

**The Fast Track Dispute Resolution Pilot
Program Was Successful, but Some
Challenges Remain**

July 2004

Reference Number: 2004-30-119

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

July 12, 2004

MEMORANDUM FOR COMMISSIONER, LARGE AND MID-SIZE BUSINESS
DIVISION
CHIEF, APPEALS

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Fast Track Dispute Resolution Pilot
Program Was Successful, but Some Challenges Remain
(Audit # 200230047)

This report presents the results of our review of the Fast Track Dispute Resolution Pilot Program (hereafter referred to as the pilot program). The objective of this review was to determine whether the pilot program was effectively designed and managed to provide Internal Revenue Service (IRS) officials with reliable information for deciding whether it should be expanded nationwide, modified, or terminated.

In summary, the pilot program was effectively designed and managed to provide officials with enough reliable information needed for converting it into a permanent program. The purpose of the pilot program was to determine if the IRS Large and Mid-Size Business (LMSB) Division and the Office of Appeals (Appeals) could accelerate the resolution of disputed tax issues in examinations of the nation's largest taxpayers. Statistics collected by the IRS show that 142 taxpayers were accepted into the 17-month pilot program, and approximately \$6.7 billion of recommended tax adjustments under dispute were resolved within the 120-day time period established for the pilot program. Comprehensive data were not available on the extent to which the pilot program saved taxpayers and the IRS time and money, largely because time and cost data have not been widely tracked or evaluated by individual tax issues in the IRS. However, both taxpayers and the IRS believe using the Fast Track process to avoid the traditional Appeals or litigation processes produced savings.

The success of the pilot program and its conversion to a permanent program that is now referred to as the Fast Track Settlement Program create some challenges in the LMSB

Division and Appeals. For the LMSB Division, it will be beneficial for managers to integrate additional Fast Track information into the Issue Management System (IMS) that is now being developed. During the pilot program, an ad hoc system that included data from an LMSB Division stand-alone application and the Appeals Centralized Database System (ACDS)¹ was used to help manage the relatively small number of pilot program cases. While the ad hoc system provided an informal, flexible, and effective way to help manage the cases in the pilot program, it does not have some functionality that will be advantageous to LMSB Division managers if the number of examinations with Fast Track issues increases as anticipated in the permanent program.

For example, the stand-alone application does not consistently capture information on the reasons why cases were not accepted into the Fast Track process, nor is it integrated with other LMSB Division management information systems. Moreover, it is not accessible to managers across the LMSB Division. LMSB Division management has recognized the need to incorporate Fast Track case information into the new IMS. However, the IMS will not have the capability to answer questions such as “How long are the different steps in the Fast Track process taking?” and “Are decisions not to accept cases into the Fast Track process being made in accordance with guidelines?”

In Appeals, the challenge is having the experienced personnel available to meet the demands of a workload that could substantially increase, due in part to abusive tax shelters. In the 1980s, abusive tax shelters posed a significant tax administration problem; in 1983, approximately 58 percent of completed tax shelter examinations were appealed. If Appeals is unable to meet the expected workload demands, the success of the Fast Track process could be in jeopardy, and it will be more difficult for Appeals to meet its goal of reducing the length of time it takes to resolve issues.

In light of these challenges, we recommended the Commissioner, LMSB Division, work with the IRS Business Systems Modernization Office in determining the feasibility of adding additional features to the IMS, so the different steps in the process and the decisions made to not accept cases into the Fast Track Settlement Program can be monitored through the IMS. We also recommended the Chief, Appeals, broaden the Appeals strategic management process in the future by establishing measures that can be used to track and evaluate whether the efforts that are underway for closing gaps between the existing staff and expected workload demands are producing the intended results.

Management's Response: IRS management agreed with our findings, and their corrective actions are responsive to our recommendations. The Commissioner, LMSB Division, agreed with our alternative recommendation to use the ACDS for monitoring Fast Track Settlement Program cases, after determining that adding more features to the IMS would not be cost-effective. The ACDS now has the capability of tracking the process steps for Fast Track Settlement Program cases, according to the Commissioner, LMSB Division. Additionally, the Chief, Appeals, agreed to broaden the Appeals strategic management process by establishing measures for evaluating efforts

¹ Appeals technical personnel use the ACDS to control and track cases throughout the appeal process.

to close the gap between existing staff and expected workload demands. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Philip Shropshire, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (215) 516-2341.

**The Fast Track Dispute Resolution Pilot Program Was Successful,
but Some Challenges Remain**

Table of Contents

| | |
|--|---------|
| Background | Page 1 |
| Pilot Project Results Support Making the Fast Track Process Permanent..... | Page 2 |
| Management Could Benefit by Integrating Additional Fast Track Case Information Into the Issue Management System | Page 4 |
| <u>Recommendation 1:</u> | Page 7 |
| Increased Workload in Appeals Could Hamper the Success of the Fast Track Process..... | Page 7 |
| <u>Recommendation 2:</u> | Page 10 |
| Appendix I – Detailed Objective, Scope, and Methodology | Page 11 |
| Appendix II – Major Contributors to This Report..... | Page 12 |
| Appendix III – Report Distribution List | Page 13 |
| Appendix IV – Alternative Dispute Resolution Initiatives Offered by the Internal Revenue Service..... | Page 14 |
| Appendix V – Management’s Response to the Draft Report | Page 15 |

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

Background

As an alternative to litigation, the Internal Revenue Service (IRS) has long provided taxpayers with an administrative process to resolve tax disputes in examinations through its Office of Appeals (Appeals). Traditionally, the dispute resolution process starts after an examination is completed and the case is transferred from an examiner to an Appeals Officer. Once a case is transferred, the Appeals Officer attempts to settle the dispute based on the strengths of the taxpayer's and examiner's positions outlined in documents submitted by each party and from the results of meetings with the taxpayer.

While nearly all tax disputes are resolved without litigation, the entire process, from the start of the examination to the resolution in Appeals, has long been criticized as especially lengthy and time-consuming for cases in the IRS Large and Mid-Size Business (LMSB) Division. LMSB Division examinations with disputes closed by Appeals in Fiscal Year (FY) 2002 took, on average, 6.6 years to resolve.

Unlike the traditional process in which an examination and the appeal occur sequentially, the Fast Track Dispute Resolution Pilot Program (hereafter referred to as the pilot program) tested whether the entire process could be expedited by using Appeals to resolve disputed issues concurrently with ongoing examinations. The pilot ran for approximately 17 months beginning in November 2001 and supported the Administrative Dispute Resolution Act of 1996,¹ which encourages the use of alternative dispute resolution techniques by Federal Government agencies. The IRS considers the pilot program one of its "success stories" in reducing the time and costs of resolving tax issues. In April 2003,² the pilot was expanded into a permanent program that is now called the Fast Track Settlement Program.

We performed the audit in accordance with *Government Auditing Standards* during the period November 2002 through June 2003. Onsite work was performed at the

¹ Pub. L. No. 104-320, 110 Stat. 3870.

² Official guidance (Rev. Proc. 2003-40, 2003-1 C.B. 1044) was issued on June 3, 2003.

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

LMSB Division Headquarters office in Washington, D.C., and Appeals offices in St. Louis, Missouri; Philadelphia, Pennsylvania; and the greater Los Angeles, California, metropolitan area. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Pilot Project Results Support Making the Fast Track Process Permanent

The LMSB Division and Appeals method in conducting the pilot program was sound. The pilot program met its objective of demonstrating that tax issues could be resolved concurrently with ongoing LMSB Division examinations, thereby decreasing the overall time between when returns are filed and all issues are resolved. Statistics collected by the IRS show that 142 taxpayers were accepted into the 17-month pilot program, and approximately \$6.7 billion of recommended tax adjustments under dispute were resolved within the 120-day time period established for the pilot program.

Comprehensive data were not available on the extent to which the pilot program saved taxpayers and the IRS time and money, largely because time and cost data have not been widely tracked or evaluated by individual tax issues in the IRS. However, both taxpayers and the IRS believe using the Fast Track process to avoid the traditional Appeals or litigation processes produced savings.

Before the pilot program effort was started, a working group of executives, managers, and technical personnel from the IRS Office of Chief Counsel, LMSB Division, and Appeals met to develop a comprehensive plan to guide the design and implementation of the pilot program. Because the plan determined in advance a number of important evaluation features, it enhanced the credibility of results and helped avoid perceptions of bias.

As summarized in Table 1, these features included the need and rationale for the Fast Track process; delineation of roles and responsibilities for participants; information on how data would be collected, analyzed, and evaluated; and a success measure. Table 1 also refers to other IRS initiatives to accelerate the resolution of issues and overcome barriers that limited their use.

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

| Table 1: Summary of Key Evaluative Features in the Design and Pilot of the Fast Track Process |
|--|
| Rationale for the Fast Track Process |
| <ul style="list-style-type: none"> • Overcome barriers that limited the use of prior dispute resolution initiatives.³ • Eliminate the duplicate actions and delays that occur under the traditional process. • Decrease the overall time between when returns are filed and all issues are resolved. |
| Participant Roles and Responsibilities |
| <ul style="list-style-type: none"> • IRS Executive-level managers provide policy oversight and communicate progress to stakeholders. • The IRS Office of Chief Counsel advises on policy and procedural issues. • LMSB Division and Appeals project coordinators review and monitor results. • Appeals Team Case Leaders or Appeals Officers lead the Fast Track process and draft closing agreements. • LMSB Division first-line managers promote using the Fast Track process. • Taxpayers agree to participate in the process and provide necessary information and resources to complete the process timely. |
| Methods of Collecting, Analyzing, and Evaluating Data |
| <ul style="list-style-type: none"> • Questionnaires obtain information about levels of satisfaction with the process, resource savings, and ideas for improvement. • Data captured include process start and end dates, types and amounts of issues, and resources used. • Existing information systems were used to capture data when possible. |
| Success Measure |
| <ul style="list-style-type: none"> • A 120-day time period was established and used to determine the overall success in resolving the disputes. |

Source: Appeals/Large and Mid-Size Business, Alternative Dispute Resolution Report (July 2001).

For example, the IRS started trying to resolve disputed issues during ongoing examinations in 1994 under its Early Referral to Appeals procedure. However, IRS statistics show that 42 taxpayers used the procedure between FYs 1997 and 2002, which is a relatively small number

³ Appendix IV outlines numerous other alternative dispute resolution initiatives built into the IRS' business processes that provide opportunities to prevent or resolve disputes administratively.

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

considering that 142 taxpayers participated in the 17-month Fast Track pilot program. While the Early Referral to Appeals and Fast Track processes are similar, there are at least three reasons why the Fast Track process is proving to be the more popular option for resolving disputes.

First, the pilot program was offered to a larger population of taxpayers because it is generally available to all of the taxpayers served by the LMSB Division. Conversely, the Early Referral to Appeals option was initially designed for and limited to the largest taxpayers in the LMSB Division, an estimated 1,200 taxpayers as of March 7, 2003. Second, the Fast Track process creates two opportunities for taxpayers to resolve issues. Under Fast Track rules, a taxpayer who is not satisfied with the outcome of the Fast Track process can also use the traditional Appeals process for unresolved issues.

Finally, significant efforts also went into marketing the pilot program, which addressed past criticisms that more could have been done to promote the use of alternative dispute initiatives. The marketing efforts for the pilot program included identifying the target audience, placing articles and advertisements in tax publications, and conducting an extensive public awareness/education campaign.

However, the success of the pilot program and its conversion to the permanent Fast Track Settlement Program create some challenges in the LMSB Division and Appeals. For the LMSB Division, it will be beneficial for managers to integrate additional Fast Track information into the Issue Management System (IMS) that is now being developed. The challenge for Appeals is having the experienced personnel available to meet the demands of a workload that could significantly increase.

Management Could Benefit by Integrating Additional Fast Track Case Information Into the Issue Management System

Although the term *management information system* has been defined in many ways, it is basically a data collection system that can serve as a major analytical tool for planning, evaluating, and controlling business activities. Further, the General Accounting Office (GAO) *Standards for Internal Control in the Federal Government* indicate information from such systems is the foundation for managers to

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

effectively set strategic and performance goals and to measure and report on the progress toward achieving them.

During the pilot program, an ad hoc system was used to monitor progress, evaluate results, and report on the pilot's progress. The system included an LMSB Division stand-alone application with descriptive and case-tracking information captured from various sources, such as Fast Track applications, participants' surveys, case progress reports, and the Appeals Centralized Database System (ACDS).⁴ We reviewed the source documents for a judgmental sample of 41 closed pilot program cases and evaluated progress information captured and reported to executives. We found that the system provided reliable data on milestones tracked, estimated resources saved, and results achieved.

While the ad hoc system provided an informal, flexible, and effective way to help manage the relatively small number of pilot program cases, it does not have some functionality features that will be beneficial to managers in the permanent Fast Track Settlement Program. For example, the stand-alone application does not consistently capture information on the reasons why cases were not accepted into the Fast Track process, nor is it integrated with other LMSB Division management information systems. Moreover, it is not accessible to managers across the LMSB Division.

The LMSB Division, recognizing the benefits of integrating its information systems, is developing a new IMS. If implemented as envisioned, the IMS will contain information that currently resides on multiple stand-alone systems: Audit Information Management System (AIMS), Coordinated Examination Management Information System (CEMIS)⁵, International Case Management System

⁴ Appeals technical personnel use the ACDS to control and track cases throughout the appeal process.

⁵ The AIMS and CEMIS are management information systems that contain data on open and closed examinations.

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

(ICMS),⁶ and Specialist Systems.⁷ By integrating the information from these systems into the IMS, officials believe they will have the ability to better prepare strategies, make resource decisions, apply consistent treatment to taxpayers, and share information across program areas.

Although we did not conduct an in-depth analysis of the IMS, our discussion with the LMSB Division Business Systems Planning Office and our limited review of the System's blueprints indicate the IMS will provide managers with information on the numbers, types, and amounts of issues accepted into and resolved through the Fast Track process. It will also provide managers with the dates the process starts and ends, which is important for determining if the overall 120-day turnaround goal established for the process is being met.

Since the LMSB Division is responsible for controlling examinations with Fast Track issues, it will be advantageous for its managers to have additional information if the number of examinations with Fast Track issues increases as anticipated in the permanent Fast Track Settlement Program. As currently planned, the IMS will not capture information needed to (1) identify the nature and extent of delays between when Fast Track applications are first received and when the process actually starts, (2) monitor the progress being made in meeting individual issue target completion dates when multiple issues are involved, or (3) determine the reasons why applications were not accepted into the Fast Track process. This additional information, among other things, would provide managers with the capability to answer questions such as "How long are the different steps in the Fast Track process taking?" and "Are decisions not to accept cases into the Fast Track process being made in accordance with guidelines?"

During discussions with IRS officials on April 23, 2004, we learned that Appeals is modifying the ACDS to capture

⁶ The ICMS is used to track cases referred and assigned to International Examination Groups.

⁷ These are management information systems used by the various LMSB Division specialists that provide technical guidance to examiners.

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

more comprehensive tracking information on Fast Track cases. While we did not evaluate the extent of the modifications being made to the ACDS, this System may provide an alternative to using the IMS. However, the ACDS currently does not have some of the same functionality features as the ad hoc system that was used in the pilot program. For example, the ACDS is not currently integrated with other LMSB Division management information systems, nor is it readily accessible to managers across the LMSB Division.

Recommendation

1. The Commissioner, LMSB Division, should work with the IRS Business Systems Modernization Office in determining the feasibility of adding additional features to the IMS and, if cost-effective, make the modifications. The modifications to the IMS should provide LMSB Division managers with the capability of determining through the system how long the different steps in the process are taking and whether decisions to not accept cases into the Fast Track Settlement Program were made in accordance with guidelines. If adding these features is not cost-effective, the Commissioner, LMSB Division, should evaluate the merits of using the ACDS as an alternative for monitoring such activities.

Management's Response: The Commissioner, LMSB Division, agreed with our alternative recommendation to use the ACDS for monitoring Fast Track Settlement Program cases, after determining that adding more features to the IMS would not be cost-effective. The ACDS now has the capability of tracking the process steps for Fast Track Settlement Program cases, according to the Commissioner, LMSB Division.

Increased Workload in Appeals Could Hamper the Success of the Fast Track Process

The challenge in Appeals is having the experienced personnel available to meet the demands of a workload that could significantly increase. In particular, much of Appeals' workforce is nearing retirement age, and its workload is expected to substantially increase due in large part to the IRS' renewed emphasis on enforcing compliance. If Appeals is unable to meet the expected demand for its

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

services, the success of the Fast Track process could be in jeopardy, and it could be more difficult for Appeals to meet its goal of reducing the length of time it takes to resolve issues.

Like other areas within the IRS, Appeals has an aging workforce and is facing a loss of critical talent. In 2003, for example, the IRS reported results from a workforce study that found about 43 percent of Appeals Officers are currently eligible for retirement or will be so in the next 2 years. Additionally, the IRS has considerable efforts underway to streamline its examination processes and hire 1,000 examiners, so more taxpayers can be examined including those involved in abusive tax shelters.⁸ The additional examinations will likely increase the number of tax disputes for Appeals to resolve, particularly those involving abusive tax shelters. Abusive shelters also posed a tax administration problem for the IRS in the 1980s. Then, as now, the IRS admittedly had limited reliable information on the size of the problem or the resources needed to address the problem. However, the abusive shelters in the 1980s imposed a significant strain on IRS resources, partly because taxpayers appealed many of the examinations involving shelters. In 1983, for example, the GAO reported⁹ that 58 percent of completed tax shelter examinations were appealed, involving 90 percent of all potential revenue from these examinations.

In light of the impact that both the potential loss of personnel due to retirement and the IRS' renewed emphasis on enforcing compliance could have on resources, we performed a limited review of Appeals and IRS strategic planning documents. The Appeals FY 2003/2004 Strategy and Program Plan includes five goals: "address the changing inventory and customer base; reduce the length of

⁸ The IRS generally describes abusive tax shelters as complicated transactions that sophisticated tax professionals promote to corporations and wealthy individuals, exploiting tax loopholes and generating large unintended tax benefits.

⁹ *With Better Management Information, IRS Could Further Improve Its Efforts Against Abusive Tax Shelters* (GAO/GGD-83-63, dated August 1983).

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

the Appeals process; improve employee satisfaction, recruitment, and retention; improve stakeholder awareness of Appeals rights and processes; and implement Appeals tax shelter resolution strategies.” Setting these goals establishes the overall direction for Appeals and conforms to the larger strategic management process in the IRS that the Congress expects each agency to follow under the Government Performance and Results Act of 1993 (GPRA).¹⁰

As part of strategic management under the GPRA, each agency is also expected to develop and implement a workforce plan¹¹ to help achieve strategic goals. To assist agencies in workforce planning efforts, the Office of Personnel Management (OPM) has published an overall framework for the process. Among other things, the OPM framework provides that agencies (1) include staff from across the organization in the process, (2) identify and analyze gaps between the existing staff and expected workload demands, (3) implement processes to close the gaps, and (4) evaluate results to identify improvement opportunities.

Both the IRS and Appeals are beginning to incorporate workforce planning into their strategic management processes and, on a high level, their work is fitting into the framework outlined by the OPM. The IRS, for example, has issued guidelines outlining an agency-wide workforce planning system so its divisions, such as Appeals, can incorporate it into their strategic planning.

The IRS and Appeals have also analyzed workforce data and identified trends, issues, and problems. Appeals is using this information and other analyses to address gaps it has identified between existing staffing and expected workload demands. For example, the Appeals FY 2003/2004 and FY 2004/2005 Strategy and Program Plans have objectives to develop a comprehensive plan for improving recruitment, develop long-term employee

¹⁰ 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.).

¹¹ A workforce plan sets long-term objectives for workforce activities at the organizational and unit levels.

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

retention plans, establish succession plans for managers, and improve training programs. As Appeals moves forward with these efforts, it will be important for it to develop measures to track and evaluate its progress toward meeting these objectives. Periodic measurement and evaluation can, among other things, provide data for identifying shortfalls and opportunities for improvement.

Recommendation

2. The Chief, Appeals, should broaden the Appeals strategic management process in the future by establishing measures that can be used to track and evaluate whether the efforts that are underway for closing gaps between the existing staff and expected workload demands are producing the intended results.

Management's Response: The Chief, Appeals, agreed to broaden the Appeals strategic management process by establishing measures for evaluating efforts to close the gap between existing staff and expected workload demands.

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

Appendix I

Detailed Objective, Scope, and Methodology

Our objective was to determine whether the Fast Track Dispute Resolution Pilot Program (hereafter referred to as the pilot program) was effectively designed and managed to provide Internal Revenue Service (IRS) officials with reliable information for deciding whether the pilot program should be expanded nationwide, modified, or terminated. Extensive data validation tests were outside the scope of this audit and would have required extensive resources and time. We did not perform any independent testing to verify the accuracy of the Audit Information Management System (AIMS)¹ data obtained from the IRS. However, we did verify selected Fast Track information for a judgmental sample of 41 cases accepted and closed on the Large and Mid-Size Business (LMSB) Division Fast Track database and the Appeals Centralized Database System (ACDS)² to source documents. Our specific tests included:

- I. Assessing the need and rationale for the pilot program and verifying whether a plan was developed and implemented with objectives, goals, success measures, milestones, targeted completion dates, and designation of management officials responsible for the results.
- II. Evaluating the adequacy of the process used in developing and measuring results (i.e., business results, customer satisfaction, and employee satisfaction) of the pilot program and whether a determination of program effectiveness was established.
- III. Reviewing source documents for a judgmental sample of 41 cases from a population of 53 cases accepted and closed in the pilot program by November 2002. We used judgmental sampling due to time constraints.
- IV. Using the General Accounting Office *Standards for Internal Control in the Federal Government* to assess the adequacy of the information system used to monitor and measure the success of pilot program cases.
- V. Reviewing and discussing blueprints for the Issue Management System with officials from the LMSB Division Business Systems Planning Office to assess whether the System will have the capability to monitor Fast Track case activities.
- VI. Reviewing Office of Appeals and IRS strategic planning documents to evaluate whether efforts being made in workforce planning are conforming to the Office of Personnel Management guidelines.

¹ The AIMS is a computer system that contains data on open and closed examinations.

² Office of Appeals technical personnel use the ACDS to control and track cases throughout the appeal process.

**The Fast Track Dispute Resolution Pilot Program Was Successful,
but Some Challenges Remain**

Appendix II

Major Contributors to This Report

Philip Shropshire, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs)

Frank Dunleavy, Audit Manager

Lisa Stoy, Lead Auditor

Gwendolyn S. Gilboy, Senior Auditor

Jean Kao, Auditor

**The Fast Track Dispute Resolution Pilot Program Was Successful,
but Some Challenges Remain**

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Chief, Appeals AP
Deputy Commissioner, Large and Mid-Size Business Division SE:LM
Associate Chief Information Officer, Business Systems Modernization OS:CIO:B
Director, Business Systems Planning SE:LM:BSP
Director, Quality Assurance and Performance Management SE:LM:Q
Director, Technical Services AP:TS
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Management Controls OS:CFO:AR:M
Audit Liaisons:
 Chief, Appeals AP
 Commissioner, Large and Mid-Size Business Division SE:LM

**The Fast Track Dispute Resolution Pilot Program Was Successful,
but Some Challenges Remain**

Appendix IV

Alternative Dispute Resolution Initiatives Offered by the Internal Revenue Service

Table 1 shows that, in addition to the Fast Track Settlement Program, the Internal Revenue Service (IRS) has numerous other alternative dispute resolution initiatives built into its business processes that provide opportunities to prevent or resolve disputes administratively. The table presents an overview for some of these other initiatives, as well as the targeted taxpayer population.

**Table 1: IRS Alternative Dispute Resolution
Initiatives to Prevent or Resolve Income Tax Disputes**

| Initiative | Overview | Intended Taxpayers |
|--|---|---|
| Accelerated Issue Resolution | Issues resolved in the current examination are carried forward to other filed returns. | Large and Mid-Size Business (LMSB) Division taxpayers |
| Advance Pricing Agreement | Allows taxpayers to request an agreement on the factual nature of intercompany transfers, a transfer pricing methodology, and an expected range of results from the methodology. | Generally applies to LMSB Division taxpayers |
| Advance Valuation of Art Work | Allows a taxpayer to obtain an IRS review of a taxpayer's valuation of art work before filing a return. | Available to all taxpayers |
| Arbitration | Taxpayers may use binding arbitration procedures for factual issues that are already in the Office of Appeals (Appeals) administrative process and not docketed in court. | Available to all taxpayers |
| Delegation Order 4-25 | Gives case managers the authority to settle certain issues for which Appeals has issued settlement guidelines. | LMSB Division and Small Business/Self-Employed Division taxpayers |
| Delegation Order 236 | Provides LMSB Division managers with the authority to settle issues for which a prior settlement has been made by Appeals. | LMSB Division taxpayers in the Coordinated Industry Case (CIC) Program ¹ |
| Early Referral to Appeals | A method by which a taxpayer may request an early referral to Appeals of one or more unresolved issues from an examination or collection action. | Generally applies to LMSB Division taxpayers |
| Fast Track Mediation | Designed to use Appeals mediation to expedite the resolution of examination or collection issues in cases that are in the jurisdiction and control of other operating divisions. | Available to taxpayers other than those served by the LMSB Division |
| Simultaneous Appeals/Competent Authority | Gives taxpayers an opportunity to request competent authority assistance when they believe action of the United States, a treaty country, or both will result in taxation that is contrary to provisions of a treaty. | Available to all taxpayers |

¹ The CIC Program is made up of approximately 1,200 of the largest LMSB Division corporations.

**The Fast Track Dispute Resolution Pilot Program Was Successful,
but Some Challenges Remain**

Appendix V

Management's Response to the Draft Report



COMMISSIONER
LARGE AND MID-SIZE
BUSINESS DIVISION

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

RECEIVED
JUL 01 2004

June 28, 2004

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR
TAX ADMINISTRATION

FROM: Deborah M. Nolan *Deborah M. Nolan*
Commissioner, Large and Mid-Size Business Division

SUBJECT: Draft Audit Report - The Fast Track Dispute Resolution Pilot
Program Was Successful, but Some Challenges Remain
(Audit # 2002-30-047)

I concur with the findings of your audit report on the review of the Fast Track Dispute Resolution Pilot Program. Your report describes the program, its history, the benefits to taxpayers, and the other IRS initiatives we have in place to accelerate the resolution of examination issues listed in Appendix IV of your report. The pilot program was a success story shared equally by the Large and Mid-Size Business (LMSB) Division and the Appeals function. During the 17-month long pilot program, we accepted 142 taxpayers into the program and resolved \$6.7 billion of recommended tax adjustments. All disputed examination issues were successfully resolved within the 120-day timeframe established in the program. Because of its success, we converted the pilot program to the permanent Fast Track Settlement Program.

As stated in your report, the goal of the Fast Track Dispute Resolution Program is to expedite the entire examination process by bringing in Appeals to resolve disputed issues concurrent with the examination rather than subsequent to it. The latter is a particularly time-consuming process. On average, our disputed examinations take about six years to resolve because of the complexity of the issues found in medium to large corporations. We expect to improve the currency and cycle time of our corporate examinations, increase revenue, and improve customer satisfaction through earlier resolution of issues with programs such as the Fast Track Settlement Program.

I agree with your assessment that challenges remain with respect to our success measures, case information tracking for program evaluation, increasing workload demands, and human resource capital. We will continue to work with Appeals to meet those challenges. Attached is a detailed response outlining the corrective actions that the LMSB Division and Appeals function plan to address your audit recommendations.

**The Fast Track Dispute Resolution Pilot Program Was Successful,
but Some Challenges Remain**

2

If you have any questions, please contact me, or a member of your staff may contact Kelly Cables, Director, Performance, Quality Assurance, and Audit Assistance, at (202) 283-8334, or in Appeals, Joseph P. Sanchez, Director, Strategic Planning and Measures Analysis at (202) 694-1814.

Attachment

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

Attachment

RECOMMENDATION 1:

The Commissioner, LMSB Division, should work with the IRS Business Systems Modernization Office in determining the feasibility of adding additional features to the Issue Management System (IMS) and, if cost effective, make the modifications. The modifications should provide LMSB Division managers with the capability of determining through the system how long the different steps in the process are taking and whether decisions to not accept cases into Fast Track were made in accordance with guidelines. If adding these features is not cost effective, the Commissioner, LMSB Division should evaluate the merits of using the Appeals Centralized Database System (ACDS) for monitoring such activities as an alternative.

CORRECTIVE ACTIONS:

The LMSB Division reviewed the feasibility of modifying the IMS to integrate additional information from the Fast Track Settlement Program with the Assistant Project Manager in Modernization and Information Technology Services (MITS). The initial IMS deployment is scheduled for Release I in November 2004. As a result, new fields cannot be added to the database at this time. A significant number of changes have been proposed for Release II, which will be prioritized by the Business Review Board in June 2004. However, when comparing the small number of Fast Track Settlement cases to the total number of LMSB cases, it is not cost effective to include the proposed modifications to the IMS in Release II.

We agree with your alternative recommendation to use the ACDS for monitoring the Fast Track process. As mentioned in your report, Appeals modified the ACDS to capture more comprehensive data on Fast Track cases. ACDS now has the capability of tracking the process steps for the Fast Track Settlement cases. LMSB can request this information from Appeals as needed. We will continue to use the stand-alone system, along with information from ACDS, to gather the data needed to monitor the activities of the Fast Track Settlement Program.

Regarding the recommendation to track rejected applications, most Fast Track applications are accepted into the program. In addition, if an application is rejected, it is typically done for further development of the issue(s). The Program Manager, Fast Track Settlement Program, works with the audit team and the taxpayer to perfect the application when further development is required.

IMPLEMENTATION DATE:

May 6, 2004 – Appeals revised procedures for recording Fast Track data in the ACDS that will enhance its accuracy.

The Fast Track Dispute Resolution Pilot Program Was Successful, but Some Challenges Remain

2

RECOMMENDATION 2:

The Chief, Appeals, should broaden the Appeals strategic management process in the future by establishing measures that can be used to track and evaluate whether the efforts that are underway for closing gaps between the existing staff and expected workload demands are producing the intended results.

CORRECTIVE ACTION(S):

Appeals agrees with your recommendation to broaden its strategic management process and will continue to emphasize recruitment, employee retention, succession planning for managers, and improved training in its FY 2005/2006 Strategy and Program Plan. Appeals previously established quantitative measures for evaluating the implementation of the strategy in its FY 2004/2005 plan and has qualitative measures in place to monitor key performance indicators related to this issue. Measures will be established to tie these factors together to measure management efforts to close the gap between existing staff and expected workload demands.

IMPLEMENTATION DATE:

October 1, 2004

RESPONSIBLE OFFICIAL(S):

Director, Strategic Planning & Measures Analysis (Appeals)

CORRECTIVE ACTION(S) MONITORING PLAN:

Appeals will include these measures in its FY 2005/2006 Strategy and Program Plan and report on them in the Business Performance Review.