gross), detail			
Current			
40.00 Appropriation	8,691	9,260	10,900
40.80 Reduction pursuant to P.L. 106-11		(35)	
Permanent			
Spending authority from offsetting collections			
68.00 Offsetting Collections (cash)	3,253	3,515	3,639
70.00 Total New Budget Authority (gross)	11,944	12,740	14,539
72.95 Change in Unpaid Obligations, SOY	1,157	1,641	1,857
73.10 New obligations	12,053	12,875	14,564
73.20 Total outlays (gross)(-)	(12,098)	(12,659)	(14,135)
74.95 Change in Unpaid Obligations, EOY	1,641	1,857	2,286
Outlays (gross), detail			
86.90 Outlays from new discretionary authority	12,049	12,595	14,096
86.93 Outlays from current balances	49	64	39
87.00 Outlays (gross)	12,098	12,659	14,135
Offsets			
Against gross budget authority and outlays			
Offsetting collections (cash) from			
88.00 Federal Sources	1,937	995	1,050
88.40 Non-Federal Sources	1,316	2,520	2,589
88.90 Total, offsetting collections (cash)	3,253	3,515	3,639
89.00 Budget authority (net)	8,691	9,225	10,900
90.00 Outlays (net)	8,845	9,144	10,496

* Does not include account 11-0109-0-X-802, White House Repair and Restoration

EXECUTIVE RESIDENCE AT THE WHITE HOUSE				
Total				
SF-300 02/07/00	IDENTIFICATION CODE	1999 actual	2000 estimate	2001 estimate
	11-0210-0-8-802			
Direct Obligations:				
Personnel Compensation:				
	11.1 Full-time Permanent	4,727	5,436	5,937
	11.5 Other personnel compenstion	864	1,552	1,830
	11.9 Total Personnel Compensation	5,391	6,988	7,767
Other:				
	12.1 Civilian Personnel Benefits	1,015	1,115	1,396
	13.4 Benefits for former personnel	0	0	0
	21.0 Travel and trans.-persons	2	12	12
	22.0 Travel and trans.-things	0	0	0
	23.2 Communications, utilities, rent	200	378	440
	24.0 Printing and reproduction	0	0	0
	25.2 Other Services	599	307	578
	26.0 Supplies and materials	1,495	469	748
	31.0 Equipment	29	55	65
	99.0 Subtotal, Direct Obligations	8,731	9,324	11,006
Reimbursable Obligations:				
	11.5 Other personnel compensation	496	509	524
	21.0 Travel and Trans.-persons	0	0	0
	22.0 Travel and trans.-things	0	0	0
	23.2 Communications, utilities, rent	171	136	210
	24.0 Printing and reproduction	161	0	180
	25.2 Other Services	883	924	989
	26.0 Supplies and materials	1,610	1,946	1,736
	31.0 Equipment	0	0	0
	99.0 Subtotal Reimbursable Obligations	3,321	3,515	3,639
	99.9 Total Obligations	12,052	12,839	14,645
Total compensable workyears:				
	Full-time equivalent employment	84	91	95
	Full-time equivalent - overtime & holiday hour	16	17	18
Reimbursable Program:				
	Full-time equivalent - overtime & holiday hour	3	3	3

EXECUTIVE RESIDENCE AT THE WHITE HOUSE				
Operating Expenses - Only				
SF-300 02/07/00	IDENTIFICATION CODE	1999 actual	2000 estimate	2110 estimate
	11-0210-0-8-802			
	Obligations by program activity:			
	00.01 Direct Program	8,683	9,260	10,900
	01.01 Reimbursable Program	3,321	3,515	3,639
	10.00 Total Obligations	12,004	12,775	14,539
	Budgetary resources available for obligation			
	22.00 New budget authority (gross)	12,004	12,775	14,539
	23.95 New obligations (-)	(12,004)	(12,775)	(14,539)
	New Budget Authority (gross), detail			
	Current			
	40.00 Appropriation	8,691	9,260	10,900
	40.80 Reduction pursuant to p.l. 106-113	0	(35)	0
	Permanent			
	Spending authority from offsetting collections			
	68.00 Offsetting Collections (cash)	3,253	3,515	3,639
	70.00 Total New Budget Authority (gross)	11,944	12,740	14,539
	Change in unpaid obligations			
	72.95 Unpaid Obligations, SOY	1,157	1,641	1,821
	73.10 New obligations	12,004	12,775	14,539
	73.20 Total outlays (gross)(-)	(12,049)	(12,595)	(14,096)
	74.95 Unpaid Obligations, EOY	1,641	1,821	2,264
	Outlays (gross), detail			
	86.90 Outlays from new discretionary authority	12,049	12,595	14,096
	86.93 Outlays from discretionary balances	0	0	0
	87.00 Outlays (gross)	12,049	12,595	14,096
	Offsets			
	Against gross budget authority and outlays			
	Offsetting Collections (cash) from			
	88.00 Federal Sources	1,937	995	1,050
	88.40 Non-Federal Sources	1,316	2,520	2,589
	88.90 Total, offsetting collections (cash)	3,253	3,515	3,515
	89.00 Budget authority (net)	8,691	9,225	10,900
	90.00 Outlays (net)	8,786	9,080	10,457

EXECUTIVE RESIDENCE AT THE WHITE HOUSE				
Operating Expenses - Only				
SF-300 02/07/00	IDENTIFICATION CODE	1999 actual	2000 estimate	2001 estimate
	11-0210-0-8-802			
	Direct Obligations:			
	Personnel Compensation:			
	11.1 Full-time Permanent	4,727	5,436	5,937
	11.5 Other personnel compensation	684	1,552	1,830
	11.9 Total Personnel Compensation	5,391	6,988	7,767
	Other:			
	12.1 Civilian Personnel Benefits	1,015	1,115	1,354
	13.4 Benefits for former personnel	0	0	0
	21.0 Travel and trans.-persons	2	12	12
	22.0 Travel and trans.-things	0	0	0
	23.2 Communications, utilities, rent	200	378	440
	24.0 Printing and reproduction	0	0	0
	25.2 Other Services	550	243	514
	26.0 Supplies and materials	1,495	469	748
	31.0 Equipment	29	55	65
	99.0 Subtotal, Direct Obligations	8,682	9,260	10,900
	Reimbursable Obligations:			
	11.5 Other personnel compensation	496	509	524
	21.0 Travel and Trans.-persons	0	0	0
	22.0 Travel and trans.-things	0	0	0
	23.2 Communications, utilities, rent	171	136	210
	24.0 Printing and reproduction	161	0	180
	25.2 Other Services	883	924	989
	26.0 Supplies and materials	1,610	1,946	1,736
	31.0 Equipment	0	0	0
	99.0 Subtotal Reimbursable Obligations	3,321	3,515	3,639
	99.9 Total Obligations	12,003	12,775	14,539
	Total compensable workyears:			
	Full-time equivalent employment	84	91	95
	Full-time equivalent - overtime & holiday hour	16	17	17
	Reimbursable Program:			
	Full-time equivalent employment	-	-	-
	Full-time equivalent - overtime & holiday hour	3	3	3

EXECUTIVE RESIDENCE AT THE WHITE HOUSE			
Multi-Year Projects			
SF-300	IDENTIFICATION CODE	1999	2000
02/07/00	11-0210-0-8-802	actual	estimate
			2001
			estimate
	Obligations by program activity:		
	00.01 Direct Program	49	100
	01.01 Reimbursable Program	0	0
	10.00 Total Obligations	49	100
	25		
	Budgetary resources available for obligation		
	21.40 Unobligated balance available, start of year	174	125
	22.00 New budget authority (gross)	0	0
	23.90 Total budgetary resources available for obligation	174	125
	23.95 New obligations (-)	(49)	(100)
	24.40 Unobligated balance available, EOY	125	25
	10		
	New Budget Authority (gross), detail		
	Current		
	40.00 Appropriation	0	0
	0		
	70.00 Total New Budget Authority (gross)	0	0
	0		
	72.95 Unpaid Obligations, SOY	0	0
	73.10 New obligations	49	100
	73.20 Total outlays (gross)(-)	(49)	(64)
	74.95 Unpaid Obligations, EOY	0	36
	22		
	Outlays (gross), detail		
	86.93 Outlays from discretionary balances	49	64
	39		
	89.00 Budget authority (net)	0	0
	90.00 Outlays (net)	49	64
	39		

EXECUTIVE RESIDENCE AT THE WHITE HOUSE				
Multi-Year Projects				
SF-300 01/00/00	IDENTIFICATION CODE	1989 actual	2000 estimate	2001 estimate
	0			
	Direct Obligations:			
	25.2 Other Services	49	100	25
	26.0 Supplies and Materials	0	0	0
	99.0 Total, Direct Obligations	49	100	25

EXECUTIVE RESIDENCE AT THE WHITE HOUSE
White House Repair and Restoration
FY 2001 Appropriation Language

For the repair, alteration, and improvement of the Executive Residence at the White House, \$5,510,000 to remain available until expended for 6 projects for required maintenance, safety and health issues, Presidential transition, telecommunications infrastructure repair, and continued preventative maintenance. (*Executive Office Appropriations Act, 2000.*)

EXECUTIVE RESIDENCE AT THE WHITE HOUSE

White House Repair and Restoration

Justification for Appropriation, Fiscal Year 2001
(in thousands of dollars)

Activity:	1999 Actual	2000 Estimate	2001 Estimate	Increase Decrease
White House Repair and Restoration	-0-	810,000	5,510,000	+4,700,000

Authorization: 3 U.S. Code 105, 109-110, 112-114

Objective: To provide for the repair, alteration, and improvement of the Executive Residence at the White House, a separate account was established in FY 1996 to program and track expenditures for capital improvement projects at the Executive Residence at the White House.

Current Accomplishments:

Roof Project: In FY1996, \$2,200,000 was appropriated for replacement of the roof. This project replaced the major roof structure, the north portico roof, and the solarium. Overall roofing installation has been completed. A final requested proposal from the contractor to install ten lead coated copper (same as roof) caps on remaining chimneys, and fabrication of new roof hatch cover is currently anticipated.

Laundry: In FY1998 \$200,000 was appropriated for the relocation and modernization of the laundry. Preliminary utility installation to outside walls of the new area is complete. Structural steel has been ordered by the contractor to begin construction of new raised floor system. Major equipment for this area has been ordered, and will be held by supplier until installation.

Requested Increases:

1. Communication Systems Repairs - This project will replace and reroute a 36-year old severely deteriorated concrete conduit (raceway) containing critical voice and data communication lines which serve the East Wing and the Residence. This raceway passes through the cooling tower discharge areaway for the Residence air conditioning system. As a result, the raceway is deteriorating from being exposed to the moisture and chemicals in the discharge air. The venting of the air for the cooling tower is inefficient, causing higher power consumption. This new project will renovate and replace the existing raceway with conduits that will not impact the cooling tower discharge airflow and cabling that will meet current voice and data infrastructure needs.
..... \$5,000,000

Agency Request**Fiscal Year 2001 – Requested Increases (continued)**

2. Cooling Tower Ozone Generation – This is a classified project to design and install an Ozone purification system to improve safety and increase the efficiency of the Residence cooling towers. This project is a further step toward a state-of-the-art solution to the difficult problem of health and safety issues to year-round cooling operations and contaminant removal \$100,000
 3. Transition Impact – The change of Administration in 2001 will require additional funds for staff overtime, moving and packing items for the outgoing First Family and setting up the living quarters for the incoming First Family..... \$100,000
 4. Family Quarters Redecoration – Historically, funds are made available for the First Family to redecorate the living quarters in the White House. The traditional funding request has been increased from \$50,000 to \$100,000 to more accurately reflect the cost of redecoration \$100,000
 5. Linen Replacement Project – Funds are requested to replace and replenish the linens used in the Executive Residence and for Official and Ceremonial Functions of the Presidency. The majority of the linens have not been replaced in 8 years. This project will involve the replacement of Presidential Seal Napkins, First Family and Guest Room Linens and Banquet Cloths \$150,000
 6. Computer Modernization Project – Ongoing modernization of the Computer Network will take advantage of changing technology, replace outdated components of the network, and upgrade software currently in use \$60,000
- TOTAL INCREASES REQUESTED..... \$5,510,000**

EXECUTIVE RESIDENCE AT THE WHITE HOUSE				
White House Repair and Restoration				
SF-300 02/07/00	IDENTIFICATION CODE	1999 actual	2000 estimate	2001 estimate
	11-0109-0-X-802			
	Obligations by program activity:			
	00.01 Direct Program	160	519	3,532
	01.01 Reimbursable Program	0	0	0
	10.00 Total Obligations	160	519	3,532
	Budgetary resources available for obligation			
	21.40 Unobligated balance available, start of year	399	239	530
	22.00 New budget authority (gross)	0	810	5,510
	23.90 Total budgetary resources available for obligation	399	1,049	6,040
	23.95 New obligations (-)	(160)	(519)	(3,532)
	24.40 Unobligated balance available, end of year	239	530	2,508
	New Budget Authority (gross), detail			
	Current			
	40.00 Appropriation	0	810	5,510
	70.00 Total New Budget Authority (gross)	0	810	5,510
	Change in unpaid obligations			
	Unpaid obligations, start of year			
	72.40 Unpaid Obligations, SOY	0	(16)	40
	73.10 New obligations	160	519	3,532
	73.20 Total outlays (gross)(-)	(155)	(463)	(2,258)
	73.40 Adjustments in expired accounts	0	0	0
	Unpaid obligations, end of year			
	74.40 Unpaid Obligations, EOY	5	61	1,335
	Outlays (gross), detail			
	86.90 Outlays from new current authority	155	463	2,258
	89.00 Budget authority (net)	0	810	5,510
	90.00 Outlays (net)	155	463	2,258

EXECUTIVE RESIDENCE AT THE WHITE HOUSE				
White House Repair and Restoration				
SF-300 02/07/00	IDENTIFICATION CODE	1999 actual	2000 estimate	2001 estimate
	11-0109-0-X-802			
Direct Obligations:				
	25.2 Other Services	160	474	3,387
	26.0 Supplies and Materials	0	45	145
	99.0 Total, Direct Obligations	160	519	3,532

WITNESSES

	Page
Rossotti, Charles	1
Harrison, P.D	1
Black, Edward	1
Lacijan, Charles	1
Buckles, Bradley	225
Schindel, Dennis	225
Rickey, Roberta	225

INDEX

	Page
Bureau of Alcohol, Tobacco and Firearms:	
Buckles, Opening Remarks	229
Questions for the Record Submitted by Subcommittee	256
Schindel, Opening Statement	227
Executive Residence at the White House: Budget Justification	283
Internal Revenue Service:	
Black, Testimony of	26
Harrison, Opening Remarks	36
Lacijan, Statement of	18
Questions Submitted for the Record by Congressman Hoyer	70
Questions Submitted for the Record by Congresswoman Emerson	68
Questions Submitted for the Record by Congresswoman Northup	65
Questions Submitted for the Record by Subcommittee	71
Rosotti, Statement of Commissioner	7





