IRS Oversight Board
Annual Report 2006

January 2007

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Message from the Board

The Internal Revenue Service (IRS) Oversight Board is pleased to have this opportunity to report to the President, Congress, and taxpayers on the progress the IRS is making as it transforms itself into a modern institution that provides efficient and effective tax administration services to America's taxpayers. To guide this ongoing and multi-year effort, the IRS — with the approval of the Oversight Board — updated its Strategic Plan to reflect the following goals for the 2005-2009 timeframe:

- Improve taxpayer service
- Enhance enforcement of the tax law
- Modernize the IRS through its people, processes, and technology

Overall, the IRS is making steady progress in meeting these goals and delivered some noteworthy gains since the Board's 2005 annual report:

- Customer service remains stable, with both gains and a few modest declines in FY2006.

- Taxpayers increasingly recognize that the IRS provides good quality service. A study commissioned by the Board in 2006 — described in its *Taxpayer Service and Channel Preference Survey Special Report* — indicates that approximately 41 percent of U.S. taxpayer households contacted the IRS at least once within the last two years, and that 85 percent rated their satisfaction as better or the same as other federal or state agencies.

- Enforcement activity has increased with almost $48.7 billion in enforcement revenue collected in FY2006 — a three percent increase over the previous year.

However, IRS modernization is still very much a work in progress; the job is far from complete and tax administration is continually evolving to reflect changing tax laws, trends, and new technology. The IRS must still meet a number of challenges before it can achieve the vision of a 21st Century tax administration agency described in the IRS Restructuring and Reform Act of 1998 (RRA 98). The Board has identified a number of areas of particular concern that merit greater attention. For example:

- The IRS still depends on archaic tools to perform its mission critical functions and must continue to update both its Business Systems Modernization and Information Technology (IT) systems.

- The agency faces a number of daunting IT infrastructure problems.

- Human capital remains one of IRS' greatest resources and biggest challenges and must be adequately addressed.

Notwithstanding the IRS' progress in improving its performance during the last six years, the Oversight Board, Congress, the Administration, and others in the greater tax administration community are seeking an overall strategy to address the tax gap — the difference between what taxpayers legally owe and what is actually collected. The IRS' most recent estimate for the annual gross tax gap is $345 billion, based on 2001 tax returns. Subsequently, the IRS collected about $55 billion of the tax due, which reduced the gross tax gap to a net gap of $290 billion. However, far too much of what is owed is left uncollected.

Based on our voluntary compliance system, it is not realistic to believe that the tax gap can ever be eliminated. However, the tax gap remains a serious and persistent tax administration problem, and its consequences are all too real. First, at the most basic level, the tax gap is an injustice to compliant taxpayers who ultimately are bearing the financial burden of those who do not pay what they owe, whether intentionally or not. It also underscores the unintended consequences of a complex tax code which can cause taxpayers to make honest mistakes. Second, non-compliance deprives our government of needed revenue to which it is entitled. Third, and perhaps most troubling, the tax gap undermines taxpayer confidence in the fairness of our tax administration system and contributes to non-compliance.

In July 2006, the IRS Oversight Board testified before the Senate Finance Committee on what it believes is the best approach to shrinking the tax gap. The Board examined the many different and complementary recommendations to reduce the tax gap, and concluded that there was no one "silver bullet" that will solve the problem. The Board has concluded that reducing the tax gap requires a comprehensive set of broad strategies that balance prevention and correction — from a simpler tax code and more complete information reporting to more IRS examinaton and collection personnel and quality customer service.

In September 2006, the Treasury Department's Office of Tax Policy publicly released a broad strategy for addressing the tax gap that included many of the Board's recommendations. Members of Congress have also shown strong interest in reducing the tax gap and their further engagement and leadership is critical as some elements of the plan, such as a simpler tax code, require legislative action.

The Board believes that the Administration, Congress and other stakeholders can find a common ground and work together to reduce the tax gap in a way that gets real results. However, this will require the efforts of everyone involved in tax administration — from the Executive Branch to Congress to the larger tax community.

Preface

In June 1997, the National Commission on Restructuring the IRS recommended the creation of an IRS Oversight Board to serve as a new governance and management body that would focus on strategic issues facing the IRS. The following year, the IRS Restructuring and Reform Act of 1998 (RRA 98) established the Board to "oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws or related statutes and tax conventions to which the United States is a party."

The Board is composed of nine members; seven come from "private life" and are appointed for five-year terms by the President and confirmed by the Senate. These private life members have professional experience or expertise in key business and tax administration areas. Of the seven, one must be a full-time federal employee or a representative of employees. The Secretary of Treasury and the Commissioner of Internal Revenue also serve as members of the Board. However, to preserve its independent oversight responsibilities and objectivity, neither the Secretary nor the Commissioner approve the Board's annual report, although their comments and guidance are both solicited and welcomed.

RRA 98 requires that the private life members of the Board be appointed without regard to political affiliation, and solely on the basis of their professional experience and expertise in one or more of the following areas:

- Management of large service organizations
- Customer service
- Federal tax laws, including tax administration and compliance
- Information technology
- Organization development
- The needs and concerns of taxpayers
- The needs and concerns of small businesses

The Board has many characteristics of a corporate board of directors, but is tailored to fit a public sector organization. RRA 98 gives the Board specific responsibilities to review and approve strategic plans of the IRS, review IRS operational functions and the selection, evaluation, and compensation of IRS senior executives, and review and approve the budget request of the IRS prepared by the Commissioner.

This report satisfies a statutory requirement in RRA 98 for the Board to report annually to the President and Congress.[1]

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I. Introduction

The IRS Oversight Board is pleased to have this opportunity to report to the President, Congress, and taxpayers on the progress the IRS is making as it transforms itself into a modern institution that provides efficient and effective tax administration services to America's taxpayers. To guide this ongoing and multi-year transformational effort, the IRS — with the approval of the Oversight Board — updated its Strategic Plan to reflect the following goals for the 2005-2009 timeframe:

- Improve taxpayer service
- Enhance enforcement of the tax law
- Modernize the IRS through its people, processes, and technology

This report is organized around the progress that the IRS is making with respect to each of the strategic goals, followed by a section on the importance of measuring success. It concludes with a discussion of a persistent problem confronting our tax administration system today — closing the tax gap.

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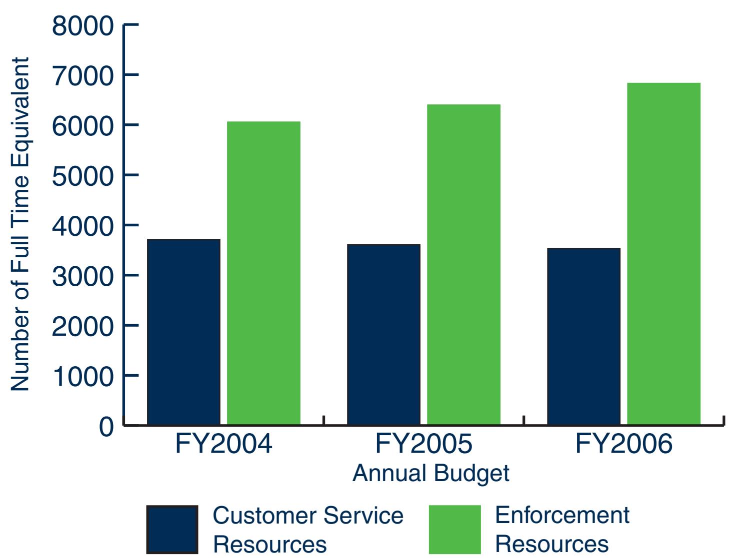
II. Strategic Goal 1: Improve Customer Service

Both good customer service and vigorous enforcement of the tax law benefit taxpayers. It is not an either/or proposition; both are necessary for effective tax administration. Good service leads to fully informed and satisfied taxpayers who understand their tax obligations and experience few problems when interacting with the IRS. Vigorous and visible enforcement of the law directly and indirectly encourages taxpayers to report and pay their tax obligations fully and honestly.

The IRS recognizes the importance of this balance and has adopted as its "working equation": Service Plus Enforcement Equals Compliance. This formula means that taxpayers are not well-served if the IRS over-emphasizes one part of its mission to the detriment of the other. It was a desire for balance that led in part to the passage of RRA 98.

The balance between service and enforcement resources has been relatively stable in the last three years. However, the Board has noted the IRS has allocated a greater proportion of its resources to enforcement activities over the past three fiscal years years, as shown in Figure 1. The Board intends to follow this trend closely to ensure that the IRS' performance remains balanced.

Figure 1: **SERVICE AND ENFORCEMENT TRENDS**



Broad Customer Service Options

The IRS offers America's taxpayers a large menu of assisted and self-assisted services — and over multiple channels. For example, IRS representatives provide assisted services on the agency's toll-free telephone lines and in person at Taxpayer Assistance Centers, also known as walk-in sites. Taxpayers may also access self-assisted services over the IRS' web site (www.IRS.gov) and its automated response toll-free telephone lines. Moreover, IRS customer service has evolved from merely providing paper forms and pamphlets and answering basic tax law and account questions. Today, taxpayers can also conduct a number of transactions electronically, such as filing and paying their taxes and tracking the status of their refunds, with even greater options to come in the future as new technology is deployed and more e-services become available. However, should they prefer, taxpayers can still receive service from the IRS through written and faxed correspondence.

Taxpayers Take Note of Improved Service

The IRS Oversight Board commissioned Roper Public Affairs and Media to conduct a survey in early 2006 of taxpayers to better understand their customer service needs and how they are being met. The *Taxpayer Service and Channel Preference Survey Special Report* is available on the Board's web site, www.irsoversightboard.treas.gov.

The survey found that 41 percent of U.S. taxpayer households contacted the IRS at least once within the last two years using a variety of service channels, such as toll-free telephones, the Internet, e-mail, face-to-face service and paper correspondence.

Approximately 22 percent of taxpayer households indicated that they telephoned the IRS; three percent said they had personally visited an IRS office; 25 percent said they had visited the IRS web site; four percent said they had sent the IRS an e-mail, and six percent said they had sent the IRS a letter by mail.

The Board is pleased to report that the "big picture" painted by the survey is quite favorable and reflects the IRS' commitment and years of hard work to improve customer service. Taxpayer satisfaction levels were high and these finding are consistent with other studies, such as the Board's annual Taxpayer Attitude Survey and the American Customer Satisfaction Index (ACSI).

Survey results indicate that taxpayers who currently use IRS customer service generally rate their experiences in a positive light. Well in excess of 80 percent of respondents in nearly all service channels rated their satisfaction with IRS service as better than, or the same as, other government agencies. For those who specifically visited an IRS office, over three-fourths gave positive marks as to the IRS' ability to resolve their tax matter and for the helpfulness of IRS staff. For taxpayers who contacted the IRS during the last two years through any of the service channels:

- 32 percent rated their satisfaction with IRS service as "better" than other federal or state agencies;

- 53 percent rated IRS service as the "same" as other agencies; and

- Eight percent said it was "worse" (with the majority of these taxpayers indicating the service was worse due to the wait time being too long or the tax matter not being resolved).

Taxpayer Service Performance Holding Steady Despite Reductions

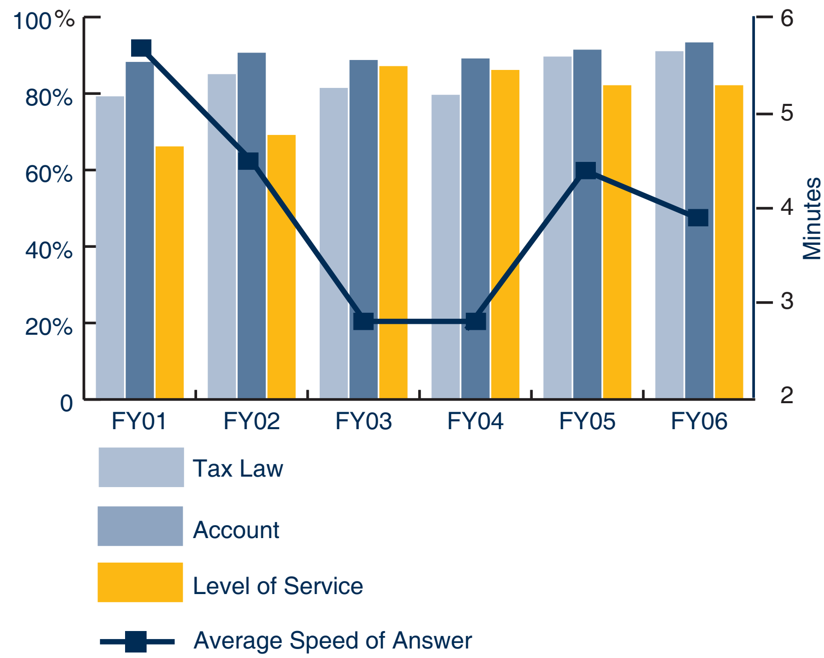
Telephone service is often seen as a key indicator of how well the agency is serving America's taxpayers. During last filing season, approximately 32.7 million people called the IRS seeking assistance. Although this represented an approximate two percent drop in calls over the previous year, properly handling this still large volume of calls is an enormous task that was complicated by budget pressures. Faced with the aforementioned greater priority on enforcement and subsequent smaller budgets for customer service, the IRS made the strategic decision to reduce its toll-free telephone level of service from 85 percent to 82 percent in FY2006 to accommodate a $5 million budget reduction. In congressional testimony, the Government Accountability Office (GAO) stated:

> *IRS officials chose to reduce telephone access because they viewed it as a more flexible area to absorb budget reductions than, for example, processing. IRS officials said that telephone access had improved in recent years to a more acceptable level, giving IRS flexibility to adjust CSR [Customer Service Representative] level of service.*[2]

The IRS also cancelled its TeleFile service that provided some taxpayers with the capability to file simple tax returns (1040EZ) over the telephone and closed some smaller call sites. Two other proposed IRS changes — a reduction in its toll-free telephone service operating hours and the number of walk-in sites — were cancelled in response to congressional reaction.[3]

Due to these cuts, the telephone level of service provided to taxpayers suffered modest declines, with more abandoned calls and longer wait times, but as illustrated in Figure 2, phone service has stabilized in the mid-eighty percent range after far lower service levels just five years ago.[3] At the same time, the IRS has improved its tax law and account question accuracy rate; also demonstrated in Figure 2.

Figure 2: **TOLL-FREE TELEPHONE SERVICE FY2001-FY2006**



IRS Web Site's Popularity Continues to Grow

The IRS' web site (www.IRS.gov) continues to grow in popularity among taxpayers and practitioners as the preferred channel to get needed information, and taxpayers used it at record levels this past filing season. As of August 31, 2006, web site usage increased by nearly nine percent and there were approximately 161 million visits.[5] The IRS also set a single day record on April 17, 2006, with 3,337,936 visits to IRS.gov, which beat the prior single-day record of 3,337,300 set on April 15, 2005.

In its congressional testimony on the 2006 filing season and the IRS' FY2007 budget request, the GAO found much to like about the IRS web site, which was redesigned in the fall of 2005 to enhance its search capabilities and make it more user-friendly. The GAO said the web site was "performing well" and made the following observations:

- *[W]e found IRS's Web site to be readily accessible, easy to navigate, and easy to search,*

- *An independent weekly study by Keynote, a company that evaluates Web sites, reported that IRS's Web site has repeatedly ranked second out of 40 government agencies evaluated in terms of average download time. The same study also reported that IRS has repeatedly ranked first out of the most* *commonly accessed government related Web sites for response time and success rate, and*

- *The American Consumer Satisfaction Index overall customer satisfaction with IRS's Web site increased from 68 to 72 percent after IRS reconfigured the site.*[6]

In addition to such popular web features as "Where's My Refund," new features include: "electronic IRS," a gateway to the many available IRS electronic options; Alternative Minimum Tax (AMT) Assistant; and Help for Hurricane Victims, a new link that provides hurricane victims information on tax issues and assistance relevant to their situation. "Where's My Refund" was accessed by 31.3 million taxpayers as of September 10, 2006, an 11.9 percent increase over the same period last year.

Walk-In Center Visits Decline

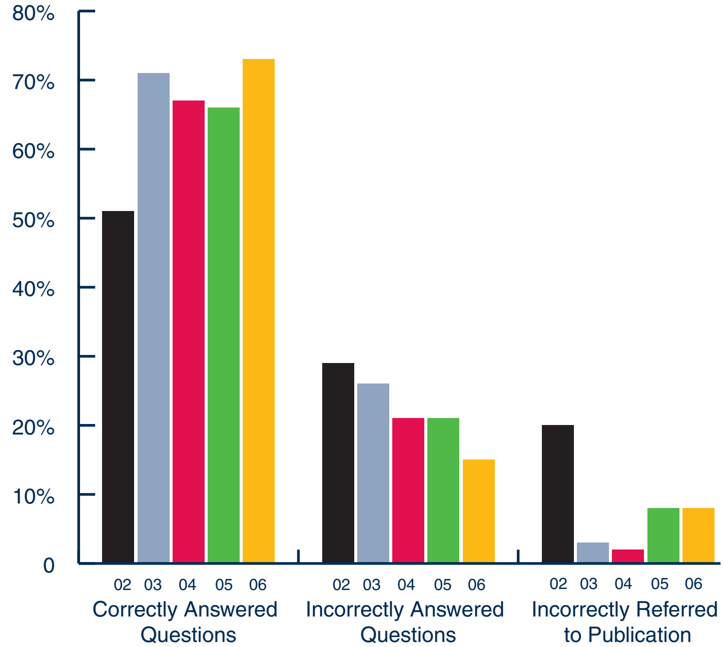
The number of taxpayers seeking assistance at walk-in centers has declined to approximately 2.8 million during the 2006 filing season, a decline of almost 12 percent from the 3.23 million taxpayers seeking in-person assistance during the 2005 filing season. GAO reports that the IRS has not reduced the types of assistance offered at its walk-in sites during the past two years, so this decline in usage is due to other factors. However, GAO also notes that the IRS quality review program used to monitor walk-in sites does not provide reliable data on the quality of service provided at them.

The Treasury Inspector General for Tax Administration (TIGTA) also evaluated the quality of service provided by Taxpayer Assistance Centers (TAC). One audit determined that auditors posing as taxpayers were unable to schedule appointments when they called. The convenience of scheduling appointments could encourage taxpayers to try to resolve tax account problems earlier, and provide them the opportunity to reduce their wait times at the TACs, thus reducing taxpayer burden.[7]

A second TIGTA audit evaluated the TAC's quality of service. Auditors visited IRS walk-in sites during filing season and asked questions anonymously, much as TIGTA has done in the past:

> *TIGTA made anonymous visits to 50 TACs and asked 200 questions to determine if taxpayers received quality service, including correct answers to their questions. Assistors correctly answered 73 percent of the questions compared to 66 percent during the 2005 Filing Season. TIGTA visited an additional 20 TACs and asked 80 tax law questions specifically related to the Katrina Emergency Tax Relief Act of 2005. Assistors answered 75 percent of those questions correctly. IRS assistors should have been trained to answer these questions. TIGTA's observations were that assistors sometimes inappropriately referred taxpayers to publications to conduct their own research, or responded to tax law questions without following required procedures, such as using the publication method guide that requires them to ask probing questions.*[8]

Figure 3: **WALK-IN SITE PERFORMANCE DURING FILING SEASONS 2002-2006**



Although the TAC results for FY2006 showed improvement compared with previous years, they are not yet on a par with quality delivered over the IRS' toll free telephone lines.

Electronic Filing Continues to Grow; But Free File Problems Arise

The use of electronic filing continued to grow during the 2006 filing season, with over 54 percent of individual tax returns filed electronically. As of October 27, 2006, more than 73 million individual tax returns were filed electronically — up six percent over the same period last year — and over 20 million taxpayers filed their returns from a home computer — up almost 19 percent. As GAO observed, this growth is significant beyond more taxpayers embracing e-file's benefits:

> *The growth of electronic filing is important, because it generates savings by reducing staff years needed for labor intensive paper processing. Between fiscal years 1999 and 2006, IRS reduced the number of staff years devoted to paper and electronic processing by 1,586, or 34 percent.*[9]

The IRS also achieved significant progress in its corporate e-file program, including the successful e-filing of the nation's largest tax return from a major US corporation that was 24,000 pages long.

However, it is now clear that the IRS will not meet the congressional goal of 80 percent of individual tax returns e-filed by 2007. The rate of growth in the past year for individual filers was less than previous years, which may be partly attributed to two reasons. The first is the cancellation of the TeleFile program, which allowed lower-income taxpayers to file simple returns over the telephone. Over three million taxpayers used the TeleFile program in 2005. TIGTA testified:

> *The IRS . . . had hoped that many of the 3.3 million taxpayers who used TeleFile in 2005 would migrate to the Free File Program. However, current Filing Season statistics indicate that many former TeleFilers are no longer filing electronically and instead are filing their returns on paper.*[10]

The second reason was changes in the IRS' agreement with the Free File Alliance that limited the eligibility of the program to taxpayers with less than $50,000 adjusted gross income (AGI), eliminating approximately 39 million taxpayers with higher AGIs from eligibility. According to a recent TIGTA report, the income limit and the ensuing negative publicity greatly reduced participation in the Free File program, which dropped almost 23 percent from 2005 to 2006."[11]

Notwithstanding these problems, improved electronic tax administration figures largely in the IRS' most recent strategic plan and its vision for an efficient and effective 21st Century tax agency that carries out its mission with the least burden and disruption to taxpayers:

> *The Internet has revolutionized our ability to serve taxpayers and their representatives. We have used the Internet to meet taxpayer demands for quick access, user-friendly tools and better service, and we will continue to use the Internet to reduce burden. In the future, we envision the public will be able to conduct the vast majority of tax interactions electronically. We will continue to improve electronic filing, payment and communications services via the Internet.*[12]

What Lies Ahead: Taxpayer Assistance Blueprint

The Board does not see the pressure for budget cuts abating in the foreseeable future, and is concerned that taxpayer service will continue to be a target for further reductions. To the extent that the IRS can accommodate future cuts without compromising service, the Oversight Board can be supportive. However, continued reduction of the customer service budget may lead to an eventual erosion of taxpayer service with negative consequences for closing the tax gap.

Continued pressure to reduce the IRS budget makes it all the more important that the IRS take a systemic, long-term approach to identifying: (1) taxpayer service needs; (2) the services the IRS should provide taxpayers; and (3) the channels over which those services will be provided. To this end and in response to congressional direction, the IRS in conjunction with the National Taxpayer Advocate and the Oversight Board is developing a five-year plan for taxpayer service, known as the Taxpayer Assistance Blueprint (TAB). It has the following objectives:

- Establish a credible taxpayer/partner baseline of needs, preferences and behaviors;
- Implement a transparent process for making service-related resource and operational decisions;
- Develop a framework for institutionalizing key research, operational, and assessment activities to holistically manage service delivery; and
- Utilize both short-term performance and long-term business outcome goals and metrics to assess service value.

The TAB is being developed in two phases. The Phase 1 report was delivered to Congress in April 2006 and the Phase 2 report is scheduled for delivery in early 2007. When completed, the TAB will help the IRS deliver effective customer service based on taxpayer needs and a set of long-term outcome goals and measures.

Channel Study: Better Serving Taxpayers; Informing the TAB

The IRS Oversight Board commissioned its own research into taxpayer service needs and channel preferences. The Board believes that the information garnered from the *Taxpayer Service and Channel Preference Survey Special Report* can help with the formulation of the TAB and ultimately how the IRS improves the way it communicates and delivers service to taxpayers. The survey contained some very promising news — especially in these tough budgetary times.

Although it found among Taxpayer Assistance Centers a strong taxpayer preference for in-person service, the survey also revealed that taxpayers were willing to consider less-costly, on-line, self-service solutions. Of the taxpayers who either called the IRS, visited an IRS office or sent the IRS a letter within the past two years, approximately 50 percent indicated that they would be willing to consider using an on-line alternative to resolve their tax matter.

In addition, analysis of the survey helped to identify six taxpayer segments, each with its own unique traits and service needs, that can serve as a basis for the development of targeted strategies and products for each segment. Moreover, these findings should help the IRS implement customer service investments that will pay off in both money saved and improved service.

III. Strategic Goal 2:
Enhance Enforcement of the Tax Law

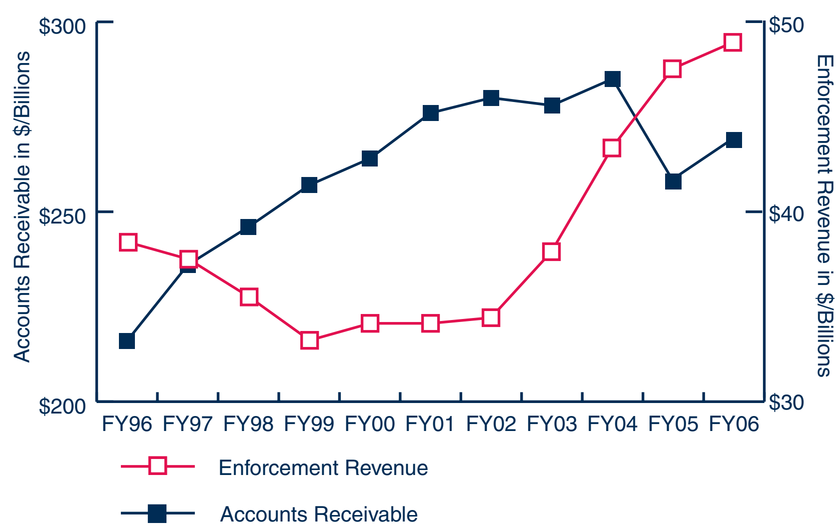
The IRS' second strategic goal is to enhance enforcement of the tax law. However, several years ago there were serious concerns that IRS enforcement activities, including audits and collections, had fallen to dangerously low levels. Key indicators, such as enforcement revenue, had declined to historic lows.

The tax gap, the proliferation of illegal tax avoidance schemes and tax dodges, and changing taxpayer attitudes toward cheating led many in the tax administration community to urge the IRS to reinvigorate and refocus its enforcement program on the most egregious areas of non-compliance.

A Turnaround in Enforcement

The Board applauds the IRS for its enforcement program turnaround. Although its current portfolio of activities is insufficient to address in a meaningful way the $290 billion annual net tax gap, it forms a solid foundation upon which to build. (The tax gap and strategies to combat it are discussed in Section VI of this report.) As demonstrated by a variety of measures, the IRS' performance on enforcement has improved considerably, and real progress has been achieved over the past six years. For example, Figure 4 shows changes in accounts receivable and enforcement revenue from FY1996 through FY2006.

Figure 4: **ACCOUNTS RECEIVABLE AND ENFORCEMENT REVENUE**



IRS Refocuses Its Enforcement Program; Four Goals Set

The IRS has identified four distinct but interrelated tax enforcement goals: (1) discourage and deter non-compliance, with emphasis on corrosive activity by corporations, high-income individual taxpayers, and other contributors to the tax gap; (2) assure that attorneys, accountants, and other tax practitioners adhere to professional standards and follow the law; (3) detect and deter domestic and offshore-based tax and financial criminal activity; and (4) discourage and deter non-compliance within tax-exempt and government entities, and misuse of such entities by third parties for tax avoidance.

In FY2006, the IRS made progress in achieving all four of these goals, but as Commissioner Everson noted in congressional testimony, the agency is especially pleased with the first two as it is seeing evidence of changed behavior in the marketplace on the part of tax professionals, including accountants and lawyers. No longer are abusive tax shelters being marketed by top-level accounting firms.[13] Specifically:

- In FY2000, the IRS audited 99,457 high income individuals. By FY2005, that number had risen to almost 220,000. Similar increases can also be seen in the coverage rates. The rate in FY2000 for high income individuals was 0.96 percent, as opposed to 1.57 percent in FY2005. For FY2006, there was an eighteen percent increase in audits of individuals with incomes over $100,000 with a coverage rate of 1.67 percent.

- The coverage rate for those with incomes over $1 million is five percent. The IRS' plan in FY2006 was to complete 234,000 high income individual audits. The IRS is well ahead of that schedule currently and may reach as many as 240,000 or more. In FY2006, audits of individuals with income of over $1 million increased to 17,015, a nearly 33 percent increase in one year.

- In FY2006, the IRS audited 10,591 corporations with assets over $10 million compared to approximately 10,829 in FY2005, a decrease of 2.2 percent. These audits remain up nearly 50 percent from FY2003.

- For corporations with assets under $10 million, the coverage rate has remained about the same. In FY2006, the IRS examined 17,871 small corporations up slightly from 17,858 in 2005. Both of these figures are more than double the 7,294 audits of small corporations in 2004.

Figure 5**: PERCENT NON-BUSINESS 1040 RETURNS EXAMINED**

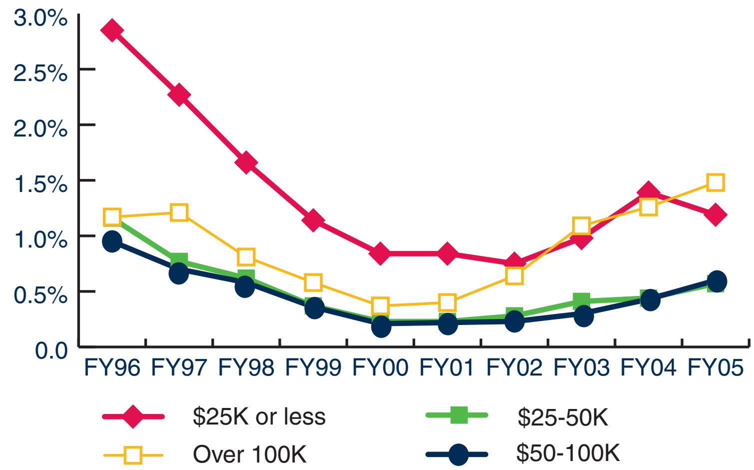
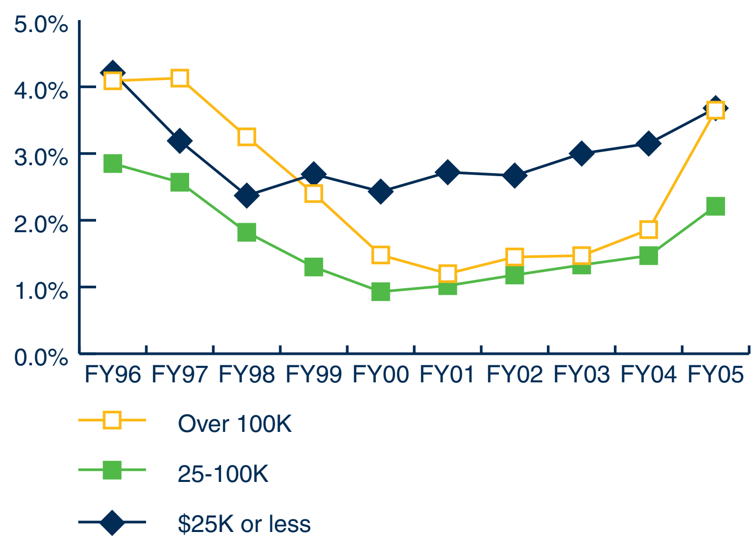


Figure 6**: PERCENT BUSINESS 1040 RETURNS EXAMINED**



Refund Fraud Prevention Encounters Problems

To assist in the detection of refund fraud, the IRS has implemented a Questionable Refund Program to detect and stop fraudulent claims for refunds on income tax returns, which uses an information system known as the Electronic Fraud Detection System (EFDS) to automate the screening of potential fraudulent tax returns. During the last four years, the Questionable Refund Program, using the EFDS as its primary tool, has helped the IRS stop hundreds of millions of dollars of fraudulent refunds. Most recently, in 2005, the IRS was able to stop $412 million in refunds with an operational EFDS in place.

Because of technical and management problems, including inadequate risk management, the IRS was unable to field an operational EFDS during the 2006 filing season, placing its Questionable Refund Program in jeopardy. Although TIGTA reported that the IRS was able to stop $93.9 million in fraudulent refunds as of May 19, 2006 without an operational EFDS, this amount falls short of the $412 million that was stopped in 2005.[14]

The most troublesome aspect of this problem, from the Board's perspective, was the failure of internal management review processes to inform IRS executives of the growing technical problems. Instead, IRS executives in senior leadership positions were unaware of the problem until it was too late to apply remedial action and the IRS entered the filing season without an operational EFDS.

This failure has caused the IRS to conduct an assessment of its procedures for managing information technology projects with an objective of preventing future occurrences of such problems. The Board has been informed of the results of IRS' assessment, and has encouraged the IRS to remedy the situation as quickly as possible.

Private Collection Agencies Begin Work

The IRS has started a pilot program that uses private collection agencies (PCAs) to collect overdue tax debt. This program was authorized by the American Jobs Creation Act of 2004 [PL. 108-357], but is not without controversy. The Board realizes that the authorization for the IRS to use PCAs has received criticism, but the IRS is proceeding with the program as authorized by Congress.

The IRS has begun sending some collection cases to three PCAs, and it has instituted various safeguards and restrictions to ensure that taxpayer rights are not violated during the collection process. The contractors are being paid from the revenue stream collected, and hence payment of the contractors does not use appropriated funds, and the IRS budget is not affected.

Some criticism of the PCA program has centered on the belief that private contractors cost more than the equivalent use of IRS employees, and the IRS Commissioner has recognized this situation during congressional hearings. However, the Board believes that it is important that taxes due to the federal government be collected, and collecting overdue taxes, even at higher cost using contractors, is preferable to not collecting them at all, as long as a positive return on investment is maintained and taxpayer rights are protected. To not collect known tax receivables is a disservice to honest taxpayers and undermines taxpayers' belief that the tax system is fair for everyone. The IRS is currently monitoring its use of PCAs and is developing empirical data on their cost-effectiveness. The Board, as well as the GAO and TIGTA, also will continue to monitor PCAs.

Resources Needed to Close Tax Gap; Budget Processes Need to Be Revisited

The IRS Oversight Board has recommended for several years that additional funds be appropriated for the IRS, including more for collection personnel. In his opening statement on a hearing that focused on the tax gap, Senator Carl Levin made a similar compelling case for providing the IRS with the resources it needs to close the tax gap:

> *Another key step to reducing the tax gap would be to give the IRS the funds it needs to go after tax dodgers. For every dollar invested in the IRS's budget, the service yields more than four dollars in enforcement revenue. Beyond the additional revenues collected, increased IRS enforcement deters those who might otherwise have dodged their tax obligations and reassures honest taxpayers that compliance with the law is not a chump's game. I hope that Congress will follow the Senate Appropriations Committee's lead and enact the President's full request for the IRS's 2007 budget. I also encourage Treasury and the President to consider asking for more IRS enforcement dollars in the 2008 budget request. I can't think of many better investments to recover revenues wrongfully lost to the U.S. Treasury and to build respect for the law and respect for the honest Americans who play by the rules and meet their tax obligations.*[15]

One of the main impediments that prevented Congress from following this recommendation is budget procedures that do not recognize that increases in the IRS budget produce a positive return on investment. The Board has recommended that this situation be corrected, and in FY2006, additional enforcement funding was provided to the IRS outside of the budgetary caps. The Board continues to urge both Congress and the Administration to re-evaluate the budgetary processes and procedures used for appropriating money for the IRS so that the effects of increasing the IRS' funding on taxpayer burden and revenue are properly considered.

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IV. **Strategic Goal 3:** Modernize the IRS Through Its People, Processes, and Technology

The ability of the IRS to perform its tax administration job at peak efficiency and effectiveness depends on its people, technology and knowledge. A modern IRS requires investments in all three of these critical elements, as described below.

Investing in People

The Board believes that human capital is the IRS' greatest resource and strength, and one of its greatest challenges. The agency possesses an extremely talented and dedicated workforce that produces high-quality work in spite of technological and resource limitations. 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.

Human Capital Strategic Plan is a Big First Step

To guide such a strategy, the IRS developed its first Human Capital Strategic Plan (HCSP), which the Oversight Board approved in February 2006. This plan guides IRS human capital priorities by identifying gaps between the current state of human capital and the desired future state — and prioritizing initiatives to close these gaps. To complement the Strategic Plan, the IRS also developed a Human Capital Strategic Implementation Plan (HCSIP), which defines a tactical approach for instituting change.

The HCSP identified the following four human capital strategic goals that link to the IRS' three strategic goals:

1. Continually assess and shape the workforce to efficiently accomplish the Service's mission;

2. Increase employee proficiency and engagement to enhance tax compliance;

3. Leverage human technology to reduce burden; and

4. Enable quick and agile management action to achieve business goals.

Most importantly, the plans identify performance metrics to evaluate whether the goals have been achieved. The Board considers the identification and use of performance measures to be a critical part of any strategic effort, and is pleased that the IRS has included an array of such measures in both plans.

For its first Human Capital Strategic Implementation Plan (2006-2007), the IRS will address workforce challenges and focus on core processes that have the most immediate and significant impact. These include: development of a strategic workforce plan, workforce flexibilities, personnel competency models, targeted recruitment, an employee engagement program, and strategic leadership succession planning.

However, additional work is needed to achieve the strategic goals. The implementation plan could be enhanced if it addressed several areas currently under discussion at the Office of Personnel Management, such as increased tele-working opportunities, reemployment of annuitants, and improved recruiting and retention models along with modernized methods of talent management. Another area meriting action is the declining percentage of IRS employees who completed the Employee Satisfaction Survey — 43 percent in 2006 as compared to 78 percent in 2004.

Other Issues Remain on the Front-Lines: Retirement and Training

Through its public meetings and listening sessions at the IRS' annual tax forums, the Board continues to hear from stakeholders and employees that workforce issues are among the greatest challenges for the IRS over the next five years. For example, several large IRS operating divisions are seeing senior, experienced employees retire or move on to the private sector.

A dominant issue that frequently arises during listening sessions with both employees and practitioners who interact with employees is adequate training. Practitioners have reported that employees sometimes lack the expertise and skills to handle difficult, complex or problem cases. A prior review by the Oversight Board of IRS division training programs 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.

A number of veteran employees with whom the Board has met report that there is significantly less mentoring and other formal on-the-job training sessions for employees than in the past. The IRS is increasing its use of self-assisted "e-learning", which has received mixed reviews from employees. However, regardless of attitudes about e-learning, there is agreement about the need for experienced staff to serve as mentors and trainers for new and inexperienced employees.

The ability to track employee training has a significant impact on IRS' ability to deliver on its Human Capital Strategic Plan. Knowing which employees have received adequate training allows the agency to target its education courses to areas that have the most impact on employee development. According to a recent TIGTA report, the IRS has not improved its management systems for tracking training data enough to be able to determine training cost or effectiveness.[16]

The IRS faces the enormous challenge of tracking over 105,000 employees with training histories, and linking them to an estimated 4.4 million training courses they have taken. TIGTA reports that it is essential that the IRS begin to track accurate data showing the type of training provided, and the direct and related support costs for each course. Coupled with a system that assesses course quality, the information would allow the IRS to determine the return on its investment in training and provide a solid basis for budgeting training expenditures. The Workforce Flexibility Act of 2004 [PL. 108-411] requires each Federal agency to assess on a regular basis how its training plans accomplish or effectively promote the agency's performance plans and strategic goals. To meet the new standards, TIGTA recommends that IRS develop and implement systemic methods to compute a return on training investments.

Other issues that have an impact on training include the development and implementation of post training measures to determine the extent to which employees are fully proficient in performing their job tasks. Employees have also indicated that better training in the use of software and hardware as well as technical tax law training would significantly improve their ability to perform their jobs at a high level.

Stakeholders also report that in the operating divisions where employees have helped plan and design training programs, employees report higher job satisfaction and empowerment. We believe that the establishment of the HCSP will put renewed focus on training and the measurement of its effectiveness.

Investing in Technology

The Board is pleased to report that the IRS' once-troubled Business System Modernization program performed markedly better in the last three years, although it still faces many challenges. The Board will continue to monitor its progress. The funding cutback the program has experienced in the past several years enabled the IRS to focus its attention on a few critical projects, and it has been successful in managing them.

The IRS has started to move a small number of taxpayer tax account records (approximately three million) to a modernized database known as the Customer Account Data Engine (CADE), which will eventually replace the antiquated Master Files. CADE allows faster refunds, improved taxpayer service, faster issue detection, more timely account settlement, and a robust foundation for integrated and flexible modernized systems. Next year, the IRS expects to have up to 33 million individual taxpayer account records stored on CADE.

However, the Board reiterates the position it has taken in prior years — cutting back modernization funding will force the BSM program to take longer and cost more than necessary, and cost taxpayers more by delaying benefits. In its testimony on the 2006 filing season and FY2007 IRS budget request, the GAO stated:

> *While the requested fiscal year 2007 BSM budget will allow IRS to continue the development and deployment of the CADE, Modernized e-File, and Filing and Payment Compliance (F&PC) projects, the proposed reduced funding level would likely affect the agency's ability to deliver the functionality planned for the fiscal year and could result in project delays and/or scope reductions. This could, in turn, impact the long-term pace and cost of modernizing tax systems and of ultimately improving taxpayer service and strengthening enforcement.*[17]

Reductions in BSM funding mean that the IRS still uses much of the same information technology it had in place six years ago, and, in some cases, four decades ago. For example:

- The IRS uses the same Master Files it developed in the 1960s, limiting it to weekly updates of its central taxpayer accounts. A modern financial institution simply cannot operate effectively or efficiently on this basis and the risk of a catastrophic breakdown remains.
- Although the IRS has modernized its systems for receipt of electronically-filed corporate tax returns, it still uses the same design for the receipt of individual paper tax returns as it did in the late 1980s.
- Taxpayers cannot access their own account information electronically as they can routinely do with their bank, credit card and mutual fund accounts.
- There are only limited opportunities for taxpayers to receive service through self-assistance. Oversight Board survey information indicates many taxpayers would be willing to use self assistance service channels if available.
- Opportunities exist for the IRS to use technology to a greater extent to deliver better and more efficient taxpayer service.

Future BSM deliverables are critical to closing the tax gap. The performance improvements described earlier in this report came as a result of improved business processes, and not generally because of modernized information technology. When the IRS is able to offer taxpayers modern products and services, taxpayers will benefit through greater burden reduction and the IRS through greater efficiencies and effectiveness.

Defining the Future of the BSM Program

To strengthen the future of the BSM program, the IRS has updated its Information Technology (IT) Modernization Vision and Strategy (MV&S), which will guide IT investment decisions. As Commissioner Everson testified: "In FY2006 and continuing in FY2007, we are revising our modernization strategy to emphasize the release of projects to deliver business value sooner at a lower risk."[18]

The Board applauds the IRS for the new vision and strategy, which the Board approved in May 2006. It recognizes the importance of the Enterprise Architecture as the foundation for prioritizing IT modernization and investment, and engages key business units in the establishment of investment priorities that will yield the greatest returns for improved taxpayer service and enforcement functions. The Board believes that this incremental and collaborative investment approach makes wise use of resources and is the key to successful business modernization.

In addition to the BSM challenges, the IRS has a significant backlog of aged information technology infrastructure that is beyond industry standard service life and needs to be refreshed. Private industry has already found that overage equipment creates a multitude of problems, including higher maintenance costs and loss of employee productivity. Not replacing this old equipment costs more in the long run. Moreover, the proper protection of data in an increasingly electronic environment demands that the IRS use the latest technology to safeguard it.

Investing in Knowledge: More Long-term Targeted Research Needed

The Board has recommended that the IRS develop a long-range strategic plan for research that goes beyond the IRS Strategic Plan's 2009 end date. This plan should describe how the IRS will bring its research on all taxpayer segments up-to-date and perform key research every year so that information on all segments will be both available and timely.

The Board believes the availability of up-to-date research data will have a two-fold effect. One, it will allow the IRS to focus more effectively its service and enforcement programs on areas that have the greatest impact on taxpayer compliance. Two, it provides feedback to evaluate the effectiveness of the IRS' service and enforcement programs on actual taxpayer compliance. Three, it would improve the IRS' ability to measure accurately the size of the tax gap. Currently, the estimated size of the tax gap is based on 2001 tax returns.

Achieving such a capability will be an improvement over the current situation in which the lack of data makes it virtually impossible to evaluate the IRS' effectiveness in improving taxpayer compliance and make informed decisions.

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V. Measuring Strategic Goals

Gauging Actual Progress on Goals and Expectations

The Board and other oversight organizations, such as the GAO and TIGTA, have long recognized that an important part of developing any strategic or operational plan is the ability to measure progress in achieving goals and expectations. In the case of the IRS, such measures are critical to determining whether investments are bringing about desired outcomes and expected performance. Further, they help the Administration and Congress make informed decisions on resources and ensure a proper balance is achieved between customer service and enforcement. GAO advises that long-term goals can help:

- an agency meet its goals by setting targets and providing incentives to meet them;
- determine whether annual goals contribute to long-term progress;
- identify gaps in performance or misaligned priorities;
- consider new strategies to improve service in the future, especially since these strategies could take several years to implement; and:
- provide a framework for assessing budgetary trade-offs--for example, for IRS, between taxpayer service and enforcement on an annual basis and over the longer term.[19]

In the Board's view, a key component of the IRS planning process is aligning the broad spectrum of strategic, tactical, budget, and annual performance plans through the use of goals, objectives, measures and standards of performance. The monitoring of performance by the Board's committees enables the Board to better understand progress toward achieving IRS strategic goals and objectives. Integrating plans, resources and performance results through all the different measures will provide a "clear line of sight" between the strategic plan and annual plans.

IRS Identifies Five Long-term Measures

In response to the Oversight Board's request, the IRS identified five enterprise-wide long-term measures with target levels of performance that can be used to evaluate the agency's progress in achieving the three goals established by the *IRS Strategic Plan 2005-2009*, shown in the following chart.

Long-term Goal	Target Value
E-file participation rate	80 percent
Individual taxpayer satisfaction	69 (Using ACSI Scale)
Employee satisfaction/engagement	A score of 4.0 (out of 5.0) from Annual Employee Satisfaction Survey
Voluntary compliance	85 percent
Non-revenue enforcement activities	Index of 137.6*

These long-term measures are "outcome-focused" and together with other performance measures will form a clearer picture of IRS' progress in achieving its strategic goals.

As part of its evaluation process, the Board has consulted with IRS stakeholders and asked them to evaluate the goals and provide the Board with feedback. The Board has now received comments from a variety of groups, including the American Bar Association Section of Taxation, American Institute of Certified Public Accountants, IRS Advisory Council, National Treasury Employees Union, Tax Executives Institute, Treasury Inspector General for Tax Administration, and National Society of Tax Professionals. The Board continues to evaluate the proposed goals, and will make its final judgment based on how effective the proposed measures are in assessing strategic progress across the three IRS strategic goals and desired outcomes.

**A number of IRS activities are primarily regulatory in nature. Examples include granting tax exempt status to qualified organizations, enforcing the Bank Secrecy Act, and dealing with non-federal government entities such as states and municipalities on tax issues. To measure the performance of these activities, the IRS is proposing an index based on outcomes in these non-revenue related functions. The index would function much like the Consumer Price Index. The IRS non-revenue enforcement index in FY2005 was 125.1.*

Defining Strategies for Specific Challenges
In addition to the IRS-wide corporate level strategic plan, the IRS has developed specific strategies that help address specific issues and organizational needs. As previously discussed, in FY2006 the IRS developed its Human Capital Strategic and Implementation Plans and Information Technology Modernization Vision and Strategy (MV&S), both of which the Board approved. The agency is also in the process of developing the Taxpayer Assistance Blueprint. Additional strategic plans may also come before the Board, and it will consider these plans to ensure they support the broader IRS-wide strategic plan and the strategies are effectively integrated to maximize performance results and outcomes.

Continuous Improvement Needed
Measures provide a performance-based methodology for continuously assessing progress toward achieving goals and objectives. The Board encourages the IRS to use a complete and balanced array of measures to assess its annual performance, which should be balanced between:

- measures important to taxpayers (customer-focused) and those important to IRS effectiveness (business-focused)
- customer service and enforcement measures
- outcome or end-result and process or output measures

Further, the IRS must continue to evolve its budget and performance plans to include more meaningful customer-focused and end-result measures. The Board is continually evaluating long term measures and goals that the IRS should include in its budget formulation process and a range of balanced measures that report on results that taxpayers, practitioners and stakeholders can readily understand, such as customer satisfaction, timeliness, and accuracy of key processes. Annual goals such as these, which challenge the IRS to produce more favorable outcomes every year, ultimately will lead to the accomplishment of established IRS strategic goals.

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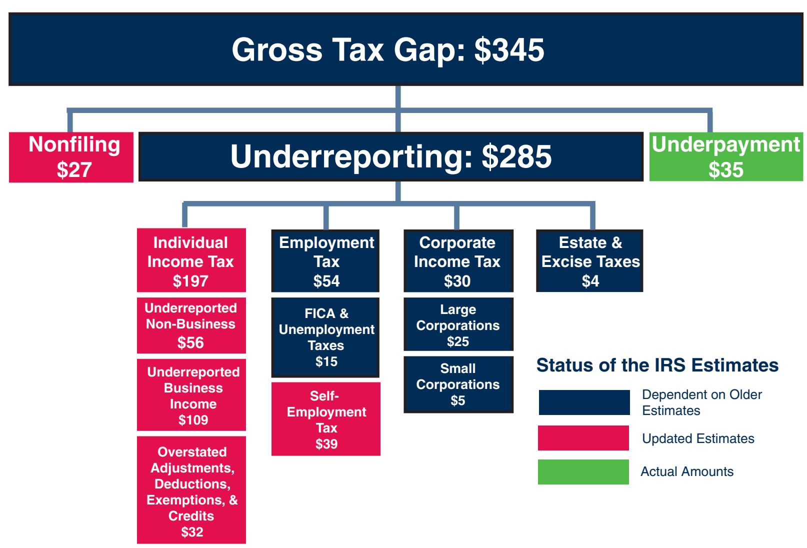
VI. Closing the Tax Gap

During 2006, Congress, the Administration and the tax administration community took aim at the tax gap, the amount of money that is legally owed by taxpayers but which is not collected by the IRS. There were numerous congressional hearings, high-level reports and proposals and a general feeling of dissatisfaction over the size of the tax gap and its effect on honest citizens, the integrity of our tax administration system, and the fiscal health of our nation.

The IRS testified before the Senate Finance Taxation Subcommittee that the agency's annual gross tax gap estimate is approximately $345 billion, corresponding to a noncompliance rate of 16.3 percent. The net tax gap, or what is remaining after enforcement and other late payments, is about $290 billion.

Figure 7: **Tax Year 2001 FEDERAL TAX GAP**
(in $/Billions)



Real Dollars – Real Consequences for Honest Taxpayers

Although it may be difficult for individual taxpayers to relate to these statistics and huge amounts of money, the tax gap's consequences are all too real and we feel them in our everyday lives. The Oversight Board described some of the effects at the Senate Finance Taxation Subcommittee's hearing on the tax gap:

- First, at the most basic level, the tax gap is an injustice. It means that compliant taxpayers are bearing the financial burden of those who do not pay what they owe, whether intentionally or not. In a very tangible way, compliant taxpayers are subsidizing non-compliant taxpayers. Further, the tax gap underscores the consequences of a complex tax code, which contributes to errors and mistakes by honest taxpayers.

- Second, the additional government revenues realized by reducing the tax gap will help decrease the budget deficit.

- Third, and perhaps most troubling, the tax gap undermines confidence in the fairness of our tax administration system and contributes to non-compliance.[21]

Getting Behind the Tax Gap Numbers

At its most fundamental level, our tax administration system starts with the expectation that taxpayers will voluntarily comply with the tax laws. In a perfect world, voluntary compliance would be easy to achieve and difficult to avoid. Taxpayers would understand their tax obligations with minimum burden and easily engage in transactions with the IRS to pay what they owed fully and timely. The incidence of inadvertent mistakes would be low, deliberate non-compliance would be unusual because taxpayers have high standards of personal integrity, and the probability of detecting non-compliance would be high.

However, reality intrudes upon this lofty idea and the large size of the tax gap serves as a stark reminder that we do not live in an ideal world. Some taxpayers do not pay what they owe and the IRS expends considerable efforts and resources identifying them and taking enforcement actions, although only a fraction of what is owed is actually recovered through enforcement. Taxpayer non-compliance is influenced by many factors, including the following:

- The overwhelming complexity of the tax code makes it difficult for taxpayers to understand their obligations and difficult for the IRS to easily assess taxpayer compliance. Moreover, complexity provides opportunities for those who are willing to exploit the system to evade taxes.

- The cash economy provides taxpayers with opportunities for undocumented income. Analysis of taxpayer compliance has shown where there is information reporting, voluntary compliance is high, and where information reporting is non-existent, compliance is low.

- Although IRS service levels have improved in the last five years, taxpayers can still experience difficulties in understanding their tax obligations. Oversight Board taxpayer attitude surveys indicate that almost two-thirds of taxpayers (66 percent) completely or mostly agree that the IRS should receive extra funding so it can assist more taxpayers over the phone and in person, a sign that taxpayers believe more service is needed. Eighty-six percent of taxpayers completely or mostly agree that the more information and guidance the IRS provides, the more likely people are to correctly file their taxes.

- Insufficient enforcement allows taxpayers to escape accountability for being non-compliant. Based on Oversight Board survey results, nine out of ten taxpayers (93 percent) believe that everyone who cheats on their taxes should be held accountable, and almost two-thirds (63 percent) completely or mostly agree that the IRS should receive extra funding to enforce tax laws and ensure taxpayers pay what they owe, a sign that a large majority of taxpayers believe there should be more IRS enforcement of the tax laws. This support for additional funding seems to recognize that additional IRS enforcement presence will have a positive effect on compliance.

- Outdated IRS technology makes the conduct of tax transactions more difficult than it could be. Conducting transactions with the IRS and determining the status of tax accounts is still not as easy as dealing with a bank or credit card company.

Strategies to Reduce the Tax Gap

In July 2006, the IRS Oversight Board testified before the Senate Finance Taxation Subcommittee on what it believes is the best approach to shrinking the tax gap. The Board examined the many different and complementary recommendations to reduce the tax gap and concluded that there was no one "silver bullet" that will solve the problem. Rather, the Board has concluded that reducing the tax gap will require a comprehensive set of broad strategies that balance prevention and correction — from a simpler tax code and more complete information reporting to better enforcement and quality customer service. The need for additional resources should also be considered, although it is not appropriate to think that additional IRS staffing, by itself, can solve the problem.

In September 2006, the Treasury Department's Office of Tax Policy publicly released a broad strategy for addressing the tax gap that included many of the Board's recommendations. Members of Congress have also shown strong interest in reducing the tax gap and their further engagement and leadership is critical as some elements of the plan, such as a simpler tax code, require legislative action.

Board Recommends Six Strategies

The Board recommends six inter-related strategies that it believes would constitute an over-arching plan to reduce the tax gap and will serve to prevent non-compliance as well as aid enforcement efforts.

The Board's first recommendation is to simplify the tax code. Complexity makes voluntary compliance difficult for honest taxpayers to achieve, gives aid to those who want to cheat, and makes it hard for the IRS to identify non-compliance.

Second, taxpayers who have their income reported to the IRS are much more compliant than those who do not. The Oversight Board recommends improved information reporting and enforcement tools to address large areas of the tax gap related to underreporting of income.

Third, the Board believes that the IRS must improve customer service, to make taxpayers aware of their legal obligations and ease taxpayer burden through modernization. The Board also recommends additional funds for both IRS collection and examination personnel to reduce the tax gap.

Fourth, there should be a much greater emphasis and focus on research so the IRS can more effectively target areas of major non-compliance and more accurately measure the tax gap. The Board recommends that the IRS develop a long-range strategic plan for research.

Fifth, the Board urges a more productive partnership between IRS and the tax administration community. Tax practitioners prepare over 60 percent of individual tax returns, and have a great deal of influence on taxpayer compliance levels. Although practitioners have professional obligations to represent their clients effectively, they also have an important role in ensuring that taxpayers are complying with their legal tax obligations.

Sixth, there must be more emphasis on personal integrity in making tax decisions. The Board has found that the vast majority of taxpayers state that their personal integrity is a very important factor in influencing their tax compliance. In our 2005 survey, 82 percent of taxpayers cite personal integrity as the principal factor for reporting and paying their taxes honestly. Our tax administration system should challenge taxpayers and preparers to be conscious of the need for integrity when making tax decisions, and maintain the highest standards of compliance.

In summary, the Board recognizes that no single initiative or program will solve the tax gap — a multi-faceted effort must be taken to shrink it. Although the Board believes more IRS staff are needed, the plan must be more comprehensive than just applying additional resources to do more of what is being done today. Implementing an effective plan will be difficult, and involves taking broad action across the legislative and executive branches of government. However, the potential results are well worth the effort.

VII. Summary

The IRS Oversight Board believes that the IRS made measurable progress in FY2006 in achieving its strategic goals. Just as importantly, the IRS made balanced progress in all parts of its mission – not just one at the expense of the others. However, in spite of these advances, the modernization of the IRS into a 21st Century tax administration agency is far from complete.

Although the service it now offers is a vast improvement over the days when taxpayers were met with millions of busy signals, IRS customer service does not match what modern financial services institutions can provide their customers. IRS Business Systems Modernization lags far behind where it should be and the IRS information technology infrastructure is aging. Employees still lack modern tools, training needs improvement, and many of the most experienced and skilled employees are becoming retirement eligible. Most troubling yet is the net $290 billion annual tax gap, which is a threat to the integrity of our tax administration system.

Clearly, there is no shortage of challenges to modernizing the IRS. However, we cannot expect the IRS to meet these challenges alone; nor should we lay all of the blame for any shortcomings on the agency's doorstep. The IRS operates in the real world and has not been given the necessary resources to carry out its mission at a high level. At the same time, the IRS and its customers — America's taxpayers — must cope with an ever-changing and exceedingly complex tax code.

The IRS Oversight Board believes that now is the time for concerted action. We cannot afford to go off in a dozen different directions, nor can we afford delay. We must take deliberate and focused action for the good of our country. America's taxpayers expect and deserve no less.

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Summary of Stakeholder Comments and Recommendations – 2006

The IRS Oversight Board reaches out to a wide variety of external stakeholders each year to listen to their views on tax administration and its impact on taxpayers. The Board consults regularly with external groups that include tax professionals, representatives of state tax departments, taxpayer advocacy groups, business associations, IRS advisory councils and committees, IRS employees, the National Treasury Employees Union (NTEU), and other groups that have an interest in tax administration.

During 2006, the Board staff met with tax professionals and IRS employees at the six IRS Nationwide Tax Forums in Anaheim, Chicago, Atlanta, Orlando, Las Vegas, and New York. In February, the Board also conducted a public forum in Washington, DC, with discussions focusing on the customer service needs of taxpayers and the importance and impact of measures. The following is a summary of the central themes from stakeholder meetings this year:

Meeting Taxpayers Needs

Stakeholders at the Board's Public Forum in February 2006 agreed that customer service should be defined from the customer's perspective, because different taxpayer groups have different definitions of good customer service. They said taxpayers span various socio-economic classes and generations, both compliant and non-compliant, and there is no "one-size-fits-all" in the delivery of customer service. Face to face interaction, flexibility, and giving IRS employees the authority to address issues at the lowest level are the best ways to solve most taxpayer problems.

Supporting the concept of the Taxpayer Assistance Blueprint, stakeholders said the IRS should be accountable for defining what services the taxpayer needs and coordinating the delivery of those services. Some tax professionals defined good customer service as delivering what the taxpayer needs at the moment of time that they need it; others said that well-trained IRS employees, not only in technical tax areas, but in customer relations defines "good customer service." Both practitioners and IRS employees agreed that the IRS needs better data and modeling to understand what services taxpayers want and need before making decisions about delivery of customer service. They called for additional research to enable the IRS to make informed decisions about reducing services that might have an unintended impact on taxpayer compliance.

Tax professionals emphasized that an important component of service and enforcement is communication. Customer service includes leveraging enforcement by communicating real-time compliance information back out to taxpayers to help them be more compliant. Service to the vast majority of taxpayers attempting to comply with the law should not be reduced to enforce payment from the minority of taxpayers who are non-compliant.

The Board heard from a number of practitioners that service at the IRS has declined as resources have shifted to enforcement. Centralization has created problems for practitioners, including reducing their ability to resolve issues on the first contact with the IRS. Some practitioners believe that centralization causes employees to be less likely to take “ownership” of a problem and carry it to resolution. Some employees agree and feel there is no longer a balance between service, accuracy and productivity. They say this diminishes their ability to resolve issues more effectively and inhibits their ability to meet taxpayer needs.

Stakeholders have praised www.irs.gov and e-services. Practitioners said the features save them time searching for information; they recommend e-services also be available to all tax professionals. Practitioners’ work is greatly aided with access to e-services, and they believe it helps the IRS as much as it helps them. Practitioners also praised the Practitioner Priority Service (PPS) for professionals, also known as the Practitioner Hot Line, as an excellent improvement to the phone system.

Practitioners commented on procedural inefficiencies at the IRS. The LMSB operating division was favorably cited for its efforts to work with its taxpayer customers to find way to operate more efficiently, particularly with regard to using common sense and judgment in knowing when it is more efficient to be more flexible. They suggested the IRS review its procedures from the customer’s perspective and determine whether they are serving as roadblocks rather than facilitating resolution of taxpayer issues. Practitioners say the IRS needs to look beyond cost-efficiency to a model that looks at a partnership with tax professionals to help taxpayers pay the proper amount of taxes. Some practitioners said the biggest increases in efficiencies in the audit process have come when the IRS reaches out and collaborates with stakeholders in the design of new and improved processes.

Employees talked about the future of customer service as self-service and automation becomes more prevalent. They see the increasing amount of self-service in their own lives, but said that the IRS will always need to provide walk-in service because of language and cultural issues, and that adequate staffing is necessary at walk-in sites to avoid harming the taxpayers who most need help.

Some employees said that the administrative burden placed on them affects their ability to meet taxpayer’s needs. They said they must spend significant time completing paperwork directly related to their workload or required paperwork for management or personnel activities. Some stated that the paperwork burden and the lack of sufficient support staff affect their ability to do their “real work.”

Some employees told the Board that stove-piped IRS data bases can contain inconsistent data. Situations were described by IRS collection employees where taxpayers who had already paid their tax debt continued to receive notices because the IRS' systems are inconsistent. Employees estimated that 10 to 20 percent of their time is wasted correcting errors due to the lack of current data.

Measuring IRS Progress

In discussing the IRS' current strategic plan, practitioners agreed that the IRS needs a small number of key service, enforcement and employee satisfaction measures. They suggested an overarching goal to reflect taxpayer compliance, measured by taxpayer error rates, and another goal to estimate taxpayer burden. There was discussion about the difficulty of measuring an overall compliance rate, and whether the margin of error might be so large that it would be difficult to determine if progress was being made.

Tax professionals agreed that establishing effective measures, setting effective goals, and having a purposeful drive to reach the goals has a significant impact on the behavior of the entire tax ecosystem. For example, setting the 80 percent e-filing goal has had an impact on tax administration. The IRS will not reach the 80 percent by 2007, but the progress to date indicates that the program has been very successful in moving the IRS in the right direction.

Stakeholders said that, to be effective, measures must come from both the top down and from the bottom up; employees need to participate in their development and understand them. They also said that measurements cannot all be internal. The general taxpaying public needs to see goals and measures that affect them published in an annual report on IRS performance. Making this information available to taxpayers publicly would increase accountability at the IRS.

Regulation of Tax Return Preparers

National Tax Forum participants discussed respective roles the IRS and the practitioner community should play in the regulation of return preparers, and reached general agreement on a series of key points, as follows:

- There should be some type of government regulation of all return preparers so as to provide some degree of protection to the American public. The practitioners believe that less than half of approximately 1.2 million tax return preparers nationwide are regulated by IRS. The practitioners find this to be an unacceptable situation that contributes to many inaccurate and fraudulent returns being filed with the IRS.

- Their general consensus is that standards of conduct and competence would help raise the level of professionalism of tax preparers, which in turn would provide better service to taxpayers and offer them more protection from unethical and unqualified preparers.

- o Practitioners believe the IRS does not do a good job of regulating electronic return originators (EROs). As a result, practitioners are highly skeptical IRS has the resources and/or ability to effectively administer any similar type of regulatory system including a testing and certification process for the assumed population of 1.2 million return preparers.

- o IRS regulation of return preparers should lean toward a multi-faceted approach with these features: (a) a requirement that all paid return preparers register with the IRS and be assigned a unique ID number to be used on all returns they submit for their clients; (b) a requirement that all registered preparers complete a minimum amount of continuing professional education each year; (c) a post-filing review process by IRS which monitors the quality of all paid preparer returns and identifies for corrective action those specific preparers who are submitting an unacceptable volume of problematic returns; and (d) an effective integration of the current IRS process for identifying problematic EROs with a newly envisioned quality review/monitoring system for all paid preparer returns. By doing this, the IRS can more readily identify the most troublesome preparers and take the necessary corrective actions including possible sanctions.

- o An effective media campaign to inform and educate taxpayers — the campaign should address taxpayers' responsibilities to seek out a reputable, registered preparer and address the requirement that the preparer sign and include a registration number on returns compiled for the taxpayer.

However, the generally supportive view toward any required testing for return preparers was not unanimous. Some preparers believe a broad tax law test would disadvantage preparers with practices focused only on individual return preparation. There also were a variety of opinions about whether some sort of certification or license should be based on testing or CPEs (Continuing Professional Education). There was generally a lot of support for some method of "grandfathering" current full-time professionals with a clean record and prior experience into a system of licensed tax preparers. There also was support for making the grandfather privilege contingent on future behavior. That is, a violation that occurred after a preparer was grandfathered into the system could require that preparer to pass a test to re-enter the system.

Most agreed that the profession should be "self-policing" — that professional organizations should be active in setting professional standards or certification. Several models used in other professions were discussed, and there was discussion about licensing preparers for specific activity. For example, preparers of individual tax returns should not be required to pass a test on corporate law. The series of licenses offered by the National Association of Security Dealers (NASD) was mentioned in this regard as a possible model for preparer regulation [NASD offers licenses for specific activities].

Practitioners believe that having an effective system to turn in fraudulent preparers would be useful; however, they agreed it would only be effective if the IRS had the resources to complete its enforcement efforts once fraudulent preparers were identified. They suggested the IRS should work more closely with the professional organizations to address this problem.

Direct IRS Portal and Electronic Filing

Practitioners offered their thoughts on a direct filing portal to the IRS, and whether electronic filing directly with the IRS would make a significant difference in their practice. Most practitioners were satisfied with e-filing and did not think a direct file portal would make much of a difference in their work or in the percentage of their clients e-filing. They said that making all IRS forms and returns "e-fileable" was much more important and would have a more significant change in the percentage of e-filed returns.

Practitioners discussed the idea of a federal mandate requiring all tax returns to be e-filed. Many practitioners said they were already achieving extremely high e-file rates because of their personal belief in the value added by e-filing and because they were already mandated to use e-file for their state's income tax returns. However, other practitioners cited various examples of current IRS systemic limitations that preclude e-filing, and said these work against any such mandate.

The practitioners were asked their reaction to the idea of IRS offering a web portal to enable any taxpayer to e-file their individual income tax return directly with the IRS for free without the need to go through a third party transmitter. Many of the practitioners said they liked using a third party vendor to handle their e-file transmissions and saw little value in a free e-file portal. They said that by working through a third party e-file transmitter, they avoid significant computer technology burdens associated with e-file, such as systems acceptability testing and the transmission and receipt acknowledgment processes for electronic returns. This, in turn, allows the practitioners to stay focused on actual return preparation and other client services.

Protection and Privacy of Taxpayer Information

Most employees believe IRS is doing an adequate, even good, job of protecting taxpayer information. They said that all material is encrypted, and it would be nearly impossible for anyone but the user with the password to access the data. They also said that employees must use common sense — that they should know better than to check their laptop with their luggage when flying.

Some employees feel there are security issues with thumb drives and the protection of taxpayer data. For data that is encrypted on a laptop, the encryption does not transfer when the data is transferred onto a flash or thumb drive. They said confidential taxpayer data in this format could easily be lost or misplaced.

Practitioners discussed the issue of computer repair technicians accidentally (or purposefully) taking taxpayer data from a computer. Many technicians use USB drives to transfer data back and forth when they are working to repair malfunctioning computers. Practitioners said it is often difficult to determine what happens to data that has been copied to a USB drive; is it deleted, or is it still there when the technician leaves the office?

Practitioners said they consider the protection of taxpayer (and client) information seriously and have safeguards in place to protect data. They described office procedures designed to protect taxpayer data: identification of taxpayers by code not SSN; close supervision of jump drives or thumb drives; background checks, drug checks, and credit checks on new hires. Most utilize desk top computers because they feel laptops present a greater risk for loss of data. And all had concerns with sending taxpayer information overseas for data entry – they questioned whether adequate security procedures are in place to protect taxpayer information flowing outside of the country.

Employees raised serious concerns about the protection of taxpayer data as the IRS implements its new contracting out for collection of past-due taxpayer accounts. They feel that taxpayer privacy may be at risk and that the IRS should take every action to make sure it is protected.

IRS' Investment in People Resources

The IRS introduced its new Human Capital Strategic Plan 2005 – 2009 this spring, yet many employees say they have not seen it. Some employees said the term "human capital" is too cold and impersonal and preferred the phrase human resources. Others said it is accurate as employees are investment assets within the IRS workplace.

Some employees said they feel overwhelmed with change, especially change related to centralization of work activities, changes in processes and work locations. They said that they do not think centralization works, that it creates problems for employees, and that it provides poor service to taxpayers. They indicated that centralization has moved work to different offices, and the employees don't know which office has responsibility for specific centralized activities. Employees do not feel they are well-enough informed when change occurs.

Employees feel strongly that there is not sufficient staff to carryout administrative activities (such as photocopying) for more skilled Revenue Officers and Revenue Agents. Employees also are concerned that IRS has downsized personnel services to the point that it seems non-functional to them and believe centralization in this area is not good.

Tools are an important issue to employees. When asked if they have the equipment and tools needed to do their jobs, most believe that they do not. Most of their issues involve low cost tools, such as USB keypads for their laptop computers. They also are not assigned cell phones, nor can they order pagers. Some field employees who must visit taxpayers buy their own cell phones for safety's sake. They feel that not having the right tools harms their productivity.

Most employees believe their performance is evaluated fairly, and that the “balanced measures” instituted several years ago work well. They said that the measures are generally realistic, depending on the manager. Overall, they seem satisfied with how they are evaluated.

Some employees think that management should have more trust in employees. Employees should be more empowered and have more authority to make decisions. They believe this would generate more motivated and engaged employees.

Recruitment and Retention

Employees suggested that retention of newly hired IRS staff is a serious problem and said that around two-thirds of new revenue officer hires in their area subsequently left the IRS within the first three years. Some employees attributed departures to high caseload demands, lack of adequate administrative support, and more lucrative opportunities outside the IRS. Others noted internal IRS short- comings, such as a technology environment that often forces new workers to operate with cumbersome and antiquated computer systems, or the stressful nature of the jobs in Collection, that contribute to higher attrition among new hires.

Employees suggested the IRS develop innovative approaches that encourage retention of employees. They suggested wider career paths that allow opportunities for advancement and allow employees to work different jobs in different divisions. In addition, offering signing or retention bonuses would encourage some of the “best and brightest” into IRS careers. They also suggested that a comprehensive exit interview process would help the IRS identify problem areas and improve retention.

Some employees spoke favorably of a newer IRS practice of hiring revenue agents from outside the agency who have more extensive accounting experience and bringing them in at the higher grade 12 or 13 level. However, there also are concerns about this practice. Employee morale could suffer among the younger staff inside the IRS if they are routinely tapped to train the newly hired older workers (relative to specific IRS procedures and practices). Secondly, there is potential for an even greater IRS vulnerability to sudden attrition among its higher graded revenue agent cadre, if many of these recently hired, experienced workers become disillusioned with the job, since many are already of retirement age.

Some employees, who had been involved in the review of revenue agent applications, expressed the view that IRS is not getting high quality applicants from outside the IRS because the pay differential with comparable jobs in the private sector is now too great. However, LMSB has shown flexibility and initiative in hiring several highly talented individuals from outside IRS by recruiting seasoned accountants with extensive experience. In their view, IRS needs to craft a more Service-wide strategy relative to grade 13 revenue agent positions—a strategy that entails sufficient grade 13 revenue agent promotion opportunities in SB/SE and TE/GE as well as LMSB.

The employees said that it was difficult to find the right experienced people to coach new employees. Many of the more seasoned employees are very productive and management does not want to take them out of the production environment. Some employees are reluctant to participate in coaching or mentoring programs because they must also manage their inventory of work while they participate as a coach. Some suggested that the IRS should look into creating a coach position as a permanent hire or look at using re-employed annuitants as coaching or training resources.

Training

Many employees agreed that there are significantly less mentoring and other formal on-the-job training sessions for employees than in the past, and a lot more “e-learning” experiences. Several viewed these e-learning approaches as merely a way for IRS to reduce staff in the education branch and otherwise save money, and not as a more effective training method. Another noted that as time goes by there are fewer and fewer experienced staff remaining to serve as mentors and trainers.

Although the employees noted that training programs needed improvement, they overwhelmingly endorsed the positive value of mentors to new IRS staff. They emphasized the critical role these mentors play in the training and development of a skilled IRS workforce, and many gave personal testimonies as to how mentors greatly benefited them earlier in their careers. One employee noted how IRS at one time established and deployed a formal cadre of qualified trainers and on-the-job mentors who ensured new employees received a well-coordinated training experience.

Employees also offered comments on various IRS “e-learning” experiences. Some employees acknowledged the benefits associated with these training methods such as the reduction in travel expenses and individual flexibility in completing the training. However, others complained about the short time frames often imposed for completing required on-line training modules, difficulties in operating the software and frequent instances when the e-learning courses were too long.

Several employees believe that management undervalues the benefits of off-site, in-person training for major IRS occupations like revenue agent and revenue officer. Employees cited benefits to this type of training such as the opportunity to meet and bond with fellow IRS employees from across the country and build esprit de corps, and the ability to establish a long- term network of colleagues to turn to for advice on how to tackle unique problems on the job.

Some employees agreed that training has improved in certain areas. Collection employees said that training is more specific to their job requirements and the delivery of programs has improved. They believe a combination of computer-assisted and face-to-face training is in the employee’s best interest.

While many employees said that the initial training for new employees was good, training on emerging issues and changing policies and procedures is inadequate. For example, training on the new bankruptcy laws that impact OIC work was conducted one year after the law was changed.

Employee Survey

Some employees described extremely low employee participation rates in their work groups during this year's survey. Most tended to attribute the low participation to the view that employees no longer find value in the process because management fails to act upon issues identified in previous iterations—particularly those items beyond the control of the work group that had been elevated to higher management. One employee stated that upper level management needed to at least acknowledge and provide feedback to employees, even if only to explain why a particular issue cannot be resolved.

Employees generally agreed that when there is a lack of participation by so many employees, they do not believe the results can be valid. The employees seemed less concerned with the union position than they did about the belief that their input would not be acted upon, particularly for concerns that had to be resolved above the local level.

Not all employees thought the survey lacked value. Several employees described very high participation rates with the employee survey in their work groups. These individuals also tended to have seen actions taken in prior years on issues identified as part of the survey process in their areas.

Biographies of IRS Oversight Board Private-Life Members

The IRS Oversight Board, by statute, consists of nine members, including the Secretary of the Treasury and the IRS Commissioner. Following are profiles of the private-life members, who are appointed by the President and confirmed by the U.S. Senate.

Chairman Paul B. Jones
Senior Vice President
General Counsel and Regulatory Policy, Time Warner Telecom
Paul B. Jones is Senior Vice President, General Counsel and Regulatory Policy for Time Warner Telecom in Littleton, Colorado. He began his career practicing law with the Coudert Freres Paris office, specializing in corporate and tax structuring transactions largely for multi-national business. In 1973, he moved to the Coudert Brothers New York office. There he served as a defense trial lawyer representing the three major broadcast networks. CBS' 60 Minutes became his principal client. Press coverage of the issues raised in one of his 60 Minutes cases brought his name to the attention of the Federal Communications Commission, where he served as a co-director of a task force charged to explore the economics of video program production and distribution, with a goal to recommend regulatory change required to expand program choice for the American public. He later became Assistant General Counsel. Mr. Jones went on to serve as Vice President for Strategy and Business Development for the CBS Publishing Group, as General Counsel for Warner Communications Cable business, and as Senior Vice President Corporate Development for Time Warner Cable Ventures. Mr. Jones graduated from Yale College in 1968, and received his J.D. from Yale Law School in 1971.

Charles L. Kolbe
Owner, Kolbe Cattle Company
Chuck and his wife Sue have managed Kolbe Cattle Co. since graduating from Iowa State University in 1965. They still do this today on land that has been in the family for the last 125 years. In 1986, Kolbe started Midland Cattle Co., a cattle trading partnership which yearly purchases and places over 150,000 head of cattle from many locations in North America. In the early 1990s, Kolbe was a founding partner in Red Oak Farms, a branded beef company that specialized in high quality fresh and pre-cooked beef products. Midland Cattle was sold to Red Oak Farms and subsequently Red Oak Farms is under the management of Premium Quality Foods. Kolbe is past president of the Iowa Cattlemen and chairman of the Iowa Beef Industry Council. A serious bicycle accident in 1997 forced him to cut back on some of the more rigorous aspects of his life but he still remains active in much of it. He was inducted into the Iowa Cattlemen's Hall of Fame in 2000.

Robert M. Tobias
Professor, American University
Robert M. Tobias is a professor at American University in Washington, D.C., and is also the Director of the Institute of Public Policy Implementation. Mr. Tobias retired in 1999 after 31 years with the National Treasury Employees Union (NTEU), where he served as General Counsel from 1970 to 1983, and as National President from 1983 until his retirement. At NTEU, and as a member of the President's National Partnership Council, Mr. Tobias focused on establishing cooperative/collaborative labor-management relationships in the Federal government. In 1996, President Clinton appointed him to the National Commission on Restructuring the IRS. Mr. Tobias also was a member of the IRS Executive Committee. He is a graduate of the University of Michigan, where he received a master's degree in Business Administration, and from The George Washington University, where he received his law degree. He chairs the Oversight Board's committee on operations.

Raymond T. Wagner, Jr.
Legal & Legislative Vice-President, Enterprise Rent-A-Car
Raymond T. Wagner, Jr. is Legal & Legislative Vice-President for Enterprise Rent-A-Car, headquartered in St. Louis, Missouri. Previously, he served in the cabinet of Illinois Governor Jim Edgar as the Illinois Director of Revenue until 1995. Prior to that, he was Director of the Missouri Department of Revenue under then-Governor John Ashcroft. Since 1993, he has been an Adjunct Professor of Law at Washington University School of Law. He served as Law Clerk for then-Chief Justice Andrew Jackson Higgins of the Missouri Supreme Court. He received his Master of Business Administration and undergraduate degrees from St. Louis University, and his law degree from University of Missouri-Kansas City School of Law. He also holds a Master of Laws-Taxation degree from Washington University School of Law. He chairs the Oversight Board's committee on operations support.

Endnotes

1. To satisfy a specific requirement, the IRS Oversight Board reports that it spent $35,721 on travel during FY2006.
2. United States Government Accountability Office, Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, “IRS Improved Some Filing Season Services, but Long-term Goals Would Help Manage Strategic Trade-offs,” November 2005, (GAO-06-51).
3. The IRS is prohibited from using funds provided in the Fiscal Year 2006 budget appropriation to reduce any taxpayer service function or program until TIGTA completes a study detailing the effect of the IRS’ plans to reduce services relating to taxpayer compliance and taxpayer assistance. TIGTA completed its study in March 2006.
4. GAO-06-51.
5. IRS Press Releases, “2006 Tax Filling Season Sets Record” (IR-2006-67) and “IRS Web Site Sets Record on April 17” (IR-2006-66).
6. United States Government Accountability Office, Statement for the Record Before the Subcommittee on Transportation, Treasury, the Judiciary, and Housing and Urban Development, and Related Agencies, Senate Committee on Appropriations, “Assessment of the Interim Results of the 2006 Filing Season and Fiscal Year 2007 Budget Request,” April 27, 2006, (GAO-06-499T).
7. Treasury Inspector General for Tax Administration (TIGTA), “Taxpayers That Call Local Taxpayer Assistance Center Telephone Numbers Are Unable to Schedule Appointments to Resolve Tax Account Issues,” September 21, 2006, (2006-40-165).
8. TIGTA, Statement of Inspector General J. Russell George before the Senate Committee on Appropriations Subcommittee on Transportation, Treasury, The Judiciary, Housing And Urban Development, And Related Agencies, Hearing on the Internal Revenue Service’s Fiscal Year 2007 Budget April 27, 2006.
9. GAO-06-499T.
10. TIGTA, Statement of Inspector General before Senate Committee on Appropriations.
11. TIGTA, “Use of the Free File Program Declined After Income Restrictions Were Applied,” September 29, 2006, (2006-40-171).
12. Internal Revenue Service Strategic Plan (2005-2009).
13. IRS, Written Testimony of Commissioner Mark Everson before Senate Homeland Security and Governmental Affairs Committee Subcommittee on Federal Financial Management, Governmental Information and International Security, Hearing on “Deconstructing The Tax Code: Uncollected Taxes and The Issue Of Transparency,” September 26, 2006.
14. TIGTA, “The Electronic Fraud Detection System Redesign Failure Resulted in Fraudulent Returns and Refunds Not Being Identified,” August 9, 2006, (2006-20-108).

15. Opening Statement of Senator Carl Levin, Ranking Member, Senate Homeland Security and Governmental Affairs Subcommittee on Federal Financial Management, Government Information, and International Security, Hearing on "Deconstructing the Tax Code: Uncollected Taxes and Issues of Transparency," September 26, 2006.
16. TIGTA, "Employee Training Data Have Not Improved Enough to Determine Training Cost or Effectiveness," September 29, 2006, (2006-10-176).
17. GAO-06-499T.
18. IRS, Written Testimony of Commissioner Mark Everson before the House Appropriations Subcommittee on Transportation, Treasury, Housing and Urban Development and District of Columbia on Internal Revenue Service's FY 2007 Budget, March 29, 2006.
19. GAO-06-51.
20. Office of National Taxpayer Advocate, Written Testimony of National Taxpayer Advocate Nina E. Olson before the Senate Finance Subcommittee on Taxation and IRS Oversight, Hearing on "The Tax Gap." July 26, 2006.
21. IRS Oversight Board, Written Testimony of Chairman Raymond T. Wagner, Jr., Senate Finance Subcommittee on Taxation and IRS Oversight, Hearing on "The Tax Gap." July 26, 2006.

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