

**IRS Oversight Board**  
**FY2008 IRS Budget Recommendation**  
**Special Report**

April 2007



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## Executive Summary

The IRS Oversight Board recommends an Internal Revenue Service (IRS) FY2008 budget of \$11.406 billion, an increase of \$808 million over the FY2007 Joint Resolution (JR) amount of \$10.597 billion. This compares to the President's request of \$11.095 billion, an increase of \$498 million over the FY2007 JR amount. The two budgets are within 2.8 percent of one another, and both support a number of program initiatives the Board believes are high priority.

The Board observes that the President's proposed budgetary increase for the IRS is made during a time when discretionary spending is under great constraints and there is stiff competition among federal departments and agencies for resources.

In this regard, the Board appreciates that the Administration recognizes the importance of the IRS' mission to the fiscal well-being of our nation and is proposing these important and much needed investments at this time. Treasury Secretary Henry M. Paulson, Jr. and Office of Management and Budget Director Rob Portman are to be particularly commended for their involvement and vision in creating this important budget submission that goes beyond just an increase in resources.

The Board is mindful that a budget is more than a request for funding—it's a plan and a commitment. It represents the next leg on the journey of implementing a long-range strategic plan. Both the President's and Oversight Board's budgets are aligned with the *IRS Strategic Plan 2005-2009*. The importance of linking the budget with the strategic plan is critical so that resources focus on programs and activities that will achieve the IRS strategic goals: (1) improve customer service; (2) enhance enforcement of the tax law; and (3) modernize the IRS through its people, processes and technology.

In submitting its FY2008 budget recommendations to the Treasury Department in June 2006, the Board identified increased funding for research, Business Systems Modernization (BSM), infrastructure, taxpayer service, and legislative proposal implementation as high priorities. The President's budget fully funds many of these high priorities to the level recommended by the Board, and partially funds the recommended increase in BSM.

Although both budgets will improve the IRS' ability to reduce the tax gap, the Board's recommended budget is more aggressive in funding enforcement and modernization initiatives, two activities that are of vital importance in the plan to improve taxpayer compliance and shrink the

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gap. However, the temptation to close the tax gap quickly should not lead to increases the IRS cannot absorb effectively. The Board believes its recommended budget avoids this problem and the IRS can efficiently spend the money the Board is requesting.

In addition, both budgets maintain balance at their core: enforcement, customer service and business systems must be adequately funded for the IRS to succeed in all parts of its mission and to ensure the long-term health of our tax administration system. In fact, “Maintain balance between taxpayer service and enforcement” is prominently listed as one of the IRS’ FY2008 priorities in the *Congressional Budget Submission*.

This is not to say that the President’s FY2008 budget request is a silver bullet for the many challenges facing the IRS and our tax administration system. It is not. Resources alone will not solve such challenges as closing the tax gap, providing service on a par with the best financial services institutions, modernizing technology, or improving voluntary compliance. They will also require innovative and strategic thinking, focused management attention, energizing goals, better research, partnerships with the private sector, and continued oversight. Most of all, we must never forget to whom we are ultimately responsible—America’s taxpayers.

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## Introduction and Scope

The IRS Oversight Board's responsibilities include overseeing the IRS in its administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws. The Board is also responsible for ensuring that the IRS' organization and operations allow the agency to carry out its mission. To this end, the Board was given specific responsibilities for reviewing and approving strategic plans and annual budgets, including performance budgets.

Specifically, the Board is required by 26 U.S.C. § 7802(d) to review and approve the IRS-prepared annual budget request submitted to the Department of the Treasury, and to ensure that the approved budget supports the annual and long-range strategic plans of the IRS. The President is required to submit the Board's budget recommendation, without revision, to Congress along with the Administration's request. Additionally, the Government Performance and Results Act (GPRA) outlines the agency's responsibilities for linking agency strategic plans, budget plans, performance plans and performance reporting to a comprehensive strategic process needed to measure agency performance.

In meeting this duty, the Board must ensure that the IRS' budget and related performance expectations contained in the performance budget: (1) support the IRS' annual and long-range plans; (2) support the IRS' mission; (3) are consistent with the IRS' goals, objectives and strategies; and (4) ensure the proper alignment of IRS strategies and plans.

In this special report, the Oversight Board examines the President's FY2008 IRS budget request of approximately \$11.095 billion—a direct appropriation increase of \$498 million, or 4.7 percent, over the FY2007 Joint Resolution amount. The report also presents and compares the Board recommended budget of \$11.406 billion for the IRS—a 7.6 percent boost over the same period.

In developing these recommendations, the Board has applied its own judgment but has also drawn on the collective wisdom of others in the tax administration community, including the IRS, Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA), the National Taxpayer Advocate (NTA), and Congress.





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## I. FY2008 Strategic Assessment

The IRS can be justifiably proud of its performance improvements during the last six years. Not only are levels of service higher, but other important measures such as accuracy and quality are improved. Enforcement productivity is higher as well, with expanded audit rates, emphasis on abusive tax shelters, and increased enforcement revenue all serving as examples of increased IRS enforcement efforts.

The IRS has achieved these improvements through a series of management actions that speak highly of IRS Commissioners and top executives that have served during this period, including:

- Implementation of an approved strategic plan and improved focus on goals and objectives from the top executive ranks down to front-line employees
- Achievement of greater efficiencies through centralization
- Increased attention on taxpayers' needs for service and highlighting the need for balance between service and enforcement
- Increased concentration on abusive tax shelters
- More attention to tax exempt organizations and the opportunities for tax evasion that exist in this segment of the economy
- Additional products and services in the world of electronic tax administration
- Additional attention on the role of third parties in promoting tax evasion schemes

Notwithstanding this progress, the IRS reported this year that the nation's annual tax gap—the difference between what taxpayers should pay and what they actually pay on a timely basis—is \$290 billion (net), based on 2001 tax returns. The tax gap has received much attention during the past year from the IRS, the Department of Treasury, and Congress. Both the Board's and the President's FY2008 budgets are focused on improving the ability of the IRS to aggressively pursue its strategic goals in order to reduce the tax gap.

One of the IRS Oversight Board's most important statutory responsibilities is to ensure that the IRS' budget request supports the agency's annual and long-term strategic plans. The Board is very pleased to report that the Administration's FY2008 budget request is clearly aligned with the IRS' most recent strategic plan, *IRS Strategic Plan 2005-2009* and the Treasury Department's tax compliance improvement plan, *A Comprehensive Strategy for Reducing the Tax Gap*. As stated in the IRS' *FY2008 Congressional Budget Submission*:

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*The President's Budget request for FY2008 supports the IRS' five-year strategic plan. This plan underscores the IRS commitment to provide quality service to taxpayers while enforcing America's tax laws in a balanced manner.<sup>1</sup>*

The significance of such an alignment between the proposed budget and the IRS' strategic plan cannot be emphasized enough. A budget request is more than a mechanism for appropriating funding; it's also a plan and a commitment. Not only does a proposed budget request funding, it also describes the activities the IRS will perform, how those activities align with the long-range strategic plan, and identifies measures to evaluate the expected results. A performance budget is more than money, it's a performance management tool, and properly used, enhances the ability of the IRS to meet its short-term performance targets and the agency's three strategic plan goals: (1) improve customer service; (2) enhance enforcement of the tax law; and (3) modernize the IRS through its people, processes and technology.

The Administration also aligned its budget request by ensuring that it supports the IRS' *IT Modernization Vision and Strategy (MV&S)*, which will help the agency meet modernization goals and convey tangible near-term benefits. The incremental strategy, which the Board approved in May 2006, will guide the investment priorities of the BSM program for FY2007 through FY2011.

### **A Private Sector Perspective of IRS Funding**

There is a great deal to like about the President's proposed budget. Overall, by recognizing the return gained by investing in tax administration, it reflects a private sector perspective of the benefits of funding the IRS. There is certainly precedent to this approach.

From the recommendations of the National Commission on Restructuring the IRS to enactment of the IRS Restructuring and Reform Act of 1998 (RRA 98), which created the Oversight Board, it was clear that the IRS had to be viewed as an investment in collecting federal revenue, and embrace private sector perspectives on customer service and use of technology.

This meant that the IRS would have to improve its customer service through modernized technology, best business practices, and better training. The IRS would have to seek greater efficiencies by moving away from labor-intensive paper processes to offering self-service solutions to taxpayers and practitioners. The agency would also have to do a better job collecting the taxes owed to the federal government and act swiftly so as not to let delinquent debts linger. And like any well-run business, the IRS would also have to set energizing goals and be able to measure its progress in meeting them.

The IRS Oversight Board was created in part to bring to bear such private sector insights to the IRS' plans, operations and budgets. Throughout its seven years of operation, the Board has attempted to apply this constructive view whenever possible.

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## FY2008 IRS Budget Recommendations

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The IRS Oversight Board commends Treasury Secretary Henry M. Paulson Jr. and OMB Director Rob Portman for their vision and hard work in crafting the Administration's FY2008 budget request for the Internal Revenue Service. It addresses the many challenges the IRS and our tax administration system face and reflects an appreciation of the uniqueness of the agency that collects 95 percent of the revenues that fund the federal government.

### Return on Investment

The Board's private sector perspective has been particularly valuable during the annual budget debate over what constitutes adequate funding for the IRS. According to the IRS, there is generally a direct four-to-one return on every dollar invested in tax law enforcement. Moreover, there is a positive but difficult-to-measure indirect effect of IRS service and enforcement on taxpayer voluntary compliance, which can be of greater magnitude than four-to-one. However, the Oversight Board, with its private sector perspective, found it perplexing that this return on investment was not recognized, let alone made a major consideration, during the entire funding process for the agency.

In her *2006 Annual Report to Congress*, the National Taxpayer Advocate took this logic one step further. She compared the IRS to the "Accounts Receivable Department" of the federal government and observed that "on a budget of about \$10.6 billion, the IRS currently collects about \$2.24 trillion a year. That translates to an average return-on-investment of about 210:1."<sup>2</sup>

Although the IRS has a unique role in the federal government, it is treated during the budget process the same as any other department or agency requesting discretionary dollars, and competes dollar-to-dollar against other agencies. The tax revenues the IRS brings to the federal government are not considered.

However, in a most welcomed development, the FY2008 IRS budget request clearly acknowledges return on investment. The IRS' *Congressional Budget Submission* states:

*Increased resources for the IRS' exam and collection programs yield direct measurable results. Once the new staff proposed in this request are trained and become more experienced, the enforcement revenue generated each year will be \$699 million.<sup>3</sup>*

The Board applauds the Administration for recognizing that enforcement activities generate substantial revenues for the nation. This equation could prove to be most valuable during consideration of the FY2008 budget resolution and the appropriations debate to follow.

### Evaluating Results

This report by the IRS Oversight Board is not simply a report of the budget dollars requested for FY2008; it is a report on the resources needed by the IRS to provide an expected level of performance for the

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resources requested—a *performance budget*. The Oversight Board fully supports the principles of performance budgeting and believes that the alignment of the resource plan with the anticipated level of performance in the performance plan is a critical component to successful achievement of strategic goals and objectives.

The IRS provided an array of measures in its performance budget that it will use to track its performance levels in FY2008 by strategic goal. Although these measures are useful for monitoring certain aspects of IRS performance, the Board believes that an expanded array of performance standards that are customer-focused, easily understood by taxpayers, and evaluate many of the daily interactions between the IRS and taxpayers are needed to complement the performance measures in the budget. The Board intends to monitor these additional performance standards during the fiscal year and evaluate them at the end of the year.

The additional performance standards suggested by the Board will:

- Focus more attention on the taxpayer perspective of interactions with the IRS
- Assist in tracking taxpayer needs and reasonable expectations
- Provide a balance between business and customer focus, between service and enforcement objectives, and between efficiency and effectiveness
- Enhance the line of sight from fiscal year performance to the IRS strategic plan objectives and goals

The IRS performance measures and target values that were included in the IRS FY2008 performance budget submitted to the Board for approval in May 2006 are provided in Appendix A. The expanded performance standards the Board will use to complement the budget performance measures during FY2008 are contained in Appendix B. At the end of FY2008, the Board plans to provide an end of year performance summary of the IRS' performance that will include both sets of measures.

The Board understands the difficulty in developing meaningful and reliable measures and performance goals. The Board does not believe that any array of measures can be perfect. Performance measurement should not be a static process but rather a continual work in progress. The IRS must implement a process to review and improve its performance measurement system and measures every year. It should continually look at its measures to identify, develop, and use better measures where its current measures do not provide timely, accurate and valid performance information.

The use of measures will not only make it easier for oversight organizations to hold the IRS accountable for achieving expected results. A robust program of performance measurement will provide a context for informed decision-making and help provide a clearer picture of the health of the entire tax administration system.

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## **II. Comparison of the Oversight Board's FY2008 IRS Budget Recommendation to the President's Request**

### **IRS Oversight Board Recommended IRS FY2008 Budget**

The IRS Oversight Board recommends an IRS FY2008 budget of \$11.406 billion, an increase of \$808 million over the FY2007 Joint Resolution (JR) amount of \$10.597 billion, as shown in Table 1. This recommendation compares to the President's request of \$11.095 billion, an increase of \$498 million over the FY2007 JR amount. The two budgets are within 2.8 percent of one another, and both support a number of program initiatives the Board believes are high priority.

Table 2 provides a summary comparison of the Oversight Board's recommendations to the President's budget request.

The Board recognizes that the President's proposed increase is made during a time when discretionary spending is under great constraints and there is stiff competition among federal departments and agencies for the resources. In this regard, the Board appreciates that the Administration recognizes the importance of the IRS' mission to the fiscal well-being of our nation and is proposing these important and much needed tangible investments.

In submitting its budget recommendations to the Secretary of the Treasury in June 2006, as required by 26 U.S.C. § 7802(d)(4)(B), the Board identified seven program initiatives as having the highest priority, based on their ability to have a long-term impact on reducing the tax gap and meeting IRS strategic goals. These initiatives are generally technology and research intensive, and the Board believes they will have their greatest effect, in the long term, of enabling the IRS to meet its strategic goals. These initiatives, and their funding status in the President's budget, are shown in Table 3.

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**Table 1: IRS Oversight Board Recommended  
FY2008 IRS Budget**

(dollars in millions)

<b>2007 Baseline</b>	<b>\$10,591.8</b>
<b>FY2007 Joint Resolution Amount (Adjusted)</b>	<b>\$10,597.3</b>
Base Adjustments	\$88.7
<b>FY2008 Base</b>	<b>\$10,686.0</b>
<b>Initiatives</b>	
<b>Enforcement</b>	
Improve Compliance Among Small Businesses and Self-Employed Taxpayers	\$86.2
Expand Document Matching in Existing Sites	\$28.0
Establish New Document Matching - Kansas City	\$23.5
Increase Individual Filing Compliance	\$6.5
Increase Compliance for Large Multinational Businesses	\$45.8
Increase Tax-Exempt Entity Compliance	\$30.2
Increase Criminal Tax Investigations	\$31.0
Reduce Fraudulent Refunds	\$11.4
Increase Tax Court Litigation, Particularly Tax Shelter Cases	\$7.6
Reduce Tax Dispute Cycle Time	\$17.2
Improve Compliance Estimates, Measures, and Detection of Non-Compliance	\$41.0
Implement Legislative Proposals to Improve Compliance	\$23.0
<b>Total Enforcement</b>	<b>\$351.4</b>
<b>Taxpayer Service</b>	
Research Effect of Service on Taxpayer Compliance	\$5.0
Expand Volunteer Income Tax Assistance	\$5.0
Implement Taxpayer Assistance Blueprint	\$10.0
<b>Total Service</b>	<b>\$20.0</b>
<b>Infrastructure</b>	
Critical Upgrades to IRS IT Infrastructure	\$60.0
Operating Costs of Newly-Deployed, Modernized Information Systems	\$39.0
Virtual Office Initiative	\$1.7
Enhance Computer Security Incident Response Center (CSIRC) and Network Infrastructure Security	\$21.0
Develop Custodial Detail Data Base	\$3.5
Fund Business Systems Modernization in Line with Current Strategy	\$223.0
<b>Total Infrastructure</b>	<b>\$348.2</b>
<b>Total Initiatives</b>	<b>\$719.6</b>
<b>FY2008 Request</b>	<b>\$11,405.6</b>
Increase over FY2007 Joint Resolution Amount	\$808.3
Percent Increase over FY2007 JR Amount	7.6%
<b>President's FY2008 IRS Budget Request</b>	<b>\$11,095.5</b>
<b>Increase over President's Budget Request</b>	<b>\$310.1</b>

## FY2008 IRS Budget Recommendations

Both budgets are aligned with the *IRS Strategic Plan 2005-2009* that the Oversight Board approved in May 2004. The Administration states in its *Congressional Budget Submission* that these priorities follow the guiding principle of “*Service plus Enforcement equals Compliance*” and sustain the following objectives:

- Modernize information systems and business processes to maximize resources and improve service and enforcement
- Enhance research to better allocate resources to IRS programs
- Discourage and deter non-compliance with emphasis on corrosive activity by corporations, high-income taxpayers and abusive domestic and off-shore tax entities
- Deter abuse within the tax-exempt community
- Simplify the tax process and improve service options for the taxpaying public<sup>4</sup>

The Administration further points out in its *Congressional Budget Submission* that in FY2008 the IRS will focus its efforts on implementing The Treasury Department’s tax compliance improvement strategy which builds upon current efforts by the Treasury Department and the IRS to shrink the tax gap (see: <http://www.treasury.gov/press/releases/hp111.htm>).

**Table 2:**  
**Comparison of President’s and Oversight Board’s**  
**FY2008 IRS Budgets**  
(dollars in millions)

	Oversight Board	President	Difference
<b>FY2007 Joint Resolution Amount (restructured)</b>	\$10,597.1	\$10,597.1	0
Total Base Adjustments	\$88.9	\$88.9	0
<b>FY2008 Base</b>	\$10,686.0	\$10,686.0	0
<b>Initiatives</b>			
<b>Total Enforcement Initiatives</b>	\$351.4	\$246.4	\$105.0
<b>Total Service Initiatives</b>	\$20.0	\$20.0	0
<b>Total Infrastructure Initiatives</b> <i>(BSM &amp; non-BSM)</i>	\$348.2	\$143.1	\$205.1
<b>Total Initiatives</b>	\$719.6	\$409.5	\$310.1
<b>FY2008 Request</b>	\$11,405.6	\$11,095.5	\$310.1
Increase over FY2007 Joint Resolution amt.	\$808.3	\$498.4	\$310.1
Percent Increase over FY2007 JR amt.	7.6%	4.7%	

**Table 3:  
IRS Oversight Board High Priority Initiatives and  
Funding Status in the President's FY2008 IRS Budget**

<b>Program Initiatives Identified by Board as High Priority</b>	<b>Funding Status in President's Budget</b>
Critical Upgrades to IRS IT Infrastructure	<b>Fully funded</b>
Enhancements for Computer Security Incident Response Center	
Research Effect of Service on Taxpayer Compliance	
Improve Tax Gap Estimates, Measures & Detection of Non-Compliance	
Tax Gap Targeted Legislative Proposals	
Fund Business Systems Modernization in Line with Current Strategy	<b>Partially funded</b>
Operating Costs of Newly-Deployed, Modernized Information Systems	<b>Not funded</b>

Although both budgets will improve the IRS' ability to reduce the tax gap, the Board's recommended budget is more aggressive in funding enforcement and modernization initiatives, two activities that are of vital importance in the plan to improve taxpayer compliance and shrink the gap. Details are contained in the following sections.

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

The IRS has made enormous strides in taxpayer service over the past six years. However, the IRS still faces challenges to expand its service options to taxpayers to rise to the level of service that financial institutions offer their customers—who are also taxpayers—such as instant access to their account information and the ability to perform virtually any transaction over the Internet. In addition, until there is meaningful simplification of the tax code, taxpayers need all the help they can get to understand, file and pay their taxes. In the *2006 Annual Report to Congress*, the National Taxpayer Advocate wrote:

*As our "Study of Taxpayer Needs, Preferences, and Willingness To Use IRS Services" demonstrates, taxpayers look to the IRS for assistance in many different forms, from direct assistance to assisted self-help to assistance to stakeholders who in turn assist taxpayers. And the IRS's tax gap data show overwhelmingly that the vast majority of U.S. taxpayers comply with their tax obligations in good faith.<sup>5</sup>*



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## FY2008 IRS Budget Recommendations

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Taxpayers value the assistance they receive from the IRS. In early 2006, the Oversight Board commissioned Roper Public Affairs and Media to conduct a survey of taxpayers to better understand their customer service needs and how they are being met. (The *Taxpayer Customer Service and Channel Preference Survey Special Report* is available on the Board's web site, [www.irsoversightboard.treas.gov](http://www.irsoversightboard.treas.gov).)

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 findings are consistent with other studies, such as the Board's annual *Taxpayer Attitude Survey* and the American Customer Satisfaction Index (ACSI). Since 1999, the IRS ACSI score for all individual tax filers has increased from 51 to 65 in 2006.

The Board's channel preference 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 to the IRS' ability to resolve their tax matter and for the helpfulness of IRS staff.

In response to congressional direction, the IRS, working with the National Taxpayer Advocate and the Oversight Board, is completing 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 behavior
- 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
- 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 was delivered in April 2007. When completed, the TAB will help the IRS deliver effective customer service based on taxpayer needs and using a set of long-term outcome goals and measures to gauge progress.

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The President's and Board's budgets for Taxpayer Service are identical: both contain \$20 million divided among three program initiatives, as shown in Table 4.

**Table 4:**  
**IRS Oversight Board and President's Taxpayer Service Program Initiatives in FY2008 IRS Budget**  
(dollars in millions)

<b>Taxpayer Service Program Initiatives</b>	<b>Oversight Board</b>	<b>President</b>	<b>Difference</b>
Research Effect of Service on Taxpayer Compliance	\$5.0	\$5.0	0
Expand Volunteer Income Tax Assistance	\$5.0	\$5.0	0
Implement Taxpayer Assistance Blueprint	\$10.0	\$10.0	0
<b>Total</b>	<b>\$20.0</b>	<b>\$20.0</b>	<b>0</b>

The three program initiatives are described in the IRS' FY2008 *Congressional Budget Submission*.

The Oversight Board supports the level of funding for customer service recommended in the President's FY2008 request. We believe that it should keep customer service levels stable which is borne out by early results of the 2007 filing season, which show most service indicators, such as Assistor Level of Service, holding steady with last year's. Tables A-1 and B-1 in Appendices A and B, respectively, show the performance levels the IRS expects to achieve in support of Strategic Goal 1 to improve customer service, and the measures that the IRS and the Board will use to monitor IRS taxpayer service performance in FY2008.

The Board believes these three program initiatives will have an impact on voluntary taxpayer compliance. Research on customer service will enable the IRS to better understand how service and outreach impact taxpayer compliance decisions and design service offerings that help taxpayers make decisions based on a thorough understanding of their obligations. Expansion of volunteer VITA sites will make more services available to taxpayers that need additional in-person assistance in understanding and meeting their tax obligations.

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

No issue has dominated recent debate on tax administration more than the tax gap—the difference between what is owed the government and what is paid. According to the latest estimates from the IRS, which are based on 2001 tax returns, the net annual tax gap stands at \$290 billion. In recent testimony before the House Budget Committee, the National Taxpayer Advocate said that this translated into an average “surtax” of approximately \$2,680 per household in 2001.<sup>6</sup> Not only is the tax gap a burden to compliant taxpayers, it also undermines taxpayer confidence in the fairness of our tax administration system and further contributes to non-compliance.

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The IRS has made some gains in enforcement. The Board stated in its 2006 Annual 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.”<sup>7</sup> At a recent Senate Budget Committee hearing on the tax gap, Commissioner Everson agreed with the Board’s assessment:

*One of the most obvious measures is the increase in enforcement revenue, which has risen from \$34 billion in FY2002 to almost \$49 billion in FY2006, an increase of 44 percent...In FY2006, both the levels of individual returns examined and coverage rates have risen substantially. We conducted nearly 1.3 million examinations of individual tax returns. This is almost 77 percent more than were conducted in FY2001, and reflects a steady and sustained increase since that time. Similarly, the audit coverage rate has risen from 0.58 percent in FY2001 to 0.98 percent in FY2006.”<sup>8</sup>*

However, even the IRS would admit that current efforts are not enough to close the tax gap in a meaningful way. There is general agreement a multifaceted strategy is needed to reduce the gap, and the Treasury Department has published such a plan, *A Comprehensive Strategy for Reducing the Tax Gap*, in September 2006.

As discussed earlier in this report, the Administration stresses that in FY2008 the IRS will focus its efforts on implementing Treasury’s tax compliance improvement strategy that builds upon current efforts by the Department and the IRS to shrink the tax gap. These efforts, which include enhanced enforcement activities such as: (1) discouraging and deterring non-compliance with emphasis on corrosive activity by corporations, high-income taxpayers and abusive domestic and off-shore tax entities; and (2) deterring abuse within the tax-exempt community, are consistent with the IRS’ current strategic plan.<sup>9</sup>

The Administration also stated that in FY2007 and FY2008, the IRS will continue to reengineer its examination and collection procedures to reduce time, increase yield, and expand coverage. As part of its regular examination program, the IRS is expanding its use of cost-efficient audit techniques.

An important part of the President’s budget is proposed legislation to expand the use of information reporting. Research shows that where third party information reporting exists, taxpayer voluntary compliance is much higher than where it doesn’t exist. By taking greater advantage of reliable third-party data to verify information reported by taxpayers, the IRS can better focus its audit resources. The Board recommends that the Administration’s legislative proposals be given thorough consideration.

The President’s and Board’s budgets for enforcement both contain 12 separate program initiatives to increase IRS enforcement activities, as shown in Table 5. The Board recommends that \$351 million be allocated to these initiatives; the President’s budget requests a total of \$246 million for these same initiatives, all of which are described in the

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FY2008 *Congressional Budget Submission*. Five of the 12 initiatives are funded at a level equal to the Board's recommendation; six initiatives are funded at lower levels, and one is not funded. The two enforcement initiatives that the Board identified as high priority, *Improve Compliance Estimates, Measures, and Detection of Non-Compliance* and *Implement Legislative Proposals to Improve Compliance*, are fully funded to the level recommended by the Board.

**Table 5:**  
**IRS Oversight Board and President's Enforcement Program Initiatives in FY2008 IRS Budget**  
(dollars in millions)

Enforcement Initiatives	Oversight Board	President	Difference
Improve Compliance Among Small Business and Self-Employed Taxpayers	\$86.2	\$73.2	\$13.0
Expand Document Matching in Existing Sites	\$28.0	\$28.0	0
Establish New Document Matching - Kansas City	\$23.5	\$23.5	0
Increase Individual Filing Compliance	\$6.5	\$6.5	0
Increase Compliance for Large Multinational Businesses	\$45.8	\$26.5	\$19.6
Increase Tax Exempt Entity Compliance	\$30.2	\$15.0	\$15.2
Increase Criminal Tax Investigations	\$31.0	\$10.0	\$21.0
Enhance Refund Fraud Identification and Reduce Fraudulent Refunds	\$11.4	0	\$11.4
Increase Tax Court Litigation, Particularly Tax Shelter Cases	\$7.6	(Note 1)	\$7.6
Reduce Tax Dispute Cycle Time	\$17.2	(Note 1)	\$17.2
Improve Compliance Estimates, Measures, and Detection of Non-Compliance	\$41.0	\$41.0	0
Implement Legislative Proposals to Improve Compliance	\$23.0	\$23.0	0
<b>Total</b>	<b>\$351.4</b>	<b>\$246.4</b>	<b>\$105.0</b>

*Note 1: Funds for this initiative are included in other initiatives.*

The IRS Oversight Board recommended that the 12 enforcement initiatives be funded at a slightly higher level—\$351.4 million as compared to \$246.4 million in the President's budget, a difference of \$105 million. Using the IRS' estimate of a direct return on investment of four to one, the additional funding recommended by the Board will, by 2009, generate over \$400 million a year in tax revenue, and more if the indirect effect of enforcement is considered.

A better perspective on what this means might be obtained by looking at the number of additional personnel that are added by the Board's budget. For those programs where there is a funding difference, the Board's budget generally funds a higher number of additional full-time equivalent employees (FTEs). Table 6 compares the number of FTEs added by both budgets for such initiatives. The Board's budget funds a

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total of 574 additional FTEs dedicated to enforcement compared to the President's budget. FTEs for Chief Counsel and Appeals are spread among the other initiatives in the President's budget, so the most realistic comparison should be at the bottom line, not the individual initiative level. The only exception is the initiative *Enhance Refund Fraud Identification and Reduce Fraudulent Refunds*, which is not labor intensive because it funds system development.

**Table 6:  
Comparison of FTEs Funded by Board's and President's  
Budget for Selected Program Initiatives**

Enforcement Initiatives	FTEs Added		
	Oversight Board	President	Difference
Improve Compliance Among Small Business and Self-Employed Taxpayers	587	485	102
Increase Compliance for Large Multinational Businesses	270	158	112
Increase Tax-Exempt Entity Compliance	219	109	110
Increase Criminal Tax Investigations	135	37	98
Reduce Fraudulent Refunds	10	0	10
Increased Tax Court Litigation, Particularly Tax Shelter Cases	42	Note 1	42
Reduce Tax Dispute Cycle Time	100	Note 1	100
<b>Total FTEs</b>	<b>1363</b>	<b>789</b>	<b>574</b>

*Note 1: FTEs for this initiative are included in other initiatives.*

As in 2006 and 2007, the Administration proposes to include these enforcement increases as a Budget Enforcement Act program integrity cap adjustment. For FY2008, the \$440 million cap adjustment covers cost increases (+\$149 million) for the \$6.8 billion base IRS enforcement program and improves the efficiency of IRS enforcement.

As can be seen from Table 5, the President's budget is funding growth in the IRS business operating divisions at a lower rate than the Board is recommending. The primary difference between the two budgets is the degree with which growth is recommended. The Board believes that the growth in enforcement resources recommended in Table 5 can be sustained by the IRS.

The IRS estimates that it will collect an estimated \$51 billion in 2007 in direct enforcement revenue. By 2010, these investments should generate \$699 million in annual enforcement revenue. The Administration points out that the return on investment is understated because it does not take into account, for example, the deterrence effect of enhanced enforcement and how much it contributes to boosting voluntary compliance.

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Tables A-2 and B-2 of Appendices A and B, respectively, show the measures that the IRS and Oversight Board will use to evaluate the IRS' performance toward achievement of its Strategic Goal 2 to enhance enforcement of the tax law. Although performance targets may appear relatively flat from FY2007 to FY2008, the IRS process for evaluating performance takes into account the hiring and training process needed to bring new employees up to the same productivity levels of current employees. This lag time only serves to emphasize the importance of the IRS being able to grow its base of enforcement personnel quickly.

Regardless of the difference, the Board strongly supports additional resources for enforcement, an investment that will pay for itself many times over. While these initiatives are insufficient in and of themselves to close the tax gap, they are certainly a step in the right direction and could help form the basis for a broader program to shrink it.

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

In identifying high priority projects in its budget recommendations to the Secretary of Treasury in June 2006, the Board identified virtually all major infrastructure and modernization program initiatives as high priority because of their ability to make the IRS more effective and efficient in the long term. Although it may take several years for a technology project to produce benefits, the Board believes modernization of IRS information technology is key to achieving its strategic goals and objectives.

**Table 7:  
IRS Oversight Board and President's Technology  
Infrastructure Initiatives**

(dollars in millions)

<b>Infrastructure Initiatives</b>	<b>Oversight Board</b>	<b>President</b>	<b>Difference</b>
Business Systems Modernization	\$223.0	\$68.2 (Note 1)	\$154.8
Critical Upgrades to IRS IT Infrastructure	\$60.0	\$60.0	0
Operating Costs for Newly-Deployed, Modernized Information Systems	\$39.0	0.0	\$39.0
Virtual Office Initiative	\$1.7	0.0	\$1.7
Enhance Computer Security Incident Response Center and Network Infrastructure			
Security	\$21.0	\$21.0	0.0
Develop Custodial Detail Data Base	\$3.5	0.0	\$3.5
<b>Total Infrastructure Initiatives:</b>			
<b>BSM and non-BSM</b>	<b>\$348.2</b>	<b>\$149.2</b>	<b>\$199.0</b>

Note 1: Includes \$6.037 million adjustment to the President's base BSM budget.

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Table 7 shows the Board’s recommended program initiatives for infrastructure for both the Business Systems Modernization (BSM) program and non-BSM technology programs. In total, the Board recommends \$348 million of program initiatives for infrastructure, nearly all of which (i.e., \$343 million) are identified as high priority. This includes all of the Board’s BSM funding initiatives, which reflect the current IRS strategy, plus the critical upgrades to information technology (IT) infrastructure, the operating costs of newly-deployed systems, and the enhancements for computer security.

**Table 8:**  
**IRS Oversight Board and President’s Proposed Budget for Major BSM Projects**  
 (dollars in millions)

BSM Project	Oversight Board	President	Difference
Customer Account Data Engine (CADE)	\$67.0	\$58.5	\$8.50
Modernized e-Filing (MeF)	\$60.0	\$55.8	\$4.2
Account Management System	\$37.0	\$29.0	\$8.0
Integrated Financial System (IFS)	\$90.0	0	\$90.0
Common Services	\$32.0	\$16.0	\$16.0
Core Infrastructure: Architecture, Integration & Management; and Management Reserve	\$104.3	\$76.5	\$27.8
<b>Total Proposed Budget for BSM</b>	<b>\$436.5</b>	<b>\$282.0</b>	<b>\$154.5</b>
	<i>(Note 1)</i>	<i>(Note 1)</i>	

*Note 1: Totals include \$46.2 million in certain IRS labor costs to BSM.*

Given the priority in which the Board views investments in IRS information technology, there is much in the President’s budget request for infrastructure initiatives for the Board to like, such as the initiatives to upgrade critical IT components and enhance computer security.

The Board believes that additional funding for BSM is appropriate, given that IRS has made significant progress in improving its modernization management controls and in implementing BSM projects—as stated by the Government Accountability Office (GAO) in their February 2007 report to Congress on BSM (GAO-07-247). Table 8 provides more detail on the full project budget proposed for BSM, by major project, by both the Board’s and President’s budget.

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In particular, the additional BSM resources requested by the President that will advance the Customer Account Data Engine (CADE), Modernized e-file (MeF) and the Account Management System are very sensible investments in the IRS modernization efforts which the Board strongly supports. CADE is the IRS' lynchpin modernization project that is replacing, in a gradual, multi-year series of "Releases," the antiquated IRS master file system developed in the 1960s. The budgeted amounts for CADE in FY2008 will be used for such things as program and transition activities, integration, requirements management and engineering services. The funds will also be used toward Releases 4.1, 4.2 and 5.0.

The requested MeF funding will enable IRS to develop a modern, more customer-friendly electronic filing system for Form 1040 series tax returns to replace the 20-year old electronic management system (EMS) currently in use. The current EMS platform for individual income tax returns is rigid and cumbersome to use, with certain limitations on the types of forms and other attachments that can be transmitted electronically to the IRS. The new MeF platform for individual income tax returns to be provided through this initiative will significantly expand the capabilities and flexibilities in the individual e-file area—making it easier to e-file Form 1040 series returns, creating opportunities for new electronic services, and increasing the chances of attaining the 80 percent e-file goal established by RRA 98.

The Account Management System initiative will provide specific capabilities to access and update taxpayer records, and generate necessary letters on accounts managed by both CADE and the legacy Master File system. These capabilities reflect critical components needed to transition core IRS computing operations to the new modernized systems and eventually retire the antiquated legacy systems.

While many of the infrastructure initiatives contained in the President's budget are similar to those recommended by the Board, there are two notable exceptions where the Board believes additional IRS funding should be given priority, but which are not reflected in the President's budget. One is in the BSM area, where the Board recommends an additional \$90 million for vital upgrades to IRS' enterprise-wide Integrated Financial System (IFS). The second is a \$39 million initiative for operating costs for newly-deployed modernized IT systems.

The IFS upgrade is needed to ensure that the IRS remains in compliance with federal accounting and other financial management requirements. As GAO stated in their recent audit of IRS' financial statements for fiscal years 2006 and 2005,

*... IRS cannot fully address the financial management issues caused by the limitations of its automated systems without successful implementation of the additional capabilities that were originally planned to be provided by future releases of IFS, such as procurement and workload management.*<sup>10</sup>



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The additional funding for the IFS initiative will enable the IRS to add procurement and asset management modules to the existing IFS application and integrate related business processes with core accounting and financial management operations. The funding will also provide for the subsequent transfer of IFS to a Shared Service Center and thereby maintain its longer term viability.

Transferring IFS to a Shared Service Center is in compliance with OMB guidance. The current IFS version of the SAP software is six years old, and standard SAP support of this version ended in December 2006. IFS is now covered by increasingly more expensive extended maintenance that does not cover the addition of new functionality. If the IRS cannot implement subsequent new federal accounting requirements or changes to existing standards, IRS compliance with federal financial management standards, and potentially the audit opinion, could be jeopardized. Attempts to change the base code of the unsupported software could increase upgrade costs or be so invasive as to prohibit future upgrades, as occurred with the IRS legacy accounting system.

The Board also views as highly important an IRS initiative of \$39 million to invest in a portfolio of specific technology components which will enable IRS to enhance efficiencies in tax administration operations by delivering modernized information systems to front-line IRS employees. Investment in these components will enable IRS to better leverage modernized systems that have been deployed. The Board understands that these non-BSM IT investments support systems that have been prioritized and selected by IRS using its new *Modernization Vision and Strategy (MV&S)* process. The \$39 million requested for this initiative would be used to invest in such items as: decision analytics tools to enhance compliance and customer service by selecting the most productive cases; enhancements to current systems to further automate manual/paper processing steps; and expansion of certain “e-service” features to enable more taxpayers to interact with the Service in an electronic, self-service fashion.

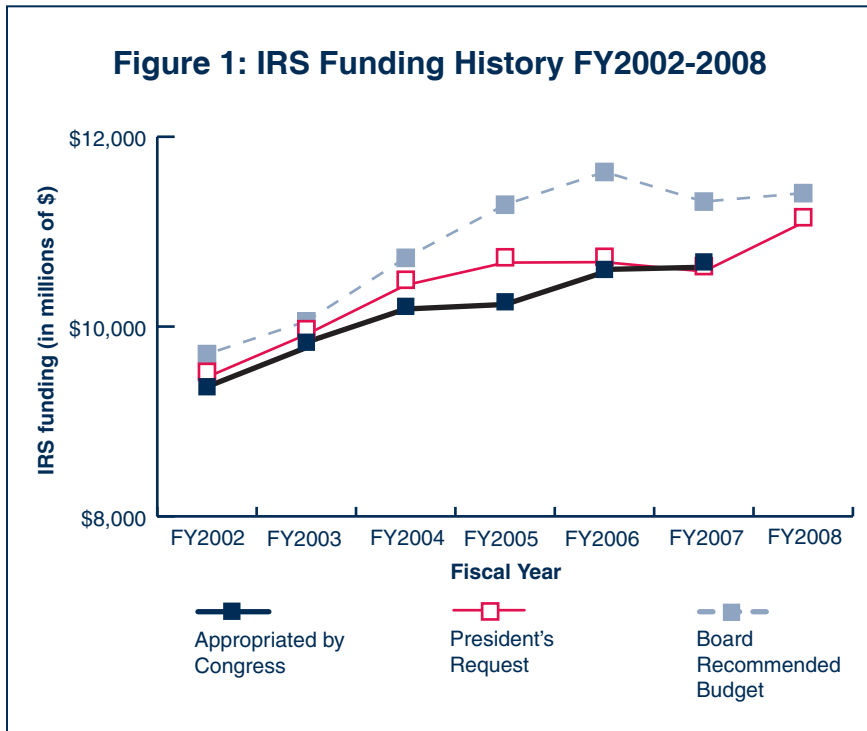
By not including the IFS funding and the additional investments in IT tools for deployed modernized systems in its request, the President’s budget excludes significant components that the Board views as among its highest priority initiatives. It is the Board’s recommendation that Congress fund these IRS infrastructure investments in the interest of smarter tax administration.

Tables A-3 and B-3 of Appendices A and B, respectively, show the measures that the IRS and Oversight Board will use to evaluate the IRS’ performance toward achievement of its Strategic Goal 3 to modernize the IRS through its people, processes and technology. The additional performance standards used by the Board to complement the measures in the IRS FY2008 budget focus primarily on measures not associated with the BSM program, in order to recognize the importance of modernizing its people, process, and technology in areas that fall outside the scope of the BSM program. Such programs and activities also make an important contribution to IRS effectiveness and efficiency.



### III. Budgetary Process and Scoring Mechanisms

In spite of recommendations made by the IRS Oversight Board, the IRS has not been funded at the most effective levels to achieve its strategic objectives. Figure 1 illustrates funding recommendations made by the Board since its inception, the President's budget request during this same time frame, and the funding appropriated by Congress. One of the principal reasons for this so-called "resource gap" is the budget process which treats the IRS the same as it does all other discretionary spending requests. It does not credit the IRS with bringing in 95 percent of all the revenue to fund the federal government, nor does it recognize the previously discussed four-to-one return on every dollar invested in tax enforcement.



To deal with this situation, the National Taxpayer Advocate (NTA) recommends the following changes:

*Congress should consider revising its budget rules in a manner that allows the budget and appropriations committees to make a judgment about the answer to the question: "What level of funding will maximize tax compliance, particularly voluntarily compli-*

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*ance, with our nation's tax laws, with due regard for protecting taxpayer rights and minimizing taxpayer burden?" and then set the IRS funding level accordingly, without regard to spending caps.<sup>11</sup>*

The NTA further notes that one way to implement this approach would be to keep the IRS within its current appropriations subcommittee but the appropriations bill would be broken into two parts—one providing a funding cap for the IRS and one providing a funding cap for all other programs. The budget committees would set the funding cap for the IRS. The appropriations committees then would retain discretion to appropriate funds at the cap or at a lesser level and to provide direction concerning how the funds are to be spent.

The NTA is the first to admit that her organization lacks the budgetary expertise to craft a comprehensive solution and offers other alternative mechanisms, such as the aforementioned "program integrity cap," which would provide additional funding for tax-law enforcement, but only if Congress agrees to fund at least the existing base of enforcement activities.

The IRS Oversight Board believes that the NTA's suggested changes form the basis for a serious debate and ultimately, action on a plan that will give the IRS the resources it needs to shrink the tax gap in a meaningful way, increase voluntary compliance and efficiency, and reduce the deficit. We stand ready to help and welcome the opportunity to discuss this further.

### IV. Conclusion

In conclusion, the IRS Oversight Board commends the Administration—in particular, Treasury Secretary Paulson and OMB Director Portman—for its FY2008 IRS budget request. It recognizes the benefits of investing in the IRS, aligns those resources with the IRS' strategic plans and activities, and provides a needed increase in resources for the agency. If implemented, it will keep the IRS firmly focused on pursuing its strategic goals and objectives.

There is much to praise in this budget. It reflects a true private sector perspective, especially when it comes to recognizing the four-to-one return on investment in tax administration, and it balances service and enforcement. More importantly, it recognizes the long-term value of investing in research and technology by fully funding most of the research and technology initiatives the Board has identified as high priority.

Given the urgency to close the \$290 billion net tax gap, the Board recommends an \$11.405 billion budget for the IRS, \$310 million higher than the President's request. However, the temptation to close the tax gap quickly should not lead to increases the IRS cannot absorb effectively. The Board believes its recommending budget avoids this problem and the IRS can efficiently spend the money the Board is requesting.

Of course, this recommended budget is merely the first step in a long process to get the IRS the resources it needs to perform its job at a high level of proficiency. The Board recognizes that modernization of the IRS is still a work in progress and will never truly end as the agency must continually change and adapt to meet new challenges and provide better service. However, this budget is an excellent start and the Board looks forward to working with policy makers and the larger tax administration community to make it a reality.

### Endnotes

1. Internal Revenue Service, *FY2008 Congressional Budget Submission*, February 5, 2007, p. IRS-4.
2. National Taxpayer Advocate (NTA), *2006 Report to Congress*, Section 2, p. 426.
3. Internal Revenue Service, *FY2008 Congressional Budget Submission*, p. IRS-5.
4. Ibid.
5. NTA, op. cit. p. 2.
6. National Taxpayer Advocate, Testimony before the House Budget Committee, "The IRS and the Tax Gap," February 16, 2007, p. 1.
7. IRS Oversight Board, 2006 Annual Report, p. 7.
8. IRS Commissioner Mark W. Everson, Testimony before the Senate Budget Committee, "The FY2008 IRS Budget and the Tax Gap," February 14, 2007, p. 3.
9. President's FY2008 Budget Submission, Analytical Perspectives, "Budget Reform Proposals," p. 215.
10. General Accountability Office, *Financial Audit: IRS's Fiscal Years 2006 and 2005 Financial Statements*, November 7, 2006.
11. NTA, *2006 Report to Congress*, Section 2, p. 445.

**Appendices:**

**Appendix A.** IRS Performance Measures Included in the  
FY2008 Budget

**Appendix B.** IRS Standards of Performance Monitored by  
the Oversight Board

**Appendix C.** FY2008 IRS Initiatives

Appendix A

**IRS Performance Measures Included in the FY2008 Budget**

The measures contained in this appendix were included in the IRS FY2008 performance budget submission and are part of the President’s FY2008 budget request to Congress. The IRS will have an opportunity to update the FY2008 performance targets for these measures based upon the final budget resources included in its FY2008 funding. At the end of FY2008, the IRS will report on its progress in achieving the FY2008 performance targets in the Treasury Performance and Accountability Report. Additional information explaining these measures and a definition of the measures used by the IRS in its FY2008 budget request are contained in the IRS data dictionary document found at [http://www.irs.gov/pub/irs-utl/2008\\_data\\_dictionary.pdf](http://www.irs.gov/pub/irs-utl/2008_data_dictionary.pdf).

**Table A-1. Performance Measures for Strategic Goal 1: Improve Taxpayer Service**

Measure	FY2004	FY2005	FY2006	FY2007	FY2008
	Actual			Planned	
Timeliness of Critical Filing Season Tax Products to the Public (Ot)	76.0%	91.4%	83.0%	85.2%	92.0%
Timeliness of Critical Other Tax Products to the Public (Ot)	76.0%	80.0%	61.2%	79.6%	86.0%
Taxpayer Self Assistance Rate (E, L)	46.4%	42.5%	46.8%	48.6%	51.4%
Refund Timeliness - Individual (paper) (Oe)	98.3%	99.2%	99.3%	99.2%	99.2%
Percent Individual Returns Processed Electronically (Oe, L)	46.5%	51.1%	54.1%	57.0%	61.6%
Percent of Business Returns Processed Electronically (Oe, L)	17.4%	17.8%	16.6%	19.5%	21.2%
Customer Accuracy - Tax Law Phones (Oe)	80.0%	89.0%	90.9%	91.0%	91.2%
Customer Accuracy - Accounts (Phones) (Oe)	89.3%	91.5%	93.2%	93.3%	93.4%
Customer Contacts Resolved per Staff year (E)	8,015	7,585	7,414	7,702	7,880
Customer Service Representative (CSR) Level of Service (Oe,L)	87.3%	82.6%	82.0%	82.0%	82.0%
Percent of Eligible Taxpayers Who File for EITC (Oe)	80.0%	N/A	*	75%-85%	75%-85%

\* Data to estimate the eligibility rate will be available late in FY2007.



**Table A-2.  
Performance Measures for Strategic Goal 2: Enhance Enforcement of the Tax Law**

Measure	FY2004	FY2005	FY2006	FY2007	FY2008
	Actual			Planned	
Examination Coverage - Individual (Oe, L)	.8%	.9%	1.0%	1.0%	1.0%
Field Exam Embedded Quality (Oe, L)	N/A	N/A	85.9%	87.0%	87.0%
Office Exam Embedded Quality (Oe, L)	N/A	N/A	88.2%	89.0%	89.0%
Examination Quality (LMSB) - Industry (Oe, L)	74.0%	77.0%	85.0%	88.0%	90.0%
Examination Quality (LMSB) - Coordinated Industry (Oe, L)	87.0%	89.0%	96.0%	97.0%	97.0%
Examination Coverage - Business (Corps. > \$10M) (Oe, L)	7.5%	7.8%	7.3%	8.2%	8.2%
AUR Efficiency (E, L)	1,514	1,701	1,832	1,932	1,808
AUR Coverage (E, L)	1.9%	2.2%	2.4%	2.5%	2.7%
Examination Efficiency - Individual (E, L)	N/A	121	128	136	136
Collection Coverage - Units (Oe, L)	N/A	53.0%	54.0%	54.0%	54.0%
Collections Efficiency - Units (E, L)	N/A	1,514	1,617	1,723	1,751
Field Collection Embedded Quality (Oe, L)	N/A	N/A	84.2%	86.0%	86.0%
Automated Collection System (ACS) Accuracy (Oe)	87.8%	88.5%	91.0%	91.0%	92.0%
Criminal Investigations Completed (Ot, L)	4,387	4,104	4,157	4,000	4,025
Number of Convictions (Ot, L)	2,008	2,151	2,019	2,069	2,135
Conviction Rate (E, L)	91.2%	91.2%	91.5%	92.0%	92.0%
Conviction Efficiency Rate (E, L)	362,849	295,316	328,750	314,008	314,560
TEGE Determination Case Closures (Ot)	143,877	126,481	108,462	118,200	109,500

**Key:**  
Oe - Outcome Measure  
E - Efficiency Measure  
Ot - Output/Workload Measure  
M - Management/Customer Satisfaction  
L - Long Term Goal

**Table A-3. Performance Measures for Strategic Goal 3: Modernize the IRS Through its People, Progress and Technology**

Measure	FY2004	FY2005	FY2006	FY2007	FY2008
	Actual			Planned	
BSM Project Cost Variance by Release/Subrelease (E)	N/A	N/A	N/A	10.0%	10.0%
BSM Project Schedule Variance by Release/Subrelease (E)	N/A	N/A	**	10.0%	10.0%

\*\* Cost and schedule variance based on +/- 10% and is reported on several project releases/subreleases.

**Key:**  
 Oe - Outcome Measure  
 E - Efficiency Measure  
 Ot - Output/Workload Measure  
 M - Management/Customer Satisfaction  
 L - Long Term Goal

## Appendix B

### **IRS Standards of Performance Monitored by the Oversight Board**

The Oversight Board regularly conducts performance reviews on IRS performance levels and regularly monitors specific performance measures and targets. The performance measures included in the IRS budget submission do not provide a complete and distinct picture of IRS performance expectations for FY2008. Therefore, the Board has chosen to add a small number of additional performance measures and targets to its budget report that the Board will monitor and report progress at the end of FY2008. These measures are focused on IRS taxpayer service activities. The Board has chosen an array of measures that include telephone activities, the timeliness of actions, actions that can cause taxpayer burden, customer satisfaction and a few internal IRS measures of efficiency. These measures are only a small number of the performance measures monitored by the Board.

**Telephone Measures** – The IRS handles millions of phone calls every year from taxpayers calling to ask questions, obtain information, respond to a notice, learn the status of an exam, and for other reasons. While more and more taxpayers are obtaining services from the IRS web site, the main contact point between taxpayers and the IRS is via telephone. Thus, more detailed information about telephone calls and the performance levels of some of the secondary phone systems with lesser call volumes will be monitored.

**Error Rate Measures** – Notice and deposit errors can cause rework, problems for the IRS, and additional taxpayer burden and can take significant time and resources to resolve.

**Timeliness Measures** – The amount of time it takes for the IRS to complete an interaction, answer the phone, or respond to a taxpayer's correspondence is a critical aspect of performance.

**Customer Satisfaction Measures** – Customer satisfaction measures are important indicators of how successful the IRS is at its interactions with taxpayers. Survey information can provide valuable insights into the needs and reasonable expectations of taxpayers.

**Table B-1. Standards of Performance for Strategic Goal 1: Improve Taxpayer Service**

<b>Standards of Performance</b>	<b>FY2004</b>	<b>FY2005</b>	<b>FY2006</b>	<b>IRS FY2007</b>	<b>IRS FY2008</b>
	<b>Actual</b>			<b>Target</b>	
Avg. Wait Time on Hold (in seconds)	158	258	242	260	260
Primary Abandoned Call Rate (percent of callers who hang up before talking to a representative)	14.9%	14.2%	14.8%	No target	No target
Secondary Abandoned Call Rate	8.0%	12.1%	6.1%	No target	No target
Automated UnderReporter Telephone Level of Service	73.0%	71.3%	64.7%	72.0%	75.0%
Notice Error Rate (individual)	9.5%	9.2%	5.4%	N/A	N/A
Notice Error Rate (business)	21.3%	7.4%	4.9%	N/A	N/A
Notice Error Rate (combined)	Measure combined in FY2007			6.7%	6.4%
Deposit Error Rate (individual)	3.5%	2.2%	1.6%	N/A	N/A
Deposit Error Rate (business)	1.0%	0.9%	1.3%	N/A	N/A
Deposit Error Rate (combined)	Measure combined in FY2007			1.4%	1.4%
Determination Letters Timeliness (days) Exempt Organizations	104	124	134	125	120
Determination Letters Timeliness (days) Employee Plans *	208	324	242	327	307
Exempt Organization Determination Customer Satisfaction	70.0%	69.0%	70.0%	71.0%	71.0%
Accounts Management Customer Satisfaction (adjustments)	65.0%	69.0%	66.0%	68.5%	69.0%
Practitioner Toll-Free Telephone Service Customer Satisfaction	N/A	81.0%	87.0%	85.0%	86.0%

\* The methodology for calculating cycle time was revised to include more complex, pre-approved plan inventory cases. FY2007/2008 targets were adjusted.

**Table B-2. Standards of Performance for Strategic Goal 2:  
Enhance Enforcement of the Tax Law**

<b>Standards of Performance</b>	<b>FY2004</b>	<b>FY2005</b>	<b>FY2006</b>	<b>IRS FY2007</b>	<b>IRS FY2008</b>
	<b>Actual</b>			<b>Target</b>	
Automated Collection System (ACS) Accuracy - composite	87.8%	88.5%	91.0%	91%	92%
W&I - Exam Timeliness (discretionary-correspondence) (days)	162	144	139	139	138
W&I - Exam Timeliness (EITC-correspondence) (days)	185	183	190	197	191
SB/SE Correspondence Exam Cycle Time (days)	190	175	181	178	175
SB/SE Correspondence Exam Cycle Time (non-EITC) (days)	173	177	199	169	169
Business Collections (days to close)	27	23	31.2	25.6	25.6
Individual Collections (days to close)	13.6	13.6	15.2	14.5	14
Exam Timeliness (Large and Mid-Size Business - combined) (months)	42.25	40.41	34.3	33	30
% OIC Field closed in less than 9 months	N/A	N/A	70%	73%	73%
<b>Customer Satisfaction (high rating)</b>					
Correspondence Exam (SB/SE)	46%	52%	53%	52.0%	52.0%
Correspondence Exam (W&I)	33%	41%	41%	42.0%	43.0%
Automated Underreporter (SB/SE)	53%	57%	58%	59.0%	59.0%
Automated Underreporter (W&I)	53%	62%	62%	63.0%	64.0%
Collections (Business)	57%	56%	54%	57.0%	57.0%
Collections (Individual)	58%	64%	63%	63.0%	64.0%
Field Collections	61%	63%	62%	63.0%	63.0%
Field Exams	57%	63%	59%	60.0%	60.0%

**Table B-3. Standards of Performance for Strategic Goal 3:  
Modernize the IRS Through its People, Progress and Technology**

Standards of Performance	FY2004	FY2005	FY2006	IRS FY2007	IRS FY2008
	Actual			Target	
Percentage of Mission Critical Positions hires achieved	N/A	N/A	99%	99.0%	99.0%
Percent managers receiving leadership training timely			69.5%	97.0%	98%
Real Estate Portfolio Cost <sup>1</sup>			-2.15%	5.3%	2.4%
Internal customer satisfaction			86.1%	82.0%	84.0%
Timeliness of completed service calls <sup>2</sup>			85.0%	88.0%	88.0%
Number of Compliant Systems - FISMA			96.0%	100%	100%

<sup>1</sup> The target for the real estate portfolio is to limit the increases in rent expense to the rate of non-pay inflation in the President's Budget. For FY2007, the target includes non-pay inflation plus a change in rent attributable to the Kansas City campus replacement. The FY2008 target is the rate of non-pay inflation, currently set at 2.4 percent. Targets may change in the out years concurrent with changes assumed in future budgets.

<sup>2</sup> In FY2007, the methodology for computing this measure was revised to ensure proper emphasis was placed on the most significant service calls. The FY2006 number was recomputed based on the new methodology.

Appendix C

**FY2008 IRS Initiatives**

**Table C-1. Taxpayer Service Program Initiatives**  
(in millions)

<b>Initiative</b>	<b>Board's Recommendation</b>	<b>President's Recommendation</b>	<b>Difference</b>
<p><b>Research Effect of Service on Taxpayer Compliance</b> Provides additional resources to research and better understand how taxpayer service affects compliance. The research will focus on: (1) meeting taxpayer needs by providing the right channel of communication; (2) better understanding taxpayer burden; (3) understanding taxpayer needs through the errors they make; and (4) the effect of service on overall levels of voluntary compliance.</p>	\$5.0	\$5.0	0
<p><b>Expand Volunteer Income Tax Assistance (VITA)</b> Expands the VITA program to provide more volunteer return preparation, outreach and education, and "asset building services" to low-income, elderly, Limited English Proficiency and disabled taxpayers.</p>	\$5.0	\$5.0	0
<p><b>Implement Taxpayer Assistance Blueprint (TAB)</b> The IRS in conjunction with the Board and the NTA conducted a comprehensive review of its current portfolio of services for individual taxpayers to determine which should be provided and improved upon. Based on the TAB's final findings, a number of telephone and web-based services will be implemented, such as the ability to inform taxpayers of their expected wait time in the telephone queue; an expanded portfolio of tax law decision support tools and a Spanish version of "Where's My Refund?".</p>	\$10.0	\$10.0	0

**Table C-2. Enforcement Initiatives**  
(in millions)

<b>Initiatives</b>	<b>Board's Recommendation</b>	<b>President's Recommendation</b>	<b>Difference</b>
<p><b>Improve Compliance Among Small Business and Self-Employed Taxpayers</b> Addresses and improves reporting, filing, and payment compliance among this taxpayer segment. The initiative will allow more audits of higher-risk tax returns, collection of unpaid taxes and investigations and where appropriate, prosecutions of persons who have evaded their taxes. This increase will produce \$144 million in additional annual enforcement revenue once the new hires reach full potential in FY2010.</p>	\$86.2	\$73.2	\$13.0
<p><b>Expand Document Matching in Existing Sites</b> Boosts coverage within the Automated Underreporter (AUR) program through increased document matching of individual taxpayer account information.</p>	\$28.0	\$28.0	0
<p><b>Establish New Document Matching – Kansas City</b> Funds a new AUR site within existing space at the IRS Kansas City campus to address the misreporting of income by individual taxpayers.</p>	\$23.5	\$23.5	0
<p><b>Increase Individual Filing Compliance</b> Boosts voluntary compliance by holding the current-year refunds of taxpayers who are delinquent in filing individual income tax returns and are expected to owe additional taxes.</p>	\$6.5	\$6.5	0
<p><b>Increase Tax-Exempt Entity Compliance</b> Increases funding and FTE to deter abuse by tax-exempt and government entities (TEGE) and misuse of them by third parties for tax avoidance or other unintended purposes.</p>	\$30.2	\$6.5	0
<p><b>Increase Criminal Tax Investigations</b> Helps the IRS aggressively attack abusive tax avoidance schemes, corporate fraud, non-filers, employment tax fraud and other tax and financial crimes.</p>	\$31.0	\$10.0	\$21.0
<p><b>Enhance Refund Fraud Identification and Reduce Fraudulent Refunds</b> Helps Criminal Investigation (CI) is the IRS organization primarily responsible for identifying and stopping false claims for refunds associated with both individual and business tax returns. This initiative will fund Electronic Fraud Detection System (EFDS) individual master file enhancements and expansion into business master file returns.</p>	\$11.4	0	\$11.4



Initiatives	Board's Recommendation	President's Recommendation	Difference
<p><b>Increase Compliance for Large Multinational Businesses</b> Increases examination coverage for large, complex business returns, foreign residents and smaller corporations with significant international activity. Two separate Board enforcement initiatives are folded into this proposal: (1) Increased Tax Court Litigation, Particularly Tax Shelter Cases; and (2) Reduce Tax Dispute Cycle Time.</p>	\$45.8	\$26.2	\$19.6
<p><b>Increased Tax Court Litigation, Particularly Tax Shelter Cases</b> This initiative provides resources to meet increased workload in litigation of high-profile, complex, and resource-intensive tax shelter and other cases. Tax court cases have increased by 60 percent since FY 2001, while the number of high-end (more than \$10 million) tax cases has increased by 89 percent since FY 2003. Many of the high-end receipts are tax shelter cases involving complex technical transactions and devices developed starting in the mid to late 1990s. This initiative will increase Counsel case closures from 24,800 to 26,636 closures annually.</p>	\$7.6	Note 1	\$7.6
<p><b>Reduce Tax Dispute Cycle Time</b> This initiative will enable the timely resolution of tax disputes, despite significant increases in cases. Timely resolution of tax discrepancies, without litigation, will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service. This initiative improves cycle time for tax law enforcement actions, and will ultimately improve customer satisfaction.</p>	\$17.2	Note 1	\$17.2
<p><b>Improve Compliance Estimates, Measures and Detection of Non-Compliance</b> Funds research studies of compliance data for new taxpayer segments that is needed to update existing estimates of reporting compliance. The IRS will now conduct an annual study of 1040-filer compliance. The data captured through these studies will help the IRS develop strategies to combat specific areas of non-compliance, improve voluntary compliance and allocate resources more effectively.</p>	\$41.0	\$41.0	0
<p><b>Implement Legislative Proposals to Improve Compliance</b> Funds proposals to expand information reporting, improve compliance by businesses, strengthen tax administration and expand penalties.</p>	\$23.0	\$23.0	0

Note 1: Funds for this initiative are included in other initiatives.

**Table C-3. Infrastructure Initiatives (Business Systems Modernization)**  
(in millions)

<b>Initiative</b>	<b>Board's Recommendation</b>	<b>President's Recommendation</b>	<b>Difference</b>
<p><b>Customer Account Data Engine (CADE)</b> Continues development of CADE – the so-called “lynchpin” of the IRS Business Systems Modernization program. CADE will allow the agency to retire the antiquated Individual Master File in 2012 and when fully operational, will house tax information for more than 200 million individual and business taxpayers.</p>	\$67.0	\$58.5	\$8.5
<p><b>Modernized e-Filing (MeF)</b> Allows for the continued development and implementation of MeF – the future of electronic filing. MeF provides a single Extensible Markup Language (XML)-based standard for filing electronic tax returns. Standardizing the formats/structures for all filings will allow transmitters to submit multiple return types in the same transmission and eliminates a large barrier to e-file growth.</p>	\$60.0	\$55.8	\$4.2
<p><b>Account Management System (AMS)</b> Funds a Common User Interface for access and update of taxpayer accounts managed by CADE and the Individual Master File, Corporate Files on Line and the Integrated Data Retrieval System. AMS will provide immediate access to integrated account data which improves the IRS’ ability to resolve account inquiries with minimal taxpayer interaction and gives taxpayers the ability to self assist or self correct.</p>	\$37.0	\$29.0	\$8.0
<p><b>Filing and Payment Compliance</b> Provides for a government/industry partnership that allows private collection agencies to assist the IRS in addressing the large volume of delinquent taxpayer cases. Between now and 2017, approximately 2.6 million such cases will be worked that otherwise would not have been.</p>	0	0	0
<p><b>Integrated Financial System (IFS)</b> Provides upgrades to the existing IRS IFS system to allow related business processes to be integrated with core accounting and financial management operations. Such an initiative would address “material weaknesses” GAO identified in its audit of the IRS’ FY2005 financial statement.</p>	\$90.0	0	\$90.0
<p><b>Common Services Projects (CSP)</b> Provides funding for new portals, which are mission-critical components of the enterprise infrastructure required to support key business processes and compliance initiatives.</p>	\$32.0	\$16.0	\$16.0

**Table C-4. Infrastructure Initiatives (non-Business Systems Modernization)**  
(in millions)

Initiative	Board's Recommendation	President's Recommendation	Difference
<p><b>Critical Upgrades to IRS IT Infrastructure</b> Reduces the backlog of IRS information technology (IT) equipment that has exceeded its life cycle. Failing to replace the IRS' IT infrastructure increases maintenance costs and the risk of disruptions to business operations. In FY2008, the IRS plans to procure and replace desktop computers, automated call distributor hardware, mission critical servers, and Wide Area Network/Local Area Network routers and switches.</p>	\$60.0	\$60.0	0
<p><b>Operating Costs for Newly-Deployed, Modernized Information Systems</b> This initiative will fund the operating costs of the IT development projects selected for the FY2007 and 2008 portfolio of major and non-major investments.</p>	\$39.0	0	0
<p><b>Virtual Office Initiative</b> The virtual office concept is structured around IT-enabled knowledge and flexibilities, and involves a managed portfolio of work environments. This initiative will support 500 participants.</p>	\$1.7	0	\$1.7
<p><b>Enhanced Computer Security Incident Response Center and Network Infrastructure Security</b> Enhances the Computer Security Incident Response Center (CSIRC). This initiative will enable the IRS to keep pace with the ever-changing security threats through increased detection and analysis capability, improved forensics, and the ability to identify and respond to potential intrusions before they occur. Additionally, it would fund enhancements to the IRS' network infrastructure security.</p>	\$21.0	\$21.0	0
<p><b>Develop Custodial Detail Data Base</b> This initiative provides \$3.5 million to develop a data warehouse for all revenue, refund, assessment, abatement, and other financial transactions posting to the Individual Master File, Business Master File, Automated Non Master File, and Corporate Account Data Engine systems, and serve as the sub-ledger of custodial financial information.</p>	\$3.5	0	\$3.5

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