

## **IRS Oversight Board**

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**WRITTEN STATEMENT OF  
IRS OVERSIGHT BOARD  
CHAIRMAN PAUL CHERECWICH, JR.  
BEFORE THE  
HOUSE COMMITTEE ON WAYS AND MEANS  
SUBCOMMITTEE ON OVERSIGHT  
MARCH 13, 2008**

The IRS Oversight Board thanks Chairman Lewis and Ranking Member Ramstad for the opportunity to submit its views on the Internal Revenue Service's operations and its FY2009 budget. Created as part of the IRS Restructuring and Reform Act of 1998 (RRA 98), the Oversight Board's responsibilities include overseeing the IRS in its administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws. The Board is also responsible for ensuring that the IRS' organization and operations allow the agency to carry out its mission. To this end, the Board was given specific responsibilities for reviewing and approving annual budgets and strategic plans.

Given the mission of the Board to provide governance over the IRS, it is most appropriate for the Board to focus its comments on the progress that IRS operations have made since the passage of RRA 98, the strategic challenges which the IRS still faces, and its recommendations for the IRS' FY2009 budget.

### **IRS Operations and Challenges**

It is now almost a decade since the enactment of the IRS Restructuring and Reform Act of 1998 and the IRS Oversight Board is pleased to report that the IRS has made steady progress in meeting the letter and spirit of that landmark legislation.

Over the past nine years, the IRS has reorganized and modernized itself to think strategically and operate with a customer-centric focus. It is becoming a performance-driven, results-oriented organization that provides taxpayers with quality service through a variety of channels, including Internet, telephone, and in-person.

It is doing a better and more efficient job of enforcing the tax laws and collecting the taxes owed the federal government. The IRS has improved its ability to interact with taxpayers electronically and is now delivering benefits to all types of taxpayers. For example, the IRS can now accept electronically many types of returns including all the major tax forms and offers more Internet-based self-serve options than ever before.

The Oversight Board praises the IRS for this improvement. The IRS has demonstrated to its skeptics that it can change for the better. However, it still faces many challenges and must not become complacent. The existence of an annual \$290 billion net tax gap, the difference

between what is legally owed and what is actually paid, is a stark reminder that improvements in tax administration are still needed.

The IRS should not settle for good performance—it must set its sights on great performance. In the Board's view, taking that important step will require increased management focus and potential “breakout” performances in four key areas: (1) customer service, (2) enforcement, (3) human capital, and (4) information technology.

To take customer service to the next level, the IRS must do more than respond to taxpayer inquiries. It must understand taxpayers' needs better through new research and implement education and outreach services tailored to the needs of specific groups of taxpayers. Great service requires that the IRS proactively provide taxpayers with information that helps them easily understand their tax obligations, provides more self-service applications, simplifies information sharing, and facilitates electronic filing. On a limited basis, the IRS has demonstrated that it can form community partnerships that perform effective outreach to taxpayers, such as the Volunteers in Tax Assistance (VITA) program. Such programs should be expanded.

Through modern electronic tax administration (ETA) services, the IRS can provide more opportunities for taxpayers and tax professionals to interact quickly, efficiently and accurately with the IRS. Great service will entail a broader use of secure electronic interactions over the Internet between taxpayers, practitioners and the IRS, such as account management and issue resolution, than is offered today. These capabilities are much along the lines of what large financial institutions already offer their customers.

The IRS must apply the results of its research program to increase the effectiveness and efficiency of its enforcement activity. In selecting taxpayers for audits, the IRS should have a high degree of confidence that an audit is necessary. High no-change rates for audits place unnecessary burdens on taxpayers and waste IRS resources. The Oversight Board expects that the IRS will use the results of the National Research Program (NRP) to focus its audit programs where they will be the most effective. Collection cases must also be worked as effectively as possible, with cases assigned to different treatment streams based on the optimum assignment of resources for the expected return and impact on compliance.

Today, enforcement is a major part of the IRS' mission but does not dwarf customer service as it did in the early- to mid-1990s. In this regard, the IRS is to be commended for doing a better job enforcing the tax code in a manner consistent with RRA 98's safeguards. As customer service improved, more resources were appropriately shifted to support enforcement activities. Key performance measures for enforcement, such as audits of individuals with higher incomes are up and enforcement revenues have increased, while taxpayer service measures such as level of service have remained stable.

Through its annual taxpayer attitude survey, the Board has also found that 94 percent of taxpayers believe it is every American's civic duty to pay their fair share of taxes. Around 86 percent cite personal integrity as a principal factor influencing whether they report and pay their taxes honestly, while only 54 percent of taxpayers indicate they are influenced by fear of an audit.

The Board encourages the IRS to find ways to leverage this strong support for voluntary tax compliance and personal integrity and reinforce the message that tax compliance is a “social norm,” much like obeying laws against shoplifting or drunk driving. The Board is particularly concerned that this message be reinforced with America's young people. Previous surveys have shown they are more willing to accept cheating “a little here or there” on their taxes.

Another area that must be addressed for the IRS to achieve great performance is workforce development. Employees are the IRS' greatest asset but the aging of the workforce represents

an enormous challenge; approximately 4,000 of its employees are retiring annually. Many of them possess unique skills and institutional knowledge that are not captured when they leave, and the IRS has found it difficult to recruit a sufficient number of skilled employees to replace them.

The IRS must devote more attention to the total career development of its workforce, from hiring to retiring. It should emphasize career development throughout the entire “work life” of employees. It should recruit more like the private sector and employ proven “best practices” to improve employee recruitment, retention, training, and succession planning. Employees should have clearly defined career development opportunities throughout their employment.

More progress must also be made in the IRS’ efforts to modernize its information technology (IT). The IRS has made slow but steady progress in replacing its antiquated IT systems. The most noticeable improvements to taxpayers include electronic filing of tax returns and Internet self-service tools such as “Where’s my Refund?”, “¿Dónde está mi reembolso?”, and Practitioner e-Services. Infrastructure improvements have also allowed the IRS to improve toll-free telephone level of service through more effective call routing. However, IRS performance is still hampered by archaic IT systems used for central record-keeping that update taxpayer account information on a weekly instead of a daily basis.

The IRS will not be able to achieve great performance until it can update its central records on a daily basis, much like any other modern financial institution. Such a capability is needed to modernize both its customer service and enforcement functions. Daily updating of records will provide current information to taxpayers, tax professionals, and IRS employees, improve IRS efficiency, and reduce taxpayer burden.

It is critical that the IRS make real progress each year to reach its three strategic goals. However, it is also vitally important that specific quantitative measures for these long-term goals be set to follow the IRS’ performance in key areas. In March 2007, the Oversight Board approved five long-term measures with target values and requested the IRS to identify an additional set of measures for employee engagement and customer satisfaction, along with a measure to assess progress in modernizing its technology systems. The Board is pleased to see the IRS make progress in measuring the achievement of its strategic goals.

### **FY2009 IRS Budget Recommendations**

One of the IRS Oversight Board’s most important statutory responsibilities is to ensure that the IRS’ budget request supports the agency’s annual and long-term strategic plans. A budget request is more than a mechanism for appropriating funding; it’s also a plan and a commitment. Not only does a proposed budget request funding, it also describes the activities the IRS will perform, how those activities align with the long-range strategic plan, and identifies measures to evaluate the expected results. A performance budget is more than money, it’s a performance management tool, and properly used, enhances the ability of the IRS to meet its short-term performance targets and the agency’s three strategic plan goals: (1) improve customer service; (2) enhance enforcement of the tax law; and (3) modernize the IRS through its people, processes and technology.

Achieving these three strategic goals will enable the IRS to address the most serious problem facing tax administration today—reducing the tax gap, the difference between what taxpayers should be paying and what they actually pay in a timely manner. The size of the tax gap is significant, with the IRS’ most recent estimates placing it at approximately \$290 billion (net) annually, based on 2001 tax returns. The imperative for closing the tax gap has never been greater. An annual net tax gap of \$290 billion averages to about \$2,200 per individual tax return, an enormous burden for the average taxpayer, and one that should not be tolerated by honest

taxpayers. It is far too large to be dismissed lightly—it imposes a large burden on all taxpayers and undermines respect for tax administration.

The IRS Oversight Board recommends an IRS FY2009 budget of \$11.737 billion, an increase of \$845 million over the enacted FY2008 amount of \$10.892 billion, as summarized in Table 1.

**Table 1: IRS Oversight Board's Recommended FY2009 IRS Budget**  
(all dollars in millions)

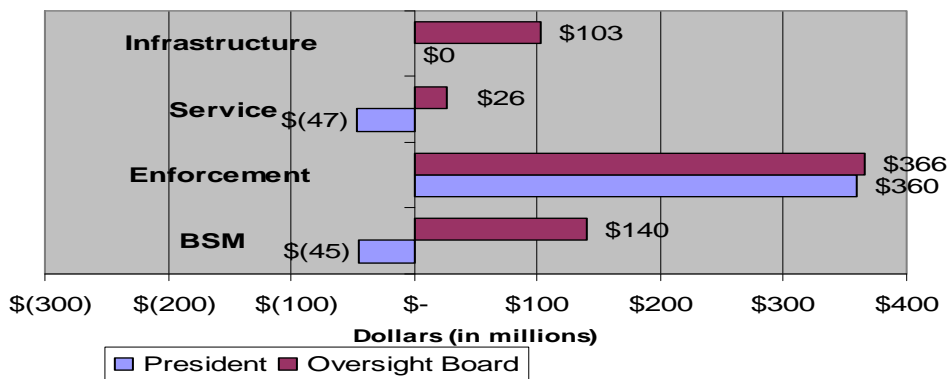
FY2008 Enacted Appropriation	\$10,892.38
Base Adjustments	\$262.62
Savings/Reinvestments	(\$61.65)
FY2008 Base Budget	\$11,093.35
<b>Initiatives</b>	
Enforcement	
Reduce the Tax Gap for Small Business/Self-Employed	\$120.7
Increase Reporting Compliance of Domestic Taxpayers with Offshore Activity	\$16.4
Reduce the Tax Gap for Large Businesses	\$52.0
Expand Federal Payment Levy Program	\$17.3
Reduce Tax Fraud	\$72.2
Enhance Financial Investigations of Narcotics Trafficking Organizations	\$24.0
Enhance BSA Compliance Program	\$3.4
Address Complexity through Up-Front Guidance, Education, and Correction Opportunities	\$8.9
Expand Examination of Tax Exempt Organizations	\$28.6
Increase Tax Court Litigation	\$5.8
Implement New Procedural Tax Court Requirements	\$3.4
Improve Tax Gap Estimates, Measurement, and Detection of Non-Compliance	\$11.1
Increase Monitoring of Preparers	\$2.5
Total Enforcement	\$366.3
Taxpayer Services	
	Dollars (M)
Maintain Processing of Critical Pension Plan Returns	\$6.3
Research Taxpayer Burden, Complexity, and Compliance	\$10.0
Expand Volunteer Income Tax Assistance and Low Income Tax Clinics	\$10.0
Total Service	\$26.3
Infrastructure/IT	
	Dollars (M)
Enhance IT Security	\$16.7
Enhance Contingency Planning and Disaster Recovery	\$8.7
Implement Security Auditing	\$6.8
Redesign Form 990 for Tax Exempt Organizations	\$23.5
Preserve Quality IT Workforce in Applications Development	\$36.8
Build Alternate Power Supply for the Computing Centers	\$11.0
Infrastructure/IT Initiatives Subtotal	\$103.5
Business Systems Modernization (BSM)	
	\$142.4
HITCA	
	\$5.50
Total Initiatives	\$644.00
FY2009 Budget Request	\$11,737.35
FY2009 Request Increase over FY2008 Base	\$844.97
FY2009 President's Request for IRS	\$11,361.51
Increase Over President's Budget Request	\$375.8

The recommended budget takes a long-term view of IRS needs. Despite the severity of the tax gap, the Board believes such a view is both warranted and needed. In submitting its FY2009 budget recommendations to the Treasury Department in June 2007, the Board identified increased funding for Business Systems Modernization (BSM), security, infrastructure, and research as high priorities. These initiatives offer the best opportunity to reduce the tax gap in the long term.

By following this approach, the Board’s recommended budget maintains balance at its core: enforcement, taxpayer service, business systems modernization, and employee development must be adequately funded for the IRS to succeed in all parts of its mission and to ensure the long- term health of our tax administration system.

The Board’s recommended IRS budget compares to the President’s request of \$11.361 billion, an increase of \$469 million over the FY2008 enacted appropriation. Although the two budgets are within 3.3 percent, they take different approaches to funding priority program initiatives at the margin. The Board recommends a total of \$644 million in program initiatives, spread among four areas: enforcement, taxpayer service, infrastructure and IT, and BSM. The President’s budget requests a nearly identical amount of funding for enforcement initiatives as the Board, but cuts taxpayer service and BSM funds, and includes no program initiatives for infrastructure and IT. Figure 2 shows the differences in graphic form.

**Figure 2. Program Initiative Funding**



Although both budgets have as a core objective the reduction of the tax gap, the Board recommends funding initiatives across the full range of IRS functions and taxpayer segments. In contrast, the President’s budget has as its central focus a short-term effort to build up IRS revenue-producing enforcement staffing at a time when the IRS is hard-pressed to replace the high number of experienced employees who are retiring. Increased staffing is important, but the Oversight Board believes the IRS cannot “audit its way out of the tax gap,” and should avoid the temptation to close the tax gap with large staffing increases in revenue-producing functions that cannot be absorbed effectively. The Board believes its recommended budget avoids this problem by focusing on ways to make the IRS more efficient in the long term, and putting more resources into technology, infrastructure, and service as well as enforcement.

Because reducing the tax gap is of critical importance, the Board has identified a subset of its recommended initiatives as having the highest priority. These initiatives are generally infrastructure and research intensive and will have the greatest effect on reducing the tax gap in the long term, and are identified in Table 2.

**Table 2. IRS Oversight Board Highest Priority Initiatives**

IRS Oversight Board Budget Highest Priority Initiatives	Dollars (in millions)
Technology/Infrastructure	
Fund Business Systems Modernization in Line with Current Strategy	\$141.0
Enhance IT Security	\$16.7
Enhance Contingency Planning and Disaster Recovery	\$8.7
Implement Security Auditing	\$6.8
Preserve quality IT workforce in applications development	\$36.8
Build alternate power supply for computing center	\$11.0
Technology/Infrastructure Subtotal	\$221.2
Enforcement	
Improve tax gap estimates, measurement, and detection of non-compliance	\$11.1
Taxpayer Service	
Research Taxpayer Burden, Complexity, and Compliance	\$10.0
<b>Total Highest Priority Initiatives</b>	<b>\$242.3</b>

None of these initiatives, except the enforcement initiative for improving tax gap estimates, are funded in the President's budget. Moreover, as shown in Figure 2, the BSM program and taxpayer service programs undergo reductions of \$45 million and \$47 million, respectively. The Board recommends that the appropriated IRS FY2009 budget closely follow the priorities and balance reflected in this statement.

The following sections discuss the Board's budget recommendations in the context of each of the IRS' strategic goals.

### **Strategic Goal 1 – Improve Taxpayer Service**

IRS customer service has made consistent gains since FY2002. For example, Toll-Free Tax Law Accuracy and Accounts Accuracy are at 91 percent and 93 percent respectively in FY2007, as compared to 84.4 percent and 90 percent five years ago. Of particular note, overall customer satisfaction with IRS Toll-Free Service has held steady at 94 percent for four consecutive years. Such stability is most welcome and a good indicator that best practices have taken root.

As a result, a more pressing challenge is to deliver more extensive electronic self-assistance tools and to perform research that identifies innovative ways to expand taxpayer education and outreach to all taxpayer segments, especially those who are now under served.

To a large degree, many of the IRS' customer service activities are designed to respond to taxpayer inquiries. Examples include toll-free telephone service and Taxpayer Assistance Centers. Overall, the IRS has done a good job fielding and answering questions, whether via toll-free telephone, the Internet, or in person at Taxpayer Assistance Centers.

The IRS expends considerably fewer resources on education and outreach services. A broader approach to customer service would entail giving taxpayers access to self-service applications so they could "pull" specific information on accounts or tax law, and "pushing" answers, information and updates to taxpayers, practitioners and other affected parties as the need for such information became apparent. Lastly, the IRS must seize opportunities to provide innovative outreach, education and community partnerships. For example, given limited resources and elimination of programs such as TeleFile, the IRS must also work to broaden and strengthen partnerships, such as Volunteers in Tax Assistance (VITA).

To take customer service to the next level, the IRS must better understand the taxpayers they serve. The IRS must conduct more insightful research, and based on this analysis, develop

services better tailored to the specific needs of particular taxpayer segments. By better understanding taxpayers, the IRS can focus both its service and enforcement efforts to increase compliance through targeted pre-filing, filing, and post-filing efforts. The IRS must find out what kind of information and assistance taxpayers need and the most effective ways of delivering that information to them.

In the last two years, the IRS has put considerable effort into developing the Taxpayer Assistance Blueprint (TAB), which establishes a five-year plan for delivering service to taxpayers. This vision entails a much broader use of electronic interactions between taxpayers, practitioners and the IRS, such as account management and the ability to resolve taxpayer issues securely over the Internet. The TAB describes an IRS that is an “interactive and fully integrated, online tax administration Agency” with the capability “for any exchange or transaction that occurs face-to-face, over the phone, or in writing to be completed electronically.” These types of services are much along the lines of what customers of large financial institutions already experience today but are still for the most part unavailable to taxpayers.

The vision of great customer service is clear, but to go from good to great the IRS must execute the five-year strategic plan articulated in the TAB to improve service beyond what is familiar and available today.

The Oversight Board disagrees with the President’s program reductions for taxpayer service and recommends that the following three initiatives be funded for a total of \$26.3 million:

- Maintain Processing of Critical Pension Plan Returns (\$6.3 million)
- Research Taxpayer Burden, Complexity, and Compliance (\$10 million)
- Expand Volunteer Income Tax Assistance and Low Income Tax Clinics (\$10 million)

The first initiative supports customer service by providing funds to maintain processing of essential pension plan return information while transitioning to a new mandated electronic filing system “EFAST2” in 2010. It also enables processing of residual returns that are IRS-only forms and not part of the mandated EFAST2 system (Form 5500EZ and Schedule SSA filings).

The second initiative provides funding to enhance understanding of the interaction between taxpayer burden, complexity of the tax law and process, and taxpayer compliance. This research will help improve understanding of these inter-relationships, in keeping with strategies put forth in the Taxpayer Assistance Blueprint (TAB) and the Department of the Treasury report, *A Comprehensive Strategy for Reducing the Tax Gap*.

The third initiative provides funding to enhance two programs to improve service delivery to two taxpayer segments with specifically identified needs: the growing number of elderly and the ethnically diverse. These taxpayer segments face unique challenges in meeting their tax obligations because of limited access to or inability to use all of the channels offered for service delivery. Additional resources will enhance the IRS’s volunteer return preparation and other services provided by the Volunteer Income Tax Assistance (VITA) and the Low Income Tax Clinic programs with emphasis on both targeted taxpayer segments. Such services help created a more fair and just tax system.

## **Strategic Goal 2 – Enhance Enforcement of the Tax Law**

Increases in IRS enforcement activity intended to produce gains in direct revenue collection must be balanced with a broad view of the tax gap. The Board recognizes that increased enforcement activity over the past five years has produced noticeable results—enforcement revenue has increased from \$34.1 billion in FY2002 to \$59.2 billion in FY2007, a gain of nearly 74 percent. The IRS estimates that it can produce more than a four-to-one return on every dollar invested in additional enforcement resources, a fact that the Board believes warrants the appropriation of additional enforcement funding.

However, while the Board applauds the increases in enforcement activity and revenue, it also recognizes that the IRS cannot “audit its way out” of the tax gap. There is wide belief, as evidenced by the Board’s recommendations for reducing the tax gap and the aforementioned Treasury Department’s tax gap strategy, *A Comprehensive Strategy for Reducing the Tax Gap*, that an integrated set of comprehensive actions is needed. Even a large infusion of resources for more enforcement personnel—something highly unlikely—would not eliminate the tax gap. There are many reasons for taxpayer non-compliance. Only a balanced program that promotes voluntary compliance across a broad continuum of taxpayers, from education and service for those who want to comply, to enforcement and even criminal prosecutions for those who refuse to comply, can be effective.

Table 3 below compares the Board’s and President’s enforcement initiatives. Although very close in dollars, the President’s initiatives place more emphasis on enforcement resources that can be shown to produce revenue in the short term. The Board takes a broader view of enforcement, and recommends program increases in such areas as expanded collection of proper taxes from recipients of federal payments, investigation of tax-related criminal activity, Bank Secrecy Act compliance, tax exempt organization examination, more published guidance for Tax Exempt taxpayers, additional litigation staff, and tax preparer monitoring.

**Table 3. Comparison of Enforcement Initiatives for Board’s and President’s Budgets**

Oversight Board’s Budget Enforcement Initiatives	Dollars (M)	President’s Budget Enforcement Initiatives	Dollars (M)
Reduce the Tax Gap for Small Business/Self-Employed	\$120.7	Reduce the Tax Gap for Small Business/Self-Employed	\$168.50
Increase Reporting Compliance of Domestic Taxpayers with Offshore Activity	\$16.4	Improve Reporting Compliance of US Taxpayers with Offshore Activity	\$13.70
Reduce the Tax Gap for Large Businesses	\$52.0	Reduce the Tax Gap for Large Business	\$69.49
Expand Federal Payment Levy Program	\$17.3		
Reduce Tax Fraud	\$72.2		
Enhance Financial Investigations of Narcotics Trafficking Organizations	\$24.0		
Enhance BSA Compliance Program	\$3.4		
Address Complexity through Up-Front Guidance, Education, and Correction Opportunities	\$8.9		
Expand Examination of Tax Exempt Organizations	\$28.6		
Increase Tax Court Litigation	\$5.8		
Implement New Procedural Tax Court Requirements	\$3.4		
Improve Tax Gap Estimates, Measurement, and Detection of Non-Compliance	\$11.1	Improve Tax Gap Estimates, Measurement, and Detection of Non-Compliance	\$51.06
Increase Monitoring of Preparers	\$2.5		
		Expand Document Matching	\$35.06
		Implement Legislative Proposals to Improve Compliance	\$23.05
<b>Total Enforcement</b>	<b>\$366.3</b>		<b>\$360.85</b>

Additional enforcement resources produce a positive return on investment and result in short-term benefits, so the benefits of increased enforcement are apparent. However, increases in

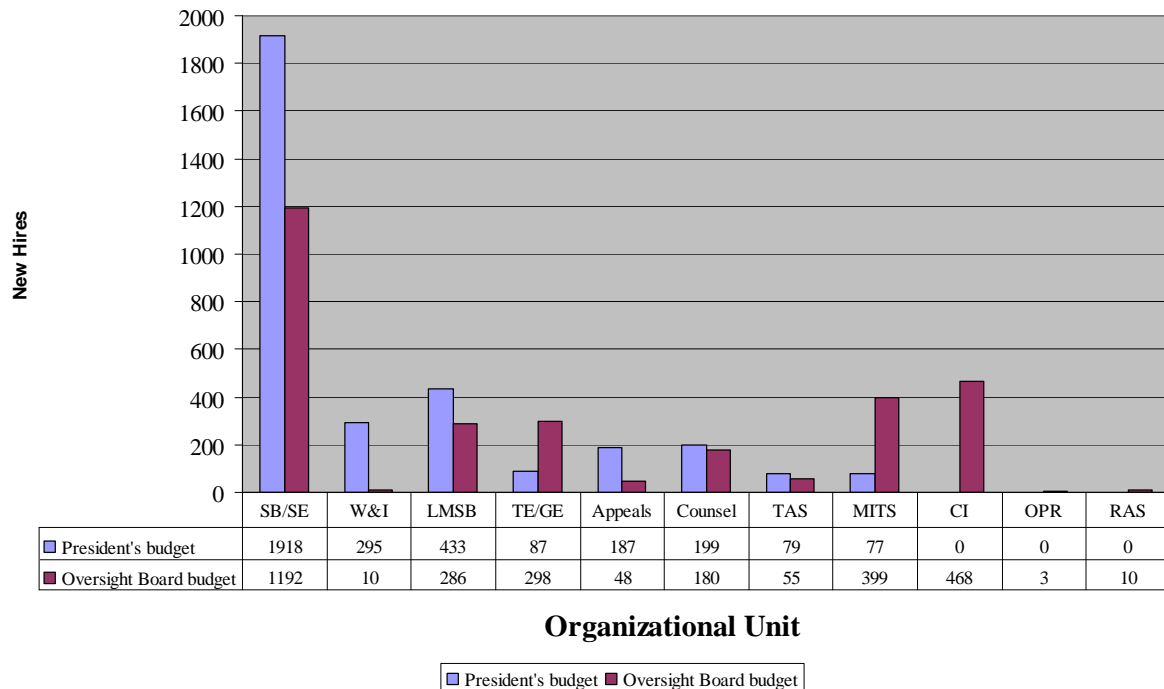


enforcement resources must also be balanced with more systemic long-range actions that improve voluntary compliance, and priorities must be considered as budget resources are limited. The Oversight Board considers technology modernization and research a higher priority than additional enforcement resources, in recognition of the long-term impact that technology modernization and research have on the IRS' ability to work more efficiently to reduce the tax gap and to be better able to focus both its service and enforcement resources optimally.

Another factor that must be considered is the degree to which additional staffing can be absorbed into various IRS organizational units. Figure 3 depicts the distribution of new hires in major IRS organizations that are required by the President's and Board's budget. The Board believes its budget strikes a more balanced posture across all IRS organizational units and expands enforcement resources for a range of activities that are important elements of IRS enforcement, although they do not generate revenue directly, such as examination of tax exempt organization reporting, regulation of pension plans, and criminal investigation of tax fraud and abusive tax shelters. These activities are all part of a balanced, enforcement program that has as a goal the promotion of voluntary compliance among all taxpayer segments.

To better understand the organizational implications of the Small Business/Self-Employed (SB/SE) and Large and Mid-Sized Business (LMSB) divisions' hiring requirements inherent in both budgets, the Board examined hiring requirements during FY2009 for the SB/SE and LMSB divisions. Table 4 shows the number of Mission Critical Occupation (MCO) employees projected to be on-rolls as of September 30, 2008, as well as the hiring requirements contained in both budgets. The Board has used a rule of thumb that 15 percent new hires is a reasonable limit on the amount of new employees that can be effectively accommodated into an organization in a year. It had concerns with the hiring implications of its own budget on SB/SE, but thought this risk could be mitigated. The President's budget would increase the percentage of new hires in SB/SE to over 23 percent of its employees in FY2009, and over 16 percent for LMSB.

Figure 3. New Hires by Organization; Board's vs. President's Budget



**Table 4. SB/SE and LMSB Hiring Requirements in the Board's and President's FY2009 Budgets**

Operating Unit Mission Critical Occupations	Projected on rolls as of 9/30/2008	Projected Attrition Hires in FY2009	Projected New Hires in FY2009 to Meet Budget Request	Total Attrition Hires and New Hires	Percent of Hires to total MCO population
Oversight Board Budget					
SB/SE	19,394	2,612	1,177	3,789	19.5%
LMSB	5,126	403	273	676	13.2%
President's Budget					
SB/SE	19,394	2,612	1,918	4530	23.4%
LMSB	5,126	403	433	836	16.3%

As in FY2006 through FY2008, the Administration proposes to include its requested enforcement increases as a Budget Enforcement Act program integrity cap adjustment. The Oversight Board's recommended enforcement initiatives would also qualify for such treatment, should Congress decide to make such an adjustment.

### **Strategic Goal 3 – Modernize the IRS Through its People, Processes and Technology**

The most effective strategy for reducing the tax gap in the long term is to provide the IRS with modern technology that enables it to operate at a high performance level. The Board has no doubts that a high performing organization with high service, quality, and satisfaction levels also minimizes taxpayer burden. Under such conditions, service and enforcement activities are prompt, efficient, and correct.

The Board has identified program initiatives for IT and infrastructure activities that are funded under the BSM and Operations Support accounts. These initiatives will further modernize the IRS core IT systems used for tax administration, upgrade its infrastructure, and improve its security posture.

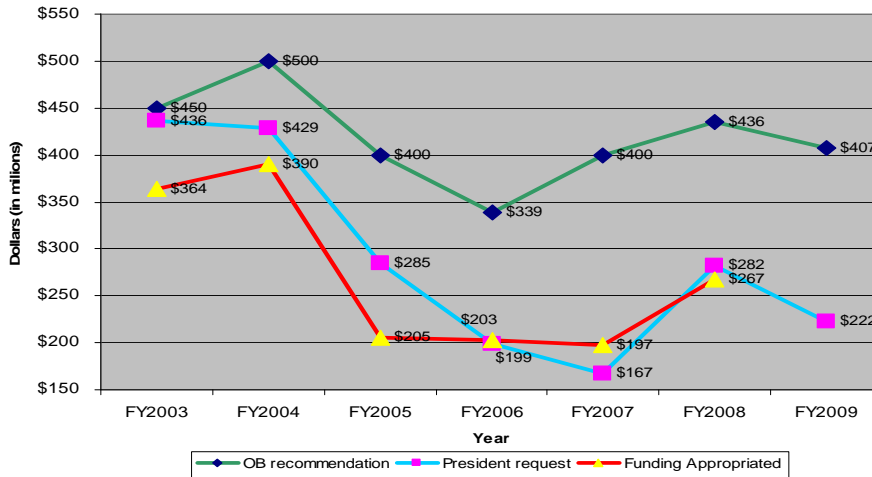
#### **Business Systems Modernization Program Initiative**

Tax administration is a knowledge-intensive activity and the IRS depends heavily on information technology (IT) to leverage the knowledge and perform its mission. The IRS has made slow but steady progress in replacing its antiquated IT systems. The most noticeable improvements to taxpayers have been increased use of electronic products and services to interact with the IRS. However, the IRS' performance is still hampered by archaic IT systems used for central record-keeping that update taxpayer account information on a weekly instead of a daily basis.

The Oversight Board has long advocated that the BSM program be funded at a higher level so progress could be made more quickly. Admittedly the program experienced a series of cost and schedule overruns during its first several years, and the result has been to slow down the funding stream to levels that dictate only modest progress can be made in modernizing the core IRS master files and account management systems. Because of its long-term effect on reducing the tax gap, the Board considers increasing BSM funding so that the pace of IT modernization can be increased as having the highest priority.

Figure 4 compares the BSM budget recommended by the Oversight Board, the amount requested by the President, and the BSM funding appropriated by Congress for fiscal years 2003 to 2008. BSM funding needs to be restored to the levels realized in FY2003 and FY2004 to make progress faster. Had the Board's funding recommendations been followed, the IRS would be closer to the day when it could update its central records on a daily basis.

**Figure 4. BSM Funding FY2003 to FY2008**



Note: FY2008 and FY2009 amounts contain \$45.2 and \$56.9 million of labor costs not contained in prior years.

**Table 5. Application of FY2009 BSM Funding to Projects in the IRS Oversight Board and President's Budgets**

Project Activities	Dollars (M)				
	FY2008	FY2009	Increase over FY2008	FY2009	Increase over FY2008
Customer Account Data Engine	\$58.5	\$80.0	\$21.5	\$58.8	\$0.3
Accounts Management Services	\$29.0	\$47.4	\$18.4	\$26.2	(\$2.8)
Modernized e-File	\$55.8	\$36.1	(\$19.7)	\$25.0	(\$30.8)
Common Services Project	\$0.0	\$16.0	\$16.0	\$0.0	\$0.0
Integrated Financial System	\$0.0	\$73.0	\$73.0	\$0.0	\$0.0
Core Infrastructure; Architecture Integration & Management; and Management Reserve	\$78.6	\$98.1	\$19.5	\$69.3	(\$9.3)
Subtotal Capital Investments	\$221.8	\$350.6	\$128.8	\$179.3	(\$42.6)
BSM Labor	\$45.2	\$56.7	\$11.5	\$43.4	(\$1.8)
BSM Program Total	\$267.1	\$407.3	\$140.2	\$222.7	(\$44.4)

Note: BSM program excludes \$1.2 M of corporate costs in Operations Support.

The Board believes that when implemented, modernized IT systems will literally save taxpayers billions of dollars in burden reduction and make the IRS much more efficient. For example, replacement of the Individual Master File by the Customer Account Data Engine (CADE) will allow the IRS to update the tax accounts for individuals on a daily basis, instead of its current weekly update process. The Oversight Board expects that a rapid refund from the IRS of three to five days will reduce the number of Refund Anticipation Loans (RALs). The National Consumer Law Center and Consumer Federation of American estimate that approximately 12 million American taxpayers spent an unnecessary \$1.6 billion on RALs in 2004 (the latest year for which data is available) to obtain their refund monies faster by two weeks. Moreover, daily updating of account records will give IRS employees and taxpayers access to the most current

taxpayer account data, eliminating the problems associated with having various data bases with less than current status. The Oversight Board expects that daily posting of account information will improve the IRS' analysis capability and greatly reduce the burdens associated with the account resolution process.

The Modernized e-File system not only makes it easier for taxpayers to file tax returns with the IRS, it reduces the human resources needed to receive and process tax returns and eliminates the error-prone transcription process. For corporate filers, it helps the LMSB division improve currency and cycle time in working large corporate tax cases. When implemented for individual tax returns, it will make the electronic filing process even simpler than it is today with the current legacy electronic filing system.

The Integrated Financial System (IFS) will provide necessary improvements to the system the IRS uses to manage its financial resources, clearly a must for any agency, especially one that is responsible for managing taxpayers' accounts as well as its own appropriated resources. The IFS upgrade is needed to ensure that the IRS remains in compliance with federal accounting and other financial management requirements. The additional funding for the IFS initiative will enable the IRS to add procurement and asset management modules to the existing IFS application and integrate related business processes with core accounting and financial management operations. The funding will also provide for the subsequent transfer of IFS to a Shared Service Center and thereby maintain its longer term viability.

The Board believes that funding for the BSM program should be accelerated, not slowed down. Failure to fund the IRS BSM program at higher levels, in the view of the Board, is a case of being penny-wise and pound foolish.

### **Information Technology/Infrastructure Program Initiatives**

The IRS must be held to the highest standards for security and data integrity while increasing its engagement in the electronic world in which most taxpayers already live. Meeting this dual challenge of high security and a high degree of electronic interaction with taxpayers demands that the IRS have a modern information systems and infrastructure.

The Board recommends six program initiatives for a total of \$103 million that will improve the IRS' operations by allowing it to make critical improvements to its technology and personnel infrastructure. By comparison, the President's budget contains no initiatives for IRS infrastructure.

Three of the initiatives, totaling \$32.2 million, enhance the IRS' security posture as the way the IRS does business continues to evolve and security threats seem to increase on a daily basis. Data security has taken on an expanded meaning in a post 9/11 world. Terrorists from around the globe are actively working to exploit weaknesses in government IT security systems with the intent of producing both great physical and economic harm. Disrupting IRS returns processing and stealing sensitive information could wreak havoc on the economy and financial markets. The IRS cannot be complacent with respect to security, and the Board recommends the following security initiatives:

- Enhance IT Security (\$16.7 million)
- Enhance Contingency Planning and Disaster Recovery (\$8.7 million)
- Implement Security Auditing (\$6.8 million)

The first initiative enables the IRS to further implement key IT security and privacy safeguards to assure the integrity of sensitive taxpayer and employee data and supporting infrastructure processes. Protecting taxpayer data is paramount. The second initiative is to enhance the IRS enterprise-wide contingency planning and disaster recovery capabilities to support critical business systems. Any unavailability of critical IRS business systems poses an unacceptably

high risk to the nation's security. The third initiative, Security Auditing, will allow the IRS to more effectively monitor key networks and systems to identify any unauthorized activities.

The remaining three initiatives, for a total of \$71.3 million, allow the IRS to improve other elements of its infrastructure. They are:

- Redesign Form 990 for Tax Exempt Organizations (\$23.5 million)
- Preserve Quality IT Workforce in Applications Development (\$36.8 million)
- Build Alternate Power Supply for the Computing Centers (\$11.0 million)

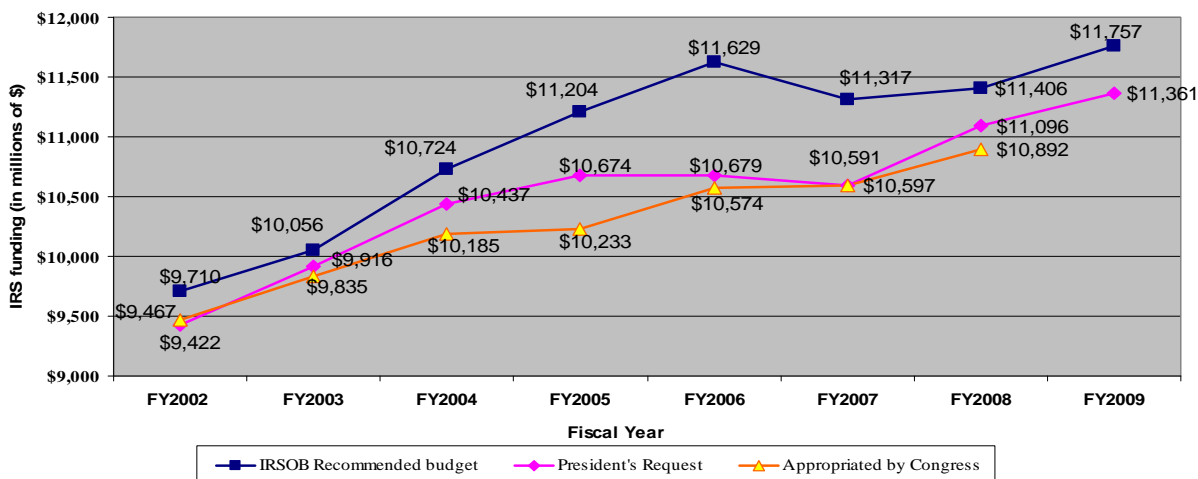
The first initiative, the only one that is not considered high priority, is recommended because it brings new efficiencies to tax filing for a segment of taxpayers who are frequently ignored because their tax returns do not produce revenue—tax exempt organizations. The Form 990 tax return is difficult to complete for tax exempt organizations to complete and for reviewers to comprehend. Worse, it fails to provide the IRS with sufficient information to detect and analyze compliance trends in the sector and target enforcement actions as needed.

The second initiative will give the IRS better tools to retain its IT workforce by mitigating intellectual and experiential loss through a series of supporting strategies such as workforce re-tooling, succession planning, and retention. The third initiative provides alternate power supply for three of the IRS's computing centers. Currently there is but a single power supply facility at each of the computing centers. An alternate power supply capability at each of the three computing centers would ensure the continuous operation of, and continuous access to, tax processing systems at the computing centers during unplanned emergencies and planned power supply tests, and avoid the revenue loss and overtime expense associated with the current process that requires total shut down periods.

### Investing in IRS is a Good Business Decision Supported by the Public

In spite of recommendations made by the IRS Oversight Board, the IRS has not been funded at the most effective levels to achieve its strategic objectives. Figure 5 illustrates funding recommendations made by the Board since its inception, the President's budget request during this same time frame, and the funding appropriated by Congress. One of the principal reasons for this so-called "resource gap" is the budget process which treats the IRS the same as it does all other discretionary spending requests. It does not credit the IRS with bringing in 95 percent of all the revenue to fund the federal government, nor does it recognize the previously discussed four-to-one return on every dollar invested in tax enforcement.

**Figure 5. IRS Funding History FY2002-2009**



The Oversight Board has urged previously Congress to view funding of the IRS as an investment.<sup>1</sup> Other members of the tax administration community, such as the National Taxpayer Advocate and the National Treasury Employees Union, have made similar recommendations.<sup>2</sup>

There are a number of approaches that Congress could take to achieve this result, such as funding the IRS outside of budget caps, and the Board believes that the implementation of such a change is best left for Congress to decide. The Board would be remiss, however, if it didn't point out providing additional funds to the IRS has been consistently supported by nearly two out of three members of the public. In its annual Taxpayer Attitude Survey, the Board has asked taxpayers whether they support additional funding for the IRS. The results for 2005 through 2007 are shown in Table 6.

**Table 6. Results of Taxpayer Attitude Survey on IRS Funding**

Survey Question 11	Percent Completely Agree			Percent Mostly Agree		
	2007	2006	2005	2007	2006	2005
The IRS should receive extra funding to enforce tax laws and ensure taxpayers pay what they owe	24	24	20	40	39	43
The IRS should receive extra funding so it can assist more taxpayers over the phone and in person	21	24	22	42	42	44

The Board believes such strong support indicates the public understands the need for effective tax administration and realizes that, ultimately, it pays for itself.

### Conclusion

Approving a budget is not just about money; it's also about choices. The Board believes its budget recommendations, if implemented, will put the IRS on an effective long-term path to achieving the IRS strategic goals, improving voluntary compliance, and reducing the tax gap.

Although the Board's recommended budget is \$375 million more than the President's request, there are some important decisions that must be made with respect to priorities and balance. The Congress must not only decide the amounts to be appropriated, but must also choose whether it wants to pursue short-term growth in enforcement activity over a more balanced path that stresses the benefits of long-term investments in technology, infrastructure, service, and research.

<sup>1</sup> IRS Oversight Board reports, *FY2006 IRS Budget Recommendations/Special Report, FY2007 IRS Budget Recommendations/Special Report, and FY2008 IRS Budget Recommendations/Special Report*.

<sup>2</sup> NTA, *2006 Report to Congress*, Section 2, p. 445, and Statement of Colleen M. Kelley, President, National Treasury Employees Union, Testimony Before the House Committee on Ways and Means, May 23, 2007.