Report of the
National Commission on
Restructuring the Internal Revenue Service

June 25, 1997

A Vision for a New IRS

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Introduction

It has been over forty years since Congress and the President have considered significant reforms to the Internal Revenue Service (IRS). With this report, once again there is an historic opportunity to overhaul the IRS and transform it into an efficient, modern, and responsive agency. Because of the vital nature of the institution—the IRS interacts with more citizens than any other government agency or private sector business in America and collects ninety-five percent of the revenue needed to fund the federal government—Congress and the President owe it to the American public to seize this opportunity.

The goal of this Report is to recommend changes to the IRS that will help restore the public's faith in the American tax system. Most American citizens are willing to pay their fair share of taxes; the Commission's recommendations will make it easier for them to do so. No single recommendation will fix the IRS, but taken as a whole, this package sets the stage for an IRS that is fair, efficient, and friendly.

This report is based upon a year of intensive work by the Commission members and the professional staff. The Commission received extensive input from American taxpayers and experts on the IRS and tax system, holding 12 days of public hearings and spending hundreds of hours in private sessions with public and private sector experts, academics, and citizen's groups to review IRS operations and services. In addition to holding three field hearings in Cincinnati, Omaha, and Des Moines, the Commission met privately with over 500 individuals, including senior level and front-line IRS employees across the country.

The Commission also received continuous input from stakeholder groups and congressional representatives, and conducted research and surveys to better understand IRS operations and gauge the American public's view of the IRS. Finally, the Commission reviewed thousands of reports and documents on IRS operations, management, governance, and oversight. The report that follows is the result of this year long effort, and it represents the collective judgment of a strong majority of the Commissioners.

As a guiding principle, the Commission believes that taxpayer satisfaction must become paramount at the new IRS and that the IRS should only initiate contact with a taxpayer if the agency is prepared to devote the resources necessary for a proper and timely resolution of the matter.

Our key recommendations are that:

- Congressional oversight of the IRS should be restructured and coordinated through a new entity which ensures that Members and staff have sufficient information to make informed decisions regarding tax administration and policy.

- Overall responsibility for executive branch governance of the IRS should be placed with a new Board of Directors, accountable to the President and the American people, to provide the expertise and continuity to ensure that the IRS achieves its mission. Board members, including those who have experience running large service organizations, will be appointed by the President and confirmed by the Senate for five year staggered terms. The Department of the Treasury would continue to be responsible for tax policy, and the Board will have no involvement in specific matters in the areas of interpretation or enforcement of the tax laws, procurement, or tax legislation.

- The Commissioner of Internal Revenue should be appointed for a five year term and should be given greater flexibility in hiring, firing, and salary decisions.

- The IRS should receive stable funding for the next three years so that its leaders can undertake the proper planning to rebuild its foundation.

- The IRS must address training, operations, technology, culture, and taxpayer education if the IRS is to operate efficiently and with customer focus.

- The IRS must update its technology and treat taxpayer information as a strategic asset to improve its customer service and compliance functions.

- The IRS must develop a strategic marketing plan to make paperless filing the preferred and most convenient means of filing for the vast majority of filers within the next ten years.

- Additional steps should be taken to improve taxpayers ability to recover damages for wrongful actions by the agency, and significant efforts should be made to protect taxpayers from unnecessary disputes with the IRS before they occur.

- Simplification of the tax law is necessary to reduce taxpayer burden and facilitate improved tax administration.

These key recommendations are all geared toward making the IRS more user friendly. Consolidated congressional oversight, an accountable Board of Directors, and a strengthened IRS Commissioner are necessary structural changes to ensure that good decisions are made, that there are clear lines of accountability, and that the IRS leadership has the continuity and expertise to guide the agency. Without all three of these elements—accountability, continuity, and expertise—along with focus of purpose in one governing entity, a turn around of the agency will be difficult.

Furthermore, a stable budget will allow the IRS leadership to plan and implement operations which will improve taxpayer service and compliance. Advancements in technology will make it easier for the IRS to resolve taxpayer problems quickly, thereby reducing the intrusiveness of the government. The Commission's taxpayer rights provisions will give Americans the ability to

fight back if they feel the IRS is not treating them fairly. Finally, tax simplification will make it easier for citizens to comply with their tax obligations with less intrusion from the IRS.

The sum of these recommendations is to make it easier for citizens to interact with the IRS. The Commission found that there are no isolated solutions and believes an integrated approach will set the stage for a more taxpayer friendly IRS and a tax system which Americans can believe in and trust.

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Gerry Harkins	Robert Tobias
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VISION

The National Commission on Restructuring the Internal Revenue Service began its work a year ago with the goal of making changes to restore the public trust in the IRS. The Commission's goal was to recommend how the IRS might better serve the American taxpayer and the federal government in the twenty-first Century.

Through many hours of receiving input from taxpayers and tax experts, reviewing reports and documents, interviewing IRS employees at all levels, and studying private sector practices, the Commission developed a vision that would guide its final recommendations—a vision of a new, customer focused IRS for the next century. This vision embraces an efficient, service oriented institution dedicated to collecting the proper amount of tax through the use of taxpayer education, modern customer service practices, and effective law enforcement techniques. The motivated, skilled employees of this new IRS would receive the proper training, incentives, authority, tools, and management oversight to get the job done. This new IRS would be able to help people comply with a simplified tax code, while managing its data collection and taxpayer accounts according to methods and standards employed in the best private and public sector organizations. Finally, taxpayers would have adequate protections when the agency exercised its powers in an improper fashion.

The Commission challenges the Congress and the President to create an agency that fulfills this vision and responds to the needs of its citizens. The Commission measures the success of this challenge in a simple manner: when surveyed, the American people should overwhelmingly answer "yes" to the following questions:

- Was filing your tax return easier than the previous year?
- Did IRS personnel treat you respectfully and professionally?
- Were all of your questions and problems handled as smoothly as account inquiries with your bank, credit card company, or utility?

Favorable responses to all three questions, coupled with fair and professional law enforcement, would signal success in providing the American people with an IRS capable of world class service and citizen satisfaction.

Section 1—Congressional Oversight, Executive Branch Governance, IRS Management, and Budget

The problems throughout the IRS cannot be solved without focus, consistency and direction from the top. The current structure, which includes Congress, the President, the Department of the Treasury (Treasury), and the IRS itself, does not allow the IRS to set and maintain consistent long-term strategy and priorities, nor to develop and execute focused plans for improvement. Additionally, the structure does not ensure that the IRS budget, staffing, and technology are targeted toward achieving organizational success. Without a change in the current structure, the Commission does not foresee an IRS able to meet the expectations of the American taxpayer.

The following discussion outlines a comprehensive package of fundamental reforms necessary to make the IRS a respected, stable institution that everyday Americans find to be fair and efficient. First, the Commission recommends more coordinated congressional oversight, so that the IRS receives clear and consistent direction from Congress. The Commission also recommends a Board of Directors, to bring accountability, continuity, and expertise to executive branch governance and oversight of IRS. In addition, the Commissioner of Internal Revenue should be appointed to a five year term and be given greater control over personnel decisions. It is essential that this governance and management structure drive fundamental change throughout the organization. That change will involve recruiting and retaining skilled personnel, better training, breaking down functional stovepipes, a shift in culture, and revamped internal measures. Finally, the Commission recommends that the IRS receive a stable budget so that it can undertake the proper planning to rebuild its foundation. None of the changes alone will fix the system, but as an integrated package they provide a blueprint to set the stage for a renewed IRS.

Introduction

The IRS governance, management and oversight structure, including Congress, the President, Treasury, and IRS senior management must:

- Develop and maintain a shared vision with continuity;
- Set and maintain consistent priorities and strategic direction;
- Impose accountability on senior management;
- Develop appropriate measures of success;
- Ensure that budget and technology support priorities and strategic direction; and
- Coordinate oversight and identify problems at an early stage.

The present dynamic between the IRS, Treasury, and Congress makes it difficult for the IRS to perform adequately. The average tenure of an IRS Commissioner is under three years and the average tenure of senior Treasury officials responsible for oversight is similarly short. Many of the key issues that need to be addressed to move the IRS into the twenty-first century, including shifting the culture to better meet the needs of taxpayers, reengineering business processes, and modernizing information technology, will require greater continuity, authority, experience, and

accountability of leadership and management. No organization with a $7.3 billion annual budget and 100,000 employees can perform to its full potential without a well functioning governance and management structure which ensures that top leaders focus on important issues and have the longevity and expertise to plan and implement strategic initiatives. With a new structure and heightened accountability, the Commission expects that the IRS will find Congress more receptive to stable funding to support IRS operations.

The current IRS governance structure is often reactive rather than strategic. The IRS reacts to pressures applied by the Congress through seven different oversight committees, often focusing issue by issue, rather than on an integrated and consistent strategic direction. Treasury reacts to problems at the IRS, typically after the IRS has been unable to resolve them. While the Government Performance and Results Act (GPRA) is helping Congress to communicate better with the IRS on strategy and direction, the traditional congressional role has been to respond to specific complaints or problems with particular programs or initiatives. The result is inconsistent and inadequate attention to the core issues facing the IRS, and scattered attention to a host of non-strategic issues. Moreover, the result is an IRS and Treasury that cannot be held accountable for achieving the IRS mission.

1. Congressional Oversight

Congressional oversight of the IRS should be coordinated through a new entity which ensures that key Members and staff discuss strategic issues comprehensively and ensures that Members have sufficient information to make informed decisions regarding tax legislation and tax administration

Congressional oversight has had some productive consequences in recent years. For example, a number of committee Members and staffs helped to uncover the Tax Systems Modernization (TSM) problems. Effective congressional oversight is essential to ensure that the IRS meets the public's expectations for their tax system. However, this effort must be coordinated for Congress to hold the President, Treasury, and the IRS accountable.

The inherent diversity of interests within Congress makes it difficult for that body to give clear and consistent direction to the IRS on macro issues. Congressional committee Members and staff generally do not see their role as defining and integrating high level management and governance issues. They believe this is the role of the IRS and Treasury. Instead, congressional committees focus their attention on specific issues and incidents, such as browsing or TSM. The seven committees (and their respective subcommittees) most responsible for IRS oversight—House Committee on Ways and Means, House Committee on Appropriations, House Committee on Government Reform and Oversight, Senate Committee on Finance, Senate Committee on Appropriations, Senate Committee on Government Affairs, and the Joint Committee on Taxation—focus on different issues that change from year to year. While the issues they address are important, there is a lack of coordinated focus on high level and strategic matters. Because the IRS tries to satisfy requests from Congress, this nonintegrated approach to oversight further blurs the IRS ability to set strategic direction and focus on priorities.

Additionally, like Congress, the Government Accounting Office (GAO) tends to focus on many lesser matters and does not integrate its myriad audits into a constructive, focused package. In the last four years, the IRS has been the subject of 140 GAO reports. At present, GAO has forty-three audits in progress. GAO's oversight is quick to point out problems, but often neglects the important work of recommending solutions, and frequently fails to provide adequate context or frame of reference for its assessments.

Congressional Oversight Recommendations

The Commission recommends that Congress create a joint committee on IRS administration to coordinate ongoing, high level oversight of the IRS. Selected Members from six committees with jurisdiction over the IRS should conduct joint hearings in areas of primary importance to tax administration, including: IRS strategic and business plans; IRS progress in meeting its objectives; IRS budget and how it is aligned with the agency's objectives; progress in improving taxpayer service and compliance; progress on technology modernization; and the annual filing season. These joint hearings also would serve as the primary forum for interaction between the Congress and the IRS Board of Directors, as described below.

It is the Commission's belief that this structure will help to coordinate oversight and reduce redundancy. To this end, the Commission recommends that that this new entity issue an annual report on IRS budget and operations to assist the committees of jurisdiction in making decisions about IRS issues. Staff from the existing committees of jurisdiction will assist in coordinating this new entity, along with the staff of the Joint Committee on Taxation. As part of this arrangement, the staff of the Joint Committee on Taxation would reassume its statutory role as the focal point for IRS oversight. The staff of the Joint Committee on Taxation should be expanded to meet this responsibility, and the Committee should have authority to contract with the private sector for oversight reports. Furthermore, the new consolidated entity should approve all requests to the GAO for investigations of the IRS, with the goal of eliminating overlapping reports, ensuring that the GAO has the capacity to handle the report, and ensuring that investigations focus on areas of primary importance to tax administration, as outlined above.

The Commission believes this approach will help achieve the following objectives: continuity and accountability within the IRS and within the Congress; increased focus on priorities and strategic direction; alignment of budget and technology with priorities and strategic direction; and earlier identification of significant problems. It also would result in substantial cost savings to the Congress and the IRS.

While this new oversight structure would allow Congress to better coordinate some efforts, it would not replace the traditional roles of the committees of jurisdiction. For example, the Committees on Ways and Means and Finance would retain jurisdiction over tax policy, and the Committees on Appropriations would retain jurisdiction over spending.

2. Executive Branch Governance

Congress should create an independent Board of Directors to oversee the IRS within the Department of the Treasury. Board members will be appointed by the President, confirmed by the Senate, and removable at will by the President.

Treasury is renowned for its expertise in capital markets, international economic affairs, economic and tax policy, and other fiscal matters. The Commission had extensive interactions with Treasury officials and found them to be honest and competent in their realm of expertise. Since the 1952 reorganization of the IRS, however, Treasury has limited its role in IRS affairs to major problems and tax policy. The generally independent structure of the IRS within the department evolved over time in response to concerns brought out in hearings in the 1920s and 1950s, which uncovered significant politicization of the agency. In addition, the expansion of section 6103 of the Internal Revenue Code in 1976 was a direct response to concerns of White House involvement in specific tax cases during the 1960s and 1970s. It is essential that the IRS be insulated from political interference and that the public have complete confidence that the tax laws are being administered in a fair and impartial manner. While Treasury retains its rightful place as the developer of tax policy for the executive branch, it generally is, and should remain, removed from tax administration.

While in the past year Treasury has taken a more active role in IRS oversight, the IRS generally has received little consistent strategic oversight or guidance from the department. The Commissioner of Internal Revenue reports to the Secretary of the Treasury through the Deputy Secretary of the Treasury, as do eleven other direct line reports. Traditionally the Secretary and Deputy Secretary focus on other responsibilities and activities, including monetary policy and capital markets, leaving the IRS largely independent. There are other interactions between the IRS and Treasury, including operational discussions through the Assistant Secretary for Management and budget negotiations through Treasury's Budget Office. These activities, however, have been limited and uncoordinated, often amounting to little more than costly and sporadic exercises in micro-management that lack the necessary strategic and long-term focus. Given that the IRS collects virtually all of the government's revenue and touches the majority of citizens, this level of attention is inadequate. The Commission is confident that Treasury, the President, and IRS would save resources and improve tax administration if the Treasury spent less time "in the details," and more time focused on priority matters and overall accountability at the IRS.

In response to problems with TSM, Treasury created the Modernization Management Board (MMB) in June 1996. As originally structured, the MMB was not a permanent structure with the longevity and expertise to assist the IRS in setting and maintaining priorities, developing appropriate measures for success, holding management accountable for results, and aligning budget and technology with priorities. In response to discussions at the Commission and in Congress, Treasury announced plans to make the MMB permanent by executive order, to expand its scope beyond technology issues, and to assemble a blue-ribbon panel of outside experts to advise the Secretary on IRS affairs. While Treasury's efforts to take responsibility for IRS technology efforts through the MMB are commendable, the Commission believes the current

Treasury initiative will not provide the necessary focus, expertise, and continuity that will be necessary for the IRS to meet the legitimate expectations of the American public.

Governance Recommendations

The Commission recommends that the Secretary of the Treasury maintain full control of tax policy, but that overall responsibility for IRS governance be placed with a Board of Directors that will be appointed by the President, confirmed by the Senate, and removable at will by the President. The Board will be responsible for overall governance of the agency, but will have no involvement in specific matters in the areas of interpretation or enforcement of the tax laws.

The role of the Board of Directors will be to guide the direction of long-term strategy at the IRS, appoint and remove its senior leadership, and hold IRS management accountable. The experience, independence, and stability of the Board also will give Congress more confidence in IRS operations. While IRS management will be responsible for day-to-day operations, the Board will ensure that the IRS is moving forward in a cogent, focused direction. Currently there is no body accountable for bringing a long-term perspective to tax administration—the result is that short-term priorities and emergencies are given attention, and longer-term initiatives like training, TSM, and re-thinking the relationship between the IRS and taxpayers are neglected. The role of this Board will be to ensure that decisions around operations, personnel, budget, and technology support an approved long-term plan.

As stated previously, the Board of Directors would be appointed by the President, with the advice and consent of the Senate. It would include seven members, five of whom would be from private life. The Board should include the Secretary or Deputy Secretary of the Treasury and a representative from the National Treasury Employees Union. The members from private life should sit for staggered five year terms, receive appropriate compensation, and be removable at will by the President. These members will be special government employees and will be subject to existing laws relating to disclosure, recusal, and conflicts of interest. It is critical that the members from private life be high stature, nonpartisan professionals, with experience particularly relevant to a 100,000 employee organization. These individuals collectively will bring to bear expertise in the following areas: (1) management of large service organizations, (2) customer service, (3) information technology, (4) organization development, and (5) the needs and concerns of taxpayers.

The Board of Directors should elect a chairperson for a two year term and meet regularly to oversee and guide the IRS. The Board should not be involved in tax policy—an area that should remain within the domain of Treasury—but instead should be focused on providing strategic direction to the IRS. The Board's powers should be enumerated by the Congress, as follows:

1. Review and approve the Commissioner's recommendations regarding IRS strategic and business plans, and IRS goals and measures relative to those plans.
2. Review and approve the Commissioner's recommendations regarding major operational and organizational plans (e.g., plans for modernizing technology systems; training; outsourcing; managed competition; reorganization of the Commissioner's office; reorganization of IRS business units).

3. Appoint and compensate the Commissioner and review and approve the Commissioner's recommendations regarding the appointment, evaluation, and compensation of senior IRS executives.
4. Review and approve the Commissioner's recommendations regarding the IRS budget, with particular emphasis on ensuring that the budget supports the IRS strategic and business plans. The Board will send the budget to Treasury to incorporate with the budget prepared by Treasury and the President, and simultaneously send a copy of the Board's budget request directly to Congress. Of course, either Treasury or the Congress may modify the budget as they deem appropriate.
5. Review the IRS annual financial audits.
6. Provide annual stewardship reports to the President, the Congress and the American public regarding the matters under its jurisdiction.

The Board's review should lead to formal decisions on the matters enumerated above. If the Board disagrees with the Commissioner's recommendation regarding a particular matter, the Board will work with the Commissioner to resolve those differences. The Board of Directors will retain final authority regarding all such matters.

In addition to its annual stewardship report, the Board may submit reports to (and may be called to testify before) the congressional committees of jurisdiction at other times. The Commission also anticipates that the Board will interact from time to time with other parts of the Executive Branch and Congress, and with stakeholder groups.

The Board should hire a small, permanent staff and have a budget to contract with outside experts and consultants to review matters under its jurisdiction. Congress also should specify certain limits on the Board's authorities and responsibilities. In particular, the Board should have no access to taxpayer information. While the Board will be responsible for overall governance of the IRS, it will have no involvement of any kind in specific matters in the following areas: interpretation or enforcement of the tax laws; tax legislation; procurement decisions; or routine and customary operational decisions. Moreover, the Board's activities will be subject to existing government safeguards designed to ensure that there is neither the perception, nor reality, of a conflict of interest, including disclosure and recusal. Additionally, the Board's activities will be subject to Treasury scrutiny and congressional oversight. The matters in which the Board will be prohibited from involvement should remain within the purview of the IRS itself, Treasury, other parts of the Executive Branch, and Congress. The duties of the Board, as outlined above, are those of governance rather than management, a distinction that is practiced effectively by most large corporations.

3. IRS Management

Congress should provide the Commissioner of Internal Revenue expanded authority over personnel and should hold the Commissioner and senior management accountable for IRS success.

Senior IRS managers have devoted significant time and effort developing long-term plans and connecting them with daily operations, and the Commission commends the IRS for those efforts. Unfortunately, there has been little or no buy-in on these efforts from Treasury, Congress, the organization as a whole, and outside stakeholders. Absent this buy-in, the IRS efforts have limited impact, and the perception is that the IRS is neither sensitive nor accountable to the American people.

Internally, the IRS Executive Committee, which is comprised of top management, is a forum for exchange of information rather than for decision making. The Executive Planning Board, which is comprised of lower level managers, tries to ensure that the budget supports priorities, but does not have the authority to direct organizational resources. In reality, the Commissioner and Deputy Commissioner are the only IRS officials accountable for the entire organization. Most successful $7.3 billion organizations have a larger group of top level managers and board members accountable for the "whole" of the organization.

The Commission is encouraged that the Government Performance and Results Act may start to connect IRS internal planning with congressional expectations and allocation of resources. The Commission encourages the IRS management and its new Board of Directors to work with Congress to ensure that the IRS budget reflects organizational priorities.

There has been a high turnover rate of IRS Commissioners over the past twenty years and in recent years many senior IRS leaders have retired, exacerbating the problems of continuity and accountability. Furthermore, the hiring practices of the IRS often stymie the Commissioner from shaping the culture and direction of the organization. Only five of the current 73 most senior executives have been at the IRS for less than fifteen years, and the IRS has encountered significant difficulties in its efforts to recruit outsiders into its executive ranks. Since the early 1950s, in an effort to insulate tax administration from political influence, the IRS has only two political appointees—the Chief Counsel and the Commissioner. Other large government agencies usually have more political appointees, making it easier to fundamentally change the institution to reflect the will of the people through the President and Congress. While institutional memory is valuable and keeping politics out of the IRS is essential, the dearth of outside thinking can limit the IRS management's ability to bring new perspectives to organizational challenges.

Senior Management Recommendations

The Commission has developed a set of recommendations in the area of IRS management. First, Congress should provide for the appointment of the Commissioner by the Board of Directors for a five year term, providing continuity of leadership at IRS. Moreover, the Board should be given flexibility to pay the Commissioner a more competitive salary, and the Commissioner should be

given greater flexibility to appoint and remove all high-level executives at the IRS (including the Deputy Commissioner, Chiefs, Assistant Commissioners, Regional Commissioners, District Directors, and Service Center Directors). If the Commissioner is to be held accountable, the Commissioner must have the flexibility to recruit his or her own management team. While the Commission anticipates that many of the executives will be selected from the ranks of the IRS, a mix of insiders and outsiders would be desirable. Because these appointees cannot be political in nature, the IRS should recruit top flight professionals to join its cadre of career Senior Executive Service managers. The Board of Directors, with five year rotating terms, will insulate the organization from politics. Because the Board will appoint the Commissioner to a five year term, the new appointees for senior management positions will not be subject to political pressure. The Commission further recommends that the Commissioner recommend the nomination of a Chief Counsel to the Board of Directors; the Board will make the final appointment of the Chief Counsel. This process will maintain the current parity in which the Commissioner and Chief Counsel are appointed independently. If, however, during the course of IRS business, the Commissioner and Chief Counsel cannot reach agreement on an issue, the Commissioner continues to have final decision making authority, as under the existing delegation orders.

To enable the Commissioner to build a management team that will help shape the direction of the IRS, Congress should allow the Commissioner to negotiate specific performance objectives with each senior executive, and to reward executives with bonuses for meeting those objectives, subject to Board approval. Moreover, the Commissioner and senior managers should develop organizational performance measures to which they will be held accountable. Current law does not allow individual IRS employees to be evaluated based on their own tax enforcement results or quotas, and the Commission does not intend that bonuses be based on this type of data.

4. Budget Process

The budget process must ensure that the IRS has an adequate long-term plan for financial resources, recognizing the IRS unique role as the nation's revenue collector and the only federal agency that interacts with almost every citizen.

The Commission believes that the IRS has an ethical obligation to serve the American people well, as it is the only federal agency that interacts with almost all citizens. Funding, therefore, should be adequate to allow the agency to accomplish its mission. Until recent years, the agency received steady increases in its appropriated funds. Beginning in 1996, however, the IRS entered into a period of uncertainty in its funding, which has made it difficult to allocate resources in a cogent, strategic manner.

In discussions with congressional leadership, the Commission found a lack of confidence in IRS abilities to accomplish strategic initiatives, from TSM to taxpayer services. In order for the IRS to regain the trust of Congress and the American people, it must prove that it is financially accountable. Additionally, with the expertise and stature of the new Board of Directors and management, the IRS will be positioned to regain the trust of Congress.

The Commission is not convinced that current IRS budget resources are allocated optimally to support strategic priorities. As discussed earlier, the IRS has had difficulty redistributing budget resources to reflect organizational focus. Furthermore, the Commission found that there may be some inefficiencies in current operations, including excess middle management in the field operations and possibly in the national office. Section 3 of this Report makes specific recommendations to introduce managed competition into IRS operations, which will help the IRS find efficiency gains. Furthermore, the Commission found that increased electronic filing will lead to cost savings. The Commission encourages the IRS to continue to use its budget to support its operational goals and to streamline operations wherever possible. The new Board of Directors will be integral to this effort, because it will be the first time that a consolidated governance body has been fully accountable for aligning IRS budget and strategy.

Budget Recommendations

The Commission recommends that Congress provide the IRS certainty in its operational budget in the near future. We recommend that the IRS budget for tax law enforcement and processing, assistance, and management be maintained at current levels of funding for the next three years. To the extent, however, that Congress is satisfied that the IRS can provide it with accurate cost and revenue information, the Commission recommends that Congress be given the discretion to decide on an annual basis whether to increase the discretionary spending limits to the extent that revenue is collected consistent with taxpayer protected rights. If the Congress increases funding for information systems, the Commission recommends that any increases in the information systems budget be targeted toward building an integrated database of taxpayer information accessible to front-line personnel and toward certain success in handling the century date change.

Over the next three years, the Commission recommends improvements in financial management at the IRS. The IRS must obtain a clean opinion on its financial audit of appropriated accounts and make significant progress in receiving a clean opinion on the custodial accounts (revenues); have independent verification that its compliance and taxpayer service statistics are reasonably accurate; and gather accurate taxpayer focused operational cost data that is verified as reasonably accurate by an independent organization.

To the extent that the IRS finds savings from efficiencies, the Commission recommends that Congress allow the IRS to use these savings to reward employee performance and invest in priority IRS operations. Additionally, after the IRS regains the confidence of Congress, the Commission recommends that IRS managers be provided with expanded authority to manage the IRS budget. The Commission also believes there needs to be greater stability to the IRS budget. To this end, the Commission recommends that the IRS submit a multi-year budget to Congress. While Congress only will be required to appropriate one year at a time, it will appropriate with the knowledge of the long-term budget requirements in mind. Once Congress feels comfortable with IRS financial accountability, Congress should consider providing multi-year appropriations for technology and other important investments.

These recommendations for consolidated congressional oversight, a Board of Directors, increased authority over personnel for the Commissioner, and a stable budget are prerequisites for changes throughout the IRS. As a comprehensive package, these recommendations will

begin the process of making the IRS an institution that everyday American's find to be fair and efficient. With clear accountability and new leadership, the IRS will have the focus and direction required to drive changes throughout the organization.

Section 2—Workforce and Culture

Congress should enable the IRS to recruit and train a first class workforce that is able to work with taxpayers to solve problems

Although the IRS has problems, many of the individual business units are staffed by competent professionals who execute their discrete functions as well as can be expected under existing organizational constraints. The Commission's staff conducted over 300 field interviews with IRS employees, and came away with an overall impression of competent, hardworking people who want to deliver a high quality product to the American taxpayer, but are constrained within the current IRS structure. Many of them agree with the Commission's findings of serious deficiencies in governance, management, performance measures, training, and culture. Of those interviewed, eighty-five percent requested that Congress stop "bashing" the IRS. They believe that broadsiding the institution for all of the difficulties and controversies surrounding federal taxes makes their jobs more difficult, particularly when Congress and Treasury are the primary sources of complexity in the tax law. The Commission agrees.

The accountants, lawyers, and taxpayers interviewed expressed universal sentiment that the quality of IRS interaction with taxpayers and the public has deteriorated over the past fifteen years. While many factors have led to this deterioration, several stand out. First, the personnel qualifications, pay levels, and training quality have deteriorated. Second, there is a shortage of basic tools available to employees to do their jobs in the most effective manner possible. This shortage includes basic equipment like facsimile machines, copiers, and computers, as well as research materials like copies of the tax code and access to online databases (e.g., LEXIS and Westlaw) needed by tax auditors and agents. Consequently, the quality of service at the primary point of taxpayer contact is low, building frustration among the taxpaying public.

Training

The IRS has a strong plan for training, but it is not receiving the institutional support needed to ensure its success. The functional units within the IRS are resistant to giving up resources to assist training personnel. This resistance is due to the IRS culture which relates power to control over resources, as well as the measurement system which rewards short-term goals over long-term investments in personnel. As a result, tax law and administrative policies are not taught consistently across the country, and the overall training and expertise of personnel is deteriorating.

The Commission believes taxpayers should deal only with IRS employees who are trained adequately and possess the skills and tools necessary to do their jobs well. Accordingly, the Commission recommends that Congress, the IRS, and the new Board of Directors make training, skills, and support of IRS personnel a priority. The IRS should implement a fully funded policy that its employees will be trained adequately, possess the requisite skills, and be given the tools to execute their jobs. This policy should be given a priority equal to the priority placed on the filing season. Other IRS operations (including enforcement and taxpayer service) should be “sized” in a manner consistent with this priority. Other major organizational changes, including reclassifying the training budget so that it is not part of overhead, undoubtedly will be necessary.

Within two years, the IRS should develop, and have verified independently, the measures necessary to ascertain whether and to what extent these standards are being met.

Stovepipe operations

Traditionally, the IRS has been characterized as a stovepipe operation. In a stovepipe operation, functional units such as taxpayer services, exam, collection, appeals, and counsel set and implement their own priorities and objectives, which often are disconnected from the other functions and the organization as a whole. This is why a taxpayer may receive a notice from the IRS, but when the taxpayer calls the toll-free number, the customer service representative is unable to help. Sometimes the customer service representative does not have the information needed to settle account problems, and sometimes the performance measures for customer service employees are not aligned with performance measures for exam or collection. Under this arrangement, the IRS looks like a conglomeration of unconnected parts, rather than an integrated organization moving toward a common goal. Although the agency has made progress in breaking down stovepipe barriers, it has not eliminated them to the degree necessary.

The Commission believes the IRS must work very hard to break down the stovepipe operations. We recognize that there is no "silver bullet" to rectifying this entrenched problem. It is our understanding that stovepipe computer systems developed around stovepipe functions, and the new Modernization Blueprint (which is discussed in Section 4 of this Report) will set the stage for eliminating these stovepipes. The new IRS leadership team should establish performance measures that encourage functions within the IRS to cooperate. Additionally, the IRS should continue on the course begun in Compliance 2000, in which cross functional teams work together to solve problems. Finally, the Commission considered more far reaching reforms to break down functional stovepipes, including reorganizing the entire organization into four divisions: individual taxpayers subject to withholding, self-employed individuals, small businesses, and large businesses. Reorganizing into specialized units focused on taxpayer needs, rather than IRS internal needs, should better serve the American public. While this idea was not fully developed by the Commission, it deserves further exploration.

Many of the recommendations in the technology section of this report also are geared toward breaking down functional stovepipes. The new governance and management structure must serve as a vehicle to push major changes through the organization. Past efforts to break down stovepipes have failed. The new Board of Directors and Commissioner, with fixed five year terms, should develop the proper structures, systems, and measures to break down stovepipe operations and direct all resources to meeting the needs of taxpayers.

Risk averse culture

Every institution has a unique fabric that is reflected in the attitudes and actions of employees. While the various functions and divisions of the IRS have different cultures and mores, some generalizations can be drawn from the Commission's work.

The culture of IRS is overly risk averse, based on a tradition of valuing checks and controls over creative approaches to solving problems. In order to evolve into a more taxpayer focused, responsive organization, a cultural shift must occur at the IRS. The positives of the culture are

that employees will execute orders and follow directions. The negatives are that the IRS environment often does not encourage personal or organizational growth, and stifles creativity, innovation, and quick problem resolution.

The IRS provides minimal incentive for managers or front-line workers for achieving mission. Most managers interviewed said that rather than use their judgment to assist taxpayers, they document changes they think will help the system, and send them through the chain of command for approval. Most managers indicated that this is often discouraging due to the time lag caused by the multiple layers of management approval required to override systems. Front-line employees and managers rarely receive a response to their suggestions. In addition, Congress, Treasury, GAO, and the press tend to focus on failures without acknowledging successes. Both internal and external forces foster an environment in which employees value rules over outcomes, and do little to encourage the use of judgment in handling taxpayer problems. While the IRS traditional career path develops good managers of labor intensive operations, it does not produce enough business strategists or innovative leaders of technology based process change.

The lack of structure to improve operations based on input from front-line personnel and managers is mirrored at the highest levels of the organization. Senior managers expressed frustration that the infrastructure and decision making process at the IRS does not encourage a full airing of issues. Dissent often is frowned upon, and top level decision makers are not always given the best options for making strategic decisions. Often, the institution views even constructive criticism, whether internal or external, as an attack, blunting the opportunity to have a full review of issues and solutions.

Internal Performance Measures

The IRS has a formal system for reviewing and evaluating its front-line employees and managers based on "critical elements" for every job description. Employees are rated by their managers on their performance in each of these elements on a five point scale. In addition to understanding that they must meet a certain level of performance for the critical elements, field employees are aware of the numerical performance goals that must be met by their group, division, and District or Service Center. Current law prohibits Revenue Agents, Tax Auditors, and Revenue Officers from being evaluated by numerical goals. Congress created this rule to ensure that taxpayers would be treated fairly and not be subject to dollar quotas that field employees might feel pressure to meet.

The Commission applauds the IRS for its attempts to develop a measurement system that influences employee behavior in a positive way. While measures have consistently improved over the past five years, they still need further refinement and development. Most employees interviewed at the IRS are concerned that the internal measurement systems (the Field Office Performance Index (FOPI), Service Center Operations Index (SCOI), and the formal system for evaluating employees that the agency uses as a vehicle to influence employee behavior) are ineffective and encourage perverse behavior. Employees believe that the numerical standards of the FOPI and SCOI do not measure long-term quality performance accurately. Consequently, employees put an emphasis on short-term performance and meeting goals of efficiency (as measured by the FOPI and SCOI), rather than on a balanced focus on efficiency, quality, and

taxpayer service. Many employees and outside observers believe the result is that the performance measures do not align with the ultimate objectives and mission of the IRS.

The Commission encourages the IRS to ensure that day-to-day measures of employee performance and behavior align with organizational goals. One of the most significant efforts that the IRS must undertake is to redesign its internal measurement system to encourage behavior which makes it easy for taxpayers to interact with the IRS. A prerequisite to building internal measures is buy-in among IRS, those responsible for governance and oversight of the agency, and external stakeholders. Once priorities are set, the IRS should use private sector experts to help it further refine its internal measures.

Constraints on management

IRS management feels that it is very difficult to realign management and front-line personnel in order to deal with workload and priority changes. In the last few years the IRS budget has decreased, and there is a growing perception that management is constrained in managing the IRS workforce. Most notably, management prioritizes keeping employees on the payrolls. From what the Commission has been able to discern, a combination of the federal civil service rules, labor relations, and management's unwillingness to make difficult decisions causes the organization to feel constrained in its ability to move workers to priority areas and remove ineffective workers. The Commission encourages the IRS to hold all workers—from senior mangers to middle managers to front-line employees—accountable for carrying out the IRS mission.

The Commission recommends that Congress enable the IRS to attract and train a qualified workforce. To do this, the IRS needs the flexibility to recruit employees from the private sector, to redesign its salary and incentive structures to reward employees who meet their objectives, and to hold non-performers accountable. We suggest that the new IRS leadership work with its Board of Directors and Congress to redesign current incentive systems. In this regard, Congress should consider providing the IRS with similar flexibility that it provided the Federal Aviation Administration. In addition, the IRS must increase its commitment to training personnel, and should encourage new ideas and approaches to serving taxpayers, increasing compliance, and increasing productivity.

Again, the Commission is convinced that the necessary changes in training, culture, measures, and quality of workforce need to be driven by IRS leaders. The Commission's recommendations in governance and management, as outlined in Section 1 of this Report, set the stage for fundamental organizational change, and are necessary prerequisites to the successful implementation of the changes recommended in Section 2.

Section 3—IRS Strategic Objectives: Customer Service, Compliance and Efficiency Gains

In evaluating how the IRS should approach its three strategic objectives of improving customer service, increasing voluntary compliance, and finding efficiency gains, the Commission adopted two guiding principles. These principles mirror the recommendations of the Commission's Measures Working Group, which included representatives from Congress, Treasury, IRS, outside stakeholders, and the Commission.

- The IRS should only initiate contact with a taxpayer if the IRS is prepared to devote the resources necessary for a proper and timely resolution of the matter.

- Customer satisfaction must be a goal in every interaction the IRS has with taxpayers, including enforcement actions. Taxpayers expect quality service in all interactions with the IRS, including taxpayer assistance, filing tax returns, paying taxes, and examination and collection actions.

Introduction

The American public expects timely, accurate, and respectful service from the IRS, but surveys rate the IRS low in customer satisfaction when compared with other service organizations. While this may stem in part from the dual nature of the IRS as both a tax administration and law enforcement agency, the Commission believes most citizens compare the service they receive from the IRS with the service they receive from financial service institutions. Because far more taxpayers are touched by the IRS in its tax administration role than its law enforcement role, this is only natural. Today's customers expect to be able to withdraw money, access account information, pay bills electronically, resolve account problems, and send and receive information twenty-four hours a day with minimal inconvenience or cost. Modern financial service companies have redefined completely the acceptable levels of customer service in the past twenty-five years. For better or worse, the public judges the IRS by these standards.

The Commission believes that good customer service and taxpayer education, which assists taxpayers in meeting their tax obligations to the government, leads to increased compliance. Two initiatives in the past decade—Compliance 2000 and the compliance research approach—embody IRS efforts to turn away from high-cost enforcement solutions to noncompliance to lower-cost, non-enforcement solutions. The traditional enforcement approach to compliance was focused on one-by-one enforcement of taxpayers through audit and examination of individual taxpayers. Not only was this approach expensive, but it did not identify patterns of noncompliance. The new approach shifts emphasis to preventing noncompliance by identifying areas in which noncompliance is most likely to occur. By integrating these research efforts with other IRS compliance programs, and ensuring proper training and technology resources, the result will be an IRS that better serves the needs of the American people.

1. Improving Customer Service

The IRS must develop a strategic plan for improving customer service that is based on communicating more effectively with taxpayers, using information as a strategic asset, and increasing its organizational commitment to training and education.

Communicating through notices

IRS notices and correspondence to taxpayers often fail to explain the problem in a clear and simple manner and fail to inform the taxpayer how to resolve it. Notices often lack essential and basic information needed by taxpayers. In a survey of certified public accountants, eighty-seven percent said that IRS notices do not contain a precise explanation of the problem. Moreover, when a taxpayer calls for assistance, the customer service representative (CSR) does not always have the background information needed to resolve the taxpayer's inquiry. Even if the taxpayer understands the notice, and fully complies, the taxpayer rarely receives confirmation of compliance, and is left with the lingering doubt that the IRS has not resolved the problem. In short, the notice process at the IRS is a struggle with a bureaucracy, rather than an interaction with a customer friendly organization seeking to resolve taxpayers' problems. The IRS should continue the progress made in its notice reengineering effort, designing its notices to provide concise explanations of the amounts owed, how the adjustment was calculated, and how the taxpayer should comply.

Communicating through telephones

Historically, taxpayers have had extreme difficulty accessing the IRS by telephone. Between October 1995 and September 1996, the IRS answered twenty-one percent of all calls, seventy-four percent of attempted calls received a busy signal, and five percent of all calls were abandoned. At the time of the drafting of this report, the IRS appeared to show substantial improvement in taxpayers' access to IRS CSRs during the 1997 filing season. The latest statistics available to the Commission show that between October 1996 and April 1997, the IRS answered fifty-one percent of all calls, thirty-six percent of attempted calls received a busy signal, and thirteen percent of all calls were abandoned. Even with this improvement, however, the level of access continues to be unacceptable and inferior to service performance in private sector service organizations.

Quality should not be sacrificed for quantity. In this regard, the IRS has made great progress in telephone response accuracy over the last few years. The IRS uses sample calls to monitor and measure the accuracy of its telephone assistance. In fiscal year 1996, according to IRS measurements and sampling, 93.3 percent of taxpayers with an account question received accurate information, and 91.6 percent of taxpayers with a tax law question received accurate information.

Technology can be used to facilitate increased customer satisfaction. For example, call routing technology, including automated call distributors (ACDs) and voice response units (VRUs), and associated analysis and scheduling packages, can provide flexibility and efficiency in routing calls to CSRs. Of course, the IRS must provide sufficient staffing so that an adequate number of CSRs are available to answer calls and respond to taxpayer inquiries. Moreover, these CSRs

must be trained to use these tools effectively and efficiently. A trained workforce with the right tools and access to taxpayer information can help lead the way toward increased customer satisfaction.

Communicating electronically

The IRS also must improve its traditional means of communicating with taxpayers—computer generated notices and correspondence, as well as telephones—and expand its use of technology to offer new forms of taxpayer communication. For example, the IRS now distributes tax information and forms through its internet web site. The IRS internet experience has been very positive in terms of the number of users (hits) and public acclaim. Based on this success, the IRS should continue to explore the use of electronic mail, with appropriate security and privacy controls, to communicate with practitioners and taxpayers.

Using information strategically

Access to timely and accurate taxpayer information is an essential ingredient for improving customer service and compliance. The recently released Modernization Blueprint recognizes this, demonstrating how the IRS plans to migrate toward an integrated set of databases that will serve both functions. By migrating from its stovepipe legacy systems to an environment in which IRS employees, as well as taxpayers, can access accurate, updated taxpayer information, the IRS will be positioned to deliver taxpayers the quality service that they expect, and to improve compliance efforts as well.

The IRS does not have an integrated database that would allow CSRs to have real time access to all relevant taxpayer data. Currently, the IRS uses the Integrated Data Retrieval System (IDRS) and the Integrated Case Processing system (ICP). Although the latter system allows a CSR to access separate account information databases from a single computer terminal, ICP is a "read only" system that only can be used to look at information, but not to update information in the accessed databases. Moreover, the IRS has only 3000 workstations equipped with ICP. The ICP is no substitute for a truly integrated accounts management database. Without such a database and information access, the IRS will continue to have significant difficulty improving its customer service.

One major problem with IRS databases is that the master file, which was designed in the 1960s, is based on a weekly posting cycle. Instead of updating taxpayer accounts each day, the data is accumulated during the five business days of each week and put into the taxpayers' accounts in the master file on weekends. Thus, taxpayer data received at the service centers may not be available on the master file for as many as ten days from the date the information is transmitted to the Martinsburg Computing Center. The result is that online access to this data by CSRs is delayed. The access is even further delayed by the need to update IDRS, the primary system used by CSRs to resolve taxpayer account issues.

The second problem stems from the stovepipe nature of IRS operations. The individual databases generally perform stovepipe functions that reflect the stovepipe organizations for which they originally were developed. The consequences of such a design can hinder customer service. For example, separate tax assessments for the same taxpayer could be found on six separate systems.

Obtaining a comprehensive view of all data required to resolve a taxpayer's account issues may require a CSR to research all six systems.

To address the stovepipe nature of legacy systems, which is a major impediment to quality customer service, IRS business and technology experts must work together to develop solutions. The starting point must be to establish a comprehensive vision of customer service and the measures the IRS will use to evaluate progress in achieving strategic customer service objectives in everything it does to facilitate taxpayers meeting their tax obligations.

The Modernization Blueprint makes integrated databases for improved customer service and compliance its first priority. The IRS needs to develop performance measures to gauge success in this effort. Working in partnership with its prime contractor, the IRS can then develop a detailed plan and schedule, consistent with the overall requirements of the Modernization Blueprint, to migrate from the legacy environment to a modernized information access system.

Training and education

A fundamental component of quality customer service is a well trained workforce with the knowledge and ability to help taxpayers resolve their problems. As discussed in Section 2 of this Report, the IRS must increase its organizational commitment to training and education, including the cultural changes necessary to encourage front-line innovation and initiative. In recent years, the IRS has begun to develop a school of taxation that incorporates the elements and principles of corporate and academic models, and the IRS should have university quality training. Ultimately, the IRS leadership must decide how to increase its commitment to training and education to ensure that IRS personnel are as well trained as their private sector counterparts.

Public-private partnership

An important aspect of customer service is understanding what is necessary to achieve customer satisfaction. Public-private partnerships, which can be institutionalized as formal advisory groups, can help in this regard when the IRS takes their advice into account. The IRS uses several such groups to advise the Commissioner on various issues, including information reporting and art valuation. In addition to the private sector guidance that the IRS will receive from the Board of Directors and new senior leadership, the IRS should continue to partner with the private sector and state tax administrators to improve its operations, particularly with respect to information reporting, training and education, customer service and compliance, electronic commerce, and financial management.

2. Improving Compliance

The IRS should continue with its new approach to addressing noncompliance of emphasizing research to prevent noncompliance before it occurs.

The IRS constantly struggles to ensure compliance with the tax law in a system that depends on citizens to voluntarily calculate and pay their taxes. The IRS traditional enforcement approach to compliance focuses on specific taxpayers, using examination and collection resources to ensure payment of the proper amount of tax. In addition to auditing between one to two percent of all

individual returns, most of which are selected for audit using the discriminate function (DIF) formula, the IRS compliance approach targets collection of assessed taxes and criminal investigation of certain transgressions. While these efforts are necessary components of a balanced, strategic compliance program, they are expensive and do not identify patterns of noncompliance.

Recent efforts, which began with the Compliance 2000 program and were supplanted by the current compliance research approach, embody a new emphasis on preventing noncompliance by identifying and addressing areas in which noncompliance is most likely to occur. This approach, which focuses on taxpayer education and outreach, is intended to yield long-term improvements in compliance. The IRS has established district offices of research and analysis (DORA) in nearly every district, and coordinates their work through a national office of research and analysis (NORA). These offices attempt to identify compliance problems, prioritize them, develop and implement focused responses to these problems, and measure the impact of the responses. In addition, the recently deployed compliance research information system (CRIS) is designed to help NORA/DORA offices identify emerging noncompliance trends.

Integrating research and enforcement

The information available from the new approach to compliance, which emphasizes research and analysis of trends, should be utilized throughout the organization. For example, the NORA/DORA offices generally focus on nonenforcement solutions to noncompliance, unlike the IRS examination and collection offices. Working together, however, these personnel can apply analytic tools developed through the NORA/DORA program to increase efficiencies and effectiveness of examination efforts, including audit selection.

Training and resources

DORA staff members interviewed by the Commission expressed the need for more training in methods and data analysis. Because the NORA/DORA approach is designed to be heavily computer and data driven, the staff must be able to manipulate and interpret the data for the effort to be successful. Staff also must have access to computer systems that are properly maintained. To date, DORAs have not had adequate technical support. For DORAs to succeed, significant investments must be made in the staff and in the maintenance of the computer infrastructure.

Taxpayer education and outreach

The IRS has diffused authority and responsibility for taxpayer education between its taxpayer service, examination, and collection functions. Taxpayer education is core to voluntary compliance. There are many facets to taxpayer education, including outreach programs, post office and library programs, small business education programs, programs at post and secondary educational institutions, practitioner education, pro bono tax clinics, emergency assistance, media information programs, volunteer tax assistance, and the distribution of tax forms and publications. Professional educators and adult education techniques facilitate greater compliance by emphasizing education over enforcement. If properly designed, taxpayer education and outreach can be a proactive method of enhancing compliance.

Estimating noncompliance

One of the most significant criticisms of the IRS compliance research approach is the lack of current, reliable data on noncompliance. A statistically valid and consistently applied approach to developing compliance initiatives (including enforcement, education, outreach, and legislative and regulatory initiatives) should be established. The methodology for data gathering should be developed by private research and statistical experts. Consistency ensures that the method for selecting returns for examination does not become obsolete or substantially ineffective. Finally, the IRS should keep in mind that taxpayers involved in any statistically valid process are helping the IRS, and they should be treated accordingly.

Repeat offenders

There is a significant difference between taxpayers finding themselves in unexpected financial difficulties trying to meet their tax obligations and taxpayers who continuously or frequently fail to meet their tax obligations. The former category of taxpayers are not encouraged to voluntarily comply when it is more burdensome to pay taxes owed than to escape through bankruptcy. Various information systems and audit programs intended to allow the IRS to manage its nonfiler inventory, track recidivism, and monitor federal tax deposits have not been successful. To address these problems, the IRS must use technology to tailor compliance programs that target repeat offenders and allow the IRS to stop compliance problems earlier in the cycle. Only by continuously improving collections programs and procedures, including payment procedures that reflect taxpayers' circumstances, will the IRS be able to improve voluntary compliance, reduce burden on honest taxpayers who have made honest mistakes, and focus enforcement resources on the small number of repeat offenders.

3. Efficiency Gains

Inquiry into the potential cost savings of private sector partnering and outsourcing, managed competition, enterprise management, and performance management is warranted.

Private sector partnering and outsourcing are approaches that public organizations use to cut their costs and increase their quality. The most important question is not whether to outsource an activity, but how to get the most effective and efficient performance for taxpayer's dollars. Sometimes this can be done through partnering or outsourcing, but there are a number of related approaches that the IRS should consider as well. The following discussion, which is taken from testimony to the Commission by David Osborne, the co-author of Reinventing Government and Banishing Bureaucracy, focuses on three such approaches—managed competition, enterprise management, and performance management. The IRS should carefully consider using a mix of these approaches to produce the proper incentive structures to motivate managers and employees to embrace continuous improvements and cost savings.

Private sector partnering and outsourcing are business decisions. The preconditions for making strategic decisions regarding private sector partnering and outsourcing include:

- Defining clear, measurable business objectives;
- Benchmarking cost and performance data in order to compare it with potential contractors;
- Examining which functions and processes are so intertwined that they must remain in-house;
- Deciding which powers of the IRS are so sensitive that private industry cannot hold them; and
- Deciding what are the core competencies of IRS, and outsourcing operations that either can be done better by the private sector or will divert management away from its core responsibilities.

The IRS will continue to have difficulty making decisions about who should do what work until accurate cost data, clear program priorities, and performance measurement standards are in place.

Managed competition

In many cases, it is wise to include public organizations in the competitive contracting process. This approach is known as "managed competition." It requires potential providers of government services—private firms and public agencies—to compete against one another for contracts, based on their performance.

Public employees often work in inefficient, bureaucratic systems they did not invent. Most of them want to be empowered to cut through the red tape that binds them. They are victims of the bureaucracy, not perpetrators. As Indianapolis Mayor Steve Goldsmith explained, "Before we let entrepreneurs provide government services, let's allow government service providers to become entrepreneurs." Also, managed competition would allow IRS to maintain some public capacity to step in if private contractors fail. In addition, some organizations decide they need to preserve some in-house service delivery so they do not lose the hands-on knowledge necessary to act as an intelligent buyer.

The most compelling reason to let public providers compete, however, is to maximize competition. When public employees face competition they often figure out how to slash costs below those of private competitors, giving the taxpayers a better deal. Managed competition does not suggest cutthroat competition for every public service. To make competition work, the IRS will need to structure it fairly and manage it carefully. It requires a significant investment and a great deal of work, and there are pitfalls at each step—one reason an approach called "enterprise management" also should be considered.

Enterprise management

Another way to create competition, enterprise management forces public service delivery organizations to function as business enterprises with financial bottom lines, usually in competitive markets. Rather than acquiring their revenues from government appropriations of

tax dollars, they earn money by selling goods and services directly to their customers. To earn their keep, in other words, they must succeed in the marketplace. Failure brings financial loss, which can lead to job loss. Success can result in increased economic rewards.

Public organizations are candidates for enterprise management only if they produce goods or services that can be sold to customers. This applies to agencies that serve "external" customers, like citizens and businesses. It also applies to government's "internal" providers. At the IRS, enterprise management would be most applicable to these long-standing internal monopolies, including data processing, printing, and notice mailing.

Performance management

When neither enterprise management nor managed competition is appropriate—whether for rational reasons or because of political obstacles—the alternative is performance management. This approach uses performance measures, standards, rewards, and penalties to motivate public organizations. These rewards and penalties can be financial, like gainsharing, or they can be quasi-economic, like giving three-day weekends to units that achieve their monthly performance targets. They also can be strictly psychological, like recognition and award programs.

Managed competition, enterprise management, and performance management are not mutually exclusive. Organizations that operate as public enterprises or that compete for contracts typically use many performance management tools to maximize their competitive advantages. One of the most powerful tools available under performance management is gainsharing, which gives employees a guaranteed portion of financial savings their organization achieves, as long as they meet specified levels of service and quality. This gives workers a clear economic stake in increasing their productivity.

Dealing with employees

Enterprise management, managed competition, and outsourcing often force public organizations to downsize, sometimes rapidly. How should the IRS deal with this possibility? Unless the agency is in a fiscal crisis so deep that it simply cannot afford to do so, the IRS should minimize reductions in force. Employees did not create the bureaucracies in which they work, and they should not pay the price of reinventing those bureaucracies. Many proponents of managed competition propose a no-layoff policy, gainsharing for employees who work more efficiently, and creating a menu of options for employees whose jobs disappear. The menu of options to help displaced workers includes:

- Shifting dislocated employees into other public jobs;
- Shifting public workers into private firms taking over the work;
- Encouraging contractors to provide comparable compensation;
- Helping managers take their organizations private; and
- Offering economic incentives and outplacement services to those who choose to retire or look for jobs elsewhere.

The key is to use attrition to downsize, shifting displaced employees into jobs vacated by those retiring or departing. The IRS may need flexibility to move people around. It can use the authority to create demonstration projects granted by the 1978 Civil Service Reform Act to do so, and can use the other flexibilities discussed in Section 2 of this Report.

The most important question is not whether to outsource a public activity, but how to get the most effective and efficient performance for the taxpayers' dollar. Sometimes this can be done through outsourcing. Often it is better done through public versus private competitive bidding, or through enterprise management. The key issue is not whether the public or private sector delivers the service, but rather what incentives operate upon that service deliverer and how much freedom from red tape that service deliverer enjoys. If one can give the operator freedom from bureaucratic restraints and genuine consequences for performance, efficiency and effectiveness usually will improve dramatically. If one can protect public employees from the threat of unemployment in the process, they will eagerly put their talents to the task and often produce remarkable results.

Again, the Commission is convinced that our recommendations regarding oversight, governance, management, budget, and workforce, as outlined in Sections 1 and 2 of this Report, are necessary prerequisites to accomplishing the IRS strategic objectives.

Section 4—Modernization

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

Introduction

Information technology should be used to enable the IRS to achieve its strategic objectives, not to drive them. This premise necessitates a clear strategic plan that identifies business requirements that IRS technologists can use to develop information systems supporting those requirements.

The IRS Tax Systems Modernization (TSM) project failed because the IRS did not have a consistent long-term strategic vision to guide the project. The IRS modernization deficiencies, as documented by GAO and the National Research Council (NRC), show both a lack of business technology integration and a failure to use best practices:

- The IRS did not possess the technical management resources necessary to manage a program as complex as TSM. Senior technical leaders were noticeably absent.
- The systems architecture within the IRS, including its functions, data, and technology building blocks, was insufficient.
- Enterprise wide technical security had not been developed.
- The IRS lacked a cost effective strategy for reducing paper tax return submissions.
- The process for selecting, prioritizing, controlling, and evaluating the progress and performance of major information systems investments was ineffective.
- The IRS failed to develop fully and put in place the requisite management, software development and technical infrastructures necessary to implement successfully an ambitious world class modernization effort.
- The IRS had inconsistent and poorly controlled software development processes.
- Organizational structure with the accountability and authority needed to manage modernization efforts was lacking below the Commissioner's office.

While the recently released Modernization Blueprint demonstrates that the IRS recognizes the need to develop a strategic plan for integrating technology with business objectives, additional steps must be taken to ensure that technology is used to enable business success. Implementation of the Government Performance and Management Act (GPRA), as well as the Information Technology Management Reform Act (ITMRA), should help to ensure that IRS implementation of the Modernization Blueprint is well managed.

The IRS has acknowledged that it lacks the intellectual capability to modernize, and that it must address its lack of personnel with appropriate training and experience. It has begun this process by hiring a promising new chief information officer (CIO) who has begun recruiting senior technical managers from outside the organization. The Commission appreciated the candor of

the CIO in describing IRS technology problems, commends him for undertaking the arduous task of developing a comprehensive system and security architecture, and expects that the CIO and his team will effect significant improvements at the IRS.

As the new CIO builds his team to address the IRS technology problems, the IRS must address three significant modernization issues—the century date change, integrating technology with strategic objectives, and developing its intellectual capital. The May 15, 1997 release of the Modernization Blueprint represents a significant IRS accomplishment, and is a major step forward in implementing the Commission's recommendations on modernization, as well as establishing a partnership with the private sector.

1. The Century Date Change

The IRS must continue to make the century date change its highest technology priority, and Congress should provide the IRS with sufficient resources to address this problem.

The century date change, which relates to the problems most computer systems will have in referring to calendar year 2000, is a high risk area for the IRS. Virtually all computer programs currently use a two digit representation of the year in which the first two digits are implied. For example, 02/12/46 is interpreted as February 12, 1946. When the calendar advances to January 1, 2000, computer programs will interpret the date as January 1, 1900.

The century date change issue has the potential to seriously impact IRS operations after January 1, 2000, and undermine public confidence in the IRS. Some impact may even be experienced before January 1, 2000 because the IRS and external systems may generate invalid dates for future events. The potential risk to voluntary compliance is significant. The IRS has made this problem its highest technology issue, and has developed a plan to correct the problem that is technically sound, but not without basically unavoidable risks.

The risks associated with the century date change are primarily managerial, not technical. The IRS has developed a plan and assigned resources; the challenge is to implement the plan. First, the IRS must complete an inventory of its second and third tier programs. Once that process is complete, the IRS must recode, test, and implement programs in all three tiers. To monitor this process, the IRS should develop detailed schedules with intermediate milestones to be evaluated weekly between now and program completion. As progress is made, the IRS should measure productivity rates so that all future efforts can be scheduled to be accomplished within available resources. In addition, the IRS must develop contingency plans to address the possibility that some milestones will not be met. Finally, because the cost of correcting century date change problems can increase with time, Congress should ensure that the IRS has sufficient resources to address these problems now, while there is still time to accomplish the task, so that the IRS does not have to compete for resources at increased cost as the deadline approaches.

Because the century date change problem carries such high risk, the best IRS technology managers have been placed on the project. This takes them away from other modernization efforts, putting the organization further behind in modernizing its accounts information database.

To ensure that the IRS is able to address the century date change problem adequately while continuing its modernization efforts, the Commissioner should ensure that the Board of Directors and Congress are aware of resource requirements so that Congress can provide the IRS with adequate resources.

2. Integration of Technology With Strategic Objectives

The IRS must recognize that technology is an enabler, not a driver, of business success, and that it needs a strategic plan with business objectives that drive the use of technology.

One of the most significant problems with TSM was the failure of the IRS to tie technology objectives directly to business objectives, and to assess success based on those objectives. Integrated technology that meets business objectives should be a principle of management that is demonstrated at the highest levels of the IRS organization.

The IRS needs a strategic business plan that flows down into business requirements and technology needs, using quantitative business indicators to evaluate the benefits of technology toward meeting business objectives. To ensure that information technology systems are developed in a disciplined, yet flexible manner, the IRS must adopt and implement industry best practices, many of which have been legislated for federal agencies in GPRA and ITMRA:

- Establishment of formal strategic business plans and business requirements between business and technology organizations;
- Use of measures to quantify the business benefits of technology investments;
- Conduct of annual strategic planning conferences between business and technology executives;
- Updating and reengineering of business processes so that outdated processes are not thoughtlessly automated;
- Formulation of multi-year budget plans with annual appropriations;
- Development of an overall architecture and design, including a security architecture;
- Consistent application and enforcement of a life cycle methodology; and
- Implementation of changes in technology systems in small, gradual steps, when feasible.

Both GPRA and ITMRA require annual reports to Congress on an agency's strategic plans. These strategic plans, and measures used to define performance improvements, should be approved by the Board of Directors. To satisfy the GRPA requirement that affected stakeholders be consulted on strategic plans, the IRS should work with additional formal and ad hoc advisory groups.

To be successful in developing and managing technology, a true three-way partnership must be achieved among congressional sponsors, IRS chief officers, and technology developers. Each partner organization should be accountable and responsible within its domain of expertise; congressional sponsors must provide strategic oversight, IRS chief officers must identify

strategic plans and operate the business in accordance with those plans, and technology developers must establish national standards for technology and manage systems development in accordance with business requirements. Resources to accomplish each task must be available to the performing organization.

3. Intellectual Capital

The IRS must obtain the intellectual capital necessary to modernize by developing its own core capabilities to manage technology and by acquiring private sector assistance with responsibilities and incentives that focus on achieving IRS success.

The IRS must use a strong leadership team to maximize its core capabilities and private sector resources, including both information technology contractors and tax professionals, for modernization. It must recognize that a richer set of in-house capabilities and skills are required to be effective when there is reliance on external supply, even though fewer personnel may be required.

Upgrading skill levels to manage contractors, however, remains a challenge for the IRS and needs to be acted upon quickly. Ideally, upgrading should occur prior to the award of an outsourced prime contract. If necessary, the IRS should seek assistance in developing this capability. The IRS cannot rely on contractors to correct problems unless it provides the necessary management and oversight. Core capabilities necessary to manage contractors in an outsourced environment are discussed in Appendix F.

If the IRS can establish expertise in managing contractors, using the personnel flexibility recommended in Section 2 of this Report, it can rely on contractors' expertise in systems development, integration, and implementation. The Commission endorses the IRS plan to use a prime contractor to bring private sector expertise to bear on its modernization program. The scope of the prime contractor's responsibility should include design and implementation of complete business solutions that satisfy constraints established by the IRS in the Modernization Blueprint. The IRS should establish incentives for the prime contractor that are based on its success in delivering and implementing systems that meet IRS business requirements. For example, contract mechanisms that align contractor interests to those of the IRS, such as performance based contracts, can be instrumental in achieving this objective.

Section 5—Electronic Filing

Electronic filing holds great potential to increase cost savings and compliance with only a small investment by the IRS. With a cohesive plan to market and implement electronic filing, the IRS can improve its customer service capabilities, modernize its processing functions, and facilitate more efficient compliance efforts. Such a plan must eliminate barriers and provide benefits and incentives for practitioners and taxpayers.

Introduction

The IRS presently receives approximately 205 million tax returns each year. The largest workload involves the nearly 120 million individual tax returns. The ten service centers process paper returns using an error prone process during which approximately forty percent of the tax return data is entered and perfected manually. The error rate for this data capture and perfection process is approximately twenty percent, half of which is attributable to the IRS. Because electronically filed returns usually are prepared by computer programs with built in checks, undergo pre-screening by the IRS, and experience no key punch errors, these returns have an error rate of less than one percent.

Presently over one half of all individual tax returns exist in electronic format prior to submission to the IRS. Practitioners usually prepare returns on their computers, but print them out and send them to the IRS on paper. Digital-to-paper-to-digital conversion inefficiencies, including physical handling of the paper returns, opening of mail, physical arranging and batching of paper documents, and error prone manual data entry, add to the cost of processing paper returns. Common sense tells us that information already in electronic format should be transmitted directly to the IRS, avoiding these redundancies and inefficiencies.

In addition, the pipeline (IRS paper return processing function) still uses antiquated equipment, such as the Distributed Input System (DIS) and Remittance Processing System (RPS), to input information from paper documents. Installed in 1984 and 1978, respectively, these systems experience significant downtime and slow operator productivity.

In 1993 the IRS established an electronic filing goal of eighty million tax returns by 2001. However, the IRS has not yet developed a comprehensive, plausible strategy to meet this goal. Better marketing to taxpayers, elimination of taxpayer burdens and barriers, increased cooperation with tax practitioners, and lower costs of filing are the keys to greater electronic filing. Previous efforts at marketing have focused almost exclusively on those taxpayers concerned with quick refunds. The IRS must reach beyond this group of taxpayers and develop appealing strategies for various segments of taxpayers and practitioners in order to achieve its stated goal.

The IRS reports that it could accept over 100 million electronically filed returns annually without requiring any new systems development effort. However, to accomplish this goal the agency needs to put in place additional building blocks, including acceptance of all form types, internet capability, and paperless payment.

1. Strategic Marketing Plan

The IRS must develop a strategic marketing plan to make paperless filing the preferred and most convenient means of filing for the vast majority of filers in ten years.

The IRS needs a strategic marketing plan to make paperless filing the preferred and most convenient means of filing for the vast majority of filers in ten years. This goal can be achieved through increased industry partnership, elimination of barriers, use of competitive market forces to lower costs, additional benefits to taxpayers, and changes to IRS systems and procedures.

In promoting movement toward electronic filing, a key element is cooperation with paid preparers. In testimony to the Commission, however, there was an overwhelming response from relevant stakeholders that the IRS has not partnered with external stakeholders to increase the level of electronic filing, and that the IRS does not make it easy for practitioners or individuals to file electronically.

The current electronic filing process can be complicated, and measures to protect against fraud can increase this complexity unnecessarily. To help move taxpayers toward electronic filing, many tax practitioners believe that these barriers should be removed by:

- Making the process truly paperless by eliminating the current requirement to file Form 8453 to obtain the taxpayer's signature;
- Reducing the cost to the taxpayer for electronic filing;
- Marketing electronic filing beyond that segment of taxpayers who desire a quick refund;
- Enabling taxpayers to file all forms electronically;
- Streamlining the annual procedures for certification as an electronic return originator;
- Enabling taxpayers to submit supplementary notes, explanations, or elections when filing electronically; and
- Eliminating the erroneous perception that electronically filed returns are prone to greater audit scrutiny.

The IRS has not achieved its original objectives for electronic filing because its current program has limited appeal to taxpayers and practitioners. The Commission has concluded that no single modification will change taxpayer or practitioner behavior, and that a comprehensive plan to remove barriers, increase benefits, and broaden the appeal of electronic filing to all segments of the taxpayer and practitioner population is essential. The Commission recommends that the IRS, Congress, and the Administration establish a goal that less than twenty percent of all tax returns be filed on paper within ten years, and that IRS leadership be held accountable for accomplishing that goal. The Commission believes that this goal can only be achieved by implementation of a comprehensive plan that is accepted by Congress, the Administration, and stakeholders. Based on extensive discussions with relevant stakeholders, the Commission has developed one such plan, which is presented in Appendix G. Many elements of this plan require legislative action,

and the Commission recommends that Congress act to pass the required legislation so that the IRS can begin to implement the plan. In holding the IRS accountable for the stated goal, the IRS should bear the responsibility for recommending changes to the plan in future years that may be necessary to achieve the stated goal.

Because the IRS will need continued input from practitioners as it implements its electronic filing strategy, it should consider institutionalizing this partnership by establishing an Electronic Commerce Advisory Group (ECAG) to address issues of mutual concern to IRS and the practitioner community. For example, the ECAG could work with IRS to develop marketing campaigns to encourage electronic filing and educate taxpayers about its benefits.

2. Incentives for Electronic Filing

Congress should eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing.

Many external stakeholders support electronic filing because they believe it reduces burden for themselves and taxpayers, in addition to reducing burden for the IRS. Presumably, as the volume of electronically filed returns increases, demand in the marketplace will drive down prices for electronic filing. Most tax practitioners charge for electronic filing today because they incur additional expenses, including costs of communications and third party transmitters. Surveys indicate that the cost of electronic filing is a disincentive to taxpayers to file electronically. The Commission expects that more taxpayers would file electronically, but for its cost.

To expand the appeal and broaden the benefits of electronic filing, the IRS strategic plan should incorporate a range of features that makes electronic filing attractive to both taxpayers and practitioners, including the following:

- Paperless filing;
- Extended due dates for electronically filed returns;
- Acceptance of all forms and attached schedules;
- Regulation of all paid preparers;
- Incentives for filing electronically; and
- Secure access to taxpayer account data for taxpayers who file electronically.

Incentives

Because increased electronic filing will yield significant cost savings for the IRS, some sharing of these savings with stakeholders may provide a useful incentive. A combined incentive and mandate plan would help to increase levels of electronic filing, particularly if it facilitates free electronic filing. In the plan outlined in Appendix G, the IRS would pay transmitters an incentive for each return filed electronically. Assuming that transmitters shared these incentives with originators based on market competition, this plan should facilitate increased electronic

filing when coupled with requirements for practitioners to file returns electronically at some point in the future. As the level of electronic filing increases, the incentives could be phased out.

Realignment of return submission deadlines
Realigning the due dates for tax and information returns could rationalize the entire filing process, provide a more realistic timetable for submission and incentives for electronic filing, level the workload of the IRS and tax practitioners, and establish the foundation for return-free filing for many individual taxpayers. These changes merit serious consideration by Congress. We also recognize that these due date realignments may have a major impact, and Congress should explore these ideas thoroughly to ensure that they have stakeholder buy-in.

In addition to tax returns, the IRS and the Social Security Administration (SSA) receive and process over 1.1 billion information returns each year—including Forms 1098, 1099, and W-2—many of which are received in magnetic format. The IRS has reported to the Commission that it receives more than five million updated, corrected information returns during the year. In addition, significant numbers of returns are corrected by taxpayers prior to submission, and untold numbers of returns are never corrected. Several stakeholder groups informed the Commission that the current due dates for W-2s and some 1099s can impose burdens on both small businesses and large providers of information returns, such as brokerage houses. While some may argue that extending the deadlines for information reporting would delay information reporting further, this logic ignores the complexities of taxpayer compliance processes and problems. In relieving these burdens on information reporting, the Commission expects that providers will continue to provide information returns to taxpayers as soon as the information is available. Sufficient time to perfect data would allow taxpayers to submit accurate information returns, eliminating the duplicative work caused by corrected return submissions and reducing extension requests. As part of its electronic filing strategy, the IRS should set a goal of receiving substantially all information returns electronically within a ten year period.

3. Modernizing return processing

The IRS should use technology to update its return processing approaches.

Increased electronic filing would facilitate IRS compliance efforts, allowing the IRS to receive information and tax returns and match data during the same calendar year. Moreover, better data capture capability will facilitate customer service. At present, only forty percent of data on individual income tax returns is entered into IRS computers. To improve compliance and customer service, the IRS must modernize its return processing approach to reflect the realities of the information age.

The IRS must process returns more efficiently once they are received. In particular, the IRS should consider aggressive plans to improve processing paper and electronic returns through managed competition. Such plans should include incentives to encourage electronic return processing. A major challenge to the IRS will be management and consolidation of its service center pipeline capacity, maintaining paper return refund processing times at six weeks, as the number of electronically filed tax returns increases.

Finally, the IRS should pursue simplification efforts that would allow more taxpayers to use Forms 1040EZ and 1040A, which are simpler to file and process. In particular, such efforts should include expansion of the TeleFile program to more taxpayers.

Section 6—Tax Law Simplification

The Commission found a clear connection between the complexity of the Internal Revenue Code and the difficulty of tax law administration and taxpayer frustration. Compounding the problem of administration is the frequency with which Congress and the President change the tax law. Throughout the course of its review, the Commission found that the laws written by Congress and the President can lead to inadvertent noncompliance, increase the compliance costs of individuals and businesses, and add to the difficulty of revenue collection. While the Commission recognizes that much of the tax law's complexity is a product of congressional and executive attempts to tailor the law narrowly while maintaining fairness, progressivity, and revenue neutrality, the fact remains that the law is overly complex and that this complexity is a large source of taxpayer frustration with the IRS.

Recognizing that Congress and the President must weigh the policy merits of any tax proposal, as well as the effects on progressivity and revenue, the Commission strongly recommends that Congress and the President work toward simplifying the tax law wherever possible.

Introduction

The success of our nation's tax administration system depends on continued voluntary compliance with the tax law. The Commission found that significant noncompliance—both inadvertent and intentional—results from various obstacles within the current system, including the cost of compliance and the complexity of the tax law. Reducing taxpayer burden by simplifying the tax laws and administration must start with the Congress and the President.

The largest cost of complying with the tax law is borne by the taxpayer. Perhaps one measure for the success of tax legislation would be to measure the cost to comply with and administer the law. While economists differ as to the actual cost of compliance, Professor Joel Slemrod has estimated that the cost to comply with the income tax each year is $75 billion. This estimate is staggering, particularly when compared to the size of the IRS annual appropriation of approximately $7.3 billion. For Congress to develop an adequate understanding of the compliance and administrative burden of the tax law, it must consider the impact of tax law changes on behavior, research and planning costs, and the costs of audits, appeals, and tax litigation.

Uncertainty also adds to complexity and the cost of compliance. Many compliance problems are a direct result of uncertain interpretation of the tax law. Tax regulations and other guidance, including the Internal Revenue Manual, assist both the IRS and taxpayers, but they must be interpreted consistently. Unlike other government regulations, tax regulations and guidance help taxpayers and practitioners understand how to comply with the law. Congress should not discourage Treasury and the IRS from writing regulations, particularly those that set forth broad principles, as they often lessen taxpayer burden, simplify the law, and promote confidence in the tax system and consistency in tax administration. In addition, because unpublished guidance can be equated to a secret code, Treasury and the IRS should share more information with the public through education about how the laws are administered.

1. Legislative Process

Congress should consider the administrability of proposed tax legislation, and should take immediate steps to improve the tax legislative process, including requiring a Tax Complexity Analysis for each tax proposal.

There currently is no mechanism in place to ensure that Members of Congress have a complete understanding of how proposed tax legislation will affect the IRS and taxpayers, and to create incentives to simplify the tax law. Furthermore, there is no mechanism in place to emphasize the importance of simplification in the legislative process.

To ensure that Congress understands the burden imposed on taxpayers and whether the IRS will be able to administer legislative proposals, and whether the proposals contribute to simplification or add complexity to the Internal Revenue Code, Congress should require any legislative proposal to be accompanied by a "Tax Complexity Analysis" before it can be considered in committee or on the floor of either the House of Representatives or the Senate. This requirement will increase the prominence of tax complexity early in the drafting process, when its consideration is more likely to affect the substance of legislation. In addition, this requirement increases the accountability of drafters by making tax complexity more transparent to Members of Congress, interest groups, and taxpayers. This requirement should be enacted as an amendment to the Budget Act, with point of order enforcement mechanisms, and should apply to any tax bill, amendment, or conference report.

Tax Complexity Analyses should identify the kinds of complexity, the extent of that complexity, and whether the provision could be recast to reduce complexity while still achieving its tax policy goals. To ensure uniformity, Congress should require the Analysis to consider the following eight issues:

- Whether the provision is new, or modifies or replaces existing law, and whether hearings were held to discuss the proposal and whether the IRS provided input as to its administrability;
- When the provision becomes effective, and corresponding compliance requirements on taxpayers (e.g., effective on date of enactment, phased in, or retroactive);
- Whether new IRS forms or worksheets are needed, whether existing forms or worksheets must be modified, and whether the effective date allows sufficient time for the IRS to prepare such forms and educate taxpayers;
- Necessity of additional interpretive guidance (e.g., regulations, rulings, and notices);
- The extent to which the proposal relies on concepts contained in existing law, including definitions;
- Effect on existing record keeping requirements and the activities of taxpayers, complexity of calculations and likely behavioral responses, and standard business practices and resource requirements;

- Number, type, and sophistication of affected taxpayers; and
- Whether the proposal requires the IRS to assume responsibilities not directly related to raising revenue which could be handled through another federal agency.

2. Role of the IRS in the legislative process

Congress must ensure that the IRS is the voice of tax administration and that it is directly included in the legislative process.

The tax legislative process is driven by revenue neutrality and progressivity estimates, but rarely takes into account the IRS ability to administer the tax law and taxpayers' ability to comply with it. Members of Congress generally are not informed as to the complexity of most legislative proposals. Because of political pressures against tax increases, Congress and the President often raise taxes by enacting cumbersome and impossibly complex rules, making it difficult for taxpayers to understand whose taxes are being raised, and by how much. Moreover, the constant incremental changes to the tax law have a significant negative effect on taxpayers' understanding of the law and the IRS ability to perform its mission effectively. Each tax law change, no matter how small, requires the IRS to reprogram its computers, retrain its personnel, and update tax forms, publications, and guidance. Taxpayer frustration, uncertainty, and cynicism increase as they are required to change their business practices and activities and reeducate themselves each year when they prepare their tax returns. These problems are exacerbated when Congress enacts changes without adequate time for public comments or comprehensive consideration of the legislation's practical implications and effect on taxpayers and IRS administration.

Although the IRS is involved in the legislative process at times, it does not have an independent seat at the drafting table and its most knowledgeable technical experts are rarely brought into the process. Treasury closely monitors and reviews interactions and communications between the IRS and Congress. While the Commission recognizes the importance of having one voice for the Executive Branch on tax policy, the Commission recommends that Congress hear an uncensored view of the administrability of all tax legislative proposals from the IRS.

To ensure that Congress understands how legislative proposals will affect taxpayers and the IRS, and to ensure that the Joint Committee on Taxation has adequate information to prepare a thorough Tax Complexity Analysis for each tax legislative proposal, Congress should require the participation of the IRS in the legislative process. For example, when the tax writing committees hold hearings to discuss specific tax legislative proposals, the IRS should be required to testify as to the administrability of each such proposal and to explain how each proposal will affect both taxpayers and the IRS.

3. Simplifying Tax Administration

Congress should simplify tax administration by limiting the assignment of non-core functions to the IRS, taking steps to improve cooperation between federal and state taxing authorities, and simplifying tax forms and publications.

Non-core functions

The purpose of the Internal Revenue Code is to raise revenue to fund the federal government for the benefit of the American taxpayers. Tax administration is complicated when Congress asks the IRS to perform functions that are not core to its mission of collecting the proper amount of tax at the least cost and burden to taxpayers. Congress often asks the IRS to use its substantial data capture and compliance capabilities for purposes not directly related to tax collection. While these diversions of IRS resources may increase overall government efficiency, they are not without cost to the IRS and the tax system. For example, when refund offset programs are used to collect child support or student loan payments, or when credits are added to the Internal Revenue Code to target a specific population already served by other federal agencies, Congress adds significant compliance and administrative burdens and runs the risk of undermining the IRS core capabilities and its nonpolitical nature. Similarly, when Congress asks the IRS to dedicate a greater share of its resources to help combat the war on drugs and money laundering, the result is fewer IRS resources to work traditional tax enforcement cases. The addition of non-core functions also further exacerbates the IRS governance and management problems, diverting the organization from establishing a strategic direction with clear priorities. With improved financial management information, the IRS should provide Congress with more accurate information as to the direct and indirect costs of requiring the IRS to assume non-core functions.

When the IRS may be uniquely qualified to administer a non tax collection function and Congress adds such a responsibility, Congress also should provide sufficient autonomy and resources. For example, in the Employee Retirement Income Security Act of 1974, Congress asked the IRS to regulate employee plans and exempt organizations. The EP/EO operation is recognized as one of the most innovative and efficient functions within the IRS. In recent years, EP/EO has developed a variety of programs to encourage voluntary compliance, including the voluntary compliance resolution program, the walk-in closing agreement program, and the administrative policy regarding self-correction. When created, the director of EP/EO was to report directly to the Commissioner with the authority to carry out the EP/EO functions as prescribed by the Secretary, and the operation was to have an independent source of funding. Recognizing that the IRS is organized to collect revenue, Congress enacted section 7802(b)(2) of the Internal Revenue Code to authorize an annual appropriation for EP/EO funding, measured by receipts of the excise tax on certain investment income. That funding mechanism has never been used, however, and EP/EO constantly struggles with the IRS core tax collection functions for resources to regulate more than $1.2 trillion in tax exempt assets and $1.7 trillion in retirement plan assets. To ensure that this non-core function of the IRS is able to continue its innovative and efficient approaches to regulating employee plans and exempt organizations, Congress should restore authority and utilize the specific appropriation mechanism.

Federal-State cooperation

Some of the complexity of tax administration could be ameliorated through greater federal and state government cooperation. Cooperative agreements between the IRS and state taxing authorities could improve the efficiency of tax administration at all levels by better utilizing resources and could reduce burden on taxpayers. For example, cooperative agreements for joint filing of federal and state returns and single processing of those returns, as well as joint examination and collection efforts and reciprocity of state refund offset programs, could simplify tax administration significantly.

One promising joint federal and state effort, the Simplified Tax and Wage Reporting System (STAWRS), was initiated to reduce burden on the nation's 6.2 million employers while improving the efficiency and effectiveness of federal and state operations. Because a business operating nationally must comply with as many as 189 different taxing jurisdictions, the STAWRS concept would provide significant simplification. However, the multi-agency approach for developing STAWRS has not facilitated progress. Meanwhile, several states have proceeded with their own initiatives. Congress and the IRS should proceed with the implementation of STAWRS in an effort to reduce taxpayer and tax administration burdens by harmonizing the wage code and providing a single point of filing for tax and wage reporting.

Tax forms and publications

While Congress often laments the complexity of tax forms and instructions, this complexity is a product of the laws written by Congress. The IRS coordinates the development of tax forms and instructions with its compliance, taxpayer services, communications, and legal advisors, as well as tax practitioner groups, to ensure that tax forms and instructions are streamlined and straightforward. Given the complexity of the law, most IRS forms and instructions are as clear and concise as could be expected.

Although the Paperwork Reduction Act has been a positive influence on the IRS by elevating the importance of burden reduction, the current presentation of taxpayer burden estimates on tax forms, instructions, and publications is meaningless and misleading to taxpayers. The actual time requirements depend on variables such as tax knowledge and experience of the taxpayer, and the complexity of the taxpayer's transactions. Ironically, the Paperwork Reduction Act can cause increased burden on taxpayers due to the manner in which paperwork burden is assessed. For example, each line on a tax form is viewed as increasing burden even though additional lines, such as a line to authorize a power of attorney, are of assistance to taxpayers. To ensure that taxpayer burden information is presented in a meaningful manner, Congress should require the IRS to publish a comprehensive estimate of taxpayer burden for the total population as part of its Statistics of Income reports, eliminating the requirements of publishing burden information on each tax form and document.

4. Other Simplification Proposals

Congress should take steps to ease the burden of tax administration on the IRS and reduce taxpayer frustration.

Over the past few years there have been increasing calls for tax reform. The impetus for this movement lies, in large part, with taxpayer frustration with the complexity of the Internal Revenue Code. The Commission's mandate did not include the ability to evaluate the merits of the various proposals for fundamental structural tax reform. However, throughout the course of its work during the past year, the Commission heard from IRS employees at all levels, taxpayers, practitioners, and other stakeholders that the complexity of the law is a major problem.

As Congress and the President simplify the tax law, they should focus on features of present law that contribute to unnecessary complexity and impose unneeded burdens on the IRS and the American people. Appendix H highlights examples of issues that Congress and the President might consider in this regard, and provides a compendium of simplification proposals that the Commission received from various stakeholder groups and academics. The Commission forwards these specific proposals to the tax writing committees of Congress, without endorsement, and urges that they be considered.

In addition, to assure ongoing focus on the need to simplify the tax law, and to provide Congress and the President, as well as taxpayers, with the tools to pursue simplification, the Commission recommends that Congress explore the following ideas.

Quadrennial simplification process

Congress should explore developing a framework, similar to that established by the Congressional Budget and Impoundment Control Act of 1974, within which Congress and the President would consider tax simplification legislation through a regular process that is methodical, thoughtful, and that includes sufficient time for public debate, deliberations, and input from taxpayers and the IRS. The simplification process would require amendments to be revenue neutral, would prohibit inclusion of nongermane provisions, and would be subject to limited rules of debate. To ensure that this process includes taxpayers, Congress might consider establishing a commission of individuals that would develop recommendations that would be included in this debate.

To assist the commission leading the quadrennial review of the tax law, the Joint Committee on Taxation should undertake a review of the Internal Revenue Code using the Tax Complexity Analysis described above. Working with Treasury, the IRS, and taxpayers, the Joint Committee should review the tax law for provisions that may have outlived their original purpose or that have been superseded by other legislation.

Compliance burden estimates

Congress should explore the feasibility of developing a "baseline" estimate of taxpayers' compliance burdens. If these estimates can be developed, they would allow Congress to have a

better sense of the impact of legislative proposals on taxpayers and on IRS resources. Future legislative proposals could be measured against such an analysis of these costs.

Establish one broad based tax system

Two of the most sweeping tax reform acts in history, those of 1969 and 1986, were not successful in their attempts to establish a truly broad based tax system. The result was the establishment and expansion of the Alternative Minimum Tax (AMT). The AMT, which is imposed in addition to the regular income tax, is intended to ensure that no individual or business taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits. While the drafters of these rules were well intentioned, in reality the AMT affects many taxpayers who do not have substantial economic income, particularly because the AMT disallows many basic support preferences. For example, recent estimates by the Joint Committee on Taxation project that the number of individuals subject to the AMT will increase ten-fold from 1997 to 2006; this number will increase if recent proposals for child credits, education credits, and capital gains tax relief are disallowed for purposes of calculating the AMT. Moreover, the approach of the AMT, which layers a tax system within the existing tax system, is unnecessarily complex to achieve the goal of maintaining progressivity in the Internal Revenue Code. It imposes a tremendous burden on taxpayers and the IRS because it requires two separate calculations of tax liability, one for the regular income tax and one for the AMT. If the tax base was designed to be truly fair and comprehensive, there would be no need for a minimum tax. Because of the way Congress "scores" or calculates the impact of a change in the tax laws, eliminating the AMT would be costly in terms of revenue. To pay for its elimination, the Congress could consider other methods that would further the goals of progressivity that underlie the AMT—making the tax base fair and comprehensive. If the Code is simplified so that taxpayers can understand it and so that it is truly fair and comprehensive, the necessity for any kind of AMT would be eliminated.

Section 7—Taxpayer Rights

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

In order to ensure that fewer taxpayers are subject to improper treatment or excessively burdened by the IRS, Congress and the IRS need to focus more attention on preventing problems before they occur. The Commission found that the passage of the Omnibus Taxpayer Bill of Rights and Taxpayer Bill of Rights 2 have had an important effect on changing the culture of the IRS. The agency spends significant resources educating personnel to treat taxpayers fairly, and the Commission found very few examples of IRS personnel abusing power. Nevertheless, with the complexity of the tax law and an agency of its size with powers to audit and collect from taxpayers, there likely will continue to be the few unfortunate examples of abuse. Many of the additional safeguards against abusive actions enacted over the last few years are helping people deal with these systemic problems, however.

1. Taxpayer Advocates

Taxpayer Advocates must be accessible to taxpayers and have the authority and accountability necessary to speak for and take actions on behalf of taxpayers.

Taxpayer Advocates play an important role and are essential for the protection of taxpayer rights and to promote taxpayer confidence in the integrity and accountability of the IRS. To succeed, the Advocate must be viewed, both in perception and reality, as an independent voice for the taxpayer within the IRS. Currently, the national Taxpayer Advocate is not viewed as independent by many in Congress. This view is based in part on the placement of the Advocate within the IRS and the fact that only career employees have been chosen to fill the position. Because a candidate for the job is likely to have additional career ambitions at the IRS after performing the Advocate position, it is difficult to perceive the Advocate as independent when the position is regarded as just another assignment for an IRS executive, with the Commissioner viewing his or her performance as determining the next position. Additionally, while the Advocate has provided recommendations for improvements at the IRS, these recommendations merely tend to highlight ongoing IRS corrective efforts with little in the way of recommendations that focus attention on issues that the IRS either is doing nothing or its efforts are inadequate. Finally, what recommendations the Advocate has provided have limited value because they do not prescribe specific legislative or administrative corrections.

In a similar vein, the independence of the local Advocates is brought into question when their work is reviewed and graded by District and Service Center Directors. These managers have performance goals that in some cases are directly opposite to the goals of the Advocates. The Advocates seek to ensure that a case is handled properly and correctly, which often is a time consuming process. Conversely, District and Service Center Directors have goals of production and dollars. The changes recommended by this Report, which emphasize customer satisfaction,

should minimize friction between the performance goals of local Advocates and the district directors to whom they report.

National Taxpayer Advocate
To ensure the independence of the national Taxpayer Advocate, candidates for this position should have substantial experience representing taxpayers before the IRS or with taxpayer rights issues. If the Advocate is selected from the ranks of career IRS employees, the selection also should be a person with substantial experience assisting taxpayers or with taxpayer rights issues, and the job description should stipulate that it will be the employee's final position within the agency.

The Taxpayer Advocate, as the voice of the taxpayer, will have a special relationship with the Board of Directors. The Board should be involved in the selection of the Advocate, and have final authority over the hiring decision. In addition to the Advocate's report to Congress, the Advocate should report to the Board and work closely with the Commissioner to resolve taxpayer issues internally. In addition, the Advocate should comment on any IRS policy action that the Advocate believes will cause or remedy taxpayers' problems. When the Advocate believes that the Commissioner has not responded satisfactorily to these comments, the Advocate will report to the Board and the Congress. Finally, the Advocate should report annually to Congress on the significant compliance burdens for taxpayers or the IRS, including specific recommendations for remedying these problems, and, in conjunction with the National Director of Appeals, the Advocate should report annually to Congress on the ten most litigated issues (for each category of taxpayer) and provide potential solutions for mitigating disputes in those areas.

Local Taxpayer Advocates
The Commissioner should ensure sufficient staffing of local Taxpayer Advocates (LTAs) and, at a minimum, that their number and geographic coverage is not reduced. The Commission is concerned that the current number of LTAs and their allocated time for taxpayer problem resolution is inadequate. The national Advocate should report annually to the Board and Congress as to whether LTA coverage levels and allocated time are adequate to resolve taxpayer problems and what the optimal staffing level should be.

The Taxpayer Advocate should develop guidance on how many times a taxpayer has to contact the IRS regarding the same situation before they are automatically entitled to be referred to the LTA. This guidance should be disseminated to all IRS employees and should be provided to the public. The Board should adopt as a performance measurement whether the standard for referral to the LTA is being met.

Finally, the Commission found that the LTAs often were buried in the organization, unknown to the average taxpayer. While taxpayers who contact their congressional representative often are funneled to an LTA, the program is not visible enough for most taxpayers to know to find an LTA when they encounter problems with the IRS. To ensure that taxpayers know how to reach an LTA, Congress should require the IRS to publish the local telephone numbers (for print and electronic mediums) for reaching the LTA in each Internal Revenue District. Finally, the Commission recommends that the IRS develop career paths for LTAs, so that individuals can

progress through the General Schedule in the same manner as examination employees, without having to leave the LTA program.

Taxpayer Assistance Orders

One of the important powers of the Advocates is the authority to issue Taxpayer Assistance Orders (TAO). Advocates rarely have used this authority, in part because problems are resolved voluntarily and because the Advocates attempt to balance their need to resolve a particular case with their need to maintain good relationships with the various IRS functions to which they regularly take cases. Practitioners state that another reason for the low number of TAOs has been the high legal barrier required to receive a TAO. A TAO may be issued if the Advocate determines that it is necessary to avoid a significant hardship to the taxpayer. The regulations explain that a "significant hardship" means a "serious privation ..... mere economic or personal inconvenience to the taxpayer does not constitute significant hardship." Because the agency has interpreted the statutory term so narrowly, very few cases are eligible for relief. During fiscal year 1996, 32,150 taxpayers requested a TAO but only 5 TAO's were granted. However, the IRS provided some assistance in 24,623 cases. To ensure that Advocates are able to provide relief for taxpayers who need it, Congress also should authorize the use of a TAO when an IRS employee is not following applicable published administrative guidance, including the Internal Revenue Manual. Finally, when determining whether to issue a TAO, Advocates should consider the immediate threat of adverse action, delay of more than thirty days in resolving taxpayer account problems, or the prospect that the taxpayer will have to pay significant professional fees for representation.

2. Taxpayers' Redress

Congress must provide taxpayers with adequate and reasonable compensation for actual damages incurred for wrongful actions by the IRS.

While the Taxpayer Bill of Rights legislation made great strides to allow taxpayers to recover damages for IRS malfeasance, current provisions do not provide adequate relief. In addition, there are many cases in which taxpayers are not able to obtain review of IRS actions.

The primary vehicle for taxpayers' redress, section 7430 of the Internal Revenue Code, allows recovery of administrative and litigation costs when the IRS position is not substantially justified. In practice it is nearly impossible to recover administrative costs because the law does not allow recovery of costs incurred prior to the time of the final administrative notice from the IRS. Because most administrative costs are incurred between the time of the preliminary notice of deficiency (i.e., the 30 day letter) and the time of the final notice of deficiency (i.e., the 90 day letter), the present construction of section 7430 is self-defeating. Moreover, because relief is not available to individuals and corporations above certain net worth ceilings, section 7430 denies redress for many taxpayers who incur attorneys' fees.

To ensure that taxpayers are able to seek true relief, Congress should raise the net worth ceilings to $5 million for individuals and $35 million for businesses and allow the award of costs incurred after receipt of the preliminary letter of proposed deficiency. The reasonableness of attorney's

fees should be determined by the court, which should take into account special factors, including the difficulty of the issues presented in the case and the local availability of tax expertise. In addition, Congress should clarify that taxpayers must be notified by the IRS of their right to appeal administrative denial of administrative and litigation costs by filing a petition with the United States Tax Court within 90 days of receiving a notice denying the application for costs, and that orders denying such relief are appealable in the same manner as other decisions of the Tax Court. Congress also should clarify that nonprofit clinics that represent low income taxpayers, and other pro bono representatives, are eligible to receive awards under section 7430, based upon the number of hours worked and costs expended. Finally, Congress should specify that if the IRS has lost a position in at least three United States Courts of Appeal, subsequent taxpayers will be entitled to recover under section 7430 because the subsequent loss would serve to indicate that the position of the IRS was not substantially justified.

Other provisions of the Internal Revenue Code allow recovery of damages against the IRS for unauthorized disclosures of tax return information, failure to release liens, and certain unauthorized collection actions. The latter action is available only for reckless or intentional violations of the law. For example, relief is not available when the IRS takes collection actions against the wrong party, as in the case of a mistaken identity. Moreover, relief is not available when the IRS is negligent or reckless in the use of its summary examination and assessment powers. Congress should provide relief in these areas. For example, Congress could amend section 7433 to allow recovery of damages for unauthorized, improper, or erroneous collection actions when the IRS is negligent, up to $100,000.

3. Quality Taxpayer Service and Treatment

IRS employee performance measures and quality reviews should ensure that taxpayers receive fair, impartial, timely, and courteous treatment.

Because of weak performance measurements, insufficient training, and a lack of proper managerial review and control, examinations and collection actions can be intrusive, burdensome, and lengthy. Taxpayer assistance can be similarly frustrating and unnecessarily time consuming. Like employees anywhere, IRS personnel generally strive to do a good job as measured by their managers. They are very much aware of what it takes to make the grade within their organization. For this reason, it is imperative that personnel measurements take into consideration the courteous and fair treatment of taxpayers and that personnel are rewarded for emphasizing the collection of the proper amount of taxes. Although individuals are not graded on actual amounts assessed, larger organizational groups within the IRS are graded by recommended dollars assessed, as well as interest and penalties. The Commission did not find performance measures to indicate whether taxpayers are treated with the utmost respect.

Quality Service Measures

The IRS mission is "to collect the proper amount of taxes." As explained in Revenue Procedure 64-22, the IRS has a duty to apply the laws enacted by Congress in a fair and impartial manner, with neither a government nor a taxpayer point of view, and issues should be raised by examiners

only when meritorious. The Commission found that some practitioners and IRS employees do not believe that employees actually are measured in a manner that promotes these standards.

To ensure that taxpayers receive quality service, performance measures for all IRS employees should be developed that incorporate the requirements of Revenue Procedure 64-22. Thus, employees should be evaluated on the basis of criteria that measure whether they apply the law in a fair and impartial manner, whether they seek to ascertain and apply the correct meaning of the law in light of congressional purpose, whether they raise only meritorious issues, whether they take positions that are consistent with established IRS positions, whether they administer the law without delay in a courteous manner, and whether they act vigorously to educate taxpayers and ensure compliance with the law.

The IRS should include as a measure for senior management the sustension rate of adjustments that are reviewed by the IRS Appeals function. While Appeals is able to consider additional factors when it reviews cases, including the hazards of litigation, low sustension rates nonetheless can be indicative of below par performance. For example, currently IRS Appeals sustains approximately 30 cents on the dollar for adjustments involving large corporations. This low rate reflects not only poor allocation of IRS resources but also represents a major burden to the taxpayer. A similar concern exists with the low sustension rates for cases settled or cases decided by the Tax Court. The taxpayer must spend significant sums to fight the IRS on cases of limited merit. Senior management must take steps to ensure that employees receive proper training, supervision, and support, so that these sustension rates can be improved. Also, the Appeals staff should provide feedback on areas that are subject to settlement so that examiners would be aware of which legal positions are not being sustained.

Quality Reviews

The Commission heard from many former and current IRS employees that increasing the number of reviews of examination by quality review staff and institutionalizing the importance of quality for all examination employees would be a good step in ensuring that these performance measures are met. In addition, the Commission believes that IRS managers must be held responsible for the training and evaluation of new examination and collection employees during their probationary period in order to determine their fitness for permanent duty.

Taxpayer Service Surveys

To measure taxpayer satisfaction and ensure taxpayers receive fair and courteous treatment, the Commissioner, in consultation with the Taxpayer Advocate, should conduct continual surveys of taxpayers who have interactions with the IRS. The findings of these surveys, gathered at the group or unit level, should be used for the purpose of continuously improving the work done by IRS employees with the public.

Several state tax administrations conduct surveys of taxpayers that have proved beneficial for management. In addition, the private sector has found such surveys useful in identifying and rewarding exceptional employees. Surveys should be conducted for all IRS locations that deal directly with taxpayers, and posts of duty with substantial staffing.

At a minimum, surveys should be constructed to allow for review of management performance. In addition, surveys should provide sufficient data for management to measure aggregate employee performance, as well as taxpayer satisfaction with services provided by the IRS. The Taxpayer Advocate should publish the results of these surveys in the annual report to the Board of Directors by district and regional offices.

4. Accountability to Taxpayers

The independence of the IRS from political pressures and accountability to taxpayers are integral to maintaining confidence in our voluntary compliance system.

Criteria for examination selection

In recent years concerns have been raised that certain taxpayers have been selected for examination for political purposes. At the same time, the paucity of information available to the public as to the criteria and procedures for selecting taxpayers for examination leaves room for taxpayers to speculate, particularly when certain examinations are brought to light through the media. For example, IRS Publication 556 merely explains that several computer methods are used to select returns, but does not indicate whether returns are selected for examination on the basis of information available in the media or on the basis of information provided to the IRS by informants. To provide taxpayers with a better understanding of the independence of the IRS from improper influence, the Commission urges the IRS to better educate the public about its procedures to the greatest extent possible within the bounds imposed by genuine law enforcement concerns. Further, the Congress should consider changes to the law based on the findings of ongoing review by the Joint Committee on Taxation of audits of nonprofit organizations.

Records archived

Because taxpayers and the IRS can learn from the past, the IRS must develop a comprehensive record keeping program to maintain and preserve the integrity of internal records. All federal agencies are required to deposit significant and historical records with the National Archives and Records Administration (NARA). Because section 6103 of the Internal Revenue Code prohibits the disclosure of tax return information, the IRS does not allow NARA personnel to review its internal records for archival purposes. The inability to resolve this problem is detrimental to developing an accurate history of the IRS through which taxpayers can hold the agency accountable for its actions. Moreover, to the extent that IRS decision makers do not have ready access to prior reports and studies, they are not able to make fully informed decisions. Congress should provide NARA access to all IRS records for archival purposes, and to assist the IRS in establishing and maintaining a comprehensive record keeping program.

Access to tax return information

The Commission heard concerns regarding the scope and use of the provisions regarding taxpayer confidentiality. In light of the complexity of the issue and the need to balance a host of conflicting interests, including taxpayer privacy, the need for third parties to use tax return information, and the ability to achieve greater levels of voluntary compliance by allowing the public to know who does not file tax returns, Congress should study these rules.

Freedom of information
Congress enacted the Freedom of Information Act (FOIA) to encourage openness in government and to provide a tool for the media to have access to information to do its investigatory job, and established specific deadlines for agency action on information requests. For requests to the IRS, the average FOIA request takes six months to process and appeals can take nearly a year, which is far in excess of the 10 business day statutory period for requests and 20 business days for appeals.

Because the media is able to perform an oversight function through its work, and disseminate the information to a larger audience, the Commission recommends that requests by the media be given priority for processing and appeals purposes. This priority should mirror the process established by the Department of Justice, which provides expedited processing for certain FOIA requests that promote public accountability, particularly when the information sought involves possible questions about the government's integrity which affect public confidence.

5. Other Taxpayer Rights Proposals

Restoration of public confidence in the IRS must begin with Congress through legislation promoting fair and impartial tax administration which focuses on preventing problems before they occur.

The Commission's task force on Taxpayer Rights developed a number of additional proposals for action by Congress which are included in Appendix I.

Section 8—Financial Accountability

In order to regain the trust of Congress and the American people, the IRS must demonstrate that it is financially accountable. This will entail developing information systems and procedures to prepare accurate and auditable financial statements and to capture necessary operational and management data to make informed business decisions.

1. Financial Reporting

The IRS and GAO must work together to resolve the IRS financial reporting problems.

Both GAO and the IRS agree that the overriding financial management problem is that the IRS financial system was not designed for financial reporting purposes. The present system predates the financial reporting requirements. Until the system modernization is complete, the IRS will have a continuing problem "making do" with what it has. The size and complexity of the tax processing systems and the care needed to analyze the impact of major system changes have contributed to the slowness of this process. The IRS has set a priority of making technology improvements that will enable it to meet its financial reporting responsibilities, and should continue these efforts.

It is clear that when the audit requirement was first imposed, the IRS had major problems with financial reporting and its control systems. It also is clear that GAO has been instrumental in identifying those problems and has helped the IRS in devising solutions. This working relationship seems strained today. The IRS continues to seek an unqualified opinion on its financial statements. To achieve this goal, GAO and the IRS must continue to work together, proactively seeking methods to overcome the IRS remaining problems. This may mean more time for the auditors and the application of more resources, but it is the attitude and relationship that is necessary for IRS to succeed in this effort.

2. Financial Statements

To regain the trust of Congress and the American people, the IRS must obtain a clean financial audit.

As one of the pilot agencies under the Chief Financial Officer Act of 1990, the IRS was required to prepare financial statements beginning with fiscal year 1992. Prior to that time, the IRS and other federal agencies were not required to prepare auditable financial statements or to have financial audits. The GAO has been unable to express an opinion on the reliability of the IRS financial statements for any of the four fiscal years from 1992 through 1995. It is now completing its audit for fiscal year 1996.

The IRS has two sets of financial statements, administrative and custodial, and two separate financial processes to account for the funds. The administrative system deals with the appropriated funds for IRS operations (approximately $7.3 billion) and the related expenditures for operation of the IRS. The custodial system tracks the tax collection process and the

distribution of the collected funds to the appropriate account, including the Treasury general fund, Social Security trust fund, and highway trust fund.

Administrative Financial Statements

Three major problems generally have been cited for GAO's inability to express an opinion on the IRS administrative financial statements for fiscal years 1992 to 1995: (1) the IRS failure to reconcile its cash balances with Treasury, (2) a lack of receipt and acceptance documentation for certain nonpayroll payments to other federal agencies, and (3) accounting for accrued liabilities at year end. Concerning the Treasury reconciliation, the IRS believes the problem is solved for fiscal year 1996, and that it is now maintaining current reconciliation with Treasury balances. The GAO has indicated that it will not take exception to the cash balance in its report on the IRS fiscal year 1996 financial statements.

The lack of receipt and acceptance documentation from other federal agencies is difficult for the IRS to solve by itself. The problem involves the government's Online Payment and Collection (OPAC) system. For the IRS, this primarily involves payments to the General Services Administration (GSA) for rent and to the Government Printing Office (GPO) for printing.

Under the interagency payment process using the OPAC system, an agency that provided goods or services to the IRS directly accesses a general (i.e., not appropriation specific) IRS account at Treasury, takes the money that the "providing" agency claims to be due, and sends a notice to the IRS through OPAC that the funds have been withdrawn from the IRS account. This is done irrespective of whether the withdrawing agency has provided the IRS Chief Financial Officer with sufficient documentation of the services provided so that subsequent approval of this payment can be sought within the IRS. The OPAC notice may or may not reference an interagency agreement or provide a contact point at the providing agency or the IRS that accounting can contact to seek the subsequent approval of payment. If the IRS does not believe it has sufficient information to verify an OPAC charge, it can "charge back" the agency (i.e., take the money back). However, the agency the IRS just "charged back" is free to do the same.

When OPAC bills do have sufficient documentation, it may take months for the IRS to record proper receipt and acceptance as the required line numbers often are in the thousands, as is the case with bills submitted by GPO for tax forms. Meanwhile, amounts have been charged to the IRS nonappropriation specific account in the Treasury general fund and cannot yet be posted correctly in the IRS accounting system until the OPAC bills are itemized in detail, by appropriation and with other accounting codes. The OPAC billing is in a suspense account and remains an issue for the IRS until resolved.

Even with timely receipt and acceptance for a specific OPAC bill, IRS also runs into problems when another agency, such as GPO, contracts with a commercial vendor to provide services for the IRS. For example, GPO contracts with third party vendors to print and mail tax packages directly to taxpayers. When the vendor completes this task, GPO "bills" the IRS. It in turn relies on GPO's internal receipt and acceptance procedures, and an exception process (i.e., phone calls and complaints), to assure itself that the task was done and the forms printed and mailed. GAO has indicated that this may not be sufficient.

The OPAC issues are a problem for other federal agencies, and there is now a government wide working group addressing it. This working group should develop a receipt and acceptance procedure similar to that required for outside vendors. GAO takes the position that receipt and acceptance documentation must be in place to properly account for and ensure that the IRS has adequate control over its expenditures, and for GAO to audit these expenditures using professional auditing standards. Because either GAO or outside contractors are auditing and expressing an unqualified opinion on the financial statements of payment recipients, including GPO, opportunities should exist for collaboration to find the most effective and efficient solutions for the IRS.

A third problem involves accounts payable and accrued expenses. The IRS records encumbrances when goods or services are ordered. This is a normal governmental practice to track the status of appropriations. At year end, some of the encumbrances, which may be estimates, are included in IRS liabilities. Because the liability does not occur until the goods or services are delivered, IRS liabilities often are overstated. For fiscal year 1996, the IRS and GAO worked together to prepare and audit, respectively, a statistical sample of subsequent disbursements to estimate IRS accounts payable. As a result of this effort, GAO is not taking exception to the liabilities reported on the statement of financial position.

Custodial Financial Statements

Two significant factors have been cited for GAO's inability to express an opinion on the custodial financial statements: (1) weaknesses in the revenue accounting system; and (2) reliability of IRS reported estimates of collectible accounts receivable. Both of these problems are difficult to resolve with the existing financial accounting system.

The basic problem with the revenue accounting system is that it has been difficult, if not impossible, to substantiate the revenue collected by matching the gross amounts collected with the individual transactions recorded in the IRS master files. The historic reason for this is that revenue posted to the Revenue Accounting Control System (RACS) comes from summary data not specifically identified with individual transactions. Income tax returns are grouped in "blocks" of up to 100 returns at the service centers, and revenue is posted in total by blocks in RACS. Financial statement revenue amounts reflect the amounts recorded in RACS. Although a record exists of the returns contained in each block, it is not well maintained nor is it easily accessible. For fiscal years 1995 and 1996, the IRS attempted to solve this problem by compiling financial statement revenue and refund amounts from the master files and reconciling the computed amounts to RACS and to Treasury schedules of receipts. This method provides detailed support to substantiate the financial information. The process was not completed in time for the fiscal year 1995 GAO audit and review; the fiscal year 1996 audit now is in progress.

Another problem with the revenue accounting system is the inability to verify the reported amounts for various types of taxes, particularly social security and excise taxes. The difficulty stems from the fact that taxpayer documentation submitted with payments does not separate the types of tax paid. For instance, federal tax deposits for payroll taxes include social security tax and income tax withheld without identifying the amount for each. Individual tax amounts are

compiled from the quarterly returns filed, which represent assessments and not necessarily payments. The amount required to be transferred to the Social Security trust fund is based on the assessed amount, not the IRS collected amount, so the outcome will be unchanged by better reporting. Similarly, excise tax payments may include up to 100 different taxes without identifying what is being paid. IRS tests indicate that the difference between the amounts collected and the amounts assessed is insignificant, but it is developing programs to identify collected amounts of excise taxes, because the amounts required to be transferred to these trust funds are based on collected amounts.

The problem with the accounts receivable verification involves separating financial accounts receivable from compliance assessments. The IRS divides its inventory of tax receivable into three major categories: (1) financial receivables; (2) compliance assessments; and (3) financial write-offs. The only receivables included on the financial statements are the financial receivables which are then reduced by an allowance for doubtful accounts. Financial receivables consist of balances due when the IRS has demonstrated the existence of a receivable through information provided directly from the taxpayer, or through actions taken by the IRS that support or validate the IRS claim, such as securing the taxpayer's agreement or a favorable court ruling. Compliance assessments consist of assessments primarily made for enforcement purposes. Actions still may be taken to collect these assessments, but because the taxpayer has not responded to validate the claim, or Appeals or the Tax Court has not yet ruled, there is not an established claim with the taxpayer. Financial write-offs are a separate category of financial receivables whose ultimate collection is unlikely. Due to the ten year statute of limitations, the IRS must maintain these accounts on the master files until the statute for collection expires.

All of the categories of receivables are commingled in the master files, but the IRS has attempted to segregate the categories by coding in the master file. For fiscal year 1995, GAO determined that errors in coding and errors in performing the statistical tests designed to test the accuracy of the coding made validity of the categorization questionable. For fiscal year 1996, GAO has indicated that the systemic process for segmenting the portfolio of receivables appears reasonable. It remains for the GAO to review supporting documentation for selected cases to verify the accuracy.

3. Operational Data

The fact that the IRS has made substantial progress toward obtaining an unqualified opinion on its financial statements does not mean that it has solved its financial management problems. The IRS has a poor track record of capturing accurate compliance, cost, and customer service data. While the Statistics of Income data is heralded as accurate and useful, and compliance research efforts appear to be helping the IRS target its resources more efficiently, the Commission found Congress and stakeholders skeptical of the IRS ability to measure and track much of the information necessary for its managers, as well as executive and legislative branch overseers, to make long-term strategic decisions and hold the agency accountable. When the IRS is unable to break down processing costs according to type of tax form, productivity gains cannot be measured. Measuring performance becomes very difficult if baseline data is lacking or unreliable.

As outlined in the budget discussion in Section 1 of this Report, over the next three years the Commission recommends improvements in financial management at the IRS. The agency must obtain a clean opinion on its financial audit of appropriated accounts and make significant progress in receiving a clean opinion on the custodial accounts (revenues); have independent verification that its compliance and taxpayer service statistics are accurate; and gather accurate taxpayer focused operational cost data that is verified as accurate by an independent organization.

The Commission recommends that an advisory committee be established consisting of individuals with expertise in governmental accounting and auditing from both the private sector and from government. This committee would advise the Board of Directors on the following issues:

- Areas of disagreement between the IRS and GAO;
- Monitoring the financial accounting aspects of the systems modernization;
- Considering the need for year round auditing so that problems are identified in time to be corrected; and
- Monitoring IRS plans for improving its internal financial management system.

The advisory committee will provide the necessary expertise to assist the Board in ensuring that the financial accountability problems of the IRS are resolved.

Conclusion

The eight sections of this Report represent a comprehensive review with recommendations for improving the IRS and the American tax system. Each recommendation aims to help create an IRS that recognizes its vital duty to represent the federal government in a fair, efficient, and taxpayer friendly manner. The IRS is in a unique position—twice as many people pay taxes as vote. Therefore, it is incumbent upon Congress and the President to ensure that the IRS does not view its mission as extracting money out of taxpayers, but rather as collecting the proper amount of taxes in the least intrusive, most helpful way possible. Implied in our analysis is the belief that most American citizens are willing to pay their fair share of taxes, and that the government should make it easier for them to do so.

As is embodied throughout this Report, the Commission believes that taxpayer service must become paramount at the IRS, and that the IRS should only initiate contact with a taxpayer if it is prepared to devote the resources necessary for a proper and timely resolution of the matter. In order to effect change at all levels of the agency, the IRS needs the appropriate accountability, continuity, and expertise in both congressional oversight and executive branch governance.

In short, all of our recommendations, taken as a total package, will make the IRS more accessible and responsive to the American people. The Commission believes that this comprehensive reform plan is necessary to restructure the IRS for the twenty-first century.

Additional Views
of Commissioners

Statement of Congressman William J. Coyne

I am writing to submit my views on the Commission's Report, as approved on June 5, 1997, and request that this letter be included in the published version of the Report.

First, I want to take this opportunity to state that The National Commission on Restructuring the Internal Revenue Service has provided taxpayers with a great public service. The Commission thoroughly and systematically reviewed critical aspects of how the IRS is managed and operated. Most importantly, rather than just identifying problem areas, the Commission undertook the much harder task of developing and laying out possible solutions.

Also, I want to thank each of the Commission Members for providing me with their valuable insight into how the IRS might be improved. Particularly, I want personally to thank the Co-Chairs of the Commission for their excellent leadership. The Co-Chairs went to great lengths to accommodate Members' differing views and concerns, including mine, with the goal of developing a consensus package of IRS reforms. I commend the Commission for a job well done.

While we did not speak with one voice on all aspects of the Commission's Report and recommendations, the fact remains that we did agree that: the IRS needs to improve its customer service, training of employees, and development and application of technology; oversight of the IRS needs to be enhanced and institutionalized, with significant input from the private sector; the IRS Commissioner needs to have flexibility in hiring a top-notch team, and remain as head of the IRS for 5 years; and, the Congress should better coordinate and focus its oversight and funding responsibilities with regard to the IRS.

There are the numerous excellent recommendations and analyses in the Commission's Report which I support. Among them are the Commission's recommendations on the need: to increase employee training, education, salaries and work incentives; to improve cooperation among IRS functions; to improve customer service through IRS telephone assistance, clearer notices, quality reviews, taxpayer surveys, and increased access to the Taxpayer Advocate offices; to integrate technology with strategic objectives, develop intellectual capital, and focus on the Century date change; to encourage tax return filing electronically; and, to resolve financial reporting problems.

However, there are several recommendations and analyses in the Commission's Report from which I dissent.

Executive Branch Governance: I agree with the Commission's view on the importance of establishing mechanisms for providing direction of long-term strategy at the IRS, and holding IRS management accountable for its decisions and operations. The Commission established the need for more oversight and accountability at the IRS. Everyone agrees with the importance of having systematic input from the private sector on all aspects of IRS management, and the value of having an IRS Commissioner for a fixed term.

I have reservations about the Commission's recommendation to allow individual taxpayers from the private sector to have final decision-making authority over the IRS administration of the tax laws, including the appointment of the IRS Commissioner. I think that this raises questions of accountability. Further, while the Commission's Report indicates that its proposed independent Board would not have authority over tax policy, tax enforcement, procurement, or other sensitive areas, it is not clear to me that these issues can be adequately separated.

As an alternative, the Administration has proposed to enhance the Department of the Treasury's oversight of major strategic, personnel, and procurement decisions of the IRS with an Executive Order creating an IRS Management Board (consisting of Treasury and other Federal officials). Also, the Administration has proposed an IRS Advisory Board (consisting of private-sector experts) to enhance oversight of the IRS. The Administration is in the process of implementing this oversight management plan for the IRS. The Administration has recognized that there is a problem, and is moving to address the problem with aggressive oversight. Because of this, I believe that adoption of the Commission's governance recommendation is premature at this time.

To further strengthen this oversight initiative, I would propose that the Congress enact, by statute, the Administration's "Plan for IRS Governance." I think this would serve to institutionalize the management responsibilities of the Administration's Oversight Management Board, and the role and functions to be performed by the private-sector Advisory Board. Also, I would suggest that the Department of the Treasury be allowed to hire needed private-sector experts, on a full-time basis, with a five-year employment contract, paid at competitive pay levels, to ensure stable and effective oversight of the IRS.

Congressional Oversight: I agree with the Commission's view that Congressional oversight of the IRS should be coordinated to ensure that Members and staff discuss strategic issues in a comprehensive manner, and that they have sufficient information to make informed decisions regarding tax legislation and tax administration.

I am concerned, however, with the Commission's recommendation to create a new entity, such as a "joint committee on IRS administration." I do not believe that better coordination of Congressional oversight of the IRS will result from creation of a seventh legislative body, another Committee, another Chairmanship, or another Committee Membership structure. Also, I do not believe that creation of another Congressional entity will reach the Commission's objective of consolidating Congressional oversight, providing clear and consistent Congressional direction, or generating substantial cost savings. The Commission's recommendation, in my opinion, would have an opposite effect.

Rather, I would suggest better use of our current Joint Committee on Taxation and more coordination by the congressional committees of jurisdiction. As the Commission's Report notes, the Joint Committee on Taxation currently has statutory authority and responsibility to review all aspects of IRS operations. The JCT has the statutory duty to "investigate the operation and effects of the Federal system of internal revenue laws," "investigate the administration of such taxes by the IRS or any executive department, establishment or agency charged with their

administration," and "to make such other investigations in respect of such system of taxes as deemed necessary." Further, the JCT is charged with "investigation of measures and methods for the simplification of such taxes, particularly the income tax," and "publication, from time to time, for public examination and analysis, proposed measure and methods for the simplification of such taxes." The JCT has the power to hold hearings and take testimony, require the attendance of witness and documents by subpoena, administer oaths, and obtain all necessary information from the IRS, including protected taxpayer information. Congressional focus and coordination with our current resources is the answer, not creation of new entity.

Taxpayer Rights: I agree with the Commission's view that taxpayers should be treated fairly and impartially by the IRS. The quality of the IRS's taxpayer service activities also is very important. The Ways and Means Oversight Subcommittee is currently considering various taxpayer rights proposals, in follow-up to the Taxpayer Advocate's 1997 report to the Subcommittee.

I am concerned, however, with the tone, analysis, and content of the Commission's Report sections on "taxpayers' redress" and "other taxpayers' rights proposals." The Commission's recommendations in these areas do not address the Commission's goal of developing proposals to "prevent problems for taxpayers before they occur."

I believe that enactment of many of the legislative proposals approved by the Commission would have a serious negative impact on the public's dealings with the IRS, and would have an adverse effect on voluntary compliance and the IRS's administration of the tax laws. While the legislative list was developed by the Commission's task force on taxpayer rights, the various proposals were not analyzed or discussed by the full Commission, in any meaningful fashion, from a tax-policy and administrative standpoint.

Simplification: I agree with the Commission's view that the Congress should systematically simplify the tax laws, consider the administrability of proposed tax legislation, and better involve the IRS in the drafting process.

However, I do not agree with the Report's analysis and discussion of IRS "non-core functions." I do not consider the IRS's child support tax refund offset program, nor the implied references to the earned income tax credit and low-income housing tax credit, to be a "diversion of IRS resources" or creating a "risk of undermining the IRS's core capabilities." Further, I think that the Congress has accurate information about administering these programs through the tax system, and has found them to be quite efficient and effective.

Also, more generally, I do not think that the Report should have included an appendix of simplification proposals, even though the Commission attempts to disclaim support for, or analysis of, the proposals. Among my concerns is that many of the proposals: are not simplification; have long, controversial histories with clear winners and losers; have significant tax policy implications; have large revenue effects; and, would not meet the Commission's own "tax complexity analysis" criteria.

In conclusion, I want to state that I look forward to continuing to work toward making the IRS the first-class Federal agency the public expects it to be.

William J. Coyne

Statement of Commissioner Ernest J. Dronenburg, Jr.

I would like to take this opportunity to commend my fellow Commission members and our Co-Chairmen, the Honorable J. Robert Kerrey and the Honorable Rob Portman for having completed such a comprehensive review and study of the challenges that face the Internal Revenue Service as we enter the twenty-first century. The product of our labor, our report to Congress, is in my opinion, a valid, workable, and well reasoned blueprint that if followed through implementation will exceed the desired result contemplated by Congress in drafting the legislation that created the Commission.

I voted for the final report and concur wholeheartedly in its findings and with all its recommendations save one. With respect to the recommendation relating to governance and the Executive Branch, it is my contention that the Commission has not gone far enough. When faced with the continuing enslavement of his people's minds and bodies, Moses said to Pharaoh, "let my people go." In order for the Internal Revenue Service to reach its potential and be successful in meeting the challenges that it faces, IRS must be released from the bondage of the Treasury Department and the conflicting policy making functions that are necessarily its highest priority.

The current Secretary of the Treasury certainly, and past Secretaries generally, have all been very capable individuals. But to successfully reform itself, the IRS must have the ability to work within the government unfettered by the political trade-offs and necessary distractions inherent to the duties of any successful Secretary of the Treasury. Monetary policy, capital markets, international economics and tax policy to name but a few, are all legitimate distractions that serve to prevent any Treasury Secretary from providing the necessary long term strategic vision that the Service is in such desperate need of.

The Restructuring Commission has recommended that, with respect to the Executive Branch, the Department of Treasury be relieved of the <u>oversight</u> responsibility of a major portion of the administrative functions of the Service in favor of a corporate model Board of Directors. This is to be accomplished while maintaining otherwise the existing line of authority within Treasury. As proposed, the operation of the Board will undoubtedly enhance strategic focus and long-term independence. The proposed design is as good as can be achieved without changing fundamentally the relationship between Treasury and the Service. I believe a true restructuring, as the Commission was charged by Congress and the President to plan, would not, as this approach did, bow to political "realities." To do it correctly, would be to propose surgery and the removal of the Internal Revenue Service from the Treasury Department completely

Inside the Beltway, this may seem to many a bold and unrealistic proposal. But for someone like myself, who has spent the last 18 years as a member of an elected board of tax administration, the solution is obvious. In my State, Tax Board members are accountable not to a cabinet level agency, not even to the Governor, but solely to the people of the State of California. The accountability to taxpayers that we at the Board experience on a daily basis is not something the Service is accustomed to. The commitment to the ideal of independence and accountability in tax administration is an important step in establishing the level of taxpayer service and efficiency

that will be necessary to maintain the confidence of the American people in our voluntary tax system in years to come.

The problems faced by taxpayers interacting with IRS are legendary. The interminable delays and lack of urgency. The total lack of authority and accountability at all levels. And the absence of even the most basic forms of strategic and visionary management. So long as the Service is subordinate to Treasury and her other priorities, even under this new board design, these problems will remain a constant. The management of a 100,000 person agency, with as critical a role to play in the successful operation of government, and that has as personal an impact on nearly every American, requires clear, direct and continuous leadership.

The Commission's proposed governance structure, including a Board of Directors, will go a long way in putting the Service on the right track in approaching and solving many of the problems otherwise identified in our report to Congress. As proposed, there may be some incidental confusion with respect to turf and responsibilities as well as some inefficiencies with respect to separation of duties, but nothing like what exists today. The actual constitution of the proposed Board of Directors, including the choices made relative to the length of terms and the membership and make-up of a Board, have been well thought out here. Fundamentally, however, that element of the report is of no real importance to me.

A separate department entirely, whether headed by a board or a commissioner, but completely severed from Treasury, is the most obstacle free and organizationally correct structure, in my opinion. It removes any law enforcement considerations and establishes the proper separation between the policy makers and those charged with administration. In my mind, the single most important factor is a commitment to a governmental structure that manifests the greatest amount of <u>independence</u> in the Service. The resulting continuity of leadership, strategic focus, authority and accountability can be brought to bear on the challenge of attaining the level of administrative taxpayer service and efficiency necessary to reestablish the confidence of the American people in their tax system as we enter the twenty-first century.

Accordingly, my alternative recommendation to Congress with respect to the governance portion of the Commission report would be to establish an independent Department of Revenue, headed by a board or a commissioner, that is accountable directly to the President, is empowered with unbridled authority for issues of tax administration, and is subject to congressional oversight consistent with other provisions of the Commission report.

Ernest J. Dronenburg, Jr.

Statement of Commissioner Larry Irving

It was both an honor and a privilege to serve as a member of this distinguished Commission. I commend the Co-Chairs for their hard work over the last year. The dedication to this process demonstrated by Chairmen Kerrey and Portman served as examples to all of us. I also commend the staff of The National Commission on Restructuring the Internal Revenue Service for their dedication and perseverance during grueling months of work. In addition, I wish to commend and thank my fellow Commissioners from whom I learned much in this process. Our work will make a significant difference in the functioning of the IRS.

It is with deep regret that I decline to sign the Commission's Report. As noted repeatedly during the Commission's deliberations, the fundamental issue at the heart of the majority's report is governance, and I simply cannot and do not support the majority's recommendations on this issue. Although I share the concerns expressed by others about the constitutionality of the governance provisions, more fundamentally, I believe that governance of the IRS should not reside in a seven person outside Board of Directors. The Board's powers ultimately could extend beyond governance issues to tax policy, law enforcement, and day-to-day management. The line being drawn between oversight and tax policy and management will, in my opinion, be almost impossible to police or maintain, and ultimately will raise serious accountability and jurisdictional questions. After four years of heading a federal government agency, I have experienced the complexities of shared jurisdiction and accountability and the thin line between oversight and management. Based on these experiences, I believe that responsibility for IRS management must continue to reside with an IRS fully accountable to the President and the Congress.

Larry Irving

Statement of Commissioner David Keating

The Internal Revenue Service contacts millions of Americans each year. For many of us, it is the only agency we deal with so regularly. It's important that Congress move quickly to improve the IRS. The Commission's report marks the starting point for fundamental reform of the IRS. The report is a comprehensive and nonpartisan document supported by 12 of the 17 commissioners. I strongly agree with the overwhelming majority of the findings and recommendations and actively participated in the consensus building process. I have, however, some concerns about certain areas. Nonetheless, I would be pleased to see the entire package become law.

My comments will highlight some important issues and discuss others where I wish the Commission could have been bolder. Due to our charter, time constraints, or lack of consensus, some findings and recommendations were not made.

Taxpayers Rights

The Commission's report repeatedly refers to "customer" service. While everyone supports the goal of improving service to citizens, I'm sure many, if not most, taxpayers certainly don't feel like they are customers. Real customers have a choice about the products and services they buy. Yet taxes are, after all, involuntary payments, and there's no choice about which IRS to use. That's one reason why taxpayers' rights issues are so important.

While the section on taxpayers rights is not as bold as I would like, there are many substantial and solid recommendations in this portion of the report. It is essential that Congress provide more rights and remedies for taxpayers by adopting these recommendations, as it modernizes and restructures IRS.

In addition to the Commission's recommendations, I want to briefly highlight certain areas that cry out for improvement.

- Innocent spouses still have too little protection under the tax laws.
- The process for appealing collection actions needs improvement because it mechanically applies rules without allowing for good judgment about what is in the best interests of the government.
- When the IRS abuses taxpayers, federal law still largely prevents the courts from allowing taxpayers to enforce their rights.
- Enforcement of the tax laws can take away the ability of citizens to be self supporting.
- The Freedom of Information Act does not allow timely access to enough information about IRS activities and IRS often improperly uses FOIA exemptions to hide embarrassing information from the public.

- Finally, the IRS is either too limited by laws and work rules or is unwilling to discipline or terminate employees who fail to treat the public fairly or courteously.

Simplification

The tax code is so convoluted that no one inside or outside the IRS understands it. Money magazine's annual test of tax preparers this year brought another sad result. All forty-five tested tax professionals got a different answer, and no one had the correct tax on a hypothetical tax return. Two out of three were off by more than $1,300.

While I am pleased that the Commission emphasized the benefits of tax simplification, our recommendations may not be strong enough to encourage it. For example, although the Commission recommended that all tax legislation be accompanied by a narrative describing issues related to complexity, I doubt that will be sufficient incentive for Congress to avoid additional complexity or encourage simplification. The committees should be required to quantify the costs of proposals that add complexity or the savings from proposals that simplify the law.

The Commission suggested that Congress consider a quadrennial simplification process, and I hope that Congress and the President will quickly implement such a process either through legislation or by executive order. The Commission found that many members of the private sector tax community were willing to volunteer substantial time to make suggestions for simplification.

A quadrennial simplification commission would harness this volunteer activity and give a broad group of people much more incentive to work for the adoption of simplification rules. This quadrennial commission would also give the Joint Committee on Taxation and the Treasury Department more incentive to suggest simplification of the law.

The IRS: "A Schizophrenic Institution"

Late in our deliberations came an interesting and innovative proposal from the National Association of Enrolled Agents from testimony by Joseph F. Lane, co-chair of their government relations committee. Mr. Lane recommended splitting the IRS into two separate operations. One would handle tax enforcement and the other would take charge of taxpayer service.

An editorial in the May 19th issue of Accounting Today ("Break Up the IRS") endorsed his recommendation, calling the IRS "a schizophrenic institution. But that's only because the agency has conflicting missions: on one hand, the IRS is a law enforcement agency, and as such it is one of the most effective and feared in the world. But on the other hand, it is now supposed to be customer-friendly, service-sensitive and technologically innovative, and as such it is a travesty." The editorial concluded that "only by demolishing the IRS and rebuilding it with its counter-

balancing strengths in mind can the nation get the friendly, efficient service it deserves with the tough-minded enforcement it needs."

I believe the Commission's recommendations for new governance will have very favorable impact on taxpayer service. It's not necessary to set up two separate agencies with their own political appointees as suggested by Mr. Lane. In fact the goals of his proposal could be accomplished through administrative action and internal reorganization. Should the Commission's recommendations become law, I hope the new IRS board and commissioner will carefully consider his analysis.

A Citizens Review Board

Buried deep within the Taxpayer Rights appendix is a phrase suggesting a citizens review board. This intriguing suggestion came to us from Samuel Walker, professor of criminal justice at the University of Nebraska at Omaha, and one of the nation's leading experts on external review of local law enforcement agencies in the United States. Professor Walker recommends that the "Internal Revenue Service should be subject to an external review procedure related to citizen complaints about treatment by IRS officials." He notes that "there is persuasive evidence that citizen review procedures have contributed to improvement in policing in many [local] jurisdictions." Even though the IRS is the nation's largest law enforcement agency, it has no such external review procedure.

Such a citizens review board would not concern itself with disagreements about proposed tax bills or allegations of criminal conduct by employees. There already are procedures to address these issues. This review process would focus only on "complaints about the manner in which IRS officials behaved toward citizens." Taxpayers could choose whether to have their cases opened for public review. IRS, which often laments its inability to comment on taxpayer complaints because of disclosure laws, would have a forum outside the courtroom where it could tell its side of the story.

"The mission of an external review procedure for the IRS should have two principal components," Prof. Walker explains. "First, it should provide an avenue of redress for citizens who feel that IRS officials have treated them in an improper or unprofessional manner. Second, it should play an oversight role in terms of identifying recurring problems, recommending solutions to those problems, and monitoring the implementation of such recommendations."

Congress should invite Professor Walker and others with experience in such programs to help implement this concept for the IRS. It has great potential to help the IRS improve its procedures while allowing taxpayers another form of relief.

A New Approach to Taxes Is Needed

While beyond the scope of the Commission's charter, fundamental overhaul of our tax system remains a critically-important goal. As I have stressed, a fundamental problem for taxpayers and the IRS is the complexity of our tax law. As the Internal Revenue Code becomes increasingly

incomprehensible, the intrusive measures allowed to IRS for enforcing it seem to become more draconian. Every detail of a taxpayer's private financial life is open for government inspection. IRS employees can make extraordinary demands on taxpayers, and can take extraordinary actions against them. Mixing such broad powers with a vague and complex law is a recipe for a civil liberty catastrophe. Actual abuse is rare, but the threat of abuse is always present.

Until we change how we tax income, we will continue to have an intrusive agency with broad powers. It doesn't have to be that way. Our economy as well as our civil liberties would be better off with fundamental tax reform. A tax return could fit on a postcard if Rep. Dick Armey's flat tax was the law. Under Rep. Bill Archer's proposed spending tax, we wouldn't even need an income tax. The government would still need some form of tax collection mechanism, but it could be far smaller than the current IRS workforce of more than 100,000, and it would not need to interact with virtually every adult American.

As soon as Congress and the President finish restructuring the IRS as recommended in the Commission's report, they should begin work on fundamental tax reform. The result will be not only a tax collection agency that has an easier task, but a healthier political and economic environment.

David Keating

Statement of Commissioners Edward S. Knight, Larry Irving, and James W. Wetzler

OVERVIEW: A CONSENSUS FOR CHANGE

Over the past year the National Commission on Restructuring the Internal Revenue Service (Commission) has performed a valuable service for this nation. Under the leadership of Chairmen Kerrey and Portman, the members of the Commission have worked hard to understand the complex problems facing the Internal Revenue Service (IRS) and have offered constructive suggestions for change. We commend our colleagues for this important effort, and we also appreciate the hard work and long hours dedicated to this Commission by its staff.

While there is much in the report that we agree with, we cannot join the Commission's majority because of our strong opposition to some of their recommendations. Our intent in writing this separate report is to inform the public debate on the IRS as the actions now being taken to improve the agency continue. Our goal is the same as that of the rest of the Commission's members: to recommend how the IRS might better serve the American taxpayer both now and as we move into the 21st Century.

In our view, one of the Commission's primary achievements is that it has identified and defined key problems with the IRS that demand prompt attention. We share the Commission's view of the identity of these key problems. For example, there is consensus within the Commission that:

- The IRS' *customer service lags* behind when compared to the service the American people receive from the best private sector financial services organizations, and that the IRS' goal should be to adopt the best customer service practices of the private sector.
- The IRS needs to continue to *improve its use of technology* for the benefit of American taxpayers and the IRS.
- The IRS needs to *change its culture* to one that is more oriented toward customer service and reducing unnecessary burdens on taxpayers.
- There should be increased use of *electronic filing* for income tax returns and information reporting.
- More can be done to build on recent reforms enhancing *taxpayer rights*.
- *Simplification* of the Internal Revenue Code is critical to improved performance by the IRS.
- The IRS needs *adequate and stable funding and budgeting* to ensure continuity in its effort to upgrade customer service.
- The IRS needs *greater flexibility* to attract and retain high caliber personnel, and it needs to take greater advantage of the management flexibilities that currently exist.
- The IRS needs additional institutional support to ensure the success of its *employee training* plan.
- The IRS needs *greater continuity in its leadership*.
- There needs to be *enhanced and institutionalized oversight of the IRS by the Executive Branch.*

We also agree that one of the most critical goals is to make the IRS more accountable. The questions are: 1) How to make it more accountable? and 2) To whom should the agency be accountable?

The IRS is a large and complex organization which has a vital mission that touches virtually every American. It collects 95 percent of this nation's revenue -- revenue that funds everything from fighter jets to Medicare checks to grants for college education. As the majority points out, the IRS is viewed as a model by the tax collection agencies of many countries. In addition, the majority states that Commission interviews with over 300 IRS employees left them with an overall impression of competent, hard working people who want to deliver a high quality product to the American taxpayer.

Despite these positive features, we all agree that the IRS has problems that need to be addressed. These problems have developed over decades and will not be resolved overnight. This consensus on the need for fundamental change is an important step in the national debate as we continue on the path to solving the problems at the IRS. It is vitally important, however, that we not delay or impede the wide-ranging reforms that have been initiated thus far.

MAKING CHANGE A REALITY

Over the last two years, the Treasury Department, working in partnership with the IRS, has spent an enormous amount of time studying and implementing wide-ranging reforms at the Internal Revenue Service. Actions taken by the Department and the IRS have been guided by the following principle: to continue making the IRS more effective, efficient and taxpayer friendly while ensuring the flow of revenues that fund vital government programs.

Treasury Secretary Robert E. Rubin and Deputy Secretary Lawrence H. Summers recognized at an early stage the seriousness of the problems facing the IRS and the need for rapid reform. In particular, they identified the critical role of Treasury oversight, the need to augment that oversight and the necessity of bringing about real reforms. These reforms include:

Technology Modernization. Utilization of technology has been critical to the effectiveness of the IRS for decades. Recent public attention has focused on the Tax System Modernization (TSM) program which began in 1988 when the IRS put into effect a plan to upgrade and modernize the agency's technological system. In the years following, however, studies by the IRS, the National Research Council and the General Accounting Office (GAO) uncovered serious problems in the modernization program. A 1995 GAO report called for massive changes in planning, management and implementation of TSM. Congress called on the IRS by May 15, 1997 to produce a plan for correcting and updating its technological capabilities.

In early 1996 the Treasury Department, taking into account the serious problems with TSM, took a "sharp turn" in modernizing IRS technology systems through a series of dramatic, concrete steps. The Department, working with the IRS:

- Created in March 1996 the Modernization Management Board (MMB) to oversee the creation and implementation of new IRS technology systems. The MMB, which includes representatives from Treasury, OMB and the National Performance Review and has a professional staff, meets monthly and is chaired by the Deputy Secretary of the Treasury.
- Hired a new IRS Chief Information Officer, Arthur Gross, who brings to the IRS extensive experience directing technology change in tax organizations. Mr. Gross immediately launched a nationwide search for new technical managers.
- Halted work on existing TSM projects in order to review and reevaluate the modernization program.
- Canceled or collapsed 26 disparate modernization projects into a more targeted and manageable 9 projects, thus avoiding significant unnecessary future costs.
- Reduced the number of IRS employees on these projects from 524 to 156.
- Drafted a Modernization Blueprint to guide the overhaul of IRS technology programs.

Modernization Blueprint. In May 1997, the new IRS Blueprint for Modernization was announced. The Blueprint for Modernization represents the first comprehensive attempt to form a strategic partnership with the private sector in order to address the problems of the past and to ensure that the IRS has the flexibility to meet future challenges.

This Blueprint describes a centralized, flexible system that permits easier access to data to provide superior service to the taxpayer, to move toward paperless operations, and to increase compliance with the law. The Blueprint includes plans for centralized data bases that will ensure taxpayer privacy and minimize cost while providing IRS customer service and compliance personnel easy access to accurate and timely information. As each part of the Blueprint is implemented, its effectiveness will be verified before work proceeds on the next part of the Blueprint.

Today, for example, when taxpayers call the IRS with questions about their taxes, IRS employees may need access to data from up to nine different computer terminals to answer the questions. The system described in the Modernization Blueprint will enable all data to be accessible through a single terminal.

Electronic Filing. In July the IRS will issue a Request for Information (RFI) on electronic filing, launching the most comprehensive effort to date to solicit input from all constituencies in the electronic filing process. The response to this request will be used in efforts to evaluate current electronic filing processes and will help determine IRS budget requirements in this area.

Tax Simplification. On April 14, 1997, Secretary Rubin announced a revenue-neutral package of more than 60 tax simplification and taxpayer rights proposals for consideration by Congress. As Secretary Rubin said at the time, these measures are designed to save individuals, families

and businesses millions of hours now spent filling out tax forms and to reduce the complexities and paperwork burdens of the existing Internal Revenue Code. The proposals include:

- **Corporate AMT Reform.** The proposal would exclude altogether from AMT (alternative minimum tax) corporations with gross receipts below $5 million. Under this proposal, roughly 95 percent of all corporations (more than 2 million) would be spared the trouble of calculating the AMT. More than 15,000 corporations pay the corporate AMT each year, and of these, more than 6,000 no longer would have to calculate and pay the AMT.

- **Exclusion For Gains on Sale of Principal Residence**. The proposal exempts up to $500,000 of gain on the sale of a principal residence. This provision would lower the number of taxpayers paying capital gains taxes on residences from 150,000 per year to roughly 10,000 per year. It also would reduce substantially the recordkeeping requirements for over 60 million households who own their own homes.

- **Simplification of Child Dependency Exemption Rules.** Under this proposal, many taxpayers no longer would have to demonstrate that they provide over half the support for children in order to claim them as dependents. Instead, taxpayers could claim their sons, daughters, grandchildren or foster children as dependents if the children were under the age of 19 (24 if full-time students) and resided with them for over half the year (a full year in the case of foster children). Filing requirements and recordkeeping would be simplified for most of the 40 million taxpayers who claim 70 million children in their homes as dependents.

The ongoing changes and improvements noted above are beginning to address the core concerns identified by the Commission. We believe that Treasury efforts in the last two years to change the governance of the IRS has been the crucial component in making IRS reforms to date.

Governance. As stated previously, the Treasury Department identified the critical role governance plays in driving change. In particular, the Department sought to bring increased *continuity, institutionalization* and *outside input* to the IRS governance structure without unnecessarily risking the core functions of the IRS. This has been achieved with a series of concrete and significant governance changes and proposals:

- **IRS Commissioner/Five-Year Term.** On May 20, the Secretary Rubin announced that the Administration will seek legislation to provide the IRS Commissioner with a fixed, five-year term. Providing a five-year term is designed to bring greater *continuity* and independence to the position without diluting the Executive Branch accountability for management of the IRS. This Administration also will seek legislation providing expanded personnel authority for the IRS Commissioner to better manage and compensate IRS employees.

  This spring the Administration announced that it would seek appointment of a new kind of Commissioner: a private sector manager with expertise in customer service and technology.

The Administration is moving aggressively to nominate someone as IRS Commissioner who has these qualifications.

- **IRS Management Board.** To *institutionalize* further the Treasury Department's IRS oversight role, Secretary Rubin announced on May 20 that he will recommend that the President sign an Executive Order to create an Internal Revenue Service Management Board composed of high ranking government officials from all relevant Executive Branch agencies. This Board will replace and expand the scope of the current MMB. Board members will provide ongoing oversight of all major IRS decisions. The Executive Order also will require the Board to meet at least monthly and to prepare semi-annual reports to the President and the Congress, which shall be transmitted by the Secretary of the Treasury.

- **Reporting to Congress.** Secretary Rubin has stated that he supports the notion of the Secretary and Deputy Secretary of the Treasury reporting to Congress semi-annually on the operations of the IRS as a further means of *institutionalizing* Treasury oversight. It would be appropriate to include this proposal in any legislation dealing with the governance issue.

- **IRS Advisory Board.** To provide him and future Treasury Secretaries additional advice on technology, customer service, taxation and other relevant areas of expertise from the private sector, Secretary Rubin also announced on May20 that he will issue an order establishing an IRS Advisory Board. Comprised of prominent citizens from *outside government*, this Board will function much like public trustees and will issue an annual report on the IRS to the American people and the Congress. The Advisory Board will help *institutionalize* the provision of *outside input* into the Department's oversight of IRS matters.

- **IRS Customer Service Review**. On May 20, Vice President Gore announced the formation of a new task force, as part of the National Performance Review, to address customer service problems at the IRS. Comprised of front line IRS employees and officials from other agencies, this task force has a mandate to find ways to eliminate waste and raise productivity to give the American people the customer service they deserve from the IRS.

These steps to improve the governance of the IRS are making real progress, and the proposals outlined above would further the progress made without jeopardizing the core functions performed by the IRS.

THE COMMISSION'S GOVERNANCE PROPOSAL: A BOARD THAT POSES UNACCEPTABLE RISKS

The American people rightly demand an IRS that is responsive to the public and is led by officials who are held accountable for achieving success. While we pursue this objective, we also must ensure that any change at the IRS minimizes risk to the vital flow of revenues that fund our government and allows current progress on reform to continue. We believe the majority's recommendations for governance fail these crucial tests.

The Commission's Proposal. The Commission has proposed that the Internal Revenue Service be governed by an outside board of private sector executives who would serve on a part-time basis and who would keep their private sector jobs and private sector salaries. The board would be a very powerful governmental body, affecting every American citizen, and without the level of direct accountability that the Treasury Secretary has to an elected President.

Everything that the President, the Treasury Secretary and the Treasury Department now do with regard to the IRS would be subject to the board's authority, including the President's current power to appoint the IRS Commissioner and the Chief Counsel. There is a vague reference in the majority report to removing IRS enforcement matters from the proposed board's purview, but the specific authority that would be given the proposed board in the report would place the part-time, private sector executives on the board knee-deep in enforcement. The board would do everything from approving all the top IRS law enforcement officials -- the Chief Compliance Officer and the Assistant Commissioner for Criminal Investigations -- to determining the level of enforcement expenditures.

We believe the proposed board structure, the majority's recommended instrument of change, would be ineffective, would violate basic principles of our democracy, and would delay and even derail efforts to improve the agency.

Private vs. Public Sector Boards. There is little argument that in most cases boards work in the private sector. Private sector boards have shareholders, directors' liability and the discipline of the marketplace to keep them in check and hold them accountable. But the IRS board recommended by the majority would have none of these private sector incentives or protections. The IRS is not and cannot be an entity that succeeds or fails based on its market performance. It performs one of the most essential functions of our government, upon which all others depend. Failure, or even the risk of failure, is not an option.

After an extensive review of models for running federal agencies, the General Accounting Office (GAO) reported in 1989 that the need for stable and effective leadership is more critical in the management of large government organizations than it is in relatively small regulatory agencies. It further found that "[t]hough boards may be useful in operating some small regulatory agencies where deliberation in a quasi-judicial environment is valued, . . . a board running a large operational organization . . . is inappropriate and not feasible." The GAO summed up the problems with boards running large government organizations in straightforward language: "the board form of organization has not proven effective in providing stable leadership, in insulating decisions from political pressures and in assuring that diverse viewpoints are considered in the decision-making process."

At a time when we should be strengthening the accountability of the President and his senior officials for the IRS, the majority proposes to diffuse that accountability by spreading it over a multi-member part-time board.

Part-Time Board, Part-Time Attention. The IRS needs full-time oversight and attention from a dedicated group of women and men whose vocation, and not merely their part-time interest, is government service. Consider how the Commission's part-time board would work in practice. At present, top IRS and Treasury officials meet daily to discuss IRS matters urgently requiring decision. Many of those matters require considerable thought, attention, and internal deliberation, and meetings sometimes must be called with little notice or on an emergency basis. This demanding, continuous process is greatly assisted by the synergy between the IRS and Treasury. Under the majority's proposal, however, that synergy would be lost. In addition, urgent matters requiring immediate board input and decision presumably would have to wait a month or more until the next board meeting, by which time these busy business executives would somehow have to be fully prepared to deal with the issue -- if it were not too late.

Delays and Uncertainty in the Process of Reform. We believe the time and energy that it would take to draft and pass legislation to create a board, seek out, nominate, confirm and appoint board members, set up a board structure, and deal with the inevitable challenges to the statutory and constitutional authority for board actions would significantly detract from and delay the implementation of the changes needed to bring the IRS up to the standards we all want it to meet. Such delays and uncertainty are unnecessary and undesirable.

Conflicts of Interest. The proposed board quickly would be faced with the appearance, if not reality, of conflicts of interest. Everyone currently associated with the governance of the IRS is subject to some of the most intense ethical reviews in government in order to avoid even the appearance of self-dealing, and they also give up their private sector salaries. But under the Commission's proposal, for example, corporate executives whose companies automatically may be subject to yearly audits will determine the audit budget for the IRS and its strategic enforcement priorities. In addition, members of the proposed board likely would have to be recused from a wide range of matters facing the IRS to avoid conflicts, reducing their ability to provide effective input, even on a part-time basis.

Conflicts With Law Enforcement. Although it is proposed that the board would only control certain IRS operations, decades of experience demonstrate that separating tax enforcement from tax collection, or tax administration from tax policy, cannot and will not work. No law enforcement agency of the United States government has ever been managed by corporate executives or other private citizens, much less on a part-time basis. It does not make sense to put such a sensitive and critical function in their hands. A person with a full-time private sector job simply does not have the sensitivities --or the insulation from special interests -- of a government official whose full-time, sworn responsibility is to uphold and enforce the law.

Independence from the President/Accountable to Whom? The majority's recommendations repeatedly state that the proposed board's members will be "independent" and will serve fixed terms intentionally different from the President's term. The report is dangerously susceptible to

a reading that is inconsistent with accountability to an elected President because it does not explicitly state that the President may remove the board *at will*.

The courts have held that *any* limitation on the President's power to remove officials performing core executive functions -- such as the IRS Commissioner or members of the proposed board -- impedes the President's ability to satisfy his constitutional obligation to take care that the laws be faithfully executed. Limiting the President's authority to remove board members also would limit dramatically the accountability of the proposed board to the American people through their elected President.

This is a crucial point on which the majority report is ambiguous. This report may serve as guidance for the Congress as it drafts and considers legislation. We and the Department of Justice have vigorously asserted that the proposed board members must be removable *at will* by the President or the structure will raise grave constitutional concerns. If the Commission intends that legislation based on its recommendation comply with the Constitution, ambiguity is harmful. Even if this ambiguity were eliminated, it would not ameliorate the serious practical defects of the majority's governance proposal.

This board's actions would be subject to serious legal challenges that could impede the flow of 95 percent of our nation's revenues.

The Justice Department's Office of Legal Counsel recently wrote that "serious constitutional concerns" were raised by governance proposals such as the one proposed by the Commission. *See* February 26, 1997 letter from Dawn E. Johnson, Acting Assistant Attorney General, Office of Legal Counsel, to Edward S. Knight, General Counsel, Department of the Treasury, at 3.

Other Constitutional Concerns. The Commission's recommendations ignore our Founding Fathers' wisdom in another significant respect. There are grave Constitutional problems with the board appointing or removing the IRS Commissioner and the IRS Chief Counsel. The Appointments Clause of the Constitution sets out the manner in which federal officers must be selected: principal officers must be appointed by the President with the advice and consent of the Senate; inferior officers must be appointed either in the same manner or by "Heads of Departments" or "Courts of Law." The Commission's report does not comply with these mandates.

At a time when we are trying to balance the Federal budget for the first time in a generation and facing difficult decisions about our spending priorities, we should not create a legally suspect regime that could threaten funding for everything from national defense to health care to education.

Summary. We believe that the Commission's proposal is fundamentally flawed and would pose unacceptable economic and legal risks to the American people while delaying ongoing and future efforts to improve the IRS. As Secretary Rubin recently pointed out, experimenting with the IRS

in such a manner could impede the important task of collecting the revenue that runs the Federal government. The majority's proposal would place at risk programs vital to the American people and make the IRS unaccountable to the taxpayers.

COMMENTS ON OTHER RECOMMENDATIONS

Because of the relatively small size of the Commission's staff, the short time available to review and analyze the many complex problems facing the Internal Revenue Service, and the scope of the Commission's mandate as stated in the Act creating the Commission, the range of topics upon which the Commission was able to provide adequate review and analysis was necessarily limited. Consequently, we strongly advise that the Commission's recommendations be subject to intensive examination and analysis before being adopted in any significant measure.

For example, the Commission proposes a number of changes to the dates by which taxpayers must file returns or reports with the IRS. We wholeheartedly agree with the majority on the need to increase substantially the number of taxpayers that file electronically, because this will provide important cost savings to the IRS. However, sharing the projected savings with taxpayers -- as an incentive for increased electronic filing -- must be done in ways that are equitable for all taxpayers. The majority's proposed changes with regard to filing dates would benefit primarily higher income taxpayers who owe taxes, because they would be allowed to delay an extra month or two (for electronic filers) before they had to pay their taxes. This delay in tax receipts would significantly increase the government's borrowing costs, a burden that would be imposed on all taxpayers. At the same time, the proposals would result in delays of refunds to millions of lower income taxpayers, and it is not likely that the proposals will appreciably decrease the IRS' workload or costs during the peak filing season.

The Commission's report includes a number of tax simplification proposals that it received from various stakeholder groups and academics, and "urges that they be considered" by the tax writing committees of Congress. Some of the proposals have merit and are included among the 60 tax simplification proposals announced by the Administration earlier this year and discussed above. But others clearly reflect bad tax policy, would not simplify the law, would unduly benefit some taxpayers over others, and would involve large revenue losses.

The Commission also received proposals concerning additional taxpayer rights measures. Protecting taxpayer rights is critical to our voluntary compliance tax system. Congress and the Executive Branch have taken several steps in recent years to protect taxpayer rights and enhance the public's understanding of, and treatment under, our system. These steps include enactment of the Taxpayer Bill of Rights (TBOR) in 1988 and the Taxpayer Bill of Rights 2 (TBOR 2) in 1996. In addition, taxpayer rights proposals were included among the 60 tax simplification proposals announced by the Administration earlier this year. However, the Commission did not evaluate the merits of these proposals: no revenue estimates were prepared; possible adverse compliance effects of these proposals were not discussed; and collateral effects of such proposals

on other policy areas were not considered. Some of the proposals in the Commission's report were considered*and rejected* by Congress in TBOR 2.

Finally, the majority recommends a new Congressional oversight committee for the IRS. We note that there are long-standing processes of Congressional oversight of the IRS and the Internal Revenue Code, and believe that this issue is for Congress to decide. Thus, we do not make a separate recommendation on this subject. We would be concerned, however, with any modification of Congressional oversight that delayed the changes and improvements already under way at the IRS or that imposed institutional barriers could thwart future IRS efforts to make necessary changes to improve customer service. The IRS must have the flexibility to take advantage of changes in technology, taxpayer preferences, and the law to make it a high performance organization.

CONCLUSION

We wish to reiterate our thanks and appreciation to fellow Commission members and to the staff of the Commission.

As we have indicated, there are many recommendations contained in the report that we wholeheartedly endorse. But we cannot endorse the recommendation that the agency that collects 95 percent of the revenue that funds our government be subject to the control of a part-time board of executives from private companies.

Both we and the other Commissioners know that changes must continue to be made, without interruption, at the IRS. The critical disagreement is how best to ensure that these changes are made successfully. It is our firm conviction that they best can be made with enhanced executive direction provided by dedicated, full-time government officials combined with ongoing advice from the private sector. The future of vital government programs is much too important to risk on the untested, and in our view fundamentally flawed, governance scheme that the majority proposes.

Edward S. Knight Larry Irving James W. Wetzler

Statement of Commissioner George Newstrom

I welcome the opportunity to comment on the final report of the National Commission on Restructuring the Internal Revenue Service.

It has been an honor to serve as a member of the Commission, and I strongly support most of the findings and recommendations included in the report. Unfortunately, there is one recommendation in the Governance Section to which I take strong exception, and this has prevented me from being able to sign the document. As a result, I would like to take this opportunity to express both my concern with regard to this recommendation and my support for the remainder.

Concerns Regarding the Recommendation to Create an Independent Board

I am unable to support this recommendation because, after more than two decades of building partnerships between public and private sector organizations, I am committed to maintaining a clear distinction between the policy making functions of government and the use of private sector contractors to make government operations more effective.

I know that the Commissioners who support this recommendation intend that the board have no role in policy making. However, it is difficult for me to understand how a body that hires the executive officers of an organization, sets their compensation, approves their budget proposals, and interacts on a regular basis with members of Congress can refrain from influencing policy. Tax policy and tax law enforcement are among the oldest and most critical functions of government. I do not believe that a board controlled by private sector members should have control over those responsible for the implementation of tax law.

I know that the IRS and Treasury must work to win the confidence of members of Congress and the American people. The Treasury Department has taken a critical step forward in proposing a new governance structure for the IRS and recommending the nomination of an IRS Commissioner with strong management experience. The IRS has redefined its core competencies and developed a plan that looks to the private sector for information technology resources that it cannot create in house. It is time to leverage these accomplishments and give them time to work.

Congress has the budget authority to hold Treasury and the IRS accountable for delivering on their plans. I believe that this is a more productive route than inserting the private sector into the governance process. It is critical to preserve the distinction between what the private sector can accomplish and those responsibilities that are an integral and inseparable part of government.

Importance of Implementing Other Findings and Recommendations

The Commission has developed a broad range of recommendations that, taken together, will strengthen the management of the Internal Revenue Service, give the IRS the ability to respond effectively to taxpayers, and increase compliance.

I commend my colleagues for their work on management and budget, workforce and culture, customer service, and compliance issues. I appreciate their concerns regarding simplification, taxpayer rights, and financial management. There are many things in these sections that I wholeheartedly endorse.

The modernization section includes recommendations that are critical to the ability of the IRS to function successfully in the twenty-first century. I was pleased to have the opportunity to work on the sections dealing with century date change, the integration of technology with strategic objectives, intellectual capital, and electronic filing. I believe that these recommendations go to the heart of building an IRS that can respond quickly and accurately to taxpayer needs and provide the quality of tax collection that is essential to a voluntary compliance system.

Finally, I appreciate the hard work and professionalism of the Commission staff without whom this report would not have been possible.

George Newstrom

Appendices

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Appendix A
Staff Members

Jeffery S. Trinca, Chief of Staff

Anita L. Horn, Deputy Chief of Staff and Senior Policy Advisor

Charles A. Lacijan, Senior Policy Advisor

Douglas H. Shulman, Senior Policy Advisor

Dean A. Zerbe, Senior Policy Advisor

Armando Gomez, Chief Counsel

George Guttman, Counsel

Lisa D. McHenry, Director of Communications and Research

James Dennis, Counsel

John M. Jungers, Research Assistant

Andrew J. Siracuse, Research Assistant

Damien M. McAndrews, Research Assistant

Margie A. Knowles, Office/Systems Manager

Janise L. Haman, Secretary/Receptionist

Appendix B
Statute Creating the Commission

Public Law104-52, 109 Stat. 509, Nov. 19, 1995, as amended by Public Law 104-134, 110 Stat. 1321, 1904 (April 26, 1996) and by Public Law 104-208, 110 Stat. 3009, 3643 (Sept. 30, 1996).

Sec. 637. National Commission on Restructuring the Internal Revenue Service

(a) FINDINGS.—The Congress finds the following:

(1) While the budget for the Internal Revenue Service (hereafter referred to as the "IRS") has risen from $2.5 billion in fiscal year 1979 to $7.3 billion in fiscal year 1996, tax returns processing has not become significantly faster, tax collection rates have not significantly increased, and the accuracy and timeliness of taxpayer assistance has not significantly improved.

(2) To date, the Tax Systems Modernization (TSM) program has cost the taxpayers $2.5 billion, with an estimated cost of $8 billion. Despite this investment, modernization efforts were recently described by the GAO as "chaotic" and "ad hoc."

(3) While the IRS maintains that TSM will increase efficiency and thus revenues, Congress has had to appropriate additional funds in recent years for compliance initiatives in order to increase tax revenues.

(4) Because TSM has not been implemented, the IRS continues to rely on paper returns, processing a total of 14 billion pieces of paper every tax season. This results in an extremely inefficient system.

(5) This lack of efficiency reduces the level of customer service and impedes the ability of the IRS to collect revenue.

(6) The present status of the IRS shows the need for the establishment of a Commission which will examine the organization of IRS and recommend actions to expedite the implementation of TSM and improve service to taxpayers.

(b) COMPOSITION OF THE COMMISSION.—

(1) ESTABLISHMENT.—To carry out the purposes of this section, there is established a National Commission on Restructuring the Internal Revenue Service (in this section referred to as the "Commission").

(2) COMPOSITION.—The Commission shall be composed of seventeen members, as follows:

(A) Five members appointed by the President, two from the executive branch of the Government, two from private life, and one from an organization that represents a substantial number of Internal Revenue Service employees.

(B) Four members appointed by the Majority Leader of the Senate, one from Members of the Senate and three from private life.

(C) Two members appointed by the Minority Leader of the Senate, one from Members of the Senate and one from private life.

(D) Four members appointed by the Speaker of the House of Representatives, one from Members of the House and three from private life.

(E) Two members appointed by the Minority Leader of the House of Representatives, one from Members of the House and one from private life.

The Commissioner of the Internal Revenue Service shall be an ex officio member of the Commission.

(3) CO-CHAIRS.—The Commission shall elect Co-Chairs from among its members.

(4) MEETING; QUORUM; VACANCIES.—After its initial meeting, the Commission shall meet upon the call of the Co-Chairs or a majority of its members. Nine members of the Commission shall constitute a quorum. Any vacancy in the Commission shall not affect its powers, but shall be filled in the same manner in which the original appointment was made.

(5) APPOINTMENT; INITIAL MEETING.—

(A) APPOINTMENT.—It is the sense of the Congress that members of the Commission should be appointed not more than 60 days after the date of the enactment of this section.

(B) INITIAL MEETING.—If, after 60 days from the date of the enactment of this section, seven or more members of the Commission have been appointed, members who have been appointed may meet and select Co-Chairs who thereafter shall have the authority to begin the operations of the Commission, including the hiring of staff.

(c) FUNCTIONS OF COMMISSION.—

(1) IN GENERAL.—The functions of the Commission shall be—

(A) to conduct, for a period of not to exceed 15 months from the date of its first meeting, the review described in paragraph (2), and

(B) to submit to the Congress a final report of the results of the review, including recommendations for restructuring the IRS.

(2) REVIEW.—The Commission shall review—

(A) the present practices of the IRS, especially with respect to—

(i) its organizational structure;

(ii) its paper processing and return processing activities;

(iii) its infrastructure; and

(iv) the collection process;

(B) requirements for improvement in the following areas:

(i) making returns processing "paperless";

(ii) modernizing IRS operations;

(iii) improving the collections process without major personnel increases or increased funding;

(iv) improving taxpayer accounts management;

(v) improving the accuracy of information requested by taxpayers in order to file their returns; and

(vi) changing the culture of the IRS to make the organization more efficient, productive, and customer-oriented;

(C) whether the IRS could be replaced with a quasi-governmental agency with tangible incentives and internally managing its programs and activities and for modernizing its activities, and

(D) whether the IRS could perform other collection, information, and financial service functions of the Federal Government.

(d) POWERS OF THE COMMISSION.—

(1) IN GENERAL.—(A) The Commission or, on the authorization of the Commission, any subcommittee or member thereof, may, for the purpose of carrying out the provisions of this section—

(i) hold such hearings and sit and act at such times and places, take such testimony, receive such evidence, administer such oaths, and

(ii) require, by subpoena or otherwise, the attendance and testimony of such witnesses and the production of such books, records, correspondence, memoranda, papers, and documents, and the Commission or such designated subcommittee or designated member may deem advisable.

(B) Subpoenas issued under subparagraph (A)(ii) may be issued under the signature of the Co-Chairs of the Commission, the chairman of any designated subcommittee, or any designated member, and may be served by any person designated by such Co-Chairs, subcommittee chairman, or member. The provisions of sections 102 through 104 of the Revised Statutes of the United States (2 U.S.C. 192-194) shall apply in the case of any failure of any witness to comply with any subpoena or to testify when summoned under authority of this section.

(2) CONTRACTING.—The Commission may, to such extent and in such amounts as are provided in appropriation Acts, enter into contracts to enable the Commission to discharge its duties under this section.

(3) INFORMATION FROM FEDERAL AGENCIES.—The Commission is authorized to secure directly from any executive department, bureau, agency, board, commission, office, independent establishment, or instrumentality of the Government, information, suggestions, estimates, and statistics for the purposes of this section. Each such department, bureau, agency, board, commission, office, establishment, or instrumentality shall, to the extent authorized by

law, furnish such information, suggestions, estimates, and statistics directly to the Commission, upon request made by the Co-Chairs.

(4) ASSISTANCE FROM FEDERAL AGENCIES.—(A) The Secretary of the Treasury is authorized on a nonreimbursable basis to provide the Commission with administrative services, funds, facilities, staff, and other support services for the performance of the Commission's functions.

(B) The Administrator of General Services shall provide to the Commission on a nonreimbursable basis such administrative support services as the Commission may request.

(C) In addition to the assistance set forth in subparagraphs (A) and (B), departments and agencies of the United States are authorized to provide to the Commission such services, funds, facilities, staff, and other support services as they may deem advisable and as may be authorized by law.

(5) POSTAL SERVICES.—The Commission may use the United States mails in the same manner and under the same conditions as departments and agencies of the United States.

(6) GIFTS.—The Commission may accept, use, and dispose of gifts or donations of services or property in carrying out its duties under this section.

(e) STAFF OF THE COMMISSION.—

(1) IN GENERAL.—The Co-Chairs, in accordance with rules agreed upon by the Commission, may appoint and fix the compensation of a staff director and such other personnel as may be necessary to enable the Commission to carry out its functions, without regard to the provisions of title 5, United States Code, governing appointments in the competitive service, and without regard to the provisions of chapter 51 and subchapter III or chapter 53 of such title relating to classification and General Schedule pay rates, except that no rate of pay fixed under this subsection may exceed the equivalent of that payable to a person occupying a position at level V of the Executive Schedule under section 5316 of title 5, United States Code. Any Federal Government employee may be detailed to the Commission without reimbursement from the Commission, and such detailee shall retain the rights, status, and privileges of his or her regular employment without interruption.

(2) CONSULTANT SERVICES.—The Commission is authorized to procure the services of experts and consultants in accordance with section 3109 of title 5, United States Code, but at rates not to exceed the daily rate paid a person occupying a position at level IV of the Executive Schedule under section 5315 of title 5, United States Code.

(f) COMPENSATION AND TRAVEL EXPENSES.—

(1) COMPENSATION.—(A) Except as provided in subparagraph (B), each member of the Commission may be compensated at not to exceed the daily equivalent of the annual rate of basic pay in effect for a position at level IV of the Executive Schedule under section 5315 of title

5, United States Code, for each day during which that member is engaged in the actual performance of the duties of the Commission.

(B) Members of the Commission who are officers or employees of the United States or Members of Congress shall receive no additional pay on account of their service on the Commission.

(2) TRAVEL EXPENSES.—While away from their homes or regular places of business in the performance of services for the Commission, members of the Commission may be allowed travel expenses, including per diem in lieu of subsistence, in the same manner as persons employed intermittently in the Government service are allowed expenses under section 5703(b) of title 5, United States Code.

(g) FINAL REPORT OF COMMISSION; TERMINATION.—

(1) FINAL REPORT.—Not later than 15 months after the date of the first meeting of the Commission, the Commission shall submit to the Congress its final report, as described in subsection (c)(2).

(2) TERMINATION.—(A) The Commission, and all the authorities of this section, shall terminate on the date which is 60 days after the date on which a final report is required to be transmitted under paragraph (1).

(B) The Commission may use the 60-day period referred to in subparagraph (A) for the purposes of concluding its activities, including providing testimony to committees of Congress concerning its final report and disseminating that report.

(h) AUTHORIZATION OF APPROPRIATIONS.—Such sums as may be necessary are authorized to be appropriated for the activities of the Commission.

(i) APPROPRIATIONS.—Notwithstanding any other provision of the Act, $1,000,000 shall be available from fiscal year 1996 funds appropriated to the Internal Revenue Service, "Information Systems" account, for the activities of the Commission, to remain available until expended.

Appendix C
Methodology

Congress created the National Commission on Restructuring the IRS to review the present practices of the IRS, and recommend how to modernize and improve the efficiency and productivity of the IRS while improving taxpayer services. In addition, Congress asked the Commission to examine whether the IRS could be replaced with a quasi-governmental agency, and whether the IRS could perform other collection, information, and financial service functions for the federal government.

Given the scale of this task, the Commission outlined six core areas for its review. Over the past twelve months, the Commission reviewed: (1) taxpayer services, including quality programs, resource allocation, taxpayer inquiries and accounts management, and the role of the Taxpayer Advocate; (2) the management and governance structure of the IRS, including the role of the Commissioner and appropriate oversight structures; (3) the current hiring, training, and evaluation practices of the IRS, and steps that could be taken to ensure that a high caliber workforce is in place; (4) the IRS technology programs, including the use of technology to improve business operations, the systems development and oversight processes, potential methods for making return filing paperless, and safeguards to ensure taxpayer privacy; (5) financial management issues, including the annual audit and budget processes, as well as accounts receivable and the tax gap; and finally, (6) the effects on tax administration of complexity in the law and the constant changing of the Internal Revenue Code.

The Commission took a qualitative approach, spending the majority of its time listening to American taxpayers and experts on the IRS and the tax system. The Commission held twelve days of public hearings to take testimony from public and private sector experts, academia, and citizens' groups. In addition, the Commission held three town meetings outside of Washington, in Cincinnati, Des Moines, and Omaha. The Commission also heard from thousands of individuals who accessed the Commission's internet site, and hundreds of others who corresponded with the staff.

In conducting its review, the Commission sought to involve all relevant stakeholders to develop a thorough understanding of the current state of the IRS. In particular, the Commission worked with the IRS and Treasury to ensure that its recommendations would be based on a full understanding of the organization. We held hundreds of hours of private task force meetings with experts and witnesses to review IRS operations, management, governance, and oversight. In addition, the Commission interviewed more than 500 individuals, including both current and former IRS employees and managers, congressional committee members and staff, executive branch officials, and public sector advisors.

As part of its work plan, the Commission interviewed many senior managers in the IRS today, and many who have recently left government service. The Commission hired a consultant who interviewed over 300 IRS field employees, from all levels and functions, in an effort to learn

what barriers they face in trying to effectively perform their jobs and deliver on the mission of the IRS.

The Commission began its fact finding efforts by studying the history and organization of the IRS. It examined prior studies of the IRS, including the report of the 1924 Senate Select Committee on the Bureau of Internal Revenue, S. Rep. No. 27, 69th Cong., 1st Sess. (1926), and the 1953 report of the Ways and Means Committee's subcommittee on Administration of the Internal Revenue Laws, 83rd Cong., 1st Sess. (Subcommittee print). The former study led to the creation of the Joint Committee on Internal Revenue Taxation; the latter report was written contemporaneously with the IRS reorganization (which was commenced by the Truman administration in 1952), which attempted to decentralize and depoliticize the IRS.

In addition to studying prior reviews of the IRS, the Commission reviewed thousands of other reports and documents on various aspects of the IRS, many of which were prepared by the IRS and the GAO.

Following are listings of the Commission's hearings and witnesses who provided testimony, individuals who spoke with the Commission or staff, and groups and consultants who provided services and research on various issues. Copies of formal testimony and many other Commission documents are available on the Commission's internet site at http://www.house.gov/natcommirs/main.htm.

Hearings and Witnesses

July 29, 1996

History of the Internal Revenue Service
Jack Taylor, Economics Division, Congressional Research Service

Review of Work Conducted by the General Accounting Office
Lynda D. Willis, GAO Director, Tax Policy and Administration Issues
Dr. Rona Stillman, GAO Office of Accounting and Information Management
Diane Guensberg, GAO Office of Accounting and Information Management

September 10, 1996

Overview of the Internal Revenue Service
Hon. Margaret Milner Richardson, Commissioner of Internal Revenue

Quality Improvement programs at the IRS
Dr. Jack West, American Society for Quality Control
Lawrence Gibbs, Former Commissioner of Internal Revenue
Tom Carroll, IRS National Director of Quality

November 7, 1996

Structure and Functions of the IRS
Cornelius J. Coleman, Former IRS Regional Commissioner

Management and Priority Setting at the IRS
C. Morgan Kinghorn, Former IRS Chief Financial Officer

Measurable Performance Objectives for the IRS
Gene L. Dodaro, GAO Assistant Comptroller General

November 8, 1996

History and Operation of Section 6103
Donald C. Alexander, Former Commissioner of Internal Revenue
James J. Keightley, Former IRS Assistant Chief Counsel (Disclosure Litigation)
William A. Dobrovir, Attorney

Tax Complexity, Compliance Burdens, and the Legislative Process
Lynda D. Willis, GAO Director, Tax Policy and Administration Issues
Michael E. Mares, American Institute of Certified Public Accountants
James R. Murray, Tax Executives Institute
Professor Elizabeth Garrett, University of Chicago Law School

January 8, 1997

Non-Tax Functions
Donald C. Lubick, Acting Assistant Secretary of the Treasury (Tax Policy)
Robert J. Carver, Former IRS Executive Officer for Service Center Operations
James J. McGovern, Former IRS Assistant Commissioner (Employee Plans/Exempt Organizations)

Taxpayer Inquiries for Technical Assistance and Account Management
Hobart J. Harris, Principal, Ernst & Young
Robert E. Barr, Vice President, Government Programs, Intuit Inc.
J. Ron Watson, IRS Executive Officer for Customer Service

Role of the Taxpayer Advocate and Problem Resolution Officers
Linda R. Martin, Former IRS National Director of Problem Resolution Staff
Roger N. Harris, National Society of Accountants
Rena Girinakis, IRS Problem Resolution Officer

January 9, 1997

Financial Accounting at the IRS
Gregory M. Holloway, GAO Director, Government-wide Audits
Anthony Musick, IRS Chief Financial Officer

Geographic Allocation of IRS Resources and Personnel
Professor Susan B. Long, Syracuse University
Wayne Thomas, IRS National Director of Compliance Research

The Tax Gap
Professor Susan B. Long, Syracuse University
Dr. Berdj Kenadjian, Former IRS Chief Economist
Lynda D. Willis, GAO Director, Tax Policy and Administration Issues
Wayne Thomas, IRS National Director of Compliance Research

January 30, 1997

Best Practices in Tax Administration and Modernization
Peter Simpson, Second Commissioner, Australian Taxation Office
Harley T. Duncan, Executive Director, Federation of Tax Administrators

Application of Technology to Returns Processing
John Dalrymple, IRS Deputy Chief Taxpayer Service
Frank L. Salizzoni, President and CEO, H&R Block
Joseph F. Lane, National Association of Enrolled Agents
John R. Galvin, Vice President, Banc One

Application of Technology to Improve Information Access
Arthur A. Gross, IRS Chief Information Officer
Professor Mary Lacity, University of Missouri
Professor Leslie P. Willcocks, University of Oxford
Gerald H. Barloco, Vice President, USAA
Daniel Schutzer, Vice President, Citicorp

January 31, 1997

Technical Management of Technology
Arthur A. Gross, IRS Chief Information Officer
Christopher Hoenig, GAO Director, Information Resources Management
Professor Leslie P. Willcocks, University of Oxford

Current IRS Governance and Oversight Arrangements
W. Scott Gould, Deputy Assistant Secretary of the Treasury (Finance and Management)
Hon. Margaret Milner Richardson, Commissioner of Internal Revenue
Michael P. Dolan, Deputy Commissioner of Internal Revenue

February 26, 1997

Tax Simplification
Hon. Richard K. Armey, Majority Leader, U.S. House of Representatives

Overview and Legislative Options for Taxpayers' Rights
Lee Monks, IRS Taxpayer Advocate
Steve Glaze, Attorney

Quality of Audits
James E. Donelson, IRS Chief Compliance Officer
John J. Monaco, Former IRS Assistant Commissioner (Examination)
Glenn A. Bedonie, Florida Department of Revenue

Collection Actions
James E. Donelson, IRS Chief Compliance Officer
Professor Marilyn E. Phelan, Texas Tech University
Steven H. Kassel, Enrolled Agent

Taxpayers' Redress
Robert T. Duffy, Attorney
Professor Ridgeley A. Scott, Widener University

Taxpayer Representatives
Michael E. Mares, American Institute of Certified Public Accountants
Bob Kamman, Attorney
Professor Janet Spragens, American University

February 27, 1997

Century Date Change
Joel C. Willemssen, GAO Director, Information Resources Management
Arthur A. Gross, IRS Chief Information Officer

Governance and Management
Professor Roy A. Schotland, Georgetown University Law Center
Professor Ernest Gellhorn, George Mason University Law School
William J. Stern, President, William J. Stern, Inc.

March 13, 1997

Information Security
Leonard Baptiste, Jr., IRS Director, Systems, Standards and Evaluation
Joseph Mahaffee, Principal, Booz-Allen & Hamilton
Richard Pethia, Software Engineering Institute, Carnegie-Mellon University

Budget Process
Charles R. Parkinson, House Appropriations Committee
Rosemary Marcus, Congressional Budget Office
Robert E. Litan, Brookings Institute

Approaches to Compliance
Professor Malcolm Sparrow, Harvard University, John F. Kennedy School of Government

National Archives and IRS Records Retention
Lou Bellardo, Deputy Archivist of the United States
Shelley L. Davis, Former IRS Historian and Author

April 17, 1997

Private Sector Task Forces
Steven C. Salch, American Bar Association
Michael E. Mares, American Institute of Certified Public Accountants
Carolyn Kelley, American Payroll Association
Clark Case, American Society of Payroll Managers
Steve Moore, The Cato Institute
Matt Kibbe, Citizens for a Sound Economy
Michael Mango, Council for Electronic Revenue Communication Advancement
Daniel Mitchell, The Heritage Foundation
Milton Cooper, Information Technology Association of America
William Brown, Iowa Bar Association
Frank Lalli, Money Magazine
Joseph Langer, National Association of Computerized Tax Processors
Joseph F. Lane, National Association of Enrolled Agents
Abraham Schneier, National Federation of Independent Business

Roger N. Harris, National Society of Accountants
Michael Knight, New York State Society of Certified Public Accountants
Karen Kerrigan, Small Business Survival Committee
Arthur Hall, Tax Foundation

April 18, 1997

Outsourcing
David Osborne, Public Strategies Group

Procurement and Acquisition
Gregory D. Rothwell, IRS Assistant Commissioner for Procurement
Anthony Valletta, Deputy Assistant Secretary of Defense (Acquisition)
Mark Forman, IBM Consulting

Written Submissions

Phil Brand, Former IRS Compliance Officer, Organizational Focus/Succession Planning and Training, November 7, 1997

Iowa Financial Executives Institute, General Comments, January 6, 1997

Carlos Silvani, International Monetary Fund, Fiscal Affairs Department, Designing a Tax Administration Reform Strategy: Experience and Guidelines, February 1997

Joseph F. Lane, National Association of Enrolled Agents, Examination and Collection, February 26, 1997

Professor Jonathan Barry Forman, University of Oklahoma Law School, How to Simplify the Tax System for Low-Income Taxpayers and for the Internal Revenue Service, March 19, 1997

Section of Taxation of the District of Columbia Bar, Employee Plans and Exempt Organizations, May 7, 1997

Internal Revenue Service Site Visits

Philadelphia Service Center, October 24, 1996
Memphis Service Center, November 18, 1996
Fresno Service Center, November 26, 1996
Cincinnati Service Center, February 24, 1997
Philadelphia Service Center, March 21, 1997
Martinsburg Computing Center, April 1, 1997

Individuals Who Met With The Commission

Donald C. Alexander, Former Commissioner of Internal Revenue
Arthur Altman, Former IRS Director of Tax Forms and Publications
Dave Attianese, General Accounting Office
Mark R. Baran, American Bankers Association
David G. Blattner, American Institute of Certified Public Accountants
Ralph Block, General Accounting Office
Phyllis Borghese, National Association of Tax Practitioners
Cosimo Borzumate, National Association of Tax Practitioners
Phil Brand, Former IRS Chief Compliance Officer
Charlie Brennan, Former IRS Chief Operations Officers

Jonathan D. Breul, Office of Management and Budget
Beth A. Brooke, Ernst & Young LLP
Ellen B. Brown, Senate Committee on Governmental Affairs
Kenneth C. Brown, Ernst & Young LLP
Christine A. Brunswick, American Bar Association
Larry A. Campagna, American Bar Association
Mortimer M. Caplin, Former Commissioner of Internal Revenue
Glenn R. Carrington, American Bar Association
Michael F. Cavanagh, Council for Electronic Revenue Communication Advancement
Milka Casanegra, Former Chief of Tax Administration, International Monetary Fund
Charles S. Casazza, Clerk, United States Tax Court
John E. Chapoton, American Bar Association
Paul Cherecwich, Jr., Tax Executives Institute
David Clark, STAWRS project
Alan Cohen, Senior Advisor to the Secretary of the Treasury
Sheldon S. Cohen, Former Commissioner of Internal Revenue
Sharon Cranford, National Association of Enrolled Agents
John Crotty, International Monetary Fund
Robert Crowe, Chiquita Brands International
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Eddie Feinstein, H&R Block
Jack R. Ferguson, Software Engineering Institute
Donna J. Fisher, American Bankers Association
Robert Fisher, American Society for Payroll Management
Donna Steele Flynn, House Ways and Means Subcommittee on Oversight
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Natwar M. Gandhi, General Accounting Office
Harriet Ganson, General Accounting Office
Rogelio Garcia, Congressional Research Service
Lawrence B. Gibbs, Former Commissioner of Internal Revenue
Kenneth W. Gideon, American Bar Association
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Mark Gillen, General Accounting Office
Newt Gingrich, Speaker of the House of Representatives
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Norman Goldstein, Social Security Administration
Harry G. Gourevitch, Congressional Research Service
Michael J. Graetz, Yale University Law School
Larry Gray, National Association of Tax Practitioners
Robert H. Green, Proctor & Gamble
Richard A. Greenstein, Former IRS and Treasury manager
William C. Greenwalt, Senate Committee on Governmental Affairs
Robert T. Guinan, Proctor & Gamble
Daniel Halperin, Harvard University School of Law
Donna Harmon, Coalition for Economic Growth

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Eileen Hattan, Legislative Aide to Senator Herbert Kohl
Patrick G. Heck, Ernst & Young LLP
Richard Highfield, Second Commissioner, Australian Tax Office
James P. Holden, American Bar Association
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Helen M. Hubbard, American Bar Association
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Len Jacobs, American Society for Payroll Management
Gregory F. Jenner, American Bar Association
Robert K. Johnson, Los Angeles County Bar Association
Michael Jones, American Society for Quality Control
Thomas A. Jorgensen, American Bar Association
Elaine Kamarck, National Performance Review
Edward Karl, American Institute of Certified Public Accountants
Don Keifer, Congressional Research Service
Kenneth J. Kies, Joint Committee on Taxation
Karen V. Kole, American Bar Association
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L. Paige Marvel, American Bar Association
Kent A. Mason, Caplin & Drysdale
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Leon Moore, Former IRS Regional Commissioner
Carl Morovitz, Departmental Budget Director, Department of Treasury
Sylvia Morrison, Congressional Research Service
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Michele Mrdeza, House Committee on Appropriations
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Michael J. Murphy, Tax Executives Institute
Robert C. Musser, Private Sector Council

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Erik G. Nelson, Procter & Gamble
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Nina E. Olson, Community Tax Law Project
Pamela F. Olson, American Bar Association
Tim Outlaw, General Accounting Office
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Ronald A. Pearlman, American Bar Association
Nancy Peters, General Accounting Office
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A.G. Jim Reames, National Association of Enrolled Agents
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Louis Roberts, General Accounting Office
Tom Roesser, Senate Committee on Finance
Morton Rosenberg, Congressional Research Service
Paul Rothstein, Georgetown University Law Center
Robert E. Rubin, Secretary of the Treasury
Marvin Runyon, Postmaster General
Ted Russell, Ernst & Young LLP
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Richard J. Sandretti, American Society for Quality Control
John Sargent, Department of Finance, Canada
Chris Schabaker, Counsel to Senator Ted Stevens
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Joy Turner, National Society of Accountants
Mary Turville, National Society of Accountants
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Johnnie M. Walters, Former Commissioner of Internal Revenue
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Robert A. Weinberger, H&R Block
James R. Whittaker, The Whittaker Group
James Wickett, National Federation of Independent Business
Alan J. Wilensky, American Bar Association
David Williams, Deputy Assistant Secretary of Treasury for Legislative Affairs (Tax & Budget)
Terry Williams, McKinsey & Company
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Barry L. Wold, Joint Committee on Taxation
Greg Woods, National Performance Review
Percy Woodward, Former IRS Assistant Commissioner Exam
George Yin, University of Virginia Law School
Robert T. Zaleski, National Society of Accountants
Rita Zeidner, American Payroll Association

IRS National Office Personnel Who Met with the Commission

Thomas Andretta, National Director for Financial Analysis
Melanie Arwood, Director, Office of Management and Analysis
Thomas F. Baker, Technical Advisor to the Special Counsel (Modernization)
Janet M. Balbo, Director, Taxpayer Service Finance Division
Leonard Baptiste, Jr., Director, Systems, Standards, and Evaluation Division
Gary D. Bell, Chief Inspector
John Benton, Economic Analysis Director
John Binnion, Assistant Commissioner (Support Services)
George Blaine, Counsel to the Assistant Chief Counsel (Income Tax & Accounting)
Brad Bouton, Operations Research Analyst
Stuart L. Brown, Chief Counsel
Joann L. Buck, Senior Advisor for Management and Administration
Vincent S. Canciello, National Director of Appeals
Thomas Carroll, National Director of Quality
Elinor A. Convery, Branch Chief, Applied Research
Dennis R. Cox, Manager, Economic Analysis and Modeling Group
Richard Creamer, Customer Service Transition Executive
Douglas C. Crouch, Deputy Chief Inspector
John Cummings, Assistant Chief Counsel (Disclosure Litigation)
John Dalrymple, Acting Deputy Chief Compliance Officer and Deputy Chief Taxpayer Service
Tom Dega, Executive Officer for Service Center Operations
Michael P. Dolan, Deputy Commissioner
James E. Donelson, Chief Compliance Officer and Acting Chief Taxpayer Service
John J. Dopkin, Chief, Tax Forms Development Branch
Judith C. Dunn, Associate Chief Counsel (Domestic)
Lisa Fiely, National Director for Financial Management
Carol Gold, Director, Employee Plans Division

Dianne Grant, Senior Advisor to Chief Compliance Officer
Arthur A. Gross, Associate Commissioner for Modernization/Chief Information Officer
Holly L. Hagen, Office of Chief Counsel (General Legal Services)
William Hannon, Director, Analysis and Studies Division
Patricia Healy, National Director for Systems and Accounting Standards
Doug Izard, Dean, School of Taxation
Thad Juszczak, Budget Execution Director
Mark Kaizen, Assistant Chief Counsel (General Legal Services)
Rhett Leverett, Legislative Liason
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Ed McHale, Acting Chief, Accounting Standards and Evaluation
David A. Mader, Chief Management & Administration
Marie Medeck, National Director of Assistance and Planning
Richard J. Mihelcic, Associate Chief Counsel (Finance & Management)
Norlyn D. Miller, Senior Technical Reviewer, Office Assistant Chief Counsel (Income Tax & Accounting)
Steven T. Miller, Special Assistant for Exempt Organizations Matters
Lee Monks, Taxpayer Advocate
Richard Morgante, National Director of Budget
Billy G. Morrison, Assistant Chief Inspector (Internal Audit)
Anthony Musick, Chief Financial Officer
Thomas S. Myerchin, National Director of Education
James O'Malley, National Director, Personnel Division
Marcus S. Owens, Director, Exempt Organizations Division
Michael Paup, Special Counsel
Charlotte Perdue, National Director, Strategic Planning Division
Evelyn A. Petschek, Assistant Commissioner (Employee Plans & Exempt Organizations)
Holly Piwowar, Economist
Alan Plumley, Analyst, Economic Analysis and Modeling Research Division
Andre Ré, National Director, Office of Compliance Specialization
Deborah Reilly, National Director of Customer Service Operations Division
Olga Rhodes, Acting Executive for Electronic Filing
Ron Rhodes, Assistant Commissioner (Collection)
Sean Rogers, Chief, Office of Labor Relations
Margaret Milner Richardson, Commissioner of Internal Revenue
Gregory D. Rothwell, Assistant Commissioner (Procurement)
Sheldon Schwartz, Director, Tax Forms and Publications Division
Bob Shimshock, Chief, Office of Revenue Accounting
Stuart L. Silhol, Staff Advisor to Chief Inspector
Jimmy L. Smith, Assistant Commissioner (Forms and Submission Processing)
Thomas Smith, Assistant Commissioner (Examination)
Linda Stiff, National Director, Government Liaison and Disclosure
Carolyn Tavenner, Senior Advisor to Chief Taxpayer Services
Wayne Thomas, National Director, Compliance Research
Thomas J. Tiffany, Executive Assistant to the Taxpayer Advocate
Joe Urban, Branch Chief, Office of Assistant Chief Counsel (Disclosure Litigation)
Robert N. Veeder, Privacy Advocate
C. Elizabeth Wagner, Assistant to the Commissioner
J. R. Watson, Executive Officer for Customer Service
Daniel J. Wiles, Deputy Associate Chief Counsel (Domestic)
Floyd Williams, National Director, Legislative Affairs
Thomas W. Wilson, Jr., National Director, Office of Corporate Examination

Groups and Consultants Providing Services

Stakeholders

American Bankers Association
American Bar Association
American Institute of Certified Public Accountants
American Payroll Association
American Society for Quality Control
American Society of Payroll Managers
Coalition for Economic Growth
Council for Electronic Revenue Communication Advancement
District of Columbia Bar Association Section of Taxation
Federation of Tax Administrators
Iowa Bar Association
Iowa Chapter of Financial Executives Institute
National Association of Computerized Tax Processors
National Association of Enrolled Agents
National Association of Tax Practitioners
National Federation of Independent Business
National Society of Accountants
National Society of Tax Practitioners
New York State Society of Certified Public Accountants
Private Sector Council
Tax Executives Institute

Consultants

APCO Associates Inc.
Ernst & Young LLP: Beth Brooke and Ted Russell
Information Technology Association of America
McKinsey & Co: Terry Williams
Public Strategies Group
Towers Perrin
Mihir Desai, Consultant
Catherine Moriarty, Consultant
Adrienne Poulton, Consultant
Cliff Wiens, Consultant

Appendix D

Management and Governance, Workforce, Oversight, and Budget Supplementary Information

1. **Activities of the Management, Governance, and Workforce Task Force**
2. **Task Force Documents**
3. **Summary of Consulting Reports Contracted by the Commission**
4. **Customer Service Measures for the Internal Revenue Service**
5. **Interviews with IRS Employees and Managers**
6. **Presidents' Budget Requests And Congressional Appropriations For the Internal Revenue Service, 1990-1998**

Activities of Management, Governance, and Workforce Task Force

December 6, 1996—Conference Call

- Task force organization
- Proposed areas for review
- Questions that need to be answered to further our work
- Public meetings and working sessions

January 9, 1996—Meeting

- Staff presentation and discussion
- Agreement on core problems or definition of differences
- Agreement on scope of final product
- Agreement on proof needed to ensure full confidence in findings and recommendations
- Map out next steps (reference attached)
    1. Task Force
    2. Hearings

January 31, 1997—Meeting

Discussion with witnesses:

- Scott Gould, Department of Treasury
- Phil Brand, Former IRS Executive
- Margaret Milner Richardson, Commissioner of IRS
- Mike Dolan, Deputy Commissioner of IRS
- Dave Mader, Chief Management and Administration, IRS

February 27, 1997—Meeting

- Discussion of IRS governance models

March 14, 1997—Meeting

- Findings
- Coordinated Congressional oversight
- Senior Management
- Field Management
- Operational Structure
- Culture

April 7, 1997—Meeting

- Department of Treasury Proposal
- Congressional Oversight of IRS
- IRS Budget Process
- IRS Senior Management Issues
    1. Commissioner's office
    2. Chief Counsel
    3. Field Offices

April 18, 1997—Meeting

- IRS and Treasury Governance Model

National Commission on Restructuring the IRS
Management, Governance and Workforce Task Force

Issues to be reviewed and debated:

I. Governance:

- Does the current structure work?
- Are there alternative governance structures which would work better?
- What entity has and should have the authority and responsibility with respect to:
    1. Accountability for entire enterprise
    2. Philosophy/Mission
    3. Selection, evaluation, and compensation of senior management team
    4. Review and approval of strategic and business plans
    5. Review and approval of financial objectives and plans
    6. Review and approval of non-ordinary major transactions
    7. Monitoring performance against plans
    8. Developing framework for and reviewing outsourcing decisions
    9. Ensuring ethical behavior and compliance with laws
- If a new structure is needed, who would be involved?
- What are current governance entities roles in the legislative process and what roles would potential new governance entities have in the legislative process?
- Administrative matters for a governance entity: meeting frequency, terms, access to information

II. Management:

- Commissioner: Term and qualifications
- Other Senior Management: Appointments
- Compensation
- Structure and authority

III. Budget Process

- Review of proposals to bring stability and efficiency to process, while not sacrificing accountability to Congress or Department of Treasury.

IV. Strategic Plan and Organizational Performance Measures

- High level priorities and initiatives
- High level measures

Option Sheet for Key Governance Decisions

Criteria (the flip side of problems)

- Set and maintain priorities and strategic direction
- Impose accountability on management
- Impose accountability on a credible governance body
- Develop appropriate measures of success
- Align budget and technology with priorities
- Continuity and coordination of oversight and management
- Focus attention on priorities

I. Responsibilities **Options**	**II. Admi**
1) Set priorities/goals/measures • Establish mission and objectives? • Review operating goals and measurements, hold management accountable? • Review and approve long-range and short-term strategic and business plans? **2) Personnel** • Select, evaluate and compensate Commissioner? Recommend Commissioner? • Review and approve Commissioner's recommendations for selection, evaluation and compensation of senior managers? **3) Budget** • Review and approve budget? Send directly to Congress? • Ensure budget's alignment with strategic direction? • Review and approve all non-ordinary, major business expenses? • Ensure clean financial audit? **4) Operational** • Review and approve all plans for modernization of tax system? • Contract for reviews and audits of high-risk, low performing operations? • Develop framework for reviewing and approving all major outsourcing? **5) Stewardship** • Report annually to appropriate Congressional committees? • Possible consolidation of Congressional oversight, by encouraging disparate committees to coordinate or combine oversight and accountability of high level issues?	**1) Nomination and Selection** • President? • Secretary of the Treasury? Input/role of: • Congress? • Stakeholder groups? • Professional groups? **2) Terms** • At pleasure of Secretary of Trea • Fixed: How many years? • Staggered? **3) Size** • 3 member? 5member? 9memb **4) Other** • Compensation? • Meeting frequency? • Participation in contracting deci • Political Balance? • Board has no access to taxpaye • No role in tax policy?

III. Organizational Placement

Options

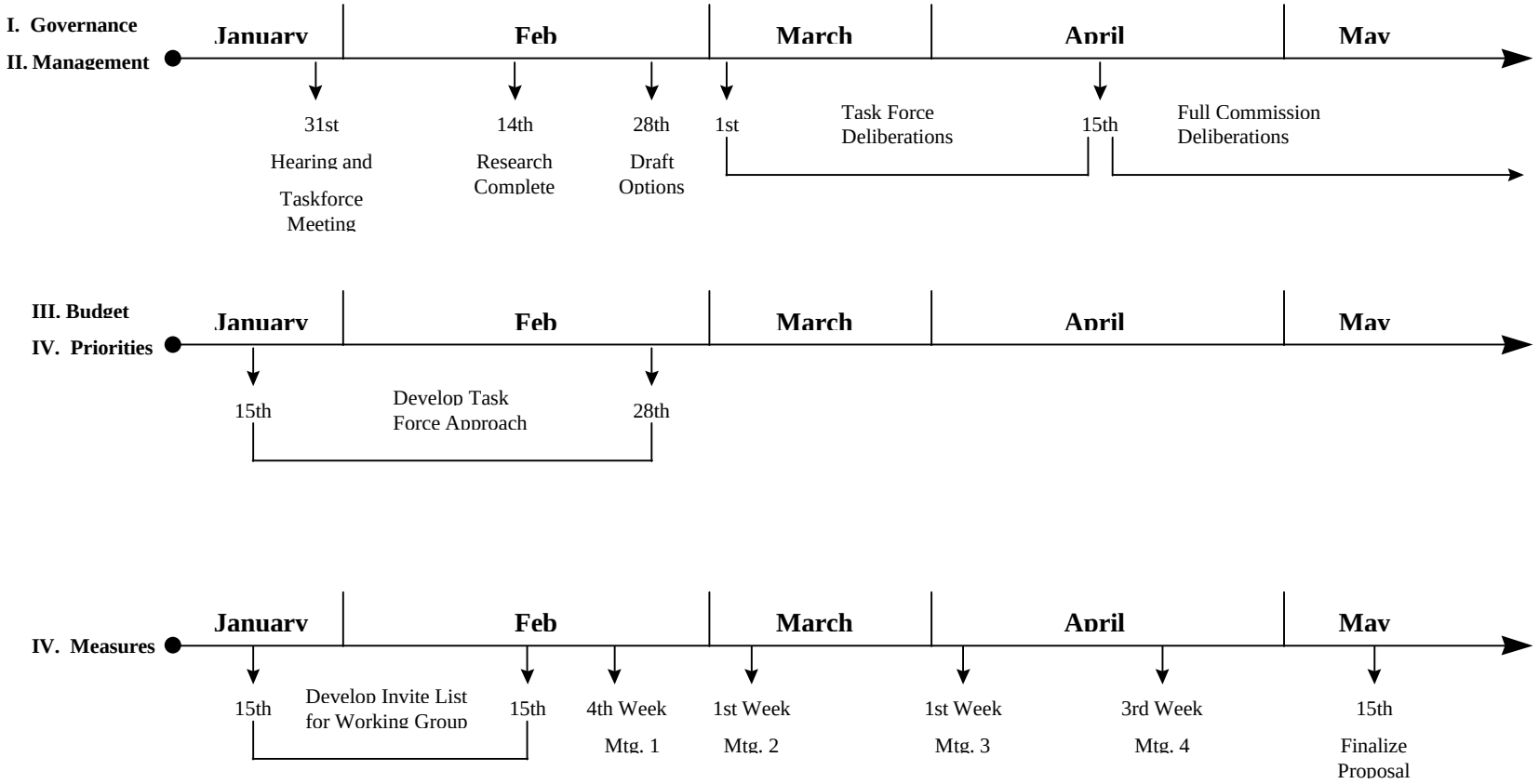
MMB	Board within Treasury	Agency Status (e.g. SSA)
Executive branch officials	Treasury officials? Other members of administration? Outside/private sector expertise? IRS officials? Union officials?	Treasury officials? Other members of administration? Outside/private sector expertise? IRS officials? Union officials?

Management, Governance & Workforce

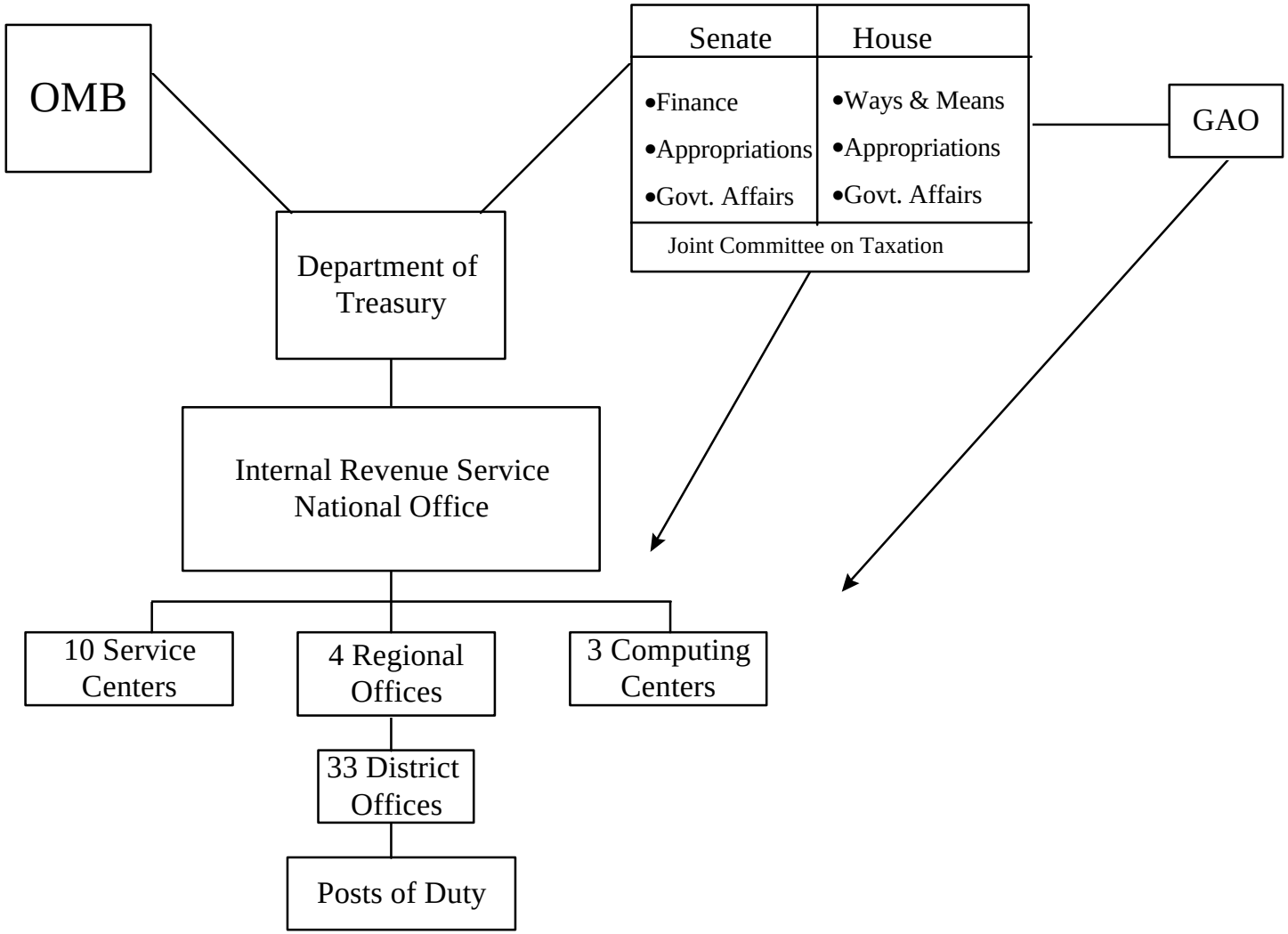
Taskforce Timeline

Draft 1/16/97

(Reference Issues to be Reviewed & Debated)

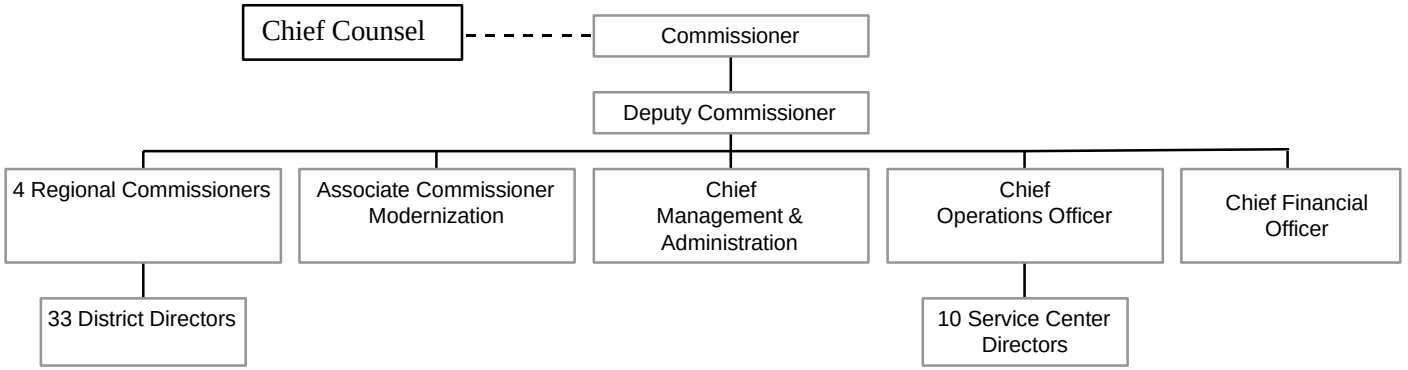


Relationships Among IRS and Overseers

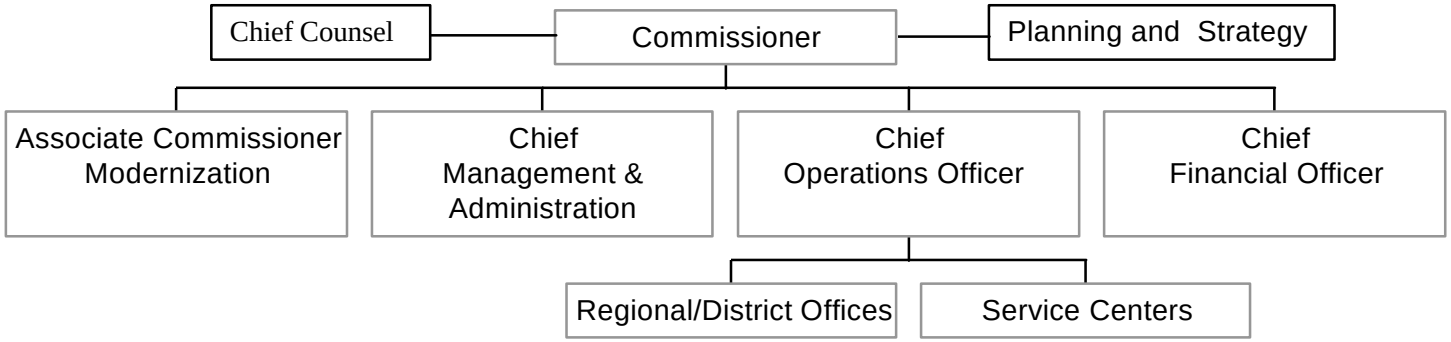


Management Structure

Current



Proposal Discussed by Commission



Consulting Reports Prepared for the Commission

The Commission asked individuals and groups from the private sector to prepare reports on various topics relating to the Commission's works. Summaries of their findings are available on our Internet site (www.house.gov/natcommirs/main.htm).

Public Strategies Group
The Public Strategies Group was charged with facilitating the development of consensus of a Measures Working Group, which included Commission members, IRS, Treasury, Congress and stakeholder groups, on a small number of customer service measures. The Public Strategies Group interviewed 11 designated representatives of stakeholder groups and 9 Commissioners on the Task Force to understand individual perspectives on IRS customer service issues. Meetings were held April 4 and 25, 1997. (See attached for summary.)

Towers Perrin
Towers Perrin was charged with reviewing middle management staffing levels at IRS district offices and service centers. The objective of the review was to develop a general estimate as to what kinds of staffing reduction and cost savings may be possible in the near term by streamlining deployment of managers at the 10 service centers and 33 district offices. Towers Perrin consultants visited four sites, reviewed IRS organizational charts, and analyzed an IRS database addressing management and non-management deployment throughout all sites. Without fundamental changes in work processes, the consultants believe that the IRS could eliminate a minimum of 400 positions resulting in savings of $27 million to $35 million dollars. This is a conservative estimate, because the consultants did not include analysis and secretarial staff. (See attached for summary.)

Field Interviews
Catherine Moriarty, an independent consultant, interviewed over 300 IRS employees. Employees from all levels and functions were interviewed in an effort to learn what barriers they face in trying to effectively perform their jobs and deliver on the mission of the IRS.

Report on IRS Approach to Addressing Noncompliance
This report, prepared by a graduate student (Adrienne Poulton) under the advisement of an international expert on compliance issues, assesses the IRS strategic approach to the problem of noncompliance. Specifically, it assesses two initiatives in the past decade- Compliance 2000 and the compliance research approach. The report analyzes each approach and offers recommendations to the IRS for ways to address noncompliance in the future.

Alternative Governance Models
This report reviewed alternative governance models for the Commission to consider. The models included Fannie Mae, the Postal Service, AMTRAK, Tennessee Valley Authority, Social Security Administration, and Federal Deposit Insurance Corporation.

Summary Of Towers Perrin Review of Management Staffing At IRS District Offices And Service Centers

May 20, 1997

- Towers Perrin, a management consulting firm, completed a high-level review of management staffing within IRS District Offices and Service Centers, which collectively employ more than 90 percent of IRS employees

- The objective of the review was to develop a general estimate of staffing reductions and cost savings that may be possible in the near term by streamlining the employment of managers at the 10 Service Centers and 33 District Offices.

- Although the consultants did not examine the operations of every site in detail, they were able to reach general conclusions as to the level of opportunity for savings through visits to four sites, detailed review of organization charts for approximately half the sites, and analysis of an IRS database addressing management and non-management deployment throughout all sites.

- The consultants estimate that a minimum of approximately 400 management positions could be discontinued in the near term without any adverse impacts on performance, or between six and seven percent of the total number of managers at these sites. Annual salary and benefit savings associated with such a reduction, once in place, would total roughly $27 million. These estimates do not assume any fundamental changes in work processes, technology, or geographical deployment, all of which could potentially facilitate larger savings over the longer term.

- In general, the greatest opportunities for streamlining were not at the first level of management, but at middle management levels between Division Chiefs and first-line managers. Opportunities were split fairly evenly between District Offices and Service Centers.

- The consultants believe the 400 position and $27 million savings estimate is conservative, reflecting only the most obvious opportunities, and not including related savings that would be possible in secretarial and other support staff. For planning purposes, a range of $27 to $35 million is suggested.

Not included in the scope of the analysis were management staffing outside the District Offices and Service Centers, and management/analytical support staffing within the sites, both of which could harbor further opportunities for efficiency.

Customer Service Measures
for the
Internal Revenue Service

Executive Summary

The Public Strategies Group was charged by the National Commission on Restructuring the IRS with facilitating the development of consensus among stakeholders in the IRS on a small number of customer service measures. It interviewed 11 designated representatives of stakeholder groups and 9 Commissioners on the Management, Governance, and Workforce Task Force to understand individual perspectives on IRS customer service issues. A Measures Working Group (MWG) met on April 4 and 25, 1997.

There was general consensus among the MWG that:

- Customer service is a strategic element of the IRS;
- There were a few key descriptors or dimensions of customer service quality:
    - Fairness
    - Respect
    - Ease
    - Understandability
    - Accuracy
    - Timeliness
    - Access
- Customers define quality; and
- Executive responsibilities included monitoring "high level" service quality indicators, and ensuring that performance indicators were aligned throughout the organization.

The MWG Stakeholders also agreed that customer service was embedded in all functions of the IRS, and the service dimensions of "Accuracy," "Understandability," "Respect," and "Access" were of the highest priority to measure and track.

Specific indicators of customer service performance agreed upon (and measures and performance standards should be developed for) were:

- Number of taxpayers who contact the IRS that receive resolution at their first inquiry;
- Understandability of all information, including notices, instructions, audit procedures;
- Customer perceptions of respectful treatment;
- Level of telephone access to citizens and tax professionals; and
- Number of notices that are error-free.

IRS Customer Service Measures

Other indicators receiving significant support by the MWG include:

- Convenience and cost to taxpayers of filing and payment;
- Perceived consistency in the application of tax laws;
- Percent of correctly filed returns;
- Time to resolution of inquiries; and
- Time on hold for telephone access.

Measures Working Group Participants

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House Committee on Government Reform and Oversight

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Donna Steele Flynn
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Michelle Kaplan
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Michael Murphy
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Pam Olson, Esq.
Skadden, Arps, Slate, Meagher & Flom, representing the American Bar Association

Tammy Perrin
Senate Committee on Appropriations

Betsy Phillips
House Committee on Appropriations

Tom Roesser
Senate Committee on Finance

Ron Watson
Internal Revenue Service

Andrew Weiss
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Skadden, Arps, Slate, Meagher & Flom

David Keating
Executive Vice President, National Taxpayers Union

Robert Tobias
President, National Treasury Employees Union

Interviews with IRS Employees and Managers

As a part of its work plan, the Commission hired a consultant to conduct a series of interviews with Internal Revenue Service employees in order to add to the Commission's understanding of the issues mentioned above and to identify areas of concern within the IRS. IRS employees from all levels and functions were interviewed in an effort to learn what barriers they are facing in trying to effectively perform their jobs and deliver on the mission of the IRS

Interview locations were selected in order to gain a broad understanding of the current barriers to achieving the mission and goals of the IRS and the specific issues outline by Congress. All four Regions were visited. Ten Districts were selected based on criteria such as population density of area served, recent organizational changes, and management challenges resulting from the recent IRS consolidation. The goal of this selection criterion was to gain an understanding of issues which may be specific to a location and those which effect the entire organization. In addition to the regions and districts, two Service Centers were visited. Interviewee selection criteria differed by job level. Most management interviewees were randomly selected, controlling for a spread of levels and functions. However, some interviews were specifically requested, such as those with Directors of Information Systems. Bargaining unit employees were selected by requesting volunteers from which specific personnel were chosen at random. The Commission was informed by IRS management that the need for requesting volunteers at the bargaining unit level was based on NTEU requirements. In total, 334 interviews were conducted. Of these 41 were with Regional personnel, 224 were with District employees, and 69 with Service Center employees. The following information breaks down interviewees by office, title, and function:

District Interviews:

	IRS Level					
Function	Total	Director & Staff	Division	Branch	Group	BU*
Appeals	1		1			
CID	10		3	2	2	3
Collection	53.5		6.5	14	13	20
Communication	4				1	3
Counsel	1	1				
Customer Service	11		3	4	3	1
Directors Staff	16	15				1
DORA	26.5	18	4.5		1	3
EP/EO	14		1	2	6	5
Examination	75		10	13	13	39
IS	10		5	2		3
PRO	2					2
Total	224	34	34	37	39	80

Regional Interviews:

IRS Level						
Function	Total	Regional Comm..	Regional Chief	Director	Officer	Analysts & Assts.
Appeals	3			3		
Collection	1					1
RC Staff	6	4				2
Communication	2				2	
Compliance	5		4		1	
Controller	2				2	
Customer Service	5		3			2
EEO	1				1	
ELF	1				1	
Examination	1					1
Inspection	1		1			
Investigation	1			1		
IS	6			4		2
PRO	2				2	
RMSS	4		3			1
Total	41	4	11	8	9	9

Service Center Interviews:

IRS Level							
Function	Total	Director & Staff	Division	Branch	Section	Unit	BU*
CID	1				1		
Collection	5			2	1		2
Compliance	8		2	3		1	2
Customer Service	14		2	2	1	1	8
Directors Staff	6	5			1		
Examination	2				1		1
IS	8		2	1	2		3
PRO	1				1		
Processing	13		4	2	2	1	4
QAMS	10		1	2	1	1	5
Underreporter	1				1		
Total	69	5	11	12	12	4	25

Given the existence of the Survey Action Feedback survey and other statistical studies of IRS employees, the decision was made to use an interview and interview guide method in this study. The reason for this decision was to avoid duplicating information which already exists and to gain a degree of flexibility in discussions with employees.

Presidents' Budget Requests And Congressional Appropriations For The Internal Revenue Service By Subcategory (By Fiscal Year, In Millions Of Dollars Of Budget Authority)

	1990	1991	1992	1993	1994	1995	1996	1997
Processing Assistance and Management[a]								
Budget request	2,013	1,571	1,806	1,810	1,873	1,763	1,805	1,780
Appropriation	1,991	1,664	1,798	1,790	1,865	1,737	1,720	1,790
Difference	-22	93	-8	-20	-8	-26	-85	10
Tax Law Enforcement[b]								
Budget request	3,471	3,500	3,632	3,853	4,074	3,944	4,524	4,528
Appropriation	3,510	3,501	3,578	3,831	4,008	4,375	4,103	4,104
Difference	39	1	-54	-17	-66	431	-421	-424
Information Systems								
Budget request	0	1,064	1,295	1,581	1,350	1,760	1,880	1,701
Appropriation	0	943	1,294	1,479	1,465	1,359	1,511	1,149
Difference	0	-121	-1	-102	115	-401	-369	-552
Total IRS Discretionary Funding								
Budget request	5,484	6,135	6,733	7,244	7,297	7,467	8,209	8,009
Appropriation	5,501	6,108	6,670	7,100	7,338	7,471	7,334	7,043
Difference	17	-27	-63	-144	41	4	-875	-966

SOURCE: *Budget of the United States Government* (1990 through 1997), Appendix.

NOTE: n.a. = not applicable.

a. The fiscal year 1996 budget proposal consolidated two accounts-Administration and Management and Processing Tax Returns-into the Processing, Assistance, and Management Account.

b. The fiscal year 1991 budget proposal consolidated two accounts-Examination and Appeals and Investigation, plus Collection and Taxpayer Services-into the Tax Law Enforcement Account.

c. The fiscal year 1998 budget request does not include the President's request for an additional $1 billion divided equally between 1998 and 1999 for IRS Technology Investments.

SOURCE: Congressional Budget Office

Appendix E
IRS Strategic Objectives: Customer Service, Compliance, and Efficiency Gains Supplementary Information

Notices and correspondence
In fiscal year 1996, the IRS decreased the number of notices issued to taxpayers to 103 million. The 103 million consists of approximately 50 million computer-generated notices from taxpayer master files, 48 million collection notices, and 5 million examination, underreporter, and information return notices. Additionally, in fiscal year 1996 IRS employees created 14 million letters of correspondence.

The Commission believes that taxpayer burden and expense should not be increased because IRS lacks the ability to post timely taxpayer correspondence and track notices and correspondence. The IRS should develop a mechanism to track (e.g., inventory) taxpayer notices and correspondence using a system integrated into taxpayer account databases. Examples of policies to increase taxpayer satisfaction and confidence in the IRS include responding to correspondence within twenty-one business days and if additional time is needed, the IRS should contact the taxpayer to explain the reasons for the delay. Other examples include improving the tone of the notices to reflect the partnership between the IRS and the taxpayer to ensure accurate reporting, data collection, and payment.

Telephone assistance
The delivery of new technology and increased authority for personnel to resolve taxpayer problems would positively affect IRS ability to keep pace with private sector call centers.

From October 1, 1995 to September 28, 1996, the IRS received a total of 219 million call attempts for assistance. Within this population, 97 million call attempts (45%) were from individual callers, defined by the IRS as the number of unique telephone numbers from which the IRS received a call attempt during any one week period. The remainder of the call attempts (55%) are considered repeat callers who unable to reach an assistor with the first call. Thus, the IRS does not measure the concept of "repeat callers" directly.

GAO, however, measures all call attempts, not individual callers. The IRS, by eliminating repeat callers, measures individual taxpayers attempting to reach assistance, even if multiple calls were required by the same taxpayer. For the period noted above, IRS measured the level of access (46.2%) as the actual calls answered (callers served) divided by the unique number demand, (i.e., the number of individual phone numbers from which the IRS received calls during a one week period of time). GAO calculated the level of access (21%) by using the number of callers served divided by the total number of call attempts. Thus 21% of answered calls as measured by GAO equates to 46.2% of taxpayers receiving assistance as measured by the IRS.

The length of time to reach assistance also affects access. According to IRS, the best available estimates calculate the length of assistance at 12.4 minutes. This estimate is comprised of a 9 minute average time that callers wait before speaking to an assistor (i.e., for approximately 2

minutes callers listen to a menu/script and approximately 7 minutes of queue time before an assistor answers) and approximately 3.4 minutes for the assistor to help the taxpayer.

However, until the ability of taxpayers to reach an assistor more closely aligns with the actual number of taxpayers seeking assistance, the IRS and GAO differing access measures will continue to be misleading and confusing. As the level of access to IRS assistance increases, the number of repeat callers will decrease and the GAO and IRS methods of measuring telephone assistance will converge. Examples of policies to increase access, satisfaction and confidence in the IRS include allowing a taxpayer to leave a message with the assurance that their call will be returned within 24 hours.

Private Sector Benchmarks

In testimony before the Commission by Hobart Harris, Ph.D., Center For Technology Enablement, Ernst & Young, there are three basic customer service principles: Near-Immediate Access, One and Done, and Immediate Follow-Up.

1. Near-Immediate Access
   Callers for private sector assistance should be able to get through the first time they call and in less than 45 seconds to a minute. The most often-quoted goal in industry is that 80% of calls should be answered in 20 seconds or less.
2. One and Done
   Callers for private sector assistance should have their questions answered on the very first call if they have all of the information needed by the call center to address their questions. Routine calls should not have to be referred for research or later follow-up for any reason. However, technical questions may require further specialization. Referrals to more knowledgeable agents should only occur occasionally and when done, the transfer should be made to another agent immediately and with the first agent still on the line. To do this, assistors must be properly trained and technology must provide access to any information that will be required to answer the callers question.
3. Immediate Follow-Up
   Telephone assistors should be able to make customer record changes immediately, without any needed additional steps and should be able to order the requested documents, forms, instructions, or publications while the taxpayer is still on the phone.

Because of the diverse purposes and needs for taxpayer calls for assistance, assistors need an integrated system to provide timely and accurate assistance. According to Hobart Harris, call centers in quality organizations generally utilize the following components:

1. Assistors have rapid (i.e. computerized) access to descriptions and examples of the rules, procedures and facts that are necessary to answer these kinds of calls.
2. Artificial intelligence-based search engines, Frequently-Asked Questions (FAQ) lists and agent-directing scripts are available to assistors to identify the information that the callers need.
3. Every telephone assistor must be equipped with an intelligent terminal that can support these functionalities.

4. If callers can generally identify the nature of their questions, then an Interactive Voice Response Unit (IVR) should be used to ask the callers to identify their needs.
5. Expert routing directs calls to agents who have received extra training in specific areas or who have access to specialized information. This gives the telephone assistors the best chance of answering the calls quickly and accurately.
6. Assistors must be able to retrieve relevant portions of callers tax account records. This retrieval is enormously complicated and involves highly sophisticated information technology.

Enhanced technology should provide IRS assistors with the ability to make automated adjustments, automated payment tracers, improved penalty and interest computations, online financial statement preparation and analysis for installment agreements, and allow call site representatives to take immediate action from a single workstation.

Taxpayer representation

With respect to represented taxpayers, practitioners have experienced continued frustration in their ability to work with the IRS to resolve a taxpayer account. The IRS should improve Power of Attorney (POA) procedures and administration. For example, POA procedures could be streamlined through the acceptance of facsimile and oral POA authorizations, inclusion of the POA authorization on the tax return (706 and 8453 already have this), and agency-wide access to POA data.

In 1993, the IRS began implementation of Corporate Education. Extraordinary, nationwide recruitment efforts were initiated to select executive-level leaders with extensive educational, organizational, and professional expertise for the director and dean positions. The IRS outlined a vision for IRS education based on the corporate university model and began implementation of initiatives leading to this vision. Unfortunately, the lack of decision making and strong management stalled implementation and created animosity and internal battles between Corporate Education and the remainder of the organization. Barriers include:

- Executive Autonomy - There is a strong history of executive autonomy in the field and a perception that power for field leaders is related to the size of their function or area. These values conflict with the organizational need to consolidate all educational activities within a streamlined educational process managed by educational professionals. Current efforts to consolidate field education are strongly resisted and more than 60% of all educational employees are managed outside of the educational process and are supervised by managers largely without educational expertise. Acceptance of this separation of the educational components reinforces the continuation of “shadow” training operations and the perception that the educational system is fragmented and dysfunctional.
- Training is not valued - There exists a general lack of appreciation for training as a value-adding activity and recognition of training as a separate area of expertise. Training is routinely the first item cut when resources become tight, and training resources are also routinely used for information sharing, meetings, and other non-

training purposes. Successful organizations recognize training as an essential tool for managing change and addressing problems. Many IRS managers and executives focus on short-term goals to the detriment of long-term goals by viewing training as an expense and time-off-the-job rather than as an investment and means of increasing productivity and quality.

- IRS Commitment to Redeployment - Another barrier is the selection and retention process and the inability to determine, design, and deliver the proper training for the employee when it is needed to perform their job. While employees can be trained to enhance their basic communications skills and to upgrade their technical skills, the effectiveness of such training depends as much on the aptitude of the employee as on the quality of the training.

Efforts essential to improving IRS education that have proven difficult to implement include the following:

- Streamlining the IRS education process, improving accountability, and centralizing budget execution;
- Establishing an infrastructure for training delivery including: education institutes, distance learning technology, an automated training administration system, and the performance development system;
- Establishing and staffing institutes to focus on specific training requirements;
- Encouraging and promoting partnering with the private sector (e.g., tax professional organizations, educational institutions, state tax departments, and other government agencies) to receive training and education materials and services;
- Linking training plans to the strategic planning and budget process;
- Increasing the authority of the Education Advisory Board; and
- Increasing use of education technology to develop and deliver just-in-time training that meets individual needs cost-effectively and to accelerate learning. (Significant savings could be realized with implementation of technology such as Interactive Video Teletraining (IVT). IVT is expected to net the IRS $53 million in savings over the next decade for a 2:1 rate of return; projecting fiscal year 1998 savings of at least 20% of the training travel budget with increased savings in following years.)

Achievement of success can be evaluated by the following benchmarks of successful education programs:

- Up-to-date training materials are provided when needed;
- Trained personnel report to new jobs/reassignments;
- Professional career/vocational counseling is available to all employees;
- Career-long learning is the norm;
- Training staff operate within a connected community with uniform accountability;
- Dedicated, professional training cadre is responsive to the field;
- Technology supports learning and job performance;
- Training staff operate in a quality achievement environment;

- In-depth measurement, evaluation and feedback document value-added and customer satisfaction; and
- Budget formulation and execution are centralized.

Examination

Tax auditors and revenue agents do not receive adequate, consistent, and continuous training. Training resources for agents have been sacrificed to meet budget requirements. While reduced funding of training and education may meet short-term goals, such resource allocations result in long-term, irreparable damage to the tax administration system.

	CPE Hours per Technical Staff Year					
	1992	**1993**	**1994**	**1995**	**1996**	**1997 Plan**
Tax Auditors	25	27	26	11	9	39
Revenue Agents	29	32	31	17	15	38

Until recently, IRS interpreted Office of Personnel Management (OPM) requirements for accounting qualifications as college level accounting credits. Recently, however, OPM directed IRS to discontinue this interpretation. Thus, tax auditors went from a 6 hour accounting credit requirement to only a "substantive knowledge of accounting principles" requirement. OPM, however, did increase the accounting credit requirements for revenue agents from 24 to 30. Salary range for selected grades of tax auditor and revenue agent positions, using salaries effective January 1997 for the Washington-Baltimore locality, are as follows:

	Without Benefits	**With Benefits**
GS-9	$31,680 - $41,185	$38,086 - $49,513
GS-11	$38,330 - $49,831	$46,080 - $59,907
GS-13	$54,629 - $71,017	$65,675 - $85,377

Currently, IRS must maintain two separate training and employee evaluation systems. A single occupation classification could be accompanied with an increase in the accounting credit requirements and attainment of increased qualifications could be phased in. For example, education criteria could include: a junior level examiner requires 15 accounting credits to qualify for the job with 40 credits of annual CPE, and a senior level examiner requires 30 accounting credits to qualify for the job with 40 credits of annual CPE.

Finally, the partnership between taxpayers, taxpayer representatives, and the IRS can be improved in examination through the sharing of third-party information, other than informant information, that the IRS has obtained (e.g., bank accounts, appraisals, loans) regarding the taxpayer.

Appendix F
Modernization Supplementary Information

Century Date Change

The century date change is a high risk area for the IRS. The IRS estimates it has 19,000 Tier I applications that comprise approximately 62 million lines of code, as well as other Tier I, Tier II, and Tier III applications that may well comprise another 30,000 applications and 40 million lines of code. All Information Systems (IS) controlled applications were certified in inventory by April 21, 1997. All non-IS controlled applications, except Tier III, were certified in inventory by May 30, 1997. This comprises 98% of all applications. The remaining 2% are Tier III applications housed in the field. These applications are being reviewed by an executive-led task force that will decide which applications will be scheduled for conversion and which will be retired. Those selected for conversion will be certified in inventory by October 15, 1997. The Commission cannot determine if the IRS will be successful, but the enormity of the risk dictates that all possible caution be exercised now to avoid problems in the future.

GAO has developed readiness guidelines for use by any federal agency in establishing its century date change conversion programs. GAO has identified a structured five phase approach for effective conversion programs: awareness, assessment, renovation, validation, and implementation. The IRS program follows the GAO guidelines and is in the assessment phase. However, several risks were identified during testimony received by the Commission on February 27, 1997:

- The first risk is that the $129M budgeted in fiscal year 1997 and fiscal year 1998 will not be sufficient. IRS must evaluate the results of the May 31, 1997 inventory to determine if additional funding is needed.
- The magnitude of many of the Tier II and III programs is unknown, and many of these programs are not currently scheduled for conversion.
- Data IRS receives from a number of outside sources may not be compliant with the century date change standard, and may have to be filtered to avoid impact to IRS systems. IRS receives data from the tax industry, 47 federal agencies, and 50 states, and 10 municipalities.

In addition to computer program modifications, additional computing and storage resources may be required, and lead times for acquisition of additional hardware must be taken into account. Another risk is the need to make other changes, such as tax law modifications, simultaneously with century date change corrections. Changes of this type could add additional complexity to programming and testing efforts, and have the potential to delay the implementation of century date change corrections.

Managing Technology

Given the structural deficiencies the Commission found at the IRS, the technological deficiencies are not surprising. Past problems are well documented in numerous reports from oversight organizations, and the Commission is more concerned in planning for the future than criticizing IRS for past problems. However, understanding the reasons for IRS problems in managing technology is necessary if future information technology modernization projects are to be accomplished efficiently and effectively.

The IRS inability to manage technology adequately is an outgrowth of issues discussed in the management and governance findings. Senior management has not be able to purposefully establish a long-term vision for its business operations, which, in turn, has affected management's ability to manage technology programs.

The belief of the Commission with respect to the use of information technology (IT) is clear: the purpose of IT is to enable IRS to achieve its strategic objectives; IT should not drive IRS objectives. This premise necessitates a clear strategic vision to identify business requirements that provide IRS Information Systems organization the guidance it needs to develop and implement IT systems that support the business vision. While the findings discussed below indicate fundamental flaws in IRS ability to manage technology, the lack of overall strategic objectives results in a shaky foundation from which to develop modern IT systems.

The Commission did not have the time or the resources to conduct a complete technical evaluation of IRS ability to manage technology. Moreover, a number of oversight organizations have already conducted such reviews in great depth. The most comprehensive reviews of the Tax System Modernization program were conducted by the General Accounting Office (GAO) and the National Research Council (NRC). The NRC Final Report, Continued Review of the Tax Systems Modernization of the Internal Revenue Service, 1996, and GAO/AIMD-95-156, July 1995 both cited a number of important deficiencies that need correction.

Subsequent reports indicated that problems continued without appreciable corrections. The Commission has found these problems have, in the past, affected the ability of the IRS to produce successful IT systems. Examples of IT projects that did not meet expectations, as documented in GAO and IRS reports, include the following:

- The IRS contracted with a private sector contractor to develop the Document Processing System (DPS), which would have been used to image paper returns, and was intended to be its cornerstone for improving returns processing. In 1996, an IRS task force concluded that, even though image and data capture technology was mature and reliable, the DPS implementation, specifically in terms of the contract structure, overall cost, and division of labor, costs too much and takes too long when compared to other organizations' implementations. The task force recommended that the IRS stop investing in DPS as it was configured under the current contract vehicle. This recommendation came after awarding a $1.3B contract in February 1994 and spending $284M through June 1996.

- The Cyberfile program was to allow taxpayers who prepared their own tax returns to file electronically from personal computers. GAO found that IRS did not adequately analyze requirements, consider alternatives, or assess the developer's capabilities to develop and operate an electronic filing system, even though the need for these critical prerequisites was brought to management's attention. The project was hastily initiated, development and acquisition were undisciplined, and Cyberfile was poorly managed and overseen. As a result, it was not delivered on time, and after advancing $17.1 million to the developer, IRS suspended development.

- The Service Center Recognition/Image Processing System (SCRIPS), a document imaging system installed in five Service Centers, experienced hardware and software problems during the 1995 filing season, including hardware problems that kept documents from feeding properly into the scanner and software problems that affected SCRIPS' ability to accurately capture name and address information. In total, IRS was able to process only about 56 percent of the expected 8.6 million 1040EZ forms it had planned to process. During the 1996 filing season, SCRIPS performed better than it did in 1995, but still was not meeting performance expectations, and may eventually cost much more than originally estimated.

- The Integrated Case Processing (ICP) program was to provide IRS Customer Service Representatives with the capabilities to quickly obtain the data needed to answer taxpayer questions and resolve a variety of taxpayer problems. GAO reported that the IRS has invested millions of dollars in ICP, but unresolved issues with the costs and benefits of ICP the testing of ICP, the redesign of work process, and software development weaknesses raise serious concerns about IRS capability to successful develop and deploy ICP.

The problems described above were caused by serious deficiencies that must be corrected before major new investments in technology can be justified. The intent of the Commission is not to criticize the IRS for past problems, but to ensure that the mechanisms exist to correct these problems, so that additional funds appropriated for technology development may be spent effectively and efficiently.

Best practices for developing IT systems

The Commission, during its investigations, emphasized identifying best practices by both industry and government in developing IT systems. Industry, academic, and government experts who provided testimony on IT best practices are listed in Appendix C. An analysis of best practices abstracted from these sources reveals that the following best practices are widely used by multiple organizations:

- Measurable, strategic objectives for IT to support is essential;
- Business and IT owners must act in partnership;
- Business processes should be reengineered prior to modernization;

- Core capabilities must exist in customer IS organizations, even when IT is outsourced;
- An overall design and architecture is needed prior to implementation of IT systems; and
- Phased, evolutionary modular approaches to modernization work best.

The need for appropriate technical disciplines and processes, particularly for an overall system design and architecture prior to implementation of individual projects was universally emphasized, and the need for a security architecture was particularly emphasized by security experts.

USAA, Citibank, and ATO emphasized the need for evolutionary approach to modernization. Citibank uses a concept known as Building Permits. New development projects must obtain a Building Permit before being approved and funded. To obtain a Building Permit, a project must be cost-justified and conform to Citibank architecture and standards framework, and use selected vendors.

Another source for best practice information is the Software Capability Maturity Model (SW-CMM) and Software Acquisition Capability Maturity Model (SA-CMM). The former describes best practices for in-house development of software, and the latter applies to managing software acquisitions from contractors. The SA-CMM will grow in importance as IRS outsources most of its software development.

Core capabilities
A number of organizations have turned to outsourcing IT development. Research by Feeney and Willcocks of Oxford University, *Configuring the Information Systems Function: A Core Capabilities Approach*, indicates that organizations that outsource IT development must possess nine core capabilities to be successful:

- **IS/IT governance**—Integrating IT effort with business purpose and activity
- **Business systems thinking**—Envisioning the business process technology makes possible
- **Relationship building**—Getting the business constructively engaged in IT issues
- **Designing technical architecture**—Creating the coherent blueprint for a technical platform that responds to present and future business needs
- **Making technology work**—Rapidly achieving technical progress- by one means or another
- **Informed buying**—Managing IT sourcing strategy that meets the interests of the business
- **Contract facilitation**—Ensuring the success of existing contracts for IT success
- **Contract monitoring**—Protecting the business's contractual position, current and future
- **Vendor development**—Identifying the potential added value of IT service suppliers

The Commission believes these core capabilities are applicable to the IRS situation as it changes its IS organization from one that develops information systems in house to a manager of private

sector development contractors. The Commission recommends that the core capabilities be used as guidelines in the organizational development of IRS Information System organization.

Information technology industry recommendations
The Information Technology Association of America (ITAA), an industry association whose member companies are marketplace leaders in systems integration, outsourcing, software, and telecommunications, conducted a study for the Commission describing its recommendations for improving IRS ability to manage technology. The ITAA report, *Realizing Strategic Business Goals Through Process Reengineering and Systems Integration,* contained the following recommendations for IRS:

- Clarify and communicate the vision of a modernized IRS;
- Ensure that business goals drive the tax system modernization; and
- Improve strategic information systems management.

To aid in the implementation of these recommendations, the ITAA further recommended that the IRS:

- Must be given the flexibility to hire, provide incentives, manage, contract out, and hold its personnel accountable;
- Make better use of the private sector skills, i.e., do not attempt to duplicate within the IRS capabilities that are better performed by the private sector; and
- Integrate program management to enhance effectiveness of implementation.

Details of these recommendations can be found in *Realizing Strategic Business Goals Through Process Reengineering and Systems Integration.*

Recent IRS progress
During the past 12 months, IRS has succeeded in creating high-level technology management mechanisms that work. GAO endorsed the operations of the Modernization Management and Investment Review Boards. Both put Strategic Information Management practices in place at the highest levels of Treasury and IRS. These boards should be integrated into overall strategic planning efforts at IRS.

Another IRS achievement was to hire a Chief Information Officer (CIO) from outside the organization. The new CIO has inherited major problems: century date change corrections that threaten the ability of IRS to function; stovepipe legacy systems that create operational and maintenance problems; a history of failed projects; lack of a business strategic plan; insufficient experienced personnel, and a decentralized IS organization with a proliferation of non-standard IS systems in the field.

The CIO has instituted positive change by establishing a project team to correct century date change problems, stopped a number of questionable projects, is developing architecture, program, and acquisition plans to modernize; and began to recruit outside personnel. The CIO

testified that he has implemented a rigorous systems development methodology and is creating a systems architecture, business requirements, and sequencing plan, all of which are needed prior to implementation of IT systems. These documents were delivered to Congress and released to the public on May 15, 1997. Development of these documents is consistent with best practice guidance the Commission has received from industry. In addition, IRS is progressing toward outsourcing of submissions processing, but cannot evaluate a pilot program before 2001. While these time tables seem long, the Commission recognizes significant analysis of returns processing efficiency must be conducted prior to outsourcing.

Taxpayer Records

The Commission believes that IRS efforts to improve customer service and streamline compliance can never be realized fully until its employees have the tools needed to easily access taxpayer data. The capability for IRS employees to respond quickly and correctly to taxpayer inquiries is of major concern to the Commission. Providing correct information to taxpayers requires that Customer Service Representatives (CSRs) have easy access to accurate, timely taxpayer account data. Presently, taxpayer account and related data is stored in a number of large data bases frequently referred to as stovepipe systems since they are not integrated. This structure hinders Customer Service Representatives from easy access to data needed to satisfy taxpayer requests in a single call. Data bases that Customer Service Representatives must frequently access include the Integrated Data Retrieval System (IDRS), Automated Collection System (ACS), Corporate Files On-Line (CFOL), Service-wide Electronic Research Project (SERP), and Centralized Inventory Distribution System (CIDS).

Legacy system problems

IRS provided information to the Commission staff describing 59 separate data bases that support various tax processing functions. The size of many of the data bases was in the gigabyte range. For many of these data bases, there is no central data dictionary. Neither is there a central data management plan that addresses data management issues across the organization.

These data bases are hosted on a variety of hardware systems. IRS reported that it currently has 49 operational mainframe systems in the two Computing Centers and ten Service Centers, with a total processor power of 1,542 millions of instructions/second (MIPS) for IBM/IBM-plug compatible machine (PCM) systems and 495 MIPS for UNISYS, as well as a total storage capacity of 10,790 gigabytes deployed. For non-mainframe systems, known as Tier II and III systems, IRS currently has 349 mini-computer based and 536 micro-based servers. IRS also has an estimated total of 6,998 gigabytes of on-line data and 180,000 gigabytes of near-line and off-line data stored on magnetic tapes.

IRS Master Files were designed in the 1960s, and are based on a one-week posting cycle. Data are accumulated during the five business days of each week and posted to the Master File data bases through a series of computer operations, commencing on Saturday and extending over several days. Thus, data captured at the Service Centers may not be available on the Master Files for as long as 10 days from the date the information is transmitted to the Martinsburg Computing Center. Computer on-line access to these data and the ability to update the information are

further delayed by the need to transmit the updated master file date to each Service Center. In turn, the Service Center updates the on-line IDRS, the primary system used to resolve taxpayer account issues.

The IRS has been characterized as a stovepipe organization in which functional units such as exam, collection, and appeals set and implement their own priorities and objectives. Each functional unit is often disconnected from the other units and the organization as a whole. The design of IRS data bases reflects this type of organization. The consequences of such a design can hinder customer service. For example, IRS testified that separate tax assessments for the same taxpayer could be found on systems such as ACS, AUR, Automated Substitute for Return System (ASFR), the Audit Information Management System (AIMS), the Integrated Collection System (ICS), and the Totally Integrated Examination System (TIES). Thus, a CSR may need to research a variety of systems to obtain a comprehensive view of all data required to resolve a taxpayer's account issues.

IRS testified that it has experienced increasing difficulties synchronizing disparate standalone data bases and expended significant funds to develop and operate standalone systems with duplicative functionality, infrastructures, and telecommunications. Minimal progress has been made in replacing the core Master File systems, thereby requiring even greater expenditures for the interfaces between the standalone systems and the Master File systems. The stovepipe systems, with standalone databases that provide fragments of customer service functionality, are unable to directly update the Master files. Further, the IDRS, designed as an end user system, is employed inappropriately as a "hub" system, between the Master Files and the stovepipe systems, and many of the stovepipe systems were developed due to a lack of success in replacing the Master Files and the need to work around the limited capabilities of IDRS.

The IRS capability to access taxpayer account data in an integrated manner is an issue that is at the core of the its ability to provide good customer service, as well as achieve high levels of compliance. GAO addressed this issue in report GAO/AIMD/GGD-96-152, September 1996:

> Making it easier for taxpayers to reach IRS by telephone is of limited value if IRS employees on the other end of the line do not have access to the data needed to help the taxpayers, which has been a long-standing problem in IRS. IRS eventually intends to provide its employees with access to greater amounts of on-line taxpayer data in shorter time frames than current systems can provide.
>
> Another major goal of IRS' vision is to increase compliance. Achieving this goal hinges on the ability of enforcement staff to readily access good data. For example, as we discussed in recent testimony on IRS' debt collection practices, existing IRS computer systems do not provide ready access to needed information and, consequently, do not adequately support modern work processes. Access to current and accurate information on tax debts is essential if IRS is to enhance the effectiveness of its collection tools and programs to prevent taxpayers from becoming delinquent in the first place.

GAO report GAO/GGD/AIMD-97-37, January 1997, describes the problems encountered by Customer Service Representatives in servicing customer inquiries. Generally, the Customer Service Representative must access each of the different systems independently. For example, an IRS employee using IDRS will know that a taxpayer was sent a notice of underreported income

but would not have access to the actual notice, which is contained it the Automated Underreporter (AUR) System. AUR would provide additional information, such as the amount of unreported income and information from the tax return that may indicate, for example, the amount of dividend or interest reported by financial institutions but not by the taxpayer.

The public has grown to expect that banks, insurance, and mail order companies will manage individual account information in a way that will enable good customer service. The Commission heard testimony from two outstanding customer-service oriented organizations during public hearings: USAA and Citibank. Both of these organizations learned to manage customers' account data using integrated data bases that are easily accessed by employees responding to customer inquiries.

Information technology industry recommendations

The ITAA report, *Realizing Strategic Business Goals Through Process Reengineering and Systems Integration,* contained the following observations on IRS improve its ability to access data:

> By coupling the latest technology with a new way of looking at how government relates to its citizens, government organizations can embark on the journey of creating a truly customer-driven government through improved access to information. For the Internal Revenue Service, this transformation means becoming as responsive to the needs and desires of its customers as any private sector. Using technology as an enabler, CSRs can view all transactions on one computer platform, on a single computer screen. Information access can be immediate and delivered to the customer through such traditional methods as telephone, mail and in person, or through alternative customer access methods such as personal computer, over the internet, or even kiosks, at any time or place. The key is to offer multiple access channels from the traditional to state-of-the-art, from personal to electronic. Many efficiencies and improvements in service will be readily apparent to include:
>
> - Reduced repetition of information
> - Reduced call handling time
> - Streamlined information access
> - Increased consistency and accuracy of information provided
> - More personalized customer service
> - More efficient problem resolution
>
> Further, when these efficiencies are combined with transformation of business processes, Customer Service Representatives will be able to focus the majority of their time on client relations rather than seeking information and processing paperwork. The end result will be a more effective method of collecting the proper amount of tax revenue, quite possibly, increased taxpayer compliance.
>
> But the transformation goes beyond the Customer Service Representative. Ultimately, the transformation will also help the government save money and manage its resources more efficiently. Better service often costs less money. A new infrastructure, in fact, often costs less than the old infrastructure. Key benefits to the Internal Revenue Service would include:
>
> - Reduced operation costs of staffing, network and equipment
> - Increased representative productivity
> - Streamlined work flows.

ITAA recommended that IRS work in partnership, sharing risks and rewards, with a skilled business partner. It made three recommendations that would help IRS improve its ability to access data:

- establish a Data Officer;.
- reorganize infrastructure for customer service; and
- implement the vision for customer service.

Details of these recommendations can be found in *Realizing Strategic Business Goals Through Process Reengineering and Systems Integration.*

Appendix G
Electronic Filing Supplementary Information

The Commission believes that the IRS must develop and implement a strategic and marketing plan to make paperless filing the preferred and most convenient means of filing for the vast majority of taxpayers. This vision can be achieved over a ten-year period by using existing infrastructure such as tax practitioners, financial institutions, and the Internet as intermediaries for submitting tax returns to the IRS. The obstacles to achieving this vision are not necessarily the cost of developing information technology systems, but entering into a partnership with practitioners and financial institutions that would provide burden reductions and incentives for filing tax returns electronically.

Processing workload

Table G-1 illustrates IRS tax return processing workload for 1995. IRS estimates that 120 million individual tax returns will be filed in Tax Year 1996, of which approximately half, or 60 million, will be prepared by paid tax preparers. Virtually all of these 60 million returns are prepared using tax preparation software. Another 10 million or more tax returns are filed by self preparers who use consumer-oriented tax preparation software products.

Table G-1. Return Types Received by IRS for Tax Year 1995

Return Type	***Forms***	***Volume***	***Electronic Volume***
Individual income tax	1040 family	116,298,325	11,142,582
Estimated tax	1040ES	35,475,945	0
Fiduciary	1041	3,187,143	6,889,074
Fiduciary estimated tax	1041ES	583,473	0
Partnership	1065	1,571,872	0
Corporation income tax	1066 and 1120 series	4,780,956	0
Estate tax	706 series	82,860	0
Gift tax	709	215,010	0
Employment taxes	940 series, CT-1, and 1042	29,006,291	0
Exempt organizations	990 series, 5227, and 4720	560,057	0
Employee plans	5500 series	1,261,700	0
Excise tax	720, 730, 2290, and 11C	787,011	0
Supplemental documents	1040X, 1120X, 2688, 4868, 7004, 8752, 1041A	11,936,542	0

Costs

IRS estimates the average cost of processing all paper returns at $2.65 a return, but acknowledges that this figure did not include all costs. Similarly, the costs of processing electronic returns was estimated at $1.15, including the processing of paper signature documents. The IRS is conducting a cost study to determine the actual costs. The Commission received an estimate from the Private Sector Council that a project by a Fortune 100 company to automate paper processing experienced a six to one cost differential of paper to electronic processing costs. This represents a significant cost savings for the IRS if the number of electronic returns can be increased significantly.

In addition to labor, overhead, and management costs to operate the returns processing pipeline, there are other cost reductions that could be realized with an increase in electronic filing, such as the following:

- Heavy dependence on manual labor creates additional recruitment and training costs for IRS since it causes spike demands for low cost labor that is not always available.
- Facility and physical handling equipment associated with paper filing is much higher than that used for electronic returns.
- After the data is manually entered into the data base, the paper return is archived. Storage costs for paper returns are higher than those for electronic returns. Any subsequent need to access a return, such as an examination or collection, or requests by taxpayers for a copy of the return, results in retrieval costs as well.

To save processing costs, the IRS currently only captures in electronic form 40% of the information submitted on paper returns. All paper data submitted by taxpayers is archived, however. After a return is posted to the Master File, IRS uses automated algorithms to detect conditions that may warrant an examination. For those returns selected for further evaluation, the paper return must be retrieved from archives, and examined manually. With electronic returns, 100% of data submitted are captured and archived electronically. This situation provides the opportunity for the IRS to enhance its detection algorithms to use an expanded set of data, while also reducing the need for retrieval of suspicious paper returns. Since this type of examination occurs without any taxpayer contact, it is the least intrusive type of examination.

Reasons for failure of existing electronic filing program

The Commission believes that the failure of electronic returns to increase at rates originally projected by the IRS does not represent a technical failure by the IRS, rather a failure to plan and market electronic filing in an organized, thoughtful manner. As early as July 1995, GAO reported that IRS had no comprehensive business strategy for promoting the benefits of electronic filing to all taxpayers. Rather, its strategy was aimed only at taxpayers desiring a quick refund. Without a comprehensive strategic plan, GAO believed that IRS would not achieve its stated goal of 80 million electronic returns by 2001. The Commission believes this situation is still true today. No comprehensive strategy has been made available to the Commission, although a high level issue paper was released by IRS in February, 1997.

Mr. Peter Simpson, Second Commissioner for the Australian Taxation Office (ATO), testified to the Commission that the technology costs for electronic filing were low, but the real keys to success were marketing the service properly and letting the private sector develop products in the marketplace. The Commission received testimony and input from the practitioner community that would confirm ATO's experience.

Information returns and document matching

Electronic filing of both tax and information returns aids earlier document matching. With today's filing profile and legacy systems, IRS delays the identification of underreporter cases for

over a year until all the documents are ready to be matched. Receipt by taxpayers of underreporter notices 18 months after filing increases the likelihood of missing taxpayer records and builds taxpayer resentment against the IRS due to the accumulation of interest and penalties.

Although it is not currently possible to perform document matching before a refund is issued, electronic filing of information returns could allow IRS to perform document matching in the same calendar year during which a tax return was submitted. Underreporter cases could then be pursued in a more timely manner. The IRS should perform income reporting verifications through matching of 100% of submitted information documents. IRS also should include the Schedules K-1 as part of the document matching process.

Plan for Making Electronic Filing More Attractive to Taxpayers and Practitioners

The Commission's comprehensive plan for increasing electronic filing is summarized in Table G-2. The Commission believes only a comprehensive plan that appeals to all segments of the taxpayer and practitioner population can make electronic filing the preferred and most convenient method of filing for the vast majority of Americans. Features of the plan are described in the following paragraphs. While this plan focuses on individual tax returns because they constitute the bulk of the IRS processing workload, the Commission emphasizes that plans should be established to encourage all returns types, such as payroll, corporate, and partnership returns, to be filed electronically.

Partnering with stakeholders

IRS needs an improved sense of partnership with tax practitioners, other organizations that supply data, and state tax administrators. We recommend IRS establish an Electronic Commerce Advisory Group (ECAG) to address issues of mutual concern to IRS, the practitioner community, other stakeholders, and state tax administrators. The Commission's intent in recommending establishment of this group is to establish an ongoing forum for discussing future electronic commerce issues.

The Commission envisions that the ECAG would address issues to help further electronic commerce among the member organizations, such as the removal of additional barriers faced by practitioners, simplification of the application to be an Electronic Return Originator (ERO), and plans to achieve complete participation by all states in the Federal/state electronic filing program. Additionally, as the IRS moves to more paperless tax administration, the ECAG is envisioned to be a forum where IRS and practitioners can mutually facilitate the ability of tax practitioners to move to more paperless business systems, such as paperless records retention systems.

Additional changes to improving partnering between IRS and preparers involve treating practitioners as valued suppliers of information to IRS. The Commission recommends such changes as elimination of filing requirements for signature documents and associated W-2s by having taxpayers retain signed 1040s and W-2s on file, regulation of all paper and electronic preparers under IRS Circular 230 to ensure standard procedures for treatment of all tax preparers, inclusion of a checkoff box on the electronic tax return that allows taxpayers to authorize their

Table G-2. Electronic Filing Plan for Individual Tax Returns

Feature	Implementation							
	98	**99**	**00**	**01**	**02**	**03**	**04**	
• Increased partnership between practitioners, tax software industry, transmitters, and IRS	X	X	X	X	X	X	X	
⇒ Creation of an Electronic Commerce Advisory Group	X							
⇒ Elimination of paper signature document form 8453	X							
⇒ Elimination of paper W-2 filing (attached to 8453)	X							
⇒ Practitioner regulation in accordance with Circular 230 to achieve more consistent compliance checks between paper and electronic preparers		X						
⇒ Authorization for preparer to discuss return information with IRS as checkoff box on return		X						
⇒ Field for inclusion of taxpayer/practitioner notes			X					
⇒ Acceptance by IRS of all 1040 forms, with retention of paper copies of attached forms/schedules by taxpayer/practitioner for forms that cannot be electronically received by IRS (i.e., treat forms as worksheets)	X							
• Expansion of TeleFile pool to include some 1040A filers		X	X					
• Increasing pool of 1040A and 1040EZ filers by changing limits		X	X					
• Additional electronic input of information returns			X					
• Due date realignment, including extensions for electronic filers			X					
• Capability to receive all forms			X					
• Paperless payment available for taxpayers		X						
• Incentives for transmitters for filing electronic returns	$2	$2	$2	$1	$1	$1		
• Paid preparers required to file all returns electronically							X	
• Systems to allow direct home PC filing (if not already supported by marketplace)				X	X	X		
• Secure access to account data for electronic filers								
• Improved marketing and advertising by IRS	X	X	X	X	X	X	X	
• Simpler filing methods, such as return free filing								
Projections of Individual Tax Returns by year (in millions)[2]	119	120	122	123	124	126	128	
Estimated number of electronic returns (in millions), less TeleFile	25	30	40	45	50	55	80	
Estimated number of TeleFile returns by year (in millions)[2]	6.5	7.0	7.5	8.0	8.5	9.0	9.2	
Remaining paper returns (in millions)	87.5	83	74.5	70	65.5	62	38.8	3
Percent of paper returns	74	69	61	57	53	44	30	

Note 1: For previous tax year (e.g., Implementation Year 98 is Tax Year 1997)
Note 2: Extrapolated from IRS Calendar Year Projections of Individual Returns by Major Processing Categories, Table 13, and Tax Year 1996 TeleFile Profile, June 24, 1996

preparer to discuss aspects of the return with IRS Customer Service Representatives, accepting of the transmitter's date/time stamp as a postmark, and development of a white field in the electronic return for tax preparers to include supplementary notes.

Elimination of Form 8453

The filing of Form 8453, the signature form for electronic returns, has been identified by practitioners as a major impediment to the efficient filing of electronic tax returns. IRS also reported to the Commission that the handling of these forms is the largest cost element associated with the processing of electronic returns. The Commission believes the filing of this form is unnecessary. Several models exist where organizations accept electronic tax returns without signature documents, including Canada, Australia, and the state of California. In addition, the Securities and Exchange Commission accepts electronic financial reports such as 10-Ks without signatures. In each of the above cases, the only requirement is for the originator to maintain the signed copy on file. While the Commission believes that electronic authentication technology will make electronic signatures viable on a national basis, the infrastructure does not yet exist to support such a program. The elimination of the Form 8453 should not wait until this technology is in place. A change to allow taxpayers to maintain the original signed copy of their returns will require legislative action, since current Treasury interpretation of existing law is that a signature is required.

Acceptance of all forms

Another significant barrier brought to the attention of the Commission by practitioner groups is that IRS does not accept electronically every form or schedule that can be attached to the 1040. As an incentive for IRS to modify its systems to accept all attached schedules, the Commission recommends that IRS, starting in 1998, accept all 1040s electronically. If certain attached schedules cannot be received electronically by IRS, the taxpayer should simply be required to maintain these forms in their records, much like a worksheet is treated today.

Regulation of preparers

Regulation of all preparers under Circular 230 is important to the development of an improved relationship between preparers and IRS, since it applies enforceable rules of conduct to all return preparers. Our recommendation is to amend 31 U.S.C. 330 to require all persons engaged in the business of preparing returns or otherwise accepting compensation for advising in the preparation of returns to comply with the standards of conduct set forth in Circular 230 as enforced by the Office of the Director of Practice which is established under Treasury. By holding all paid preparers to the same levels of due diligence, the proposal seeks to ensure that taxpayers are not misled by their representatives. Return preparers that violate the rules of conduct are subject to disbarment from return preparation or representation of taxpayers before the IRS. The ability of the Director of Practice to administer and enforce actions based on allegations of professional misconduct should not be compromised by the organizational placement of the Director.

Uniform requirements will increase professionalism, encourage continuing education, improve ethics, and better enable the IRS to prevent unscrupulous tax preparers from operating. Regulation under Circular 230 promotes the integrity of our tax system, places all return preparers on a level playing field, promotes voluntary compliance and standardizes the

procedures for all preparers for electronic filing and other compliance procedures. Currently, commercial return preparers are allowed to represent taxpayers before the IRS at the examination level and only for returns which they prepared. Higher education and qualification criteria should continue to be enforced for representation at all levels before the IRS. The Commission does not envision complex and cumbersome registration procedures or requirements, simply a system to capture preparer information already provided on the tax forms for a database of preparers.

Realignment of due dates
The complete schedule for revised due dates is shown in Table G-3 and G-4. The Commission believes these changes better support same year document matching and possible future implementation of simpler return filing processes, such as return free filing.

Expansion of TeleFile pool
TeleFile is considered by IRS and the Commission to be a successful program. The number of taxpayers using TeleFile increased approximately 50% in 1996 to close to 5 million filers. To encourage even more taxpayers to use this method of filing taxes, we recommend that IRS consider expanding the TeleFile pool in two ways. The first method is to expand the TeleFile pool by including more taxpayers now filing 1040A returns. This expansion currently is being evaluated by IRS and if IRS assessments indicate favorable benefits, the expansion should be accomplished. A second approach is to expand the number of 1040EZ filers by changing the limiting conditions so that additional taxpayers could use the simpler form and thus be eligible for TeleFile.

Paperless payment
The Commission also recommends that paperless payment methods be made available to taxpayers. This option could be as simple as using the existing direct deposit blocks in reverse to authorize an electronic transfer of funds to the IRS. Other options include the use of debit and credit cards. Some municipalities and states have already started allowing the use of credit cards for payment of taxes. Typically, the taxpayer must absorb the cost of any merchant fee when using credit cards to make tax payments. Receipt of tax payments also could be privatized through electronic funds transfer or submission of paper payment to a financial institution or other third party processor for electronic transfer to IRS.

Incentives
A major incentive for tax practitioners is a combined incentive and required electronic filing plan to encourage practitioners to file electronically, and requiring practitioners not to charge taxpayers extra for electronic filing if they accept the incentive payments. The Commission recommends that IRS pay transmitters an incentive for submitting electronic returns until 2004. Transmitters would be expected to share the payment with originators based on market competition. The recommended payment schedule is shown on Table G-2. A second incentive, one geared to taxpayers, is faster refund cycles.

The Commission believes that this plan offers several benefits. The incentives provide a short term benefit to transmitters and originators and provide taxpayers with free electronic filing services. Surveys indicate that the cost of electronic filing is a major reason taxpayers do not file

Table G-3. Information Return Preparation and Processing Dates

Information Returns[1]	Paper	Electronic	Current
Information returns due to taxpayer	February 15	N/A	January 31
Information returns due to IRS and SSA[2]	March 15	April 15	February 28
Automatic Extension of filing	April 15	May 15	none
Additional Extension of filing	N/A	N/A	March 30
Additional Extension of filing	N/A	N/A	April 29

Table G-4. Tax Return Preparation and Processing Dates

Income Tax Returns and Pass-through Entity Returns[3]	Paper	Electronic	Current
Corporate (domestic)	**March 15**	**April 15**	**March 15**
Additional Extension of filing	August 15	September 15	September 15
S-Corp	**March 15**	**April 15**	**March 15**
Additional Extension of filing	August 15	September 15	September 15
Partnership (domestic)	**March 15**	**April 15**	**April 15**
Automatic Extension of filing	N/A	N/A	July 15
Additional Extension of filing	August 15	September 15	October 15
Trusts	**March 15**	**April 15**	**April 15**
Automatic Extension of filing	N/A	N/A	July 15
Additional Extension of filing	August 15	September 15	October 15
Estates[4]	**April 15**	**May 15**	**April 15**
Additional Extension of filing	same	same	90 days up to 6 months
Form 990	**April 15**	**May 15**	**May 15**
Additional Extension of filing	same	same	90 days up to 6 months
Form 990C (cooperatives)	**September 15**	**October 15**	**September 15**
Automatic Extension of filing	same	same	March 15 of following year
Form 990T (corporation)	**April 15**	**May 15**	**May 15**
Automatic Extension of filing	August 15	September 15	November 15
Form 990T (401(a) trust)	**April 15**	**May 15**	**April 15**
Additional Extension of filing	same	same	90 days up to 6 months
Form 990T (other trusts)	**April 15**	**May 15**	**May 15**
Additional Extension of filing	same	same	90 days up to 6 months
Individuals	**May 15**	**June 15**	**April 15**
Automatic Extension of filing	July 15	August 15	August 15
Additional Extension of filing	September 15	October 15	October 15

First quarter individual estimated payment continues to be due April 15. However, with the change in return filing due dates, the prior year's tax liability may not yet be known on April 15. Therefore, the first quarter estimated payment should be based on 100% (or 110% for higher incomes) of the second preceeding year's tax with a "catch-up" on the second estimated payment (due June 15).

[1] Information returns and transmittal documents include Forms 1099, 1098, W-2, and W-3

[2] IRS receives 1099s and 1098s and SSA would be required to capture all Forms W-2 and W-3 information (including state and local). Form W-3 would be revised to add lines to report state and local payroll information.

[3] For 1994 tax return year; 5,306,301 Partnership and S-Corporation returns and 476,980 Estate and Trust returns were filed.

[4] For those estates electing a calendar year.

electronically. Incentives, combined with other changes to make electronic filing more attractive, are expected to increase volume and encourage market dynamics to react with competitive products in sufficient numbers to provide taxpayers with a range of choices. Based on briefings the Commission received from industry, there are already signs that this marketplace development is beginning. The Commission recommends that regulations concerning electronic filing should be examined to ensure they do not impede the development of products in the marketplace that facilitate electronic filing.

In 2004 incentives will terminate and all practitioners will be required to file electronically. The Commission believes this requirement also encourages the market to develop products, while at the same time providing more than adequate time for practitioners to prepare for the requirement. Many practitioner groups have told the Commission that they support this requirement as a means to get the industry to adopt electronic filing as common practice.

Home filing

As more Americans have personal computers (PCs) in their homes, filing tax returns from home should have more appeal to taxpayers. The Commission envisions that the marketplace will develop systems that will allow taxpayers to file directly from their home PCs, and using appropriate security and privacy safeguards, independent of any IRS action. Should this situation not occur, we recommend that IRS develop systems to allow taxpayers to transmit tax returns directly to IRS using home computers. One example of a market development that could occur is for banks and other financial institutions to incorporate options for electronic filing as part of home PC banking services, offering competitive tax filing services as part of an overall package of products available to customers. Other organizations could offer the same or similar services.

Secure access to taxpayer records

The Commission recommends that IRS allow taxpayers and their authorized practitioners who file electronic returns be provided secure access to their own account information by 2006. We recognize that this capability cannot be achieved until IRS first integrates its data bases, but we believe this capability should be planned for and developed as part of modernization, and not added as an additional requirement in the next century. Banks currently offer this feature to customers who participate in home banking services. As the number of consumers participating in home banking grows, this feature becomes another capability taxpayers will expect for their IRS account as well.

Changes to IRS systems and procedures

IRS changes to complement the above actions would include less restrictions on advertising to improve taxpayer understanding of the benefits of electronic filing, acceptance of all form types and addition of a white field for supplementary notes, more frequent payment cycles for electronic returns, and expansion of IRS infrastructure to accept more than 100M returns.

Filing of Form W-2

The Commission recommends that the current threshold for magnetic/electronic reporting to the Social Security Administration (SSA) be lowered. The current procedures require submitters of more than 250 W-2s to file using magnetic or electronic format. The Commission recommends

this threshold be lowered to 100 W-2s, and that the threshold be applied in the aggregate to third party preparers. The immediate goal is to reduce the 53 million paper W-2s, with the long range goal of using incentives to transition to electronic filing.

We also recommend a single point of filing of Forms W-2 and W-3 by having SSA capture all form information, including state and local information. Electronic submission of the majority of Forms W-2 and W-3 will reduce SSA's data capture burden. SSA should then transmit the captured data to the appropriate governmental agency. IRS must revise Form W-2 to add state and local information.

Appendix H
Tax Law Simplification

Legislative Process

In order to achieve a more rational tax code, the tax legislative process should be methodical, thoughtful, and include sufficient time for thorough contemplation of the likely impact of proposed legislation. A model tax legislative process should approach tax law changes with sufficient time for public debate, deliberations, and input from taxpayers and the IRS.

When Congress considers legislation early in the legislative process, and allows ample opportunity for public comment, it can better understand the policy, economic, and administrative effects of proposals. Congress should seek to ensure that all interested parties have a forum to discuss the impact of these proposals. In particular, Treasury should be invited to provide its comments on the policy and economic impact of the proposals, and the IRS should be invited to discuss the administrability of the legislation. While Treasury speaks for the Administration on tax policy issues, the IRS should be the voice of tax administration. As such, Congress must hear from the tax administrator so that it can consider potential implementation problems prior to enactment of tax legislation.

As the voice of tax administration, the IRS should be able to submit legislative recommendations to improve tax administration directly to Congress. In addition, the IRS should work with the tax writing committees to ensure that they have sufficient information to prepare a Tax Complexity Analysis for each legislative proposal. In this regard, the IRS should explain the impact of proposals on forms, instructions, publications, and regulatory guidance. Moreover, the IRS should share its knowledge as to the impact on taxpayer record keeping and compliance burdens, as well as how it will integrate the proposals with its existing examination and collection activities. The IRS also should identify any other foreseeable administrative problems and technology and resource needs resulting from proposed legislation. Finally, the IRS should develop procedures (e.g., a database of its expert employees) to ensure that the right people are involved in the legislative process. While personnel from the National Office may be helpful, a revenue agent from the field may be more appropriate.

Because Congress must consider the impact of its actions on taxpayers, the private sector must have a role in the tax legislative process. The tax writing committees should actively encourage participation of taxpayers and their representatives through hearings and public comment periods. A mechanism enabling the private sector to volunteer its comments to the tax writing committees or the Joint Committee on Taxation should be established whereby the list of the private sector comments is included as part of the committee and conference reports and a listing of such submissions should be distributed to each member of the tax writing committees. The staff of the tax writing committees should make the private sector comments available to any member of Congress. Private sector comments should be available to all Members of Congress, as well as the public.

Tax Complexity Analysis

The Tax Complexity Analysis increases the prominence of tax complexity early in the drafting process, when its consideration is more likely to affect the substance of legislation. Ideally, a Tax Complexity Analysis should be prepared by the sponsor of the legislation. When the President submits legislative recommendations to the Congress, these recommendations also should be accompanied by a Tax Complexity Analysis. The analysis should be prepared before proposals are scored for revenue and distributional impact so as to help guide the estimators as they make assumptions as to the impact of proposals on economic behavior.

Compliance Burden Estimates

The Tax Complexity Analysis should focus on a formal process to be established for informing Congress of the potential magnitude of taxpayer and IRS compliance burdens resulting from proposed legislation. When a House, Senate or conference committee reports any bill that includes a revenue provision, the report could include the compliance cost estimates. Similarly, any amendment to a revenue bill could be subject to a point of order unless a compliance cost estimate was provided at the time of its consideration and compliance estimates should be required for conference reports or floor amendments.

Burden estimates, for example, might require specific cost estimates for each tax provision that is estimated to either increase or decrease federal revenues by $100 million. The $100 million threshold could be indexed for subsequent inflation. A qualitative assessment of compliance costs could also be presented when the estimated Federal revenue effect of a provision is less than $100 million in any fiscal year. The analysis should contemplate including cost estimates for such provisions where costs are disproportionate to the change in revenues. For example, offsetting revenue effects within the same provision may result in a net revenue impact that is close to neutral. In this instance, the revenue effect of one part of the provision before netting could exceed $100 million for one class of taxpayers.

The information provided should allow Congress to better understand not only aggregate costs, but also the cost per taxpayer and the Federal costs per dollar of revenue raised. The presentation format could include fiscal year revenue effect, number of taxpayers affected, taxpayer compliance costs, and IRS administrative costs. The costs to be considered should be the direct costs that taxpayers or the IRS would spend to comply with the proposed changes. Any costs that the taxpayer is already bearing under the current system of taxation would not need to be counted again. Such estimates already apply to the IRS when new regulations are proposed or finalized, and the IRS already must estimate its own staffing requirements when implementing new legislation and provide estimates for tax forms showing the time required to maintain records, learn about the operation of the law, and complete the tax forms. While compliance estimating may require additional Joint Committee on Taxation staff and space, the Commission believes that this cost is inconsequential when compared with the enormous burden imposed upon taxpayers today.

Federal-state cooperation

As technology has changed and the United States is able to transform to a more paperless society, the IRS must be given the tools to adapt through the ability to enter into cooperative agreements for tax administration. The ability of the IRS to enter into tax administration agreements with state taxing authorities would reduce the burden on the public as well as on tax agencies, improve the efficiency of tax administration at all levels by better utilizing available resources, and increase the collection of delinquent federal and state taxes. Also, the IRS could increase the availability of walk-in assistance through shared federal and state facilities. Significant improvement in the level of taxpayer service already has been seen in Idaho where shared state and federal facilities have been implemented.

Simplification proposals

The following list is a compendium of simplification proposals that have been advanced by various stakeholder groups and academics, including the American Bar Association, the American Institute of Certified Public Accountants, and the Tax Executives Institute. In addition, the list includes a number of proposals announced by Treasury on April 14, 1997, and April 23, 1997. All of these provisions will affect tax policy, progressivity, and revenues to varying degrees, but could be used by the tax writing committees so that the frustrations of millions of taxpayers can be ameliorated. Accordingly, these simplification proposals are forwarded, without endorsement, to the Committee on Ways and Means and the Committee on Finance.

General

Avoid hidden tax rates

One of the more perverse creations of the Tax Reform Act of 1986 was the phase-out. The "bubble," which was a phase-out of the fifteen percent rate bracket, subjected taxpayers with less taxable income to higher marginal rates than taxpayers with higher taxable income. The "bubble" was replaced in 1990 with phase-outs of itemized deductions and phase-outs of personal exemptions. While phase-outs are intended to increase progressivity by increasing the tax burden of higher income taxpayers, they create a range of marginal rates that can apply to taxpayers with identical economic income. Rather than using phase-outs, which can be complicated to apply and serve as disguised rate increases, Congress could establish rate schedules that reflect actual economics.

Harmonize definitions

In its quest to target benefits narrowly and prevent specific abuses, Congress often writes new definitions when existing definitions could be used instead. The resulting complexity caused by these overlapping definitions tends to generate additional taxpayer frustration. For example, the Internal Revenue Code currently defines "dependent" at least five different ways—for purposes of determining filing status, calculating the "kiddie tax," qualifying for the earned income tax credit and dependent care credit, and determining personal exemptions. In addition, recent proposals for a nonrefundable child credit would establish yet another definition. While all of

these programs have somewhat differing goals, Congress could provide significant simplification for most individuals and the IRS by harmonizing the definitions.

A second example of overlapping definitions can be found in the various versions of ownership attribution rules scattered throughout the Internal Revenue Code. In each instance, the purpose of the attribution rules is to identify whether ownership is deemed to exist due to the presumed relationship between the actual owner and the taxpayer. Congress could provide significant simplification for many businesses and the IRS by establishing one set of ownership attribution rules that would identify ownership based on family relationships, entity relationships, and ownership of options.

Standardize indexing

Many provisions, including standard deductions, personal exemptions, and income brackets, are indexed for inflation. However, these provisions are not adjusted consistently because the law requires different reference years and rounding conventions. Congress first enacted indexing because the failure to index for inflation results in tax increases each year. Nevertheless, more consistency will lead to less complexity.

Temporary provisions

A significant source of complexity and taxpayer frustration is the regular expiration (and sometimes, retroactive reenactment) of temporary provisions of the Internal Revenue Code. For example, the exclusion from gross income for certain employer provided educational assistance under section 127 of the Internal Revenue Code has been extended nine times since its enactment in 1978. When section 127 expired and then was extended retroactively in 1996, Congress narrowed the provision by eliminating the preference for graduate education; at the time of writing this report, the provision has expired yet again. Even though temporary provisions often are reenacted, their temporary nature creates unnecessary uncertainty and complexity for taxpayers and the IRS.

Return free filing

Congress should consider whether it is appropriate to continue to place the burden of calculating taxes each year on the American taxpayer, or whether it should shift this responsibility and burden to the government, which could be facilitated by offering a return free system. At least thirty-six countries maintain alternative filing systems, including several of the United States largest trading partners. Most of these countries employ a final withholding system, in which individuals do not file returns because their employers withhold the total amount due through the payroll system. Two countries, Denmark and Sweden, have gone further, establishing tax reconciliation systems in which the tax agency calculates individuals' tax returns on the basis of information reporting, and sends bills or refunds to taxpayers each year during the filing season.

In an October 1996 report, the GAO estimated that as many as 51 million individuals would not have to prepare any tax returns at all if the IRS were able to establish a tax reconciliation system. The basic concept is for the IRS to produce an account statement for individuals on the basis of income reported on information returns and information on filing status and dependents. The IRS would mail the account statements to taxpayers, indicating their balance. Taxpayers then would

review their statements, notify the IRS if they agreed, or submit a return indicating corrections. The GAO estimated that this approach would save taxpayers at least 155 million hours annually preparing their returns, as well as millions of dollars of fees paid to tax return preparers, and would reduce IRS return processing and compliance costs. To implement such a system, however, the IRS would need to receive accurate information returns electronically and substantially improve its information technology capabilities. Moreover, to expand the pool of eligible individuals, Congress would have to take steps to simplify the tax code, particularly by harmonizing the overlapping definitions of "dependent."

Individual Tax Simplification

Establish a family allowance

The proposal would consolidate the present law standard deduction, personal exemption, dependent care credit, earned income tax credit, and the proposed child credit into one "family allowance," the amount of which generally would equal the sum of the benefits provided through programs that it would replace. The proposal would retain the additional standard deductions for elderly and blind taxpayers. The allowance, which would be indexed for inflation, would not be phased out. By consolidating five programs into one allowance, and by eliminating the phase-out thereof, this proposal could eliminate much of the complexity that most working individuals face each tax season. Instead of determining eligibility under various programs, taxpayers would determine the amount of their allowance from tables indicating amounts for single and married filers with and without dependents. Taxpayers electing to itemize their deductions would be entitled to a reduced family allowance. Finally, the proposal would simplify the definition of dependent to include a child (natural, adopted, or foster) or grandchild if under age 19 (or 24 if full-time students), if the child resides with the taxpayer for more than one half of the year, or as any other person currently qualifying as a dependent under the support test of section 151 of the Internal Revenue Code.

Simplify itemized deductions

The proposal would replace current itemized deductions with a reduced family allowance for individuals taking deductions for qualifying mortgage interest, charitable contributions, and state and local taxes. These three remaining deductions would be allowed on the Form 1040, thereby eliminating the Schedule A. Moreover, by extending the availability of the three remaining deductions to all individuals and eliminating the phase-out of certain itemized deductions, the proposal creates greater equity in the tax law.

Simplify the earned income tax credit

The earned income tax credit (EITC), which was established in 1975 as a means of incenting workforce participation by individuals below the poverty line, has been difficult to administer for the IRS. A recently released study of the EITC indicates that its high overpayment rate is due, in part, to the complexity of the credit. A number of proposals have been advanced to simplify the EITC and reduce its overpayment rate. For example, on April 23, 1997, Treasury announced a package of eight proposals to improve the operation of the EITC. In addition, the American Tax Policy Institute sponsored a study of the EITC in 1993, which suggested alternative designs for the program in addition to improvements in the current design. Congress and the President

should work together to simplify the EITC, maintain its high participation rate, and reduce its overpayment rate to below ten percent.

Simplify the kiddie tax
The proposal would remove the linkage to parents' and siblings' taxable income for purposes of calculating the kiddie tax, and instead subject the unearned income of children under the age of fourteen to the fiduciary income tax rates. In addition, the proposal would expand the election for parents to include their children's income on their return, with appropriate changes to avoid problems that may be encountered when matching with information returns.

Relief for sale of principal residence
The proposal would establish an exclusion of up to $500,000 of gain from the sale of a principal residence in lieu of the current law rollover provision and one-time exclusion for taxpayers over the age of 55. By establishing a $500,000 exclusion, this proposal eliminates the necessity for most homeowners to maintain records on the basis of their principal residence and continues the legislative goal of encouraging home ownership.

De minimis exception to passive loss limitation
The proposal would permit individuals to deduct losses from passive activities to the extent that they do not exceed $1000. By eliminating unduly burdensome computational and record keeping requirements for individuals with de minimis amounts of passive losses, the proposal provides simplification for many individuals.

Optional self-employment tax contributions
The proposal would allow all individuals to elect to increase their self-employment income for purposes of obtaining Social Security Insurance coverage. By extending the availability of the current rule to taxpayers other than farmers, the proposal creates greater fairness in the tax law.

Simplify mileage allowances
The proposal would replace existing mileage allowances with a business and a nonbusiness mileage allowance schedule. By consolidating mileage allowances, this proposal would simplify tax calculations for many individuals.

Simplify interest expense deductibility
The proposal would replace the deductions for investment interest and home equity indebtedness interest with a deduction for personal interest on obligations up to an aggregate value of $100,000. By eliminating the tracing requirement currently imposed on investment interest, the proposal vastly simplifies the personal interest deduction.

Business Tax Simplification

Allow certain businesses to elect independent contractor classification
The proposal would allow certain businesses to elect to treat service providers as employees or independent contractors. Businesses electing independent contractor treatment would be required to withhold on payments to covered individuals. The Secretary would be required to establish

tables for withholding, which would reflect amounts required for income and self-employment taxes. By providing an election, the proposal allows many businesses to avoid the uncertainty of the present law definition. Moreover, by establishing a withholding regime, the proposal could eliminate the need for many service providers to file estimated tax returns.

Establish straight-line depreciation

The proposal would require the use of the straight-line method for calculating depreciation, and would provide for shorter recovery periods. By eliminating the numerous methods permitted under current law, this proposal simplifies record keeping and tax preparation for millions of businesses. Moreover, use of the straight-line method broadens the tax base, eliminating many of the concerns underlying the present law alternative minimum tax.

Harmonize attribution rules

The proposal would replace all existing ownership attribution rules with one set of rules to cover family attribution, entity attribution, and option attribution. By eliminating the existing overlapping definitions, the proposal simplifies many calculations for millions of taxpayers.

Simplify hedging rules

The proposal would codify the existing hedging regulations and establish additional categories of ordinary assets to ensure that business property is treated as ordinary property. By eliminating the uncertainty created by the Supreme Court's decision in Arkansas Best, the proposal would modernize the hedging rules to reflect current business practices.

Repeal collapsible corporation rules

The proposal would repeal section 341 of the Internal Revenue Code, which recharacterizes the gain recognized upon the sale or liquidation of stock in a collapsible corporation as ordinary income. Because the statutory purpose of this statute was rendered obsolete by the complete repeal of the General Utilities doctrine in the Tax Reform Act of 1986, elimination of these complex rules will simplify tax planning for closely held businesses.

Simplify like-kind exchanges

The proposal would replace the existing like-kind exchange rules with an exclusion for gain on the disposition of business or investment property if the taxpayer uses the proceeds to obtain replacement property that is similar or related in service or use. By eliminating the necessity to locate a third party, the proposal provides taxpayers with greater flexibility and eliminates unnecessary complexity, uncertainty, and transactional costs.

Simplify personal holding company rules for consolidated groups

The proposal would repeal the requirement of section 542(b)(2) of the Internal Revenue Code that imposes separate company income testing on each member of a consolidated group. This proposal furthers general principles of consolidation and equalizes the tax treatment of all corporations subject to the personal holding company tax.

Modify look-back method for long-term contracts
The proposal would allow taxpayers to elect not to apply the look-back method with respect to long-term contracts if for each prior contract year, taxable income computed using estimates was within 10 percent of actual taxable income.

Index the accumulated earnings credit
The proposal would increase the accumulated earnings credit to reflect current dollars, and index the limit prospectively. By adjusting the limit for inflation, the proposal furthers equity and eliminates the potential for annual tax increases that do not reflect economic reality.

Estate and Gift Simplification

Gift return exclusion
The proposal would repeal the requirement of filing a gift tax return for charitable gifts that are deductible under section 2522 of the Internal Revenue Code. Because these gifts are deductible, no gift tax arises on covered transfers to charity. By eliminating the requirement of filing a gift tax return for transfers that do not give rise to the gift tax, the proposal simplifies the tax treatment of charitable giving.

Repeal of throwback rules for domestic trusts
The proposal would repeal the throwback rules applicable to domestic trusts. Changes made to the fiduciary income tax brackets by the Tax Reform Act of 1986 largely eliminated the potential abuses targeted by these rules. By eliminating the application of these obsolete provisions to domestic trusts, the proposal eliminates the complex tax calculations and record keeping burdens imposed on trust fiduciaries and beneficiaries.

Unified credit portability
The proposal would allow the surviving spouse to utilize the unused unified credit and generation skipping transfer exemption of the first-to-die spouse. By eliminating the necessity of using lifetime hedging gifts and trusts, this proposal ensures that married persons can utilize the maximum exemptions permitted by law without incurring extensive estate planning costs.

Repeal special rule applicable to charitable lead annuity trusts
The proposal would repeal section 2642(e) of the Internal Revenue Code, which imposes special rules on charitable lead annuity trusts for purposes of calculating the generation skipping transfer tax. By revoking a rule that rarely, if ever, applies, this proposal eliminates unnecessary complexity and simplifies the tax treatment of charitable giving.

Repeal use of Crummey powers
The proposal would amend Chapter 12 of the Internal Revenue Code to repeal the use of Crummey powers, which treat certain transfers in trust as completed gifts of present interests if the beneficiary is provided a period (typically 30 days) during which to demand outright possession of the property transferred in trust. By eliminating the use of complicated trusts and the application of a rule that rarely is used, the proposal would simplify tax planning for many individuals.

Repeal special rule for transfer of appreciated property in trust
The proposal would repeal section 644 of the Internal Revenue Code, which is intended to prevent the use of trusts to avoid tax on capital gain at high marginal rates. Changes made to the fiduciary income tax brackets by the Tax Reform Act of 1986 largely eliminated the potential abuses targeted by these rules. By eliminating this obsolete provision, this proposal simplifies the computation of fiduciary tax returns.

Simplify treatment of direct skips that are nontaxable gifts
The proposal would repeal section 2642(c) of the Internal Revenue Code, which disallows the $10,000 annual exclusion for generation skipping transfer tax purposes for certain transfers in trust. The current provision discourages direct skips in trust, but does not apply to direct skips of cash. By simplifying the treatment of these nontaxable gifts, this proposal eliminates unnecessary complexity and provides taxpayers with flexibility to provide the gifts outright or in trust.

Clarify treatment of certain disclaimers
The proposal would clarify that transfer-type disclaimers qualifying under section 2518(c)(3) of the Internal Revenue Code are treated the same as all other qualified disclaimers for income and gift tax purposes. Because current law is silent as to the treatment of these disclaimers, this proposal provides greater certainty to affected beneficiaries.

Simplify treatment of certain short-term OID obligations
The proposal would conform the treatment of short-term original issue discount obligations held by nonresident aliens for income and estate tax purposes. By exempting the income from these obligations from the estates of nonresident aliens, this proposal eliminates a trap for unwary investors who die while holding these obligations.

Pension Simplification

Emphasize compliance over penalties
This proposal would exempt employers who discover and correct inadvertent violations of plan qualification requirements from penalties for those violations, if the correction is not made in response to an IRS notice of examination. By encouraging employers to maintain and monitor qualified plans and eliminating penalties for employers that correct their own errors, this proposal facilitates greater compliance.

Facilitate communication with plan participants
The proposal would allow employers to deliver participant notices, other forms of plan communication, and plan transactions by electronic or other means, provided that any participant may obtain a paper copy upon request. The Secretary would be authorized to promulgate regulations to ensure privacy and security of such communications.

Simplify top-heavy rules
The proposal would amend section 416(c)(2) of the Internal Revenue Code to allow top-heavy plans to satisfy the minimum contribution requirement by providing a matching contribution in an amount equal to employee contributions, up to four percent of the participant's compensation.

Repeal prohibition on certain qualified plan loans
The proposal would allow sole proprietors, partners, and S corporation shareholders to take loans from a qualified plan subject to the same rules applicable to other plan participants. By providing parity among all plan participants, this proposal encourages individuals to save for retirement without fear of plan disqualification or imposition of the 10 percent excise tax on prohibited transactions.

Design-based safe harbor for minimum distributions
The proposal would establish a design-based safe harbor for minimum distributions, allowing taxpayers to elect to receive annual distributions equal to 10 percent of the account balance on the required beginning date. By simplifying the calculation of minimum distribution amounts, this proposal minimizes the possibility of incurring harsh penalties or plan disqualification.

Repeal application of nondiscrimination rules to governmental plans
The proposal would amend sections 401 and 403 of the Internal Revenue Code to repeal the application of various nondiscrimination rules to governmental plans. Since 1977 these rules have not been applied to governmental plans by the IRS because these plans have broad, almost universal coverage. Moreover, application of these rules to governmental plans could be unduly burdensome on state and local governments.

Simplify post death distributions
The proposal would eliminate the distinction between distributions that begin before or after the death of a participant in a qualified retirement plan. By repealing unnecessarily complex rules, this proposal provides a consistent and simplified approach to post death distributions, minimizing the potential for imposition of harsh penalties or plan disqualification.

Partnership Simplification

Partnership elections
The proposal would eliminate the prohibition of incorporated entities from partnership treatment and would allow subchapter S corporations to convert to partnership status without recognizing gain. An S corporation could convert without recognizing gain if it does not have accumulated C corporation earnings and profits or C corporation built-in gain, or if it elects to recognize gain on the conversion. By allowing corporations to elect partnership treatment, the proposal minimizes the impact of the tax law on choice of entity. Moreover, the election allows taxpayers to avail themselves of the more flexible partnership rules without paying the transaction costs of a conversion from subchapter S.

Partnership definitions

The proposal would define the terms "general partner" and "limited partner," using a material participation standard to distinguish between the two terms. By defining these terms, which are used to determine income and payroll tax liability, as well as passive loss limitations, the proposal provides certainty for taxpayers engaged in business through limited liability companies, limited liability partnerships, and other state law entities classified as partnerships for federal tax purposes whose owners are not denominated as general or limited partners under local law.

Simplified rules for electing large partnerships

The proposal would establish special rules for partnerships with more than 250 partners, or partnerships with more than 100 partners upon election by the partners, including simplified pass-through of partnership items, computations at the partnership level, and adjustment of items at the partnership level. In addition, the proposal would require large partnerships to furnish Schedules K-1 to their partners before the earlier of (1) three and one-half months following the close of the partnership's taxable year, or (2) two and one-half months following the close of the calendar year in which the partnership's taxable year ends.

Clarify the definition of liability

The proposal would codify the definition of "liability," as it was defined in temporary regulations issued in 1988. Because the term "liability" is central to many operative provisions of subchapter K, the proposal eliminates uncertainty for many partnerships.

Repeal excise tax on transfers to foreign partnerships

The proposal would repeal the excise tax imposed by section 1491 of the Internal Revenue Code and replace it with deemed royalty rules similar to section 367 of the Internal Revenue Code (which applies to transfers of appreciated property to foreign corporations). By replacing the excise tax with an income tax, the proposal eliminates the harshness of present law without compromising the flexibility of taxpayers to enter into cross-border transactions.

Simplify partnership allocation rules

The proposal would provide that allocations attributable to nonrecourse liabilities must be paid in accordance with the partners' interest in the partnership. By simplifying the partnership allocation rules, and ensuring that allocations of partnership items reflect the economic substance of the partnership relationship, the proposal eliminates unnecessary complexity for many partnerships.

Closing of partnership year with respect to deceased partner

The proposal would close the taxable year of the partnership with respect to a partner whose entire interest terminates, whether by death, liquidation, or otherwise. By aligning the treatment of deceased partners, the proposal provides uniform treatment for partners whose entire interest in a partnership terminates.

Simplification of partnership termination rules
The proposal would modify section 708(b)(1)(B) of the Internal Revenue Code to provide that a partnership terminates only upon the sale or exchange of 50 percent or more of the interests in the partnership, if the interests are sold or exchanged in one transaction, or a series of related transactions. By eliminating the potential for inadvertent terminations of partnerships and incorporating the step transaction doctrine, this proposal ensures that a technical termination of a partnership only results from the coordinated sale or exchange of one half of the interests in the partnership.

Simplification of partnership distribution rules
The proposal would modify the rules relating to distributions of partnership property to require adjustments to partnership basis in remaining partnership property following distributions of partnership property that reduce the partner's interest. In addition, the proposal would modify the rules relating to distributions of stock to a corporate partner, to require the corporation whose stock was distributed to reduce the basis of its assets if the corporate partner owns 80 percent by vote or value of the stock distributed.

Simplify foreign partnership reporting requirements
The proposal would clarify that a foreign partnership engage in a United States trade or business is required to file a return, require annual information reporting by United States partners of controlled foreign partnerships, and conform the reporting rules and penalties relating to changes in ownership and transfers to foreign partnerships to those applicable to foreign corporations. By rationalizing the reporting requirements of foreign partnerships and eliminating distinctions between requirements applicable to foreign corporations, these proposals simplify administration in this area.

Clarify partnership debt-equity rule
The proposal would clarify that a partnership realizes cancellation of indebtedness income upon the transfer by the partnership of a partnership interest to a creditor in satisfaction of a debt. By providing a rule that mirrors the treatment of corporate stock for debt exchanges, the proposal clarifies the law of partnerships in bankruptcy and provides greater parity among the tax treatment of business entities.

Clarify the statute of limitations for pass-through entities
The proposal would clarify that the individual's return, not the pass-through entity's return, starts the running of the statute of limitations. By codifying the rule established by the Supreme Court for S corporations in Bufferd, the proposal provides certainty for partnerships, S corporations, and certain trusts.

Financial Products Simplification

Life-nonlife consolidation
The proposal would repeal section 1504(b)(2) of the Internal Revenue Code, and related provisions, to allow life insurance companies maximum ability to file consolidated returns.

Safe harbor for captive insurance companies
The proposal would establish a safe harbor providing that insurance premiums paid to a wholly-owned subsidiary are deductible provided such premiums, combined with any other premiums paid by related parties, do not exceed 50 percent of the total premiums received by the captive insurer for the taxable year. By providing a safe harbor for determining the nature of captive insurers, this proposal provides much needed certainty and should eliminate costly litigation in this area.

Simplify application of policy interest rates
The proposal would modify section 808(d)(1)(B) of the Internal Revenue Code to require use of the greater of the prevailing State assumed rate or the applicable federal rate for purposes of calculating excess interest. By eliminating inconsistencies in the calculations of policy interest rates, the proposal simplifies taxpayers' recordkeeping requirements.

Safe harbor permitting RICs to avoid PFIC treatment
The proposal would establish a safe harbor under which regulated investment companies (RICs) would be relieved of the onerous burden of determining whether foreign investments are treated as passive foreign investment companies. If a RIC owns less than 10 percent of the outstanding stock of a foreign company and less than 5 percent of the RIC's assets are invested in the holding, a RIC would not be required to apply the PFIC rules. By providing this safe harbor, this proposal simplifies the tax treatment of RICs significantly.

International Simplification

Simplify exchange rates used in translating foreign taxes
The proposal would simplify the rules for translating foreign tax payments into dollar amounts by providing for translation using average exchange rates for the taxable year to which the taxes relate. By reducing the amount of time necessary to calculate deemed paid foreign tax credits, this proposal simplifies recordkeeping and administration of these rules.

Simplify foreign tax credit limitation for individuals
The proposal would allow taxpayers with no more than $300 ($600 in the case of joint returns) of creditable foreign taxes, and no foreign source income other than passive income, to claim their foreign tax credit directly on Form 1040 if the income is shown on a payee statement. By eliminating the necessity to complete the complex Form 1116, this proposal simplifies the treatment of passive foreign income that is subject to information reporting.

Simplify rules applicable to dispositions of interests in controlled foreign corporations
The proposal would simplify the treatment of income derived from the disposition of stock in a controlled foreign corporation, including deemed dividend treatment for gains on dispositions of lower-tier controlled foreign corporations, proportional reduction in the taxation of subpart F income in the year of disposition for acquiring United States shareholders, and repeal of the limitation on look-through treatment of certain dividends to United States shareholders out of earnings from periods during which the recipient was not a United States shareholder. By

rationalizing these rules, these proposals greatly simplify the operation of controlled foreign corporations.

Tentative carryback adjustments for foreign tax credits
The proposal would extend the application of section 6411 of the Internal Revenue Code, which allows taxpayers to file an application for tentative carryback and refund adjustments, to foreign tax credit carrybacks.

Eliminate PFIC/CFC overlap
The proposal would eliminate the overlap of the passive foreign investment company (PFIC) and controlled foreign corporation (CFC) rules by treating a PFIC that is also a CFC as if it is not a PFIC with respect to its 10 percent United States shareholders. By eliminating the unnecessary and duplicative overlap of these rules, this proposal eliminates complex calculations for taxpayers already subject to the complexity of subpart F.

Simplify foreign tax credit limitation baskets
The proposal would merge all 10-50 corporation foreign tax credit limitation baskets into a single 10-50 basket, except those associated with passive foreign investment companies. By reducing the complexity and compliance burdens of taxpayers owning between 10 and 50 percent of a foreign corporation, this proposal reduces the bias against participation in foreign joint ventures by United States companies through affiliates that are not majority owned.

Repeal high-tax kick out rule
The proposal would repeal section 904(d)(2)(A)(iii)(III) of the Internal Revenue Code, which excludes any high-taxed income from the foreign source passive income basket used to calculate the foreign tax credit. By eliminating a significant source of complexity in the calculation of foreign tax credits, the proposal simplifies the treatment of passive foreign investments.

Regulatory authority for same country exception
The proposal would permit the Secretary to issue regulations under section 954(c)(3)(A) of the Internal Revenue Code, treating certain countries or possessions as a single country for purposes of the same country exception of subpart F. This authority would allow multinational companies to consolidate their operations in covered countries or possessions when such countries or possessions participate in common markets.

Mark-to-market election for PFIC shareholders
The proposal would allow shareholders of passive foreign investment companies with "marketable" stock to avoid application of the interest-charge method by electing to mark their PFIC shares to market annually. By allowing taxpayers who are unable to use the present law current inclusion method, this proposal provides greater flexibility to investors in passive foreign investment companies.

Elimination of uniform capitalization rules applicable to certain foreign corporations
The proposal would eliminate the application of the uniform capitalization rules of section 263A of the Internal Revenue Code to foreign corporations that do not conduct business in the United

States. By eliminating the requirement of uniform capitalization inventory adjustments for these corporations, this proposal significantly simplifies the calculation of earnings and profits of foreign subsidiaries.

Repeal of sailing permit requirement

The proposal would repeal the requirement for aliens to obtain a certificate ("sailing permit") from the IRS district director prior to departure from the United States. By replacing a rule that often is ignored by taxpayers and the IRS with a requirement that aliens file a year-to-date tax return within 90 days of their permanent departure from the country, this proposal simplifies the tax treatment of departing aliens.

Simplify application of trading safe harbor

The proposal would repeal section 864(b)(2)(C), which prohibits the use of a principal office within the United States for purposes of qualifying for the securities and commodities safe harbors. Current law has the effect of shifting certain administrative jobs from the United States to foreign tax havens, and generally increases the cost of operating investment funds designed to attract foreign investors, but does not serve to prohibit any tax abuse.

Election to calculate earnings and profits using GAAP

The proposal would allow taxpayers to calculate the earnings and profits of foreign corporations using generally accepted accounting principles (GAAP). This election would allow taxpayers to avoid expensive and time consuming adjustments.

Appendix I
Taxpayer Rights Supplementary Information

Taxpayer Rights Proposals

Offers in compromise
The proposal would require the Commissioner to ensure that national and local expense allowances give taxpayers adequate means to provide for basic living expenses when considering an offer in compromise.

Eliminate interest differential.
The proposal would amend section 6621 of the Internal Revenue Code to eliminate the differential between interest rates applicable to overpayments and underpayments of tax. By eliminating the necessity for and complexity of interest netting, the proposal furthers the goal of fundamental fairness for taxpayers and generally simplifies tax administration.

Eliminate application of failure to pay penalty during period of installment agreement
The proposal would amend section 6651 of the Internal Revenue Code to eliminate the application of the failure to pay penalty during periods when a taxpayer is in compliance with an installment agreement entered into pursuant to section 6159 of the Internal Revenue Code. Taxpayers who have entered into an agreement to pay their tax liabilities, including interest, should not continue to be penalized.

Taxpayers' right to installment agreement
The proposal would amend section 6159 of the Internal Revenue Code to require the IRS to enter into an installment agreement for amounts that do not exceed $10,000, upon request by the taxpayer, if the taxpayer has not been delinquent in filing returns or paying tax shown due thereon at any time during the prior five years, and has not qualified under this safe harbor previously.

Payment of taxes
The proposal would require tax payments to be made to the order of the Treasurer, United States of America. Because the IRS receives much of the backlash for policies and activities that are not within or completely within its control and this backlash is encouraged by writing checks payable to the order of the IRS. This change properly reflects the true recipient of tax dollars and promotes payment as our social responsibility for the funding of federal government operations and programs.

Seed money for clinics representing low-income taxpayers
The proposal would authorize the IRS to establish a program to support the creation of clinics representing low-income taxpayers. By establishing a program for awarding grants to endow such clinics, this proposal would help to ensure that low-income taxpayers involved in controversies with the IRS could obtain representation. This program also will conduct outreach and education to populations that do not speak English as a first language.

Clarify and expand the jurisdiction of Tax Court
The proposal would clarify that a Tax Court order of refund is appealable, but the Tax Court does not have jurisdiction to review refund offsets. The proposal also would expand the jurisdiction of the Tax Court to issue declaratory judgments regarding an estate's initial or continuing eligibility for an extension of time for payment of estate tax pursuant to section 6166 of the Internal Revenue Code. Finally, the proposal would increase the jurisdictional limit of section 7463 to $25,000, and index that amount prospectively, to provide streamlined procedures for taxpayers to appeal IRS determinations in informal proceedings.

Centralize cataloging and review of complaints and Board oversight
The proposal would require the IRS to centralize the cataloging and review of taxpayer complaints of IRS misconduct on an individual employee basis. The proposal also would require the Commissioner and Taxpayer Advocate to establish guidelines for internal review and discipline of IRS employees, and the Board of Directors to ensure independent oversight of IRS internal review. This function would be similar to that performed by citizen's police boards that monitor internal police reviews. The proposal also would require the IRS to establish a toll-free number for taxpayers to register complaints, to be included in Publication 1.

Require IRS employees to explain taxpayers their rights
The proposal would amend section 7521 of the Internal Revenue Code to require IRS employees to notify taxpayers of their rights prior to commencing any interview or examination, to inquire whether the taxpayer understands these rights, and to inquire whether the taxpayer is represented by an attorney, accountant, or enrolled agent, in which case the interview or examination should be terminated until such time as the taxpayer's representative is present. Taxpayer should be informed of their right to have the examination take place in a reasonable place and that the place does not have to be the taxpayers' home. In addition, taxpayers should be required to be notified of the reasons for selection of their return for examination upon notification of the examination. Finally, the proposal would require the IRS to provide taxpayers with a written explanation of the applicable burdens of proof on taxpayers and the IRS.

Joint and several liability
The proposal would require the IRS to clearly alert taxpayers of their joint and several liabilities on tax forms. A discussion of the possible consequences of joint and several liability should be included in the instructions to the various tax forms and publications.

Procedures relating to extensions of statute of limitations
The proposal would amend section 6501(c)(4) of the Internal Revenue Code to require IRS employees to notify taxpayers of their right to refuse to extend the applicable statute of limitations, or to limit such extension to particular issues.

Penalty administration
The proposal would require the Taxpayer Advocate to prepare a study and provide an independent report to Congress by July 30, 1998 reviewing IRS penalty administration and the implementation of penalty reform recommendations made by Congress in the Omnibus Budget

Reconciliation Act of 1989, including legislative and administrative recommendations to simplify penalty administration and reduce taxpayer burden.

Individual/joint tax treatment
The proposal would require the Secretary to prepare a study on the feasibility of treating each individual separately for tax purposes, including recommendations for eliminating the marriage penalty, addressing community property issues, and reducing burden for divorced and separated taxpayers.

Burden of proof
The proposal would require the General Accounting Office to prepare a report on the burdens of proof for the taxpayer and the IRS in a dispute. This report should highlight the current differences between criminal (IRS and non-IRS) and civil burdens of proof. In addition, the report should examine the differences between the burdens of proof for individuals in civil IRS disputes versus other civil disputes with the federal government, and should comment on the impact of changing these burdens on tax administration and taxpayer rights.

Protection of taxpayer information
The proposal would require the Joint Committee on Taxation to evaluate whether the Congress should encourage the IRS to accept the recommendation of the American Institute of Certified Public Accountants to provide administrative forbearance of requests by the IRS to obtain tax advice or planning memoranda from the files of taxpayers' advisors, except in cases referred for criminal investigation.

Additional Discussion of Taxpayer Rights Proposals

Taxpayers' redress
The Commission recommends a significant expansion in providing taxpayers' redress for IRS malfeasance. The purpose of this expansion is twofold: first, to compensate the taxpayer for the damages he has suffered from IRS misconduct; and, second, to reinforce for IRS management the importance of improving the performance of IRS personnel.

There historically has been a concern that expanding taxpayer rights to redress would be disruptive to collection efforts. Setting aside the issue of whether it is appropriate that taxpayers should be provided rights only to the extent that it does not disrupt collection efforts, the Commission found no evidence that the rights to redress and collection of representation fees provided to the taxpayer under the Omnibus Taxpayer Bill of Rights and Taxpayer Bill of Rights 2 have caused disruption to IRS collection efforts. In addition, the costs of expanding taxpayers' redress have been vastly overestimated. For example, the costs of reimbursing representation fees was originally estimated to be over $100 million per year. The actual cost has been approximately $5 million per year.

Penalties, interest payments and installment agreements.
The Commission heard from a number of sources that because of high interest payments and penalties it is very difficult for many taxpayers to resolve their tax disputes with the IRS. These

high penalties and interest payments are created to raise revenue, not to act as a deterrence to taxpayers. The penalties and interest payments are often at a level where they actually are a significant disincentive for many taxpayers to reach an agreement with the IRS. In addition, the penalties and interest payments (coupled at times with unreasonably low living allowances) are so heavy a burden that taxpayers will enter an agreement only to find later that they cannot meet the terms.

In addition to high penalties and interest payments, the Commission also heard from many sources that it is sometimes difficult for taxpayers to obtain installment agreements or offers in compromise. The Commission heard testimony that there is wide geographic variance in taxpayers getting installment agreements or offers in compromise. The Commission believes that installment agreements and offers in compromise can be useful in resolving tax disputes and should not be discouraged.

The Commission believes that the recommendations on penalties, interest payments and installment agreements will help relieve the unnecessary burdens placed on taxpayers to come into compliance and pay their taxes. The recommendations will benefit taxpayers, should increase revenues in the long term, and improve voluntary compliance.

Tax clinics

The purpose of the tax clinics is twofold: to provide representation for low-income taxpayers and perform outreach to certain populations. The IRS does not aggressively conduct outreach to taxpayers who that do not speak English as a first language.

The Commission believes the work of the clinics will benefit the IRS. By providing representation and counseling, the clinics will eliminate many frivolous cases. The clinics will also help ensure that actions brought are only for meritorious issues and are done in a professional manner—thereby minimizing the burden for the courts and the IRS.

The tax clinics will be required as part of their work to perform outreach and education to populations that do not speak English as a first language. This effort will encourage greater voluntary compliance. The Commission intends that the funds only provide seed money and that the tax clinics should be self-supporting within five years.

Use of surveys to obtain taxpayer feedback

The Commission found that several states, foreign countries and some parts of the IRS use surveys to get customer feedback. Surveys give taxpayers an opportunity to share their opinion on the services provided and also assist management in improving services.

Examples of surveys are included below. The first is a survey provided by the State of Florida to taxpayers who have been audited by independent contractors hired by the state to perform audits of businesses. The second is a “Customer Satisfaction Survey” developed by the IRS Office of Appeals, which will be distributed to taxpayers starting in July 1997.

State of Florida Survey:

1. Did your Notification of Audit advise you of the taxes to be audited, audit period and records the auditor would need?
2. Did the auditor make an appointment with the appropriate person at your office?
3. Was the auditor usually on time for appointments?
4. During the pre-audit interview, or shortly thereafter, did the auditor:
    a. Explain the areas of your business to be examined?
    b. Explain the general audit process and the approach?
    c. Explain the applicable tax issues for your type of business?
    d. explain your taxpayers rights?
5. Did the auditor usually try to minimize the disruption to your business operations?
6. Did the auditor conduct the audit in a professional, courteous manner?
7. Did the auditor offer assistance that would help you comply with Florida's tax statutes?
8. Before or during the exit interview, did the auditor:
    a. Provide the audit workpapers and adjustments?
    b. Explain the audit issues and results?
    c. Explain your hearing and appeal rights?
9. Did the auditor educate you and your staff in the correct method of tax application for any errors?
10. Have you undergone an audit by any other governmental agency?
    a. If yes by whom?
    b. Based on the questions above, how did this audit compare?

Office of Appeals Survey:

Taxpayer Name:
Field Exam____ Office Exam____Service Center____ Collection____

How did you learn about the IRS Office of Appeals?
IRS employee____ IRS publication____ Previous knowledge____
Taxpayers representative____ Other_____

At the IRS Appeals conference were you the:
Taxpayer____ Taxpayer's representative____

At the conclusion of the Appeals process, did you reach:
Agreement on all of the issues____ Agreement on only some of the issues____
No agreement on any of the issues____

Please rate your level of satisfaction with each of the following items:

1. The time it took to hear from Appeals after you notified the IRS that you wanted an Appeals conference:
    Completely satisfied____
    Somewhat satisfied ____
    Neither satisfied nor dissatisfied____
    Somewhat dissatisfied ____
    Completely dissatisfied ____
    Unable to answer ____

2. The time it took for the Office of Appeals to schedule you initial conference after they first contacted you:
   Completely satisfied____
   Somewhat satisfied ____
   Neither satisfied nor dissatisfied____
   Somewhat dissatisfied ____
   Completely dissatisfied ____
   Unable to answer ____

3. The time it took to get you case through the Office of Appeals process:
   Completely satisfied____
   Somewhat satisfied ____
   Neither satisfied nor dissatisfied____
   Somewhat dissatisfied ____
   Completely dissatisfied ____
   Unable to answer ____

4. The IRS explanation of the Appeals process *before* you went to Appeals:
   Completely satisfied____
   Somewhat satisfied ____
   Neither satisfied nor dissatisfied____
   Somewhat dissatisfied ____
   Completely dissatisfied ____
   Unable to answer ____

5. The Appeals officer's explanation of the appeals process:
   Completely satisfied____
   Somewhat satisfied ____
   Neither satisfied nor dissatisfied____
   Somewhat dissatisfied ____
   Completely dissatisfied ____
   Unable to answer ____

6. Appeals correctly applied the law to the facts in your case:
   Completely satisfied____
   Somewhat satisfied ____
   Neither satisfied nor dissatisfied____
   Somewhat dissatisfied ____
   Completely dissatisfied ____
   Unable to answer ____

7. Appeals was fair in resolving your case:
   Completely satisfied____
   Somewhat satisfied ____
   Neither satisfied nor dissatisfied____
   Somewhat dissatisfied ____
   Completely dissatisfied ____
   Unable to answer ____

8. Appeals was impartial in resolving your case:
   Completely satisfied____
   Somewhat satisfied ____
   Neither satisfied nor dissatisfied____

Somewhat dissatisfied ____
Completely dissatisfied ____
Unable to answer ____

9. Your overall experience with the Appeals process:
   Completely satisfied____
   Somewhat satisfied ____
   Neither satisfied nor dissatisfied____
   Somewhat dissatisfied ____
   Completely dissatisfied ____
   Unable to answer ____

Did the Appeals officer inform you of the following:

a. How much you owed? Yes____No____
b. How the amount you owed was computed? (if you asked)
   Yes_____ No_____ Not applicable_____
c. About your payment options.
   Yes____ No____ Not applicable____

Would you use Appeals again?
Yes ____ No____ Not Sure ____

Is there anything the IRS could do to improve the Appeals process?
Don't Know ____ No ____
Yes (please explain) _____
_____
_____

Quality review

The improvement in quality of examination will mean that many taxpayers no longer will be subject to groundless assessments by the IRS. However, it also means that many taxpayers may face additional assessments. Reviews by the GAO and Internal Audit have found that poor quality of audit has often translated into the IRS not making proper assessments against a taxpayer.

The tables below provide an historical review of the sustension and recovery rates for the IRS in Appeals and the Tax Court. Table I-1 shows the recovery rates in appeals since fiscal year 1992. Table I-2 provides details by case size for the recovery rates for "S" cases (under $10,000, no appeal allowed and informal rules of evidence) and regular docketed cases in Tax Court. Table I-3 shows the closures and recovery rates for "S" and regular docketed tax cases closed between fiscal year 1992 and fiscal year 1996.

Table I-1. Recovery Rates in Appeals

	FY 1996	FY 1995	FY 1994	FY 1993	FY 1992	FIVE YEAR TOTAL
Nondocketed						
Number of Work Units Closed	43,731	42,281	41,576	43,281	44,347	215,216
Additional Tax and Penalties:						
• **Proposed ($1,000)**	11,623,092	9,893,945	8,629,987	8,507,266	8,891,067	47,545,357
• **Revised ($1,000)**	3,880,121	2,877,568	2,384,268	2,519,875	2,588,071	14,249,903
Percent Recovered	33.38%	29.08%	27.63%	29.62%	29.11%	29.97%
Docketed						
Number of Work Units Closed	20,136	19,059	22,148	23,378	25,140	109,861
Additional Tax and Penalties:						
• **Proposed ($1,000)**	2,043,079	2,341,895	2,939,049	2,492,774	3,194,118	13,010,915
• **Revised ($1,000)**	435,602	615,915	768,859	447,616	832,348	3,100,340
Percent Recovered	21.32%	26.30%	26.16%	17.96%	26.06%	23.83%
Total						
Number of Work Units Closed	63,867	61,340	63,724	66,659	69,487	325,077
Additional Tax and Penalties:						
• **Proposed ($1,000)**	13,666,171	12,235,840	11,569,036	11,000,040	12,085,185	60,556,272
• **Revised ($1,000)**	4,315,723	3,493,483	3,153,127	2,967,491	3,420,419	17,350,243
Percent Recovered	31.58%	28.55%	27.25%	26.98%	28.30%	28.65%

TERMS:

Work units - Historically Appeals has tracked its inventory in “works units”. A work unit generally involves one or more related taxpayers for one or more periods, for which the protests contain substantially the same primary issue. A work unit can , and often does, involve more than one tax return.

Additional Tax and Penalties - All of the docketed amounts and the bulk of the nondocketed amounts represent District proposed deficiencies (as defined in IRC Sec. 6211). However, the nondocketed figures also contain adjustments which are not subject to Tax Court jurisdiction. This includes cases referred to Appeals by Collection such as Trust Fund Recovery cases and Offer in Compromise cases.

SOURCE: Office of the National Director of Appeals, IRS

Table I-2. Recovery Rates by Case Size Cumulative through September 1996
Consolidated (except TEFRA)

Disposals / revenue yield	TOTAL	ZERO	1 TO 300	301 TO 6,000	6,001 TO 99,999	100,000 TO 499,999
(Disposals / revenue yield statistics include workunits with closing codes 03, 04, 05, 08, 11, 12, 13, 14, 15 ar						
Nondocketed						
Workunits	43731	6438	1902	18006	13901	2436
Proposed deficiency	11623092K	533368K	297843	37054K	339362K	472935K
Proposed deficiency/workunit	265786	82847	157	2058	24413	194144
Revised deficiency	3880121K	369205K	14482	18805K	169030K	184463K
Revised deficiency/workunit	88727	57348	76	1044	12160	75724
Revenue yield	33.38%	69.22%	48.44%	50.75%	49.81%	39.00%
Docketed						
Workunits	20136	167	315	9965	7862	1416
Proposed deficiency	2043079K	5651K	70396	22707K	219557K	286050K
Proposed deficiency/workunit	101464	33840	223	2279	27926	20213
Revised deficiency	435602K	1134K	41198	8593	87194K	92518K
Revised deficiency/workunit	21633	6791	131	862	11091	65338
Revenue yield	21.32%	20.07%	58.52%	37.84%	39.71%	32.34%
Total						
Workunits	63867	6605	2217	27971	21763	3852
Proposed deficiency	13666171K	539019K	368239	59761K	558918K	758985K
Proposed deficiency/workunit	213979	81608	166	2137	25682	197037
Revised deficiency	4315723K	370339K	185480	27398K	256223K	276981K
Revised deficiency/workunit	67574	56070	84	980	11773	71906
Revenue yield	31.58%	68.71%	50.37%	45.85%	45.84%	36.49%

TERMS: Same as Table I-1

SOURCE: Office of the National Director of Appeals, IRS

Table I-3. Closures and Recovery Rates for "S" and Regular Docketed Tax Cases Closed FY 1992 - FY 1996

		Case Type				
Year	**"S"[1]**	**0-$10K**	**$10K-100K**	**$100K-$1M**	**$1M-$10M**	**>$10**
FY 1992						
• Closure	13,226	7,612	9,889	3,038	489	
• Recovery Rate (%)	49.6	55.6	47.8	40.9	29.7	27
FY 1993						
• Closure	12,678	6,785	9,597	3,055	521	
• Recovery Rate (%)	47.7	56.5	48.7	47.2	36.2	20
FY 1994						
• Closure	11,745	7,662	10,217	3,195	648	1
• Recovery Rate (%)	47.1	53.7	46.5	44.0	44.5	25
FY 1995						
• Closure	9,872	5,633	8,086	2,562	473	
• Recovery Rate (%)	49.1	58.3	48.7	40.1	35.7	32
FY 1996						
• Closure	11,903	6,161	7,967	2,664	463	
• Recovery Rate (%)	45.7	62.6	48.0	39.6	32.4	18

Note 1: "S" cases are under $10,000, no appeal allowed and informal rules of evidence

Terminology and Definitions - Office of Chief Counsel

Recovery Rate: the percentages of taxes recovered in a settlement or litigated case to the amount of tax in dispute (Tax Owed on Decision / Tax in Dispute). Tax in Dispute is the amount of tax in the statutory notice and petition. Tax Owed on Decision is the amount of tax as found in the decision and stipulation and reflects the redetermined deficiency after application of carrybacks and other allowances from years not in dispute. Accordingly, the recovery rate reflects the result of litigation reduced by these carrybacks and other allowances.

Sustension Rate: Sustension rate is the percentage of taxes sustained in a settled or litigated case to the amount of tax in dispute (Deficiency Sustained / Tax in Dispute). Tax in Dispute is the amount of tax in the statutory notice and petition. The Deficiency Sustained is the deficiency in dispute as redetermined in the decision and stipulation before application of carrybacks and other allowances from years not in dispute.

Sustension rate data is available only for docketed cases closed in fiscal years 1994 and 1995 involving corporate cases with over $10 million dollars in dispute and CEP cases. This data historically had not been collected within Chief Counsel's information systems. However, Counsel has begun to collect sustension rate data on large corporate cases in order to evaluate litigation results more accurately (i.e. prior to the application of carrybacks from other nonlitigation tax years).

SOURCE: Office of Chief Counsel, IRS

Appendix J
Feedback From Field Hearings

The Commission held three field hearings outside Washington, D.C. in the following cities:

- Cincinnati: March 21, 1997
- Omaha: April 4, 1997
- Des Moines: May 12, 1997

The turnout at the field hearings was high. Although held during the workday, over 100 people of all ages and backgrounds attended each hearing to listen or participate. (A list of speakers and their affiliations is attached.) The speakers included ordinary taxpayers, accountants, enrolled agents, current and former IRS employees, and tax return preparers. Although focusing on different issues, most expressed unhappiness with either the current tax system or the way it is being administered. Many of the same concerns were raised at all of the field hearings.

Tax complexity. There was virtually unanimous agreement that the tax code is too complex and needs to be simplified. There was broad agreement that many of the things that the IRS is blamed for can be laid at the feet of Congress. Not a great deal of thought is given to the administration of provisions that are being considered by Congress or its interplay with other provisions of the tax code. The assumption is that once a provision is enacted, it can be made to work by the IRS, and that any failings in this area are the fault or problem of the IRS.

Administration of the tax system. There was widespread sentiment that the quality of interactions with the IRS has deteriorated. Although many blame the recent IRS budget cuts, it is unclear that funding is the sole answer.

Notices
Many taxpayers and practitioners complained that notices are either indecipherable or not very helpful in explaining the issue being raised.

Taxpayer response
The mechanism for taxpayers to respond to IRS notices is not working. Many taxpayers have difficulty contacting the IRS—either by telephone or through face to face contacts. When contact occurs, the results are often unsatisfactory. Many times the IRS cannot adequately explain the problem. This is a result of an inability to access relevant data through IRS computers or a lack of understanding of the issue. Often, it is difficult to reach the right IRS person. Depending on the nature of the action, the taxpayer must either deal with a service center, a district office, or some other location. There is no centralized or one-stop service point.

When taxpayers are required to make multiple contacts, the process often starts all over again. It is nearly impossible to reach the same IRS person twice. Often, the second person is unaware of the problem raised and has no indication what action, if any, has been taken to deal with the

problem. This is very frustrating for taxpayers. Often, practitioners advise that if small dollar amounts are at stake, the taxpayer should just pay the money demanded even if the IRS is wrong. This does not encourage respect for the IRS or the tax system.

IRS response
Even when the taxpayer responds timely to an IRS notice—through a letter or a telephone contact—there is no certainty that the IRS is aware of the contact. Often, a second notice or other action is taken by the IRS independent of the taxpayer action. Unlike the private sector and other government agencies, there is no one caseworker assigned to most IRS notices. When names and telephone numbers of IRS personnel are given, the person often cannot be reached. This further frustrates and angers taxpayers.

Many taxpayers resent the serious penalties for failing to respond to an IRS notice promptly and correctly while the IRS often takes its time in responding to taxpayers. Usually, there is no certainty that the IRS has received and acted on a taxpayer communication.

Taxpayer service. Taxpayers testified that the quality of service being provided by the IRS has been decreasing noticeably over the past few years. As discussed above, taxpayers using the telephone often have trouble getting through. The number of IRS offices and the available hours are decreasing. As part of its plan to reorganize operations, the IRS has been closing or reducing the functions of many local offices. In places like Omaha and Des Moines this means either no access or a long drive to the nearest IRS office.

A taxpayer who needs an IRS form or publication often has to resort to the IRS toll-free number to order such items. Even if a taxpayer gets through, the response time is slow. A number of practitioners and taxpayers complain that it takes four to six weeks to get the forms.

Training and quality. There is almost universal agreement that the IRS has cut back significantly on training. This has continued to increase the knowledge gap between practitioners and IRS employees. In addition to providing incomplete or incorrect information to taxpayers, many practitioners resent having to provide training to an auditor who is examining their client's return. It is also unclear that the IRS is providing its examiners with the tools needed to research tax questions and keep up with changes.

IRS personnel. Although many witnesses complemented IRS personnel on doing a difficult job, a significant number were concerned that the IRS does not properly oversee its personnel. Some witnesses testified that they had encountered rude, abusive, or unhelpful IRS personnel, but had no sense that management was willing to do anything about it. Some IRS employees noted that supervisors are unwilling to take corrective action because of the difficulty of firing poor performers. Overall, taxpayers believe there is no striving for excellence. Trust and respect of the IRS is decreasing. Although many view the IRS as doing a difficult job, a number of individuals were concerned that the IRS retaliates against those who criticize it.

Electronic filing. Although the IRS is encouraging practitioners to file electronically, it has not done enough to increase its appeal. The two most common complaints include the need to file

paper signature documents (Form 8453), and that some forms cannot be filed electronically—such as the AMT and fuels credit tax forms.

Earned income tax credit. From an administration standpoint, everybody who mentioned the earned income tax credit (EITC) raised concerns, including: 1) it is a social welfare program that the IRS is not equipped to administer; 2) the large number of persons with questionable eligibility applying for it; 3) the frustration of practitioners that certain individuals are improperly taking it; 4) the difficulty in applying it; and 5) resentment that practitioners are being asked to police the credit. The Commission did not hear from any recipients of EITC, however.

Cycle time. The time it takes to interact with the IRS to resolve a problem is taking longer and longer, according to practitioners. Some of this is due to the reorganization and some to the slowness of the IRS. The bottom line is that it costs more to deal with the IRS. Although the IRS speaks of doing a quality job, there is no sense that this is taken seriously.

IRS management. Although the IRS describes itself as a financial services organization, the feedback from the hearing indicates the IRS does not have much appreciation for modern business management practices, customer service, or financial services. One former executive noted that the IRS sometimes takes actions to solve a problem before it has the facts on what the problem actually is and what the solution should be. Moreover, some IRS employees believe that their input is routinely ignored by Washington. Seeking input is a formality. Practitioners also fault the IRS for ignoring their input.

Witnesses

Cincinnati Hearing, March 21, 1997

Richard E. Ayres	Accountant
Peter Beck	CPA
Mark Berliant	Attorney
Marlene Bunten	IRS Problem Resolution
Felicia Calvert	Private Citizen
Jeff Dickstein	Lawyer
Michael Enriquez	Tax Consultant
Linda Gill	CPA
Steve Herrington	IRS Union Representative
Martin Horwitz	Attorney
Roger Hoyer	Private Citizen
Mary Malotke	Small Business Owner
George Quirk	Retired
Patricia Stone	Former IRS Employee
Diana Thompson	Enrolled Agent
Marianne Wilson	Small Business Owner

Omaha Hearing, April 4, 1997

Elayne Goldstein	IRS Problem Resolution
Edward Jacksha	Retired Businessman
Dean Jungers	CPA
Howard Kaplan	Attorney
Janice Mumm	CPA
Gary Radil	Attorney
Charlotte Roscoe	IRS Union Representative
Ray Scholl	Tax Practitioner
Joan Shuminski	Enrolled Agent
Todd Timm	IRS Employee
Samuel Walker	College Professor
Bob Wolfson	Businessman

Des Moines Hearing, May 12, 1997

Diana Baberol	IRS Problem Resolution
Bill Brown	Lawyer
Judy DeSantis	Drug Enforcement Agent
Curtis Jenkins	Retired IRS District Director
Burns Mossman	Attorney
Rick Oelerich	Enrolled Agent
Merle Richardson	Retired Farmer
Richard A. Rue	Businessman
Randy Schabacker	National Treasury Employees Union
Jeffery Strawhacker	CPA
Judy Vande Zandschulp	Enrolled Agent
Cliff Wilson	Small Business Owner

Appendix K
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