



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

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MEMORANDUM FOR SECRETARY SNOW

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SUBJECT: Management and Performance Challenges Facing  
the Internal Revenue Service

**SUMMARY**

The Reports Consolidation Act of 2000<sup>1</sup> requires that we summarize, for inclusion in the *Department of the Treasury Accountability Report for Fiscal Year 2003*, our perspective on the most serious management and performance challenges currently facing the Internal Revenue Service (IRS).

The Treasury Inspector General for Tax Administration's (TIGTA) assessment of the major IRS management challenge areas for Fiscal Year (FY) 2004 has not changed substantially from the prior year. While the IRS has acted to address each challenge area, the TIGTA was unable to remove any challenge area at this time. The TIGTA has reprioritized the issue entitled Processing Returns and Implementing Tax Law Changes During the Tax Filing Season because other issues appear to be more significant. We have also clarified the issue area previously entitled Erroneous Payments by renaming it Erroneous and Improper Payments.

The TIGTA believes the major management challenges, in order of priority, facing the IRS in FY 2004 are:

- Systems Modernization of the Internal Revenue Service
- Tax Compliance Initiatives
- Security of the Internal Revenue Service
  - The Employees and the Facilities
  - The Information Systems
- Integrating Performance and Financial Management
  - Performance Management
  - Financial Management

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<sup>1</sup> Pub. L. No. 106-531.

- Complexity of the Tax Law
- Providing Quality Customer Service Operations
- Erroneous and Improper Payments
- Processing Returns and Implementing Tax Law Changes During the Tax Filing Season
- Taxpayer Protection and Rights
- Human Capital

## **DISCUSSION**

Discussion of the major IRS management challenge areas, including examples of relevant TIGTA audit work, follows.

### **Systems Modernization of the Internal Revenue Service**

The latest attempt at the modernization of the IRS' computer systems, mandated by the IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>2</sup> and started in FY 1999, is expected to take 10 to 15 years at a cost of \$7 to \$10 billion. Thus, modernization will likely remain on the TIGTA's list of major challenges for years to come.

The RRA 98 places a greater emphasis on serving taxpayers and meeting their needs in the IRS' new structure. Dramatic improvements in service to taxpayers are heavily dependent on modernizing the IRS' core computer systems. To achieve its mission, the IRS needs high-quality, efficient, and responsive information systems. The systems must also provide an infrastructure that is sufficiently flexible to adapt to evolving business needs, and one that can be efficiently managed.

FY 2003 was deemed a "critical" year for the modernization efforts; however, few projects were deployed. In fact, overall progress has been slower than expected, costs have increased, and fewer capabilities are being delivered than originally planned. For example, the Customer Account Data Engine (CADE), which is planned for release in five incremental stages, will be the modernized foundation for managing taxpayer accounts and consists of databases plus related applications that will replace the IRS' existing Master File<sup>3</sup> processing systems. Release 1 of the CADE, originally planned for release in January 2002, is substantially behind schedule. The IRS now plans to deploy Release 1 by March 2004. In addition, Releases 2 and 3 have also been rescheduled to July 2005 and July 2006, respectively.

The CADE project delays can be attributed to underestimating the complexity of this effort and difficulties in identifying and managing the project requirements. As a result of delays in deploying the CADE, approximately 35 million taxpayers did not receive the benefits of faster tax return processing, and thus faster refunds, during the 2002 and 2003 Filing Seasons. In addition, other modernization projects that will provide improved customer

<sup>2</sup> Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

<sup>3</sup> The Master File is the IRS' database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

service and compliance activities will be delayed because they are dependent upon the CADE.

The IRS Commissioner has demonstrated considerable concern about the progress of the IRS modernization efforts to date. As of the end of September 2003, the IRS has six special studies to assess various aspects of the IRS' and the PRIME<sup>4</sup> contractor's work on modernization. Until significant changes are made to facilitate better progress on modernization, it will remain a major management challenge for the IRS.

### **Tax Compliance Initiatives**

For some time, the IRS, the Congress, and other interested stakeholders have been concerned because tax compliance has been slowly eroding. Gross accounts receivable continued to rise during the past fiscal year. Therefore, the challenge to IRS management is to establish a tax compliance program that identifies those citizens who do not meet their tax obligations, either by not paying the correct amount of tax or not filing proper tax returns. Thus, the TIGTA continues to list tax compliance as a major challenge facing IRS management.

The number of tax returns filed and the total dollars the IRS has received annually have been increasing with the growing economy. Specifically, in 15 years, the number of returns filed has grown by 22 percent, from 140 million in 1987 to 171 million in 2001. From FYs 1988 to 2002, the amount of revenue received by the IRS grew from \$935 billion to \$2 trillion. Nevertheless, enforcement actions against individuals and businesses that purposefully concealed tax liabilities or even refused to submit tax returns had fallen dramatically, despite concerns with the high levels of tax cheating. Since FY 2000, however, both enforcement revenues collected and the use of collection enforcement tools, including liens, levies, and seizures, have increased.

With increased budgets and hiring authority, the staffing level of revenue officers in the field collection offices increased. Yet, even with hiring authority, staffing in field examination programs continued to decrease because retirements and other departures exceeded the number of new employees. Furthermore, replacing experienced employees with new hires results in less examination time available because of the need for training and coaching the new people, and the need to work a greater mix of less complex cases until the new employees gain experience. In spite of this, in FY 2002, the Examination and Collection functions both increased the percentage of time categorized as direct time spent examining tax returns or collecting taxes.

Still, collection statistics have not returned to their pre-1998 levels. One Collection program designed to resolve tax liabilities is the Offer in Compromise (OIC)<sup>5</sup> Program. Enactment of the RRA 98 made the OIC Program accessible to more taxpayers by adding "effective tax administration" as a factor in determining whether to accept an offer, and the offer inventory increased by 200 percent. As an inventory reduction strategy, the IRS initiated the

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<sup>4</sup> The Prime Systems Integration Services Contractor (PRIME) is the contract under which Computer Sciences Corporation is responsible for designing new systems to meet IRS business needs, developing these systems, integrating them into the IRS, and ultimately transferring operation of these systems to the IRS.

<sup>5</sup> An OIC is an agreement between a taxpayer and the Federal Government that settles a tax liability with payment of less than the full amount owed when certain conditions exist.

Centralized Offer in Compromise (COIC) Program in August 2001. In a recent audit, the TIGTA found that the COIC Program is making progress in reducing the backlog of offers in process; however, it could better monitor the process to ensure prompt, timely acceptance or return of offers. For example, the Automated OIC system could be used to periodically track trends in reasons why offers are returned to taxpayers and then modify or highlight forms, instructions, and outreach information for those issues. Further, the IRS could develop a method to identify the primary sources of not-processable offers and a strategy to address the issues of not-processable and unrealistic or frivolous offers.

In another audit, the TIGTA found that IRS regulations and related operational practices for granting extensions of time to file tax returns might have caused many taxpayers to lose respect for the April 15 deadline for paying income taxes. Extensions of time to file are granted to taxpayers that require more time to file their tax returns; however, it does not extend the time to pay the taxes. The IRS granted extensions of time to file to approximately 6.9 million individual taxpayers in Calendar Year (CY) 1999. Many of these taxpayers subsequently presented the IRS with significant compliance problems – about 2.1 million did not pay their taxes by April 15 as required by the Internal Revenue Code. This noncompliance delayed the collection of taxes totaling \$12.7 billion. Further, \$1.5 billion of these taxes remained uncollected almost 2.5 years after they were due. At the root of these compliance problems is a decision to grant extensions of time to file to taxpayers who have not paid their taxes by April 15, which generally prevents the IRS from assessing the Delinquency Penalty<sup>6</sup> of 5 percent per month that would otherwise apply to the delinquent taxes of many taxpayers with extensions.

### **Security of the Internal Revenue Service**

Security breaches could be orchestrated by many different types of individuals (e.g., computer hackers, unhappy taxpayers, disgruntled employees, terrorists), or the loss of taxpayer data could result from natural disasters. Recent events, such as the power blackout in the Northeast, the September 11, 2001 terrorist attacks, the anthrax mail threats, and attacks by computer worms and viruses, illustrate all too graphically the vulnerability of the IRS' infrastructure, computer systems and other equipment, taxpayer data, and employees. While attention to strengthening the perimeter has shown good results, security controls of the infrastructure and applications that guard sensitive data, remain weak. For this reason, the security of IRS employees, its facilities, and the information systems continues to be a significant challenge facing IRS management for FY 2004.

### **Security of the Internal Revenue Service – The Employees and the Facilities**

The IRS remains vigilant to prevent attacks from terrorists and destruction of property by natural forces, and has adopted the threat advisory rating implemented by the Department of Homeland Security. Still, the most likely sources of threats to the safety of employees, as well as the security of taxpayer information and computer systems, are employees (or former employees) who are unhappy with their employers or co-workers, taxpayers who are dissatisfied with IRS service, individuals bent on personal

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<sup>6</sup> The Delinquency Penalty is also known as the Failure-to-File Penalty, although it could be applied to less than one-third of taxpayers who failed to file timely in CY 1999.

profits, computer hackers who break into computer systems for fun or illegal activities, and computer enthusiasts who spread worms and viruses for no apparent reason.

The first line of defense is usually the outer perimeter security. A part of the outer perimeter security is the Guard Services. A recent TIGTA audit of the contract for guard services provided at several IRS locations did not identify any issues related to criminal convictions or immigration violations with the current employment of security guards. However, increased oversight is needed to ensure the contractor's compliance with all contract terms and conditions, particularly those concerning licensing. Because of inadequate oversight, the contractor operated, for periods of time, guard services at two locations without all company and individual security guard licensing required by the contract and by law, thereby increasing the risk to the safety and security of IRS employees and property.

### **Security of the Internal Revenue Service – The Information Systems**

The IRS has developed adequate security policies and procedures but has not implemented them effectively. As a result, sensitive information remains vulnerable to attacks from a variety of sources. Although the TIGTA recognizes that total security can never be achieved and that there are necessary trade-offs between security and operational needs, the Office of Audit (OA) continues to identify significant weaknesses in infrastructure and applications security.

Wireless networks, for example, are rapidly gaining popularity in the Federal Government and private sectors because they are inexpensive and provide greater flexibility than wired networks. With the advantages, however, come security vulnerabilities, particularly with unauthorized disclosure of sensitive data. Therefore, before a wireless network is implemented, the advantages need to be carefully weighed against the risks. In a recent review, the OA identified several wireless security problems, including an unauthorized wireless application, which was directly connected to the IRS-wide internal network containing sensitive taxpayer information, plus the storage of unencrypted electronic mail messages with sensitive information.

In another TIGTA review, the OA found that the IRS did not adequately protect some systems with sensitive taxpayer data from possible illegal manipulation, destruction, or theft. In addition, fundamental access controls, such as monitoring inactive accounts and user activity, were lax. Moreover, TIGTA audits during the past 3 years identified the main reasons for systems security weaknesses as inadequate accountability, security awareness, and training for key security employees. These underlying causes are management and operational issues, not technical ones. The IRS has focused on the technical solutions but has put little effort into management and operational concerns. Thus, the end result is an organizational culture that does not appear to place strong emphasis on the security and privacy of taxpayer data.

## **Integrating Performance and Financial Management**

*The President's Management Agenda*<sup>7</sup> includes both Budget and Performance Integration and Improved Financial Performance among the five Government-wide goals. The Administration hopes to put a greater focus on performance by formally integrating it with the budget decisions. The President is also concerned about the financial management of Government agencies and believes that a clean financial audit is a basic prescription for any well-managed organization. Without accurate and timely financial information, it is not possible to accomplish the President's agenda to secure the best performance and highest measure of accountability for the American people.

### **Performance Management**

The Government Performance and Results Act of 1993 (GPRA)<sup>8</sup> is intended to increase agency accountability and improve the quality and delivery of Government services. The GPRA holds Federal agencies accountable for program results by emphasizing goal setting, customer satisfaction, and results measurement. Federal agencies are required to prepare multi-year strategic plans, annual performance plans, and annual program performance reports. *The President's Management Agenda* requires agencies to produce performance-based budgets and, over time, agencies will be expected to identify high-quality outcome measures, accurately monitor the performance of programs, and begin integrating this presentation with associated costs.

The Office of Management and Budget (OMB) noted, in its 2002 Executive Branch Management Scorecard of the Treasury's progress in improving its performance, that the IRS is developing outcome measures and working to rationalize its budget structure. These efforts, and other improvements in performance measures, will make it easier to manage Treasury's programs to yield maximum results. However, significant barriers remain, particularly in the IRS' collection program for which the OMB assigned a "results not demonstrated" rating.

In reviews of the IRS' Wage and Investment (W&I) Division's Compliance function, the TIGTA found that the function has a comprehensive strategic planning process to help ensure it manages resources and meets its annual goals and performance levels for the Discretionary Examination Program and the Automated Underreporter (AUR) Program. The IRS, however, does not have long-term outcome goals and measures to assess the effectiveness of the Programs. For example, the Discretionary Examination Program will not be able to measure the success of its efforts to improve its goal of service to all taxpayers through the fair and uniform application of the tax law, and the AUR Program will not be able to measure its effect on reducing taxpayer burden and improving voluntary compliance. In addition, the AUR Program currently does not have sufficient data available to establish these long-term goals and measures or baselines.

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<sup>7</sup> *The President's Management Agenda*, announced in the summer of 2001, is an aggressive strategy for improving the management of the Federal government. It focuses on five areas of management weakness across the Government where improvements and the most progress can be made.

<sup>8</sup> Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

### **Financial Management**

Financial Management, too, remains a challenge to IRS management, even though for the third consecutive year, the IRS was able to produce financial statements covering its tax revenue and administrative activities that are fairly stated in all material respects. According to a recent General Accounting Office (GAO) report, many of the IRS' longstanding systems and internal control weaknesses continued to exist, necessitating continued reliance on costly compensating processes, statistical projections, external contractors, substantial adjustments, and monumental human efforts to prepare a set of reliable financial statements.<sup>9</sup> The report further noted that one of the largest obstacles facing IRS management today continues to be the agency's lack of a financial management system capable of producing the reliable and timely information its managers need to assist in making day-to-day decisions.

The Integrated Financial System's (IFS) scheduled October 1, 2003, implementation has been postponed to February 2004 at the earliest. This system represents a key element of the corrective actions being taken by the IRS to ensure its accounting system is in compliance with the Joint Financial Management Improvement Program's (JFMIP)<sup>10</sup> Federal Financial Management System Requirements, and provides accurate and timely financial information for management decision-making. The TIGTA's on-line audit of the system showed that the IRS established a framework to identify material administrative accounting requirements for inclusion in the IFS. However, the TIGTA identified 64 JFMIP requirements that were not specifically or fully addressed in the IFS' System Requirements Report. Of these 64 requirements, 36 represented mandatory JFMIP requirements.

Along with financial accountability, the Federal Government has a stewardship obligation to prevent fraud, waste, and abuse and to use tax dollars appropriately. The Office of Procurement, a key partner in delivering the IRS mission, awards and manages obligations that amount to nearly 20 percent of the IRS' budget. Most mission-critical programs rely on contract support. A recent TIGTA audit of the use of four of the nine Enterprise License Agreements (ELA) showed that the IRS is not utilizing the ELAs in a cost-effective manner. Two of the four ELAs included in the review were significantly under-utilized and one was over-utilized.

As a result of concerns of the Senate Finance Committee, the TIGTA also reviewed IRS purchase card transactions for potential fraud/misuse indicators and to identify questionable purchases. The TIGTA identified a small percentage of purchase card transactions that appeared to be intentional misuse of the cards. Additionally, screening of the purchase card data identified transactions that included items purchased from the IRS' Restricted Purchase List as well as transactions that appeared to be split purchases designed to circumvent delegated procurement levels.

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<sup>9</sup> *United States General Accounting Office Report to the Secretary of the Treasury – IRS' Fiscal Years 2002 and 2001 Financial Statements* (GAO-03-243, dated November 2002).

<sup>10</sup> The JFMIP is a joint undertaking of the Department of the Treasury, the GAO, the OMB, and the Office of Personnel Management, working in cooperation with each other and other agencies to improve financial management practices in the Federal Government.

### **Complexity of the Tax Law**

The scope and complexity of the U.S. tax code make it virtually certain that taxpayers will face procedural, technical, and bureaucratic obstacles in meeting their tax obligations. Although the IRS has consistently and commendably sought to ease the process for all taxpayers, each tax season brings new problems. Some older problems also stubbornly resist solution. Besides new tax law, other factors that can contribute to the complexity issue include language barriers, interpretations of the laws, and unclear IRS instructions. For this reason, the TIGTA continues to list complexity of the tax law as a major challenge facing IRS management.

For example, the TIGTA found that language for limited English proficient (LEP) taxpayers can be a barrier to accessing important benefits or services, understanding and exercising important rights, complying with tax filing responsibilities, or understanding the information provided by the IRS to the taxpaying public. Although LEP taxpayers have several verbal services to choose from when they need non-English assistance from the IRS, these taxpayers may be requiring this assistance because the IRS' written products (i.e., notices, forms, and publications) in non-English languages are limited.

In another review, the TIGTA estimated that more than 4,200 farmers' tax accounts might have been overpaid by more than \$4.4 million. A provision in the Taxpayer Relief Act of 1997<sup>11</sup> allowed farmers to elect to compute their tax liabilities by averaging farm income over a 3-year period. The IRS originally interpreted the farm income averaging provision of the tax law to exclude negative income from the calculations. However, members of the Senate clarified the intent of the Congress and recommended that proposed IRS regulations be amended to show that "taxable income" may be negative for the purpose of farm income averaging. These changes were implemented for Tax Year (TY) 2000 and were made retroactive to TY 1998, but farmers were required to file amended tax returns to claim any refund of tax for TYs 1998 or 1999. However, many farmers did not know about the opportunity to amend their tax returns for refunds.

Another example is the election notification process for small business corporations. In September 2002, the TIGTA issued a report that discussed how this process may be one of the factors that is hampering first-time filers from filing the U.S. Income Tax Return for an S Corporation (Form 1120S), and the TIGTA recommended that the IRS simplify the process of filing election forms and Forms 1120S. A recent TIGTA follow-up review found that the IRS had taken some corrective actions; however, the IRS cannot reasonably ensure that approximately 604,000 taxpayers (over a 5-year period) have been notified of the acceptance or denial of their elections. Unclear instructions regarding the filing of elections and related relief provisions may prevent taxpayers from making elections and obtaining the tax benefits of filing a small business corporate return.

### **Providing Quality Customer Service Operations**

The IRS' mission is to provide top quality service to every taxpayer in every transaction. Customer service is a major concern of the Congress and other stakeholders. In fact, the

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<sup>11</sup> Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 5 U.S.C., 19 U.S.C., 26 U.S.C., 29 U.S.C., 31 U.S.C., 42 U.S.C., and 46 U.S.C. app.).



RRA 98 mandated that the IRS be more responsive to customer needs. There are many ways in which the IRS provides customer service. The most direct include walk-in service, toll-free telephone service, electronic customer service, written communications to taxpayers, and accurate and timely tax refunds. Each of these services affects a taxpayer's ability and desire to voluntarily comply with the tax laws. Providing high-quality services can also be a challenge to the IRS.

Because quality service at IRS Taxpayer Assistance Centers (TAC) was a major concern, an amendment to the Treasury spending bill<sup>12</sup> for FY 2002 required the TIGTA to conduct visits to all TACs in CYs 2002 and 2003 and report to the Congress on whether taxpayers are provided correct and prompt answers to their questions. From January through December 2002, TIGTA auditors made 399 anonymous visits to 199 TACs located in the 50 states and Washington, D.C. During these anonymous visits, TIGTA auditors asked 802 questions related to 22 tax law topics that are within the scope of topics that TAC employees should have been trained to answer. Besides receiving incorrect tax law responses, the auditors were sometimes referred to IRS publications or even denied service.

The IRS established an accuracy goal of 80 percent for FY 2003, and plans to use the TIGTA's CY 2002 results as baseline figures to measure improvement during FY 2003. The TIGTA has issued audit reports for three reviews in CY 2003, which show that the IRS continued to improve services, but has not yet met the 80 percent goal. For example, in May and June 2003 TIGTA auditors made 64 anonymous visits to 32 TACs and asked 128 tax law questions. The IRS employees correctly answered 7 percent more questions and referred 94 percent fewer taxpayers to publications than the same period last year.

In addition to the TAC audits, the TIGTA also assessed the IRS' responses to taxpayer questions submitted via the IRS' Internet site (the *Digital Daily*) and toll-free telephone assistance lines. The IRS met its goal of providing an e-mail response within 2 business days for 89 percent of the questions anonymously submitted to the *Digital Daily* by TIGTA auditors and for which the IRS provided a response. However, the IRS does not have an effective system to ensure responses are provided for all the questions submitted. Specifically, auditors did not receive a response for 16 percent of the 90 questions anonymously submitted.

The TIGTA auditors also monitored a judgmental sample of 294 toll-free tax law calls between January 27 and March 13, 2003, and compared the results to records from an IRS statistically valid sample of 6,011 calls monitored during the same period. The 2 samples showed that Customer Service Representative (CSR) performance was professional and timely in 98 percent or more of the total number of calls monitored. Although TIGTA's sample showed a customer accuracy rate of 73 percent as compared to the IRS' measured rate of 81 percent, the need for CSRs to fully probe the taxpayer for information was clearly evident as an ongoing issue requiring improvement in both of the samples taken.

As a result of a TIGTA audit of the 2002 Filing Season,<sup>13</sup> the IRS has added new toll-free numbers for specific services (including telephone numbers on notice correspondence for

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<sup>12</sup> Pub. L. No. 107-67.

<sup>13</sup> The period from January through mid-April when most individual income tax returns are filed.

service specific to the type of notice), initiated skill-based routing to direct calls to CSRs with greater precision, and began using screeners for all tax law calls rather than having the callers navigate through a complex menu. The IRS also developed a training strategy for 2003 to address the need for greater flexibility to move CSRs among applications, and the training curriculum for newly hired CSRs was changed to enable them to handle account and balance-due calls. In addition, all CSRs will be trained to have a primary specialty and a back-up application assignment.

### **Erroneous and Improper Payments**

Stewardship responsibility over public funds is a major challenge facing IRS management. Both the President and the Congress have expressed concerns with the large amount of erroneous or improper payments made by Federal agencies. Two recent pieces of legislation – the Improper Payments Information Act of 2002<sup>14</sup> and Section 831 of the National Defense Authorization Act for FY 2002<sup>15</sup> – provide an impetus for all agencies to systematically address improper payment activity annually, and to identify and recover contract overpayments.

Improper and erroneous payments include inadvertent errors, payments for unsupported or inadequately supported claims, payments for services not rendered, payments to ineligible beneficiaries, and payments resulting from outright fraud and abuse by program participants and/or Federal employees. The IRS has identified filing fraud issues and potentially erroneous refunds being generated from misapplications of the Earned Income Tax Credit (EITC) as a material weakness.

The EITC Program, a major Federal effort to assist the working poor, is a refundable credit available to taxpayers who file returns with certain earned income. The EITC was established to offset the impact of Social Security taxes on low-income families and encourage them to seek employment rather than welfare. Historically, the EITC Program has been vulnerable to high rates of noncompliance (overclaims).<sup>16</sup> Based on an IRS report, of the estimated \$31.3 billion in EITC claims made by taxpayers for TY 1999, an estimated \$8.5 to \$9.9 billion (27 to 32 percent) should not have been paid. The GAO has listed the IRS' administration of the EITC Program among the high-risk areas for the Federal Government.

IRS efforts to improve the administration of the EITC Program are ongoing. The IRS reports that it has denied approximately \$2.25 billion in erroneous claims since September 2000, and it has implemented a number of initiatives targeting outreach, education, and compliance efforts. The IRS also participated in a joint Treasury-IRS task force to study EITC overclaims. This resulted in the IRS initiating a significant change to the way it will address EITC noncompliance, for example, by requiring EITC applicants who meet certain criteria to pre-certify and requiring new information on EITC returns.

The IRS also recently reorganized the EITC Program Office to capitalize on the strategic planning and research resources in the W&I Division's Office of Strategy and Finance. It

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<sup>14</sup> Pub. L. No. 107-300, 116 Stat. 2350.

<sup>15</sup> Pub. L. No. 107-107, 115 Stat. 1012, 1186.

<sup>16</sup> An EITC overclaim is the amount of the EITC claimed by taxpayers above the amount to which they are entitled.

also created an Executive Advisory Council made up of IRS executives involved in the administration of the EITC Program to help provide better oversight and coordination of the Program. The Program Office has drafted new annual performance measures for the EITC Program for FYs 2003 and 2004.

In addition to the EITC Program, potential improper payments to contractors and vendors are a major concern. The TIGTA is focusing more attention on payments to contractors and vendors, via audits of invoices. Additionally, the TIGTA's Procurement Fraud Section investigates allegations of fraud, waste, and abuse involving IRS procurements and misconduct by IRS employees and persons outside of the agency. For example, a judgment was recently entered against a Virginia couple in a Government contracting fraud case. The lawsuit centered on a 1995 contract between the IRS and a laptop computer repair company. The IRS contract called for the company to repair laptop computers and bill the IRS for its actual costs, plus a fixed markup. This repair company entered into an agreement with another company to do the actual repairs, and created a third corporation to act as a "middleman" between the two companies. By running invoices through this shell corporation, the repair company was able to fraudulently alter the invoices. The Government's suit alleges that from March 1996 through November 1997, the IRS paid \$428,902 under this contract as a direct result of the fraudulently inflated invoices.

### **Processing Returns and Implementing Tax Law Changes During the Tax Filing Season**

The tax return filing season impacts every American taxpayer and is, therefore, always a highly critical program for the IRS. In addition to providing customer service to American taxpayers, the IRS must coordinate tax law changes, programs, activities, and resources to effectively plan and manage each filing season. Often, the Congress passes these tax changes late in the year and the IRS must implement the changes before the tax filing season begins. Consequently, this issue remains on the TIGTA's list of major challenges facing IRS management.

Overall, the 2003 Filing Season went well. The computer programming requests initiated by the IRS to implement the new tax law provisions were timely and generally accurate. In addition, most of the 122 million individual income tax returns received through the end of May 2003, were timely and accurately processed. Some 52 million of these returns were processed electronically, an increase of 12 percent over the 2002 Filing Season. The biggest increase in alternative ways of filing was seen in the volume of on-line filing from home computers. In May 2003, the IRS reported that nearly 12 million taxpayers had used this filing method, which is a 27 percent increase over last year.

Even though the computer programming requests were timely and generally accurate, some errors and omissions were identified. For example, computer programming requests to implement the new retirement savings contribution credit and to change the IRA deduction contained errors or omissions that could have denied credits or deductions to some taxpayers or may have resulted in the loss of tax revenue by allowing certain taxpayers to receive larger credits or deductions than they were eligible to receive. The TIGTA also identified some areas of the tax laws that were not correctly implemented and could have resulted in loss of taxpayer entitlements or erroneous tax assessments. For

example, taxpayers with potentially unclaimed Additional Child Tax Credits were not notified of the possible eligibility, taxpayers were allowed retirement savings contributions credits and student loan interest deductions in excess of the amounts allowed by the new tax law changes, and taxpayers were allowed a “dual benefit” for the tuition and fees deduction and the education credit.

The IRS, in a move towards a paperless tax filing system, initiated the TeleFile Program on a limited basis in 1992. During the 1996 Filing Season, the TeleFile Program was offered on a nationwide basis to taxpayers who filed their tax returns using the single status, and was further expanded during the 1997 Filing Season to include those taxpayers who filed their tax returns with the married filing jointly status. The number of taxpayers using the TeleFile System each year decreased from the 1998 to 2002 Filing Seasons. Since the expansion of the TeleFile Program in 1997, the IRS has not identified any additional opportunities to expand taxpayer TeleFile Program eligibility. To provide measurable benefits to both the taxpayer and the IRS, and to enable the IRS to continue to move towards its goal of having 80 percent of all tax returns e-filed by 2007, the TIGTA recommended that the IRS develop a strategy outlining steps to be taken to offer the TeleFile Program to those taxpayers who file an Income Tax Return for Single and Joint Filers With No Dependents (Form 1040EZ) and are currently ineligible to use the TeleFile system. The TeleFile Program would then be an excellent way for the IRS to promote free e-filing to a segment of taxpayers who may be seeking an alternative to using the Internet.

### **Taxpayer Protection and Rights**

The RRA 98 included fundamental changes to tax law procedures and 71 provisions that increase or further protect taxpayers’ rights. Due to the comprehensive nature of the RRA 98, the IRS has dedicated significant attention and resources toward implementing the provisions. The IRS has taken several actions to improve compliance with these provisions. For example, in some instances, the IRS added a higher level of managerial review, implemented new computer controls to prevent certain violations from occurring, and provided additional training and guidance to help employees and managers understand the provisions’ requirements.

The TIGTA has reported that the IRS has fully implemented three taxpayer rights provisions – *Mitigation of Failure to Deposit Penalty, Seizure of Property, and Taxpayer Advocate-Hardships*. In addition, the IRS is generally compliant with two other provisions – *Illegal Tax Protestor Designation and Collection Due Process for Liens and Levies*.

The RRA 98 requires the TIGTA to review 10 of the 71 taxpayer rights provisions, as well as 2 other taxpayer rights provisions in prior legislation. The TIGTA’s FY 2003 audits are the fifth cycle of reviews assessing the mandatory RRA 98 provisions. The TIGTA’s most recent audit results on these taxpayer rights provisions are:

- *Notice of Levy* – Though managers review and approve manual levies issued by Automated Collection System employees, managers are not required to review or approve manual levies issued by revenue officers. Thus, these taxpayers are at risk of not having their appeal rights properly protected.
- *Restrictions on the Use of Enforcement Statistics to Evaluate Employees* – A review of enforcement employees’ performance and related supervisory documentation revealed

no instances of the use of tax enforcement results, production quotas, or goals to evaluate employee performance.

- *Notice of Lien* – Lien notifications were not always mailed within 5 business days after the day of the filing of the liens. The number of days late ranged from 1 to 17 days. Thus, taxpayers could have less than the 30-day period allowed by the law to request a hearing.
- *Seizures* – The TIGTA determined that the IRS complied with legal provisions and internal procedures when seizing taxpayers' property for payment of delinquent taxes.
- *Illegal Tax Protestor Designations* – The IRS has not reintroduced past Illegal Tax Protestor (ITP) codes on the Master File, and formerly coded ITP taxpayer accounts have not been reassigned to a similar ITP designation. In addition, the IRS does not have any current publications with ITP references. However, IRS employees continue to make references to taxpayers as ITPs and other similar designations in case histories.
- *Assessment Statute of Limitations* – Employees properly advised taxpayers of their right to refuse or restrict the scope of the statute extension in 74 percent of the tax returns sampled.
- *Denials of Requests for Information* – The TIGTA again identified some responses to the Freedom of Information Act<sup>17</sup> or the Privacy Act of 1974<sup>18</sup> requests where information was improperly withheld; however, the number of denials had decreased since the prior year.
- *Collection Due Process* – The IRS substantially complied with the requirements of the law and ensured taxpayers' appeal rights were protected in 98 percent of the appeal cases reviewed.

Neither the TIGTA nor the IRS could evaluate the IRS' compliance with the following four provisions since IRS management information systems do not track the specific cases:

- *Restrictions on directly contacting taxpayers instead of authorized representatives.*
- *Taxpayer complaints.*
- *Separated or divorced joint filer requests.*
- *Fair Debt Collection Practices Act Violations.*

### **Human Capital**

Like many other Federal agencies, the IRS has been experiencing workforce issues over the past several years ranging from recruiting, training, and retaining employees to problems associated with the IRS' recent reorganization and modernization efforts. The GAO has identified human capital issues as a major challenge facing many agencies, and in 2001, *The President's Management Agenda* proposed an aggressive strategy for improving the management of the Federal Government, including human capital issues. Some projections estimate that 19 percent of the Federal workforce will retire by FY 2005. While the IRS has taken some steps to resolve its human capital problems, many problems still exist. Therefore, the TIGTA continues to include human capital issues in its list of major management challenges facing the IRS.

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<sup>17</sup> 5 U.S.C. § 552.

<sup>18</sup> 5 U.S.C. § 552a.

To address many of its human resource concerns, the IRS created the Human Resource Policy Council (HRPC) to ensure a coordinated approach to agency-wide issues, policies, and strategies. The Council is composed of the Chief Human Capital Officer and representatives from each of the IRS' major organizations. The HRPC decided, for example, to eliminate agency-wide restrictions regarding fast-track promotion of IRS managers.

The new IRS is a flatter organization with more challenging roles for employees and managers. Technical training requirements are increasing for its employees, while managers also need training designed and delivered to meet their specific needs. Moreover, the IRS workforce has large numbers of individuals in key job series at or near retirement and forecasted retirement losses of managers only increases the demand for training and development needed for future IRS leaders.

The IRS, for example, estimates that, by FY 2006, 44 percent of the Large and Mid-Size Business Division revenue agent population will be eligible to retire. In addition, approximately 35 percent of all Small Business/Self-Employed Division non-seasonal employees will become eligible for retirement by 2006. The Tax Exempt and Government Entities (TE/GE) Division also projects that it will experience significant attrition over the next few years. Nearly 10 percent of TE/GE Division employees have more than 30 years of service and another 22 percent have more than 25 years of service.

Thus, the IRS may not only be faced with replacing many technical and managerial positions but will also face training this new workforce. This comes at a time when the IRS can hardly afford to lose its experienced workforce since it is now first showing signs of increasing its productivity in both examination and collection areas. Moreover, the IRS does not have adequate data to assess its training program. For example, the IRS Oversight Board requested training data from the IRS in order to perform an assessment and develop a baseline of training in the IRS. However, the data provided by the IRS did not contain basic information to show how training funds and resources were used or reflect any measure of their effectiveness.