DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

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MEMORANDUM FOR SECRETARY GEITHNER

FROM: J. Russell George
Inspector General J. Russell George

SUBJECT: Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2010

The Reports Consolidation Act of 2000[1] requires that the Treasury Inspector General for Tax Administration (TIGTA) summarize, for inclusion in the *Department of the Treasury Accountability Report for Fiscal Year 2009,* its perspective on the most serious management and performance challenges confronting the Internal Revenue Service (IRS or Service). The top ten challenges in order of priority are:

1. Modernization;
2. Security;
3. Tax Compliance Initiatives;
4. Implementing Tax Law Changes;
5. Providing Quality Taxpayer Service Operations;
6. Human Capital;
7. Erroneous and Improper Payments and Credits;
8. Globalization;
9. Taxpayer Protection and Rights; and
10. Leveraging Data to Improve Program Effectiveness and Reduce Costs.

TIGTA's assessment of the major IRS management challenge areas for Fiscal Year 2010 has changed from the prior year. The changes include reorganizing the priority of challenges four through nine, revising the titles of three challenges to better reflect their current emphasis, and adding a new challenge entitled "Globalization."

Although not listed as challenges, two issues – tax law complexity and proposed healthcare reform legislation – warrant additional consideration. While "Complexity of the Tax Law" does not appear on this year's list of challenges because it has been overtaken by other concerns, it remains a serious, underlying issue with wide-ranging implications for both the IRS and taxpayers. Tax law complexity and frequent revisions

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[1] 31 U.S.C. § 3516(d).

to the Internal Revenue Code make it more difficult for the IRS to explain and enforce the tax laws and more costly for taxpayers who want to comply. However, as the IRS lacks the authority to enact changes to the tax law, it can do little but continue to react to the frequently changing Internal Revenue Code while the debate over many significant issues continues.

Similarly, numerous tax law changes are contained in the healthcare reform legislation presently working its way through Congress. The proposals include a number of provisions that could have a significant effect on the IRS in the coming year. As policies under consideration continue to look toward the Internal Revenue Code to effect changes, the IRS potentially faces the challenge of responding quickly by shifting resources and altering established plans. However, in doing so, there is some risk to the IRS's overall mission if the actions taken cause a decline in the quality and effectiveness of service or taxpayer perception.

The following is a discussion of each of the most serious management and performance challenges facing the IRS during Fiscal Year 2010.

Modernization

The Business Systems Modernization Program (Modernization Program or Program) is a complex effort to modernize IRS technology and related business processes. It involves integrating thousands of hardware and software components while replacing outdated technology and maintaining the current tax system. The IRS originally estimated that the Modernization Program would last up to 15 years and incur contractor costs of approximately $8 billion.[2] The Program is now in its 11th year and has received approximately $2.7 billion for contractor services, plus an additional $353 million for internal IRS costs.

TIGTA reviews have identified weaknesses in program management processes throughout the life of the Modernization Program. While the IRS has improved its controls over these processes as the Program has continued to mature, several weaknesses continue to exist. Recent TIGTA audits have identified continued problems in requirements development and management, program management, contract management and security controls.

Although the Modernization Program has continued to help improve IRS operations, project development activities have not always implemented planned processes effectively or delivered all planned system capabilities. The past year's Program performance did not continue the trend of improvement it demonstrated in the prior three years. For example, from May 2008 to May 2009, five of the 17 project milestones scheduled for completion were significantly over budget, and three of 17 milestones were significantly behind schedule.

[2] Treasury Inspector General for Tax Administration, Ref. No. 2009-20-136, *Annual Assessment of the Business Systems Modernization Program* (2009).

The Modernization Program has experienced significant and frequent turnover of high-level IRS and Program executives. Since the Program began in 1999, three Commissioners, five Chief Information Officers, and, recently, a Chief Technology Officer have overseen the Program. Many of these executives have made major changes to the Program's direction and strategies during their tenure. These changes in direction and strategy have made it challenging to achieve continuity and long-term success.

The IRS has recognized that it faces challenges in meeting the requirements of the next phase of project development and system integration. As a result, the IRS has stated that a strategy correction is needed to meet changing business needs, have a more agile information technology environment, and reduce risks with associated costs to build and maintain systems.

The immediate challenge recognized by the IRS is the future of the Customer Account Data Engine,[3] the acknowledged centerpiece of the Modernization Program. Since the IRS initiated the Customer Account Data Engine project in 1999, after spending $335 million in development costs, it has been able to process only about 30 percent of the individual income tax returns filed. Limitations in Customer Account Data Engine capabilities, including those reported by TIGTA and the Government Accountability Office (GAO) in previous years, have resulted in the IRS's effort to reengineer processing of individual taxpayer accounts and the ability to use downstream systems to improve customer service. With the pending changes and the yet to be determined implementation of a reengineered process, the risks to the success of the Modernization Program are significant.

Since 1995, the IRS has identified and reported the Modernization Program as a material weakness. The Program and processes have not progressed enough to eliminate the material weakness designation. Until the IRS is able to show consistent progress and improvement in the management of its Modernization Program and adequately addresses past TIGTA and GAO recommendations, the Program will remain a high risk for the IRS and will continue to be considered a material weakness.

Security

Millions of taxpayers entrust the IRS with sensitive financial, personal, and other data that are processed by and stored on IRS computer systems. Reports of identity theft from both the private and public sectors have heightened awareness of the need to protect these data. The risk that taxpayers' identities could be stolen by exploiting security weaknesses in the IRS's computer systems continues to increase, as does the risk that IRS computer operations could be disrupted. Internal factors (such as the

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[3] The Customer Account Data Engine is the foundation for managing taxpayer accounts in the IRS Modernization plan. When completed, it will consist of databases and related applications that will replace the existing IRS Master File processing systems and will include applications for daily posting, settlement, maintenance, refund processing, and issue detection for taxpayer tax account and return data.

increased connectivity of computer systems and increased use of portable laptop computers) and external factors (such as the volatile threat environment resulting from increased terrorist and hacker activity) require strong security controls.

Homeland Security Presidential Directive-20[4] requires Federal Government agencies to develop business continuity plans[5] to enable the recovery of critical functions after a disaster or emergency. To comply with the Directive, the IRS must develop and continually update its business continuity plans to protect employees and recover critical business processes, data, and information technology systems. The IRS must protect large amounts of sensitive taxpayer data in addition to more than 100,000 employees and contractors in more than 660 facilities throughout the country. In reviews of these plans,[6] we determined that the IRS's business continuity planning efforts have not been sufficient to ensure that critical business processes and systems may be efficiently restored in the event of a disaster. We also found a majority of the incident management, business resumption, and disaster recovery plans lacked detailed planning information and recovery strategies.

The Federal Information Security Management Act (FISMA)[7] requires each Federal Government agency to report annually to the Office of Management and Budget and to Congress on the effectiveness of its security programs and to perform an annual independent evaluation of its information security program and practices. The number of incidents reported by Federal agencies has increased dramatically over the past three fiscal years, from 5,503 incidents in 2006 to 16,843 incidents in 2008.[8] The IRS has made steady progress in complying with FISMA requirements since the law's enactment in 2002 and continues to place a high priority on efforts to improve its security program. However, the IRS needs to do more to adequately secure its systems and data. Past audits have shown that the most significant areas of concern are compliance with mandated security configurations, implementation of access controls for computer systems, and use of audit trails to detect computer intrusions and misuse.

[4] *National Continuity Policy*, dated May 4, 2007 (also known as National Security Presidential Directive-51). This Directive establishes a comprehensive national policy on the continuity of Federal Government structures and operations.

[5] IRS business continuity plans include an Occupant Emergency Plan, which provides instructions to safely evacuate employees and visitors from a facility or shelter them in place; an Incident Management Plan, which addresses the overall command structure that would be implemented in an emergency; a Business Resumption Plan, which provides instructions for recovering and restoring disrupted business processes; and a Disaster Recovery Plan, which addresses recovery and restoration of information technology systems and data.

[6] Treasury Inspector General for Tax Administration, Ref. No. 2009-20-038, *Better Emergency Preparedness Planning Could Improve Business Continuity Efforts* (2009).

[7] Federal Information Security Management Act of 2002, 44 U.S.C. §§ 3541–3549.

[8] U.S. Government Accountability Office, GAO-09-701T, *Information Security: Agencies Make Progress in Implementation of Requirements, but Significant Weaknesses Persist* (2009).

The introduction of malware,[9] also known as malicious code or malicious software, into the IRS network continues to present a growing security concern. Although the IRS has had success in preventing serious infections, the number of malware incidents within the IRS continues to rise. Malware is difficult to combat because it is delivered through commonly used applications and devices, such as e-mail, the Internet, and portable media devices. Without sufficient controls to prevent the introduction of malware, IRS computers and the sensitive taxpayer data stored on them are at risk of compromise that could result in identity theft and fraud.

Identity theft and phishing[10] schemes are also growing security concerns. TIGTA works closely with the IRS to identify and investigate these schemes. Attempts at identity theft and phishing related to Federal income taxes continue to rise with incidents growing more than seven times in 2008.[11] In its 2009-2013 Strategic Plan, the IRS identifies the explosion in electronic data, online interactions, and related security risks as a major trend expected to affect the Service over the next five years.

Tax Compliance Initiatives

Another compelling challenge confronting the IRS is tax compliance. Tax compliance initiatives include the administration of tax regulations, collection of the correct amount of tax from businesses and individuals, and oversight of tax-exempt and government entities. Increasing voluntary compliance and reducing the Tax Gap[12] are currently the focus of many IRS initiatives. Nevertheless, the IRS is facing significant challenges in obtaining more complete and timely data, and developing the methods necessary to interpret the data.

Businesses and Individuals

The IRS estimated the gross Tax Gap for Tax Year 2001 to be approximately $345 billion. Underreporting of taxes, which is comprised of four major components (individual income tax, employment tax, corporate income tax, and estate and excise taxes), is estimated at $285 billion and accounts for the largest portion of the Tax Gap. Overall, the underreporting of individual income tax and employment tax constitute over 70 percent of the gross Tax Gap.

In August 2007, the Department of the Treasury and the IRS issued a report entitled *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance*, which details the strategy being taken to address the Tax Gap by increasing

[9] Malware refers to a program inserted into a computer with the intent of compromising the confidentiality, integrity, or availability of an organization's data, applications, or operating systems.
[10] Phishing is the act of sending an e-mail to a user falsely claiming to be an established, legitimate enterprise in an attempt to scam the user into surrendering private information that could be used for identity theft.
[11] Internal Revenue Service Strategic Plan 2009-2013.
[12] The IRS defines the Tax Gap as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely paid for a tax year.

voluntary compliance.[13] TIGTA provided an evaluation of this strategy in 2008 and reported that the long-term success of the strategy will, in large part, be dependent on addressing several risk factors, including some that are beyond the control of the IRS.[14]

The IRS's Fiscal Year 2010 budget submission requests $603 million above its Fiscal Year 2009 enacted budget. More than half of this amount, $332 million, is intended for additional compliance initiatives that will target the Tax Gap. The IRS must continue to seek accurate measures for the various components of the Tax Gap and the effectiveness of the actions taken to reduce it. Broader strategies and better research are needed to determine what actions are most effective in addressing noncompliance.

Tax-Exempt Entities

The IRS continues to face challenges in administering programs focused on ensuring that tax-exempt organizations comply with applicable laws and regulations to qualify for tax-exempt status. The number of organizations granted tax-exempt status each year continues to increase. With more than $15 trillion in assets currently controlled by tax-exempt organizations or held in tax-exempt retirement programs and financial instruments, the IRS recognized in its 2009-2013 Strategic Plan that it must provide more careful oversight and advisory support than ever before. In addition, the IRS's Fiscal Year 2010 budget submission recognizes the importance of maintaining a strong enforcement presence in the tax-exempt sector to ensure charitable organizations are not used for non-charitable or illegal purposes, including financing terrorist activities.

In a report issued in Fiscal Year 2009, we determined that the Federal Government is at risk of losing future tax revenue because the IRS has not developed or implemented the processes necessary to identify and address noncompliance with State volume cap limits for tax-exempt private activity bonds. Without these processes, tax-exempt private activity bonds could be issued in excess of federally mandated yearly State dollar limits without the IRS detecting and addressing the noncompliance.[15]

Implementing Tax Law Changes

Each filing season tests the IRS's ability to implement tax law changes made by Congress. It is during the filing season that most individuals file their income tax returns and contact the IRS with questions about specific tax laws or filing procedures. Correctly implementing tax law changes is a continuing challenge because the IRS must identify the tax law changes; revise the various tax forms, instructions, and

[13] An updated report providing an overview of efforts to close the Tax Gap was issued in July 2009.
[14] Treasury Inspector General for Tax Administration, Ref. No. 2008-30-094, *Additional Actions Are Needed to Effectively Address the Tax Gap* (2008).
[15] Treasury Inspector General for Tax Administration, Ref. No. 2009-10-097, *Future Tax Revenues Are at Risk Because Certain Tax-Exempt Bonds May Exceed Annual Dollar Limits Without Detection* (2009).

publications; and reprogram the computer systems used for processing returns. Changes to the tax laws have a major effect on how the IRS conducts its activities, what resources are required, and how much progress can be made on strategic goals.

Congress frequently changes the tax laws, so some level of change is a normal part of the IRS environment. However, certain types of changes and the timing of those changes can significantly affect the IRS in terms of the quality and effectiveness of its service and how taxpayers perceive the IRS. In its 2009-2013 Strategic Plan, the IRS identifies the increasing complexity of tax administration, which includes responding to new tax provisions and adjusting to expiring ones, as a major trend expected to affect the Service over the next five years.

American Recovery and Reinvestment Act

The American Recovery and Reinvestment Act of 2009[16] (Recovery Act) was signed into law on February 17, 2009. The Recovery Act presents significant challenges to all Federal agencies as they move to implement provisions quickly while attempting to minimize risk and meet increased standards for transparency and accountability. With its numerous tax provisions, the Recovery Act poses significant challenges to the IRS as the Nation's tax collection agency and administrator of the tax laws. These provisions, which impact both individual and business taxpayers, will challenge the IRS as it attempts to implement the required changes over multiple filing seasons.

Other Tax Law Changes

Other recent legislation that has affected the IRS includes the Housing and Economic Recovery Act of 2008,[17] the Emergency Economic Stabilization Act of 2008,[18] and the Economic Stimulus Act of 2008.[19] These three Acts contained numerous tax law changes that challenged the IRS during the 2009 Filing Season. Despite these challenges, the 2009 Filing Season was generally successful, although the Recovery Rebate Credit, part of the Economic Stimulus Act of 2008, did cause significant taxpayer confusion. Although the IRS initiated a number of efforts to educate and assist individuals in computing the Recovery Rebate Credit, the Credit still resulted in millions of taxpayer errors. Two significant issues that could affect the IRS's 2010 Filing Season include Alternative Minimum Tax relief and the proposed healthcare legislation.

Providing Quality Taxpayer Service Operations

Since the late 1990's, the IRS has increased its delivery of quality customer service to taxpayers. In July 2005, Congress requested that the IRS develop a five-year plan, including an outline of which services the IRS should provide and how it will improve

[16] Pub. L. No. 111-5, 123 Stat. 115.
[17] Pub. L. No. 110-289, 122 Stat. 2654.
[18] Pub. L. No. 110-343, 122 Stat. 3766.
[19] Pub. L. No. 110-185, 122 Stat. 613.

services for taxpayers. The IRS developed the plan – the Taxpayer Assistance Blueprint – which focuses on services that support the needs of individual filers who file or should file the Form 1040 series tax returns.[20] The Blueprint includes performance measures, service improvement initiatives, and an implementation strategy for improving future service investment decisions. The IRS has begun implementing the initiatives, but many are dependent on future funding.

Despite having a plan in place to improve service, providing quality service to taxpayers remains a significant challenge for the IRS. For example, the Toll-Free Telephone Program only achieved a 58.8 percent Level of Service[21] during the 2009 Filing Season (through March 7, 2009) because of increased call demand for prior year Adjusted Gross Income and the Recovery Rebate Credit. Furthermore, the average speed to answer taxpayers' calls was 586 seconds (9.8 minutes), and the number of blocked calls during the 2009 Filing Season increased more than seven times over the 2008 Filing Season.[22] Taxpayer Assistance Centers[23] answered only 67 percent of tax law questions accurately and 82 percent of tax account[24] questions accurately.[25] Additionally, the Volunteer Program, which plays an increasingly important role in the IRS's efforts to improve taxpayer service and facilitate participation in the tax system, accurately prepared only 59 percent of TIGTA's test tax returns.

The Department of the Treasury and the IRS recognize that effective taxpayer service has a significant impact on voluntary tax compliance. Assisting taxpayers in preparing their returns by answering tax questions reduces the burden of notices and correspondence that taxpayers might have received if they made errors on their returns. Taxpayer service also reduces overall unintentional noncompliance and the need for compliance activity in the future. The IRS continues to focus on the importance of improving service by emphasizing it as one of the two main goals in its 2009-2013 Strategic Plan.

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[20] The Form 1040 series tax returns include any IRS tax forms that begin with "1040" such as the U.S. Individual Income Tax Return (Form 1040), U.S. Individual Income Tax Return (Form 1040-A), and Income Tax Return for Single and Joint Filers With No Dependents (Form 1040EZ).

[21] Level of Service is the IRS's primary measure of providing taxpayers with access to an assistor. Level of Service reflects the relative success rate of taxpayers who call the 20 Customer Account Services toll-free telephone lines seeking assistance from an assistor. It measures the success rate of access to the telephone system using the number of calls answered by IRS assistors.

[22] A blocked call is one that cannot be connected immediately because either: 1) no circuit is available at the time the call arrives (i.e., the taxpayer receives a busy signal); or 2) the system is programmed to block calls from entering the queue when the queue backs up beyond a defined threshold (i.e., the taxpayer receives a recorded announcement to call back at a later time). The IRS refers to the latter type of blocked call as a courtesy disconnect. The IRS blocked more calls during the filing season rather than allow more callers to wait on hold.

[23] Taxpayer Assistance Centers are walk-in sites where taxpayers can obtain answers to both account and tax law questions, as well as receive assistance in preparing their tax returns.

[24] A tax account is a record of a taxpayer's tax and tax-related data recorded on the IRS's Master File database.

[25] Treasury Inspector General for Tax Administration, Ref. No. 2009-40-058, *Interim Results of the 2009 Filing Season* (2009).

Human Capital

Since 2001, the GAO has designated strategic human capital management as a high-risk area within the Federal Government. In its 2009 update, the GAO reported that despite significant progress over the last few years the area remains a high risk because of a continuing need for a government-wide framework to advance human capital reform.[26]

The Commissioner of Internal Revenue (Commissioner) indicated his recognition of the need for greater attention to human capital. The Commissioner established the Workforce of Tomorrow Task Force to address recruitment and retention issues so that the IRS has the necessary leadership and workforce in place to address future challenges. Beginning in Fiscal Year 2008, TIGTA developed a broad audit strategy for addressing human capital at an IRS agency-wide level using the Human Capital Assessment and Accountability Framework[27] as a guide.

Like many other Federal Government agencies, the IRS has experienced workforce challenges over the past few years, including recruiting, training, and retaining employees, as well as an increasing number of employees who are eligible to retire. More than half of the IRS's employees and managers have reached age 50, and 39 percent of IRS executives are currently eligible for retirement. To fill the projected shortage in leadership, the IRS has stated that it must recruit one manager a day for the next 10 years. Furthermore, the rate at which new recruits in mission critical occupations are leaving the IRS during the first and second year of employment has increased since Fiscal Year 2005. The pending loss of institutional knowledge and expertise at all levels and the challenge of retaining a highly skilled workforce increase the risk that the IRS may not be able to achieve its mission.

The IRS's challenge of having the right people in the right place at the right time is made more difficult by many complex internal and external factors. The work performed by IRS employees continually requires greater expertise as tax laws become more complex, manual systems used to support tax administration become computer based, and attempts by taxpayers and tax practitioners to evade compliance with the tax laws become more sophisticated. The IRS must also compete with other Government agencies and private industry for the same human resources, complicated by the fact that younger generations of employees move between jobs more frequently than employees in the past. Furthermore, budget constraints, legislative changes, and economic shifts can create unforeseen challenges for the IRS in addressing its long-term human capital issues. In its 2009-2013 Strategic Plan, the IRS identifies human capital challenges as a major trend expected to affect the Service over the next five years.

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[26] U.S. Government Accountability Office, GAO-09-271, *High Risk Series: An Update* (2009).
[27] The Framework was established by the United States Office of Personnel Management. It provides consolidated guidance for agencies to transform human capital management and understand what is to be done, how it can be done, and how to gauge progress and results. It also presents the expectations that guide the agency's assessment of human capital efforts.

Erroneous and Improper Payments and Credits

As defined by the Improper Payments Information Act of 2002,[28] an improper payment is any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for credit for applicable discounts. For the IRS, improper and erroneous payments generally involve improperly paid refunds, tax return filing fraud, or overpayments to vendors or contractors.

Refundable Credits

The IRS administers numerous refundable tax credits. These refundable credits allow individual taxpayers to reduce their tax liability below zero and, thus, receive a tax refund even if no income tax was withheld or paid. Two significant refundable credits are the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit. The recently enacted American Recovery and Reinvestment Act of 2009 also authorized several new refundable credits, examples of which include the Making Work Pay Credit and First-Time Homebuyer Credit.

The EITC remains the main refundable credit and continues to be vulnerable to a high rate of noncompliance, including incorrect or erroneous claims caused by taxpayer error and resulting from fraud. The IRS has successfully developed a number of processes to identify erroneous EITC payments prior to issuance. However, because compliance resources are limited and alternatives to traditional compliance methods have not been developed, the majority of the potentially erroneous EITC claims identified continue to be paid in error. The IRS reports $10 billion to $12 billion annually in erroneous EITC payments.[29]

Contract and Other Payments

Each year, the Federal Government spends billions of dollars to acquire goods and services. In Fiscal Year 2008, Federal contracting outlays were more than $500 billion. Similarly, contract spending by the IRS represents a significant outlay of Service funds. Numerous past TIGTA audits have identified millions of dollars in questioned costs and several instances of contractor fraud. A summary of our work in this area over a period of approximately four years concluded that an incomplete invoice verification process resulted in the IRS paying approximately $7.5 million in questionable contract charges. In addition, an analysis of Defense Contract Audit

[28] Pub. L. No. 107-300, 116 Stat. 2350.
[29] Treasury Inspector General for Tax Administration, Ref. No. 2009-40-024, *The Earned Income Tax Credit Program Has Made Advances; However, Alternatives to Traditional Compliance Methods Are Needed to Stop Billions of Dollars in Erroneous Payments* (2008).

Agency reports issued in Fiscal Years 2006 and 2007 identified approximately $167 million in questionable charges directly related to IRS contracts.[30]

Globalization

The scope, complexity, and magnitude of the international financial system present significant enforcement challenges for the IRS. As technology continues to advance and cross-border transactions rise, the IRS faces the growing challenge created by economic globalization. Technological advances have provided opportunities for offshore investments that were once only possible for large corporations and wealthy individuals.

Taxpayers with international activities – individuals, businesses, and tax-exempt organizations – continue to grow in number and variety. Examples of this trend include: 1) United States-based corporations more than tripled their foreign profits between 1994 and 2004, from $89 billion to $298 billion, with 58 percent of those profits earned in low-tax or no-tax jurisdictions; 2) the number of multinational corporations worldwide has grown from an estimated 3,000 in 1990 to over 63,000 in 2007; 3) the total income reported for 2005 from active foreign corporations owned by United States taxpayers exceeded $1.8 trillion; and 4) the percentage of Americans' income originating from foreign sources doubled between 2001 and 2006.

The IRS is challenged by a lack of information reporting on many cross-border transactions. In addition, the varying legal requirements imposed by different jurisdictions result in the formation of complex business structures that make it difficult to determine the full scope and effect of cross-border transactions. However, over the past few years, the IRS has taken actions to better coordinate international tax compliance issues. In September 2007, the IRS announced a Service-wide Approach to International Tax Administration highlighted by three strategic goals: 1) improving taxpayer service; 2) enhancing enforcement and modernizing the IRS for improving voluntary compliance with international tax provisions; and 3) reducing the Tax Gap attributable to international transactions. In addition, the Commissioner has emphasized that international issues will be a top priority during his tenure. The IRS has also made other changes to its structure and processes, including increasing cooperation and outreach efforts to foreign governments. In its 2009-2013 Strategic Plan, the IRS identifies accelerating globalization as a major trend expected to affect the Service over the next five years.

Taxpayer Protection and Rights

The IRS must ensure that tax compliance activities are balanced against the rights of taxpayers to receive fair and equitable treatment. The IRS continues to dedicate significant resources and attention to implementing the taxpayer rights provisions of the

[30] Treasury Inspector General for Tax Administration, Ref. No. 2008-10-092, *Procurement's Control Environment Was Ineffective and Did Not Prevent Overpayments to Contractors* (2008).

IRS Restructuring and Reform Act of 1998 (RRA 98).[31] Annual audit reports are mandated for the following taxpayer rights provisions:

- Notice of Levy;
- Restrictions on the Use of Enforcement Statistics to Evaluate Employees;
- Fair Debt Collection Practices Act Violations;
- Notice of Lien;
- Seizures;
- Illegal Protestor Designations;
- Assessment Statute of Limitations;
- Restrictions on Directly Contacting Taxpayers Instead of Authorized Representatives; and
- Separated or Divorced Joint Filer Requests.

In general, the IRS has improved its compliance with these statutory taxpayer rights provisions. The IRS has shown improvement over prior years when documenting that taxpayers were informed of their rights. However, there were still instances in which there was no documentation in the related case files to show that taxpayers were advised of their rights regarding assessment statute extensions,[32] and the IRS did not always follow procedures for mailing notices to taxpayers or their representatives in Federal Tax Lien cases.[33]

Some IRS management information systems do not track cases that require mandatory annual audit coverage.[34] Thus, neither TIGTA nor the IRS could evaluate the Service's compliance with certain RRA 98 provisions.

Leveraging Data to Improve Program Effectiveness and Reduce Costs

While the IRS has made some progress in using its data to improve program effectiveness and reduce costs, this area continues to be a major challenge. The IRS lacks a comprehensive, integrated system that provides accurate, relevant, and timely financial and operating data that describes performance measures, productivity, and associated costs of IRS programs. In addition, the IRS cannot produce timely, accurate, and useful information needed for day-to-day decisions, which hinders its

[31] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).
[32] Treasury Inspector General for Tax Administration, Ref. No. 2009-30-113, *Fiscal Year 2009 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (2009).
[33] Treasury Inspector General for Tax Administration, Ref. No. 2009-30-089, *Additional Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process* (2009).
[34] Treasury Inspector General for Tax Administration, Ref. No. 2009-30-046, *Fiscal Year 2009 Statutory Review of Disclosure of Collection Activity With Respect to Joint Returns* (2009) and Treasury Inspector General for Tax Administration, Ref. No. 2009-30-054, *Fiscal Year 2009 Statutory Review of Restrictions on Directly Contacting Taxpayers* (2009).

ability to address financial management and operational issues to fulfill its responsibilities.

TIGTA and the GAO have continued to report that various IRS management information systems are insufficient to enable IRS management to measure costs, determine if performance goals have been achieved, or monitor progress in achieving program goals. In its most recent financial statement audit, the GAO noted that the IRS continues to face several key issues that represent material weaknesses in internal control, including not having current and reliable ongoing cost information to support management decision making and to prepare cost-based performance measures.[35] In addition, our analysis of the IRS's December 31, 2008, Federal Financial Management Improvement Act of 1996 (FFMIA)[36] remediation plan found that the IRS did not include remediation actions to address certain GAO findings and recommendations related to the IRS's noncompliance with the FFMIA. These findings and recommendations related to the IRS's Integrated Financial System, which provides the Service with an integrated accounting system to account for and control resources.[37]

Conclusion

The above are the ten major management and performance challenges for the IRS in Fiscal Year 2010. TIGTA's Fiscal Year 2010 Annual Audit Plan contains our planned reviews and is organized by these challenges. If you have questions or wish to discuss TIGTA's views on the IRS's challenges in greater detail, please contact me at (202) 622-6500.

cc: Deputy Secretary
Assistant Secretary for Management and Chief Financial Officer
Commissioner of Internal Revenue

[35] U.S. Government Accountability Office, GAO-09-119, *Financial Audit: IRS's Fiscal Years 2008 and 2007 Financial Statements* (2009).
[36] Pub. L. No. 104-208, 110 Stat. 3009.
[37] Treasury Inspector General for Tax Administration, Ref. No. 2009-10-094, *The Internal Revenue Service's Federal Financial Management Improvement Act Remediation Plan As of December 31, 2008* (2009).