IRS Oversight Board

WRITTEN TESTIMONY OF
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BEFORE
THE JOINT CONGRESSIONAL REVIEW
ON THE
STRATEGIC PLANS AND BUDGET OF THE INTERNAL REVENUE SERVICE
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Introduction and Summary

Thank you, Mr. Chairman for this opportunity to present the views of the IRS Oversight Board on the current state of our tax administration system and the Internal Revenue Service's progress in meeting the letter and spirit of the IRS Restructuring and Reform Act of 1998 (RRA 98). I also want to thank and commend you and the members of the Joint Review for your continued leadership, expertise and oversight of the IRS. It is greatly appreciated.

As a prelude to my remarks, I would like to take a minute and invite you to envision how a tax administration system would work in an ideal world. With such a system, we would find:

- Taxpayers fully understand their tax obligations
- Burden on taxpayers is low
- Filing is efficient and easy
- Enforcement is swift, certain and professional
- Level of voluntary compliance is high

In short, taxpayers would find compliance easy to achieve and difficult to avoid.

It is now seven years since the passage of RRA 98. It is a logical time to ask that question we frequently hear when we are on a journey: Are we there yet? The answer is: not yet. But we can get there using a roadmap.

The IRS Strategic Plan is that roadmap. The current Strategic Plan was developed by the IRS and approved by the Oversight board in 2004. It establishes three goals for the IRS:

- Improve Taxpayer Service
- Enhance Enforcement of the Tax Law
- Modernize the IRS through its People, Processes and Technology

The IRS' first Strategic Plan in the post-RRA 98 era, approved by the Board in 2001, set the agency's direction. And during the past seven years, the IRS has achieved significant gains on a number of important fronts, although the pace of improvement has been frustrating at times, especially to taxpayers. The quality of telephone service has greatly improved, helping taxpayers navigate and comply with an extremely complex tax code. The IRS now estimates that more than half of individual taxpayers will file their returns electronically in 2005 and millions are using the IRS web site to download forms, get information on their tax law questions and track the status of their refunds.

The IRS' computer modernization program met its cost and schedule milestones in 2004, and the first taxpayers have finally been moved off the old tape-based system to a modern reliable database. Although the agency's enforcement effort had been suffering from a declining resource base, the IRS was able in FY 2004 to increase its enforcement resources and showed an impressive gain in enforcement revenue.

Enforcement activities increased substantially in 2004, with a 40 percent jump in audits of high-income taxpayers, doubling the number of audits from four years ago. Audits of large businesses also increased. And in a major victory against those who participated in a particularly abusive tax shelter known as "Son of Boss," the IRS offered a very favorable settlement for the government and collected about $3.2 billion so far in back taxes, interest, and penalties from over 1,100 taxpayers.

What is important about this improved performance is that progress has been made in both the service and enforcement functions of the IRS' mission – something the Oversight Board has advocated since its inception. The results achieved clearly demonstrate that it is possible to reach the desired balance.

However, the IRS still confronts a number of challenges, not the least of which is closing the estimated $300 billion plus tax gap. As Senate Finance Committee Chairman Charles Grassley said last month, "[T]he tax gap – like a loaf of bread – is made up of many different slices. We need to understand each one better and look at several ways to address them. But let me make it clear, we will work to address the tax gap – we owe nothing less to the millions of honest working families who find tax day the toughest day of the year. It is absolutely wrong that families have to tighten their belts and find new ways to keep the family budget balanced because others are not paying their fair share."[1]

Other challenges confront the agency. First, although the initial results produced by the National Research Program are to be applauded, the IRS still needs to get a better handle on understanding noncompliance, particularly underreporting. Second, as I will discuss in greater detail in my testimony, the IRS is making significant cuts in customer service, such as the forthcoming closure of a number of Taxpayer Assistance Centers. The Board is concerned that the IRS has not fully estimated the potential impact of such reductions on taxpayers – the overwhelming majority of whom want to comply with the tax code but need help doing so. Third, despite the Board's recommendation in its previous annual report, the IRS has not yet addressed its near- and long-term human capital issues ranging from employee training to a potential wave of retirements beginning next year.

The IRS Strategic Plan is the vehicle by which the IRS will meet these challenges. The IRS would greatly benefit from setting outcome measures to gauge progress in achieving its goals. They could have an energizing effect on the agency, improve accountability, help measure progress, and in turn, assist Congress and the Administration in making informed budget decisions.

Lastly, to achieve the goals established in the Strategic Plan, the IRS needs a realistic budget that not only funds customer service, enforcement and Business Systems Modernization but which provides for the anticipated expenses the agency will incur, such as congressionally-mandated pay raises, inflation and rent increases.

Ensure Balance

Many of the IRS' well-publicized problems can be traced to shifts between customer service and enforcement. Often compared to a swinging pendulum, the IRS would focus almost exclusively on one part of its mission to the detriment of the other.

Achieving a balance between customer service and enforcement has become the IRS' greatest challenge. Indeed, the problems that led to the enactment of RRA 98 were due in part to a zealous over-reliance on enforcement dollars at the expense of taxpayer service. RRA 98 specifically addresses this problem by stating, "The IRS shall review and restate its mission to place a greater emphasis on serving the public and meeting taxpayers' needs."[2] Only with the passage of RRA 98 has there been the recognition that both service and enforcement must be provided.

RRA 98 called upon the IRS to provide both quality customer service and fair enforcement. The Board has consistently stated that to be truly successful, and compatible with the spirit of RRA 98, the IRS had to succeed in all parts of its mission. It could no longer be an either/or proposition. This insistence on balance is also at the core of the IRS strategic plan and Commissioner Everson's formula, "customer service plus enforcement equals compliance." The balanced approach is also shared by many others in the larger tax community.

At the Board's 2005 annual public meeting, the American Institute of Certified Public Accountants observed: "Commissioner Everson recognizes that any increase in enforcement funding must be balanced with positive responses to the taxpaying public as customers. We encourage this type of balanced approach and stand ready to work with the Service to ensure the needs of America's taxpayers are fulfilled." [3]

These sentiments were also embraced by the Treasury Inspector General for Tax Administration Russell George, who said, "Enhancing enforcement while improving customer service is the proper direction for the IRS," and the National Taxpayer Advocate who argued that "taxpayer service and enforcement activities work hand in hand to promote high levels of compliance."[4]

More than just a strategy or an equation, the balanced approach to tax administration is producing positive results that the Board believes should be further encouraged. As previously noted, the IRS has made considerable strides in improving customer service since the passage of RRA 98 and these improvements are reflected in taxpayer satisfaction surveys such as the American Customer Satisfaction Index (ASCI). In 2004, the overall customer satisfaction score of individual tax filers increased by almost two percent, showing a steady increase since 1999.[5]

However, now that the tax gap has taken center stage, there is the temptation to fall back on old habits, say customer service is fixed and direct all resources to enforcing the tax laws. It's the considered opinion of the Board, that this new slant would represent a major setback to achieving RRA 98's goals. We should stay the course set by the balanced approach.

The Board's concerns in this regard are shared by Members of Congress, taxpayers and practitioners. At the April 14th Senate Finance Committee hearing on closing the tax gap, Ranking Member Baucus observed:

> *But I want to offer a word of caution to the administration and to Commissioner Everson. The IRS cannot close the Tax Gap simply by increasing enforcement. Issuing more liens. Conducting more seizures. Levying more bank accounts.*
>
> *We do need targeted, appropriate enforcement. If, however, the IRS lets taxpayer service slide— If the IRS diminishes the access and accuracy of taxpayer service – including the essential need for face-to-face taxpayer service – then we fail to help taxpayers comply with the law on the front end. Ensuring up front quality is more efficient than back end enforcement.* [6]

At the Board's 2005 public meeting, the National Association of Enrolled Agents made a statement in a similar vein:

> *NAEA supported the creation of the [IRS Oversight Board] as a defense against the tendency of policymakers to swing wildly between two extremes: funding taxpayer service to the exclusion of funding compliance programs on the one hand, and funding compliance programs to the exclusion of funding taxpayer service on the other. At the end of the day, both of these objectives must*
> *be adequately funded for the system to work correctly.* [7]

Taxpayers have also taken notice and want a balanced system too. Almost two out of three participating in the Board's 2004 taxpayer attitude survey supported additional IRS funding for enforcement (62 percent) and taxpayer assistance (64 percent).[8]

Mr. Chairman, the long-term health of our tax administration system must be our overarching goal. To succeed in meeting that goal the IRS must meet the needs of <u>all</u> parts of its strategic plan and critical mission on behalf of America's taxpayers – not just one or the other. We must have balance; we must have quality customer service and effective enforcement to achieve real compliance.

<u>Closing the Compliance Gap</u>

The aforementioned Senate Finance Committee hearing, "The $350 Billion Question: How to Solve the Tax Gap" highlighted the growing seriousness of the tax gap problem and the IRS' difficulty in closing it. David M. Walker, Comptroller General of the United States, testified that in spite of the recent turnaround in staffing and some enforcement results, "IRS's recent compliance estimate indicates that compliance levels have not improved and may be worse than it originally estimated."[9] Indeed, the problem is so severe that "Tax Law Enforcement" has been placed on General Accounting Office (GAO)'s "high-risk" list.

The IRS National Research Program (NRP) recently completely its assessment of individual taxpayer compliance for 2001 and came up with the tax gap estimate – actually a range of $312-353 billion. Underreporting noncompliance, *e.g.*, understated income, improper deductions, overstated expenses and erroneously claimed credits, represents the largest component of the tax gap – between $250-292 billion, or more than 80 percent.[10] However, as the GAO noted, it is important to get behind the NRP methodology to get a true picture of the tax gap:

> *[F]or some areas of the tax gap, the estimate relies on outdated data and methodologies, including data from the 1970s and 1980s used to estimate corporate income tax underreporting and some employment tax underreporting. IRS does not have firm plans for obtaining more contemporary information on compliance for these areas of the tax gap or again measuring individual income reporting compliance.* [11]

Given these challenges, the Board applauds the IRS for the progress it has made in some specific enforcement areas, such as correspondence examinations and the 40 percent increase last year of audits of high-income individuals. Working in conjunction with the Department of Justice, the agency has also won some important victories in high-profile abusive tax shelter cases. Additionally, last May the IRS made a settlement offer regarding a particularly abusive tax shelter known as “Son of Boss,” and to date, $3.2 billion in taxes, interest and penalties have been collected from the more than 1,100 taxpayers who participated in the offer. The number of criminal prosecutions is also up, but still fall short of pre-1998 levels.

In 2004, legislation was enacted allowing the IRS to use private collection agencies (PCAs) to augments its collection efforts. However, expectations should be tempered regarding the PCA initiative; only 10 percent of the tax gap is due to underpayment. Let me also note, Mr. Chairman that the Oversight Board, GAO and Treasury Inspector General for Tax Administration (TIGTA) have recently agreed to meet quarterly to bring a common perspective to the oversight of the PCA program.

However, in spite of these successes, it is clear that current IRS enforcement efforts are insufficient to close the tax gap in any meaningful way. They simply will not provide the breakthrough that is required; much more is needed across the board.

The Board concurs that a multi-pronged effort must be taken to shrink the tax gap. In addition to providing additional enforcement resources, which I will discuss in the budget section of my testimony, other actions can and must be taken.

The Board believes that while the NRP assessment was a good start; it was just that – a start. The Board shares the National Taxpayer Advocate’s concern that much more and better research is needed. Ms. Olson stated that the IRS should be conducting extensive research now to develop a “long-term and sustained strategy for reducing the tax gap. This strategy must focus on the indirect effects as well as the direct effects of IRS initiatives.”[12]

The need for better data to measure the tax gap and the effectiveness of enforcement actions was also voiced by the Treasury Inspector General for Tax Administration J. Russell George. At the Senate Finance Committee hearing, he made a compelling case:

> *Although better data will help the IRS identify non-compliant segments of the population, broader strategies and better research are also needed to determine what actions are most effective in addressing non-compliance… [I]n two recent audit reports, TIGTA identified examination programs that the IRS implemented nationwide before obtaining results on their possible effectiveness or before implementing an effective strategy to measure the results of the program.*

The IRS must continue to obtain accurate measures of the various components of the tax gap and the effectiveness of actions taken to reduce it. The information is critical to the IRS for strategic direction, budgeting and staff allocation. The Department of Treasury also needs these measures for tax policy purposes. Additionally, the Congress needs this information to develop legislation that improves the effectiveness of the tax system.[13]

The Board is in full agreement with this assessment as we are with TIGTA’s recommendation that delays in Business Systems Modernization (BSM) must be addressed. In addition to helping provide quality customer service to taxpayers, modernizing IRS' antiquated computer systems will give IRS enforcement personnel the tools they need. For example, the Filing and Payment Compliance project will help the Private Collection Agency initiative.

Although the Board has no authority to make tax policy recommendations, I would be sadly remiss not to mention the corrosive effect that tax code complexity has on enforcement and closing the tax gap. The complex tax code frustrates honest taxpayers who are trying to comply with the law while proving opportunities for those who exploit its complexities to devise sophisticated and hard-to-detect illegal tax avoidance schemes.

The Chief of Staff of the Joint Committee on Taxation George Yin made the following well-reasoned argument for simplification at the tax gap hearing:

> *Much has been written about the benefits of simplification. In terms of ways to reduce the tax gap, I believe that simplification ranks as the most important. Complex laws spawn many inadvertent errors as well as opportunities for intentional non-compliance. Complex laws also contribute to taxpayer confusion and real or perceived unfairness in the tax system. Studies have shown that taxpayers are less likely to be compliant if they perceive the system to be inequitable.*[14]

There are other detrimental consequences stemming from a complex tax code: IRS' enforcement workload has grown both in sheer numbers and complexity because of the code. According to a TIGTA analysis, in FY 2004, hours spent per return on examinations were up 23 percent for individual tax returns and 19 percent for corporate returns over the previous year.[15] Indeed, as we peel away the layers of many of the IRS' problems – from resources to customer service to enforcement – we often find tax code complexity at their core.

In this regard, the Board fully supports the President's federal advisory panel to simplify the tax code. In addition to reducing taxpayers' burdens, simplifying the tax code would be the greatest boost of all for both service and enforcement. It is an essential part of any broad strategy for closing the tax gap.

Stabilize Customer Service

Since the issuance of the IRS Restructuring Commission Report and the passage the following year of RRA 98, the IRS has achieved tangible gains in customer service. In 2005, the agency turned in yet another successful filing season.

Taxpayers can now get through on the IRS toll-free telephone lines and the accuracy and quality of the responses to their tax law and account questions have remained steady and at reasonable levels. Taxpayers are also afforded a number of self-serve options over the telephone and the IRS' web site that help reduce the burden of filing and paying their taxes. There were almost twice as many visits to *IRS.gov* this filing season than last, and more than five million taxpayers took advantage of the innovative Free File program – a more than 40 percent increase from the same period last year.

Taxpayers recognize and value the services the IRS provides to help them understand and comply with the complex and ever changing tax code. The 2004 IRS Oversight Board Tax Compliance Study found that "the most heavily relied upon source of tax information and advice are IRS representatives (82 percent see them as very/somewhat valuable), and IRS printed publications such as brochures (82 percent) and the IRS web site (77 percent). The only non-IRS provided information source that is nearly as highly rated is a paid tax professional (81 percent.). Further, more than 90% of those surveyed said that IRS customer service is either very or somewhat important to them.[16]

However, the Board notes that in spite of these improvements, IRS customer service is still not on a par with private sector financial services organizations. IRS customer service is still a work in progress, and complacency is our worst enemy. At a recent hearing of the House Ways and Means Subcommittee on Oversight on the 2004 filing season and proposed FY2006 IRS budget, Government Accountability Office Director, Strategic Issues James R. White noted that there were "slippages in telephone access such as more abandoned calls and longer wait times."[17] Walk-in assistance has proven to be particularly helpful for many taxpayers who do not have access to computers and the Internet, or prefer one-on-one personal assistance. Yet, according to Treasury Inspector General for Tax Administration Russell George, service levels at these sites have improved, but are still not meeting expectations.[18]

It is against this backdrop that the Board raises its concern that reductions in customer service and modernization resources in the proposed FY2006 IRS budget will have a negative impact on the IRS' ability to delivery quality service to taxpayers and improve overall taxpayer compliance. The cuts are troubling for a number of reasons.

The IRS has already announced that it will end its TeleFile service, used by almost four million taxpayers. The Board is concerned that these taxpayers will return to paper filing. Tax return and tax account transcripts provided by Taxpayer Assistance Centers (TACs) must now be requested by phone or mail, which requires a two-week waiting period. These transcripts are often needed urgently by those applying for mortgages or other loans. This change in procedure burdens taxpayers and is counter to the IRS commitment to provide excellent customer service.

Other possible customer service cuts include:

- Closing a large number of Taxpayer Assistance Centers, which in total serve 7.5 million taxpayers each year, many of them elderly and lower-income taxpayers and those with limited or no English proficiency;
- Reducing hours on the IRS' toll-free lines; and
- Providing fewer paper versions of forms and publications, further burdening lower-income taxpayers who do not have ready access to the Internet.

These proposed reductions in customer service are raising concerns throughout the tax community. The GAO warned at the Ways and Means Oversight Subcommittee hearing that "the risk, as IRS shifts its priorities toward enforcement, is that some of the gains in the quality of taxpayer service could be surrendered." [19]

And while these real and potential reductions may not signal a return to the days of hundreds of millions busy signals and completely unacceptable levels of customer service, they are certainly a step in the wrong direction. And as we increasingly learn, quality customer service is not an end in itself but an essential part of that balance of customer service and enforcement that leads to compliance.

Ways and Means Oversight Subcommittee Chairman Ramstad correctly observed that "retaining the good will of American taxpayers by providing professional service and detailed guidance on how to comply with the law are critical to sustaining voluntary compliance." [20] The GAO Comptroller General David M. Walker testified at the Senate Finance Committee hearing that "providing quality service to taxpayers is an important part of any overall strategy to improve compliance and thereby reduce the tax gap."[21] And TIGTA expressed similar views at the Senate hearing:

> *The IRS must exercise great care not to emphasize enforcement at the expense of taxpayer rights and customer service. I believe that steps to reduce the current level of customer service should be taken only with the utmost thought and consideration of their impact, and only with all the necessary data to support these actions. Customer service goals must be met and even improved upon, or people will lose confidence in the IRS' ability to meet part of its mission of providing America's taxpayers quality service by helping them understand and meet their tax responsibilities.*[22]

Indeed, as previously noted, the IRS has not provided the information we need to measure the short-term impact of these reductions on taxpayers. In the absence of such research, the Board urges that no precipitous actions be taken that could threaten the hard won improvements in customer service and further expand the tax gap. Moreover, until meaningful and substantive tax simplification is enacted into law, taxpayers will need all the help they can get to understand the tax code.

Commit to Modernization

Modernizing its computer systems through the Business Systems Modernization (BSM) program is one of the IRS Strategic Plan's goals. The IRS' once deeply troubled BSM program has experienced better performance in 2004. Due to improved management focus, BSM delivered on schedule in 2004 important technology products that will generate greater efficiencies throughout the agency and create real benefits in both customer service and enforcement.

For example, the first taxpayers have been moved to a modernized reliable data base (Customer Account Data Engine) and corporate taxpayers are now able to conduct many of their transactions with the IRS electronically (Modernized e-File).

Future BSM deliverables are also critical to improved customer service. As the ACSI scores illustrate, there is still a gap between customer satisfaction levels for banks and the IRS. Banks offer daily updating of accounts, electronic access by customers to account records, and a full range of electronic transactions – options which the IRS cannot yet provide. With the help of modern technology, the IRS must close this gap if it is to be perceived by taxpayers as having services on a par with financial institutions.

But clearly, the IRS has made real progress in managing BSM. Given such progress in 2004, if the IRS can continue to demonstrate improvement in 2005, then in 2006 it would seem most desirable and logical to increase BSM's funding. BSM funding levels have been severely reduced in the last several years. Indeed, BSM funding was $388 million in FY2004, $203 million in FY2005, and is now requested at $199 million in FY2006.

The Board strongly believes that cutting back on modernization will force the program to take longer and cost more than necessary. Of greatest concern is the age of IRS' existing computer systems which will eventually become impossible to maintain. As time passes, a catastrophic disruption in our nation's tax system becomes more likely.

Therefore, the Board recommends that the BSM program move forward at an accelerated pace. Not only will this allow the IRS to operate more efficiently and effectively, it will strengthen the agency's efforts to enforce the tax law and improve customer service.

Both GAO and TIGTA have reported on the cost overruns and delays the BSM program has experienced. One cost you won't hear about, however, is the cost to the taxpayers of delaying the benefits of a modernized IRS.

Let me offer one concrete example. According to the ConsumerAffairs.com web site, in the 2003 tax filing season, an estimated 12.1 million taxpayers nationwide obtained Refund Anticipation Loans (RALs). Further, the economic burden of RALs falls particularly hard on families who can least afford the cost. A report by the National Consumer Law Center (NCLC) and the Consumer Federation of America (CFA) found that roughly 57 percent of the families who purchased RALs in 2003 – 6.92 million of the 12.1 million – received the federal Earned Income Tax Credit (EITC). The EITC provides financial assistance to the working poor. Those 6.92 million EITC recipients spent a total of $1.74 billion on RAL-related fees, including check-cashing fees, according to the NCLC and CFA.

The Customer Account Data Base (CADE), the largest of the BSM projects, offers as a benefit the ability of the IRS to issue an electronic refund to taxpayers who electronically file in about three to five days, which I expect will take a major bite out of the RAL business. There will be no need for a RAL if the IRS can issue a refund in three days. Even if such a capability reduces the number of RALs by only 60 percent, that will still save EITC taxpayers over $1 billion a year. So, every year the IRS delays its ability to issue a three-day refund to electronic filers costs taxpayers over a billion dollars a year.

Let me offer another taxpayer-focused perspective. Professor Joel Slemrod of the University of Michigan testified to the President's Panel on Tax Reform that individual taxpayers spend approximately $85 billion a year complying with the tax code. If a modernized IRS makes taxpayers only five percent more efficient, that would still save taxpayers over $4 billion a year. That's why it pays to complete BSM as quickly as the IRS can manage the program.

Human Capital and Training

Improving its human capital is in the second half of goal three of the Strategic Plan. The Board believes that human capital is the IRS' greatest resource and strength, and one of its greatest challenges. The IRS possesses an extremely talented and dedicated workforce that produces very high-quality work in spite of the technological and resource limitations previously described. However, such a workforce cannot be taken for granted. It must be carefully selected, trained and given the skills and tools it needs to meet the demands of tax administration in the 21st century. Human capital cannot be an afterthought; it must be integrated into any IRS strategic plan.

As we stated in our 2004 annual report, the Board has serious concerns regarding the IRS' lack of a strategic approach to human capital. In 2003, the Board recommended that the IRS focus on its people resources – specifically on the way that it hires, trains and retains employees. We called upon the IRS to develop an agency-wide human capital strategic plan that focuses on five key areas:

1. Replace lost critical talent – The IRS has a "graying" workforce with 25 percent eligible to retire by 2006. Many of these individuals possess critical skills, such as maintaining legacy IT systems, and institutional knowledge that could easily be lost.
2. Build skills for complex work – Tax administration will become more complex in the future as demonstrated by the challenges in combating abusive tax avoidance transactions that are increasingly more sophisticated and harder to detect. Enhanced IT skills will become more important in this new environment, such as the use of technology as the preferred means of doing business.
3. Manage change – Even though the IRS customer-focused organization is firmly in place, change will continue throughout the agency. The IRS is no longer a static organization; new technology and process redesign will bring further challenges and greater change, and with it, an increased demand for leaders and managers with change management skills and experience.
4. Enhance performance – Given budgetary constraints, the IRS must enhance its performance each year to meet greater work demand and improved customer service and enforcement goals. Management skills take on greater importance in such a high performance, goal-driven environment.
5. Engage the entire workforce – Workforce engagement remains a challenge. Surveys indicate that upper management levels of the IRS are engaged in its mission and strategic goals; but the same cannot be said for front-line managers and rank-and-file employees.

So far, the IRS has yet to develop an agency-wide human capital plan that deals with these five concerns, although some are addressed in part in the agency-wide strategic plan.

Nevertheless, there have been some gains. The Board was pleased to see improvements in the IRS' third annual employee satisfaction survey, conducted by The Gallup Organization, in which approximately 75 percent of the workforce participated.

According to Gallup, the IRS made "steady progress increasing employee engagement" from 2001 to 2003. It reported that the percentage of employees who saw themselves as being engaged rose from 21 percent to 31 percent from 2001 to 2003. The ranking of the IRS increased from the 34th to the 50th percentile of comparable organizations.

However, these improvements are dwarfed by the remaining challenges. Sixty-nine percent of IRS employees are still not engaged and the Gallup survey also showed that less than a majority of employees (43 percent) can strongly agree that they know what is expected of them at work. Greater and more focused attention is needed on workforce issues.

Training at the IRS

At last year's IRS Nationwide Tax Forums and the Board's 2005 annual open meeting, the Board also heard from stakeholders and dozens of agency employees who saw workforce issues as the greatest challenge for the agency over the next five years. The lack of adequate training was a dominant issue.

Stakeholders described an expanding training gap at the IRS, where employees often lack the expertise and skills to handle difficult, complex or problem cases. IRS employees also reported that they were inadequately or unevenly trained. Stakeholders added that in the operating divisions where employees have helped plan and design training programs, employees report higher job satisfaction and empowerment.

The Oversight Board has studied IRS' division training programs and determined that there is no clear vision for training across the agency, and no real linkage between strategic training planning at the national and operating division level, nor is there an agency-wide "champion" for training. Admittedly, reduced budgets have had a negative impact on training, such as inconsistent treatment per employee across the four operating divisions and the inability to provide leadership training and effective management succession across the agency. However, TIGTA also recently reported that the IRS' Human Resources Investment Fund is so poorly managed that 60 percent of its funds were spent on administrative costs while turning away employees for lack of money.[23]

Inadequate training budgets will not allow the IRS to proceed with plans for hiring, training, and retaining qualified individuals to address the enforcement and customer service needs of the agency. Adequate funding for training is critical and will allow the IRS to develop and retain a well-trained, well-equipped workforce supported by enhanced technologies. The workforce of the future must be prepared to deal with not only the approaching gap created by the retirements of senior, experienced employees, but also to deal with the increasingly complex and abusive tax avoidance schemes that are contributing to the growing tax gap.

The ability of the IRS to realize its long-term vision and goals depends upon effective, efficient, well-trained and motivated employees. It also depends upon the IRS' ability to implement effective measures to assess the impact of training, and to plan and design new methods of training that address emerging critical compliance needs.

Two years after the IRS Oversight Board raised concerns on human capital issues, the same problems persist; the IRS has not adequately addressed them. The agency has not yet dealt with the reality of an aging workforce and has failed to provide clear guidance, direction and training for its employees.

The Board recommends that the IRS develop a strategic human capital plan that addresses these issues. Faced with pending retirements, the IRS must have a plan in place to refresh its workforce, preserve invaluable knowledge, and institute succession planning throughout the agency. The IRS must also have a plan to recruit and retain qualified personnel, especially future executives from the private sector who can bring to bear best practices and new ideas to the challenges and opportunities that the 21st Century brings. And lastly, the IRS must better train and equip its workforce with necessary skills. The IRS will be hard pressed to close the compliance and customer service gaps if the training gap is not closed as well.

Measure Long-Term Goals

Mr. Chairman, in my opening remarks I described an ideal world of tax administration. If we are to make informed management decisions on tax administration, we need to establish some meaningful but achievable goals for a realistic world. Now that the IRS has made significant gains in many areas, it is important that quantifiable long-term goals be set to guide our decision-making, especially in seeking to achieve the critical balance between service and enforcement.

I believe that there is a general consensus that the IRS must begin to set long-term goals as a way to measure both performance and to help the Administration and Congress make informed decisions on resources and budgets.

This imperative was clear throughout this year's congressional hearings on the IRS. The Comptroller General David M. Walker testified that the IRS "lacks quantitative long-term goals for improving taxpayer compliance, which would be consistent with results oriented management."[24] James R. White, GAO's Director, Strategic Issues, took another tack: "IRS is developing, but currently lacks, long-term goals that can help them inform stakeholders including the Congress, and aid them in assessing performance and making budget decisions."[25] As previously noted, TIGTA came to a similar conclusion about the value of such goals. Indeed, an agreed-upon set of long term goals between the IRS and Congress could not only help the allocation of resources but prevent the wild swings in the pendulum between customer service and enforcement.

The Board appreciates the difficulty associated with developing measures and performance goals. Setting long-term goals requires a high level of consultation and consensus building. Achieving agreement among Congress, the executive branch, external stakeholders and the public will be particularly challenging. Nevertheless, some initial progress has been made.

As discussed in the Board's 2004 annual report, during the FY2005 budget formulation process, the IRS took the important step of aligning performance and requested resources. However, the agency must continue to integrate performance into its decision-making and resource allocation processes to achieve completely an integrated performance budget.

Further, the IRS modified its budget and performance plans to include more customer-focused and "end result" measures. The agency also implemented the "Embedded Quality" program/methodology to gauge the accuracy of completed actions. As the IRS expands this program to capture even more data, it can better identify and resolve specific accuracy problems – thereby, improving the work product and in turn, the level of service to taxpayers.

The work of Congress would be facilitated if there existed a set of long-range measures for effective tax administration that were widely accepted as representing a desirable but realistic tax administration system the country would like to achieve. These goals would set a valuable context for making decisions on the proper balance between service and enforcement. They would create an environment of accountability where everyone who is part of the system – taxpayers, the IRS, and decision-makers in the executive and legislative branches – are all aware of overall goals and their contributions to goal achievement.

The Board believes it is imperative to identify the key attributes of an effective tax administration system. Such attributes can identify desired outcomes and create a road map for the next decade that will complement the IRS' strategic, budget and annual performance plans. In addition, it could be integrated into the government-wide Key National Indicators Initiative whose purpose is to help assess the overall position and progress of our nation, frame strategic issues and chart future directions.

A Realistic Budget

The Oversight Board believes there is much to like in President Bush's FY2006 budget request for the IRS. First, the Oversight Board recognizes and appreciates that at a time when most budgets are being tightened, the President is asking for a greater budget increase for the IRS than for other non-defense and non-homeland security agencies. The Board is encouraged by the request for additional enforcement funding and is pleased that the Administration acknowledges that investments in IRS enforcement result in increased tax revenue.

However, the Board recommends even more funding than the President has requested; our recommendation builds on the President's budget request. The Board calls for $11.6 billion in funding for FY2006, a nine percent increase over the Administration's recommendation. A comparison of the Board's recommendation and the President's request is shown in the following table:[26]

Comparison of Administration's Request, IRS Oversight Board's Recommendation, and Enacted Appropriations *(in $ millions)*

FY2005			FY2006	
Admin.	**Oversight Board**	**Enacted**	**Admin.**	**Oversight Board**
10,674	11,206	10,233	10,679	11,629

The Board believes that the IRS must begin to close the tax gap through greater enforcement. For that reason, we recommend an additional $435 million over the President's request for IRS enforcement efforts that could easily generate more than a billion and a half dollars in additional tax revenue using the Administration's return on investment of four-to-one. From its private sector perspective, the Board believes it makes perfect sense to make the additional investments in enforcement that will pay for themselves many times over.

The Board also recommends additional funding towards stabilizing customer service and supporting the BSM program. As I mentioned earlier in my testimony, the Board is concerned that proposed reductions in customer service and modernization resources in the FY2006 budget request will have a negative impact on the IRS' ability to deliver quality service to taxpayers, which ultimately, will also have an adverse effect on taxpayer compliance.

Clearly both service and enforcement are necessary if high levels of taxpayer compliance are to be achieved. Re-stating Commissioner Everson's equation in other terms illustrates this point: *Prevention+ Correction = Compliance*.

Taxpayer service is prevention, and designed to prevent non-compliance by informing taxpayers of their tax obligations and offering assistance in filing accurate returns. Preventing taxpayer errors is usually cheaper and less painful than correcting them. Enforcement is correction, and is designed to apply appropriate treatments to non-compliant taxpayers based on the severity and cause of their non-compliance. Looking at the equation in these terms provides greater insight into the importance of service.

Indeed, Senate Appropriations Subcommittee on Transportation, Treasury, the Judiciary, Housing and Urban Development, and Related Agencies Chairman Christopher Bond stated at an April 7th hearing that he hears almost daily complaints that the tax code has become "unmanageable and confusing, resulting in excessive cost and administrative burdens that far exceed reasonable tax compliance."[27]

Given this environment, the Board asks, "Shouldn't public policy be tilted in favor of assisting taxpayers?" We recognize that there can be a tension between affordability and good public policy. However, we must not overlook the overall impact on taxpayers when making decisions on federal expenditures.

For example, the proposed closing of selected TACs, which in total served 7.7 million taxpayers in FY2004, will save about $55 million in federal expenditures, or about $7 per taxpayer served. The savings may seem attractive at first but we should be conscious of the burdens that this reduction of service imposes on taxpayers and how it affects tax revenues. Therefore, we urge the members of the Joint Review to follow the Board's FY2006 budget recommendations for customer service funding.

We are also aware of the severe limitations that Congress is under in appropriating federal monies to worthwhile needs. For example, Congress may agree with the Board's budget recommendations, but the existing budget evaluation methodology makes it difficult to act on these recommendations because enforcement initiatives are considered simply as an expense, and are not recognized for the amount of revenue that will be raised. For that reason, the Board is pleased to see the Administration's recommendation to adjust Appropriations Subcommittees 302(a) allocations to increase enforcement funding for the IRS.

However, this recommendation comes with restrictions that could limit the additional funding to enforcement functions. Because enforcement spending would be set at a fixed amount, the Board is concerned that these restrictions could result in unintended consequences, such as additional reductions in taxpayer services or modernization, should enforcement not be fully funded or unanticipated costs arise.

Rather than dwell on the Board's FY2006 budget recommendations, I believe it is more important to recognize the long-term effect of an under-funded IRS, as well as the benefits of additional IRS funding. The appropriations process has not been able to fund the IRS at all levels many people in tax administration, including the Board, but also including many IRS stakeholders, believe is necessary. It is time to step back and look at the problem from a more strategic perspective.

The Board recommends that Congress take a hard look at the procedures it uses to appropriate IRS funding. Last year, the IRS produced enforcement revenue of $43 billion, approximately four times the total IRS budget. This year, the Administration in its proposed budget recognized that there is a four-to-one direct return on investment from IRS enforcement. Any indirect effects on voluntary compliance resulting from either customer service or enforcement are in addition to those direct effects.

How can the appropriations process be changed to recognize these realities? Let me suggest for your consideration two approaches that have been used in the past, one as recently as last year.

In the late 1990s, Congress set aside approximately $144 million a year for five years, outside of the caps on discretionary spending, specifically earmarked for Earned Income Tax Credit enforcement. A similar approach could be taken again for a broader enforcement initiative.

Last year, in the JOBS bill, Congress authorized the IRS to use private collection agencies and authorized the Secretary of the Treasury to retain part of the money collected. This was the first time I can recall that the revenue stream has been used to pay for IRS operations. If this is an acceptable approach, perhaps it could be used more broadly. A mere one percent of last year's enforcement revenue of $43 billion could pay for an appreciable IRS enforcement effort. Alternatively, it could provide adequate funding for the IRS BSM program. Controls could be imposed that would still give Congress oversight over how the money was to be spent, but it would relieve the pressure on the appropriations process that seems to be failing the IRS.

Lastly, I want to raise an issue that the Oversight Board brought to the forefront in a special budget report it issued in March 2005. The IRS needs a realistic budget that recognizes and provides for the anticipated expenses it will incur, such as congressionally-mandated pay raises, inflation and rent increases. By not fully funding these costs, the IRS will be challenged yet again to make other cuts in critical programs to pay for them.

Conclusion

Mr. Chairman, in conclusion, the Board strongly believes that our nation can ill afford to return to the days when the IRS fluctuated between customer service and enforcement. We cannot shift resources to pursue those who knowingly avoid taxes while neglecting the needs of honest taxpayers attempting to comply with a complex tax code.

As I previously stated, our goal must be to create a tax administration system where taxpayers would find compliance easy to achieve, but difficult to avoid. Since the passage of RRA 98, the IRS has been on the right track and making progress toward that ultimate goal. We must now give them the tools, guidance and resources to finish the job. Thank you and I would be happy to answer your questions.

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[1] Senate Finance Committee Chairman Charles Grassley, Opening Statement before the Senate Finance Committee, April 14, 2005.
[2] P.L. 105-206, Title I, Section 1002.
[3] American Institute of Certified Public Accountants, Statement to the Internal Revenue Service Oversight Board Public Meeting, February 1, 2005.
[4] National Taxpayer Advocate Nina M. Olson, Testimony before the Senate Finance Committee, April 14, 2005.
[5] American Customer Satisfaction Index, "ACSI Overall Federal Government Scores with Historic Scores of Agencies Measured 1999-2004", December 15, 2005.
[6] Senate Finance Committee Ranking Member Max Baucus, Opening Statement before the Senate Finance Committee, April 14, 2004.
[7] National Association of Enrolled Agents, Statement to the Internal Revenue Service Oversight Board Public Meeting, February 1, 2005.
[8] Internal Revenue Service Oversight Board, Annual Taxpayer Attitude Survey, April 2005.
[9] Comptroller General of the United States David M. Walker, Testimony before the Senate Finance Committee, GAO-05-527T, April 14, 2005.
[10] IRS Fact Sheet
[11] Walker, op. cit
[12] Olson, op. cit.
[13] Treasury Inspector General for Tax Administration Russell George, Testimony before the Senate Finance Committee, April 14, 2005.
[14] Joint Committee on Taxation Chief of Staff George K. Yin, Testimony before the Senate Finance Committee, April 14, 2005.
[15] George, op. cit.
[16] Internal Revenue Service Oversight Board, Annual Taxpayer Attitude Study, April 2005.
[17] Government Accountability Office Director, Strategic Issues James R. White, Testimony before the House Ways and Means Subcommittee on Oversight, GAO-05-416T, April 7, 2005.
[18] Treasury Inspector General for Tax Administration J. George Russell, Testimony before the House Ways and Means Subcommittee on Oversight, GAO-05-416T, April 7, 2005.
[19] Ibid.
[20] Chairman Jim Ramstad, Opening Statement before the House Ways and Means Subcommittee on Oversight, April 7, 2005.
[21] Walker, op. cit.
[22] George, op. cit.
[23] Treasury Inspector General for Tax Administration, Audit Report, "The Human Resources Investment Fund is Not a Cost-Effective method of Providing Tuition Assistance, March 2005.
[24] Walker, op. cit.
[25] White, op. cit.

[26] Internal Revenue Service Oversight Board, FY06 Budget/Special Report.
[27] Chairman Christopher Bond, Opening Statement before Senate Appropriations Subcommittee on Transportation, Treasury, the Judiciary, Housing and Urban Development and Related Agencies, April 7, 2005.