

**Additional Validation and Increased
Oversight Are Needed to Effectively
Implement the Internal Revenue Service
Restructuring and Reform Act of 1998**

May 2000

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

May 4, 2000

MEMORANDUM FOR COMMISSIONER ROSSOTTI

A handwritten signature in black ink that reads "Pamela J. Gardiner". The signature is written in a cursive, flowing style.

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Additional Validation and Increased Oversight Are Needed to Effectively Implement the Internal Revenue Service Restructuring and Reform Act of 1998

This report presents the results of our review of the Internal Revenue Service's (IRS) implementation of the IRS Restructuring and Reform Act of 1998 (RRA 98).¹

In summary, we found the IRS used an aggressive, proactive approach with appropriate consideration to the level of executive involvement needed to implement this complex legislation. However, to effectively implement RRA 98, the IRS needs to develop accurate action plans, conduct additional validation of completed action items, and increase oversight of the training and implementation efforts by officials responsible for legislative sections or provisions.

IRS management agreed that these actions need to be taken and has already begun to take action on our recommendations. Management's comments have been incorporated into the report where appropriate, and the full text of their comments is included as an appendix.

¹ Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may call Walter E. Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs), at (770) 455-2475.

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Executive Summary

On July 22, 1998, the President signed into law the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98).¹ The purpose of RRA 98 was to amend the Internal Revenue Code of 1986 and to restructure and reform the IRS. Many of the specific sections (also called provisions) of RRA 98 are complex and affect a broad range of taxpayers in a variety of significant ways. Implementation will result in the most extensive restructuring of the IRS and its governing laws in the last 40 years.

This audit is part of coverage scheduled in the Treasury Inspector General for Tax Administration (TIGTA) Fiscal Year 1999 Audit Plan. Our overall objective was to evaluate the IRS' planning and implementation of RRA 98. We reviewed the process for identifying, coordinating, and monitoring necessary actions and evaluated the effectiveness of the IRS' implementation of selected provisions of RRA 98.

Results

The IRS' implementation team for RRA 98 used an aggressive, proactive approach, giving appropriate consideration to the level of executive involvement needed to implement this complex legislation. The Chief Operations Officer established a network of accountability by assigning executive owners for the individual sections of RRA 98. However, to effectively implement RRA 98, the IRS needs to develop accurate action plans, conduct additional validation of completed action items, and increase oversight by officials responsible for legislative provisions.

An Extensive Accountability Network Was Established to Manage the Implementation Effort

IRS executives were assigned as provision owners with responsibility for implementation of RRA 98 provisions. These executives developed implementation plans and tracked the overall implementation effort on-line with an IRS internal computer system. The National Resource Center was established to provide consistent coordination required by RRA 98. Field coordinators were appointed as local points of contact for IRS employees.

¹ Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685

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The Provision Report Used to Manage the Conversion Effort Was Not Always Accurate and Complete

Inaccurately recorded or missing action items resulted in misleading or incomplete information on action plans, which were combined into the Provision Report. In response to our concerns, the Deputy Chief Operations Officer required all provision owners to review the Provision Report for accuracy and prepare files of documentation to support the status of each action. Additionally, the RRA 98 implementation team performed a 100 percent review of Request for Information Services (RIS) requirements that resulted in several additional RIS actions being identified as needing submission to Information Systems or addition to the action plan.

Critical Actions Necessary to Implement Failure to Deposit Penalty Provisions Were Not Implemented Timely

Necessary actions were not taken to ensure effective implementation of RRA 98 § 3304, Mitigation of Failure to Deposit Penalty. Penalty notices to taxpayers were not revised, revisions to publications did not provide important information on new taxpayer rights, and the Provision Report used by management to track implementation actions was not accurate. The provision owner did not provide necessary oversight and validation over implementation actions. Consequently, numerous incomplete penalty notices were issued, and business taxpayers may have paid penalties that they are entitled to have abated. We reported these issues to management, and corrective actions have been initiated to partially address them.

Training Efforts Need to Be Strengthened to Ensure All Employees Are Effectively Trained on the Internal Revenue Service Restructuring and Reform Act of 1998 Provisions

Effective employee training is critical to the successful implementation of RRA 98. Provision owners realized that training would be required for many of the provisions. Numerous training methods were used to provide employees with critical information as quickly as possible. However, provision owners did not identify or track the employees who should be or were trained on provisions of RRA 98 and have not adequately evaluated the effectiveness of their training efforts.

Other Audit Reports Have Identified Issues with the Implementation of Various Provisions of the Internal Revenue Service Restructuring and Reform Act of 1998

TIGTA's Office of Audit has conducted several annual audits that are required by RRA 98. Separate reports have been issued for each of these audits, and these reports

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identified additional issues related to implementation of RRA 98. In addition to these reports, audit work is currently being conducted covering various other specific provisions of RRA 98, such as the Innocent Spouse provision.

Summary of Recommendations

We recommend that the Deputy Chief Operations Officer's staff periodically review documentation that supports the implementation of critical actions to ensure they effectively meet the requirements of the legislation.

In order to ensure that RRA 98 § 3304, Mitigation of Failure to Deposit Penalty, is effectively implemented, we recommend several actions for the Assistant Commissioner (Examination). We recommend he ensure that clear procedures are provided to Service Centers regarding use of the stuffer form, identify taxpayers who still need information on their penalty abatement rights, and provide additional oversight until full implementation of this provision is completed.

In order for RRA 98 training to be effectively provided, we recommend procedures be established to require that provision owners take control over the training effort for their provisions.

Management's Response: IRS management agreed to the recommendations made in this report and has already begun taking corrective action to address these issues. A five-point plan was developed by the RRA 98 Executive Steering Committee to strengthen the implementation process.

Service Centers were contacted to ensure that they understood the requirements for use of the stuffer form, and taxpayers who required notification of their potential abatement rights were identified and contacted. Periodic coordination meetings are now being held between Masterfile programmers and the Office of Interest and Penalty Administration to ensure that the final phase of implementation for the RRA 98 § 3304 is addressed effectively.

Lastly, all future initiatives of the nature of RRA 98 will have centralized end-to-end accountability for training by provision owners. To ensure that senior management is aware of the tools available to centrally manage this type of training, the Chief Human Resource Officer will communicate the tracking capabilities of the Administrative Corporate Education System to them as part of the transition to the new IRS structure.

Management's complete response to the draft report is included in Appendix VIII.

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Objective and Scope

The overall objective of this audit was to evaluate the Internal Revenue Service's (IRS) planning and implementation of the IRS Restructuring and Reform Act of 1998 (RRA 98).¹ To accomplish our objective, we reviewed the process for identifying, coordinating, and monitoring actions taken to implement RRA 98 and evaluated the effectiveness of the IRS' implementation of selected sections (also called provisions) of RRA 98.

We used the results of a TIGTA risk analysis to select specific provisions to evaluate as part of this audit.

Prior to this review, the Treasury Inspector General for Tax Administration's (TIGTA) Office of Audit conducted a risk analysis of RRA 98 provisions. Risk was defined as the IRS' inability to protect taxpayer rights, reduce taxpayer burden, protect revenue, develop economical processes, and/or implement changes to Information Technology.

We reviewed essential implementation actions and training plans for each of the provisions selected for our audit.

In selecting the provisions to include in this audit, we used the results of the risk analysis and intentionally avoided selection of provisions that were included in other TIGTA audits. The provisions selected are detailed in Appendix VI.

Our audit was performed in Atlanta, Andover, Cincinnati, Dallas, and Washington, D.C. between April and October 1999. This audit was performed in accordance with *Government Auditing Standards*.

Details of our audit objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

¹ Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685

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Background

Implementation of RRA 98 will result in the most extensive restructuring of the IRS and its governing laws in the last 40 years.

The Chief Operations Officer assigned executives to be owners of the various provisions of RRA 98 and gave them oversight responsibilities for the provisions.

The Taxpayer Treatment and Service Improvements Program Office opened the RRA 98 Home Page website to control and monitor implementation of RRA 98.

On July 22, 1998, the President signed RRA 98 into law. The purpose of RRA 98 was to amend the Internal Revenue Code of 1986 and to restructure and reform the IRS. Implementation will result in the most extensive restructuring of the IRS and its governing laws in the last 40 years.

The Chief Operations Officer was assigned overall responsibility for providing oversight for the implementation of RRA 98. As of July 1, 1998, the Chief Operations Officer assigned functional executives to be owners of the various provisions of RRA 98 and gave them oversight responsibilities for these provisions. On July 6, 1998, the National Resource Center (NRC) was established to provide consistent coordination of policy and program questions or issues that may arise from the implementation of RRA 98. As of March 15, 1999, more than 1,100 inquiries had been submitted and more than 66 guidance memoranda had been posted to the NRC website.

On August 18, 1998, the Taxpayer Treatment and Service Improvements Program Office established an Intranet website to control and monitor implementation of RRA 98. This website identifies all significant provisions of RRA 98 on a webpage titled Provision Report. The Provision Report is a primary control used by IRS management in the planning and implementation of RRA 98. This on-line report identifies the effective date of each provision, the owner function, the overall implementation status, and all of the actions needed to fully implement each provision. Many of our audit tests were designed to determine the accuracy and effectiveness of this management control.

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Results

The IRS approach was proactive and considered needed executive involvement. However, to effectively implement RRA 98, the IRS needs to develop accurate actions plans, conduct additional validation of completed action items, and increase oversight by officials responsible for legislative provisions.

The IRS' implementation team for RRA 98 used a proactive approach, giving appropriate consideration to the level of executive involvement needed to implement this complex legislation. However, to effectively implement RRA 98, the IRS needs to develop accurate action plans, conduct additional validation of completed action items, and increase oversight by officials responsible for legislative provisions.

An Extensive Accountability Network Was Established to Manage the Implementation Effort

Provision owners have complete responsibility for implementation of their provisions, although actions may cross various functional areas.

Before the final version of RRA 98 was signed into law, the Chief Operations Officer assigned individual implementation ownership of the provisions of RRA 98 to IRS Assistant Commissioners. These executives designated individuals on their staffs to act as their representatives in ensuring that these provisions were implemented. This was a unique approach because many actions necessary to implement each provision would cross functional lines. Regardless of whether some or many actions on their action plans would be completed by other functions, provision owners were assigned responsibility for the complete implementation of their provisions.

These executives worked in conjunction with the RRA 98 team to develop implementation plans for the provisions. An Executive Steering Committee (ESC) was established to track the implementation effort. A tracking program was established on the IRS' internal computer system, so provision owners could easily update provision status and to allow on-line monitoring of the implementation effort.

In addition, the NRC was established to provide consistent coordination of policy and program questions

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or issues that may arise from the implementation of RRA 98. The IRS identified and trained approximately 185 RRA 98 field coordinators to be the local points of contact for coordination and questions in each district, region, and service center.

The IRS Office of the Chief Counsel worked actively to help the IRS implement RRA 98 by providing advice, drafting or assisting in drafting necessary guidance for both taxpayers and IRS employees, and developing training materials. The Office of the Chief Counsel also provided significant support to the NRC.

Establishing executive responsibility is an initial step in the implementation process. Executives need to provide consistent monitoring and oversight to ensure critical actions are taken.

However, establishing the executive network is just an initial step in the implementation process. The executives must provide consistent monitoring and oversight to ensure critical actions are taken to implement the legislation. Weaknesses in this oversight have resulted in various implementation problems. Most of the remainder of this report details these issues and makes recommendations to address them.

The Provision Report Used to Manage the Conversion Effort Was Not Always Accurate and Complete

As stated earlier, the Provision Report was a primary control used by IRS management in the planning and implementation of RRA 98. This on-line report identifies the effective date of each provision, the owner function, the overall implementation status, and all of the necessary actions needed to fully implement each provision.

The Provision Report was not consistently maintained and updated. This resulted in misleading or inaccurate information being reported to provision owners.

Provision owner representatives did not consistently maintain and update the Provision Report. Some essential actions were inaccurately recorded or missing from the Provision Report. Consequently, provision owners relied upon misleading or incomplete information to monitor the major developments and progress of the implementation. Examples of

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inaccuracies or missing items in the Provision Report can be found in Appendix VI.

The Deputy Chief Operations Officer emphasized the importance of having accurate and complete descriptions on action plans at several ESC meetings. Even with this emphasis, the Report was not properly maintained by the various provision owner representatives. Several of these representatives explained that the magnitude of this legislation was so overwhelming that it was hard to keep everything up-to-date. Another mentioned that the cross-functional implementation concepts were new, and it was hard to get the individual action owners to grasp their responsibilities. Another representative relied heavily on the individual action owners to keep their actions accurately recorded and did not conduct much oversight.

In response to our concerns, the Deputy Chief Operations Officer required that provision owners review the accuracy of and prepare files to document the status of each action item.

In response to our initial memorandum dated June 22, 1999 (see Appendices IV and V), the Deputy Chief Operations Officer required all provision owners to review the Provision Report for accuracy and prepare documentation files to support the status of each action. In addition, she initiated a 100 percent review of Requests for Information Services (RIS), which usually require computer programming changes, to ensure that all required system changes related to RRA 98 were made.

The RIS review resulted in several additional RIS actions being identified as needing submission to Information Systems or added to the action plan. These actions included the following:

- *Section 3304, Mitigation of Failure to Deposit Penalty* - Two additional RISs have been submitted and one additional RIS will be submitted at a later date.
- *Section 3401, Due Process in IRS Collection Actions* - One additional RIS was added to the action plan.

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- *Section 3506, Statements Regarding Installment Agreements* - One additional RIS was prepared.

We may conduct follow-up reviews to determine the impact of the delays in implementing the system changes associated with these RIS actions.

Recommendation

In addition to actions management has already taken in response to our memorandum, we recommend that:

1. The Deputy Chief Operations Officer's staff conduct periodic reviews of documentation maintained in the Provision Report files to support key implementation actions to ensure that actions were taken timely and that they met the requirements of RRA 98.

Management's Response: The IRS was proactive in formulating an implementation strategy. Executive accountability was established for each provision before enactment of the legislation. The implementation team worked diligently to scrutinize provision action plans and identify potential issues. These issues were discussed at an ESC established to track implementation progress and resolve issues.

During June 1999, the ESC discussed steps that could be taken to strengthen the implementation process. Based on this discussion, the ESC agreed to a five-point plan. First, a comprehensive review of all RISs, which seek computer programming changes, would be made to determine RIS accuracy and to identify additional RIS requirements. Second, all forms and publications revisions were reviewed for content accuracy. Third, provision owners were required to establish files for each provision that contain the documentation for each completed action. Fourth, provision owners were asked to review implementation actions for provisions yet to become effective at ESC meetings. Fifth, an independent review of action plans for accuracy, completeness, and timeliness was conducted.

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The documentation files have been extensively reviewed at ESC meetings and the implementation team will continue this review, as appropriate.

**Critical Actions Necessary to Implement Failure
to Deposit Penalty Provisions Were Not
Implemented Timely**

The IRS did not take necessary actions to ensure it effectively implemented RRA 98 § 3304 provisions. Penalty notices to taxpayers were not revised, revisions to publications did not provide important information on new taxpayer rights, and the Provision Report used by management to track implementation actions was not accurate. The provision owner did not provide adequate oversight and validation to ensure the necessary actions were taken to implement this section of the law. Consequently, numerous incomplete penalty notices were issued, and business taxpayers may have paid penalties that they are entitled to have abated.

Approximately 540,000 apology letters had to be issued because actions to notify taxpayers of their rights were not taken in a timely manner.

We notified IRS management in a memorandum dated June 22, 1999 (see Appendices IV and V), that actions were needed to address the above issues. IRS management took several corrective actions in response to our memorandum, including issuing an apology letter to all taxpayers who received a Failure to Deposit penalty notice to advise them of their new rights and creating a stuffer form for future notices. We found that the IRS assessed \$678,613,247 in penalties to approximately 505,000 taxpayers. These taxpayers were sent apology letters on July 20, 1999.

However, our further review identified that the apology letters were not sent to all taxpayers who should have received them. Because several processing cycles were not included in the initial analysis, approximately 35,000 additional taxpayers should have received letters. After we notified them of the error, IRS management agreed to perform another analysis and issued the additional apology letters.

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Stuffer forms to be included with penalty notices were not mailed to all taxpayers who should have received them.

In addition, the stuffer forms created to explain the new taxpayer rights were not consistently issued. These stuffer forms were to be included with Business Masterfile penalty notices involving a Failure to Deposit penalty assessment. The required start date for issuance of the stuffer forms was August 2, 1999. We visited three IRS service centers to analyze the stuffer form issuance process and determine whether they were issued in accordance with requirements. None of the service centers began issuing the stuffer forms with the notices on the required start date.

Guidance issued to the service centers on how to use the stuffer forms was unclear.

We found that the guidance issued to the service centers on how to use this form was unclear and that the Office of Interest and Penalty Administration did not proactively address inconsistencies in the issuance process as they occurred. In addition, the process of including these stuffer forms was initially a manual process, requiring intervention from clerical support, rather than an automated process. Lastly, the computer program initiating the use of the stuffer form was not issued to the service centers until August 4, 1999, midway through the first week it was to be used. Consequently, service centers did not consistently or timely begin issuing stuffer forms.

For example, one service center was not clear on which notices required the form. Therefore, it included stuffer forms with many types of balance due notices to business taxpayers, even when these notices did not relate to Failure to Deposit penalties. It also began using the stuffer form one week later than was intended because of the delay in receiving the computer program. Another service center began issuing the stuffer form two weeks later than was intended. The third center's inventory records indicated these stuffer forms were not included with penalty notices until six weeks after they were required. Thus, taxpayers who were issued notices during these periods of delay did not receive the stuffer form.

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Expeditious and consistent implementation of procedures to issue apology letters and stuffer forms would have protected taxpayers' rights.

Therefore, some taxpayers did not receive the information related to their penalty abatement rights, while others may have been confused by information they received that did not relate to their tax situations.

Expeditious and consistent implementation of procedures to issue apology letters and stuffer forms to taxpayers would have protected taxpayers' rights. In order to ensure that this occurred, the provision owner should have tracked and followed up on the progress of these significant action items to ensure the actions were properly completed.

Recommendation

We recommend that the Assistant Commissioner (Examination), the Executive Provision Owner:

2. Ensure that clear procedures are given to service centers on which notices require the stuffer form.
3. Identify those taxpayers who should have received a stuffer form and notify them of their potential abatement rights.
4. Provide additional oversight until full and appropriate implementation of this provision is completed.

Management's Response: IRS management agreed that clear procedures should be provided to the service centers. After TIGTA notified IRS management that they believed some service centers were not correctly implementing the procedures, IRS management contacted the centers to ensure that they correctly understood the requirements for use of the stuffer.

The statement that was on the stuffer is now automatically generated on the Business Masterfile notice when a Federal Tax Deposit (FTD) penalty assessment is present. Therefore, the stuffer is no longer necessary, and no further instructions are needed.

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IRS management identified all taxpayers who required notification of their potential abatement rights and may not have received such notification. An apology letter or a staffer was sent to all of these taxpayers. Therefore, no further action is necessary.

The Office of Interest and Penalty Administration continues to meet with Masterfile FTD penalty programmers and analysts and the IRS Office of the Chief Counsel in developing the RIS and instructions for the final phase of implementation for § 3304 of the legislation.

Training Efforts Need to Be Strengthened to Ensure All Employees Are Effectively Trained on the Internal Revenue Service Restructuring and Reform Act of 1998 Provisions

To effectively implement RRA 98, the IRS was required to initiate a significant number of immediate actions and coordination efforts. Provision owners knew from the beginning that training would be required for many of the provisions. Technical modifications made by the Congress after the date of enactment added further complexities to the implementation process.

Because RRA 98 included provisions that significantly changed the way front-line IRS employees interact with taxpayers, training was critical to ensure these changes were understood and implemented.

Training was critical to ensure that front-line employees were aware of the many changes that affect their day-to-day interaction with taxpayers. Since many provisions were effective upon the date of enactment, it was not possible for the IRS to deliver immediate, up-to-date manuals or technical guidance to front-line employees. Training methods used to provide employees with critical information as quickly as possible included:

- Management awareness memoranda
- Interactive video training
- Website questions and answers

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- Self-study reference guides
- Training conducted at Continuing Professional Education sessions
- Limited formal training

The IRS performed an initial analysis of RRA 98 provisions to identify functions and types of employees who should receive training in the various provisions. This analysis was used in preparing individual RRA 98 training plans for each employee.

Our review indicated that provision owner representatives did not identify or track the employees who should be or were trained on their assigned provisions of RRA 98.

On July 22, 1999, the Commissioner testified before the House Ways and Means Subcommittee on Oversight. He stressed that increased training of employees is essential for delivering on the mandates that the Congress gave and the service taxpayers expect. Additionally, he stated that money in the Fiscal Year (FY) 2000 budget request is essential and will only begin to rectify the RRA 98 training deficit. On May 25, 1999, the Commissioner testified that \$17 million in the FY 2000 budget was to train employees on RRA 98.

However, our review of the training effort indicated that provision owners did not identify or track the employees who should be or were trained on their assigned provisions of RRA 98. Provision owner representatives informed us that district managers maintained training records for their employees. The records were not centralized or forwarded to the provision owners for their management of the training program.

Furthermore, the provision owners have not adequately evaluated the effectiveness of their training efforts. At the time of our review, the only evaluations on the effectiveness of RRA 98 training that we found in our sample of provisions were in the Collection function, and those evaluations covered only Collection function employees.

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The primary reason for the lack of management control over RRA 98 training is that provision owners do not see themselves as responsible for ensuring all required employees receive the necessary training.

The primary reason for the lack of management control over RRA 98 training is that provision owners do not see themselves as responsible for ensuring all required employees receive the necessary training. They believe this is the responsibility of local district management. In addition, although the Chief Operations Officer assigned the overall implementation responsibility to provision owners, they believe each function is responsible for training its own employees on the provisions of RRA 98.

Since provision owners do not maintain and monitor training records and evaluate the effectiveness of training, we were unable to determine whether all required employees were adequately trained on the provisions of RRA 98.

One service center temporarily suspended tax lien filing due to lack of training on RRA 98 provisions.

Audit work performed by another TIGTA audit team identified that one service center temporarily suspended tax lien filing due to lack of training on RRA 98 provisions. This occurred from January 19 through March 22, 1999. During this period, Automated Collection System (ACS) management directed that no Notice of Federal Tax Liens (NFTL) be filed by the ACS until employees received proper training on RRA 98. When a NFTL is not filed, the government's interest in the delinquent taxpayer's assets is not protected, and the taxpayer's other creditors are not notified of their delinquent federal tax liabilities.

Recommendation

The Deputy Chief Operations Officer should establish procedures to ensure:

5. Provision owners take control over the training effort for their provisions. Procedures should require records of employees who need training, employees receiving training, and how effectively the training met objectives.

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Management's Response: IRS management agreed that provision owners could have exercised more control over who attended training and made use of systems already in place, such as the Administrative Corporate Education System (ACES), to accurately track who received the training and its effectiveness. IRS management decided that all future initiatives of this nature will have centralized end-to-end accountability for training by provision owners.

In preparation for Phase 3 training for RRA 98 provisions, Learning and Education Institutes met with provision owners to determine the best approach to embedding all pertinent provisions into the occupational curricula for their functional areas. Each Institute then reached agreement with the provision owners as to the course update schedule where embedding would occur. This effort negates the need to have further, separate training on RRA 98 provisions.

To ensure that senior management is aware of the tools available to centrally manage legislative implementation training, the Chief Human Resource Officer will communicate the capabilities of the ACES to track the delivery and effectiveness of training programs to senior IRS management as part of the transition to the new IRS structure.

**Other Audit Reports Have Identified Issues with
the Implementation of Various Provisions of the
Internal Revenue Service Restructuring and
Reform Act of 1998**

TIGTA's Office of Audit has conducted several audits this year related to implementation of additional provisions of RRA 98. These audits were conducted to meet the requirements of RRA 98. Separate reports have been issued for each of these audits, and this section (and the corresponding appendix) is intended to

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provide a summary of work performed by TIGTA related to RRA 98.

The following audits are among those that have been conducted related to the IRS' implementation of RRA 98. Appendix VII summarizes the results, associated recommendations, and IRS management's response for each of these reports:

- *The Internal Revenue Service Should Improve Its Federal Tax Lien Procedures* (Reference Number 199910074, dated September 1999)
- *The Internal Revenue Service Has Not Fully Implemented Procedures to Notify Taxpayers Before Taking Their Funds For Payment of Tax* (Reference Number 199910071, dated September 1999)
- *The Internal Revenue Service Can Further Improve Its Complaint Processing Procedures and Systems* (Reference Number 199910070, dated September 1999)
- *The Internal Revenue Service Needs to Improve Compliance with Legal and Internal Guidelines When Taking Taxpayers' Property for Unpaid Taxes* (Reference Number 199910072, dated September 1999)
- *The Internal Revenue Service Is Addressing the Use of the Illegal Tax Protestor and Nonfiler Designations* (Reference Number 199910080, dated September 1999)
- *The Internal Revenue Service Should Continue Its Efforts to Achieve Full Compliance with Restrictions on the Use of Enforcement Statistics* (Reference Number 199910073, dated September 1999)
- *The Internal Revenue Service's Procedures for Responding to Written Requests for Collection Activity From Joint Return Filers Vary From Statutory Requirements* (Reference Number 199910077, dated September 1999)

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- *The Internal Revenue Service Needs to Enhance Guidance on and Monitoring of Compliance with Procedures for Directly Contacting Taxpayers and Their Representatives* (Reference Number 199910076, dated September 1999)
- *The Internal Revenue Service Is Now Tracking Potential Fair Debt Collection Practices Act Violations, But May Not Always Be Properly Reporting Violations* (Reference Number 2000-10-014, dated December 1999)
- *The Internal Revenue Service Needs to Improve Its Compliance with Procedures When Processing Requests for Information Under the Freedom of Information Act* (Reference Number 2000-10-058, dated March 2000)

TIGTA's Office of Audit is currently conducting reviews of the IRS' implementation of the Innocent Spouse, OIC, and Third-Party Summons provisions of RRA 98.

The audit work covered by the above-mentioned reports is required annually. In addition, TIGTA's Office of Audit is currently conducting reviews of the IRS' implementation of the Innocent Spouse, Offer-in-Compromise (OIC), and Third-Party Summons provisions of RRA 98. These reports will be issued later in FY 2000. Additional audit work may be conducted covering various other provisions of RRA 98.

Conclusion

The IRS has established an extensive accountability network to manage the implementation of RRA 98. However, the IRS needs to increase oversight of legislative efforts by provision owners. Employee training needs to be enhanced and monitored to ensure front-line employees effectively implement provisions of RRA 98. Without additional oversight by provision owners, the IRS risks not effectively implementing legislative requirements and may deny taxpayers their rights.

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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the Internal Revenue Service's (IRS) planning and implementation of the IRS Restructuring and Reform Act of 1998 (RRA 98).¹ We evaluated the effectiveness of the IRS' implementation of selected sections (also called provisions) of RRA 98 and the process for identifying, coordinating, and monitoring necessary actions.

We primarily focused on the overall planning and implementation of RRA 98. Our audit concentrated on internal controls, required actions, and issues associated with planning and implementation. To evaluate whether these controls were operating effectively, we tested some specific sections of the law to determine whether those sections had been appropriately implemented.

The Treasury Inspector General for Tax Administration's (TIGTA) Office of Audit conducted a risk analysis of RRA 98 provisions. Risk was defined as the IRS' inability to protect taxpayer rights, reduce taxpayer burden, protect revenue, develop economical processes, and/or implement changes to Information Technology. For our review, we selected a judgmental sample of RRA 98 provisions based on this assessment of risk (see Appendix VI). To accomplish our overall objective, we:

- I. Evaluated the effectiveness of the IRS' process for identifying, coordinating, and monitoring the necessary actions to implement RRA 98.
 - A. Determined whether the IRS identified all provisions of RRA 98 that need to be implemented.
 - 1) Determined whether National Office management is using the Provision Report webpage on the RRA 98 website to monitor the implementation of all significant provisions of RRA 98.
 - 2) Matched all of the provisions controlled on the Taxpayer Treatment and Service Improvements (TSI) RRA 98 website to the provisions published as part of RRA 98 and reconciled any differences.

¹ Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685

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- B. Determined whether all IRS functions that are needed to implement RRA 98 had been identified.
- 1) Interviewed National Office management to determine who assigned the functional responsibilities for implementing the individual provisions of RRA 98 to determine:
 - a) Whether these persons were knowledgeable and acting within the scope of their authority.
 - b) Whether each individual provision was assigned to an IRS executive and whether the executive was responsible for the overall implementation of the provision.
 - c) Whether functional responsibilities were assigned in a manner that prevents duplication of efforts.
 - 2) Evaluated the Provision Report webpage to determine whether these reports indicated involvement by necessary functions.
- C. Determined whether all necessary actions needed to implement RRA 98 had been identified.
- 1) Interviewed National Office management to determine whether there was cross-functional representation in the process used to select the necessary actions.
 - a) Obtained and reviewed the minutes from the Executive Steering Committee, provision owner, and other pertinent meetings.
 - (1) Identified implementation actions discussed in each of these meetings.
 - (2) Determined whether the actions identified in these meetings were posted to the Provision Report webpage.
 - b) Determined whether the IRS had involved the IRS Office of the Chief Counsel and Legislative Affairs functions in the implementation.
 - (1) Interviewed IRS Office of the Chief Counsel and Legislative Affairs executive management to determine to what extent they have been involved in this implementation.
 - (2) Determined whether these two functions are providing technical guidance and, if so, in what form.
 - 2) Reviewed General Accounting Office, IRS, and TIGTA memoranda, reports, and news articles related to the implementation.

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- a) Determined whether these sources were used to derive additional actions and whether these actions were posted to the RRA 98 Provision Report.
 - b) Identified any other sources of implementation actions, through discussions with TSI personnel.
- D. Determined whether effective monitoring processes had been established to ensure provision implementation is accurately tracked and reported to responsible officials.
- 1) Interviewed National Office management, using an internal control questionnaire, to obtain an understanding of the internal control system or plan they are using to implement RRA 98.
 - 2) Interviewed provision owners in each function to obtain an understanding of their responsibilities to validate and verify reported implementation information.
 - 3) Interviewed TSI personnel to determine their validation and reporting responsibilities.
 - 4) Evaluated the current Provision Report to identify inconsistencies and questionable information. Discussed these issues with the responsible TSI analyst(s).
 - 5) Selected nine provisions based on a risk assessment and evaluated several essential actions from each provision that were reported as complete to determine whether these actions were taken and whether they adequately address the associated provision.
- II. Determined whether selected provisions of RRA 98 have been effectively implemented.
- A. Determined whether necessary actions had been completed or planned for our sample of provisions.
- 1) Obtained the most current Provision Report and action plans for our sample of nine selected provisions.
 - a) Contacted provision owners' designated representatives responsible for report input to discuss implementation actions and to obtain and review training records, Requests for Information Services (RIS) submitted to the Information Systems function, revised notices, stuffer forms, and publications, and any other evidence used to support completed actions.
 - b) Reviewed notices, stuffer forms, publications, and RISs to determine whether they adequately reflect legislative requirements for the provision.

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- c) Determined whether actions listed adequately address the intent of the provision and whether additional actions are needed.
 - d) Reviewed training plans and records that are used to ensure all required employees are trained on the provisions of RRA 98.
 - e) Evaluated actions that are not yet completed to determine whether delays in completion could adversely affect taxpayers.
- 2) Determined whether policy and program guidance posted to the Intranet is available to front-line employees who need the information.
- a) Interviewed administrators for the National Resource Center (NRC) and TSI websites, the Taxpayer Electronic Bulletin Board, and any other electronic sites for RRA 98 information to determine the following:
 - (1) Do they have any statistical information on the number and type of employees who have access to each of the above sites?
 - (2) Have they performed an analysis of source of who accessed their websites?
 - b) Selected a sample of questions and answers posted on the NRC website and determined whether the employee who asked the question received the necessary information to answer his/her question.
 - c) Interviewed provision owners' designated representatives and TSI officials to determine their reliance on the Intranet to communicate to front-line employees.
 - d) Interviewed TSI analysts to determine if the IRS initiated actions resulting from questions or input received by the NRC.
 - (1) Did the actions adequately address issues identified through NRC input?
 - (2) Are additional actions needed to address employee comments and concerns?
- 3) Determined what audit results the other TIGTA reviews identified relating to implementation of RRA 98.
- a) Evaluated audit plans for RRA 98 audits currently being performed by other TIGTA offices to determine coverage that would relate to this review.

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- b) Periodically discussed audit results in these areas with Audit Managers and Senior Auditors for each of these reviews and incorporated these results into our overall audit report.
- c) Maintained liaison and coordination with other audit teams conducting the current year filing season review and the Year 2000 Filing Season readiness review.

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Appendix II

Major Contributors to This Report

Walter E. Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs)

Gary E. Lewis, Director

Tammy Whitcomb, Audit Manager

Michael Laird, Senior Auditor

James Popelarski, Senior Auditor

George Franklin, Auditor

Allen Gray, Auditor

Steven Holmes, Auditor

Susan Price, Auditor

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Appendix III

Report Distribution List

Deputy Commissioner Operations C:DO
Chief Operations Officer OP
Deputy Chief Operations Officer OP
Executive Officer for Service Center Operations OP:SC
Assistant Commissioner (Collection) OP:CO
Assistant Commissioner (Customer Service) OP:CS
Assistant Commissioner (Employee Plans/Exempt Organizations) OP:E
Assistant Commissioner (Examination) OP:EX
Assistant Commissioner (Forms and Submission Processing) OP:FS
Director, Office of Program Evaluation and Risk Analysis M:O
National Director, Taxpayer Treatment and Service Improvements C:DO:TSI
National Director of Appeals C:AP
National Director for Legislative Affairs CL:LA
Office of the Chief Counsel CC
Office of Management Controls M:CFO:A:OMC

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Appendix IV

**Memorandum #1: The Internal Revenue Service Has Not Effectively Implemented
Failure to Deposit Penalty Provisions of the Internal Revenue Service
Restructuring and Reform Act of 1998**



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20226

June 22, 1998

RESPONSE DATE: July 7, 1998

MEMORANDUM FOR DEPUTY CHIEF OPERATIONS OFFICER

Gary E. Lewis

FROM: Gary E. Lewis
Acting Regional Inspector General for Audit

SUBJECT: The Internal Revenue Service Has Not Effectively
Implemented Failure to Deposit Penalty Provisions of the
IRS Restructuring and Reform Act of 1998

During our audit of the Internal Revenue Service's (IRS) implementation of the Restructuring and Reform Act of 1998 (RRA'98), we identified problems with implementation of the failure to deposit penalty provisions (Section 3304). We previously forwarded these concerns informally via electronic mail for your information. Within 15 calendar days, please agree in writing to the facts in the memo, or provide the basis for any disagreement.

The overall objective of our review is to evaluate the IRS' efforts to implement provisions of the RRA'98. Our review includes:

- An assessment of the effectiveness of the IRS' processes for identifying, coordinating, and monitoring the necessary actions to successfully implement the Act; and,
- An evaluation to determine if selected provisions of the Act have been effectively implemented.

We conducted a risk analysis of all non-mandatory provisions of RRA'98, in which we defined risk as the IRS' inability to protect taxpayer rights, reduce taxpayer burden, protect revenue, develop economical processes, and implement changes to Information Technology. We judgmentally selected nine provisions of RRA'98 to conduct our audit tests based on our assessment of risk.

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Background

Implementation of RRA'98 will result in the most extensive restructuring of the IRS and its governing laws in the last 40 years.

On July 22, 1998, President Clinton signed into law the IRS Restructuring and Reform Act of 1998. The purpose of this Act was to amend the Internal Revenue Code of 1986 and to restructure and reform the IRS. Implementation of RRA'98 will result in the most extensive restructuring of the IRS and its governing laws in the last 40 years. Many of the specific provisions of the Act are complex and affect a broad range of taxpayers in a variety of significant ways.

Section 3304 of RRA'98 allows taxpayers to avoid cascading failure to deposit penalties by designating the tax period to apply their payment and allows for waiver of the penalty when filing requirements change. The taxpayer must make this designation during the 90 calendar days immediately following the date of an IRS penalty notice. This section of the law became effective for deposits required on or after January 19, 1999 (180 days after the date the legislation was signed).

The IRS's ability to waive the failure to deposit penalty has been expanded.

This section also expands the IRS's ability to waive the failure to deposit penalty. The IRS may waive the penalty for the first deposit a taxpayer is required to make after the taxpayer is required to change the frequency of payroll deposits. To have the penalty waived, the taxpayer must meet net worth requirements and must have filed a timely employment tax return.

Results

The IRS did not take necessary actions to ensure it effectively implemented Section 3304 provisions. Penalty notices to taxpayers were not revised, revisions to publications and the new revenue procedure do not provide important information on new taxpayer rights, and provision reports used by management to track implementation actions were

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not accurate. The provision owner did not provide necessary oversight and validation to ensure that the adequate actions were taken to implement this section of the law. Consequently, numerous incomplete penalty notices have been issued, and business taxpayers may have paid penalties that they are entitled to have abated.

IRS Did Not Revise Failure To Deposit Penalty Notices to Reflect the New Provisions

The legislation allows taxpayers to avoid cascading failure to deposit penalties.

To ensure taxpayers were aware of their right to designate application of the Federal Tax Deposit (FTD) payment, penalty notices should have been revised to reflect this new legislation. However, the action plan for this provision did not include an action to revise these penalty notices, and therefore they were not revised.

We determined that 2,223,968 penalty notices have been generated through June 12, 1999.

We are currently working to quantify the number of penalty notices that have been issued, and the resulting taxpayer impact. Initially, we determined that the IRS generated 2,223,968 penalty notices from January 19 through June 12, 1999. We cannot determine how many taxpayers have received these notices because some taxpayers may have received more than one notice. We also could not determine how many taxpayers would have qualified for relief from the penalties because some notices generated during this period regard tax deposits made prior to the effective date of provision 3304.

Failure to deposit computer paragraph (CP) penalty notices are generated in the payroll penalty section of IRS service centers. According to the provision owner representative, the principal notices used to notify taxpayers of a failure to deposit penalty assessment include:

CP 102 - Math error on F-941 resulting in a net balance due.

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CP 103 - Math error on Form CT-1 resulting in a net balance due.

CP 161 - Notification of the tax, penalty and interest due for a tax return without a math error.

CP 207 - Notification of impending failure to deposit penalty assessment to be made without schedule of liabilities.

The provision owner representative advised us that the amount of work required to implement this legislation is overwhelming, and that the failure to revise the notices was a mistake. Efforts are currently underway to develop an interim stuffer to include in penalty notices, and in the future to revise penalty notices to include a statement to reflect this provision. These recent efforts need to be documented in the provision report for further tracking.

Revisions to the Publications and the New Revenue Procedure Do Not Provide Complete Information to Taxpayers on Their New Rights as Provided by Section 3304.

Taxpayers rely on publications prepared by the IRS to assist them in preparing their tax returns. The IRS is obligated to produce publications that clearly explain taxpayer rights provided by new tax legislation. To explain the new provisions of Section 3304, IRS revised several publications, and published a new Revenue Procedure.

Information in publications did not clearly explain taxpayers' new rights.

We found that the publication revisions regarding application of FTD payments include very limited information related to the change, and continue to use confusing examples that were used before the law was changed. In addition, the revisions related to the waiver of penalty when filing requirements change do not give sufficient information on the criteria that must be met to receive this waiver. The new revenue procedure does not explain the expanded penalty waiver that could apply when a

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taxpayer's deposit schedule changes. See *Attachment 1* for our analysis of the specific publications.

The provision owner representative told us that the publications were not revised to provide a complete explanation of taxpayer's rights because a detailed discussion is beyond the scope of the publications. She indicated that the explanation would be more appropriate in the penalty notice.

Provision Reports for Section 3304, Used by Management to Determine Implementation Status, Are Not Accurate.

The actions on the Provision Report do not address future requirements of Section 3304. Section 3304 requires that any deposits made after December 31, 2001 must be automatically applied to the most recent period or periods within the specified tax period to which the deposit relates. The action plan includes two actions, actions 247 and 879, to accomplish this part of provision 3304. We were provided with documentation to show the programming changes, Requests for Information Services (RIS) # TCP-8-0068 and # TCP-9-0027, as supporting documentation for these completed actions. However, neither RIS satisfies the requirements of provision 3304.

Our review disclosed that there is no validation of actions reported as complete.

Our review disclosed that there is no validation of actions reported as complete. The provision owner representative depends on the action item owners to complete their tasks. Therefore, there is no verification that completed actions were actually performed, or that they actually satisfy legislative requirements.

Conclusion

The IRS should provide appropriate explanations in notices and publications to ensure taxpayers are advised of their new rights under provision 3304.

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Timely and accurate modifications to processing systems are necessary to ensure taxpayers are protected from cascading penalty assessments. Management should perform validation to ensure that actions are completed accurately and thoroughly address the legislative provisions.

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Attachment 1

Analysis of Publications

**Publication 51 (Circular A)
Agricultural Employer's Tax Guide**

This revision does not fully explain taxpayer's new rights. The revision states,

"You may be able to designate the period to which a deposit applies after you receive a penalty notice."

Immediately succeeding the above sentence, Pub 51 provides a detailed explanation of how the taxpayer's tax deposits will be applied on a FIFO basis. We believe this space could have been used to better explain the taxpayer's rights. For example, the space could have been used to provide the following information,

"Taxpayers may now designate the application of a deposit of taxes to a period or periods within the return period to which the deposit relates. The designation must be made during the 90 days immediately following the date of a IRS penalty notice informing the taxpayer that a penalty has been imposed for the return period to which the deposit relates. Designation may not be made with the deposit. It is allowed only after a penalty notice is sent."

**Publication 80 (Circular SS)
Federal Tax Guide for Employers in the U.S. Virgin Islands,
Guam, and American Samoa**

The revision is the same as the revision we noted in Pub 51.

**Publication 179
Federal Tax Guide for Puerto Rican Employers**

The revision of Spanish publication 179, Federal Tax Guide for Puerto Rican Employers contains the same language as in the above publications 80 and 51.

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**Publication 334
Tax Guide for Small Business**

The revision of Pub 334, *Tax Guide for Small Business*, does not fully explain taxpayer's relief from failure to deposit penalties. Pub 334 states,

"In some cases, the IRS can waive the penalty for failure to timely deposit employment taxes for first-time depositors. For deposits required after January 18, 1999, this waiver is expanded to include the first deposit required after a required change in frequency of deposits. See Publication 15 for more information."

There is no mention of the criteria that must be met for a taxpayer to qualify for the waiver. Taxpayers must meet the net worth requirements applicable for an award of attorney's fees (generally \$2 million for individuals and \$7 million for corporations), and they must file their employment tax return on or before the due date. We believe this information should be provided to taxpayers so they can determine whether they qualify for the penalty waiver. Furthermore, Pub 15 does not provide additional information.

**Publication 225
Farmer's Tax Guide**

The revision to *Publication 225, Farmer's Tax Guide*, states,

"If you are late the first time you are required to deposit employment taxes, the IRS may waive the penalty. To qualify you must have filed your employment tax return on time."

There is no mention of the net worth requirement or the expanded waiver.

**Publication 553
Highlights of 1998 Tax Changes**

The revision of *Publication 553* also falls short of providing taxpayers with the information they need to understand their rights under provision 3304.

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Appendix V

Management's Response to Memorandum #1

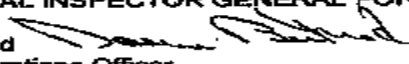


OPERATIONS OFFICER

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

July 15, 1999

MEMORANDUM FOR ACTING REGIONAL INSPECTOR GENERAL FOR AUDIT

FROM: Darlene R. Berthod 
Deputy Chief Operations Officer

SUBJECT: The Internal Revenue Service Has Not Effectively
Implemented Failure to Deposit Penalty Provisions of the
IRS Restructuring and Reform Act of 1998

We appreciate the opportunity to review and comment on your recent memorandum entitled "The Internal Revenue Service Has Not Effectively Implemented Failure to Deposit Penalty Provisions of the IRS Restructuring and Reform Act of 1998." We also thank you for meeting with us to discuss the draft memorandum. We believe the discussion was beneficial. As we stated in the meeting, we agree with a number of the issues raised in your memorandum and are taking steps to correct the deficiencies.

IRS Did Not Revise Failure To Deposit Penalty Notices to Reflect the New Provisions

(1) TIGTA Finding: "... penalty notices should have been revised to reflect this new legislation."

We agree with this finding. The provision owner immediately initiated several actions to correct the deficiency cited. Key actions include:

- Preparing three key Requests for Information Services (RIS) and holding high level pre-RIS meetings;
- Advising taxpayers of their new rights and other changes made by the provisions of section 3304 through contact with payroll services, professional associations, and a news release;
- Including interim staffers in notices issued (until final programming of the penalty notice is completed) to advise taxpayers of the provisions of section 3304(a) and (b);

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- Developing an apology letter to send to all first quarter 1999 penalty notice recipients advising them of the provisions of section 3304(a) and (b); and
- Facilitating tracking by revising the provision report to add recent actions taken, and also actions to be taken in the future.

We have taken the necessary steps to correct the problem, and to ensure that taxpayers are not harmed. In our recent press release, a copy of which is attached, we state that IRS will give taxpayers 90 days from the date of the apology letter it sends them to call and make a deposit designation, rather than 90 days from the notice's date.

(2) TIGTA Finding: "Initially, we determined that the IRS generated 2,223,966 penalty notices from January 19 through June 12, 1999."

As we discussed with your staff at our meeting, it is difficult to quantify the number of taxpayers impacted by section 3304. We have done some preliminary testing which has resulted in an estimate of impacted taxpayers far fewer than the number quoted in your memorandum.

(3) TIGTA Finding: "These efforts need to be documented in the provision report for further tracking."

We concur with this finding. As stated earlier, we have revised the provision report to incorporate and document recent efforts. We have also added, for tracking purposes, actions we will take in the future.

Revisions to the Publications and the New Revenue Procedure Do Not Provide Complete Information to Taxpayers on Their New Rights as Provided by Section 3304.

(1) TIGTA Finding: "We found that the publication revisions regarding application of FTD payments include very limited information related to the change, and continue to use confusing examples that were used before the law was changed."

We agree with your finding that our presentation about the new rules in Publication 51 was confusing and did not clearly explain taxpayers' new rights. Specifically, we could improve clarity and eliminate confusion by placing the sentence you quote in your memorandum relating to the change after the example you referenced. However, we believe that the wording of the example needs to remain the same because it accurately describes the current statutory method for allocating deposits. The new method does not become effective until 2002; at that time we will change the example.

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As we discussed at our meeting with your staff, we do not agree that the amount of information in our publications is too limited. A detailed explanation of the new "designation of deposit" rules is beyond the scope of the employment tax publications. The better place for the explanation is in the penalty notice itself, since employers can only designate their deposits after receiving a penalty notice, and by following the process outlined in Revenue Procedure 99-10. We believe that extensive coverage in the publications of these complex rules would be counterproductive and only serve to confuse employers. For that reason, we included only a brief mention of the new rules in our publications for awareness purposes. In the publications for year 2000, we will also include a reference to the Revenue Procedure. This was not possible in the 1999 editions since they went to print before the Revenue Procedure was issued. It should be noted that the penalty notice will also refer to the designation of the deposit rules in Revenue Procedure 99-10. We continue to believe that this is the right approach for informing and educating employers about these new rights.

- (2) TIGTA Finding: ". . . the [publication revisions] related to the waiver of penalty when filing requirements change do not give sufficient information on the criteria that must be met to receive this waiver."

The reasoning described above for not providing extensive coverage regarding the "designation of deposit" rules in our employment tax publications also applies to the penalty waiver. Our publications are intended to provide employers with the information they need to voluntarily comply with their tax obligations; in this case, information on how to deposit, when to deposit, and brief information about the penalties that could apply if deposits are not made timely. Since the law does not allow employers to claim a penalty waiver at the time they make deposits, it would not be appropriate to cover these rules in detail. We believe that doing so could send an unintended message that employers are not required to timely deposit if they are depositing for the first time or if their schedule of deposits change. Because this was the first year of the law change, we decided to briefly mention the waiver in some of our publications for awareness purposes only. We believe that the proper vehicle for informing and educating taxpayers about the issue is through the notice process, because the waiver can only apply when a penalty notice is about to be issued.

- (3) TIGTA Finding: "Attachment 1 . . . Publication 334, Tax Guide for Small Business."

The noted reference in Publication 334 ("See Publication 15 for more information.") was in error and will be removed in the 2000 edition.

- (4) TIGTA Finding: "The new revenue procedure does not explain the expanded penalty waiver that could apply when a taxpayer's deposit schedule changes."

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We do not believe that this procedure requires a revenue ruling or revenue procedure to explain it. As we discussed at our meeting with your staff, we believe that the penalty waiver was clear on its face. The Service issues only a limited number of revenue rulings and procedures. The decision as to what guidance will be published by the IRS is made jointly by the Chief Counsel, the Commissioner, and the Assistant Secretary of the Treasury (Tax Policy). The penalty waiver in section 3304 appears to us to be explicit about when it applies and to whom and, therefore, does not require additional explanation in a revenue procedure. However, we agree that the penalty waiver should be communicated to taxpayers at an appropriate time, and we will do so through the notice process.

Provision Reports for Section 3304, Used By Management to Determine Implementation Status, Are Not Accurate.

(1) TIGTA Finding: ". . . there is no validation of actions reported as complete. The provision owner representative depends on the action item owners to complete their tasks. Therefore, there is no verification that completed actions were actually performed, or that they actually satisfy legislative requirements."

Prompted by your finding, I have reminded the provision owners that they are specifically accountable for ensuring all the action items listed in their provisions are complete, accurate, and timely. Additionally, the provision owners and I have identified additional steps that will be immediately taken to strengthen the entire implementation process. These steps, discussed in the attached paper, provide for:

- a 100-percent independent review of RIS actions with a view toward both ensuring all RRA98 provisions have the information systems support they need and learning lessons that can be applied to the implementation of future tax legislation. (The RRA 98 RIS review results have been shared with a task force conducting a broader review of the RIS process);
- a comprehensive review of forms and publications for accuracy and to see if they could be made more helpful to taxpayers;
- a personal review by the provision owners of the documentation for all closed actions to ensure that they are truly closed and the establishment of files containing such documentation;
- a review of the action plans for provisions yet to become effective to ensure they are complete and up to date, as well as scheduling these provisions for discussion during upcoming RRA98 ESC meetings; and

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- a fresh look, by a different executive or staff person, at the action plans for provisions already effective to ensure accuracy, completeness, and timeliness.

Summary

I can assure you that we are making every effort to remedy the deficiencies noted in your memorandum. Thank you for keeping your commitment to bring findings to our attention immediately, rather than wait until you issued your final report. This has allowed us to take corrective action now, and better meet our common interest of making sure taxpayers receive all the expanded rights provided by RRA98.

If you have any questions or need additional information, please call me at (202) 622-6860 or a member of your staff may call the provision owner, Thomas W. Wilson, Jr., Assistant Commissioner (Examination), at (202) 622-4400.

Attachments (2)

cc: Commissioner
Deputy Commissioner Operations
Chief Officers
RRA 98 Provision Owners

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Attachment

**IRS RESTRUCTURING AND REFORM ACT OF 1998 (RRA98)
Treasury Inspector General for Tax Administration (TIGTA)
Implementation Review Actions
June 15, 1999**

On June 14, 1999, the RRA98 Executive Steering Committee (ESC) discussed steps it could take to strengthen the RRA98 implementation process and set completion dates for these steps. Based on this discussion, the ESC agreed to do the following:

1. **Request for Information Services (RIS) Review.** We will initiate a comprehensive staff level review of RIS actions. We have assembled a team with representatives from Taxpayer Treatment and Service Improvements (TSI), Business Systems Requirements Office, and Information Systems (IS). The actual RIS documents will be compared with the RRA98 provisions to ensure that all RIS needs are covered. As part of this review, IS will provide a list of the RRA98 RISs that are not included in the action plans so provision owners can ensure they are added. RIS actions are "show stoppers" and merit a 100 percent review. The team will meet with Provision Owners to discuss issues.

Completion Date: June 30, 1999.

2. **Forms and Publications.** Provision Owners will review all forms and publications needed to implement their provisions. They will check for accuracy and also try to view the forms and publications from the taxpayer's perspective so that they may make suggestions as to how forms or publications can be made more helpful to taxpayers. The results of this review will be sent to Shelly Schwartz, National Director of Forms and Publications Division, with a copy to Darlene Berthod. Negative responses are required.

Completion Date: For completed revisions - July 31, 1999;
For open revisions - 30 days before the action item completion date listed in the implementation plan data base.

3. **Closed Actions.** Provision Owners will personally review the documentation for all closed actions and ensure the actions are truly closed. They will establish a file for each provision that contains the documentation for each closed action item so that TIGTA and/or General Accounting Office will not have to wait for IRS to find the documentation. Special attention should be given to closed RIS actions. The RIS

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documentation needs to be closely checked against the provision requirements and shall include the RIS and the IS response. TSI staff will spot check these files for completeness.

Completion Date: July 31, 1999.

4. Action Plans for Provisions Yet to Become Effective (list of 22). Provision owners should ensure that the action plans for these provisions are complete and up-to-date. Each of them will be listed as "Highlighted Provisions" for upcoming RRA98 ESC meetings and provision owners will discuss their status. TSI will notify Provision Owners when the provisions are placed on the ESC agenda.

Completion Date: Provision Owners shall complete their reviews by August 31, 1999; Starting with the June 28 ESC meeting, these provisions will be highlighted for discussion.

6. Action Plans for Provisions Already Effective. In order to obtain a fresh look at these provisions, Provision Owners should either assign a different staff person or an executive from the same or different functional area to review each provision for accuracy, completeness, and timeliness. TSI will meet with the staff representative or executives before they begin their review to discuss methodology and provide a review checklist. The reviewers will meet with the Provision Owners to discuss findings and resolve issues. Provision Owners will then ensure the database is revised accordingly. Provision Owners will present the findings at a subsequent RRA98 ESC meeting and, using the review checklist, highlight the changes that were made.

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Department of the Treasury
Internal Revenue Service
Communications Division
Washington, DC 20224

NEWS

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EMPLOYERS MAY QUALIFY FOR PENALTY REDUCTION

WASHINGTON -- Some businesses penalized for failing to make timely employment tax deposits during the first quarter of 1999 may be able to lower their penalties because of tax law changes that apply to federal tax deposits due after January 18, 1999.

Although the Internal Revenue Service intended to advise taxpayers of these relief provisions when it sent the penalty notices, it inadvertently omitted the explanations. The IRS will write to these taxpayers, apologizing for the omission and telling them about the new relief features. It will also include the relief information with future penalty notices. Eligible taxpayers, who would have received the penalty notices in late May or early June, may get the penalty relief by calling the IRS at the number listed on the notice.

One relief provision allows taxpayers to designate the period to which a specific deposit applies, rather than having deposits applied against tax liabilities in the order they were due. This can prevent the "cascading" of penalties, which occurs when a deposit is less than the amount due and a portion of the next deposit is applied against the earlier shortfall. This results in a second penalty, for the new deposit shortfall.

For example, a taxpayer who should deposit \$3,000 each month but deposits only \$2,000 for the first month of the quarter would incur a penalty ranging from two to 15 percent, depending on the lateness of the deposit. If the taxpayer next deposits \$3,000 the following month, \$1,000 is applied against the previous month's shortfall, leaving the second month's deposit short by \$1,000, again incurring a penalty.

The tax law now gives the taxpayer 90 days from the date of the penalty notice to contact the IRS and designate the periods against which the deposits apply. In the above example, by designating that the second month's deposit applies to that month's liability, the taxpayer incurs only the one penalty for the first month's shortfall.

In light of its omission of this relief information from the recent penalty notices, the IRS will give affected taxpayers 90 days from the date of the apology letter it sends them to call and make a deposit designation, rather than 90 days from the notice's date.

(more)

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The other penalty relief provision is for employers who are required to change the frequency of their deposits. These taxpayers may get a penalty waiver for the first deposit due under the new schedule, provided they filed the applicable employment tax return on time and had a net worth under \$2 million (\$7 million, in the case of a corporation).

For example, an employer depositing monthly moves to the semiweekly schedule in 1999 if the employment tax liabilities during the 1997 to 1998 lookback period exceeded \$50,000. If the first 1999 payday was Friday, Jan. 15, the tax deposit would have been due on the following Wednesday, Jan. 20, rather than in February. If the taxpayer filed the applicable return on time and met the net worth limit, the IRS would waive any late deposit penalty for Jan. 20. All the taxpayer has to do is contact the IRS and request the waiver.

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Appendix VI

Inaccurate or Missing Action Items on the Provision Report

On August 18, 1998, the Taxpayer Treatment and Service Improvements Program Office (TSI) used an on-line Provision Report as a primary control in the planning and implementation of the various sections of the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98).¹ This on-line report is structured by sections, which are called provisions, and these terms are used interchangeably in this appendix. The Report identifies the effective date of each provision, the owner function, the overall implementation status, and all of the necessary actions needed to fully implement each provision. Our audit tests were designed to determine the accuracy and effectiveness of this management control. Examples of the inaccurate or missing actions on the Provision Report are included in this Appendix.

Following are the results of our review of the nine provisions selected in our sample:

Provision 1203

RRA98 § 1203 defines 10 specific acts of willful misconduct for which an IRS employee must be terminated, including such things as providing false statements under oath and willful understatement of a tax liability. Section 1203 had IRS-wide implications, and implementation was a major undertaking that includes developing procedures, publishing and distributing guidance documents, revising computer programs, training employees and managers, etc.

We found the following inaccurately recorded or missing action items on the Provision Report:

- *Action #3107 - Design process for case handling.*

As explained by IRS management, this action included focus group interviews. The due date was February 15, 1999, and the actual completion date of April 1, 1999, was not entered on the Provision Report.

¹ Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685

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- *Action #3114 - Conduct training.*

As explained by IRS management, the completion date of August 20, 1998, is incorrect. The training was actually completed in October 1998. Additionally, this action was duplicated by another action, Action #0532, which was later deleted.

We identified some additional pending actions not on the Provision Report, as follows:

- During the April 5, 1999, Executive Steering Committee Meeting, the Deputy Chief Operations Officer requested a test of front-line managers to ensure that they have what they need to discuss §1203 with their employees. Based on our inquiry, an update to Action #3614 was entered on July 21, 1999.
- A new Employee Orientation Package that includes § 1203 should have been ready by October 1999. Based on our inquiry, Action #3799 was added to record this new package.
- Corporate Education (Dallas) is working with the Communication Division to provide a Manager's Toolkit for Provision 1203. The actions required to complete this task were not on the Provision Report.

Provision 3301

Provision 3301 equalizes the interest rate for overpayments and underpayments for any period of mutual indebtedness between a taxpayer and the IRS. No interest will be imposed to the extent that underpayment and overpayment interest run simultaneously on equal amounts. This equalization of interest rates is available for any type of tax imposed by the Internal Revenue Code.

We found the following inaccurately recorded or missing action items on the Provision Report:

- *Action #0246 - Coordinate on multi-functional Request for Information Services (RIS) to ensure uniform procedural and computational changes to programs and procedures involving return processing and compliance adjustments on interest.*

An incorrect RIS number was reported for this completed action, and the action status was not timely updated. RIS # TCP-8-0200 was provided to us as supporting documentation for Action #0246. However, this RIS does not address Provision 3301. The correct RIS is # EXM-9-0001.

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- *Action #0728 - Make programming change to IRS computer systems to identify modules that were netted.*

The RIS number was not recorded for this action item, and the action status was not timely updated. Recording RIS numbers is important to ensure that the RIS can be appropriately tracked to completion. RIS # EXM-9-0001 was provided as supporting documentation, but the RIS number had not been recorded on the action plan.

- *Action #0894 - Revise the Internal Revenue Manual (IRM), Chapter 21, regarding interest netting.*

This action indicates IRM 21, regarding interest netting, was revised February 4, 1999. The explanation field indicates, "Ruling not completed by CC." We requested a copy of the IRM 21 revision. However, IRM documentation that was provided to us in support of this action did not address interest netting. We believe this action might not be completed.

- *Action #0722 - Work with Customer Service, Appeals, and other affected functions to develop and issue a case processing procedure.*

The action plan indicates this action was completed February 4, 1999. However, the Director of Interest and Penalty Administration informed us this action was satisfied by the training described in Actions #0727 and #1786 that were completed in November 1998. Therefore, case processing procedures were not issued. The action plan does not reflect this.

- *Action #2028 - Reply to RIS to identify modules that were netted.*

Multiple actions and statuses were included in the action item description. To ensure these actions are timely completed, the IRS should record and track them separately.

Provision 3303

Provision 3303 limits the penalty amount for failure to pay tax to half the usual rate (0.25 percent rather than 0.50 percent) for any month that an installment payment agreement with the IRS is in effect.

We found the following inaccurately recorded action item on the Provision Report:

- *Action #0912 - Issue Taxpayer Education Bulletin Board Release regarding elimination of Individual Masterfile (IMF) failure to pay penalty during Installment Agreement.*

This action is a duplicate of #0839 that has been completed.

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Provision 3304

Provision 3304 allows business taxpayers to avoid failure to deposit penalties by designating application of a tax deposit after a penalty notice is received. This provision also establishes that after 2001, the IRS will automatically apply deposits to the most recent period. Lastly, the provision expands the penalty waiver to cover depositors whose deposit frequency requirements have changed.

Inaccurately recorded action items are described earlier in this report (see page 7).

Provision 3305

Provision 3305 suspends the accrual of interest and penalties after 18 months unless the IRS sends the taxpayer a notice within 18 months following the latter of:

1. The original due date of the return (without regard to extensions) or
2. The date on which a timely return is filed.

We found the following inaccurately recorded action item on the Provision Report:

- *Action #0249 - Coordinate on multi-functional RIS.*

This action item indicates two RISs were completed, RIS # EXM-8-0103 and RIS # EXO-8-0017. However, RIS # EXO-8-0017 does not address RRA 98. In addition, four completed actions on the action plan duplicate the action accomplished for Action #0249. This makes the action plan redundant and confusing. Actions #0249, #0732, #0880, #0886, and #0887 all address the preparation and submission of one RIS, # EXM-8-0103, and should have been combined into one action item. In addition, Actions #0886 and #0887 indicate that programming actions were needed for the Combined Annual Wage Reporting Federal Unemployment Tax Act and Automated Underreporter systems. However, we were told that no changes were required for these systems, and no RISs were prepared. Therefore, the Provision Report is misleading.

Provision 3465

Provision 3465 requires that the IRS:

1. Develop procedures under which any taxpayer may request early referral of issues from the Examination or Collection function to the Office of Appeals.

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2. Develop procedures for a taxpayer or the Office of Appeals to request non-binding mediation of any unresolved issue at the conclusion of the appeals procedure or an unsuccessful attempt to enter a closing agreement or an offer-in-compromise.
3. Develop a pilot program under which the Office of Appeals and the taxpayer may jointly request binding arbitration. These procedures are to be extended to all taxpayers.
4. Ensure an appeals officer is regularly available within each state.
5. Consider using videoconferencing techniques for conferences between appeals officers and taxpayers from rural areas seeking appeals.

We found the following inaccurately recorded or missing action items on the Provision Report:

- *Action #0838 - Revise IRM 21 allowing early appeals of examinations and collections, non-binding mediation, or binding arbitration.*

The Customer Service function did not revise IRM 21 as reported for a completed action item because later it was determined this was not necessary. Therefore, Action #0838 should have been reported as deleted rather than completed.

We identified an additional pending action not on the Provision Report, as follows:

- Provision 3465 stipulates that the IRS must also consider using videoconferencing techniques for conferences between appeals officers and taxpayers from rural areas seeking appeals. Documentation was provided showing that action on this requirement had been taken. Although documentation shows work had been performed on this requirement, no action item was listed on the Provision Report at the time of our review. Videoconferencing Action #3691 was subsequently added to the Provision Report.

Provision 3705

Provision 3705(a) requires the IRS to:

1. Include in all manually-generated correspondence the name, telephone number, and unique identifying number of the IRS employee the taxpayer may contact regarding the correspondence.
2. Include in other correspondence a telephone number that the taxpayer may call.
3. Provide a taxpayer, during a telephone or personal contact, the employee's name and unique identifying number. The name and identifying number must be prominently disclosed.

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We found the following inaccurately recorded action items on the Provision Report:

- *Action #3469 - Communicate decision to use identification (ID) badge to all functions and disseminate servicewide procedures for providing ID number on tax-related contacts.*

The completion date of November 27, 1998, is incorrect. This part of the provision was not effective until January 22, 1999. A memorandum from the Deputy Commissioner Operations was issued January 15, 1999. Draft procedures were faxed on January 20, 1999. Those procedures were included in IRM 114.1.2.17.1, issued May 20, 1999.

- *Action #1571 - Revise Publications 542 and 553 to reflect waiver of estimated tax penalty for underpayments created or increased by RRA 98.*

This action is unrelated to Provision 3705. The action description involves tax penalty underpayments, which does not relate to IRS Employee Contacts.

Provision 3706

Provision 3706 requires that an employee may use a pseudonym only if:

1. The employee provides adequate justification for the use, such as personal safety.
2. Use of the pseudonym is approved by the employee's supervisor prior to such use.

The effective date is July 22, 1998.

We found no significant inaccurately recorded or missing action items related to this provision.

Provision 3710

Provision 3710 authorizes the IRS to approve alternatives to social security numbers for use as identifying numbers by tax return preparers.

The effective date is July 22, 1998.

We found no significant inaccurately recorded or missing action items related to this provision.

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Appendix VII

**Additional Treasury Inspector General for Tax Administration
Reports Related to the Internal Revenue Service's Implementation of
the Internal Revenue Service Restructuring and Reform Act of 1998¹**

***The Internal Revenue Service Should Improve Its Federal Tax Lien Procedures
(Reference Number 199910074, dated September 1999)***

During the initial implementation period, the Internal Revenue Service (IRS) was not consistently implementing federal tax lien (FTL) sections (also called provisions) of RRA 98. Therefore, the IRS was not always informing taxpayers and their representatives of the taxpayers' right to a hearing once a FTL is filed.

Since the IRS was not consistently implementing RRA 98 FTL provisions, we recommended that the IRS improve FTL procedures, make system changes, and revise existing management information systems to ensure that RRA 98 FTL requirements are met and associated IRS procedures are followed.

IRS management agreed with the findings and recommendations in the report and agreed to take corrective action.

***The Internal Revenue Service Has Not Fully Implemented Procedures to Notify
Taxpayers Before Taking Their Funds For Payment of Tax (Reference Number
199910071, dated September 1999)***

We found the IRS' efforts to fully implement changes in 26 U.S.C. § 6330 (1986) related to taxpayer levies were not effective in the offices we tested. The IRS did not consistently notify taxpayers of their appeal rights and of the intent to levy, as required by 26 U.S.C. § 6330 (1986) and its own guidelines. Consequently, taxpayers' rights were potentially violated in some instances.

We recommended implementing additional safeguards to ensure the applicable legal and IRS procedures are followed when issuing levies. We also recommended that Collection and Customer Service management request an opinion from the IRS Office of the Chief Counsel on those levy cases where money may have been taken improperly, to determine if restitution to the taxpayers is warranted.

¹ Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-26, 112 Stat. 685

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IRS management agreed with the majority of our observations and findings and concurred with all recommendations in this report.

The Internal Revenue Service Can Further Improve Its Complaint Processing Procedures and Systems (Reference Number 199910070, dated September 1999)

We found that the IRS currently does not have an integrated complaint processing system for identifying and reporting taxpayer complaints and allegations of employee misconduct. Instead, it uses various existing systems and procedures that were implemented prior to enactment of RRA 98. However, the IRS is taking significant actions to improve its complaint processing procedures and systems. While significant actions are being taken, further improvements are needed to ensure that employees are knowledgeable of the complaint processing procedures and are willing to report complaints and allegations of misconduct.

We made recommendations to improve the reliability of the IRS' information concerning taxpayer complaints and allegations of employee misconduct that are provided to Treasury Inspector General for Tax Administration for inclusion in our Semiannual Report to the Congress. We recommended that, as part of the development of its centralized and integrated complaint information system, the IRS ensure appropriate interfaces exist among the multiple complaint processing systems to facilitate accurate reporting. In addition, we recommended that the IRS ensure that taxpayer complaints be distinguished from taxpayer inquiries, problems, and issues not of a complaint nature.

We also recommended that after assessing the results of RRA 98 § 1203 training, the IRS should identify and provide any additional training needed on the complaint processing procedures (e.g., non-RRA 98 § 1203) and re-emphasize the employees' responsibility for reporting taxpayer complaints and allegations of employee misconduct. In addition, we recommended that the IRS periodically survey its employees to determine the effectiveness of the training and the employees' willingness to report taxpayer complaints and allegations of employee misconduct.

The response to our draft report indicated agreement with our conclusion that the IRS' complaint processing needs further improvement and noted that a specific action plan will be developed within 60 days of the September 17, 1999, response. The response also noted that the IRS initiated a project to integrate complaint data from its current information systems and will form a Steering Committee to coordinate and oversee this initiative.

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The Internal Revenue Service Needs to Improve Compliance with Legal and Internal Guidelines When Taking Taxpayers' Property for Unpaid Taxes (Reference Number 199910072, dated September 1999)

We found that while the IRS followed legal and internal guidelines in 64 percent of the seizures conducted, improved compliance is needed to ensure that all guidelines are consistently followed.

We recommended that the IRS use comprehensive seizure checklists that include legal and internal guidelines to help ensure employees follow the applicable procedures when conducting seizures. We also recommended that the IRS request an opinion from the IRS Office of the Chief Counsel on those seizures that did not follow legal guidelines to determine if the IRS should make restitution to those taxpayers.

IRS management is in agreement with the issues in this report and is implementing corrective actions.

The Internal Revenue Service Is Addressing the Use of the Illegal Tax Protestor and Nonfiler Designations (Reference Number 199910080, dated September 1999)

We found that the IRS has taken actions and is substantially in compliance with RRA 98 as it relates to no longer designating taxpayers as Illegal Tax Protestors (ITP), removing the ITP designation from the Individual Masterfile, and disregarding the ITP designation made on or before July 22, 1998, on other IRS computer and paper files. In addition, the IRS has various nonfiler programs to determine if taxpayers are filing returns. However, we were advised by IRS programmers that none of these programs designate taxpayers permanently as nonfilers on IRS' main computer files and, therefore, are not applicable to this RRA 98 provision.

We recommended the IRS continue to monitor the actions in process to fully comply with the provisions of RRA 98. Also, IRS management should monitor the planning and implementation of the newly proposed program of frivolous nonfiler designations to ensure it meets the intent of RRA 98, when implemented.

IRS management is in agreement with the issues included in this report and is planning to take corrective actions.

The Internal Revenue Service Should Continue Its Efforts to Achieve Full Compliance with Restrictions on the Use of Enforcement Statistics (Reference Number 199910073, dated September 1999)

We found the IRS is currently not in full compliance with RRA 98 § 1204. Our independent testing in 28 IRS offices showed that the IRS has controls in place to identify and report violations; however, there are still instances when records of tax enforcement results are being used to evaluate employees or to impose or suggest production quotas or goals.

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We did not make any recommendations for corrective action because the IRS' proposed regulations for a balanced system of business measures appears to be the appropriate first step in resolving these problems. As part of our Fiscal Year 2000 Audit Plan, we will assess the effectiveness of the progress and implementation of the balanced system of business measures as it relates to the use of enforcement statistics.

IRS management generally agreed to the issues addressed in this report and stated that they will take whatever steps are necessary to eliminate violations. In some cases, the IRS believes there is a need to involve the IRS Office of the Chief Counsel to clarify differences in interpretation, such as the inclusion of records of tax enforcement results in employees' self-assessments. In addition, IRS management plans to review documents where violations occurred and cycle time was overemphasized to resolve any interpretive differences that may exist regarding legal or procedural issues.

The Internal Revenue Service's Procedures for Responding to Written Requests for Collection Activity From Joint Return Filers Vary From Statutory Requirements (Reference Number 199910077, dated September 1999)

We found that the IRS procedures are different from the statutory requirements set out in 26 U.S.C. § 6103 (e) (8) (1986). This provision requires the IRS to send written responses to joint filer taxpayers or their representatives who request, in writing, collection information on their joint return liabilities, while the IRS' procedures allow the information to be provided orally. In addition, the IRS does not have a method to identify joint filer requests and responses. Therefore, the IRS cannot determine if it complies with the provision and cannot determine if IRS employees are protecting the taxpayers' right to receive written responses to their written requests for joint return collection information.

We recommended that the IRS ensure that its practice of allowing oral responses to written joint filer requests complies with statutory requirements. In addition, we recommended the IRS conduct an analysis to determine the volume of written joint filer requests received and whether IRS employees are properly responding to taxpayers. This would enable the IRS to determine the type of management control process needed to track the requests and measure compliance with the joint filer provision.

IRS management agreed to the recommendations and is planning corrective actions.

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The Internal Revenue Service Needs to Enhance Guidance on and Monitoring of Compliance with Procedures for Directly Contacting Taxpayers and Their Representatives (Reference Number 199910076, dated September 1999)

We found that, while the IRS has procedures that should enable it to protect taxpayers' rights during an interview with the taxpayer or when IRS employees appropriately bypass a representative and contact a taxpayer directly, we could not determine whether IRS employees complied with the procedures or protected taxpayers' rights. Current IRS management information systems do not separately record or monitor cases where taxpayers requested representation during an interview so we could not identify or review cases. There is no requirement for the IRS to maintain separate records for these situations.

We recommended that the IRS complete its efforts to develop national guidance for employees and develop a process to determine whether employees are complying with the law when a taxpayer requests to consult with a representative or the employee bypasses a representative.

IRS management agreed with the issues addressed in the report and is planning corrective actions.

The Internal Revenue Service Is Now Tracking Potential Fair Debt Collection Practices Act Violations, But May Not Always Be Properly Reporting Violations (Reference Number 2000-10-014, dated December 1999)

We did not identify any civil actions where money has been paid out to taxpayers as a result of Fair Debt Collection Practices Act (FDCPA)² violations. We did identify two FDCPA violations that resulted in employee administrative action for the period July 22, 1998, through March 18, 1999. However, we cannot ensure that these were the only FDCPA violations resulting in administrative action for that period. We were unable to make these determinations for two reasons. First, the IRS' management information systems did not reflect FDCPA violations at the time of our review. Second, IRS management may not have always properly reported potential FDCPA violations. IRS management has since updated its management information system to include FDCPA violation codes.

Because of our limited scope of review on the second condition, we did not make any recommendations in this report. We will review this issue again as part of our

² Fair Debt Collection Practices Act of 1996, 15 U.S.C. Sections 1601 and 1692

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Fiscal Year 2000 audit effort and will make any warranted recommendations for corrective action at that time.

The Internal Revenue Service Needs to Improve Its Compliance with Procedures When Processing Requests for Information Under the Freedom of Information Act (Reference Number 2000-10-058, dated March 2000)

We found that, for 12.1 percent of the denied or partially denied Freedom of Information Act (FOIA)³ requests, the IRS improperly withheld information that should have been provided to the requester. In addition, we found that, for 7.6 percent of the denied or partially denied Privacy Act (PA)⁴ requests, the IRS improperly withheld information. While conducting the audit, we also identified instances where the IRS did not comply with its statutory or procedural obligations. As a result, we recommended that the IRS improve its management practices and oversight to ensure that FOIA requests are processed in accordance with the dictates of the statute as well as IRS procedures.

In addition, given the IRS' emphasis on providing quality service to taxpayers, we have identified opportunities for the IRS to improve the service it provides to FOIA and PA requesters. While we recognize that our recommendations concerning customer service go beyond the IRS' statutory obligations imposed by the FOIA and the PA, we included them to assist the IRS in reaching its goal of providing quality service to its customers.

A draft of this report was provided to the IRS for review and comment on February 16, 2000. We requested management's written comments by March 17, 2000. However, although we received a draft version of their comments, we had not received a signed response by March 24, 2000.

³ Freedom of Information Act, 5 U.S.C. Section 552 (1994)

⁴ Privacy Act of 1974, 5 U.S.C. Section 552a (1994)

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Appendix VIII

Management's Response to the Draft Report



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

APR 20 2000

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR
TAX ADMINISTRATION

FROM:

for Charles O. Rossotti *Bob Wenzel*
Commissioner of Internal Revenue

SUBJECT:

Draft Audit Report – Additional Validation and Increased
Oversight Are Needed to Effectively Implement the
Internal Revenue Service Restructuring and Reform Act of
1998 (Audit No. 19990065)

Thank you for the opportunity to review and comment on your draft report which evaluates the IRS' planning and implementation of this important legislation. Your report reviewed our process for identifying, coordinating and monitoring necessary actions, as well as evaluated the effectiveness of our implementation of selected provisions of the legislation.

We believe the report confirms that the steps taken by the IRS to manage the implementation process were both sound and timely. We are also encouraged by the results of your audit wherein you state that "[T]he IRS' implementation team for RRA98 used an aggressive, proactive approach, giving appropriate consideration to the level of executive involvement needed to implement this complex legislation."

In order to fulfill the mandate Congress gave us in this legislation, many changes were required in every aspect of how the IRS works. These include implementing specific provisions of the law, such as the taxpayer rights provisions, as well as changes in the way performance is measured, people are managed and evaluated, the way the organization is structured, and the reengineering and replacement of nearly every basic business system.

Our first priority was implementation of the 71 taxpayer rights provisions in the legislation, many of which were effective either on the date of enactment or within 6 months of it. Given the short timeframes, our capacity to provide guidance to the public and to employees and to conduct training for the 100,000 employees affected was stretched to the limit.

Many of the steps taken were unique to the implementation of this legislation and were set in motion prior to the legislation's effective date. As you note, IRS executives were

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assigned cross-functional implementation responsibility for each provision. A National Resource Center was established on the IRS' Intranet site to coordinate policy and program questions to ensure that consistent messages were sent to all employees. To date, more than 1,200 employee questions have been answered at this site. Also, a real-time database was used to record and monitor the progress of the more than 1,600 actions needed to implement the legislation. Lastly, approximately 185 field coordinators representing each district, region, and service center were identified and trained to be local points of contact for coordination and questions.

This legislation gives the IRS a new direction and a new challenge – namely to measure its success in terms of its effect on the people it serves as well as the taxes it collects. We agree that we must respect taxpayer rights and provide high quality service to every taxpayer. Given the magnitude of our challenge, it is not surprising that there are risks and setbacks. It is also not surprising that we are encountering obstacles that must be overcome.

I would also like to take this opportunity to thank you for sharing your preliminary findings concerning the actions we took to implement section 3304, Mitigation of Failure to Deposit Penalty, of the legislation. Your early notification allowed us to take immediate corrective action. Subsequently, several additional steps were taken to strengthen the overall implementation process. These steps are discussed in our response to recommendation 1.

Our comments on the specific recommendations in the report are at Attachment 1. Comments on Appendix VI are at Attachment 2. If you have any questions, please call Wayne Thomas at 622-6860 or a member of your staff may call Stuart DeWitt at (202) 622-3723.

Attachments (2)

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Attachment 1

COMMENTS ON RECOMMENDATIONS

IDENTITY OF RECOMMENDATION #1

The Deputy Chief Operations Officer's staff conduct periodic reviews of documentation maintained in the Provision Report files to support key implementation actions to ensure that actions were taken timely and that they met the requirements of RRA98.

ASSESSMENT OF CAUSE(S)

The implementation of this legislation required the successful execution of more than 1,600 distinct action items as well as a coordinated training effort. While the vast majority of these actions were completed timely, some needed improvement or further development.

CORRECTIVE ACTIONS

The IRS was proactive in formulating an implementation strategy. Executive accountability was established for each provision before enactment of the legislation. The implementation team worked diligently to scrutinize provision action plans and identify potential issues. These issues were discussed at an Executive Steering Committee (ESC) established to track implementation progress and resolve issues.

During June 1999, the ESC discussed steps that could be taken to strengthen the implementation process. Based on this discussion, the ESC agreed to a five-point plan. First, a comprehensive review of all Requests for Information Services (RIS), which seek computer programming changes, would be made to determine RIS accuracy and to identify additional RIS requirements. Second, all forms and publications revisions were reviewed for content accuracy. Third, Provision Owners were required to establish files for each provision that contain the documentation for each completed action. Fourth, Provision Owners were asked to review implementing actions for provisions yet to become effective at ESC meetings. Fifth, an independent review of action plans for accuracy, completeness, and timeliness was conducted.

The documentation files have been extensively reviewed at ESC meetings and the implementation team will continue this review, as appropriate.

IMPLEMENTATION DATE: N/A

RESPONSIBLE OFFICIAL
Deputy Chief Operations Officer

CORRECTIVE ACTION MONITORING PLAN: N/A

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IDENTITY OF RECOMMENDATION #2

Ensure that clear procedures are given to service centers on which notices require the stuffer form.

ASSESSMENT OF CAUSE(S)

The sheer volume of work required to implement the penalty and interest provisions of this legislation was overwhelming to the Office of Interest and Penalty Administration. Better coordination between Examination and Customer Service would have made implementation of this provision smoother.

CORRECTIVE ACTIONS

We agree that clear procedures should be provided to the service centers. After you notified us that you believed some service centers were not correctly implementing our procedures, we contacted the centers to ensure that they correctly understood the requirements for use of the stuffer.

The statement that was on the stuffer is now automatically generated on the BMF notice when a FTD penalty assessment is present. Therefore, the stuffer is no longer necessary and no further instructions are needed.

IMPLEMENTATION DATE: N/A

RESPONSIBLE OFFICIAL

National Director, Specialty Taxes, Office of Interest and Penalty Administration

CORRECTIVE ACTION MONITORING PLAN: N/A

IDENTITY OF RECOMMENDATION #3

Identify those taxpayers who should have received a stuffer form and notify them of their potential abatement rights.

ASSESSMENT OF CAUSE(S)

The sheer volume of work required to implement the penalty and interest provisions of this legislation was overwhelming to the Office of Interest and Penalty Administration. Better coordination between Examination and Customer Service would have made implementation of this provision smoother.

CORRECTIVE ACTIONS

We have identified all taxpayers that required notification of their potential abatement rights and may not have received such notification. An apology letter or a stuffer was sent to all of these taxpayers. Therefore, no further action is necessary.

**Additional Validation and Increased Oversight Are Needed
to Effectively Implement the Internal Revenue Service
Restructuring and Reform Act of 1998**

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IMPLEMENTATION DATE: N/A

RESPONSIBLE OFFICIAL

National Director, Specialty Taxes, Office of Interest and Penalty Administration

CORRECTIVE ACTION MONITORING PLAN: N/A

IDENTITY OF RECOMMENDATION #4

Provide additional oversight until full and appropriate implementation of this provision is completed.

ASSESSMENT OF CAUSE(S)

The sheer volume of work required to implement the penalty and interest provisions of this legislation was overwhelming to the Office of Interest and Penalty Administration. Better coordination between Examination and Customer Service would have made implementation of this provision smoother.

CORRECTIVE ACTIONS

The Office of Interest and Penalty Administration continues to meet with Masterfile FTD penalty programmers and analysts and Chief Counsel in developing the RIS and instructions for the final phase of implementation for Section 3304 © of the legislation.

IMPLEMENTATION DATE:

January 1, 2002

RESPONSIBLE OFFICIAL

National Director, Specialty Taxes, Office of Interest and Penalty Administration

CORRECTIVE ACTION MONITORING PLAN

This will be monitored via the Taxpayer Treatment and Service Improvement RRA98 action plan.

IDENTITY OF RECOMMENDATION #5

Provision owners take control over the training effort for their provisions. Procedures should require records of employees who need training, employees receiving training, and how effectively the training met objectives.

ASSESSMENT OF CAUSE(S)

Under the training plan adopted for this legislation, provision owners provided field offices with guidance as to who should attend the training and relied on field management to report on completion of the training and accomplishment of training goals.

**Additional Validation and Increased Oversight Are Needed
to Effectively Implement the Internal Revenue Service
Restructuring and Reform Act of 1998**

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CORRECTIVE ACTIONS

We agree that provision owners could have exercised more control over who attended training and made use of systems already in place, such as the Administrative Corporate Education System (ACES), to accurately track who received the training and its effectiveness. We have decided that all future initiatives of this nature will have centralized end-to-end accountability for training by provision owners.

In preparation for Phase 3 training for RRA98 provisions, Learning and Education Institutes met with provision owners to determine the best approach to embedding all pertinent provisions into the occupational curricula for their functional areas. Each Institute then reached agreement with the provision owners as to the course update schedule where embedding would occur. This effort negates the need to have further, separate training on RRA98 provisions.

To ensure that senior management is aware of the tools available to centrally manage legislative implementation training, the Chief Human Resource Officer (CHRO) will communicate the capabilities of ACES to track the delivery and effectiveness of training programs to senior IRS management as part of the transition to the new IRS structure.

IMPLEMENTATION DATE:
September 1, 2000

RESPONSIBLE OFFICIAL
Director, Human Resources Technology

CORRECTIVE ACTION MONITORING PLAN
The CHRO will draft and send a memorandum communicating the capabilities of ACES to senior IRS management by September 1, 2000.

**Additional Validation and Increased Oversight Are Needed
to Effectively Implement the Internal Revenue Service
Restructuring and Reform Act of 1998**

Attachment 2

COMMENTS ON APPENDIX VI

Provision 3301

Action #0894 - Revise the Internal Revenue Manual (IRM), Chapter 21, regarding interest netting.

TIGTA Comment - This action indicates IRM 21, regarding interest netting, was revised February 4, 1999. The explanation field indicates, "Ruling not completed by CC." We requested a copy of the IRM 21 revision. However, IRM documentation that was provided to us in support of this action did not address interest netting. We believe this action might not be completed.

IRS Response - IRM Chapter 23, section 104.8, has been revised to provide procedures on interest netting. This revision has been submitted for publication. IRM Chapter 21 will refer personnel to this section.

Action #2028 - Reply to RIS to identify modules that were netted.

TIGTA Comment - Multiple actions and statuses were included in the action item description. To ensure these actions are timely completed, the IRS should record and track them separately.

IRS Response - Information Systems (IS) has provided a written response to the RIS reflecting the programming services that will be provided. IS determined implementation for RIS EXM-9-0001 would take place in three phases: January 2001, December 2001, and January 2002. IS assures us that multiple implementation dates in a single RIS do not present a tracking problem.