2001 TAX RETURN FILING SEASON

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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2001 TAX RETURN FILING SEASON

TUESDAY, APRIL 3, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:08 p.m., in room 1100 Longworth House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE CONTACT: (202) 225–7601
March 27, 2001
No. OV–3

Houghton Announces Hearing on 2001 Tax Return Filing Season

Congressman Amo Houghton (R–NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the 2001 tax return filing season. **The hearing will take place on Tuesday, April 3, 2001, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

Oral testimony at this hearing will be from invited witnesses only. Witnesses will include Internal Revenue Service (IRS) Commissioner Charles Rossotti, the National Taxpayer Advocate Nina Olson, and representatives from the U.S. General Accounting Office, the U.S. Department of the Treasury Inspector General for Tax Administration, and tax practitioner groups. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The 2001 tax return filing season refers to the period from January 1st to April 15th (April 16th this year in most of the United States) when U.S. taxpayers will file over 130 million tax returns, including 42.3 million e-filed returns (a projected 9.6 percent increase over the 2000 filing season). During this period the IRS is expected to issue over 96.8 million tax refunds, answer 62 million telephone calls from taxpayers asking for assistance, and its homepage will receive 2 billion hits.

In announcing the hearing, Chairman Houghton stated: "Customer Service. This was the promise of the new IRS after the Restructuring and Reform Act of 1998. This hearing gives us the opportunity to ensure that the IRS is living up to its promise by processing taxpayer questions, returns, and refunds as efficiently as possible. I am looking forward to the Commissioner's testimony."

FOCUS OF THE HEARING:

The Subcommittee will review the progress in customer service offered by the IRS in the 2001 tax filing season, including progress in the customer communications system, electronic filing, and systems modernization.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should *submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, with their name, address, and hearing date noted on a label*, by the *close of business,* Tuesday, April 17, 2001, to Allison Giles, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, typed in single space and may not exceed a total of 10 pages including attachments. **Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.**

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at "http://www.house.gov/ways__means/".

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman HOUGHTON. Ladies and gentlemen, thank you very much for being here. The hearing will now come to order. It is good to see you, Commissioner. Thanks very much for your presence here. You may have one of the most difficult jobs in the city. I believe, though, that you have run the agency admirably, and I know the service is not where you want it to be yet, but you have made great strides and I am sure you have high hopes.

Let me say just a few words about customer service. Customer service means many things, among them are courtesy, efficiency, and, most importantly, fairness. The relationship between the IRS and the ordinary citizen, because of the nature of the function, sometimes can be potentially difficult, but if each time the taxpayers reach out to the IRS or the IRS reaches out to them and they are treated with these three objectives in mind, the IRS will be able to increase its trust in the eyes of the American public. So we will discuss many topics today and ask many questions, but the underlying theme will remain the same: courtesy, efficiency and fairness.

One more thought. No one can understate the importance of security. Taxpayers must feel that the information on their tax returns is safe. This information must be secure from both internal browsing and external break-ins. And I know, Commissioner, that you have made security a focal point. So I thank you for coming today. And the rest of the witnesses, I thank you also and I look forward to your ideas. I am pleased to yield to our ranking democrat, my friend, Mr. Coyne.

[The opening statement of Chairman Houghton follows:]

Opening Statement of the Hon. Amo Houghton, M.C., New York, and Chairman, Subcommittee on Oversight

Good afternoon. It is good to see you Commissioner. You may have one of the most difficult jobs in this city. Because nobody particularly likes to interact with the IRS, it is all that more important that when they must, the service they receive be the best possible. I believe that you have run this agency admirably. I know service is not where you want it to be yet, but you have made great strides.

I want to say a few words about customer service. Customer service means three things to me: (1) courtesy, (2) efficiency, and most importantly (3) fairness. If each time a taxpayer reaches out to the IRS, or the IRS reaches out to him, heaven forbid, he is treated with these three objectives in mind, the IRS will improve its image and increase its trust in the eyes of the American public. We will discuss many topics today and ask many questions. The underlying theme will remain the same: courtesy, efficiency, and fairness.

Thank you Commissioner for coming today and to the rest of the witnesses. I look forward to hearing your ideas.

I want to add one more thought. I cannot understate the importance of security. Taxpayers must feel that the information on their tax returns is safe. This information must be secure from both internal browsing and external break-ins. I know, Commissioner, that you have made security a focal point, but do not let your guard down. If you do, you risk the trust of the taxpayers.

I am pleased to yield to our ranking Democrat, Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. I, too, would like to welcome Commissioner Rossotti. With less than 2 weeks before Monday, April 16th, it is timely that this Oversight Committee of Ways and Means review how the 2001 tax return filing season is progressing. Reports are that all systems are up and running and that this filing season may be one of the best ever. The commissioner is doing an excellent job in reorganizing and modernizing the IRS and should be commended for the work that he has completed already.

The tax return filing season is a huge and complicated operation. Taxpayers will file over 130 million tax returns this year, including 42 million e-filed returns. IRS employees will issue nearly 97 million tax refund checks, answer over 60 million telephone calls from taxpayers, and serve nearly 6 million taxpayers at IRS walk-in sites. Inevitably, some problems will occur, hopefully with the expert oversight and advice of those testifying before us here today, these situations can be quickly addressed. I am pleased that for the first time this Subcommittee will have the opportunity to hear from the new IRS Taxpayer Advocate, and from the Treasury Inspector General for Tax Administration. Thank you, Mr. Chairman.

[The opening statement of Mr. Coyne follows:]

Opening Statement of the Hon. William J. Coyne, M.C., Pennsylvania

With less than two weeks left before Monday, April 16th, it is timely that the Ways and Means Oversight Subcommittee review how the 2001 tax return filing season is progressing.

Reports are that all systems are up and running and that this filing season may be one of the best ever. The Commissioner is doing an excellent job in both reorganizing and modernizing the IRS and should be commended.

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Inevitably, some problems will occur. Hopefully, with the expert oversight and advice of those testifying before us today, these situations can be quickly addressed.

I am pleased that, for the first time, the Subcommittee will have the opportunity to hear from the new IRS Taxpayer Advocate and from the Treasury Inspector General for Tax Administration.

I also want to personally welcome the IRS Commissioner and the other witnesses appearing before us today.

Chairman HOUGHTON. Thank you very much, Mr. Coyne. I would just like to say that we have several new Members. They may show up at any point: Mark Foley, Sam Johnson and also Earl Pomeroy. Karen Thurman, who was not a member last time, but was in the previous Congress, will be here also. So now, Mr. Commissioner, you are on. Do want to turn that microphone on?

STATEMENT OF HON. CHARLES O. ROSSOTTI, COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. ROSSOTTI. Is that better? Last year when I came before you, I said we had a clear direction for the IRS and had taken some important steps to improve the IRS. Now, for the first time, I can tell you that we have a real plan, a strategic plan that lays out how we will build on that foundation we have laid to make the IRS everything the American public has a right to expect it to be.

On January 30, 2001, the IRS Oversight Board approved the IRS strategic plan. It follows closely the letter and spirit of the Restructuring Act and reflects the new and modernized IRS. The strategic plan shows how the IRS can dramatically improve service to taxpayers, ensure fairness and compliance with our tax laws, and moreover, meet all of these goals while continuing to shrink in size relative to the economy. The biggest challenge presented by this plan is that we have to continue to administer the world's largest and most complex tax system, while simultaneously reengineering and improving how the agency works at its most basic level.

In other words, we must operate effectively and modernize at the same time. Our entire plan is based on this dual approach: strategies to improve performance over the next 2 years, while modernizing the agency in the longer term. In connection with our mission and goals, we have developed 10 strategies and for each of these, for 2001 and 2002, have defined specific priorities and responsibilities for carrying them out. For example, in the 2001 filing season, we are demonstrating how we can build on our positive trends in both meeting taxpayer needs, one of our strategies, and broadening the use of electronic interactions, one of our other key strategies.

On the electronic front, so far this filing season, our online filing for home computers is up about 37 percent compared to last year. It has already reached a total volume of about 5 million in that category, which is what we had last year. In total, we expect to receive about 40 million returns electronically this year. There are some specific reasons for this. For example, in this filing season we have added 23 forms and schedules that can be filed electronically. Next year, in 2002, there will be 38 more, which will bring, essentially, all forms and all schedules into the electronic filing program.

I am also pleased to report that our website has received about 1.3 billion hits this fiscal year. In addition to the page hits, we have had about 103 million downloads. These are mostly forms the people get. That's almost twice as many—in fact, it is twice as many as last year—and as I like to say that is a lot of trips to the post office that people do not have to make.

We have also recently announced a new feature where taxpayers who need an extension to file of course, all taxpayers are entitled to an automatic extension till August 15th can now do that with a simple phone call, no paper, and they also get a confirmation. Another thing that we are piloting that has a lot of exciting potential for the small-business community and for practitioners, is our Internet-based system for businesses to file and pay Federal payroll taxes online. This is called EFTPS online. It allows taxpayers to enroll once in the system and then to securely make Federal tax payments, and also check their payment history over the Internet. Using this system, they will also be able to schedule future payments through the Internet, and cancel payments if necessary.

Let me also stress that during the past year we completed a comprehensive set of changes and upgrades to strengthen our security for the electronic filed returns. With respect to taxpayers who needed assistance from us during the filing season, we have made steady progress in providing telephone service, which is our single most important channel. Busy signals use to be a major problem. A few years ago there were 400 million busy signals, which is more than there are people in the United States. Busy signals have been reduced to a minimal level on the order of four percent. At least people can now get through on the line. With respect to total calls answered, we have had answered, so far this filing season, about 51 million calls through March 23rd, which is about a 14 percent total increase.

With respect to taxpayers who actually want to talk to a live customer service representative, so far this filing season, about 66 percent of taxpayers have gotten through, compared to about 62 percent last year at this time. These are all upward trends. On the other hand, certainly this level of service is not up to the long-term goal, which is comparable to perhaps 90 percent in the private sector. We still have a ways to go.

Moving to our longer-term modernization program, I think we have made progress on our three key change initiatives for modernization. In response to RRA 98, the new customer focused organization structure is in place now and largely implemented. There is a top management team, as well as a field organization in place for each of the four operating divisions and our functional units. We have also approved a set of balanced measures to measure the performance of this new organization, and most of these measures will be in place, fully deployed, through most of the organization by the end of this fiscal year.

These kinds of changes are very important in enabling us to tailor our services to taxpayer needs, as well as to focus our compliance programs where they will do the most good. For example, we recently rolled out a specialized part of our website for the small-business, self-employed community. In addition, for the large-business community, we have initiated two issue resolution programs that are reducing the amount of time it takes for large businesses to resolve tax issues with us.

The third piece of modernization has to do with business systems modernization, our technology program. This program officially kicked off almost exactly 21 months ago, and we believe that we have made solid progress, although we have to acknowledge, this is an extremely difficult program. But in three key areas we have made progress. One is developing an agencywide vision and architecture, the second is building our program management capacity, and the third is delivering on some specific initial projects.

With respect to the overall architecture, which is the road map of the future for modernizing our systems, we approved the enterprise architecture document earlier this year. Our management capability, which include such things as use of our lifecycle management methodology, has improved, although it still needs maturing.

With respect to our first two projects, we will be delivering our first two projects shortly after the filing season in the next couple of months. One is a project which will enable us to build on the progress on phone service and improve it further, and the other is some better tools for our examiners that will be examining corporate income tax returns.

Mr. Chairman, in spite of the progress that I have noted, it is clear that we are still not reaching the level in quality of service, that we think taxpayers deserve, nor, in fact, are we collecting all the taxes that are due efficiently. We have a lot to do.

I can cite some of the things that still need improvement. I mentioned the phone service. It has significantly improved, but it is still not on the level of what taxpayers receive in the private sector. Because of our antiquated computer systems, even when taxpayers do get through to us, we sometimes cannot provide them with updated information on their accounts, which in turn, results in frustration from both the taxpayer and the IRS employees who want to help them.

As a matter of fact, if I looked across all of our business processes, most of them operate too slowly or inaccurately or inefficiently. Many of our notices, which we send 100 million to taxpayers, are still confusing, and it is not just because of the writing. It is because we do not always have the right data to put on those notices.

We are on the path of achieving the goal of 80 percent electronic filing by 2007, which is a part of RRA. However, it is going to be difficult to continue at a pace rapid enough to reach this goal. Finally, with respect to our financial statements, we are very pleased we received, for the first time, a clean opinion on all of our financial statements from GAO. But, they also noted that we continue to have significant material weaknesses in our financial management, and many of those weaknesses cannot be corrected except through business systems modernization.

On the compliance side, we are also very concerned about the continued drop in audit and collection activity. I think the risks of these declines are not simply the dollar value of the taxes which are left uncollected. The greatest risk to me is that the average taxpayer, who honestly pays taxes, could lose confidence if the IRS fails to act effectively and efficiently to collect what is due from those who may not pay what they owe.

I think the effect of the decrease in examination coverage is especially important with respect to fairness. Because it is relatively easy for the IRS to verify most of the income of average, lower or a middle income taxpayers, but it is much harder, and often requires an examination, to verify the income of higher income and certainly corporate taxpayers. I think I testified earlier that the drop in this coverage was caused by several factors, one of which is the long-term decline in staffing. Other factors include the need to assign compliance staff to customer service duties during the filing season, as well as some added responsibilities imposed by RRA.

Finally, let me just note, with respect to the modernization program, and I am speaking of business systems modernization, that we are at a critical juncture. We are really starting to get into serious implementation of this program, which will require more funds. I am pleased to say that the modernization blueprint, which was outlined by the President in the budget blueprint earlier this year, did note they were going to include $397 million in investments for the ITIA fund to modernize IRS' computer systems.

In conclusion, Mr. Chairman, I think we are on the right track, but that track is long and it is going to take a lot of sustained effort to get all the way around to where our strategic plan says we need to be. With then continued support of your Committee and the other Committees of Congress, we are confident, however, that we can achieve what we set out to do in our plan and make the IRS what it needs to be for the American people. Thank you.

[The prepared statement of Commissioner Rossotti follows:]

Statement of the Hon. Charles O. Rossotti, Commissioner, Internal Revenue Service

Mr. Chairman and Distinguished Members of the Subcommittee, I am pleased to discuss the IRS' 2001 tax filing season, our FY 2002 budget request and the initiatives we are undertaking on behalf of America's taxpayers.

INTRODUCTION: A PLAN FOR TODAY AND THE FUTURE

Mr. Chairman, last year when I came before you, I said we had a clear direction and had taken some important steps to improve the IRS. Now, for the first time I can tell you that we have a real plan that lays out how we will build on the foundation we have laid to make the IRS everything the American public has a right to expect it to be.

On January 30, 2001, the IRS Oversight Board approved the IRS Strategic Plan. It follows closely the letter and spirit of the IRS Restructuring and Reform Act of 1998 (RRA 98) and reflects the new and modernized IRS. The strategic plan shows how the IRS can dramatically improve service to taxpayers and ensure fairness and compliance with our tax laws. Moreover, the Agency will meet these goals while continuing to shrink in size relative to the economy.

The greatest challenge presented by the IRS strategic plan is that we must continue to administer the world's largest and most complex tax system while simultaneously reengineering and improving how the Agency works at its most basic level. In other words, we must operate effectively and modernize at the same time.

Mr. Chairman, I want to emphasize the importance of this two-pronged, or dual approach of strategies to improve performance over the next two years while modernizing the Agency in the longer term. Let me illustrate how this approach is now working. In conjunction with our mission and goals, we developed 10 major strategies. For each of these strategies, operational priorities and improvement projects for FY 2001 and 2002 were defined and responsibilities assigned for carrying them out. Some of our major strategies include:

Meet the Needs of Taxpayers. Each year, the IRS has millions of interactions with taxpayers who need information or assistance to file their returns or pay what they owe. The taxpayer should always receive quality service from the IRS that is helpful based on his/her particular situation and need. Taken together, the fundamental changes underway in all aspects of our operations will provide taxpayers accurate and prompt information to assist them in filing, paying, and resolving issues in a time and manner convenient for them. In the short-term, we will implement this strategy through actions such as expanding phone-hours, adding more convenient locations and providing additional assistors during peak hours.

Reduce taxpayer burden. One of the themes underlying improved IRS's business practices is to shift from addressing taxpayer problems well after returns are filed to addressing them early in the process, and in fact preventing problems wherever possible. Over the next two years, we will make substantial progress to reduce taxpayer burden although much more will be possible through our longer-term business system modernization efforts. Increasing our partnerships with states and practitioners will be a major part of this strategy. In the short-term, we can make improvements, such as expanding our Voluntary Compliance Agreement Program and providing specific information over the Internet to taxpayers groups. The new IRS "Small Business Self-Employed Community" web page is an excellent example of this strategy.

Broaden the use of electronic interactions. Electronically-filed returns improve service for taxpayers and boost productivity by reducing errors, speeding refunds, and reducing labor costs. We will enhance technology to allow filing of a full range of returns, eliminate requirements for separate signature documents, tailor marketing and education programs to attract taxpayers and practitioners with varying needs, and broaden the number of payment options. Customer education and assistance programs provided through the IRS web site, such as the distribution of forms and publications and answers to tax law questions, are growing rapidly. We are making excellent short-term progress on this strategy. Examples include the elimination of paper signatures for *e*-filed returns and dramatically increasing the number of forms that can be filed electronically.

Address key areas of non-compliance. Research indicates that there are major non-compliance problem areas. These include abusive tax shelters and trusts as vehicles for managing assets and for wealth transference. Unpaid employment and withholding taxes by businesses have also increased and overpayment of refunds due to erroneous return claims is high. We will make progress in combating key areas of noncompliance over the next two years as demonstrated by our recent actions on illegal offshore trust programs. In 2002, the IRS will change its processing procedures and begin processing and matching K–1s (schedules filed by partnerships, trusts and S-corporations to provide information on income/losses distributed by business entities, to individual partners, beneficiaries and shareholders).

Stabilize traditional non-compliance areas. Regardless of how successful we are in preventing taxpayer errors, intervention through examination and collection actions and investigations is necessary when noncompliance or non-payment is found or suspected to be occurring. Since we have limited resources, it is essential that we apply these resources where they will be of most value. More focused and rapid intervention can enormously improve the effectiveness and efficiency of our activities, while improved case management tools can improve the quality and speed of cases and ensure that taxpayer rights are observed. The recent funding of the STABLE (Staffing Tax Administration for Balance and Equity) initiative is key to the IRS stemming and turning around the decline in collection and exam activities.

These major compliance improvements will require, however, a fundamental redesign of our most complex business processes. They are also very dependent on new technology from our Business Systems Modernization program (BSM). Therefore, our strategy is to stabilize and improve traditional compliance programs in the near term, while working through BSM for long-term and fundamental improvements.

Over the past year, the IRS also made steady progress on three key modernization programs. In response to RRA 98, the new customer-focused organization is currently being implemented, and a top management team is in place for each of the four Operating Divisions and functional units. We also approved balanced measures for much of the new organization and have slated approval of measure for the remaining organizational units for the current fiscal year. Both of these programs should start delivering benefits now.

The third piece of modernization, the Business Systems Modernization program (BSM) is off to an excellent start. The Enterprise Architecture plan, which is the roadmap for modernizing the Agency's business systems and supporting information technology networks, was approved earlier this year. BSM is just beginning to deliver tangible improvements; it will deliver a growing number of benefits with each succeeding year for the remainder of the decade. Each of these programs is discussed in detail later in the testimony.

Mr. Chairman, I want to stress that this dual approach will require sustained support from the Congress and the public, as the change will take time and will inevitably include setbacks along the way. It will also require investments, especially for business systems modernization, and adequate funding for current operations, such as customer service and compliance.

PROGRESS MADE: INITIAL SUCCESSES UPON WHICH TO BUILD

Mr. Chairman, I would like to discuss some of the progress the IRS has made over the past year, particularly as it relates to how we are making it easier for all taxpayers to file their returns and pay their taxes and how we are ensuring the fairness of our tax administration system.

CHECKBOX INITIATIVE

Beginning this filing season, Paid Return Preparers can use the Third Party Authorization Checkbox on all Form 1040 Series returns with the exception of TeleFile. This checkbox indicates the taxpayer's desire to allow the IRS to discuss the tax return and attachments with the preparer while the return is being processed. This provides for a significant reduction in paperwork for millions of taxpayers. It also addresses a problem with which we have been grappling for years.

Including a checkbox on the family of 1040 returns is a direct response to requests from our external stakeholders, such as the South Florida Citizen Advocacy Panel (CAP), National Society of Accountants, National Association of Tax Practitioners and National Association of Enrolled Agents.

The checkbox designation should enable practitioners quickly to resolve questions concerning the processing of the taxpayer's return. It should also reduce the number of contacts necessary to resolve processing questions and eliminate the need for the submission of paperwork for a Power of Attorney, which is not required to resolve simple problems with a taxpayer's account. Our initiative also addresses the practitioner groups' concern that this designee not be afforded post-assessment correspondence or representation.

Mr. Chairman, the IRS calculates that taxpayers will save an estimated 75,000 hours initially by not having to prepare a third party authorization disclosure form (Form 8821). Additional time will be saved because processing issues will be resolved immediately, thereby eliminating unnecessary post-filing contacts. However, we recognize that the net burden reduction, as currently calculated, will be somewhat smaller because there will be an increase in burden for reading and understanding Forms 1040 instructions for the new checkbox authority.

We further expect over a million taxpayers to use the checkbox feature in lieu of filing Form 2848 (Power of Attorney and Declaration of Representative). Therefore, taxpayers will save an estimated 1.9 million hours initially by not having to prepare Form 2848. Once again, the net burden reduction will be less because we must assume there will be an increase in the burden for reading Forms 1040 instructions and understanding the new checkbox authority.

The burden reduction that will result from the checkbox initiative is even greater when one considers the 8 million notices related to math errors and return preparation that were issued in 2000. Twenty-seven percent of these notices were related to returns prepared by paid preparers. The IRS estimates that taxpayers will save approximately 779 thousand hours by referring notices to their designees rather than responding to the IRS in writing or by telephone. Similarly, we estimate that taxpayers will save more than a million hours related to correspondence by allowing IRS to resolve issues by contacting their designees.

REDESIGNED NOTICES

As part of its continued effort to improve its correspondence to taxpayers, the IRS began sending out six redesigned notices, including those dealing with math errors, balance due, overpayments and offsets. The new notices should: (1) reduce the number of times taxpayers need to contact the IRS; (2) be easier to understand; and (3) facilitate resolution of inquiries. The combined yearly volume of these six notices is about 10.5 million.

Following RRA 98's directions, the new notices also contain more information, including: (1) the formula for how the IRS computes the penalty or interest; (2) the section of law from which the penalty or interest is based; and (3) a table that details account information under each penalty or interest section to specific periods that the charges apply. Members of the Citizen's Advocacy Panel reviewed the notices before we released them in October 2000.

Despite extensive testing, some of the first notices sent out were missing information. The IRS has since corrected errors in the programming for these notices and mailed explanations to taxpayers as appropriate.

We are continuing our redesign efforts on 23 additional notices. We plan to release four of the notices in 2002 and the remaining 19 in 2003.

CHANGE OF ADDRESS

Due to a licensing agreement between the IRS and the U.S. Postal Service, taxpayers who move after filing their tax returns should receive future correspondence from the IRS on a more timely basis.

Under this arrangement, the IRS will use the Postal Service's National Change of Address (NCOA) database to update the addresses in its own Master File of taxpayer data. This address updating process should also provide quicker resolution of undelivered refund problems.

The IRS will check the names and old addresses in the NCOA weekly update files against the names and addresses in the IRS database. Where there is an exact match, the IRS will update its file with the taxpayer's new address. According to the Postal Service, there are about 800,000 address changes each week.

In addition to helping IRS get refunds to taxpayers, this new program will permit the IRS to make earlier contacts with them to resolve issues such as delivery of a returned refund, possible unreported income, examination of a return, or collection of unpaid tax. The delay in delivery that can result from a letter going to an old address, then being forwarded, may cause a taxpayer's reply and a subsequent IRS letter to cross in the mail. Unraveling such situations can be time-consuming and frustrating for both the taxpayer and the IRS.

STABILIZATION OF COMPLIANCE ACTIVITIES

Earlier this year, Congress approved the staffing plan for the STABLE (Staffing Tax Administration for Balance and Equity) initiative. The funding was included in the Fiscal 2001 Appropriations bills.

The STABLE staffing plan reflects the new modernized IRS and represents a careful judgment as to how these additional resources, together with our internal management improvements, can best be used to improve our service to taxpayers and compliance effectiveness.

The two principles that guided the budget request were, first, allocate incremental resources directly to staffing front line positions. Second, these additional resources will provide a balanced improvement between service and compliance programs. With the increased staffing levels, we expect the IRS to be able to slightly increase levels of service and to stabilize the level of exam and collection activity while complying with the taxpayer rights provisions of the RRA.

Our overarching goal is to achieve the greatest possible improvements in both taxpayer service and compliance efforts by determining how best to use the STABLE resources in conjunction with the base FY 2001 budget request. We believe that STABLE achieves this goal.

In our reorganization effort over the last two years, we have carefully studied the use of nearly every position in the IRS. One of the key findings in this analysis is that the use of compliance personnel such as revenue agents and revenue officers on "details" to taxpayer service duties during the filing season is not efficient. This practice, while necessary as a short term solution to inadequate service, takes highly trained and high graded personnel away from important exam and collection casework during a substantial part of the year, causing reduced levels of productivity and delays in completing cases.

Another key finding of the study is that the IRS provided very minimal levels of activity in assisting taxpayers to understand their tax obligations and avoid mistakes in filing, especially in the small business areas. Many stakeholders groups have stressed that this problem causes errors later in the process, which are expensive for both taxpayers and the IRS.

In our new structure, instead of increasing the number of expensive and scarce compliance personnel, we have provided for additional positions in taxpayer service and education. A significant portion of the STABLE resources will be used to fill these positions. By hiring staff to perform these service and educational functions, we can avoid the need to use more expensive compliance personnel on details during the filing season, thus allowing us to accomplish two objectives efficiently: increase our level of taxpayer education and taxpayer service and increase the number of staff years actually applied to exam and collection casework.

With this approach to the STABLE staffing, together with our reorganization and technology improvements, we expect to show measurable improvements in our key programs in FY 2001. Because of the time required to hire and train people, we will not achieve the full impact until FY 2002. Some of the improvements we expect in key areas in FY 2001 are:

- Increase the level of service on our toll free telephone service from approximately 59.1 percent in FY 2000 to approximately 63.4 percent in FY 2001, while also improving our quality measures.
- Reverse the downtrend of the last five years in compliance, increasing the number of overdue accounts closed by our telephone and field collectors by 8.6 percent.
- Increasing the number of exams of individuals conducted in person by about 6.2 percent, while also improving quality.

In examination, we will focus on the areas with the greatest risk of underreporting of income. For example, the number of exams of higher income individuals and corporations will increase more rapidly than the average.

This additional staffing will allow us more quickly to resolve innocent spouse claims, offers in compromise cases and collection due process cases we completed—key taxpayer rights included in RRA 98. We will also increase our commitment to pre-filing assistance to taxpayers through communication and education programs and pre-filing agreement programs. These areas are of particular importance and concern for the small business community.

Targeting Our Resources

We must promote fairness by combating key areas of non-compliance. To this end, the IRS must apply its limited resources where they will be of the most value. Some of the special problem compliance areas include: underreporting, non-filing and abuse of trusts and passthroughs; abusive corporate tax shelters; accumulations of unpaid trust fund taxes; and erroneous refund claims.

Abusive corporate tax shelters continue to be an important compliance initiative for the IRS. From the information that IRS and Treasury receives from a variety of internal and external sources, we know that there are a significant number of transactions that have no legitimate business or economic purpose other than reducing taxes.

These abusive corporate tax shelters could seriously undermine the tax system if all corporations believe they must engage in these transactions to keep up with the competition.

We have a coordinated effort with Treasury to deal with this problem and our Office of Tax Shelter Analysis (OTSA) plays an important role in it. The IRS does not want to impede normal tax planning, and through the OTSA, we have available a means to separate the real problems from quite legitimate transactions. In addition, a "Tax Shelter Hotline" and our commitment to issue more guidance in this area will help us respond to abusive transactions on a more timely basis.

Promoters of abusive tax shelters are also using offshore tax entities in their tax schemes to unlawfully reduce or eliminate taxes. Last month, in the largest IRS enforcement action ever taken, law enforcement authorities in multiple states executed over three dozen search warrants and made four arrests as part of a series of investigations of alleged illegal offshore trust programs involving the diversion of millions of dollars of income for hundreds of clients.

I want once again to express my appreciation for the fine work done by our Criminal Investigation Division, the United States Attorneys offices in Boston and San Francisco, the Tax Division of the Department of Justice, and the Costa Rican law enforcement authorities. Last week's historic enforcement activities send an unmistakable signal about IRS' commitment to pursue investigations of promoters and their clients who would try to move money off-shore to evade taxes.

It further represents the IRS' continuing efforts to combat tax compliance problems caused by those who promote and participate in the use of trusts and offshore schemes designed to evade U.S. taxes.

Frauds Alerts: Buyer Beware

In February 2001, The Internal Revenue Service issued a nationwide alert to taxpayers, warning them not to fall victim to a number of tax scams that are being promoted. These schemes take several shapes, ranging from promises of special tax refunds to illegal ways of "untaxing" yourself. Taxpayers were told that they could report suspected tax fraud to the IRS by calling 1–800–829–0433.

One of these illegal tax schemes involves telling employers that they do not have to withhold federal income tax or employment taxes from the wages paid to their employees. Using a bogus interpretation of the Tax Code, the con artists are selling the unsuspecting and the unscrupulous a phony and illegal scheme that in the long run will cost these employers a huge tax bill that can include stiff penalties and jail time.

In addition to this warning, the IRS devoted a special consumer alert to this problem. We told working men and women that if they have concerns that their employer is failing to withhold these taxes to call our toll-free number at 1–800–829–1040. We are also asking our stakeholder groups to help us get the word out about this problem.

Taxpayers can get more information on how the IRS is combating this bogus withholding scheme by going to our web site at www.irs and clicking on the "Small Business and Self Employed Community" page. From there, taxpayers can click on "tax schemes" and get all the necessary information. Taxpayers can also link to the IRS' Criminal Investigation home page and get a very detailed description of its employment tax enforcement program, including a breakdown of cases and a number of significant convictions of those who thought they could get away with evading their tax responsibilities.

I want to stress that IRS Criminal Investigation works closely with all parts of the Agency to investigate and refer for prosecution individuals and companies who have willfully failed to file or pay employment taxes. In the past three years, 127 individuals were sent to federal prison, a halfway house or home detention on employment tax issues. Nearly 86 percent of those sentenced for evading employment taxes served an average of 17 months in confinement and were ordered to make restitution to the government for the taxes evaded plus interest and penalties.

Revenue Protection Strategy

The IRS revenue protection efforts in 2001 will again identify and look at certain tax returns before issuing refunds. In addition to identifying questionable refunds, the IRS will continue its emphasis on improving compliance with the Earned Income Tax Credit (EITC) provisions of the Internal Revenue Code, including the use of our dependent database to identify questionable issues relating to incorrect claims on dependent exemptions, filing status and EITC credits.

The Earned Income Tax Credit Preparer Outreach Program will also continue. As part of this program, IRS revenue agents will visit tax professionals nationwide prior to January 2001, to provide individual assistance and to answer any questions about EITC. Some of the visits will also include a review of files to determine if due diligence requirements for the preparation of EITC have been met.

2001 FILING SEASON

The IRS is delivering a very successful filing season as it continues to meet the mandates that Congress set forth in RRA 98 and the challenges of modernization.

By continually managing this change and risk in an orderly and integrated fashion, I am pleased to report that as we approach the home stretch, the 2001 tax filing season has been smooth and almost error free. The 2001 filing season continues to demonstrate how we can build on positive trends in service to taxpayers, especially as our major technology and organizational initiatives take effect.

Projected net collections for FY 2001 will exceed the $1.9 trillion collected last year. During FY 2001, we also project to receive 215.4 million returns, including over 130.3 million individual returns, and expect to issue over 96.8 million individual refunds. As of March 9, 2001, the average dollar amount per refund is up over 5 percent over last year, and the average refund is $1,823.

Electronic Tax Administration

Mr. Chairman, RRA 98 mandated that at least 80 percent of returns be filed electronically by 2007. Reaching this and the other Electronic Tax Administration (ETA) goals is an enormous challenge, but well worth the effort.

The IRS' overarching goal is to conduct most of its internal and external transactions by electronic means. To meet this objective, we must make it not only technologically possible, but also attractive to the public to make a permanent change from paper to electronic means. Indeed, a robust ETA system helps form the foundation of a modernized IRS. It is key to easing taxpayer burden and can provide multiple benefits to taxpayers, practitioners and our tax administration system.

Let me also stress that during the past year, the IRS completed a sweeping set of changes and upgrades to add an extra layer of protection for the millions of taxpayers using the *e*-file program. We have strengthened our system's security and we will remain vigilant to keep our *e*-filing processes the safest possible.

The 2001 filing season statistics continue to demonstrate that an increasing number of taxpayers are taking the advantage of these initiatives and filing taxes electronically. Through March 15, 2001, over 29.3 million individual taxpayers filed using one of the three *e-file* options*;* a 10 percent increase over the same period last year.

• Nearly 21.7 million taxpayers *e-filed* their returns electronically through an IRS-authorized Electronic Return Originator (ERO), an 11.2 percent increase over the same period last year.

• Approximately 4.2 million taxpayers filed their tax returns on-line via their home computer through a third party transmitter, On-line filing is running 37 percent ahead of last year and as of March 15, is already approaching the 2000 total volume of 5 million.

• Almost 3.5 million taxpayers filed their returns over the telephone using the award wining TeleFile system. Oklahoma and Georgia joined Kentucky and Indiana in the Federal/State TeleFile option.

• Overall, 11 million taxpayers chose to file both their federal and state tax returns simultaneously in a single electronic transmission. This year, 35 states and the District of Columbia are participating in the program.

Mr. Chairman, let me also note that paper and electronic return preparation and filing are also offered through IRS local offices as well as Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites. Taxpayers who cannot afford either to pay a professional tax preparer or buy a personal computer and tax software may also go to local IRS offices to have their returns prepared. The tax software we use in our offices is competitively procured in the open market. Through this method, the IRS both electronically prepares and files simpler returns for lower-income taxpayers at their request.

New in ETA for the 2001 Filing Season

In order to improve our ETA program and ease taxpayer burden, the IRS listened to taxpayers, industry and practitioners. We heard that we must make electronic filing more attractive and remove barriers. Let me briefly discuss our efforts this filing season to meet these concerns.

First, the IRS is working to address the frustration that taxpayers and practitioners experience when they find they cannot file some forms electronically. For the 2001 filing season, we added 23 additional forms to the 1040-*e-file* program. These include Form 2106–EZ for un-reimbursed employee business expenses; the Form 2688 application for additional extension of time to file; and Form 8379 for injured spouse claims.

We plan to roll out the remaining 38 forms and schedules for the 2002 filing season. This means we will open *e-file* eligibility to 99.1 percent of all taxpayers, potentially adding 3.8 million new *e-filers* to the growing rolls. Equally important, it means that preparers will be able to go essentially 100 percent electronic for all of their customers by 2002.

Second, the IRS is making electronic filing paperless by eliminating the requirement for a separate paper document with the *e-file* return. In 2000, the IRS successfully tested the use of a Personal Identification Number (PIN) code as the taxpayer's signature, eliminating the need to file the paper*jurat*. This year's program extended the option to taxpayers nationwide, with some exceptions, and permits them to select a PIN, and then file electronically without any paper. So far, 4 million taxpayers have chosen this option.

Third, this filing season, more electronic payments options have been made available to taxpayers, such as accepting debit payments through TeleFile and accepting credit cards for Forms 1040ES, estimated tax payments, and Forms 4868, extensions of time to file. As of March 10th, 22,718 payments averaging $3,177 were made via credit card and another 24,064 payments averaging $1,026 were made by Automated Clearing House (ACH) Direct Debit where taxpayers can authorize either their checking or savings account to be debited.

Fourth, our e-Services project under BSM will help us conduct most transactions with taxpayers and their representatives in an electronic format. By 2002, the e-Services' goals are to: (1) provide the capability to register new electronic return originators over the Internet; (2) permit delivery of transcripts to authorized parties electronically; and (3) allow third parties who are required to provide certain forms 1099 and information returns to check the taxpayer identification numbers for accuracy before submission.

Fifth, contributing to this year's successful *e*-filing season is IRS' new marketing campaign, "40 Million People Already Know *e-file* is the Way to Go." In conjunction with its advertising agency, and as authorized by RRA 98, the IRS developed a fully integrated campaign with TV, radio and print advertising. As the *e-file* program matures, our data- and market-driven marketing campaign is shifting away from merely promoting awareness of *e-file* to emphasizing its value, such as saving taxpayers time.

ETA Also Easing Business Taxpayer Burden in 2001

A strong ETA program must embrace the needs and expectations of all taxpayers, including business taxpayers. In 2001, the IRS continues to make progress serving the electronic tax administration needs of this important sector.

For example, beginning last April, employers could file their Form 941 on line, saving time and paperwork. And for the first time, companies and payroll service provider will be able to file both the Quarterly 941 and Annual 940 (*Employer's Annual Federal Unemployment Tax Record*) electronically. A direct debit payment was also made available through Form 941 TeleFile

Another major ETA initiative eases the information-reporting burden for employers. Providers of certain information statements, including W–2s, now have the option of giving taxpayers the information electronically, instead of on paper.

These new rules were a direct response to requests we received from lenders, educational institutions, employers and stakeholders who wanted the option to deliver these statements in an electronic format. Under the new option, providers will save the cost of processing, printing and mailing paper statements. And recipients will receive the information faster and more efficiently without the worry of mailing delays or lost statements.

The Electronic Federal Tax Payment System (EFTPS) also continues to be a runaway success. In 2000, EFTPS topped all of its 1999 numbers for new enrollments, dollars and transactions. It processed more than 63 million federal tax payments—a 14 percent increase over the previous year year. And EFTPS also received a staggering $1.5 trillion—a 15 percent increase over the previous year. Payroll companies, tax practitioners and financial institutions have been instrumental in helping us grow this program and the use of electronic payments.

Why has EFTPS been so successful? Over the years, EFTPS has delivered a high level of service and accuracy. It consistently exceeds industry standards, and delivers a 99.9 percent accuracy rate for payments appropriately applied.

We developed the system with a focus on being able to handle significant volume with accuracy, integrating checks and balances to make sure information is correct and verified at each step of the process. EFTPS delivers a level of precision that can be compared to stringent banking and financial transaction standards for accuracy.

This year, we are conducting an exciting new pilot program to test our new Internet-based application for businesses to pay federal taxes on line. This new feature, EFTPS–OnLine, allows businesses to enroll in the system, securely make federal tax payments and check their electronic payment history over the Internet. Using EFTPS–OnLine, businesses will be able to schedule future payments through the Internet and cancel payments if necessary. They will also have access to on-line help and "how-to" pages with step-by-step instructions.

One of our primary EFTPS priorities is security and it continues with our new Internet feature. EFTPS–OnLine uses the strongest available security and encryption technology to ensure taxpayer privacy and protection. After evaluating the pilot results, we plan to make EFTPS–OnLine available to all business taxpayers and to individuals taxpayers who are required to make estimated quarterly payments.

There are currently more than 3 million taxpayers enrolled in EFTPS and with the addition of the new Internet feature, we expect that number to continue to grow.

Web-Based Help

The Internet continues to offer exciting new opportunities for easing taxpayer burden and improving service. The IRS web site, the *Digital Daily (www.irs.gov)*, has already received almost 1.3 billion hits this fiscal year. According to the "Lycos 50", since almost the beginning of the year, the IRS has consistently ranked among the top 10 user searches. As of March 21, 2000, it came in as Number 6.

Anyone with Internet access can receive: tax forms, instructions, and publications; the latest tax information and tax law changes; tax tables and rate schedules; and hypertext versions of all taxpayer information publications, including the very popular Publication 17, "Your Federal Income Tax"; all TeleTax topics; answers to the most frequently asked tax questions; a library of tax regulations; and the weekly Internal Revenue Bulletin that contains all the latest revenue rulings, revenue procedures, notices, announcements, proposed regulations and final regulations. However, to ensure that taxpayer privacy is protected, our web site will not provide or receive individual taxpayer data until adequate safeguards are in place.

Since coming on line in January 1996, taxpayers have downloaded over 412.9 million forms, publications and products. Through February 2001, there have been over 103 million downloads as compared to 51.5 million for the same period in 2000—an increase of almost 100 percent.

The IRS web site also has a W–4 Calculator in its "Tax Info for You" section. In addition, the expanded use of online customer service technologies provides greater taxpayer access to IRS' help while on the *Digital Daily*.

Earlier this year, the IRS launched its new user-friendly "Small Business and Self-Employed Community" web page that can be accessed from our web site. It was developed by our Small Business/Self-Employed Operating Division specifically to benefit the millions of small business owners, the self-employed and start-up businesses who often confront more complex tax issues than taxpayers who have their taxes withheld by an employer.

This convenient "one-stop shopping" for assistance can provide most, if not all, of the immediate products and services that a small businessperson needs, such as a section on common problems, a calendar of important tax deadlines, helpful tax hints, forms and publications and a direct link to stakeholder sites, such as the National Association of Home Builders and the National Restaurant Association.

I mention these two associations because for the first time ever, the IRS is providing industry-specific tax information for the construction and restaurant industries. For example, if a food server wants to know the deadline for reporting tips, he or she can go to our site and in two clicks, learn that Form 4070 should be filled out and turned into the employer by February 12th.

In the near future, we will add more of these targeted areas to the web site, such as for the automotive and oil and gas industries. We will also add a Smart Q&A Wizard that will make it easier for taxpayers to search our growing database of frequently asked questions and get the information they need.

The IRS web site will continue to evolve and improve in design, content and features. The biggest leap in the future will be from its current state as an information source to include a transactional-based portal.

CD–ROMs

The Federal Tax Forms CD–ROM contains more than 600 tax forms and instructions for the current tax year, an archive of forms and instructions dating back to 1992 and some 3,000 pages of topic-oriented tax information. Users can electronically search, view-on-screen, or print any of the items contained on the CDs. The two-issue subscription is conveniently available through the *Digital Daily* for $21. If ordered by fax, mail, or telephone, the cost is $26 (includes postage and handling).

In conjunction with the Small Business Administration, the IRS also produced the latest edition of the joint small business CD–ROM, "Small Business Resource Guide: What You Need to Know About Taxes and Other Topics." It has consistently received highly favorable reviews from small businesses and external stakeholders. The Year 2001 version of the CD–ROM is being made available free of charge, one-per-customer, by calling our toll-free number at 1–800–TAX–FORM. It can also be ordered on the IRS web site.

The CD–ROM provides an array of helpful information for business operators, including actions to take before going into business and tax filing and reporting responsibilities when starting, expanding, closing and selling a business. In addition, it includes all of the business tax forms, publications and instructions for *e-filing*. The CD–ROM also allows users with Internet access to link to other helpful federal and state web sites.

Telephone Assistance

Throughout the 2001 filing season, the IRS will provide telephone assistance 24 hours a day/7 days a week at 1–800–829–1040. After April 16, we continue to offer around-the-clock service for refund and account callers, and service will be available for tax law assistance Monday through Saturday from 7:00 AM until 11 PM.

For the filing season through March 9, approximately 65 percent of the taxpayers who wanted to talk to a customer service representative got through, compared to 61.7 percent last year at this time. In addition, 10.5 million of taxpayers used our automated services to get information such as refund status, an increase of 132 percent since last year, and the trend has been upward. In the last four weeks, the level of service averaged 68.9 percent. The upward trend in phone service is encouraging and shows that our investments in training, management and technology are beginning to pay dividends. However, I concur with Treasury Secretary O'Neill's characterization of IRS's current level of phone service as "unacceptable." We still have along way to go before we can be satisfied with the quality of our phone service.

The IRS will continue to implement many process and systems enhancements to improve both the convenience and the quality of telephone communications. These changes are major, affecting approximately 14,000–15,000 employees in more than 20 locations around the country. With the benefit of new call routing technology and new software planning tools, we are realigning the work assignments and training of many of these assistors so that the employees will have the right specialized training and knowledge to answer taxpayers inquiries efficiently and accurately. We will make increasing use of the technology to direct taxpayer call more accurately to the right assistor, and enable taxpayers in many cases to make uses of "self-service" applications, either through the phone or the Internet.

As these changes take place, the average complexity of calls answered by the Customer Service Representatives (CSRs) will continue to increase as: more of the simpler calls are routed to automated services; alternative language services are expanded; and CSRs handle topics previously referred to compliance personnel.

During FY 2001, the IRS will introduce and test a new series of measures consistent with industry standards to improve monitoring of the delivery of the service experience and utilization of resources. The current measurement system will be maintained concurrent with this new effort through 2002 to allow IRS to solicit external expertise to validate and assess the new measures and develop an implementation plan. IRS will solicit external expertise to validate and assess the new measures and develop an implementation plan.

Earlier this year, the IRS also inaugurated its San Patricio, Puerto Rico call site. Now that the center is fully operational, it will be able to take the majority of the Spanish-speaking traffic. Our Spanish-speaking customer service representatives in the States will still play a critical role, but creating this center will allow us to make the best use of all of our bilingual assistors. By staffing this call site, we have made real progress in reducing the current deficit of Spanish speaking customer service representatives..

Forms By Fax and Phone

Taxpayers can receive more than 150 frequently used tax forms 7 days a week, 24-hours-a-day from IRS TaxFax. Taxpayers can request up to three items per-call. Taxpayers use their fax machine to dial the service at 703–368–9694. The only cost to the taxpayer is the cost of the call. Taxpayers can also request forms and publications by calling 1–800–TAX–FORM.

Recorded Tax Information

TeleTax has 148 topics available 24 hours a day using a Touch-tone phone. Taxpayers can call (toll-free) 1–800–829–4477 to hear recorded information on tax subjects such as earned income credit, child care/elderly credit, and dependents or other topics, such as electronic filing, which form to use, or what to do if you cannot pay your taxes. As of March 9, 2001, over 2.6 million have taken advantage of the service so far this filing season. Nearly 2.97 million taxpayers used TeleTax for the comparable period last year.

Automated Refund Information

In FY 2000, more than 13.79 million taxpayers used the Automated Refund Information system on TeleTax to check on the issuance of their refund checks. As of March 9, 2001, the number stands at over 23.8 million—up 73 percent from last year. Taxpayers may call 1–800–829–4477 to check on their refund status Monday through Friday from 7 AM to 11:00 PM if using a touch-tone phone, or 7:30 AM to 5:30 PM for rotary or pulse service.

Taxpayer Assistance Centers

While many taxpayers prefer to use the telephone and the Internet to communicate with the IRS, our modernization studies and experience with the highly successful "Problem Solving Days" showed that some taxpayers need to meet in person with IRS representatives to get the assistance they need.

For those taxpayers who prefer to visit an IRS office, walk-in service is available at more than 400 locations nationwide. At many sites, walk-in service will be offered on 12 Saturdays between January 27 and April 14. So far this filing season, we have served over 3.37 million taxpayers at all Taxpayer Assistance Centers—a 4.54 percent decrease from last year.

The Saturday Service sites were selected based on their weekend accessibility, year-round operational status, and high traffic volume. They include non-traditional locations, such as shopping malls, community centers and post offices.

With the help of the additional personnel provided for by the STABLE initiative, we are broadening the services available in our local offices so that taxpayers who wish to come in person will be able to resolve most tax account issues. We have defined a new job category called Tax Resolution Representatives. These employees will have the training and authority to provide "one-stop service" for a broad range of issues ranging from answering tax questions to resolving payment problems.

We also believe that by energizing the VITA return preparation program and co-locating these activities at the Taxpayer Assistance Centers, the IRS will be able to focus on simple account and collection issues. In 2001, the Stakeholder Partnership, Education and Communications (SPEC) branch of our Wage and Investment Operating Division will work with more than 17,000 volunteer sites across the country to assist an estimated 4.6 million taxpayers. We will also work to better track the impact and benefits of the volunteer program.

SERIOUS CHALLENGES REMAIN

Mr. Chairman, in spite of the progress the IRS has made since the enactment of RRA 98, it is clear that we are still not providing the level and quality of service that taxpayers deserve, nor are we collecting the taxes due efficiently.

As previously discussed, the level of phone service—while improving—is still unacceptable and not on a level with what taxpayers receive in the private sector. We cannot provide taxpayers with up-to-date information on their accounts, resulting in enormous frustration for both taxpayers and the IRS employees who want to help them. In fact, nearly all of our business processes operate too slowly, inaccurately and inefficiently. Many of our notices are still confusing and poorly written. Achieving the 80 percent electronic filing goal by 2007 will be very difficult.

The IRS is also deeply concerned about the continued drop in audit and collection activity. In fact, the GAO testified before the Senate Finance Committee in February 2000 that the current level of IRS enforcement activity is too low. Clearly, the declines we have witnessed in the past few years must stop or the fairness and effectiveness of our tax system will be undermined. The risks of these declines are not simply the dollar value of the taxes left uncollected. The greatest risk is that the average taxpayer who honestly pays taxes loses confidence if the IRS fails to act effectively and efficiently to collect from those who do not pay what they owe.

To help address these problems, the President's budget includes follow-on funding for the STABLE initiative, begun earlier this year. These funds will complete the hiring of almost 4,000 staff and will enable the IRS to address the declines in audits and the drop in customer service that have occurred over the past several years.

Mr. Chairman, the drop in exam and collection activity in FY 2000 was caused by several factors, including the long-term decline in staffing, the need to assign compliance staff to customer service duties during the filing season, and added RRA 98 responsibilities.

Between FY 1992 and 2000, the Agency's workforce fell by 17 percent while the number of tax returns filed (including supplemental documents, such as Forms 1040X, 4868, 2688, 1120X and 7004) increased 13 percent to 230 million. RRA 98 also created very significant additional resource demands on the IRS Exam and Collection staffs. Expanded programs, such as the innocent spouse provisions, offers in compromise and due process in collection required more that 4,200 IRS staff annually for administration. Other provisions, such as the requirements for notifications of third parties, tacked on more time to complete each exam and collection case. More than 30 additional steps have been added to the completion of an exam.

RRA 98 also had some very profound indirect impacts on IRS operations. Two provisions, in particular, have greatly affected the time required to conduct many activities. They are: Section 1203, commonly known as the "ten deadly sins" provision, and Section 1204, which broadly prohibited use of enforcement statistics in setting goals or making personnel evaluations at any level in the IRS.

Section 1203 caused a great deal of concern, caution, and hesitation among front-line employees and their managers with respect to taking enforcement action. And Section 1204, prohibiting use of enforcement statistics, caused a great deal of confusion and hesitation among managers to use any quantitative data to evaluate operations or to direct employees with respect to matters of time and efficiency. The effect of Section 1204 has been magnified by the extensive number of investigations and disciplinary actions of managers that was undertaken in 1998 and 1999 for misuse of statistics. In addition, uncertainty over the reorganization, which flattened the organization and eliminated management layers, caused some temporary loss of focus. The effect of all these factors was to increase the time it takes to complete cases, reducing the number of cases completed per FTE by 20 to 30 percent.

In its March 2001 financial audit of the IRS' Fiscal Year 2000 Financial Statements, the GAO pointed out the continued problem with the IRS' management of unpaid tax assessments. The GAO found that the IRS' "inability to actively pursue significant amounts in outstanding taxes owed to the federal government continue to hinder IRS's ability to effectively manage unpaid assessments."

The GAO report pointed to a much larger and fundamental weakness that threatens the IRS' mission: the pressing need to overhaul IRS' systems and processes. The IRS core data systems that record taxpayers' tax accounts are fundamentally deficient. The IRS will never be able to perform its mission without replacing these systems. The solution to these problems is not simply to do more of everything in the way it has always been done. Instead the solution is to modernize the IRS to do things more efficiently and effectively.

Replacing virtually the entire technology infrastructure in the next 10 years, while also delivering short-term service improvements demanded by taxpayers, employees, and the Congress, remains an enormous challenge fraught with risk. But we have no choice; we must move ahead for the good of America's taxpayers and the good of our Nation. The President's budget includes close to $400 million in investments to modernize the IRS' outdated computer systems. This multi-year project will provide the IRS with the modern tools needed both to deliver first class customer service to America's taxpayers and to ensure that compliance programs are administered efficiently.

Mr. Chairman, there have also been some questions as to whether the "audit rate" as publicly reported by the IRS understates the ability of the IRS to verify the accuracy of individual tax returns. Simply focusing on the audit rate does substantially understate the IRS' capacity to find errors in returns, especially in certain kinds of returns. In my many press interviews in the past few years in which this topic has come up, I have consistently made this point, often citing our computer matching program as an example of a technique that the IRS uses in addition to traditional audits.

With the use of document matching and other return verification techniques for more that will eventually be enabled by new technology, it is my view that there is no need to return to the levels of individual audit coverage that existed even five years ago, which was three times the FY 2000 level. The IRS strategic plan and budget proposals as presented to the IRS Oversight Board do not call for this approach. However, our strategic plan sets forth an approach in the short run to stabilize our level of traditional compliance activities, such as individual audits, at or slightly above current levels and to focus them on the areas where they are most required. In the long run, we will rely on our business systems modernization program to increase the effectiveness and efficiency of these activities.

The IRS has for many years relied on a range of techniques to verify certain items on tax returns. Each of these techniques is appropriate for particular classes or types of potential errors. With respect to Information Returns Processing, or document matching as it has often been called, this technique is very effective for verifying income items reported by third parties, including wages, interest, dividends and miscellaneous payments. It can also be used to verify gross sales of assets, but cannot be used to verify the gain or loss on such sales since we have no third-party reporting on the cost basis of assets. It is also of limited value in verifying some deductions, such as mortgage interest.

Document matching is not useful for verifying business income, gain or loss on asset sales, or most itemized deductions. We estimate that the total personal income that cannot be verified by document matching represented about $1.2 trillion in FY 1998, or 19.7% of total reported personal income. An important role of audits is to verify these major categories of income and deductions.

The significance of verifying income and deduction items through audits is illustrated by the fact that the average in-person audit of an individual return results in an assessment of approximately $9,540, while the average assessment from a document matching case is $1,506. In FY 2000, the IRS closed 277,212 in-person audits of individual returns and assessed $2.4 billion from this program; in the document matching program in FY 2000, the IRS closed 1,353,545 cases and assessed $2.1 billion.

With respect the question of why document matching cases are not considered audits, the technical reason is that Section 7605(b) of the tax code generally limits the ability of the IRS to require a taxpayer to submit books and records for inspection by the IRS more than once. Since document matching cases do not require the taxpayer to submit books and records to the IRS, a document matching case does not preclude a subsequent audit. Revenue Procedure 94–68 specifically defines IRS taxpayer contacts, including document matching, which are not considered audits for the purpose of Section 7605(c). More generally, it is my understanding that some years ago the IRS proposed to change the definition of an audit to permit inclusion of the document matching cases in the overall reported number of audits and this proposal was criticized as possibly inflating IRS's statistics.

Notwithstanding these previous issues, all of IRS statistics, including the number of document matching cases, are publicly reported and it is our goal to make these reports as informative and meaningful as possible.

TURNING THE CORNER

Although overcoming these weaknesses is an enormous challenge, the IRS has achieved the first modernization milestones. If we continue to build on these initial successes, taxpayers and our tax administration system can begin to realize the benefits of modernization.

ORGANIZATIONAL MODERNIZATION

Following RRA 98's directions, the IRS designed and has made substantial progress in implementing a new organizational structure. It closely resembles the private sector model of organizing around customers with similar needs. The IRS created four customer-focused operating divisions to best serve taxpayers: Wage and Investment, Small Business and Self-Employed, Large and Mid-Size Business, and Tax Exempt and Government Entities. There are also a number of functional units, including Appeals, the Taxpayer Advocate Service, Criminal Investigation, and Communication and Liaison.

The modernized IRS organization was officially inaugurated, or "stood up", on October 1, 2000 and a top management team is in place for each of the operating divisions and business units. However, many challenges and much hard work remain as the different parts of the new organization are staffed and trained. The final stages of implementation, including the redistribution of workload, will require another two years through FY 2002.

In the short-term, the reorganization should be largely invisible to taxpayers and tax practitioners. In the long-term, they will see the positive changes that modernization is intended to produce. The new organization will place a greater emphasis on pre-filing services and early resolution of complex issues. More resources will be devoted to pre-filing activities, such as education and outreach to help taxpayers comply with the tax law and get their tax returns right the first time. Post-filing activities will be geared to problem prevention with targeted enforcement activities for non-compliance. Most importantly, the focus and clear assignment of responsibility will result in faster action to fix problems and improve the way that business is done.

BUSINESS SYSTEMS MODERNIZATION PROGRAM

The Problem

For an organization so critically dependent on technology, IRS' systems are woefully obsolete and inefficient. The facts cannot be disputed. The IRS is saddled with a collection of computer systems developed over a 35-year period. The most important systems that maintain all taxpayer records were developed in the 1960s and 1970s.

In an age of faster and more powerful computers, taxpayers are shocked to hear that their most important personal financial data is stored and updated once a week on magnetic tape. Our jury-rigged system of computers poses other problems. As *Money Magazine* observed in its April 2001 edition, "overlaying new software onto old has created a hodge-podge of data bases, many of which do not talk to one another. Until our consolidation as part of the Y2K program, there were 147 mainframes and 8,700 software products."

The effect of this obsolete technology on service to taxpayers and productivity also cannot be disputed. As compared to what the private sector can offer, the IRS' services are wholly unsatisfactory.

Many credit card companies and banks provide their customers with real-time account information; their phone representatives can often make adjustments on the spot. However, due to our archaic technology, IRS employees often do not have access to current taxpayer account information. Adjustments to a taxpayer's account may not take effect for up to 16 days because of delays in updating files and data among different systems cannot be synchronized. Payments and notices cross in the mail, often generating more notices and frustration.

Indeed, the IRS has only a 40 percent rate for correctly resolving an account problem over the phone the first time e.g., a payment is not posted to a taxpayer's account or taxpayer does not understand why he or she received a bill for an estimated penalty. Our overall account quality is improving but in this filing season is still only 70 percent

While the IRS Web site has proven to be an extraordinarily valuable source of information for taxpayers, we cannot yet use the Internet to provide taxpayers information about their returns or their tax accounts, or to exchange messages to resolve issues.

Inadequate technology and the concomitant lack of accurate data also seriously hamper our ability to identify and collect unreported or unpaid taxes. Individual audits are not started until 14–20 months after a return is filed. When they are started, the information available to our auditors is limited, extending the time to complete the audits and increasing the burden on the taxpayer. Collection of outstanding balances of individual and business taxes is extremely slow, usually taking years rather than months as in the commercial world.

The Opportunity

By taking full advantage of proven best business practices and new technology, we can greatly improve performance on all three of our strategic goals. The IRS can improve service to taxpayers and reduce their burden. The IRS can improve compliance and its collection activities, ensuring that the tax laws are fairly administered. And we can do this with limited increases in staff resources. Taxpayers will reap the benefits in a number of key areas, such as speed, access and accuracy. Let me briefly illustrate how this works in each of these three areas.

Nearly all taxpayers will be able to file and pay electronically, regardless of the type of form or tax. Taxpayers filing electronically and having correct returns would receive refunds in their bank accounts within 2 to 3 days.

We will emulate the best business practice of providing service to customers at times and through channels convenient to them, whether it is by phone, letter or on-line.

The level of phone service would increase to 90 percent. (Level of service measures the relative success rate of taxpayers who call the IRS through toll-free services and wish to speak to an operator. It excludes calls routed to automated systems.) We would expand web-based services to include exchange of information and resolution of accounts through the Internet. First time resolution of account inquires would double from 40 to 80 percent. Taxpayers would receive consistent and accurate answers to their questions regardless of the communications channel they chose. IRS employees would also have access to comprehensive taxpayer histories, thereby increasing the accuracy of the information and the transactions contained in them.

We also will provide more ways for taxpayers to resolve some issues by themselves, without requiring assistance from IRS staff. At the same time as we create the ability for taxpayers to check on such things as the status of their refunds and tax deposits through the automated systems on the telephone or the Internet, some in-person service requirements may be reduced. We are already beginning this process through such exciting initiatives as the EFTPS (Electronic Federal Tax Payment System) -OnLine program. It allows businesses to enroll in the system, securely make federal tax payments and check their electronic payment history over the Internet. And we have barely touched the full potential of electronic tax administration

The effect on our compliance activities would also be profound. Third party matching data would be made available earlier. Assembling all available data about a taxpayer case for our employees will avoid the need to get duplicate data from taxpayers. With the advent of many new best private sector practices, such as risk-based compliance techniques, the IRS also has the opportunity to allocate its compliance resources more efficiently, both in specific cases and around patterns of noncompliance. And when intervention is called for, we can use analytically-based techniques to assist in determining the appropriate action.

Most individual tax returns would be selected for audit within the same year and those audits will be completed more rapidly. "No change" determinations would be cut substantially.

The collection time for outstanding balances would be reduced to an average of six months. Improved systems will allow us to identify much more quickly which taxpayer accounts need attention from either telephone or in-person collectors. They will provide much more complete and accurate information to the collectors before they even deal with the taxpayer, and computer tools will assist them in closing cases.

These changes will also greatly increase our ability to "leverage" staff and use them more effectively and efficiently, while reducing the amount of time we take from taxpayers.

Our ability to ensure protection of taxpayer rights will be increased by building into the computer tools used by our employees the correct notifications and other protections prescribed by law.

The Solution

As I discussed in the introduction to my testimony, we are making substantial progress on the short-term improvement projects that support our major strategies. The other part of that dual approach is the Business Systems Modernization (BSM) program. It was established to take the IRS to the next level and make longer term, fundamental changes to our business processes and practices while managing the inherent risks of the process. Over the remainder of this decade, it will deliver the major benefits to taxpayers and our tax administration system that modernization and RRA 98 are all about. And that process has already begun.

Earlier this fiscal year, the IRS Executive Steering Committee approved the Enterprise Architecture. It is the roadmap for modernizing the Agency's business systems and supporting information technology networks. The Enterprise Architecture (Version 1.0) will guide the agency's business and technology improvements in the coming years. The approval of the architecture marks a major milestone in our progress towards the goals of Business Systems Modernization and will enable us to design and build new business and technology projects that will be the backbone of the modernized IRS.

The IRS previously published a blueprint in 1997. It was the first comprehensive view of modernized tax systems and guided the IRS in efforts to update technology. The new Enterprise Architecture reflects the lessons learned since 1997 and incorporates elements of the IRS reorganization into the four new customer-oriented operating divisions. It is an evolving document designed for constant use, with updates scheduled for spring and fall 2001 and regular updates thereafter. This new blueprint will ensure that IRS business systems' technology is compatible. And it will enable IRS employees to do their jobs better and provide taxpayers better service.

Because of the scale, complexity and risk of BSM, we can only carry out the plan by defining manageable projects, which are subject to a disciplined methodology. Each of these projects will be carried out through a step-by-step "enterprise lifecycle" in which successively greater amounts of detail are defined. The process requires that a vision and strategy phase be completed as a first step, prior to commencing tasks such as infrastructure development, information systems delivery, or process-reengineering. The final milestone in the cycle is an initial "deployment" of a project as an operational system. The IRS' Enterprise Program Management Office manages this process.

Also key to BSM's success, is the Tax Administration/Internal Management Vision and Strategy Project. Through the project, we have instituted a practice that ensures the Operating Division Commissioners and staff develop and take ownership of a process and systems modernization approach that is consistent and integrated with the overall vision of the future IRS. The project's ultimate goal is to create an enterprise-wide view of tax administration that is reflected in BSM.

The Business Systems Modernization Organization (BSMO) has nowidentified all the major initiatives for the next several years that link directly to our major strategies. Moreover, BSMO defined the major dependencies between and among projects and created a sequencing plan for their initiation, development, and deployment. It has also estimated the costs associated with each initiative and developed multiyear spending estimates consistent with this program. It now has a strategy for achieving the major goals of business systems modernization. The following are some of the key projects we will be working on during the next three years and beyond.

- **Deployment of the Customer Communications 2001 Project—**The Customer Communications Project is the first deployment of a business capability under the BSM effort. It is now in final testing before deployment in the third fiscal quarter. The IRS will greatly improve the efficiency and effectiveness of IRS' Automated Call Distributors (ACDs) and provide customer service levels on a par with the private sector. Hardware and software improvements will be made to the telephone system that is used to receive, route and answer more than 150 million taxpayer telephone calls each year. At a later date, Internet access capabilities will be added. This project will deliver direct benefits by increasing the number of calls that can be answered with available staff and will be a critical foundation element for subsequent projects, since virtually all major systems require communication with taxpayers.

• **Development of the Customer Relationship Management Exam (CRM Exam) Project—**Development has already begun. Through CRM, the IRS tackles some of the most complex tax calculations, including carryback/carryforward, the Alternative Minimum Tax, and Foreign Tax Credit. This initiative will enhance the revenue agent's capabilities, reduce exam time, produce consistent results and reduce the burden on taxpayers who must deal with the IRS on these complex tax issues.

• **Development of the Security and Technology Infrastructure Releases (STIR)**—The design for STIR was approved and development was initiated. This project provides the essential underlying security infrastructure for the planned 2002 project deployments of the Customer Account Data Engine (CADE), Customer Communications (2002), and e-Services and Customer Account Management System. Development, testing and first release are expected by October 2001.

• **The Customer Account Data Engine.** (CADE) is the cornerstone of the data infrastructure. It is designed to provide a modern system for storing, managing, and accessing records of taxpayer accounts. CADE will create applications for daily posting, settlement, maintenance, refunds processing, and issue detection for taxpayer accounts and return data. The database and applications developed by CADE will also enable the development of subsequent modernized systems.

CADE is scheduled to be released in stages, beginning first with simple tax returns being moved into the new CADE system, followed by increasingly complex taxpayer returns. As more taxpayer account information is moved into the new CADE system through these staggered releases, other modernized applications will be put in place to provide the interfaces necessary for IRS employees, and affected taxpayers, to access and carry out transactions. System development, testing and initial deployment are expected to be completed by January 2002.

• **Development of the Enterprise Data Warehouse/Custodial Accounting Project (EDW/CAP)—**Today, the IRS has a variety of dedicated research databases, and also uses its operational databases for operations research/analysis. The timeliness, consistency and standardization of the data in these separate systems do not support integrated analysis and corporate-wide decision making. The inconsistent and redundant data in stovepipe systems can result in inconsistent management and reporting data.

Through EDW/CAP project, the IRS will develop an integrated enterprise data warehouse to support organizational data needs, such as those that are critical to managing our new compliance initiatives. For example, it will provide a single integrated data repository of taxpayer account and payment/deposit information, fully integrated with the general ledger. And it will identify payment and deposit information at the point of receipt. The operating divisions will be given access to pertinent revenue, assessment, disbursement, and seized asset information. In addition, it will provide the IRS with the capability to maintain financial controls over the $2 trillion of tax revenue received annually.

• The **e-Services** project will support our ability to meet the overall goal of conducting most transactions with taxpayers and their representatives in electronic format, as required by RRA 98. By 2002, the e-Services will: (1) provide the capability to register new electronic return originators over the Internet; (2) permit delivery of transcripts to authorized parties electronically; and (3) allow third parties who are required to provide certain forms 1099 and information returns to check the taxpayer identification numbers for accuracy before submission.

An important aspect of e-Services project is that it will be one of the first projects to provide a practical and limited application to define and test the design of our critical security infrastructure for sending and receiving taxpayer data internally and externally.

• **Customer Account Management (Individual Assistance and Self-Assistance Operating Models).** In today's environment, taxpayers are often unable to receive timely and accurate responses to requests and inquiries. These operating models will provide improved technology and business processes that will enable the IRS to: better manage customer service functions; maintain and utilize customer data to improve taxpayer interactions with the IRS; provide comprehensive account and tax law assistance to taxpayers and practitioners; and manage the case work flow of customer inquiries. There is a separate release strategy for each of the operating models based on the customer segment that benefits the most from the new capabilities.

- **Tax Education (Direct and Indirect) Operating Models.** These models address improving business processes and operational systems within the pre-filing business area (*i.e.* before a return is filed). In the past, there has been minimal investment in pre-filing activities, such as making educational materials, information and forms more readily available. With the organizational modernization, pre-filing activities will become more prominent. The Tax Education Operating Models will help taxpayers reduce or eliminate errors before they become compliance problems by developing proactive and targeted educational materials that are available 24/7 in various formats from web-based products to published documents. Utilizing third-party partnerships, the IRS will develop and make available in plain language reliable educational information, guidance and advice.
- **Individual Assistance Operating Model for Reporting Compliance.** The current compliance environment has produced a number of problems, such as extended cycle times, reduced coverage and decreased customer and employee satisfaction. This project will have a significant impact on the present Reporting Compliance operational environment by providing: (1) robust, issue driven compliance planning that utilizes outcome-based improvement to ensure fair and effective selection of cases; (2) highly automated decision engines for risk-based case selection, treatment assignment and resource allocation to decrease cycle time; (3) electronic case files with pre-identified issues to support productivity gains and increased coverage; (4) case working tools, workflow management and remote access to critical data; and (5) new technology and processes to establish collectability, secure payments and facilitate payment agreements at the closure of cases. The IRS will deliver these new capabilities through four releases by 2006.
- **Filing and Payment Compliance Operating Model**. This is an end-to-end strategy to resolve collection issues quickly and fairly. It augments, refines and replaces existing processes and technology to enable the IRS to interact with taxpayers in a seamless and efficient manner. Protection of taxpayer rights at all times is an important component of this strategy. Taxpayers who are able to resolve their cases with no direct IRS contact are provided various self-correct options. Field or Collection Call center staff will assist taxpayers who need help to resolve their delinquent tax cases. They will have access to real-time data to ensure that appropriate actions are taken and taxpayer rights are protected. The operating model will decrease cycle time to approximately six months. We will deliver this operating model through four releases by 2007.

Establishing a Balanced Measurement System

All federal agencies must have appropriate quantitative performance measures. They are required by the Government Performance and Results Act (GPRA) and are essential to any large organization's proper operation. An integral part of our overall modernization program is establishing balanced performance measures that support and reinforce the IRS' mission and strategic goals. However, because of past IRS experience with measurements and RRA 98 requirements (Section 1204), developing appropriate measures is an especially sensitive and difficult task.

Critical to our efforts was establishing measurements based on what we needed and wanted to measure, rather than using what is most easily measured. Our balanced measurement system was designed to measure the progress we are making to achieve our three strategic goals: (1) service to each taxpayer; (2) service to all taxpayers and (3) productivity through a quality work environment.

Also critical is ensuring that measures are aligned at all levels, from the top of the organization to the front-line employee. This does not mean that all of the organization's levels and components have precisely the same measurements. Obviously, this would be impossible. Rather, it means that the measures or evaluations are aimed at encouraging the type of behavior that will advance the organization's overall strategic goals, and do not encourage inappropriate behavior.

In developing measures for each organizational level, it is important that each component of the balanced measurement system reflect responsibility at that level. At the top of the organization, management has control over strategies and allocation of resources. However, at the mid-level, managers have less control over these variables, but do exercise control over the effectiveness of training, coaching and guidance of employees. And at the individual level, each employee has control over his or her work and self-development.

In the balanced measures system being implemented, there will be quantitative measurements keyed to each of the three strategic goals (service to each taxpayer; service to all taxpayers and productivity through a quality work environment) at both the strategic level and the operational level. In general, quantitative measures will not be used at the individual employee level.

In September 1999, we issued a Balanced Measures Regulation to formally establish our new performance management system. The publication of the regulation, which followed a public comment period, set forth our structure for measuring organizational and employee performance.

At the strategic level, our measures are designed to gauge overall performance on accomplishing the mission and strategic goals. This level is meaningful for the IRS as a whole, or for those parts of it that are responsible for providing a full range of services to large sets of taxpayers.

We began identifying specific strategic measures in FY 2000 and will refine and finalize these measures in FY 2001. Experience has shown that the development of good performance measures is an evolving process that improves with time. Accordingly, we anticipate there may be changes to the specific measures. We expect, however, that the strategic intent behind these measures will remain firm.

At the operational management level, our measures are focused on successfully executing our core business functions within the organizational units. At this level, we derive the balanced measures of organizational performance as follows: customer satisfaction, business results and employee satisfaction. This can be easily contrasted with measuring at the individual level.

All quantitative measurements assess organizational performance, not individual performances. It is impossible to capture in any quantitative measurement system all that is important in evaluating an individual. As of January 2000, we redefined the system for setting and measuring performance expectations for nearly all managers and executives to align with the balanced measurement system.

For front-line employees, we do not use quantitative measurements to evaluate performance, except in certain submissions processing functions. In most cases, it is not practical to quantify the performance of an individual employee in a meaningful and appropriate way. Instead, we incorporate the desired activities and behavior consistent with the strategic goals into the "critical elements" of each employee's position description.

We began to implement the balanced measures system at the operational level in 1999, starting with the three functions, Customer Service, Examination, and Collection, that most directly affected large numbers of taxpayers and employees. We implemented the operational measures for these functions within the existing organizational structure and have now transferred these measures to the new organization.

Since that time, we approved additional balanced measures for Large and Mid-Size Business, Tax Exempt and Government Entities, Taxpayer Advocate Service, Information Systems, Criminal Investigation, Appeals, and for additional Submission Processing and Customer Service product lines within the Wage and Investment and Small Business/Self Employed Operating Divisions. We have slated balanced measures for the remaining organizational units for approval in fiscal year 2001. In the interim, we are using 64 indicative measures and workload indicators in our annual performance plan as we complete our measures development.

However, we still have work to do. We must agree on a final set of Agency-wide strategic measures and then begin implementing a comprehensive suite of strategic measures covering all taxpayer segments. Most importantly, we must continue to learn how to use balanced measures as a tool to achieve a high level of performance for all three of our strategic goals.

Development of the balanced measurement system and, even more so, learning the new ways of working will take years. By focusing our attention on what is important for achieving our strategic goals, we will stay on the right path and continue our progress.

CLEAN FINANCIAL OPINION AS REPORTED BY LAWRENCE W. ROGERS, FORMER IRS CHIEF FINANCIAL OFFICER AND CURRENTLY, ACTING DIRECTOR FOR ADMINISTRATIVE ACCOUNTING, SYSTEMS AND POLICIES

Mr. Chairman, due to the combined efforts of the IRS and the General Accounting Office, I am pleased to report that the GAO rendered an "unqualified" or clean opinion on the IRS' FY 2000 Financial Statements. This includes both the Revenue and Administrative accounts.

The GAO's opinion means that the IRS properly accounted for $8.3 billion in appropriated funds; over $2 trillion in revenues collected; and over $190 billion in refunds. In his message opening the FY 2000 Treasury Accountability Report, Secretary O'Neill stated that "Good stewardship of taxpayer resources is a responsibility I take very seriously." At the IRS, we also want to ensure that every manager and employee takes that responsibility seriously.

In fact, the success on the financial opinions can be greatly attributed to the hard work and dedication of the IRS staff; the significant improvements made to IRS' internal controls; and management focus placed on the financial audits. I would also be remiss if I did not recognize the hard work of our GAO auditors who provided us with such excellent advice.

Congress, too, has played an important role in insuring that the financial audit is an important factor when evaluating agency performance. And we thank you for your strong, vigorous and continued leadership in this area. In last year's appropriations hearings, the Chairman of the House Appropriations Subcommittee on Treasury, Postal Service, and General Government also stressed the importance of a clean financial audit for IRS. Planning is already underway to insure that we maintain the same level of commitment for the FY 2001 and all future audits.

To achieve the clean financial opinion, the IRS made significant improvements in several areas. Specifically, we:

- Implemented reconciliation procedures for IRS fund balances and ensured prompt review/reconciliation was performed;
- Revised our reporting and disclosure for the statement of net cost to properly classify IRS programs;
- Improved management of property and equipment (P&E) inventories;
- Improved our review and management of suspense accounts;
- Reduced the number of computer security weaknesses;
- Addressed issues related to safeguarding taxpayer data; and
- Improved our ability to substantiate unpaid assessments.

However, long-standing inadequacies in our financial reporting systems must still be addressed through the broader efforts to modernize the IRS' systems and organization as mandated by RRA 98. The ultimate key to better financial management at the IRS is improved technology. A complete description of our efforts and response to the GAO report may be found in Appendix A.

BUDGET SUPPORT FOR MODERNIZATION

The IRS modernization program, and particularly, Business Systems Modernization, is at a critical juncture. The President's budget request funds two major initiatives that will greatly help the IRS. First, the budget includes close to $400 million in investments to modernize the IRS' outdated computer systems. This multi-year project will provide the IRS with the modern tools needed both to deliver first class customer service to America's taxpayers and to ensure that compliance programs are administered efficiently.

Second, the President's budget also includes follow-on funding for the STABLE initiative, begun in 2001. These funds will complete the hiring of almost 4,000 staff and will enable the IRS to address the declines in audits and the drop in customer service that have occurred over the past several years. Further details on the President's request on the IRS will be included in the formal budget transmission to occur next week.

Mr. Chairman, in conclusion, I believe that the IRS is on the right track. We have demonstrated both the ability to make some short-term improvements in service, and more importantly, the ability to produce a viable and cogent strategic plan that will guide our efforts to make changes in the entire way we do business and provide service to taxpayers. With your continued support and support of the American people, I am convinced more than ever that we can succeed.

Appendix A—2001 Financial Audit

GAO Findings

The IRS believes that the GAO report is generally accurate and we have submitted a number of specific comments that we believe expand upon the information contained in the report, rather than challenge its findings.

Management of Unpaid Tax Assessments

First, to address the issues related to Trust Fund Recovery Penalty (TFRP) processing (*e.g.*, delays in posting, related tax liabilities, etc.) an IRS task group was established to review and recommend necessary changes. This group developed programming requirements to design an automated TFRP system that allows for systemic links. Phase I initial programming has been completed. Phase II will be implemented in FY 2002 to systematically accept downloads of data and cross-reference payments received for assessments made.

Controls Over Refunds

The GAO observes that the IRS does not always review Earned Income Tax Credit (EITC) claims in time to identify invalid claims. The IRS believes that this observation should be placed in the proper context.

The IRS has succeeded in several of its initiatives to prevent erroneous EITC refunds from being issued. Specifically, the IRS: (1) used its dependent database to identify questionable issues relating to EITC; (2) implemented the new legislation requiring re-certification before the taxpayer can claim EITC on the current tax year due to improperly claiming EITC in the previous year; (3) banned taxpayers from claiming EITC for either two or ten years after the tax year where there was a determination that the taxpayer's claim was due to intentional disregard of the rules and regulations, or fraud; and (4) implemented an automatic freeze on refunds where there is an open examination.

The results of our efforts are clear. Since 1999, the IRS worked over 55,000 recertification cases. Our case reviews also resulted in 7,680 two-year bans and 62 ten-year bans for processing year 2000, and 337 two-year bans and two 10-year bans for processing year 2001 (as of mid-February).

Property and Equipment (P&E)

The IRS agrees with most of the GAO's comments regarding Property and Equipment. However, we do not believe that the report puts into proper perspective the substantial progress IRS achieved during FY 2000. We believe it is important to highlight the fundamental changes in the P&E management of IRS.

Prior to October 1999, there were multiple information systems organizations in IRS besides the Chief Information Officer (CIO). This was a major contributing factor to the lack of accountability and commitment in maintaining an accurate and complete Information Technology (IT) inventory, thus, resulting in the long-standing property material weakness.

Today, the IRS has one information systems organization with total responsibility for the IT inventory. Since October 1999, the Information Systems organization has made significant progress in improving how the inventory is managed and maintained.

To implement the GAO recommendation that "systems and controls be in place for FY 2000," the IRS devoted P&E employee resources to undertake and accomplish the task. The IRS had already established the Financial and Management Controls Executive Steering Committee (FMC ESC). It is chaired by IRS Deputy Commissioner Bob Wenzel and is the major coordination point in the IRS for improving financial management systems. The FMC ESC established the Property Subcommittee, consisting of executives of the offices of the CIO, Chief Financial Officer (CFO), and Procurement. This Subcommittee met weekly and made decisions to ensure systems and controls for P&E were developed and functioning for FY 2000 and the future. This Subcommittee will continue to function until all property issues are resolved.

The IRS also established the Asset Management Modernization Project Office whose full time job is to implement industry "best practices" and deploy new automation tools. A complete discussion of these and other improvement projects can be found in our response letter.

In summary, we believe that through the major automation and process improvements I have outlined, the IRS significantly reduced the long-standing material weaknesses identified by GAO. With continued executive support and dedicated staff resources, the momentum attained to date can be sustained, and the underlying deficiencies in IRS' property management eliminated.

Manual Tax Receipts and Taxpayer Information

On October 30, 2000, the IRS established a Subcommittee on Security under the FMC ESC. The Subcommittee provides an agency-wide senior executive forum to address, and to make decisions on, security policies and priorities. It focuses on efficiently and effectively implementing and communicating these policies and priorities throughout the IRS. The Director of the Office of Security is the Chair of the Subcommittee.

Computer Security

Recognizing the critical need to enforce federal law and regulations concerning privacy and non-disclosure of confidential tax information, the IRS created the Office of Security to establish and enforce standards and policies for all major security programs including, but not limited to, physical security, data security, and systems security. The OS provides the IRS with a proactive, independent security group that is directly responsible for the adequacy and consistency of security over all IRS' operations.

Our security approach is consistent with GAO's September 1996 report, *Information Security: Opportunities for Improved OMB Oversight of Agency Practices*, which noted that, "Such a program can provide senior officials a means of managing information security risks and the related costs rather than just reacting to individual incidents."

Using a security framework, we are setting priorities for resources and we are measuring and demonstrating success in improving the overall security posture of the IRS. We are also taking a proactive approach by conducting security reviews at the computing centers and campuses. Our Office of Security works closely with local and Headquarters management to develop solutions, monitor implementation, and conduct on-going reviews to ensure weaknesses do not recur.

Revenue Reporting and Distribution

In its report, GAO notes that there are continued weaknesses in fundamental internal controls. To address this issue, the IRS implemented procedural changes to ensure expedited processing of million-dollar returns. We also provided procedures to monitor timely posting of returns and to identify taxpayers who had not yet filed their returns. This will ensure processing prior to the end of the certification period.

The GAO also noted there was a delay in posting to the Highway Trust Fund and the Airport and Airway Trust Fund in the amounts of $346 and $34 million, respectively. There are three reasons why amounts received in a quarter are certified in a subsequent quarter: (1) late filed returns; (2) processing delays (lack of documentation, etc); and (3) subsequent activities. In the above cases, we needed additional documentation and returns were filed late. It should be noted that there is no penalty for late filing provided the taxpayer has submitted his or her payment on time.

IRS' Structuring of Installment Agreements and Compliance With the Internal Revenue Code

The IRS has made considerable improvements on the structuring of installment agreements. In FY 1999, twenty percent of the unpaid cases examined were noncompliant with the Code. In FY 2000, the non-compliant percentage dropped to two percent. To ensure that agreements are compliant, the IRS issued guidance to its employees. We are also developing training on processing new installment agreements.

Furthermore, the IRS is revising its guidelines to reemphasize the necessity of ensuring that installment agreements cover all outstanding taxes. If this cannot be accomplished, the case will then be handled in accordance with Offer-in-Compromise procedures. The IRS will also continue to monitor and enforce the guidelines on installment agreements.

Federal Tax Liens

The GAO has noted significant improvement in the IRS' processing of federal tax liens. To better refine the processing of liens, the IRS: (1) issued guidance to its employees and provided additional training; (2) instituted monitoring and enforcement of the processing guidelines for liens; and (3) centralized the control of the federal tax lien process to one site. Previously, the process had been decentralized to each of the 33 IRS districts.

Long-Term Efforts

A major concern shared by the IRS and taxpayers is privacy and security, both internal and external. Let me restate the IRS' commitment to recognizing taxpayer privacy to the maximum extent possible in all Service initiatives. Given the vulnerability of modern electronic information systems to cyber attacks, hacking, and natural disaster, we are focusing resources on risk management processes, secure messaging and authentication, physical security, cyber attack response capability and disaster recovery measures.

The IRS will make substantial progress in improving its stewardship of assets over the next two years, although much more will be possible through our longer-term business system modernization efforts. The following are some of the ways we will implement this strategy.

Privacy

The IRS will incorporate privacy protection principles into all of its programs and policies. We will enhance the privacy impact assessment methodology, applying it to all stages of a system's development and requiring it as a part of a system's certification.

Security

The IRS will establish a Critical Infrastructure Plan to ensure that information systems critical to the financial security of the United States survive. The IRS will also continue to work with the computing centers to enhance their physical security to Level V, the Department of Justice's highest physical security designation. In addition, we will assist service and computing centers in conducting integrated disaster recovery exercises. Furthermore, the IRS will review the state of its security and focus on providing solutions to identified vulnerabilities and completing security certifications of sensitive systems. The IRS will bring the Computer Security Incidence Response Center to full operational capability and will provide oversight of selected IRS program areas to ensure practices are consistent with policy and guidance.

Property Management (IT)

The IRS will enhance and enforce policies and procedures to ensure accountability for use of information technology (IT) property. There will also be a transition from the current internally developed IT property tracking system (Integrated Network and Operations Management System—INOMS) to a Commercial Off-the-Shelf (COTS) solution. The IRS will connect the IT asset system with the non-IT property management so there is one comprehensive property system throughout the IRS.

Financial Systems

The IRS will implement a Joint Financial Management Improvement Program (JFMIP) approved financial management system. We will select a COTS product that best satisfies our internal management needs through an enterprise resource-planning product. Our first phase of implementation will be replacement of the core financial system, with planned future implementation of other internal management modules.

Strategic Plan

The Strategic Plan stresses that the IRS must demonstrate effective stewardship of the assets and information entrusted to it by improving our internal processes for information management, financial management, and asset management.

Conclusion

To summarize, the Internal Revenue Service is committed to improving financial management. We view all of these actions as necessary to build upon current processes and systems to provide the best financial information possible that meets statutory and policy requirements. Additionally, it must be stressed that the long-term solution to many of the issues identified through the audit process can only be addressed by the design and implementation of new or enhanced automated systems that will be developed over the next several years.

Chairman HOUGHTON. All right. Thanks very much. Before we go to the questions, I would like to introduce our newest Member, Earl Pomeroy, who is a very distinguished man for many reasons, one of which is he is my neighbor down the hall here. Anyway, Earl, and also Karen Thurman, who was on this Committee two

Congresses ago, not last Congress, and now again. Thanks very much, Karen, for being here.

I would just like to ask a question and then I will turn it over to Mr. Coyne, and we will go back and forth here. You have talked about this electronic filing and I think it was you that put out this goal of 80 percent filing electronically by the year 2007; is that right or was that before you?

Mr. ROSSOTTI. Well, it was included in the Restructuring Act. I think the origin of it might have been the Presidential commission that studied the IRS, but in any case, it was included in the Restructuring Act as a goal.

Chairman HOUGHTON. Tell us a little bit about that. Is that going to be a stretch? How does it look? What are the incentives? Just give us a feel for it.

Mr. ROSSOTTI. It is definitely going to be a stretch in terms of timing. We actually have to average 20 percent-a-year growth between now and 2007 approximately to get there. We did hit 20 percent this year. We may be slightly under 20 percent this coming year. I think the important thing, and I think some or the other folks who are going to testify later will say this, is that it will not happen automatically. It will not happen just because it is currently going up at 20 percent. We have to take some aggressive steps and we are.

I mentioned in my testimony, one of the key things was the ability to file all forms and returns electroncially. Right now, you cannot file all returns because there are certain schedules and forms that are not accepted. That particularly affects practitioners, because 55 percent of the returns are prepared by practitioners and many of them tell us they do not want to file some of their returns electronically and some of them on paper. That is one obstacle we are trying to remove.

Another issue was that electronic filing was not entirely paperless. You had to file a separate form with your signature document. We came up with a strategy this year that eliminated that requirement. You could supply us with a self-selected identification number and two pieces of information from your prior-year return. That has had some startup issues, especially with some of the practitioners, but nevertheless we think it will work with some fine-tuning and that will eliminate that issue.

Another issue has to do with practitioners having sufficient incentive just to change the way they do business. In our modernization program, one of the things we are going to be doing in an early implementation, we expect by 2002, is to provide some additional services to some practitioners who work with us electronically. This will include not just filing the returns, but being able to communicate with us, for example, to get transcripts of tax returns and eventually to settle their accounts. This will essentially provide a broader reason for people to do business electronically with us.

Then, finally, there is the marketing and promotional activities, like any product. You have to promote it and we are continuing to do that. We have a lot of things that we have to do. I have only mentioned a few of them. It will not happen automatically.

On the other hand, the trends in favor of us are just cultural. The newer generation of people, like my two children, they are around 30 years old and I do not know that they have ever bought a postage stamp. I think they do everything by e-mail and computers. They are the kind of generation that is going to automatically generate an interest in things electronic.

Chairman HOUGHTON. Thanks very much. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. Commissioner, welcome and thank you for your testimony. Is there a difference between the level of funding for 2000 between what the chairman of the oversight board would like and what the IRS has submitted to the administration?

Mr. ROSSOTTI. Well, I am afraid the administration has not submitted its budget yet, so I do not think I can really go into what the President's budget is going to be until it is submitted.

Mr. COYNE. But as far as your request to the administration for funding from the IRS, is there a difference between yours and what Mr. Levitan would like?

Mr. ROSSOTTI. Well, Mr. Coyne, I think we ought to wait a little until we see the President's budget. I think Mr. Levitan, in their public meeting, had made some comments about what they perceive to be the differences between their view on certain items and what they believe the administration was going to have. I think I would be best advised to wait until the President's budget is submitted before commenting on the budget, other than mentioning that they did say in the blueprint they would include $397 million for the modernization fund.

Mr. COYNE. It has been reported that over the last several years audit and collection levels at the service has declined. Could you point out to us here today what the major areas of noncompliance have been?

Mr. ROSSOTTI. Well, of course, one of the things is we have not had for a long time, a very good up-to-date, accurate assessment of how the compliance levels have trended. We are relying on some old estimates. I think, as we noted in our strategic plan, there are really problem areas of noncompliance across the spectrum. There is going to be, in fact, a hearing at the Senate Finance Committee this week on one area, which are the sort of organized tax avoidance schemes, such as these abusive trusts and devices such as that, which are sold to taxpayers, alleging that they can avoid taxes, and we think—we do not know what the numbers are, but there could be many billions of dollars of taxes that are not paid on that kind of scheme.

There are significant problems that we have in collecting employment taxes. We are behind in some areas because of the inventories that have a build up of collections. We have, as you know, in some cases, refunds that get through that should not get through, both based on the earned-income tax credit as well as other refunds. At the other extreme in the corporate area, we have had some major initiatives recently in the last year to deal with abusive corporate tax shelters, which are a different kind of tax shelter. They are kind of technical devices. So if you really look across the board, there are wide ranges of areas of noncompliance, and we are trying to be very focused with the limited resources we have on each of those.

Mr. COYNE. Later on today, the Treasury's Inspector General, Mr. Williams, is going to testify, and I quote from his testimony, that "over a 4-day period during this current filing season, their auditors made 368 random test calls to the IRS' toll-free number, and were unable to gain access 37 percent of the time. When successful in getting through, however, the IRS incorrectly responded to 47 percent of the questions. The topics for the test calls were obtained as the most frequently requested requests of callers." Could you address that?

Mr. ROSSOTTI. Well, as I said in my testimony, we certainly believe we made progress in both the quantity, access and quality of calls. But we are far from satisfied with where we are. By looking at the entire filing season rather than just 4 days, we know what the access is. If someone wants to talk to a person and tries to get through, right now, for the season as a whole, the access is about 66 percent. In other words, about two-thirds of the time, which is not too different from what they found.

In terms of quality, we have a very complete system that tracks in a statistical way actual calls that are made by taxpayers that we have up in Philadelphia, as a matter-of-fact, not in Pittsburgh, but it happens to be in Philadelphia, a site that actually randomly samples all calls that are made and listens into them, because we can do that electronically, and through a statistical means actually rates the accuracy of the calls.

I can give you the statistics for the whole filing season. On tax law calls, the accurate response rate was 74.5 percent for the filing season so far. On accounts calls, which are people calling about their account, it was 86 percent. Neither of those is an acceptable level, although, especially in the accounts, we have improved drastically or at least significantly over what it was last year. I think in terms of where we are going with this, we want to try to get to a commercial level of access, which would be more in the 90 percent range, and certainly, a significant improvement.

In terms of both of those, there are two key things that we are doing besides just better management and better training. One of them is the technology program; in fact, a near-term technology program will provide us additional capacity to answer calls and some additional ability to route calls more precisely. We are also completely reorganizing our whole telephone operation, in the sense that we have about 25 different call sites where there are people who answer calls.

In the older structure, we tried to answer pretty much all the different kinds of calls, which, if you think about it, is an enormous range across the tax laws as well as accounts. What we are doing is working on a plan which we call center optimization, which looks across the whole network, across the whole country, and tries to figure out where we can specialize both the sites and the people in the sites, so that they will become more knowledgeable about the specific kinds of questions they need to answer and then direct the calls to the right kinds of people.

We are convinced that this is the only way we will get completely up to the level of accuracy we need to, because it is just too difficult to answer the entire range of calls in so many different places. This is an example of something where we are doing short-term things, as we are doing this filing season, but we are also making some fundamental changes to really reorganize the way the whole thing works in order to get both access and quality up to the levels that we want.

Mr. COYNE. Thank you.

Chairman HOUGHTON. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman, and thank you, Commissioner, for being with us again. I think this Subcommittee is very cognizant of your challenge to both reengineer the IRS, while maintaining the taxpayer service as necessary to operate a very complicated system and a very complicated Tax Code.

If I could focus on a couple areas, one is with regard to electronic filing, I am concerned that you are saying it would be very difficult to meet the goal, but you think the goal is very important for both taxpayer service and also for the IRS itself, to be able to operate efficiently and more accurately. It seems to me, looking at your data, that you have done a pretty good job with regard to folks who file their own returns. In fact, we have about a 37-percent increase on home computers, for instance, this year, which is impressive, only about 10 percent, though, among practitioners.

We are going to hear from some practitioners later and I want to pose some questions to them if I can come back. I have to step out for awhile for another meeting. I hope to be back. What can you do to improve that rate among the practitioners? As you know, more than half the returns are filed by practitioners. You mentioned we can put all forms and all schedules on, rather than the forms we currently have online, but specifically with regard to practitioners, what are your ideas for the next few years?

Mr. ROSSOTTI. Well, I think there are really three things we are trying to do concretely. One of them is to be able to file all the 1040 forms online because they do not want to do some of them on paper and some of them electronically. The first time I ever met with a practitioner on this subject when I came into office, that was one of the first things I heard. It has taken us some time, but by 2002 we will be there.

The second thing is getting rid of the papers, the signature document. We came up with a scheme this year. There is some maturity, some perfection we need to do on that, and we will be working with the practitioners this year to gain their experience and improve it next year.

The third thing is to broaden their ability to interact with us electronically, beyond just filing returns, into dealing with us on other subjects. I think I mentioned that briefly in an answer to the Chairman's question. In our modernization program, our e-services project is aimed squarely at that point. It is directly aimed at enabling us to have, in a secure way, the ability to communicate with practitioners. If we can succeed in our schedules, we will be rolling out the first part of that capacity in 2002, and perhaps, the remainder in 2003.

Within the next 2 years, I think we will have dramatically increased the attractiveness of our offerings to practitioners.

Mr. PORTMAN. Commissioner, can I interrupt you just for a second? I have got a couple of questions I would like to get at and my orange light is going to come on in just a second. If you can get back to me in writing, that would be great with regard to any other point on practitioners, specifically with regard to the PIN numbers. There has been some information that has recently come to our attention, Federal Computer Week just said there is a lot of complaints about the new system, enabling taxpayers to select their own PIN. We think there is about a 20 percent error rate that you have acknowledged with regard to PIN numbers, and we understand that there are a lot of taxpayers who have been required to file their signatures the old-fashioned way, by mail, in addition to filing returns electronically.

I know you have tried several PIN systems in recent years. They all seem to have some inherent problems and complexities. If you could sort of cut through some of the red tape for us on that and give us what the best systems might be over the next couple of years, that would be very helpful to me and I think to the Subcommittee.

[The following was subsequently received:]

Currently, IRS offers the Self-Select PIN program for signing the 1040 Individual Income Tax Return electronically, using a self-selected five-digit personal identification number. The Self-Select PIN is totally paperless. The PIN eliminates the need to send in Form 8453 and Form 8453OL. There have been over 8.8 million returns filed electronically using the Self-Select PIN.

However, the IRS has not yet determined which system would be best for the next couple of years. IRS is exploring the feasibility of reinstating the Practitioner PIN program. Under this program, the taxpayer self-selects his or her own personal identification number and personally inputs the PIN as his or her electronic signature. The difference between the two programs is that the Practitioner must maintain an Authentication Worksheet for a period of 3 years. The worksheet has the taxpayer's PIN listed along with his or her pen and ink signature confirming that the PIN he or she selected will serve as their electronic signature. The Self-Select PIN does not require a Worksheet. Instead, it requires two pieces of information from the taxpayer's prior year tax return—Adjusted Gross Income and Total Tax—to authenticate the taxpayer. Reinstating the Practitioner PIN program, as well as maintaining the Self-Select PIN program, will provide practitioners with a choice between the two systems depending on their business and client's needs.

Mr. PORTMAN. States, as you know, require the taxpayer to retain a signed copy of their returns. It has to be produced if the IRS conducts an audit. That is what we kind of came up with in the commission a few years ago, and we talked about that in this Subcommittee at various hearings. That seems a lot less complex to me still, and I wonder why the IRS has not gone to that.

[The following was subsequently received:]

Although some states may allow taxpayers to file returns electronically and retain the signature on a paper copy, IRS does not consider this appropriate for electronic filing of federal tax returns. States can be reasonably confident that the information filed with them is the same as on the federal tax return. However, in the federal environment, we are not provided with this same level of confidence. Administration of the tax laws would likely be more difficult if taxpayers retained the signed copy of their returns. If necessary, the Service would need to use other means to prove that a return filed electronically without a signature was, in fact, the taxpayer's return.

Mr. PORTMAN. Now, my orange light is on. Let me skip over my questions on the telephone side and just to say quickly there that you had done well in going from 50 percent to about two-thirds. The error rate is still disconcerting, and one of the issues I would love to get back in writing, would be to move to an e-mail system where you are able to respond to more than just tax law questions by e-mail, but actually respond to specific questions on specific accounts. I know there are some security issues with that and some modernization issues with that, but it seems to me that would enable your people to have a little more time to respond and come back with a response that was, frankly, a little more accountable to them and a little more thoughtful, which might lower that rate of inaccuracy that Mr. Coyne talked about.

[The following was subsequently received:]

Currently, IRS has two Modernization projects underway that will provide web-based account customer service. The first project, Internet Refund application, is an automated application that will provide English and Spanish refund status information for our customers over the Internet during next year's filing season. Although the initial version of the application will not support e-mail, it will include "what-to-do-next" templates and checklists with information taxpayers should have available when calling or writing IRS to facilitate resolution of refund problems. IRS will pursue e-mail capability in the future iterations.

The second project, Electronic Account Resolution, will offer practitioners the capability to resolve account-related issues electronically using a secure internet application. The first implementation of Electronic Account Resolution is scheduled to occur in September 2002. Our Electronic Tax Administration Office has used the Practitioner Secure Messaging System (PSMS) Prototype as the basis for determining the requirements for the Electronic Account Resolution.

Mr. PORTMAN. The final question I have for you is with regard to the oversight board. How is it working? I met with the oversight board. I know you have spent a lot of time with them, which I appreciate greatly. Chairman Levitan testified yesterday before the Oversight Committee. I wonder if you would give us a brief overview of the oversight board?

Mr. ROSSOTTI. My sense is that the oversight board has taken its responsibilities very seriously, very much in the spirit of the Restructuring Act, and has put in a great deal of serious time learning about the IRS. They were appointed in September. They organized at the first meeting. They have had three full-scale meetings, each about two days, the most recent one about 2 weeks ago which included a public meeting, and then they have three Subcommittees that have been organized that have focused on key areas.

I think at this point they are up and running in a full-scale way. They focused a lot of their attention on the strategic plan in the budget, and as I mentioned in my testimony, in January they actually approved the strategic plan. I think that was an appropriate focus for them and something they contribute a lot of value to. Now they have been focusing on the budget to support the strategic plan, and they have issued a report on that. I think they are going to issue some more reports, including the testimony. The Chairman testified yesterday and I believe he is going to testify Thursday.

My sense is this board is doing what the Congress intended it to do, which is to get into an in-depth understanding of the IRS' problems. They certainly have been candid about identifying our problems if you heard the testimony yesterday, but they have also been very constructive about laying out what they think needs to be done. Just speaking personally, I have been involved with a number of boards, both being on them and presenting to them and so forth, in different contexts, but I think this is one of the most substantive kinds of meetings that I have ever been engaged with.

I mean, they have been very substantive, very intense. You were there at one of them for a period. They are fully capable because of their backgrounds, to really know what questions to ask in-depth about almost any subject about the IRS. And they have not hesitated to do that. They have also met with all the outside stakeholder groups and with GAO. The Comptroller General came over to meet with them. I believe if you wanted to have one body that has devoted the time and has the expertise to understand what is going on about the IRS, you have that in the IRS Oversight Board.

Mr. PORTMAN. Thank you, Mr. Chairman.

Chairman HOUGHTON. Well, I will bet you are very proud of that; rather than asking where is it, it is how is it doing.

Mr. PORTMAN. More fun to ask that.

Chairman HOUGHTON. I would like to ask Mr. Pomeroy if he has a question.

Mr. POMEROY. I do, Mr. Chairman, and thank you. I would just begin by saying Commissioner Rossotti has come to North Dakota, and I never would have thought there was anyone who could make people stand and cheer the IRS, but by golly he did. It was a wonderful presentation. That kind of segues into the point that I want to make. There is a lot of debate around tax policy. There always will be. Unfortunately, sometimes I think frustration at the structure of the Tax Code, or disappointment about the impact of the Federal government's revenue demands on taxpayers, is ultimately channeled into frustration on the service and the outstanding professionals that run the Internal Revenue Service.

I so appreciate your background, Commissioner, coming from such demonstrated levels of success in the private sector at senior levels of management, to look at the system during this critical period of time and evaluation. My question is whether or not the resources are there, allowing you to get the tasks we, under statute, demand that you perform, done and done well? Obviously, the numbers cited by Ranking Member Congressman Coyne are disturbing, and would be a reflection of whether—raise significant questions in terms of whether the resources have been there as needed.

I guess, to put a point on my question, it is my understanding that the service has sought a $9.7 billion increase for the upcoming fiscal year. That amount itself has generated controversy with the oversight board believing that more was appropriate, I understand. Any idea how you are going to fare in the upcoming President's budget?

Mr. ROSSOTTI. Again, as I said to Mr. Coyne, I think I am best advised not to be commenting on the President's budget until it is released. I do not think I should do that. I will say, just to back up one step, that in 2001, which is the fiscal year we are in now, Congress passed a budget that after a lot of debate and a lot of work that was, from my point of view, a budget that enabled us to make significantly more progress then we had for a number of years in the two key areas.

One is, as I just mentioned, we have to operate. We have to have some staff. We have to have trained people. This is the first year we are actually out hiring some people to replace people that left and to make some modest increases and also to move our modernization. That is good and we want to try to continue that in 2002. Without getting into details, because it has not been announced yet, I think the 2002 budget that will be released, will allow us to continue to make progress in both of these areas. I think there will always be room for debate about how fast we make progress and how much we have, but I think we will be able to make progress in 2002, as well as we have been in 2001.

Mr. POMEROY. Good. I would hope that the request from the IRS is met in the President's budget, and I will be looking specifically at whether the funding matches the $9.7 billion request. As I look at that, I will note that this advisory board that has taken its responsibilities, as you mentioned, very substantively, and have no stake other than sound administration of the service itself, I believe you were $500 million low in that request. So we will have some benchmarks to evaluate whether or not the resources are there.

Regardless of how you feel about the tax code or tax policy, you represent an agency that has to get its work done. And if it does not, literately discredits the entire Federal government in a way that is more fundamental than what most agencies would. Thank goodness for your distinguished leadership, and I mean it, at doing the best possible under the circumstances, but you need resources and I hope that they are there for you. Thank you. I yield back, Mr. Chairman.

Chairman HOUGHTON. Thanks very much. Mr. Weller.

Mr. WELLER. Thank you, Mr. Chairman and Mr. Commissioner. Good to see you again. I look forward to working with you. I know when I came in, and I apologize for running late, but my friend and colleague, Rob Portman, was discussing with you the progress on electronic filing, something that reduces a lot of paperwork and we all hope moves forward in simplifying the tax filing process for taxpayers in this new economy.

One of the concerns that has been raised to me by some who are in the business of helping prepare tax filing, as well as individual taxpayers, I know Mr. Portman referred to the PIN issue, but others have said that also the Social Security number becomes a problem, as well. I was wondering, do you have any idea what percent of electronic filings, where there is a complication, results from a number that does not match up?

[The following was subsequently received:]

Our Electronic Filing program is designed to perform a matching process with the social security number (SSN) and name (combined is known as a (TIN)) provided by the taxpayer against the SSN and name information maintained by the IRS. The Social Security Administration (SSA) provides the IRS with weekly updates of SSNs and matching names. If, during the initial validation process of electronic filing, the SSN and associated name on the tax return does not match the information on file with the IRS, the return is rejected to the preparer with an explanation of the errors. Electronic Filing information, as of April 10, 2001, reveals approximately three million rejects, (a single return may have multiple rejects as the primary and secondary taxpayers, as well as dependents are checked) because of mis-matching information between what was on the returns and the information on the IRS master file from SSA records.

Mr. ROSSOTTI. I can get you that number. I do not have it off the top of my head. Let me just point out that verifying social security numbers is not something that is unique to electronically filed returns. It is exactly the same, whether they are filed on paper or electronic. The only difference is that it is quicker to identify the problem electronically, which actually helps people, because we identify that rather than sending them a piece of paper in the mail telling them their social security number is wrong.

The reason we do that is really is part of the compliance program. I think the Congress, the IG and GAO and everyone has recognized that this is an important thing to do, to verify all the social security numbers for people who claim dependents or EITC qualifying child, those sorts of things. This is something that is really not related to electronic filing as much as it is making sure the returns are accurately filed. I can get you the numbers. I will get back to you with the specific numbers about how many returns have social security number——

Mr. WELLER. Because I have been hearing numbers of up to 10 percent of those electronic filings being rejected because of social security numbers. Now, whether those numbers are accurate, I wanted to hear from you.

Mr. ROSSOTTI. We will get you those numbers. My only point is the same issue applies whether taxpayers file electronically or on paper and it is just quicker to identify them electronically.

Mr. WELLER. Have your people ever sat down with the Social Security Administration and tried to figure out a way to ease that process? Because I realize it occurs probably when people marry, a woman may take her husband's name and a change in status, what kind of conversation do you have with Social Security?

Mr. ROSSOTTI. We actually do that on a regular basis. I was just talking about it with some people this morning and the kind of issues that come up are small issues. One example that I heard, for example, is that some people were getting names rejected because the social security number—in earlier periods they had not allowed hyphens in certain people's names and then they went and cleaned up the names to put the hyphens in. That was a good thing for them to do, but it did not match what people put on their returns in some cases. There are all these little issues, but in total they add up. We are working with the Social Security Administration to figure out ways to make it as easy as possible for people to make the corrections, and also make sure our files match.

Mr. WELLER. I would appreciate it if you could share with the Subcommittee, just to follow up on this question, where you are in the progress, what the status of your conversation/cooperation with the Social Security Administration would be. They are not far from you and to try to solve that problem, just to simplify the process of filing taxes.

[The following was subsequently received:]

IRS has established a working relationship with the social security Administration (SSA) to resolve the difference between IRS taxpayer information and the SSA social security number and name data. Jointly, IRS and SSA make every effort to insure that the TIN information on file with the IRS is accurate. All changes to IRS programming that require validation of taxpayer, taxpayer spouse, or taxpayer dependents are coordinated with SSA before implementation. All decisions that impact taxpayer Social Security numbers and name are made jointly between IRS and SSA. The IRS also has procedures in place to use prior year return information to validate spouse and dependent information where the information IRS has is different from SSA information. As of the first of April, the IRS identified over five hundred thousand cases where the information on the tax return did not match the SSA information on file with the IRS. Through this matching program, the IRS has "validated" three hundred thousand of these. Each of the 300,000 records has been marked and the IRS and SSA will contact these taxpayers this summer in an effort to correct this discrepancy.

In addition, IRS will continue to meet with SSA to discuss issues concerning the date of birth and name control mismatches and the accuracy of Citizenship Codes that can also cause returns to reject.

Mr. WELLER. Let me shift over to a kind of a different subject, and that is you come out of the business sector. You are a successful businessman. What is your philosophy about government agencies competing with private businesses in supplying services and products?

Mr. ROSSOTTI. Well, I think that, by and large, it is not a wise thing for the government agencies to get into business and compete with the private sector. We have enough to do just with what our mission is.

There are some gray areas. There were some issues about exactly how far we should go in order to promote electronic filing, offering additional services, and we have made a determination. As a matter of fact, it was included in the Restructuring Act guidance that we should work with the private sector and foster competition rather than get into that business. For example, we have no intention of getting into the tax software business that distributes software.

Mr. WELLER. That was the question I wanted to follow up. So you have on plans to provide specific software to taxpayers that would than obtain that through the private sources.

Mr. ROSSOTTI. Yes, that is correct.

Mr. WELLER. You do not want to compete it?

Mr. ROSSOTTI. That is correct. As a matter of fact, we had a discussion on that subject with the House Appropriations Committee, the last October hearing, and there is some report language in our appropriation bill that asks us to provide a report to the Committee, which we will, but as I testified at that point, we do not plan and we do not think it would be wise for us to get into that. But we are trying to figure out ways that we could encourage the competition as was specifically required in RRA to drive the costs down as much as we can for the taxpayer, but that would be within the realm of the private sector, not by the IRS getting into the business.

Mr. WELLER. Thank you, Commissioner. I look forward to working with you, and look forward to hearing your report. Thank you very much.

Chairman HOUGHTON. Thanks, Mr. Weller. Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman.

Commissioner Rossetti, I am glad to be back on this Committee. Certainly, we have been through a couple of good taxpayer rights bills over the last couple of years together. So it is nice to be back here again.

I have a couple of questions that I would like to talk about. Over the last couple of weeks, we have been, obviously, doing some tax bills, and there has been a lot of concern about the earned income tax credit and being fraudulent. I know we have put a lot of work into doing this.

I noticed it was kind of a secondary in your prepared remarks to us as compared to a story that actually was in the Wall Street Journal yesterday talking about businesses and tax shelters. So can you kind of bring me up to date where we are on the earned income tax credit and what you are seeing in the other filings that seem to go kind of unnoticed on occasion?

Mr. ROSSOTTI. Well, I think, as I said in my opening statement and in our strategic plan, there are compliance problems across the entire spectrum. There really are, and they affect all types of returns and all types of taxpayers.

With respect to the earned income credit, that remains a problem. We issued a report last year that tried to quantify that. We have a little better quantification on that than we do in some other areas, and we did find that there were about, after everything was said and done—and this was for the filing season '98, so it is kind of old data before we had done some new initiatives, but at that time, there was about $7.5 billion of erroneous claims out of $30 billion.

I stress that we use the term "erroneous claims" or "over-claims" because we do not really know in all cases what causes these claims. Some of them may very well be deliberate. Some of them could be simply the fact that there is a complex set of calculations in the EITC. So we do not know exactly what causes them, but we do know what the amount of them was, and that is a significant amount of money. We do have a special appropriation from Congress to work on it.

We have one new feature that we have implemented this year to try to deal with it which is called the dependent database, which was authorized by law and gives us data from the States on who the custodial parents are, and we can use that to match with taxpayers claiming the EITC.

We are working on that, but as you noted in your question, it certainly is not the only area of non-compliance. Ranging from these abusive trusts to the corporate tax shelters to the employment taxes, no matter where you go, you find it. Obviously, the majority of taxpayers in every one of these groups is very compliant and very honest, but there are those who try to take advantage of it, and we try to do what we can.

Mrs. THURMAN. I do appreciate that answer because it always comes back to us like somebody is doing something that they are not supposed to be doing on either one of those questions on any one of those sides.

The second thing that I would like to ask you is—actually, there are two, before I run out of time. One was there was a notice in the FNA Today that was talking about the IRS electronic newsletter that was dated April 1st dealing with taxpayers and preparers are actually misrepresenting instructions used in a notice 703. This has to do with Social Security benefits, and I just was kind of going to ask, can you give us some idea of the extent of this problem, how many taxpayers are making this mistake, and more importantly, something that we might be able to help on is do you think it would be fair for us to be forcing these folks to pay penalties and interest due to the lack of a clarity of a notice that IRS actually sent out.

[The following was subsequently received:]

Unfortunately, the IRS currently does not have a tracking tool that will provide the number of taxpayers that were misled by the language on Notice 703. The issue was discovered through research by IRS technical staff. As a result, the language of Notice 703 will be revised.

Penalties will only be assessed on those taxpayers in this circumstance that have made the same error in a previous tax year. Normally, only interest will be assessed.

Mrs. THURMAN. Second, different subject, but just in case we run out of time, when I was on this Committee before, there was a piece of legislation that was passed specifically to deal with the complexities of the IRS Code. I think what we finally came up with was that after the bill was passed out of the Committee, it would go to the Joint Tax Committee, and then in consultation with you all, that it was to try to help us streamline this and make this the least complicated form that we could come out with.

I would like to kind of get an update on where we are in that area as well.

Mr. ROSSOTTI. Let me answer that question first.

Yes, you are correct. That is exactly what was passed, and we have been following that.

The way it works is that when there is a specific proposal for a Tax Code change—and I think there is a threshold of how significant it is—the Joint Committee staff gets together with us through our legislative affairs office and we send them an analysis. We have been doing this now, I guess, for at least 2 years.

Mrs. THURMAN. You just send them an estimate, but do you have conversation about ways of writing this, so that it achieves the same in, but makes it less complicated?

Mr. ROSSOTTI. Well, that is not exactly what we are required to do.

We provide them a specific statement as to what additional complexity, what changes, or what the impact is going to be. It is kind of like an impact statement.

For example, it says such and such a change that it is going to require changing these forms. There are going to be so many more line items or so many less line items, and here is how many taxpayers are going to be affected, and that sort of thing. We provide that to the Joint Committee staff and then they provide that to the Ways and Means Committee and the Finance Committee for inclusion in the Committee reports. We have been doing this since that provision went into effect.

Mrs. THURMAN. I guess the follow-up question on that, then, was has our Tax Codes gotten less complicated because of that.

Mr. ROSSOTTI. I am afraid I could not say that. I do not think it has gotten less complicated.

I think that there was one occasion, I do know, in which there was a proposal to change the way capital gains were treated. In fact, I remember calling Chairman Archer on this particular point myself and saying this is really going to cause a significant problem. I think the Chairman figured out a way to save that so it would not have that particular impact. So, at least at a certain level, it has had some beneficial impact, but, of course, there have been no really big tax bills enacted since that provision was implemented either.

Mrs. THURMAN. Well, they have come out of this Committee. The other issue was on the 703.

Mr. ROSSOTTI. I am afraid I am going to have to get back to you on that first question because I do not have the answer. I will have to get back to you on it. I just do not have the answer in my head.

Mrs. THURMAN. I would love to hear from you because it does deal with the Social Security benefit taxable income, and if we are in a situation where we have given now some bad information or makes it complicated, then I would really like to be able to look at this penalty issue.

Mr. ROSSOTTI. We will get back to you. I just do not have the information readily available.

Chairman HOUGHTON. Thank you, Mrs. Thurman. Mr. Coyne.

Mr. COYNE. Commissioner, as part of the reforms 2 years ago, there was what was called the 10 Deadly Sins provision that was in there, and one of them had to do with the willful failure to file any return after the due date for filing returns and extensions for employees. Are you familiar with that?

Mr. ROSSOTTI. Yes, I am.

Mr. COYNE. Have you had to enforce that at all?

Mr. ROSSOTTI. Yes, sir. As a matter of fact, last year we provided a complete report to the Congress. So I can give you an update on all of the provisions, all of the sections, not only that one section of 1203(b). I think that we have a great deal of experience trying to administer that provision.

Mr. COYNE. So you have submitted that as part of a report?

Mr. ROSSOTTI. We submitted it last year, and I have got an update that I can give you this year, if you like, on the whole section.

Mr. COYNE. OK, that would be good.

Mr. ROSSOTTI. It gives all the statistics on how many investigations there have been and how many people have been dismissed for violations of various subsections.

Mr. COYNE. Thank you. Thank you.

Chairman HOUGHTON. Mr. Commissioner, thanks very much. We are delighted that you have been here with us.

Now I would like to call the second witness, Nina Olson, National Taxpayer Advocate Service. She is an old hand, having been in this office for a little over a month.

So, Ms. Olson, you will never be more objective than you are now. So we would love to hear your testimony.

STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE

Ms. OLSON. Thank you, sir.

I am pleased to appear before you today to address the 2000 filing season. As you know, this is my first appearance before you as the National Taxpayer Advocate. I come to this position with over 25 years of front-line experience in tax practice and procedure, and yet, during my first 30 days on the job, I have learned an enormous amount about how the IRS works.

I already knew from my private practice that IRS employees are dedicated public servants. They are a valuable resource for anyone trying to identify and resolve taxpayer problems. I would like to acknowledge with gratitude my predecessor, W. Val Overson, the first National Taxpayer Advocate, and the Deputy National Taxpayer Advocate, Henry O. Lamar.

I know that the National Taxpayer Advocate's independence and authority are a matter of interest to this Subcommittee. So I will address this issue first.

The Commissioner of Internal Revenue delegated certain authorities to the National Taxpayer Advocate on January 17th, 2001. Some TAS employees may prefer more authority than will be re-delegated to them. I have made it clear to my employees that I will not hesitate to seek additional authorities if we need them. However, I am keenly aware that if we become a shadow IRS, we may lose our effectiveness as an advocate for systemic change.

Some doubt our independence. I have no such doubt. I believe it is appropriate for the Taxpayer Advocate Service to be located within the IRS. TAS is not TIGTA or the GAO. The National Taxpayer Advocate is not a watch dog. She is an advocate before, during, and after the filing season.

For at least the last two filing seasons, IRS compliance personnel were detailed to the customer assistant sites or telephone lines in order to assist more taxpayers. Whenever operational personnel are detailed out of their original areas, response times in those areas lengthen. If the delay is more than 30 days over normal processing time, the matter will meet Taxpayer Advocate criteria.

We are concerned that the number of cases arising from delays of more than 30 days may prevent us from assisting taxpayers we are uniquely designed to help, mainly those suffering from some form of financial hardship or irreparable harm.

No review of the filing season would be complete without mentioning the earned income credit. The statute and procedures developed to reduce error and fraud in this program must also protect the rights of taxpayers. If we subjected middle-class and more affluent taxpayers to the kind of intrusive inquiries we routinely subject a taxpayer to in an EIC audit, the entire EIC audit program would be shut down in response to taxpayer complaints.

Last month, I observed the operation of the dependent database. Once the database is refined, it should significantly lessen the number of eligible taxpayers examined, have a chilling effect on those taxpayers contemplating fraud, and provide an opportunity to better educate those taxpayers who are being examined.

The Taxpayer Advocate Service recognizes the importance of electronic tax administration to the integrity of the tax system. However, we are concerned that taxpayers who face language or literacy barriers, or who do not have ready access to computers, will be left behind in the push for electronic filing.

We are mindful of Congress' direction that the IRS not interfere with the free operation of the market. We also do not believe that the IRS should enter the business of tax return preparation.

As I outline in my written comments, I believe there is a middle ground, but before we reach it, we must answer this question. To what extent should the tax system protect a vulnerable population in the tax preparation arena? This is not a decision the IRS can undertake without further guidance from Congress.

Every filing season results in a host of document-matching procedures and taxpayer notices. Taxpayers and practitioners alike are confused by the various forms these communications may take. We sympathize with the taxpayer's frustration in determining his or her rights related to IRS notices, including the right to appeal.

We have addressed these issues in our administrative and legislative recommendations and will continue to be active in this area.

The Taxpayer Advocate Service's dual mission of problem resolution and systemic advocacy involves a delicate balancing act with almost irreconcilable tension, but this tension can be a source of creativity for all. By being independent, but remaining inside the IRS structure, the National Taxpayer Advocate has access to all IRS employees. This places an obligation on TAS employees to persuade and negotiate, but that is the job of an effective advocate.

Mr. Chairman, I thank you for this opportunity to come before this Subcommittee, and I welcome your questions.

[The prepared statement of Ms. Olson follows:]

Statement of Nina E. Olson, National Taxpayer Advocate, Internal Revenue Service

Mr. Chairman and Distinguished Members of the Subcommittee:

I am pleased to appear before you today and to address the Subcommittee on matters relating to the 2001 filing season. As you know, this is my first appearance before this Subcommittee in my capacity as National Taxpayer Advocate. I started my employment with the Internal Revenue Service on March 1, 2001, a little over a month ago, in the middle of the 2001 filing season. I have spent the last 30 days travelling the country, visiting service centers to observe the return submission process, and meeting with Taxpayer Advocate Service field employees and managers as well as employees and management of IRS operating and functional divisions. I emerge from this "on-boarding" process extremely pleased with the Service's progress in re-engineering its systems and its corporate culture. I believe that the Internal Revenue Service will continue to progress in this regard, however haltingly it may appear at times.

Although I come to this position with over 25 years of front-line experience in tax practice and procedure, during the last 30 days I have learned an enormous amount about the internal workings of the IRS, including its information technology systems. I know from my private practice that IRS employees are among the most dedicated of public servants. I also know that they are a valuable resource for anyone trying to identify and resolve taxpayer problems, making them essential to the mission of the Taxpayer Advocate Service. Thus, I am firmly committed to maintaining open lines of communication between my office and all functions of the IRS, whether located here in the Washington, DC area or in any of the field offices. To that end, I have held and will continue to hold Town Hall Meetings on my trips to the field. I will also continue to reach out to taxpayers, practitioners, and consumer and business groups, as my predecessor did before me.

I would like to publicly acknowledge, with gratitude, my predecessor, W. Val Oveson, the first National Taxpayer Advocate. Mr. Oveson came on board when the Taxpayer Advocate Service was more a concept than a reality. With the able assistance of the Deputy National Taxpayer Advocate, Henry O. Lamar, he carved this organization out of whole cloth to become the organization of dedicated and professional public servants that it is today. I can only try to imagine the effort it took to get the Taxpayer Advocate Service off the ground. Mr. Oveson has left the new National Taxpayer Advocate a truly wonderful gift—an up and running organization poised to undertake the challenging and interesting work ahead. I am the humble recipient of that gift, and I am forever grateful. I am also appreciative of Mr. Lamar's fine leadership of the Taxpayer Advocate Service during the period following Mr. Oveson's resignation and prior to my reporting to duty. His ongoing support in his role as Deputy National Taxpayer Advocate will be invaluable to me.

I look forward to presenting you with the Report on the FY 2002 Objectives of the Taxpayer Advocate Service on or before June 30th, 2001. The Taxpayer Advocate Service is entering an exciting period, with challenges related to delegation of additional authorities, the revision of the content and format of the Annual Report to Congress, a pilot 4-year integrated training program, and improved procedures for monitoring and gathering case data.

With regard to the Annual Report, we at the Taxpayer Advocate Service take seriously Congress' charge to us that we give you suggestions, based on our and other's first-hand, front-line experience with taxpayer problems. We are in the process of redesigning the Annual Report, so that the final product will not only provide you with its current elements, including legislative recommendations, but also illustrative examples and a substantive discussion and analysis of each recommendation's impact on information and business systems, as well as privacy considerations. We may use the legislative recommendations to highlight developing issues, exploring and suggesting a range of solutions for your consideration. In short, we at the Taxpayer Advocate Service want the Annual Report to be a useful working document, providing you with valuable, practical information.

2001 Filing Season: General Comments

The 2001 filing season is a remarkable one for me, in part because I have experienced it from differing vantage points—initially as a private tax attorney and a low income taxpayer clinic director and now as an employee of the Internal Revenue Service. It is also unique on a personal level, in that it is the first filing season in 25 years in which I have prepared and filed no tax returns other than my own. In each of the prior 25 years, I have prepared between 25 and 200 returns for compensation. My comments thus reflect my past experience as a private practitioner, as well as the perspective of the National Taxpayer Advocate.

The Taxpayer Advocate Service (TAS) has an odd relationship with the filing season. We do not prepare or process income tax returns. Nor are we set up to answer customer service questions. There are, however, several discrete areas associated with the filing season for which TAS is responsible or which significantly impact TAS operations.

Manual Refunds: Requests and Processing

Taxpayers experiencing significant hardship and who need their refunds immediately, may contact the Taxpayer Advocate Service and request our assistance in expediting their refunds. The manual refund process may help in documented situations of hardship (e.g. eviction, medical coverage) and where we have the ability to intercept the automated refund process. Manual refunds can be issued by electronic funds transfer or regular paper checks. We secure authorized signatures; obtain documentation of the hardship; check for outstanding debts, which might offset the refund; and monitor the account to prevent erroneous or duplicate refunds from occurring. When these steps are not followed, the taxpayer can face financial responsibilities for a duplicate refund including interest. We exercise great care to ensure we do not create more costly and devastating taxpayer problems. We also recognize that IRS officials may incur financial responsibilities resulting from the issuance of erroneous refunds.

The Taxpayer Advocate Service is currently monitoring its issuance of manual refunds to ensure that second, erroneous refunds are not issued. We are increasing our access to various databases so that we may better identify situations when a manual refund will be offset by existing federal or state agency debts. Although field advocate employees review these procedures as part of their own filing season readiness, the TAS is also incorporating a review of these procedures in our 2002 Servicewide filing season preparations.

Social Security Number Problems

This past year the TAS identified a potential disruption of service to many of the two million taxpayers who have name and social security number mismatches on a joint income tax return. Frequently, the mismatch occurs because taxpayers neglect to inform the Social Security Administration of a name change following a change in marital status. We suggested that the proposed implementation of 1996 legislation, which required the IRS to strengthen validation procedures for social security numbers, would cause taxpayers concern and undue alarm. As described by Acting National Taxpayer Advocate Henry O. Lamar in our 2000 Annual Report, IRS Operations and the Taxpayer Advocate Service worked together to develop what we call a "soft" notice for taxpayers with secondary social security number problems. This notification allows taxpayers time to correct their official records before filing their *next* tax return. Thus, we were able to prevent taxpayers' 2000 refunds from being frozen without an opportunity to correct the information. This is an excellent example of how the TAS is able to work within the IRS in a nonadversarial manner in order to advocate on behalf of taxpayers.

Taxpayer Advocate Caseload

The filing season impacts TAS in another way: for at least the last 2 filing seasons, IRS personnel normally assigned to front line compliance positions were detailed to the customer assistance sites or phone lines for the worthy objective of assisting more taxpayers during filing season and improving its customer service level. Unfortunately, whenever other operational personnel are detailed out of their original areas, response times in those areas inevitably lengthen. If the delay is more than 30 days over normal processing time, the matter will automatically meet TAS case criteria, as set forth in Internal Revenue Code Section 7811.

The Taxpayer Advocate Service is currently preparing an analysis of its FY 2000 and 2001 monthly receipts inventory. We will identify the types of cases that are coming to TAS and their criteria for eligibility. We expect that this analysis will point up some of the deficiencies in our own case-tracking system and the current limitations of our case management system. We will use this information to address inconsistencies (or recommend design improvements) in our own databases, and we will work with both the Wage & Investment and Small Business/Self Employed Operating Divisions to determine how we can avoid unnecessary "overflow" referrals. To some extent this overflow will be mitigated by the hiring of Tax Resolution Representatives under the STABLE initiative, thereby freeing up compliance employees to do their own work. We also expect to see a positive impact on our overflow case inventory as the Service improves its monitoring and measurement of the level and delivery of service.

TAS is also reviewing our intake procedures to make sure we are accepting those cases in which we can actually "add value" to the taxpayer's case. In fact, we have identified "Reducing Inappropriate TAS Caseload" as a strategic goal. We are concerned that the dominance of cases arising from delays of more than 30 days or from multiple unsuccessful taxpayer contacts with the IRS actually prevents us from assisting the one category of taxpayers who TAS is uniquely designed and mandated to help, namely those suffering some form of financial hardship or irreparable harm. Over the next year, we will make a concerted effort to educate taxpayers about our unique role within the IRS and also review our case acceptance procedures. Finally, we will initiate an education campaign within the IRS to ensure that IRS employees understand the criteria for case referral and feel comfortable referring appropriate cases to TAS.

Earned Income Credit

No review of any filing season would be complete without mentioning the Earned Income Credit (EIC). Over the years I have been a consistent advocate for the rights of low income taxpayers, and I have personally represented hundreds of such taxpayers in EIC examinations, refund claims, audit reconsiderations, and Tax Court cases. I will be vocal in my advocacy that the statute and procedures developed to reduce error and fraud in this program must also protect the rights of taxpayers. Too often, taxpayers who file for the EIC do not have professional representation and because of the burdens of poverty, language or literacy barriers cannot make an effective case for themselves. It is my firm belief that if we subjected middle class and more affluent taxpayers to the kind of intrusive inquiries we routinely subject a taxpayer to in an EIC audit, the entire EIC audit program would be shut down in response to taxpayer complaints.

Last month I spent several days at two service centers, observing the return submission and processing pipeline as well as the operation of the Dependent Database (DDB). The DDB is a very sophisticated and valuable tool for EIC administration. It is essentially a series of rules that, when applied to a taxpayer's return, will identify those returns that present the possibility of taxpayer error or, more seriously, an attempt at fraud. The IRS employee reviewing these returns can determine which rules are implicated and can tell the taxpayer what information should be submitted to support the claim. This single bit of information alone will resolve many cases, since pre-2001 the IRS could not necessarily tell the taxpayer what information triggered the return review. However, the system is only as accurate as the underlying databases. If the databases are not regularly (or correctly) updated, we will be needlessly contacting taxpayers and causing them undeserved aggravation.

Another problem with the DDB is that it will sometimes flag the second-filed return in a dueling claims situation. In certain circumstances it is still possible for a noncustodial parent to file electronically and receive a refund, including the EIC, causing the second-to-file custodial parent's return to be audited. This occurs when there is nothing in the DDB to trigger an examination of the noncustodial parent's return; that is, no rules are apparently violated. Obviously in this situation, we will lose revenue and needlessly distress the custodial parent.

Representatives of the Taxpayer Advocate Service will be working with the DDB design team to explore solutions to this and similar limitations. It is my belief, however, that the DDB, once refined, will significantly lessen the number of eligible taxpayers examined, have a chilling effect on those taxpayers contemplating fraud, and provide an opportunity to better educate those taxpayers who are being examined.

Electronic Tax Administration and the Information Age Gap

The Taxpayer Advocate Service recognizes the importance of electronic tax administration to the integrity of the tax system. We stand completely behind the Service's efforts to modernize the return submission and processing pipeline. However, we are concerned that one category of taxpayers will be left behind in the push for electronic filing. Today, low income taxpayers have several options for filing a tax return. They may file a paper return and wait an average of 4 to 6 weeks for a refund. They might seek out a return preparer, pay one fee for return preparation, another fee for electronic submission, and a third fee for a refund anticipation loan, if they need their refunds immediately.

Low income taxpayers can also visit a Volunteer Income Tax Assistance (VITA) site, or, if they are elderly, a Tax Counseling for the Elderly (TCE) site. Such taxpayers may also be able to utilize TeleFile, or visit an IRS Taxpayer Assistance Center**.** Finally, if the taxpayer has access to a personal computer, he or she can file electronically through the *e-file* program, even accessing filing software from the IRS website. Thus, on the surface it appears that low income taxpayers have a multitude of filing options.

Taxpayer Advocate Service employees, VITA and TCE volunteers, and low income taxpayer clinics have all expressed concern about the impact of refund anticipation loans (RALs) on low income taxpayers. One particularly compelling example of the RAL's detrimental impact involves a taxpayer who uses his RAL as a down payment for an automobile and makes one or two additional payments before he learns that his refund is denied. The automobile is repossessed, the taxpayer loses the monthly payments he's made, he owes the financing company for a vehicle he does not have and, if the company forgives the balance of the loan, the taxpayer has cancellation of indebtedness income. Taxpayers do not necessarily distinguish the IRS from the parties driving this scheme. Such practices have a negative impact on tax compliance.

I believe that the Customer Account Data Engine (CADE) now under development and testing by the Internal Revenue Service, will ultimately remove most if not all of the demand for RALs. CADE applications for refund processing should enable taxpayers to receive a deposit of their refunds within 2 to 3 days of final return processing. Further, the IRS and Financial Management Services (FMS) are now able to establish deposit accounts for taxpayers who do not have bank accounts. These deposit accounts can receive direct deposits of tax refunds.

Although I applaud and support these efforts, I do not believe our inquiry should end here. Low income taxpayers may not have access to VITA sites (which are not necessarily located where low income taxpayers live or work); VITA sites may not be equipped with computer equipment appropriate for electronic return filing; low income taxpayers may not have access to personal computers or be computer literate; and finally, the TeleFile system does not accept a return from a single taxpayer who claims a dependent. These factors, combined with the sheer complexity of determining filing status and entitlement to dependency exemptions and the EIC, demonstrate that low income taxpayers will continue to require the assistance of return preparers in the future.

It is interesting to note that of 576,351 1999 Form 1040 returns claiming EIC with math errors, 44% of those returns showing computational errors were commercially prepared. In addition, commercially prepared returns accounted for 55% of the math error adjustments in which the EIC was partially or fully disallowed. *Essentially, taxpayers whose income is so low as to be eligible for the Earned Income Credit are a captive market for return preparers who are not very accurate or who are not making the proper inquiries of their clients in order to accurately complete the returns.*

The Taxpayer Advocate Service is concerned that down the road, as RALs become relatively obsolete, some commercial return preparers will seek to recover the lost revenue through increased electronic filing fees and/or return preparation fees. We are mindful of Congress' direction in Section 2001(a)(3) of the IRS Restructuring and Reform Act of 1998 that the IRS not interfere with the free operation of the market. We also do not believe that the IRS should enter the business of tax return preparation. However, I would like to suggest that there is a middle ground.

Congress, for example, could investigate whether low income taxpayers operate within a free and open market or if that particular market segment is imperfect and requires some corrective action. Congress could determine that a taxpayer who is eligible for EIC in order to maintain a baseline standard of living should not see his EIC reduced by large return processing or preparation fees.

One solution to this dilemma is to establish National Filing Days, similar to National Problem Solving Days, during the filing season. The National Filing Days could be located at public schools or houses of worship, be staffed by volunteers, offer on-site electronic return submission and direct deposit accounts. Congress could also establish a separate grant program for administrative expenses (including computer equipment) incurred by VITA initiatives. Thus, free tax return preparation would be available to low income taxpayers where they live and worship.

Other less complicated measures can address the more obvious consumer abuses. The Taxpayer Advocate Service is currently suggesting that the IRS incorporate a consumer alert into appropriate brochures and publications. This caveat would state in clear and simple language that taxpayers who pay for their return preparation should receive a copy of their returns, *signed by the preparer*. For that matter, members of Congress can include this information in their constituent communications. The notice might include a toll-free number so that taxpayers could report their preparer to the IRS if he or she refuses to sign the return. This program dovetails into the Service's current efforts to educate return preparers about the EIC substantive and due diligence requirements. It will enable the Service to actually locate those preparers most in need of education.

I must emphasize, though, that to some extent the solution to the low income taxpayer return preparation dilemma rests on a judgment call by Congress. Does the tax system have some responsibility to protect a vulnerable population from questionable market practices in the tax arena? This is not a decision the Internal Revenue Service can undertake without further guidance from Congress, given the directive in RRA 98 that the IRS refrain from interfering in the commercial return preparation marketplace.

Taxpayer Advocate Service Independence and Authorities

The final issues I would like to address are not related to the filing season specifically. As you know, the Commissioner of Internal Revenue Service delegated certain authorities to the National Taxpayer Advocate on January 17, 2001. These authorities, once delegated to the field, will enable TAS employees to resolve taxpayer problems more quickly. In many cases, the delegated authorities should eliminate the need to refer the case back to the originating function. Generally, the delegated authorities provide to the TAS the authorities that former Problem Resolution Officers derived from their district directors. We hope to have a redelegation, implementation, and training plan in place by July 1, 2001.

I am aware that some TAS employees will be dissatisfied with the redelegation order. These dedicated employees would like very much to resolve a taxpayer's case entirely within the Taxpayer Advocate shop. In some instances, this may be the appropriate result. I have made it clear to my employees that if, after we have tested these new authorities, we find that we need additional authorities, I will not hesitate to seek them. But I am keenly aware that if TAS takes on more IRS authorities, it risks becoming a "shadow IRS" and it loses its effectiveness as an advocate for systemic change. That is, after all, the ultimate goal—to work with the *other* IRS operating and functional divisions in identifying and mitigating individual and systemic taxpayer problems.

Some commentators doubt the Taxpayer Advocate Service's ability to maintain its independence while remaining part of the Internal Revenue Service. I have no such doubt. I believe that it is appropriate for the National Taxpayer Advocate and the Taxpayer Advocate Service to be located within the IRS. The Taxpayer Advocate Service is not TIGTA or the GAO. The National Taxpayer Advocate is not a watchdog. Rather, she is an advocate.

Congress has charged the National Taxpayer Advocate with the mission of assisting taxpayers with their problems and assisting the IRS and Congress in mitigating those problems. It is indeed a very difficult mission, with almost irreconcilable tensions built into it. But I believe that this tension can be a source of creativity for all of the participants. By being independent but remaining inside the IRS structure, the NTA is a player at the table with access to all members of the IRS management team as well as the field employees. This relationship places a strong obligation on TAS employees to persuade and negotiate, and to have courage in the face of opposition or bureaucratic obstacles. But that is the job of an effective advocate.

I am committed to seeing that each and every member of the Taxpayer Advocate Service is trained and supported so that he or she can well serve the taxpayer, the Internal Revenue Service, its Oversight Board, and the Congress. I look forward to this challenge.

Mr. Chairman, thank you for this opportunity to come before this subcommittee and discuss these matters.

Chairman HOUGHTON. Well, thanks very much. I appreciate it. Mr. Coyne, would you like to ask a question?

Mr. COYNE. Thank you, Mr. Chairman.

The Taxpayer Advocate's office in the past has had the problem with the innocent spouse provision, and I was just wondering if you could update us at this point on what the status of the large numbers of those instances are.

Ms. OLSON. We pulled an inventory on March 23rd of our cases. Nationwide, Taxpayer Advocate cases were approximately 2,000, out of about 50,000 cases, or one out of 25 or 4 percent of our caseload. I honestly do not know yet whether that seems a large number or small number.

What I found very interesting is that of those 2,000 cases, 95 percent of them related to the criteria that we use to accept a case resulting from unreasonable delays, more than 30 days; something unresolved by the time it was promised; or systemic failure. The cases were not related to the criteria that we use for the immediate and irreparable harm, the significant hardship type criteria. Those counted for only 10 percent of the cases.

We found that the average processing of those cases was over 180 days, and, interestingly, we found that very few of the cases dealt with tax years after the restructuring act. Almost 20 percent of them dealt with 1980s cases, where the underlying tax liability was in the 1980s, and 60 percent of them dealt with the years 1990 through 1997.

We found some interesting information that we are using to think about recommendations for the innocent spouse program. Currently, all innocent spouse cases by the operation unit are being reviewed, every single one of them. And the Service did that, obviously, to ensure that with a new statute there was some continuity and consistency in the decision. But we do need to ask, should we be doing this, because that review adds 2 or 3 months.

We also found that there was a long delay, often 2 months, when a case was actually closed, and the decision had been made. Two or 3 months were related to an accounting function of trying to separate out the accounts from the innocent spouse and the non-electing spouse, and we couldn't close the case finally until we had done that actual accounting separation.

Let's see if there is anything else. We found that in our particular cases, for many of the cases that were categorized innocent spouse, there was no 8857 form, the request for innocent spouse relief, that had yet been filed. Somebody had just called us saying we are an innocent spouse. So the paperwork hadn't even begun, and yet they are on our system as an innocent spouse case.

We also found that a large number of cases were categorized as innocent spouse, and they were injured spouse, and we had not made that determination.

Finally, we found that some cases were categorized as an innocent spouse case that are really more an erroneous type offset.

So that has led me to believe that in just our own data we need to go in and look at how we are categorizing these cases and then to really see what is going on in the national program about innocent spouse.

Mr. COYNE. On another subject, on the earned income tax credit, in your testimony you point out, and I quote, "It is interesting to note that of 576,000 1990 Form 1040 returns claiming EITC with math errors, 44 percent of those returns showing computational errors were commercially prepared. In addition, commercially prepared returns accounted for 55 percent of the math error adjustments in which the EITC was partially or fully disallowed." And I think that goes to your earlier comment in your testimony where you point out about the necessity to be as fair with EIC filers as you would be with moderate- and low-income filers in other circumstances. Thank you.

Chairman HOUGHTON. Thanks very much. Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman.

First of all, Ms. Olson, I just want to tell you that if I don't say this, my office will absolutely have a fit. So let me just say on behalf of my congressional staffers who work very hard in trying to also solve people's problems, they have been very impressed with the Taxpayers' Advocates. They have been very forthcoming. I have actually had the opportunity to sit with one just recently on a case that my office has been involved in on an estate tax issue, and they have been knowledgeable and yet trying to—you know, this is—what you do is not easy. It is not an easy job when you are trying to make it work and sometimes that just doesn't happen. And you can see it in them, and I appreciate their concern.

Ms. OLSON. Thank you. I will pass that on to them.

Mrs. THURMAN. In saying all of that, and as kind of the question that I asked the Commissioner, and certainly because of being one that would be right down there in the front-line with some of these folks, I really do look forward to any recommendations, as you have put out and as was put out recently in your report, things that we can do to make it easy. I guess I thought we had gone a little bit further a couple of years ago when we thought that when this Committee did a tax bill that there would be a lot more conversation, not just how many taxpayers or—you know, I really would like to hear the complexity because it certainly sounds to me—and with your background and working with low-income families that the complexity is as much of a problem as any real fraud and abuse that seems to be spouted every so often when we try to get into a tax fight up here.

Ms. OLSON. I think that we are looking at our annual report, and we have engaged in discussions with your staff as to how we can turn this into a tool for you all. We are hoping that this year we will provide examples in our legislative recommendations so that you can see what has brought us to make this recommendation. For certain recommendations, we hope to do an analysis of the information system impact, just simply saying this will save money, this will save time and effort, this will be an easy thing to do.

We will be looking at privacy considerations because I think that that is something that we don't spend enough time about, and we may have some insight on that from the field, maybe even just the appearance of privacy. There may be something that is perfectly legal, but it sends shivers up taxpayers' spines. So I think we have really heard from you your expectations of this document.

I will say that we are—and I have utilized my liberty, my honeymoon period as the new Advocate to come in and suggest that we revisit some of our legislative recommendations over the last 3 years. And you may find the Taxpayer Advocate Service being so independent that they are reversing some of their own legislative recommendations.

Mrs. THURMAN. Well, and I think one of the other services that has been provided for people that don't know this is just the ability for them to come into our Web sites and be able to go out to you all or even to IRS to find out some answers and questions has been an enormous help for us to send people, you know, and then they eventually probably end up back talking to us.

Ms. OLSON. Right.

Mrs. THURMAN. But at least it is available to them, and I know that the Taxpayers' Advocate group from Jacksonville were in a couple of months ago, I guess even prior to your appointment. But they have really given us some help in that way, too.

I really think that you can offer us, instead of us even slamming people that you are trying to help, that we really figure out what we have done to cause a problem out there, so I appreciate the work that you all do. Thank you.

Ms. OLSON. Thank you.

Chairman HOUGHTON. Thanks, Mrs. Thurman.

Ms. Olson, I think I only have one further question. We are going to be hearing from taxpayer preparer groups and their continued need for tax simplification. If there is one area you think needs to be simplified in this brief tenure you have had here, what would you think it would be?

Ms. OLSON. I think there are two specific areas where we see problems that also taxpayer practitioner groups do. One obviously is the areas that impact all taxpayers, dependency exemptions, filing status, and then if you go into the low-income population, the earned income credit. And they do seem to be linked, and we do seem to spend an inordinate amount of time wrestling with these very basic issues that touch almost every single taxpayer. What status do you claim? Are you single, married filing jointly, head of household?

I think that there is a lot out there. We have certainly made some recommendations about how you can unify the various definitions, conform the definitions, and keep different provisions for where there are true policy reasons for keeping those definitions. And I think that we can make those changes. Certainly my report, the annual report, will reflect some very specific recommendations on those issues.

The second one is penalty and interest reform, and my advocates, we have been polling the field asking for examples from the front-line employees of where they see cases where they feel that the taxpayer should be given relief in the interest situation, where the tax debt has accrued interest. And we just can't get there under the current statute.

And we have certainly been looking at penalty reform over the years and have made a recommendation about that. And so we hope that over the course of the year we will be able to give you some very concrete examples of things that might help in crafting legislative fixes for these issues. And as you see in our report, penalties and interest is the top most litigated issue in our list of ten most litigated issues. It is not the underlying tax that they are going to court about.

Chairman HOUGHTON. Well, thanks very much.

Ms. OLSON. Thank you.

Chairman HOUGHTON. We appreciate this.

Mrs. THURMAN. Mr. Chairman.

Chairman HOUGHTON. Yes, go ahead, Mrs. Thurman.

Mrs. THURMAN. I have to ask you this because I just—the great staff that I have over here said you need to ask her about this.

Ms. OLSON. OK.

Mrs. THURMAN. And it actually deals with a Second Circuit Court of Appeals ruling, and it is called the mail box rule. Evidently, there is a misconnect, just so you will know, between some of the—our Florida office and out of here. So if you would let your Florida office know about this, I could get a constituent very happy. Thank you.

Chairman HOUGHTON. OK. Thanks very much.

Ms. OLSON. I am familiar with that, yes.

Chairman HOUGHTON. OK. Well, thanks very much, Ms. Olson. We are delighted to have you here.

OK. Now we have our next panel: Hon. David Williams, Inspector General, Treasury Inspector General for Tax Administration, Department of Treasury; and James R. White, Director of Tax Policy and Administration Issues of the General Accounting Office.

Well, gentlemen, thanks very much for being with us. Mr. Williams, would you like to testify?

STATEMENT OF HON. DAVID C. WILLIAMS, INSPECTOR GENERAL FOR TAX ADMINISTRATION, U.S. DEPARTMENT OF THE TREASURY

Mr. WILLIAMS. Thank you, sir. Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to appear here today to discuss the 2001 tax filing season and the IRS' continuing efforts to improve taxpayer service.

The IRS is experiencing success in processing tax returns and issuing refunds. The IRS also continues to provide substantive information to taxpayers on its Web site. This filing season alone, the Web site received over 986 million accesses. While these are bright spots to recognize, the IRS is faced with the challenge of processing a greater number of returns around April 15th, since many taxpayers have chosen to file later than expected.

Electronic returns, while significantly up, have not reached the anticipated level. Challenges also continue to exist regarding the performance of and the plans to enhance customer service. The IRS acknowledges the need for customer service improvements. Our audit results also show the need for improvement.

Over a 4-day period during this filing season, our auditors made 368 random test calls to IRS toll-free numbers and were unable to gain access 37 percent of the time. When successful in getting through, the IRS incorrectly responded to 47 percent of the questions. The topics of the test calls were obtained from the IRS' list of frequently asked questions. We also encountered a similar situation when we visited 47 taxpayer assistance centers in 11 States. The IRS did not provide auditors with the correct answers 49 percent of the time. In the majority of our contacts, we were served within 15 minutes and were treated courteously. However, in over 10 percent of the contacts, the IRS did not provide an adequate professional response.

Dramatic improvements in customer service are heavily dependent on the success of the IRS systems modernization initiatives. Among the benefits taxpayers are expected to receive from systems modernization initiatives are: better and quicker access to tax help; readily available, accurate, and current account information; more electronic filing capabilities; more refund in days instead of weeks; and expanded self-service options over the telephone and the Internet.

To accomplish modernization, the IRS contracted with a consortium of experienced information technology companies led by a major integrator. This contract, known as the PRIME, is a multibillion-dollar contract over a 15-year period. Since it began 2 years ago, about $400 million has been spent on systems modernization. And while the basic architecture and program management processes have been established to guide the modernization, thus far most of the ongoing systems projects are taking longer and costing more than originally estimated. As a result, benefits to taxpayers have yet to be realized.

The customer communications project is intended to be the first major systems modernization accomplishment. This project is designed to route taxpayer calls to a customer service representative who is best qualified to answer the taxpayer's question anywhere in the United States and will also provide expanded self-service telephone and Internet services. Although progress has been made on the project, deliverables originally scheduled for 2001 have been scaled back significantly, including the ability to route calls to the best qualified person. Also, implementation dates for the deliverables have steadily slipped and cost overruns have occurred. As a result, the expectation of answering an additional 9.6 million calls during the 2001 filing season will not be realized, nor will the telephone assistors be freed up for other work.

This situation in part is due to the decision to move the project's development stage before completing critical foundational products, such as the risk management plan and security testing schedules, initial software design failures, and virtually no allowance for unplanned events. The project has special significance since it is the first systems modernization deliverable for taxpayers' benefits. In this and other instances, the PRIME and the IRS have overestimated their ability to deliver products on schedule and within cost estimates.

I would be pleased to respond to questions that you have at the appropriate time.

[The prepared statement of Mr. Williams follows:]

Statement of the Hon. David C. Williams, Inspector General for Tax Administration, U.S. Department of the Treasury

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to appear here today to discuss the 2001 tax filing season and the IRS' continuing efforts to improve taxpayer service.

The IRS is experiencing success in processing tax returns and issuing refunds. The IRS also continues to provide substantive information to taxpayers on its Web Site. This filing season alone, the Web Site has received over 986 million accesses. While these are bright spots to recognize, the IRS is faced with the challenge of processing a greater number of returns around April 15th since many taxpayers have chosen to file later than expected. Electronic returns, while up significantly, have not reached the anticipated level. Challenges also continue to exist regarding the performance of and plans to enhance customer service.

The IRS acknowledges the need for customer service improvements. Our audit results also show the need for improvement. Over a four-day period during this filing season, our auditors made 368 random test calls to the IRS' toll-free number and were unable to gain access 37% of the time. When successful in getting through, the IRS incorrectly responded to 47% of the questions. The topics for the test calls were obtained from the IRS' List of Frequently Asked Questions.

We also encountered a similar situation when we visited 47 Taxpayer Assistance Centers in 11 states. The IRS did not provide auditors with correct answers 49% of the time. In the majority of our 90 contacts, we were served within 15 minutes and were treated courteously. However, in over 10% of the contacts, IRS did not provide an adequate professional response.

Dramatic improvements in customer service are heavily dependent on the success of the IRS' systems modernization initiative. Among the benefits taxpayers are expected to receive from systems modernization initiatives are:

- Better and quicker access to tax help;
- Readily available, accurate and current account information;
- More electronic filing capabilities;
- More refunds in days instead of weeks; and
- Expanded self-service options over the telephone and the Internet.

To accomplish modernization, the IRS contracted with a consortium of experienced information technology companies, led by a major integrator. This contract, known as the PRIME, is a multi-billion dollar contract over a 15-year period. Since it began 2 years ago, about $400 million has been spent on systems modernization. While the basic architecture and program management processes have been established to guide the modernization, thus far, most of the ongoing modernization projects are taking longer and costing more than originally estimated. As a result, benefits to taxpayers have yet to be realized.

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- The decision to move to the Project's development stage before completing critical foundational products, such as the risk management plan and security testing schedules,
- Initial software design failures, and
- Virtually no allowance for unplanned events.

This Project has special significance since it is the first systems modernization deliverable for the taxpayer's benefit. In this and several other instances, the PRIME and the IRS have overestimated their ability to deliver projects on schedule and within cost estimates.

I'd be pleased to respond to any questions that you have at the appropriate time.

Chairman HOUGHTON. Thanks very much. Mr. White.

STATEMENT OF JAMES R. WHITE, DIRECTOR, TAX ISSUES, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY RANDOLPH C. HITE, DIRECTOR, INFORMATION TECHNOLOGY SYSTEMS ISSUES, AND ROBERT F. DACEY, DIRECTOR, INFORMATION SECURITY ISSUES

Mr. WHITE. Mr. Chairman and Members of the Subcommittee——

Chairman HOUGHTON. Do you want to put the microphone on? Thank you.

Mr. WHITE. Mr. Chairman and Members of the Subcommittee, we are pleased to be here today. As requested, our testimony deals with three related subjects: IRS' performance during the 2001 tax filing season, the status of IRS' business systems modernization effort, and the security of IRS' electronic filing system. It is fitting to discuss these topics together. The only contact most Americans have with IRS comes during the filing season. If the promise of IRS' modernization is to be realized, that is, if taxpayers are to receive better service in future filing seasons, then IRS must succeed at modernizing its information systems and ensuring the security of tax data.

With respect to this year's filing season performance, as shown by Figure 1 and also on page 11 of my statement, IRS had received roughly 50 million tax returns by March 16th. The white bars are total returns, starting in 1997. Our preliminary analysis of data available to date shows several positive aspects to the filing season as well as some concerns.

First, IRS' reorganization into four operating divisions has been virtually invisible to taxpayers. Neither positive nor negative effects on service are evident—not surprising, given the newness of the divisions.

Second, IRS has processed tax returns and issued refunds without significant problems and has seen a continued increase in the percentage of returns filed electronically, as shown by the gray bar in Figure 1. The rate of growth in the number of electronically filed returns is important because Congress set a goal that IRS receive 80 percent of all returns electronically by 2007. IRS has projected growth in electronically filed returns of about 20 percent this year; however, the actual increase to date has been only about half that. IRS had tried to make electronic filing more convenient this year by allowing more filers to sign their returns with a PIN number. While used by millions of taxpayers, the PIN program has encountered some problems, however. Many taxpayers have had their returns rejected, for example.

Third, as shown in Figure 2 on page 19 of my statement, IRS has done a better job of answering the telephone this year compared to last. Figure 2 shows level of service or the percentage of calls that are answered. Because IRS rerouted a substantial number of calls this year to improve service, we adjusted the 2001 base to allow for valid comparison to 2000. The comparison to 1998, however, is less certain. In any case, however, there are concerns about assistor productivity, including concerns about the amount of time taken by assistors between calls. Even with the improved service this year, further improvement in telephone assistance is needed if IRS is to achieve its goal of providing top-quality service.

Fourth, the quality of tax law assistance of walk-in sites remains poor, as TIGTA reports. IRS has changed the way it has organized and staffed to provide walk-in assistance and is planning to make changes to improve service during the 2002 filing season.

Turning now to business systems modernization, we have long held that IRS needs to establish fundamental modernization management controls before it begins to build and implement modernized systems. IRS has made important progress in developing and implementing these capabilities, but it still is not where it needs to be. In Figure 3, also on page 31 of my statement, the bottom four horizontal timelines represent four key ongoing systems acquisition projects. The stars on those lines show where detailed design and development began on those projects. The fact that IRS has moved past those stars without all the needed management controls implemented means the risk associated with those projects is now considerably greater. At these later stages in a project's life cycle—that is, after detailed design and development has begun—any systems rework is much more expensive and time-consuming. Given that IRS needs additional money for modernization and is seeking congressional approval of these funding needs, this is an opportune time to ensure that IRS addresses these risks. And just today, the Commissioner told us he is taking steps to pull back on some projects in order to focus on these concerns.

Finally, with respect to the security of IRS' electronic filing systems and electronically transmitted taxpayer data, our review last year showed that IRS had ineffective controls to ensure security. We demonstrated that individuals both inside and outside of IRS could gain unauthorized access to IRS' electronic filing systems and view, modify, copy, or delete taxpayer data. According to IRS officials, IRS moved promptly to correct the access and control weaknesses we identified before this filing season. It developed plans to improve security over its electronic filing systems and internal networks and said that it had substantially implemented those plans.

Mr. Chairman, this concludes my statement. We would be happy to answer any questions.

[The prepared statement of Mr. White follows:]

Statement of James R. White, Director, Tax Issues, U.S. General Accounting Office

Mr. Chairman and Members of the Subcommittee:

We are pleased to participate in the Subcommittee's hearing on the Internal Revenue Service's (IRS) 2001 tax return filing season. As requested by the Subcommittee, our testimony deals with three related subjects: (1) the status of the 2001 filing season, (2) the status of IRS' business systems modernization effort, and (3) the security of IRS' electronic filing system. It is fitting to discuss these three topics together. The only contact most Americans have with IRS comes during the filing season, when they file their returns, call IRS for help, or visit an IRS walk-in site for assistance. If the promise of IRS' modernization is to be realized, that is, if taxpayers are to receive better service in future filing seasons, IRS must succeed at modernizing its information systems and ensuring the security of tax data.

Our statement is based on (1) the preliminary results of our review of the 2001 filing season being done at the Subcommittee's request, (2) past and ongoing reviews of IRS' systems modernization effort, and (3) information in our recently-issued report on the security of IRS' electronic filing systems.[1]

Our testimony makes the following points:

- Although the 2001 filing season appears to be running smoothly, there are some matters that require further attention. First, not unexpectedly, IRS' reorganization has had little effect on taxpayers this year, but several challenges remain if the reorganization is to ultimately improve taxpayer service. Second, although the percentage of returns filed electronically has increased, the rate of increase is below expectations. Third, in an effort to make electronic filing truly paperless, IRS now allows electronic filers to "sign" their returns with a Personal Identification Number (PIN). Although many taxpayers have successfully used a PIN, many others who tried to do so had their returns rejected for reasons that are still not clear. Fourth, data obtained from IRS indicate that taxpayers are having an easier time reaching IRS to ask questions about the tax law, their accounts, and their refunds; but IRS still has concerns about the productivity of its telephone assistors. And, fifth, IRS' walk-in sites are continuing to provide poor tax law assistance this year. Although IRS has changed the way it is organized and staffed to provide such assistance, it has deferred making changes to improve the quality of that assistance until fiscal year 2002.
- With respect to business systems modernization, we have long held that IRS needs to establish fundamental modernization management controls before it begins to build and implement modernized systems. IRS has made important progress in developing and implementing these capabilities, but it is still not where it needs to be. We are therefore concerned that IRS is allowing its system acquisition projects to get ahead of its capabilities for managing them and ensuring that modernized systems deliver promised value, on time and within budget. While allowing acquisition and building management controls to proceed concurrently introduces an element of risk when systems acquisition projects are in their early, formative stages, the risk is considerably greater when projects enter their later phases (detailed design and development). At these later junctures in a project's life cycle, system rework, due to not employing disciplined modernization management controls, is much more expensive and time-consuming than it is earlier. Given that IRS needs additional money to invest further in modernization, both near-term and longer term, and is seeking congressional approval of these funding needs, this is an opportune time to ensure that IRS addresses these risks.
- Our review of IRS' electronic filing systems last year showed that IRS had ineffective controls to ensure the security of those systems and electronically-transmitted taxpayer data. We demonstrated that individuals, both inside and outside of IRS, could gain unauthorized access to IRS' electronic filing systems and view, modify, copy, or delete taxpayer data. Although IRS said that it had not evidence of any such intrusions, it did not have adequate procedures to detect intrusions if they had occurred. According to IRS officials, IRS moved promptly to correct the access control weaknesses we identified before this filing season. It developed plans to improve security over its electronic filing systems and internal networks and said that it had substantially implemented those plans. Sustaining effective computer controls in today's dynamic computing environment will require top management attention and support, disciplined processes, and continuing vigilance.

Preliminary Data on the 2001 Filing Season Show Mixed Results

At the Subcommittee's request, we are reviewing IRS' performance during the 2001 filing season. Our testimony today on the 2001 filing season focuses on four specific areas—the effect of IRS' recent reorganization on the filing season, IRS' performance in processing returns and refunds, the ability of taxpayers seeking help to reach IRS by telephone, and the quality of service being provided taxpayers who visit an IRS walk-in site. Our preliminary analysis shows mixed results; there are several positive aspects of this filing season as well as several concerns. Specifically,

- not unexpectedly, given its newness, IRS' reorganization has had little effect on taxpayers this year; but several challenges remain if the reorganization is to achieve its ultimate goal of improving customer service;
- IRS has processed income tax returns and refunds without any significant problems and has received a growing percentage of returns electronically; but

the rate of growth in electronic filing is less than expected, and many taxpayers encountered problems in trying to file their electronic returns with a PIN;

- IRS has done a better job of answering the telephone when people call for assistance, but there are continuing concerns about declines in the productivity of telephone assistors that have prevented further improvements in service; and
- IRS changed the structure and increased the staffing of its field assistance program in an effort to provide better service, but remains concerned about the quality of tax law assistance being provided by its walk-in sites.

Our preliminary analysis is based primarily on data provided by IRS that we did not verify. However, those data generally came from management information systems that we have used in the past to assess IRS operations.

IRS' Reorganization Has Had Little Effect on Taxpayers This Year; Several Challenges Remain If the Reorganization Is to Achieve Its Ultimate Goal

This year marks the first filing season since IRS reorganized into four operating divisions based on the type of taxpayer. The responsibilities of one of those four divisions, the Wage and Investment (W&I) Division, include processing individual income tax returns and assisting taxpayers at walk-in sites and over the telephone.[2] Other than some persons having to mail their returns to different service centers than in the past, IRS' organizational changes appear not to have altered the way individual taxpayers are interacting with IRS this filing season. For example, taxpayers are calling the same telephone numbers for assistance that they called last year and are generally visiting the same walk-in sites to pick up forms or get help preparing their returns.

We have also seen no evidence that the reorganization itself has led to significant changes in the level of service being provided taxpayers this filing season. That is not unexpected. The reorganization provides a focus on taxpayer segments that IRS expects will help it better understand taxpayers' needs and identify changes to its systems and procedures for meeting those needs. Because the reorganization has just been completed, IRS generally has not yet identified those changes in its systems and procedures that may better serve taxpayers. In the long term, IRS must overcome several challenges if it is to realize the full potential of its reorganization, in terms of improved taxpayer service.

Identifying needed changes and determining whether new approaches to serving taxpayers are successful and worth expanding requires real-time, reliable program performance data. As we will be discussing later, IRS has made and is making several changes to the measures it uses to assess its performance in processing returns and refunds and serving taxpayers. IRS plans to have most of these new and revised measures in place this fiscal year and collect sufficient information to set targets or goals for the measures in fiscal year 2002. We support IRS' efforts to improve its performance measures. The new and revised measures could provide useful information in helping IRS assess its performance. Because trend data on the new measures will not be available until 2002, there will be limited ability to compare IRS year-to-year performance.

IRS also has to do a better job of assessing the information it does collect. As we discuss in a report on IRS' telephone assistance that we will be issuing to the Subcommittee later this month, although IRS has undertaken efforts to analyze its performance in providing telephone assistance and identify ways to improve that performance, its analyses did not cover all of the key management decisions and other key factors that affect telephone performance. For example, in studying the productivity of its telephone assistors, IRS considered the average time taken to handle a call but not the time in-between calls. Without such a comprehensive analysis, IRS management lacks information that would be useful when making decisions about how to improve performance. We recognize that collecting and analyzing performance data is costly. However, not having timely, reliable, and comprehensive performance data to support management decision making and aid congressional oversight can also be costly.

Having real-time, reliable data to support decision making also requires that IRS successfully modernize its information systems. We will be discussing IRS' progress in that regard later.

IRS' Processing of Returns and Refunds Appears To Be Proceeding Smoothly, But Preliminary Data on Electronic Filing Raises Some Questions

Although there is much analysis still to do, our preliminary review has not identified any significant problem that has adversely affected IRS' ability to process returns and refunds. IRS has developed several new or revised measures for assessing its processing performance this year. However, meaningful performance data related to those measures will not be available for analysis until later in the year, and, as discussed earlier, there will be limited opportunities to compare IRS' performance with prior years. One indicator of IRS' performance that has not been revised is the percentage of individual income tax returns filed electronically. That indicator shows that the upward trend in electronic filing is continuing although at a slower rate of increase than expected. IRS has undertaken several initiatives this year to enhance the processing of individual income tax returns. Although it is too soon to assess the results of those initiatives, there are indications that one initiative—allowing electronic filers to "sign" their returns with a PIN—has encountered some problems.

IRS' Tax Processing Systems Appear To Be Operating Without Significant Problems

For the first time in several years, the information systems that IRS uses to process returns and remittances are not affected by extensive Year 2000 changes, consolidation of computer operations, or replacement of critical equipment, prompting us to anticipate few problems this year. That appears to be the case so far this filing season. Except for some problems associated with IRS' effort to allow electronic filers to "sign" their returns with a PIN, which we will discuss later, we have seen no evidence that IRS is not processing returns or issuing refunds as quickly as it has in the past.

Given the volume of tax returns and remittances and the programming changes that IRS makes annually to its systems, some "glitches" are to be expected. In that regard, IRS experienced minor programming issues during start-up related to notices, and the programming was corrected. For example, in one case, fewer than 8,000 payment due notices were not mailed timely, which may have resulted in taxpayers being assessed penalties and interest due to no fault of their own. To remedy the situation, when the notices were mailed, IRS included a statement that said that the notice had been delayed due to technical difficulties and that the payment due date was extended with no impact on the amount due.

IRS Has Developed Several New or Revised Measures for Assessing Its Processing Performance

IRS has developed several new or revised measures for gauging its performance in processing returns, refunds, and remittances. This is part of an agency-wide effort to develop a system of balanced measures to help IRS achieve its mission of providing America's taxpayers with top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

The new or revised measures are described in table 1.

TABLE 1: NEW OR REVISED PERFORMANCE MEASURES FOR RETURNS PROCESSING

Measure	Description
Letter Accuracy (new)	Percent of letters issued by the Submission Processing function that are incorrect.
Notice Accuracy (revised)	Percent of notices issued by the Submission Processing function that are incorrect.This measure was revised to include only notices for which Submission Processing is identified as the owner and to include systemic errors.
Deposit Accuracy (new)	Percent of payments applied in error by, for example, issuing a refund to a taxpayer who overpaid when the taxpayer wanted any overpayment credited to next year's tax bill.
Deposit Timeliness (new)	Interest value of money not deposited by the close of business the business day after receipt, per $1 billion in deposits. Measure assumes an 8 percent interest rate.
Refund Timeliness (revised)	Percent of refunds not issued in 40 days or less. IRS changed the date it uses to start computing the time it takes to issue a refund.
Refund Accuracy (revised)	Percent of returns with an IRS-caused error in the entity information (e.g., name or Social Security number) or refund amount. IRS revised this measure to include systemic errors.

TABLE 1: NEW OR REVISED PERFORMANCE MEASURES FOR RETURNS PROCESSING—Continued

Measure	Description
Refund Interest (new)	Amount of interest paid per $1 million in refunds issued.
Productivity (new)	Weighted volume of documents processed per staff year expended at the Submission Processing Centers

Source: IRS data.

One performance measure that IRS revised for the 2001 filing season is "refund timeliness". IRS' goal is to issue a refund on paper returns within 40 days. Before this year, IRS used the date the taxpayer signed the return as the start date for determining the number of days before it issued the refund. Under the revised measure, IRS is using the date that IRS received the return. According to IRS, the way it previously measured timeliness was flawed because the taxpayer could have signed the return several days before mailing it—something that could cause IRS to miss its 40-day goal but over which IRS had no control. IRS had originally decided to use the postmark date as the starting date for its computation. However, IRS subsequently determined that it would be labor intensive and costly to use the postmark date—a date that IRS does not currently record for returns received by the filing deadline of April 15. Instead, IRS decided to use the IRS-received date, which is the date that the document is received at a submission processing center's loading dock—a date that IRS already records. Because that date could be several days later than the date the taxpayer signed the return, IRS has, in effect, increased its chances of meeting the 40-day goal. To maintain something of a level playing field and to better enable IRS to compare this year's performance with prior years', it seems that, at a minimum, IRS should have adjusted its 40-day goal downward to approximate the number of days it "saved" by changing the computation start date.

We will continue to monitor IRS' progress in benchmarking its new or revised performance measures and will report the status of IRS' efforts in our final report on the 2001 filing season.

Use of Electronic Filing Continues an Upward Trend, But at a Reduced Rate of Increase

One indicator of IRS' performance in processing returns that has not changed is the percentage of individual income tax returns that have been filed electronically. Pursuant to a provision in the IRS Restructuring and Reform Act of 1998, IRS' goal is to have 80 percent of all returns filed electronically by 2007. Electronic filing has several advantages for taxpayers and IRS. For example, IRS acknowledges receipt of an electronic return, electronic filers receive their refunds faster, up-front mathematical checks and other filters in the electronic filing system help to reduce the number of taxpayer errors that IRS has to correct after the return is filed, and returns filed electronically bypass the error-prone manual procedures that IRS uses to process paper returns.

As noted in our report on the 2000 filing season, the number of individual income tax returns filed electronically increased substantially—about 20 percent—in both 1999 and 2000, bringing the total to 35 million returns.[3] IRS' projection for this year was 42 million returns—another 20-percent increase. However, filing data as of March 15, 2001, indicate that IRS may fall short of that projection.

As shown in table 2, about 29.3 million returns had been filed electronically as of March 16, 2001. Although that is a 10.2-percent increase compared to the same time last year, the rate of increase is considerably lower than last year. The rate of increase over the last month of the filing season would have to increase substantially for IRS to achieve its projected growth of 20 percent for the year. Figure 1 shows how the numbers of returns filed overall and electronically have changed over the past 5 years. Table 2 provides more detailed information on filings for the past 3 years.

Figure 1: Individual Income Tax Returns Received IRS in Total and Electronically

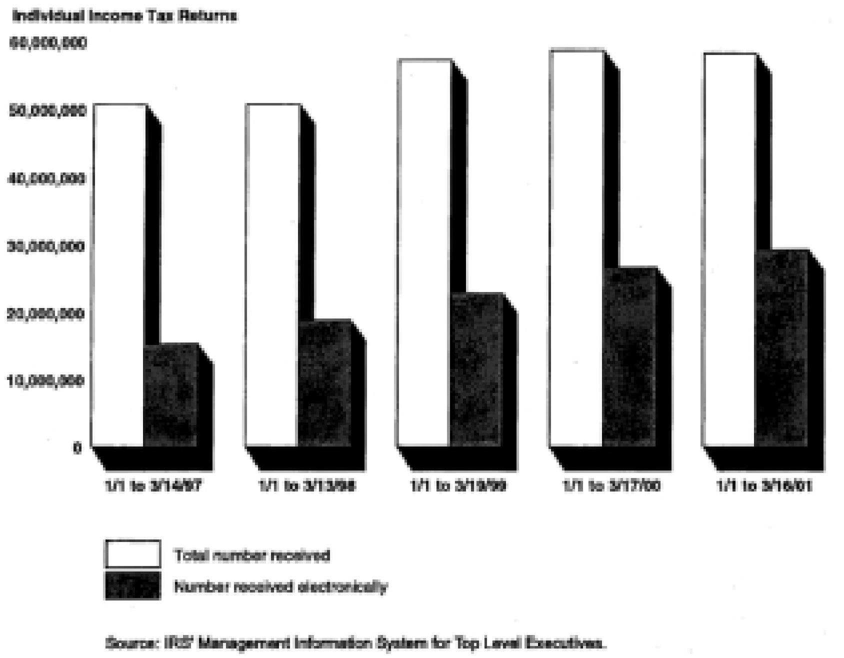


TABLE 2: INDIVIDUAL INCOME TAX RETURNS RECEIVED BY IRS

[Number of returns in millions]

Filing type	1/1/99 to 3/19/99	1/1/00 to 3/17/00	Percent change: 1999 to 2000	1/1/01 to 3/16/01	Percent change: 2000 to 2001
Paper	34.4	32.1	−6.7	28.9	−10.0
Electronic					
Traditional [a]	16.8	19.6	16.7	21.7	10.7
On-line [b]	1.6	3.1	93.8	4.2	35.5
TeleFile [c]	4.5	4.1	−8.9	3.5	−14.6
Subtotal	22.9	26.6	16.2	29.3	10.2
Total	57.3	58.7	2.4	58.2	−0.9
Percentage of total filed electronically.	39.9	45.4		50.3	

Note: Subtotals, totals, and percentages may not compute due to rounding.

[a] Traditional electronic filing involves the transmission of returns over communication lines through a third party, such as a tax return preparer or electronic transmitter, to an IRS service center.

[b] On-line returns are prepared and transmitted by the taxpayer through an on-line intermediary using a personal computer and commercial software.

[c] Under TeleFile, certain taxpayers who are eligible to file a Form 1040EZ are allowed to file using a toll-free number on touch—tone telephones.

Source: IRS' Management Information System for Top Level Executives.

IRS Has Initiatives Underway to Improve Processing

IRS has several initiatives underway to improve the processing of individual income tax returns. These initiatives include (1) allowing electronic filers to "sign" their returns with a PIN, thus reducing some of the paper processing associated with electronic filing; (2) validating spouses' Social Security numbers (SSN), thus ensuring more accurate returns; and (3) enabling taxpayers to authorize IRS to discuss their returns with their paid preparers, thus expediting the resolution of certain issues that arise during processing. Although it is too soon to assess the affect of these initiatives, there is some information that the PIN initiative, while used by millions of taxpayers, has encountered some problems.

Allowing Electronic Filers to Use a PIN

A major criticism of the electronic filing program over the years has been that it is not entirely paperless. For example, all electronic filers, except those who filed by telephone (i.e., TeleFile) had to send IRS a signature document. According to IRS, feedback from the tax practitioner community indicated that making electronic filing paperless would significantly increase taxpayers' and tax practitioners' willingness to file electronically. For the past 3 years, IRS has allowed taxpayers to pay their taxes electronically, thus eliminating the need for taxpayers to send IRS checks and paper vouchers. But until this year, most electronic filers still had to send IRS a form with their signature.

For the 2001 filing season, IRS instituted the self-select PIN program that makes it possible for taxpayers who file on-line or through a tax practitioner to "sign" their returns electronically and thus file a totally paperless return. The self-select PIN program, so named because taxpayers select their own 5-digit PIN, replaces the two alternative signature options that IRS tested last year. The major difference between the self-select PIN program and the alternative signature options tested last year is that virtually all taxpayers filing through a practitioner or on-line this year can file a totally paperless tax return. Last year only certain taxpayers could do so. Before IRS will accept an electronic return with a PIN, the taxpayer must include in his or her electronic submission two pre-identified pieces of information from the previous year's tax return. This information is required to help IRS assure that taxpayers filing with a PIN are who they say they are. If IRS determines that the information is correct and the submission passes other up-front checks that have been in place for several years, the electronic submission is accepted and the return is considered filed; otherwise the submission is rejected.

As of March 11, 2001, about 5.9 million returns had been filed electronically using the self-select PIN. Of those 5.9 million returns, about 3.3 million were filed through practitioners and about 2.6 million were filed on-line. For the same time period last year, about 4.7 million returns were filed using the two alternative signature programs.

One intriguing part of the PIN usage this filing season is that as of March 11, 2001, about 64 percent of the electronic returns filed on-line had a PIN compared to about 16 percent of the returns filed electronically through practitioners. IRS intends to conduct focus groups with tax practitioners later in the year, and one of the issues to be discussed is what prevented practitioners from using the self-select PIN. IRS officials said that they believe large tax practitioners are not using the PIN more extensively because many of their customers are first-time clients and neither the customer nor the practitioner has ready access to the necessary data from last year's return. Without that information, the practitioner may simply file the return electronically with the paper signature document.

According to a representative of the largest tax preparation company, returns filed electronically using self-select PINs have higher reject rates—about twice as high as the reject rates they usually experience on electronic submissions—causing additional burden on the taxpayer and the practitioner. As a result, the company had been advising its clients to use the self-select PIN with caution. Data obtained from IRS indicated that of about 6.8 million reject conditions identified on electronically filed returns as of March 15, about 1.5 million involved problems related to PINs.[4] A representative of the National Association of Enrolled Agents told us that one of the problems associated with the self-select PIN program is that many taxpayers and practitioners don't understand what information is needed to use a PIN.

We will continue to monitor the use of PINs and the issues surrounding that program as we proceed with our assessment of the filing season. As part of that effort, we will attempt to determine to what extent, if at all, PIN-related problems caused taxpayers to not file electronically.

Validating Secondary SSNs

During its processing of tax returns, IRS validates SSNs on the returns. If IRS determines that an SSN is invalid, it can disallow the related exemption or deny a claimed earned income credit or child tax credit.[5] That, in turn, can change the taxpayer's tax liability and reduce or eliminate any refund the taxpayer might be expecting. In past years, IRS has validated primary[6] and dependent SSNs. This year, IRS has expanded its SSN validation effort to include secondary SSNs.

Because of a concern that taxpayers are treated fairly in the validation process, the Committee on Government Reform sent a letter to the Commissioner of Internal Revenue in January 2001 requesting information about this initiative. In his February 2001 response, the Commissioner said that IRS has an extensive, multi-step process to determine the acceptability of a secondary SSN. If an individual fails to furnish a correct secondary SSN, IRS said it would disallow the exemption but would not alter the joint filing status claimed on the return.

Authorizing IRS to Discuss Returns with Preparers

IRS added a checkbox to the individual income tax forms that are being filed this year that enables taxpayers to

authorize IRS to discuss their returns with their paid preparers. By being able to contact the return preparer directly, IRS believes that it can expedite the resolution of certain issues that arise during processing, such as math errors and missing information on the return, and thus reduce taxpayer burden. In testimony before the House Government Reform Committee last year, the Commissioner of Internal Revenue estimated that about 2.5 million notices generated from returns processing were related to returns prepared by paid practitioners.

Level of Telephone Service Has Improved, But Declines in Assistor Productivity and Delays in Modernization Prevent Further Improvement

Millions of taxpayers call IRS each year with questions about the tax law, their accounts, and their refunds. One important indicator of IRS' performance in assisting these taxpayers is "level-of-service", which is computed by dividing the number of calls answered by the number of call attempts. We have adjusted computation of that indicator this year to allow a more accurate comparison with IRS' performance in past years, although a completely accurate comparison is not possible because data for one of IRS' phone lines does not show the extent to which taxpayers hung up before being served. The adjusted indicator shows that IRS has been answering a greater percentage of calls this filing season than it did last year. However, declines in the productivity of telephone assistors and delays in modernization have prevented even further improvement. Further improvement is needed if IRS is to achieve its goal of providing telephone assistance comparable to that provided by leading public and private telephone customer service organizations. In an effort to facilitate that kind of comparison and better gauge its performance in assisting taxpayers, IRS is putting in place some new measures of telephone service.

According to Data From IRS, the Accessibility of IRS' Telephone Service Has Improved

Taxpayers calling on IRS' toll-free assistance lines can obtain needed information by talking to an assistor or by using an automated "interactive application." However, unlike last year, taxpayers calling on the assistance lines in 2001 are given the option of being routed to another telephone line, the Tele-Tax line, for an automated response to an inquiry about their refund.[7] IRS is routing refund inquiry calls to the Tele-Tax line in an effort to improve taxpayer service. According to IRS, in previous years, these calls would have been answered by a similar automated refund inquiry service on the assistance lines. Sending these calls to Tele-Tax frees up the assistance lines for calls that require an assistor's help, making it less likely that taxpayers calling on these lines will get a busy signal.

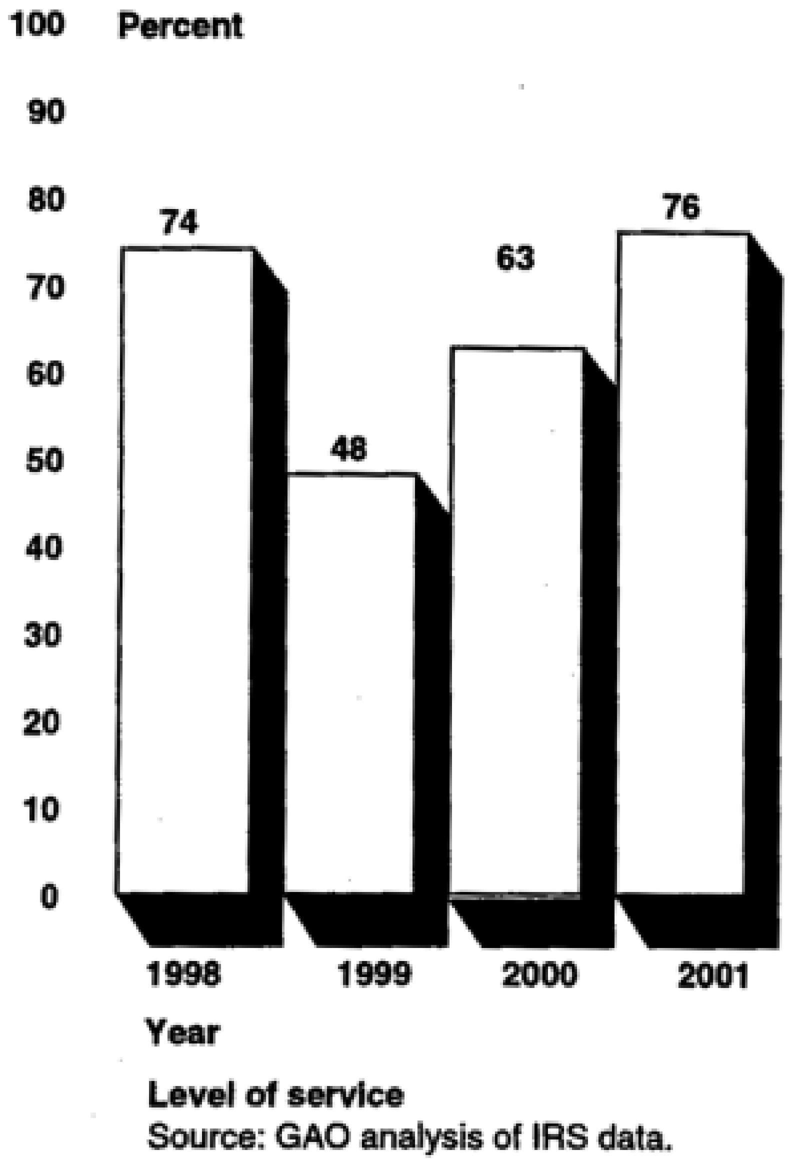
Because of this change in routing, the level-of-service computation has to be adjusted to properly compare IRS' performance this year with last year. As computed in previous years, level of service reflected IRS' performance on its toll-free assistance lines. Because refund inquiries were answered by automated systems on the assistance lines in previous years, they were included in computing level of service. Even though those inquiries are no longer being answered on the assistance lines, they should be included in computing level-of-service for comparability.

Although including the Tele-Tax refund inquiries in the computation of level of service makes the measure more comparable to previous filing seasons, it is not completely comparable because it assumes that all of the callers who were routed to Tele-Tax were actually served. Unlike data for the assistance phone lines, data for the Tele-Tax line does not allow IRS to determine whether taxpayers hung up before completing an automated service, calls that IRS refers to as "abandoned". Calls to the assistance phone lines that are abandoned are not counted as "calls answered" in computing level of service.

While the adjusted level-of-service computation is not completely comparable to previous years, it does indicate that level of service has improved relative to 2000. Other information from IRS supports this view. According to IRS data, for example, the level of service through March 10, 2001, for calls routed to assistors was somewhat higher than for a comparable period last year and the number of calls receiving busy signals on the assistance lines during the first 11 weeks of the filing season had declined from about 5.4 million in 2000 to about 3.1 million in 2001. IRS data also indicate that there have been virtually no busy signals on the Tele-Tax line this filing season.

As shown in figure 2, as of March 17, 2001, IRS' level of service, including the refund inquiries answered through the Tele-Tax line, was 76 percent—13 percentage points above last year.

Figure 2: Toll-Free Telephone Level of Service for the First 11 Weeks of the 2001, 2000, 1999, and 1998 Filing Seasons



Source: GAO analysis of IRS data.

Table 3 contains more detailed information behind the level of service computations depicted in figure 2.

TABLE 3: TOLL-FREE TELEPHONE LEVEL OF SERVICE FOR THE FIRST 11 WEEKS OF THE 2001, 2000, 1999, AND 1998 FILING SEASONS

[in millions]

Telephone service	Filing season			
	2001 [a]	2000	1999	1998
Call attempts.				
Excluding refund calls routed to Tele-Tax.	18.7	28.4	41.4	29.2
Refund calls routed to Tele-Tax in 2001.	11.6			
Total call attempts	30.2	28.4	41.4	29.2
Calls answered				
Automated	1.6	7.5	6.6	Not available
Assistor	9.7	10.4	13.2	Not available
Refund calls routed to Tele-Tax in 2001.	11.6			
Total calls answered	22.9	17.9	19.8	21.5
Level of service	76%	63%	48%	74%

Note: Totals may not compute due to rounding.
[a] The level-of-service computation for 2001 is not completely comparable to the computation for the other years because the Tele-Tax data does not account for taxpayers who may have abandoned their calls before getting an answer.
Source: GAO analysis of IRS data.

Figure 2 and table 3 indicate that the level of service this year is higher than in 1998. However, because available data for those years are not comparable, we do not know if that is an accurate representation.

Assistor Productivity Decline and Modernization Delays Have Prevented Further Phone Service Improvement

Taxpayer access to telephone assistors is less than it could be because (1) telephone assistor productivity—measured by IRS as how quickly assistors complete telephone calls—has declined for the third filing season in a row and (2) implementation of a modernization project has been delayed. Increases in assistor productivity could lead to further improvements in telephone service by allowing assistors to answer more calls, thus reducing the extent to which taxpayers receive busy signals or are kept on hold. Implementation of the modernization project could lead to improved service by freeing up assistors to handle more calls.

As we discuss in a report to be issued to the Subcommittee later this month, the productivity of telephone assistors declined during the 1999 and 2000 filing seasons. According to IRS officials, although some of the decline in 2000 was caused by assistors handling more of the types of calls that take longer to answer, four policy changes that had the unintended effect of lowering productivity in the 1999 filing season continued to adversely affect productivity in the 2000 filing season. Specifically, in 1999, IRS (1) discontinued automatically routing another call to an assistor immediately upon completion of a call; (2) increased restrictions on using productivity data when evaluating assistors' performance; (3) disproportionately diverted staff from peak demand shifts to other shifts when it implemented 24-hour-a-day, 7-day-a-week assistance; and (4) discontinued measuring the productivity of individual call sites.

According to IRS officials, these factors have continued to negatively affect productivity in the 2001 filing season. The officials said that although some of the decline can be explained by assistors answering more complex calls, assistors clearly are not using their time efficiently. In that regard, according to IRS, site visits it made earlier this year indicated that assistors who were directly monitored (i.e., someone sitting with them) spent about half as much time wrapping up a call after the taxpayer had hung up than assistors who were remotely monitored. IRS, in conjunction with the National Treasury Employees' Union, has taken steps intended to improve productivity. For example, IRS has conducted a series of training sessions at call sites designed to assist supervisors in ensuring assistors use their time productively, particularly with respect to the time they spend wrapping up calls. According to IRS officials, data shows that productivity has improved during the year as a result of these efforts.

Delays in implementing a modernization project has also prevented further improvements in telephone service. IRS' Customer Communication Project is one of the most important first steps in improving customer service as envisioned in IRS' modernization plans. As a key part of IRS' strategy for improving level of service, Customer Communications enhancements are designed to free-up assistors to handle more calls by routing and answering more calls through automation. However, one of the enhancements designed to significantly improve level of service will not be implemented until May or June 2001—at least 3 months later than expected and too late to provide the expected benefits this filing season.

Under this enhancement, IRS expected to implement a telephone voice recognition capability in February 2001. Voice recognition would allow callers with rotary-dial telephones to interact with IRS' automated routing and answering system in the same way as touch-tone callers do. Also, voice recognition would require callers with a touch-tone phone to use the automated system even if they do not respond to phone menu prompts to press the appropriate touch-tone key. According to IRS, a significant number of callers, whether they have rotary-dial telephones or not, do not respond to the prompts; assistors must answer these calls to determine what the taxpayer is calling about and then route the call to the most appropriate source of assistance. Voice recognition would have allowed IRS to offload some of this workload from live assistors and answer more calls.

According to the Treasury Inspector General for Tax Administration (TIGTA), the Customer Communication Project fell behind schedule, in part, because some key work products were not timely completed and several identified barriers to deployment, such as an inadequate database to track modernization project risks and the need to complete the security certification process, had not been overcome.[8]

IRS is Putting in Place New Performance Measures for Telephone Operations

According to IRS officials, its current level of service measure is not strategically aligned with those used by world-class customer service organizations, and does not focus efforts at enhancing the customer's experience or clearly show how human capital and technology investments affect performance. Therefore, IRS is planning to replace its current level of service measure with two primary measures of service, one for measuring IRS' success at providing taxpayers access to assistors, and another for measuring IRS' success at serving taxpayers though automated services. Also, IRS intends to gather data on other new measures, including measures of how long taxpayers have to wait to speak to IRS assistors.

We support IRS' efforts to improve its performance measures, particularly efforts to better gauge how well IRS serves taxpayers and how its performance compares to that of leading private and public telephone customer service organizations. However, unless IRS maintains its current measures while transitioning to its new measures, it will not have comparable data to monitor performance from one year to the next. We recognize that there is a cost associated with maintaining current measures while developing new measures, and we recognize that doing so may not always be feasible. However, without comparable historical performance data, IRS will be unable to assess the results of past efforts to improve performance, such as the 1999 policy changes discussed earlier.

IRS Has Deferred Making Changes to Improve the Quality of Tax Law Assistance Provided by Walk-in Sites Until Fiscal Year 2002

IRS changed the way it was organized and staffed to provide face-to-face assistance for the 2001 filing season. Despite these changes, there are continuing concerns about the quality of tax law assistance being provided. According to IRS officials, the staffing and training challenges associated with the restructuring made it impractical for IRS to make changes to improve the quality of tax law assistance this fiscal year. Instead, IRS, with the help of a contractor, is studying how the quality of face-to-face assistance should be measured and improved, with the expectation of making changes for the 2002 filing season.

IRS Has Changed the Way Its Taxpayer Assistance Centers Are Organized and Staffed

Taxpayers can obtain forms, get answers to questions about the tax law and their accounts, and get help in preparing their returns at about 400 Taxpayer Assistance Centers (TAC), which were formerly known as walk-in sites. Before IRS' reorganization, the TACs and associated staff reported to 33 district offices. According to IRS officials, differences in the way TACs were organized and operated within each district caused inconsistencies in the assistance provided to taxpayers. To provide more consistency in field assistance, the 400 TACs now report to the W&I Division's Field Assistance unit, through a network of 7 area and 34 territory offices. As of March 17, 2001, according to IRS, the TACs had assisted about 3.4 million taxpayers, compared to about 3.9 million taxpayers as of the same time last year.

According to IRS, it began the year with about 1,000 technical employees in field assistance and had hired another 504 as of March 16, 2001. Of those 1,504 technical employees, 1,041 are in a new position—taxpayer resolution representative (TRR)—that IRS had established as part of its reorganization. Persons filing these positions will be required to assume some functions previously done by compliance staff, such as office audits, in addition to their taxpayer assistance duties.

Although IRS is filling the TRR positions primarily from qualified staff in related job series, additional training is required. According to officials, IRS is surveying the new staff to assess the training gaps and prioritizing the delivery of abbreviated training to fill the gaps. Not all of the gaps were filled in time for the 2001 filing season. For example, about 100 staff placed in TRR positions in January 2001, who needed the full 6 weeks of required first-year training, received only 3 weeks of that training.

Considerable hiring and training is also required for new managers in the Field Assistance unit. Managers of the former walk-in sites were compliance staff who generally moved to the new Small Business and Self Employed Division as part of IRS' reorganization. As of December 31, 2000, IRS had filled 29 of the 34 territory manager positions and 154 of the 226 group manager positions authorized. According to IRS officials, about one-half of the new managers had no field assistance experience and some had no managerial experience.

IRS and TIGTA Reviews Show That TACs Provide Poor Quality Tax Law Assistance

According to W&I field assistance officials, the quality of tax law assistance provided to taxpayers who walk into one of IRS' TACs this year is about as poor as the quality reflected by IRS' own reviews last year.

IRS employees posing as taxpayers conducted 272 visitations to TACs before the 2000 filing season and another 272 during the filing season. IRS' final report on the combined results found, among other things, that although 92 percent of the "assistors spoke to reviewers in a pleasant manner and tone of voice,"

- 81 percent of the reviewers' questions were not answered correctly; and,
- 21 percent of the reviewers were denied service.

Officials based their characterization of the quality of this year's field assistance on reviews of quality during late January and early February 2001 by TIGTA. According to TIGTA, its review of TAC quality involved 90 contacts in which tax law questions were posed to IRS representatives. In 7 of those 90 contacts (8 percent), service was denied (i.e., the TIGTA reviewers were not given an opportunity to speak with an assistor). When service was provided, TIGTA's reviewers received inaccurate answers 48 percent of the time. Although TIGTA's results might indicate that service quality, although not good, has improved compared to the results of IRS' reviews last year, such a comparison cannot be made because TIGTA used a different methodology from the one used by IRS. One of the recommendations resulting from IRS' quality reviews during fiscal year 2000 was that IRS develop a comprehensive, year-round quality review program for walk-in offices. The recommendation anticipated changes in the scope of the reviews, the selection and training of reviewers, the review checksheet, and the relevant database. In that regard, field assistance officials informed us that IRS, with help from a contractor, is studying how field assistance quality should be measured and improved. According to IRS officials, because of that study and the staffing and training challenges associated with the restructuring, IRS decided not to conduct its own review of quality during the 2001 filing season and to defer making changes to improve the quality of tax law assistance provided by TACs until fiscal year 2002, after the results of the ongoing study are known.

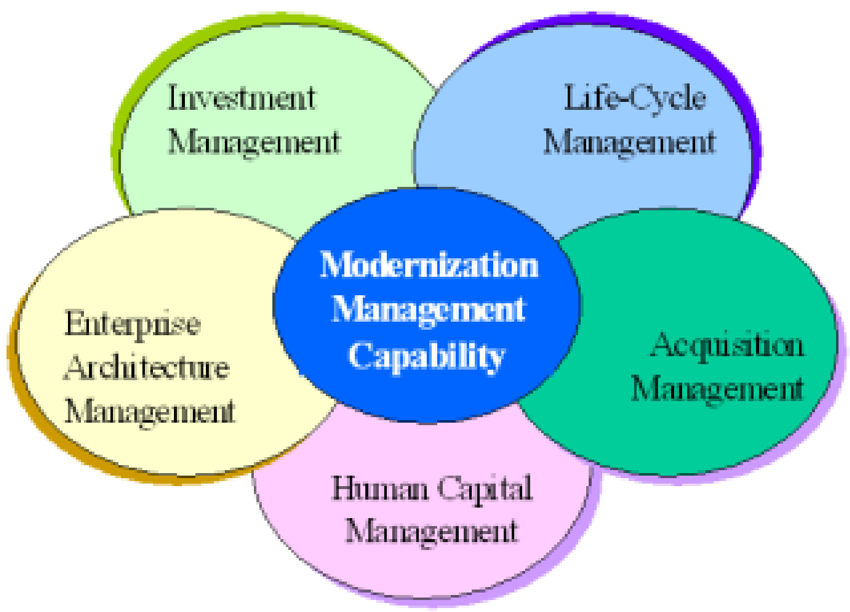
Despite Important Progress, IRS Has Yet to Fully Implement the Capabilities Needed to Effectively Manage the Business Systems Modernization Program

We turn now to business systems modernization (BSM)—IRS' multiyear program to put in place the technology that will support revamped business processes. This multi-billion-dollar program, which began a little over 2 years ago and has thus far received congressional approval to obligate about $450 million,[9] is vital to achieving IRS' new, customer-focused vision and enabling IRS to meet performance and accountability goals. BSM consists of a number of new systems acquisition projects that are at differing stages of acquisition and implementation, as well as various program-level initiatives intended to establish the capacity for IRS to effectively manage the projects.

We have long held—and communicated to IRS—the importance of establishing sound management controls to guide its systems acquisition projects; to its credit, IRS has made important progress in this area. Nevertheless, IRS is starting to let project acquisitions get perilously ahead of controls—proceeding in some cases with detailed systems design and development without having the capacity in place to help ensure that projects perform as intended and are completed on time and within budget. We remain concerned that at these later stages in systems' life cycles, the risk of rework due to missing modernization management controls increases, both in terms of probability and impact. Given that IRS expects to totally exhaust congressionally-approved BSM funding by about November 2001, and thus is seeking additional money for fiscal year 2002, this is a good time to ensure that the overdue modernization management controls are emphasized as a BSM priority.

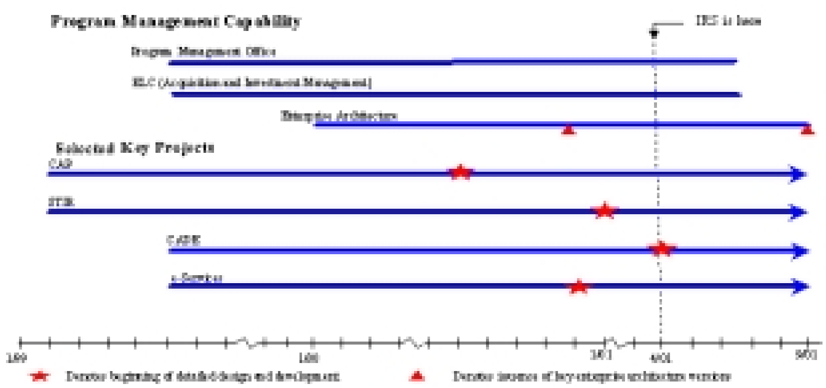
Beginning in 1995, when IRS was involved in an earlier attempt to modernize its tax processing systems, and continuing since then, we have made recommendations to implement fundamental modernization management capabilities before acquiring new systems. We concluded that until these controls were in place, IRS was not ready to invest billions of dollars in building modernized systems.[10] Although IRS has since taken steps that have partially addressed our set of recommendations, important ones remain unfulfilled. In general, the areas in which we found controls to be lacking and made recommendations to fill these voids fell into five interrelated and interdependent information technology management categories, as shown in figure 3—investment management, system life-cycle management, enterprise architecture management, software acquisition management, and human capital management.

Figure 3: Information Technology Management Control Areas Needing Attention



In December 1998, IRS hired a systems integration support contractor to, among other things, help it develop and implement these program capabilities. Subsequently, the Commissioner adopted a modernization strategy that appropriately required, for example, (1) the use of incremental investment decision making, (2) adherence to a rigorous systems and software life-cycle management method, and (3) development and implementation of an enterprise architecture or modernization blueprint to guide and constrain the content, sequencing, and integration of systems investments. This approach, however, involved development of these kinds of program-level management capabilities while simultaneously proceeding with project acquisition, in anticipation that program controls would be in place and functioning when these projects reached their later, less formative stages. Figure 4 illustrates this approach.

Figure 4: Concurrent Development of Program-Level Controls and Projects



During BSM's first 18 months, progress in implementing these management controls was slow, while at the same time project acquisitions moved rapidly. At that time we reported to IRS' Senate and House appropriations subcommittees that projects were getting ahead of the modernization management capacity that needed to be in place to manage them effectively. In response to our concerns and the subcommittees' direction, IRS appropriately pulled back on the projects and gave priority to implementing needed management capacity.

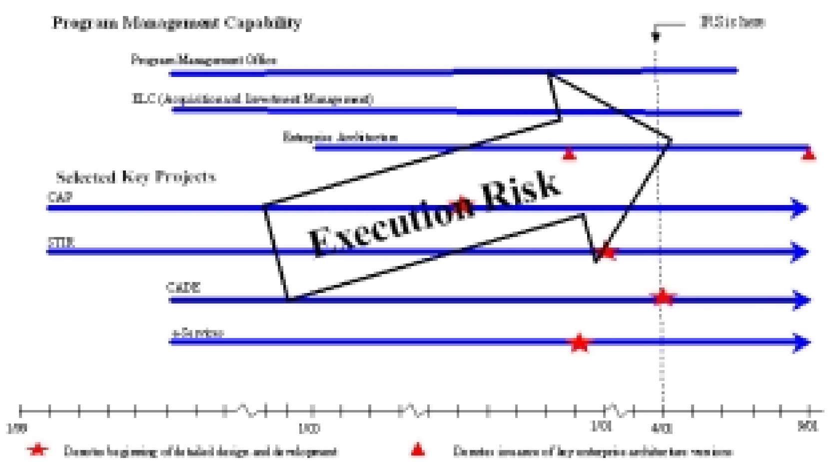
Despite this shaky start to implementing management controls, IRS has since made important progress in its modernization management capacity. For example, last year we reported that IRS (1) largely defined and implemented its system life-cycle methodology that incorporates software acquisition and investment management processes, (2) defined program roles and responsibilities of IRS and its modernization contractor and began relating with the contractor accordingly, (3) began formally managing modernization risks in an effort to proactively head off problems, and (4) made progress toward producing the first release of its enterprise architecture.[11]

In addition, we recently reported that IRS had taken steps to address our recommendations aimed at strengthening management of individual BSM projects.[12] For instance, it started to manage the Custodial Accounting Project[13] as an integral part of the modernization program. On another project, the Security and Technology Infrastructure Release,[14] IRS assessed security threats and vulnerabilities, analyzed the resulting risk in terms of probable impact, and planned to reevaluate project requirements in light of this risk analysis. Recently, IRS hired experienced technical and managerial executives and augmented existing modernization staff with experienced IRS information systems personnel.

We are concerned, however, because projects are entering critical stages without certain essential management controls in place and functioning. In particular, in our ongoing work for IRS' appropriations subcommittees, we found that IRS is proceeding with building systems—including detailed design and software development work—before it has implemented two key management controls. First, IRS has yet to develop a sufficiently defined version of its enterprise architecture to effectively guide and constrain acquisition of modernization projects. Second, it has not yet implemented rigorous, disciplined configuration management practices. Both of these are requirements of IRS's own systems life-cycle methodology and are recognized best practices of successful public and private-sector organizations. This increases the risk of cost, schedule, and performance shortfalls. We have discussed these missing controls with the Commissioner and his BSM executives; they have stated that they plan to have them in place by the end of June 2001.

Timing is critical. While the lack of controls can be risky in projects' early stages, it introduces considerably greater risk when these projects enter design and development. To mitigate this added risk, IRS needs to fully implement the remaining management controls that we have recommended. Figure 5 illustrates the growing risk that accompanies project development in its later stages.

Figure 5: Increased Risk Associated With Inadequate Controls at Later Stages of Project Development



The timing of this hearing is appropriate for ensuring that IRS implements the remaining needed modernization management controls. While Congress has appropriated about $578 million for this program to date, it also took steps to limit the agency's ability to obligate funds until certain controls were in place by establishing a multiyear capital account—the Information Technology Investments Account—to fund IRS systems modernization initiatives. IRS has received about $450 million of this total, and has submitted a plan to Congress to spend the remainder over the next 7 months. In addition, IRS plans to include $396 million in funding for BSM in its upcoming fiscal year 2002 budget request. This is, then, an opportune time to ensure that IRS addresses these outstanding risks as a condition of future funding.

IRS Had Ineffective Controls to Ensure the Security of Electronic Filing Systems And Electronically-Transmitted Taxpayer Data

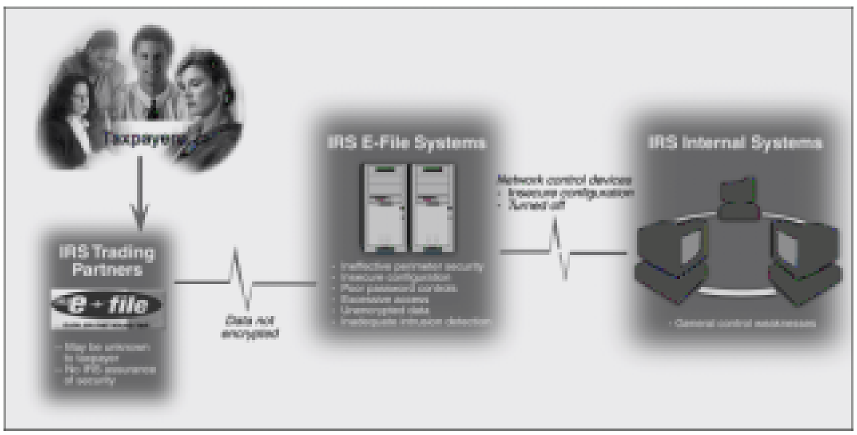
As a major steward of personal taxpayer information, IRS has a demanding responsibility in collecting taxes, processing returns, and enforcing the nation's tax laws. In conducting its work, IRS must obviously depend to a great extent on interconnected computer systems. Due to the nature of its mission, IRS collects and maintains a significant amount of personal and financial data on each American taxpayer. These data typically include the taxpayer's name, address, SSN, dependents, income, deductions, and expenses. The confidentiality of this sensitive information is important because American taxpayers could be exposed to a loss of privacy and to financial loss and damages resulting from identity theft and financial crimes should this information be disclosed to unauthorized individuals.

Computer security is an important consideration for any organization that depends on information systems and computer networks to carry out its mission or business. However, without proper safeguards, systems and networks pose enormous risks that make it easier for individuals and groups with malicious intent to intrude into inadequately protected systems and use such access to obtain sensitive information, commit fraud, disrupt operations, or launch attacks against other computer networks and systems. And the number of individuals with the skills to accomplish this is increasing; intrusion—or hacking—techniques are readily available and relatively easy to use.

We recently examined the effectiveness of key computer controls designed to ensure the security, privacy, and reliability of IRS' electronic filing systems and electronically filed taxpayer data during last year's tax filing season. Our recent report discusses the computer control weaknesses that we found, along with actions that IRS says that it took to correct these weaknesses before this year's filing season.[15] What we found to date concerning IRS' electronic filing program can illustrate the challenges that many organizations are facing.

In an attempt to meet the 80-percent electronic filing goal provided for in the IRS Restructuring and Reform Act of 1998, IRS has aggressively marketed the electronic filing program and has authorized private firms and individuals to be electronic filing trading partners. These partners include electronic return originators, who prepare electronic tax returns for taxpayers, and transmitters, who transmit the electronic portion of a return directly to IRS. Except for TeleFile taxpayers, who file their returns using the telephone, IRS does not allow individual taxpayers to transmit electronic tax returns directly to the agency; they must use the services of an IRS trading partner. Figure 6 demonstrates the path that an electronically filed tax return took from the taxpayer to IRS during the time of our review.

Figure 6: Electronic Filing Journey, 2000 Filing Season



During the 2000 filing season, IRS did not implement adequate computer controls to ensure the security, privacy, and reliability of its electronic filing systems and the electronically-transmitted tax return data that those systems contained.

We demonstrated that individuals, both internal and external to IRS, could gain unauthorized access to IRS' electronic filing systems and view, modify, copy, or delete taxpayer data. Our successful access did not require sophisticated techniques. Last May, for example, we were able to access a key electronic filing system using a common handheld computer. We could gain such access because IRS at that time had not

- effectively restricted external access to computers supporting the electronic filing program through effective perimeter defenses;
- securely configured its electronic filing operating systems, which used several risky and unnecessary services;
- implemented adequate password management and user account practices (for example, we successfully guessed many passwords and noted user IDs and passwords posted conspicuously on a monitor);
- sufficiently restricted access to computer files and directories containing tax return and other data (for example, all users had the ability to modify numerous sensitive data and system files, and certain users with no "need to know" had access, contrary to policy); or
- used encryption to protect tax return data on electronic filing systems (as is required by IRS' *Internal Revenue Manual).*

Further, these weaknesses jeopardized the security of sensitive business, financial, and taxpayer data on other critical IRS systems that were connected to electronic filing computers through its servicewide network because IRS personnel turned off (bypassed) network control devices that were intended to provide security between electronic filing systems and other IRS systems. Although IRS stated that it did not have evidence that such intrusions had actually occurred or that intruders had accessed or modified taxpayer data, it did not have adequate procedures to detect such intrusions if they had occurred. For example, IRS did not (1) record certain key events in system audit logs, (2) regularly review those logs for unusual or suspicious events or patterns, or (3) deploy software to facilitate the detection and analysis of logged events. Consequently, IRS did not recognize or record much of the activity associated with our tests.

These serious access control weaknesses existed because IRS had not taken adequate steps during the 2000 filing season to ensure the ongoing security of electronically transmitted tax return data on its electronic filing systems. For example, IRS had not followed or fully implemented several of its own information security policies and guidelines when it developed and implemented controls over its electronic filing systems. It decided to implement and operate its electronic filing computers before completing all of the security requirements for certification and accreditation.[16] Further, IRS had not fully implemented a continuing program for assessing risk and monitoring the effectiveness of security controls over its electronic filing systems.

According to IRS officials, IRS moved promptly to correct the access control weaknesses we identified before the current filing season. It developed plans to improve security over its electronic filing systems and internal networks and said that it has substantially implemented those plans. In his response to our report, the Commissioner said that "electronic filing systems now satisfactorily meet critical federal information security requirements to provide strong controls to protect taxpayer data." Sustaining effective computer controls in today's dynamic computing environment will require top management attention and support, disciplined processes, and continuing vigilance.

Application controls also need to be designed and implemented to ensure the reliability of data processed by the systems. IRS believes that electronically filed tax returns are more accurate than paper returns and has implemented many application controls designed to enhance the reliability of data processed by its electronic filing systems. However, we identified additional opportunities to strengthen application controls for IRS' processing of electronic tax return data. Based on IRS statistics, it processed electronic tax returns and paid refunds of about $2.1 billion without receiving required authenticating signatures or electronic PINs from taxpayers. Data validation and editing controls did not detect certain erroneous or invalid data that could occur in tax returns. In addition, weaknesses in software development controls increased the risk that programmers could have made unauthorized changes to software programs during the 2000 filing season.

Further, taxpayers who filed electronically may not have been aware that transmitters, who actually send the data to IRS and may be unknown to the taxpayers, could have viewed and modified their data and that such data are transmitted to IRS in clear text—human readable form. This is because IRS decided to (1) not allow taxpayers to file most electronic returns directly to IRS, (2) require taxpayers who elected to file electronically to use the services of third-party transmitters, and (3) not accept electronic tax returns in encrypted form. In addition, taxpayers may not have been aware that IRS has no assurance of the security of its electronic filing trading partners' systems. Other than providing guidance about protecting certain passwords, IRS did not prescribe minimum computer security requirements for transmitters and did not assess or require an independent assessment of the effectiveness of computer controls within the transmitters' operating environment.

We provided specific technical recommendations to improve access controls over IRS' electronic filing systems and networks. We also recommended that IRS complete the certification and accreditation of its electronic filing systems, assess security risks and routinely monitor the effectiveness of security controls over electronic filing systems, improve certain data reliability and integrity controls, and notify taxpayers of the privacy risks of filing electronically. IRS agreed with our recommendations and said that it implemented most of the improvements, including correcting critical vulnerabilities, before this year's filing season. IRS further said that the actions it has taken demonstrate a systematic, risk-based approach to correcting identified weaknesses. Such an approach will continue to be important in ensuring that corrective actions are effective on a continuing basis and that new risks are promptly identified and addressed.

Mr. Chairman, that concludes our statement. We would be pleased to respond to any questions that you or other members of the Subcommittee may have at this time.

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[1] *Information Security: IRS Electronic Filing Systems* (GAO–01–306, Feb. 16, 2001).

[2] The other three operating divisions are: (1) Small Business and Self Employed, serving fully or partially self-employed individuals and businesses with assets of $5 million or less; (2) Large

and Mid-Size Business, serving businesses with assets over $5 million; and (3) Tax Exempt and Government Entities, serving pension plans, exempt organizations, and governments.

[3] *Tax Administration: Assessment of IRS' 2000 Tax Filing Season* (GAO–01–158, Dec. 22, 2000).

[4] The number of reject conditions cannot be equated to the number of electronic submissions that were rejected because one submission can have more than one reject condition.

[5] IRS considers an SSN invalid if it is missing from the return or if the SSN and associated name on the return do not match data in the Social Security Administration's records.

[6] On a joint return, the person whose name appears first on the return is considered the primary taxpayer. The other person is considered the secondary taxpayer.

[7] In addition to automated refund information, Tele-Tax provides recorded information on about 150 tax topics.

[8] *Progress in Developing the Customer Communications Project Has Been Made, But Risks to Timely Deployment in 2001 Still Exist*, TIGTA, Reference No. 2001–20–055, Mar. 12, 2001.

[9] IRS requested and Congress established a multiyear systems modernization account and funded it with about $578 million via IRS' fiscal years 1998, 1999, and 2001 appropriation acts. To date, IRS has received approval from Congress to obligate about $450 million from the account.

[10] *Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is to Succeed* (GAO/AIMD–95–156, July 26, 1995).

[11] *Tax Systems Modernization: Results of Review of IRS' Third Expenditure Plan* (GAO–01–227, Jan. 22, 2001).

[12] See, for example, *IRS' Custodial Accounting Project* (GAO–01–444R, Mar. 16, 2001) and GAO–01–227, Jan. 22, 2001.

[13] The Custodial Accounting Project is expected to provide a single data repository of taxpayer accounts and tax payments as well as related tax revenue accounting and reporting capabilities. IRS also plans for this project to, among other things, automatically reconcile accounts and payments, post updates to IRS' general ledger, and produce revenue accounting reports.

[14] This project is the common integrated infrastructure to support and enable modernization business systems applications. As designed, it consists of a combination of custom and commercial off-the-shelf software, hardware, and security solutions, integrated to form the technical foundation upon which modernized business systems applications will operate.

[15] GAO–01–306.

[16] Accreditation is the formal authorization for system operation and is usually supported by certification of the system's security safeguards, including its management, operational, and technical controls. Certification is a formal review and test of a system's security safeguards to determine whether or not they meet security needs and applicable requirements.

Chairman HOUGHTON. Thanks very much. Well, Mr. Williams, based on what you said, do you think the 2001 filing season was successful?

Mr. WILLIAMS. I am sorry, Mr. Chairman.

Chairman HOUGHTON. Based on the information you have given me, do you think the 2001 filing season was successful?

Mr. WILLIAMS. Yes, generally I think it has been a successful filing season. The numbers are up. I think IRS has met the goals. The 1040 are being processed in a timely fashion, so far as we know.

We have some concerns with regard to enforcement and customer service, but the filing season itself we felt good about the IRS' performance.

Chairman HOUGHTON. OK. The accuracy of the tax law questions when TIGTA called the IRS telephone assistance line was less than 50 percent. And these questions came from the IRS list of frequently asked questions. What are we going to do to solve this problem?

Mr. WILLIAMS. The modernization that is moving in our direction we feel very good about. We think that it is very difficult to train low-paid and seasonal workers to answer complex tax law questions. The modernization will bring to them automated tools that will both allow the account to be accessible in a way that has accurate and current information, and it will provide the answers to the kinds of questions that are posed by taxpayers. So we feel that that is certainly part of the solution.

The IRS is moving, although we are not very comfortable with the pace, with regard to simplifying notices and working on forms to simplify those as well. There are taxpayer education programs and programs for preparers that we think will be very helpful, too. And then the IRS needs to continue advising you of efforts to simplify the taxpayer burden with regard to legislation. You asked IRS to begin that, and they have given you the first few products. We need to aggressively continue letting you know where IRS just can't get the job done in terms of explaining to the customers.

Chairman HOUGHTON. All right. Thank you. Now, very briefly, Mr. White, you talked about the security issue. Has the GAO been able to test the new security measures?

Mr. WHITE. Mr. Chairman, let me bring up Mr. Dacey. He is the Director of Information Security Issues at GAO.

Mr. DACEY. Mr. Chairman, no, we have not. We plan to do that as our normal follow-up process.

Chairman HOUGHTON. When will that be?

Mr. DACEY. That will be some time this late summer or fall.

Chairman HOUGHTON. All right. And when you do that, will you report to the Committee? Will you report to the Commissioner? What will you do with that information?

Mr. DACEY. When we finish that, we will go through our normal process of reporting that out in our reports.

Chairman HOUGHTON. Well, I would be interested—I don't know if the rest of the panel would—in getting that information. If you could pass it along to us, it would be appreciated. Mr. Coyne, would you like to ask questions?

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Williams, I wonder if you could outline for us what portions of your funding, the IG's funding, and staffing are allocated to the following compartments: systemic problems at the IRS as one category; complaints about high-level IRS employee actions; and, number three, fraud and abuse in the tax system itself. Are you able to break down what your commitments are to those?

Mr. WILLIAMS. Yes, sir, I am. We have about 1,000 people, and our funding, of course, is largely in support of those efforts.

With regard to attacking the systemic problems and the root causes for issues that come forward and trying to make recommendations for those, we have about 375 of our FTE dedicated to that. They produce about 160 reports a year.

With regard to our fraud efforts, of the 1,000 we have about 475 of our FTE dedicated toward attacking fraud and abuse. They conduct about 4,000 investigations a year.

With regard to complaints and allegations that we have regarding our GS–15s and SES'ers and Presidential appointment level personnel, we have about 8 percent of our resources on that, and we manage about 540 complaints annually. That has been the history of our short existence in the first 2 years.

Mr. COYNE. So the last one you put in percentage terms instead of employee terms? Eight percent, did you say?

Mr. WILLIAMS. Yes, sir.

Mr. COYNE. Eight percent of the personnel?

Mr. WILLIAMS. Yes. Our investigators—8 percent. Our investigators manage that, and within their case inventory are a mixture of general kinds of investigations and high-level investigations.

Mr. COYNE. All right. Thank you.

Chairman HOUGHTON. Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman. I have a couple of questions.

In your testimony, Mr. White—I had to figure out who was writing this—you talk about the folks that are actually giving this information, either the telephone—and the problems that have caused. Can you give me who this person might be, what kind of background, what kind of training, what kind of training goes into this person? Because I noticed here it said that in some cases they couldn't even get the 6 weeks' training that was necessary. I need to know a little bit about who this person is that may be answering these questions.

Mr. WHITE. Yes, there are different kinds of assistance there. The IRS has about 10,000 telephone assistors, and then I think the type of assistance you are referring to there is the walk-in assistance. A lot of those people are moved over from other spots in IRS, and they are now taxpayer resolution representatives.

Mrs. THURMAN. So they have some background in the law, they have——

Mr. WHITE. They have some background, but IRS has also recognized that there are training needs associated with these people. They need a fairly broad-based knowledge of IRS and IRS processes in order to deal effectively with taxpayer problems. And so far what we have found is in standing up these new positions and filling these new positions, while they have been trying to meet training needs, there still are unmet training needs there.

Mrs. THURMAN. So maybe one of the recommendations is to make sure before we put them out, they are on the frontline or answering phones or whatever, that they should be given some kind of training before we let that happen? Because the next follow-up question I have, especially based on some of the issues that we have heard from other folks, either the Taxpayer's Advocate and/or the Commissioner, I mean, if I am a taxpayer and I call these lines or I go in for this assistance, I mean, I am assuming that the information that I am getting back is correct. And I make a determination based on that information on how I might file. And if my filing is not correct or the information I was given was incorrect, and I don't meet—and all of a sudden I get audited or there is a penalty or whatever, I mean, how do we correct that part for the taxpayer who actually may end up getting the wrong information and they end up having to pay the penalties?

Mr. WHITE. Part of the correction there is the responsibility of middle-level managers at IRS, and in order to better manage that program, they need, first of all, information, about what performance actually is, and then they need to do the kinds of studies to be able to link IRS' training efforts, for example, to the quality of answers. Are assistors getting the right kind of training so that they can give better answers? And that requires an in-depth evaluation of the performance data to make those kinds of linkages. It is not easy to do, but that is the responsibility of middle-level management.

Mrs. THURMAN. But are you seeing that happening now?

Mr. WHITE. We see continued needs for that kind of evaluation. With respect to telephone assistance, for example, we are issuing a report to this Subcommittee later this week where we recommend that the Commissioner ensure that exactly those kinds of performance evaluations are done.

Mrs. THURMAN. I just had a situation in my office where somebody was given some information of not to pay by a tax preparer. I don't know where they got this information if they didn't have this final piece of paper that tells them what the valuation of their property was. So for 4 years, they didn't pay anything. All of a sudden now they are sitting here with, you know, $100,000 worth of penalties and didn't even include, you know, what their estate tax would have been. And these folks are making $14,000 a year. Needless to say, they are in a real bind.

But it just strikes me that if we are giving wrong information and—I mean, you know, where do we go to make this work? I don't know. And how do we make sure that the taxpayer is not getting the penalty for an answer that was given incorrectly?

Mr. WHITE. It is a good question. Again, I think part of the response there is that better information systems are needed at IRS. They need to be able to track those kinds of cases. They need to have the data on how many cases are taking that long to resolve. And then with that kind of data, they can do the sort of analysis to try to figure out what the causes are, and with that information then presumably managers could take informed action to fix the problems.

Mrs. THURMAN. So then based on what, I guess, some of us on this side have asked about with this next budget coming up, is there a number, I mean, based on what has been submitted and—I mean, have you all looked at what the cost of doing this would be? And when we make a recommendation to, you know, the appropriators to make sure that this is covered, is there a magical number out there that makes this work?

Mr. WHITE. I don't think there is a magical number for the sort of evaluation of performance that we are talking about. There clearly is a cost to doing those kinds of evaluations. So it is a management——

Mrs. THURMAN. And then the training.

Mr. WHITE. Yes. There is a cost there as well, and ultimately it is a management judgment that has to be made by higher-level management at IRS about how much of this is worth doing.

Mrs. THURMAN. I will be interested to see the budget to see if it reflects some of the issues that you have raised here today as far as training and personnel and what we are doing. So I hope we will have an opportunity to look at that when it comes in.

Chairman HOUGHTON. Thanks very much. Gentlemen, we appreciate your being here with us. I would like to call the next panel: Mark Ernst, president and chief executive officer of H&R Block, who comes from Kansas City; and Claudia Hill, Chair of the Government Relations Committee, the National Association of Enrolled Agents, from Cupertino, California.

Mr. Ernst, delighted to have you here with us. Would you like to testify?

STATEMENT OF MARK A. ERNST, PRESIDENT AND CHIEF EXECUTIVE OFFICER, H&R BLOCK, KANSAS CITY, MISSOURI

Mr. ERNST. Thank you, Mr. Chairman, Members of the Subcommittee, and thanks for inviting us.

As you know, Mr. Chairman, H&R Block prepares about one in seven individual income tax returns—over 16 million, which works out to about 37,000 per congressional district. We serve clients at 9,000 offices in the United States, and we publish Kiplinger TaxCut software as well as offer online tax preparation and electronic filing.

We are reshaping the company to also offer clients financial planning, mortgages, savings and investment products, so they can combine tax compliance with an annual financial checkup. And to expand our business services, we have built a national accounting practice anchored by RSM McGladrey.

My comments this afternoon can be boiled down to four points:

First, the filing season has gone very well, but not without some problems. We want to highlight three and hope to work with the IRS to fix them.

Second, because we are likely to fall short of the 2007 electronic filing goal set by Congress in 1998, we urge elevated efforts by the IRS and tax professionals, and we recommend a more dramatic incentive to taxpayers in the form of a 3-year refundable credit to accelerate electronic filing.

Third, IRS reform is progressing well, and we are impressed by Commissioner Rossotti's success. To maintain that momentum, we hope that Congress will follow the recommendation of the IRS Oversight Board to ensure adequate funding.

And, fourth, IRS can operate more effectively if it enlists more help from its external stakeholders.

First, on the filing season, although the season does not end for another 13 exciting days, we have enough information to report that it has been successful. Our experience in working with the IRS has been very positive. The e-file system has worked well across all service centers, and we have experienced very little down time.

As of March 15th, our return preparation is up approximately 2 percent and electronic filing is up about 8 percent. Over 87 percent of our returns are electronically filed. Electronic filing through our TaxCut software and Web-based tax preparation is up 58 percent over last year.

But every season has glitches. Three from this year are particularly noteworthy.

First, the IRS needs to aggressively enforce its new rules requiring tax practitioners to use a client's W–2 in order to e-file.

Enforcement delays this year gave unfair competitive advantages to firms that improperly used pay stubs or leave-and-earnings statements to prepare substitute W–2s.

Despite warnings that this might occur, the IRS response was too little and too late. More needs to be done next year so compliant taxpayers and practitioners won't be hurt.

Second, the IRS needs to improve the debt indicator.

When the debt indicator works, taxpayers learn whether any delinquent State or Federal taxes, student loans, or child support payments will be offset against their refunds. The program helps taxpayers by making them aware of problems they need to resolve. It helps tax preparers and lenders by clarifying risk, which helps lower the cost of refund anticipation loans. And it helps the IRS by increasing electronic filing and improving compliance.

But when errors occur, as they did this year when all Social Security numbers were not included in IRS offset screens until February 1st, all suffer. The firms participating in this year's DI test incurred significant losses, which eventually get passed through as higher fees or discourage electronic filing.

We look forward to working with the IRS to make the DI program run more effectively when it is renewed, as we hope it will be, in 2002.

The third glitch involves difficulties using PINs in place of paper signature documents to authenticate electronic filing.

The PIN program needs to be redesigned because the reject rate caused by taxpayer-provided information that doesn't match data in IRS computers is unacceptably high. The reject rate this year for self-prepared returns, using software or online applications, has been 20 percent compared to a normal reject rate of 12 to 13 percent. Almost all the difference is related to PIN rejects.

Whether this occurs because taxpayers or tax practitioners enter the wrong data or because the IRS has wrong data in its computers, the program is in trouble if e-filers using a PIN have a greater likelihood that their returns will be rejected.

Second, on electronic filing generally, we need to face the fact that 3 years after Congress set twin goals of electronically filing all computer-prepared returns by 2002 and electronically filing 80 percent of all tax and information returns by 2007, projections are that America will not meet these targets.

The IRS and practitioners must redouble our efforts to convert paper filers. We need more promotion and marketing, more cooperation from CPA firms, a more workable PIN program, and friendlier standards to encourage more professionals to enlist as authorized e-filers.

But because the present arsenal of incentives may not be adequate, we recommend a more dramatic jump-start, which is the enactment of a $10 to $15 refundable tax credit for a limited period of time for taxpayers who choose electronic filing.

Third, on the budget for 2002, we are concerned about reports that the administration may not endorse the IRS Oversight Board's recommended budget, especially the personnel and technology initiatives.

We believe the IRS should have the funds it needs to do its job. Too much is at stake to shortchange computer updates or risk breakdowns, especially when Congress is about to add new provisions to the tax code.

And, finally, on working with the IRS, we continue to find a welcome spirit of partnership. The new national accounts manager system works well. We get excellent help in solving problems, and

IRS staff, especially in the Electronic Tax Administration area, are responsive and diligent.

Mr. Chairman, we look forward to working with the Subcommittee to ensure that for most Americans the tax-filing experience is, if not enjoyable, at least tolerable. We appreciate the chance to be here today and welcome your questions.

[The prepared statement of Mr. Ernst follows:]

Statement of Mark A. Ernst, President and Chief Executive Officer, H&R Block, Kansas City, Missouri

Mr. Chairman and Members of the Subcommittee:

I'm Mark Ernst, President and Chief Executive Officer of H&R Block. We appreciate the opportunity to discuss the 2001 tax filing season. With me is Robert Weinberger, our Vice President for Government Relations.

About H&R Block. H&R Block, founded in 1955 and headquartered in Kansas City, is America's largest tax return preparation company. Over 175,000 individuals take our tax training courses annually. With more than 9,000 U.S. offices, we handled over 16 million individual returns in 2000, which is one in seven received by the IRS and about 37,000 per Congressional district. We are leaders in electronic filing, originating over half the practitioner e-filed returns that the IRS receives. We publish *Kiplinger* TaxCut® tax preparation software, which has over 1.6 million users, and we author the annual "*H&R Block Income Tax Guide*." Internationally, we prepare tax returns at over 1,200 offices in Canada, Australia, and the United Kingdom.

In the past several years, we have reshaped the company to offer our clients—many of whom view a stop at H&R Block as an annual financial check-up—more than tax services. We also offer financial planning, mortgages, and savings and investment products. And to expand our business services, we have built a national accounting practice anchored by RSM McGladrey.

Filing Season News. We're offering a number of innovations this year to make online tax preparation and e-filing more appealing. In addition to our online program for do-it-yourself tax filers, we offer "*Electronic Refund Advances*" that allow online e-filers to get a loan in the amount of their refund in as little as 24 hours. Our "*Professional Review*" allows taxpayers who use our do-it-yourself program to have an experienced H&R Block tax professional review, sign, and guarantee their return. "*Ask a Tax Advisor*" enables any taxpayer to connect with a Block tax professional by phone, e-mail, or online chat for immediate answers to specific tax questions. And our new "*Professional Tax Service*" allows customers to enter their tax information in our online tax organizer and then send it to an H&R Block tax professional, who will prepare, sign, and guarantee the taxpayer's federal and state return.

We're also aiding clients with "*Express IRAs*" to convert refunds in a tax-advantaged way into retirement savings. And this year, in cooperation with the U.S. Department of Health and Human Services, we advised clients of their potential eligibility for free or low-cost state children's health insurance programs (SCHIP) and how to get more information. We've been told that calls to the "Insure Kids Now" 800-number in January-February tripled over last year.

We continue to emphasize the multiple benefits of e-filing while reducing cost as a possible barrier. This year, we did not charge additional fees for e-filing in 80% of our offices, we participated in the IRS's PIN, DI, and Web hyperlink programs, we distributed 500 IRS public service announcements promoting e-filing to local TV stations with whom we place our ads, and we offered additional services to online and software clients that created value-added incentives to e-file—and that suggest a future in which combinations of new technology and traditional service will enable customers to be served when, where, and how they choose.

Filing Season Results. Although the main 2001 tax filing season does not end for 13 exciting days, we have enough information to report that it has generally been successful. Our own experience in working with the Service has been very positive. The e-file system has worked very well this year across five service centers. We experienced very little IRS down-time as compared to previous years.

Our return preparation as of February 28 is up 2.4%, and e-filing is up 7.8%, as nearly 90% of our returns are e-filed. E-filing through our *Kiplinger* TaxCut® software and Web-based tax preparation is up about 60% over last year.

Filing Season Problems. Given the range of disruptions that might occur, we count ourselves lucky when things go so well. That said, we believe more can be done to make the next filing season even better. No system that processes 1.2 billion tax and information returns, issues 97 million refunds, answers over 100 million assistance calls, and collects almost $2 trillion annually—much of it in a 105-day filing season—will ever be error-free. Let me identify three glitches in an otherwise good season—in shorthand LES, DI, and PIN:

LES/W–2 Requirements: Under new IRS rules, tax preparers need a client's W–2 form before electronically filing his taxes. Some firms, however, improperly use pay stubs or leave and earnings statements (LES) to prepare substitute W–2s. Their clients file earlier and get refunds sooner, which is a competitive advantage over firms that comply with the rules. We alerted the IRS to the potential for this problem prior to tax season. We hoped that swift enforcement would address it.

Delays, however, blunted any impact until after February 16, following the early peak of the filing season, costing many honest firms tax business and income. One of our company-owned districts near a military base in North Carolina, for example, saw business plummet by nearly 50% during what should have been our busiest time of the season. If the IRS expects firms to follow the rules, it must enforce the law against those who do not. The IRS was ill-prepared to deal with violators, despite advance warnings, and when it acted it did too little, too late. More needs to be done for next year.

Debt Indicator (DI): This is the second year of a test of a Debt Indicator in which, at the taxpayer's instruction, IRS and the Financial Management Service electronically signal the representatives of taxpayers who use bank products (like refund anticipation loans) if offsetting obligations (delinquent federal or state taxes, student loans, or child support payments) will reduce refunds. The information helps taxpayers and enables lenders to avoid making loans for which they will not be repaid which, in turn, enables them to pass reduced costs through to clients in the form of lower fees charged.

Last year, the program worked fairly well although there were some problems. In anticipation of the DI, the provider of bank products for H&R Block led the industry in lowering fees. For taxpayers, the private sector and the IRS, it should have been a "win-win" with e-filing up, bank fees down, and compliance improved. But IRS didn't get the DI working properly until well into the tax season.

This year, again, there were problems. Social Security numbers ending in 00 to 32 were not included in IRS offset screens until February 1. Returns reported as having no offset had offsets taken when refunds were processed. The result was unhappy taxpayers and significant losses for participating firms.

When it works well, the DI program benefits taxpayers, tax preparers, lenders, and the IRS. Unfortunately, when errors occur, all suffer. We believe the program is worth continuing and look forward to working with the IRS to ensure better execution.

One use of a DI—supporting RAL transactions—may decline as the IRS fulfills its strategic plan to speed refunds to all e-filers within 48–72 hours. We welcome faster refunds as a solid plus for taxpayers, a strong incentive to e-filing, and a showpiece of IRS's computer modernization program. But if the IRS wants to win taxpayer confidence in electronic notifications and two-way e-transactions—both e-filing and e-responses—it must make its responses reliable so taxpayers are not confused.

• ***PINs***. Practitioners welcomed the IRS allowing taxpayers to use a self-selected personal identification numbers (PIN) in place of paper form 8453 that is otherwise required to be sent by mail with a signature to authenticate an e-filed return. To obtain a PIN, the taxpayer must provide his correct name, SSN, date of birth (now required only for on-line filers), AGI, and total tax from last year's return.

This year, thousands of PIN applications submitted with correct "shared secrets" information were rejected, costing tax professionals time and income as they worked to correct the rejects, and angering many customers who anticipated easier filing and faster refunds. Some preparers abandoned the program as it became easier to use the paper 8453 form instead of having to deal with a PIN reject and asking the client to return to file an 8453.

Under the online e-filing program, for self-prepared returns using software or online applications, the reject rate this year has been about 20% compared to our normal e-file rejection rate for TaxCut® and online customers of about 12–13%. Almost all of the difference is attributable to PIN rejects.

One problem is that IRS records are sometimes wrong. As a result, a taxpayer may enter the correct AGI and total tax but the IRS system says it's wrong.

IRS also has potential errors in its records of citizenship, marriages, decedents, and name, SSN, and DOB as received from the Social Security Administration.

The IRS believes the majority of PIN rejects are caused by customer error. But whether the problem is with the practitioner, the taxpayer, or the IRS, one fact remains: If you e-file using a PIN, your return is more likely to be rejected. We hope to work with the IRS to solve this problem so that filers won't abandon PINs and e-filing in frustration next year.

If PINs, intended to make e-filing easier, make it harder, more complex, more expensive, and less satisfying, the entire e-filing program will be endangered. We look forward to helping the IRS find error-free, non-paper, simple signature authenticators that work to encourage, not discourage, e-filing.

In highlighting these points, we don't want to detract from the larger conclusion that the filing season is going well and IRS's overall record is good. We hope to work with the IRS to mend these problems next year.

IRS Reform. In the last year, the IRS's four new divisions "stood up," a landmark in continuing reform, and the IRS Oversight Board began its work. Commissioner Rossotti has continued impressive initiatives to improve the agency's performance, modernize technology, and improve customer service. We think he's doing a great job.

Electronic Filing Shortfall. The IRS has increased its e-filing promotion to achieve Congress' twin goals of e-filing all computer-prepared returns by 2002 and e-filing 80% of all tax and information returns by 2007. But the early numbers this year are slightly below IRS projections and the projections are that the targets will not be met unless more Americans overcome apprehensions and more practitioners enlist.

Our suggested priorities, many already a part of the IRS strategy, remain: (1) a continuing focus on private-sector cooperation, through the Electronic Tax Administration Advisory Committee, through industry's Council on Electronic Revenue Communication Advancement (CERCA), and especially with accounting firms who will soon be able to e-file all forms and attachments; (2) expanding IRS's already-strong marketing and promotion; (3) universal PINs to enable paperless filing—*if* the information needed to validate the PIN does not itself become a hurdle and *if* IRS rejects are not so numerous as to make the PIN counterproductive; (4) streamlining the application process to make it easier for tax practitioners to become Electronic Return Originators (EROs) and easing suspension rules for EROs—high ERO application standards and stringent suspension rules are barriers that deter participation in the program; and (5) continued reform of old rules for the e-filing program.

E–Filing Jump Start. Despite our optimism and support, we may face the uncomfortable reality that for many Americans, the incentives to e-file—beyond a faster refund—are simply not compelling. Before reaching that conclusion, we believe both the IRS and tax professionals can try harder to persuade taxpayers of the benefits of e-filing. And Congress can help.

We recommend a three year refundable tax credit of $10–25 to encourage e-filing and to provide the dramatic pull needed to convert more American taxpayers and enable the IRS to meet your goals for 2002 and 2007.

The IRS Restructuring and Reform Act of 1998 allows IRS to pay "appropriate incentives," and the Clinton Administration last year proposed a $10 tax credit for those who e-filed in 2002–6. We prefer incentives that go to taxpayers, not to e-file originators or transmitters.

Complexity. In three of the last five years, we sent the Ways & Means Committee, the Senate Finance Committee, the Treasury, and the IRS ten modest suggestions for Tax Code simplification, several of which have now been enacted. We look forward to working with you on your efforts to simplify the tax law, especially as it affects average American families.

Check Box. This year, the IRS allows taxpayers to check a box to allow their tax preparer to be contacted by the IRS for additional information. The idea is good but it only authorizes contact with tax preparers, not tax preparation companies. We recommend modifying the program to allow us to help clients with in-office personnel rather than bring back the actual tax preparer since we have both seasonal and year-round tax preparers.

IRS Liaison. This year, the IRS installed an accounts manager system for its largest external customers to serve as our ombudsman in solving various problems. The program has worked well and it deserves high marks. We found other IRS staff responsive and diligent, especially in the area of electronic tax administration.

Most IRS interaction with practitioner groups comes through formal advisory committees or public liaison meetings. Outreach and information sharing have increased. Status reports and briefings are excellent.

As a large customer, we also work directly with senior IRS officials to manage an ongoing agenda. We are often an early-warning system for the IRS, spotting problems before they generally appear. We hope to expand our contacts to improve cooperation, reduce bumps in the next filing season, and participate in the IRS's planning process. The problems that inevitably occur each filing season, especially as new programs are implemented, can be reduced if private-sector partners have a greater opportunity to discuss ideas in the planning stage to identify issues and share perspectives.

FY 2002 Budget. While the President will not submit his detailed IRS budget until April 9, early reports indicate that the Administration will not support the full $10.26 billion recommended by the IRS Oversight Board. Plans to hire 4,000 new employees would be trimmed by 1,400 and a $1 billion fund for two years of technology modernization would be cut to $400 million.

We strongly support the agency receiving the funds it needs to do its job, especially in modernizing outdated technology, so that the risk of any system breakdown is reduced. IRS reform and restructuring requires dependable financial support to enable the agency to fulfill its strategic plans for better customer service, faster return processing, more effective law enforcement, and modernized technology.

Conclusion. Mr. Chairman, there are many other areas I could comment on, and I will be happy to respond to your questions. We look forward to working with the Subcommittee to ensure that for most Americans the tax filing experience is, if not enjoyable, at least tolerable. We are working to ensure that lessons from this tax season will help us all achieve smoother filing next year, with refunds issued promptly, and with the IRS continuing on the path of reform.

Chairman HOUGHTON. Thanks very much. Ms. Hill.

STATEMENT OF CLAUDIA HILL, CHAIR, GOVERNMENT RELATIONS COMMITTEE, NATIONAL ASSOCIATION OF ENROLLED AGENTS, CUPERTINO, CALIFORNIA

Ms. HILL. Mr. Chairman, members, my name is Claudia Hill——

Chairman HOUGHTON. Would you put the microphone on?

Ms. HILL. OK. Thank you. Mr. Chairman, members, and staff, my name is Claudia Hill, and I am an enrolled agent from Cupertino, California, in private practice. I work primarily with individuals, small business, and I am an electronic filer—some. Some.

On behalf of my more than 10,000 enrolled agent colleagues in the National Association of Enrolled Agents, I would like to express my appreciation for our ability to present testimony at this hearing today and to express my appreciation for your interest in hearing what the taxpayers have to say about dealing with the filing season.

I have several comments. The first one has to do with the IRS budget. Over the last decade, the IRS has been asked to do more with fewer resources. While the overall budget has grown in recent years, by many measurements it has declined. At the same time, Congress has demanded and the Commissioner has delivered a greater emphasis on taxpayer service. While much of the technology infrastructure for a modern accounts management system has yet to be delivered, our members report that IRS is generally doing a more professional job of handling case management issues and general tax questions from taxpayers.

Unfortunately, we have also witnessed a corresponding decline in service at the audit and collection levels. Experienced IRS employees in these areas have been reassigned to cover the phones and help with tax returns during filing season. It is our belief that adequate resources for the IRS make a difference in the public satisfaction with the IRS specifically and the Federal government in general. We also believe it is essential that IRS be given adequate resources to maintain an enforcement presence.

Taxpayers need to know that there is a consequence to non-compliance. When audit collection efforts are reduced as greatly as they have been in recent years, it sends an ambiguous message about our voluntary tax system. Some people start thinking the system really is voluntary. As a front-line practitioner, we then must deal with taxpayers who want to play audit roulette or engage in illegal tax schemes.

As to modernization, this is the first filing season since the IRS completed its business restructuring in an effort to organize around its customers. NAEA members are beginning to see some positive returns. Access to information has been dramatically enhanced with the continued improvement of the IRS Web site. The new small business self-employed Web site is a marvel of accessibility and usability. The new criminal investigations site gives practitioners a resource to point to when we find taxpayers who don't believe the IRS is using compliance resources to fight abusive trust and employment tax avoidance schemes. More forms are capable of being filed electronically than ever before, and access to forms and information on the Web is available through public libraries, through home computers. It has been a great, a very good improvement.

The communications and public liaison efforts of the IRS have been greatly enhanced to inform and advise the public on a broad range of issues, and partnerships between the IRS and the public on a broad range of association needs, taxpayer needs are developing and longstanding issues are being resolved in a timely and cost-effective manner.

The ability of the agency to collect more accurate data more efficiently and then to be able to use that better data will help taxpayers deal with the Service and practitioners deal with the taxpayers and the IRS. We look forward to the day when we can resolve problems online, when we can use information that we have gathered electronically and communicate with the IRS electronically. Our message to Congress is to stay the course with these investments in technology and insistence with customer service, make sure the IRS and its partners deliver benefits to taxpayers and practitioners on schedule.

Every year we survey our members on the problems of the filing season, and the number one response we get from our members is tax law complexity. We then ask our members to choose the most complex item in the Internal Revenue Code. We have dubbed their selection "the tax headache of the year." For the second time in 2 years, the overwhelming response has been the individual alternative minimum tax. It is affecting more of our population, including senior citizens, farm families, middle-income taxpayers, U.S. taxpayers living and working overseas, employees expected to bear the majority of their own employment-related expenses, and workers with incentive stock options.

Now, how can one type area of the tax code affect such a wide variety of taxpayers? Because in the last 15 years, the regular tax system has been changed, rearranged, and indexed, without attention to the AMT system running silently beneath it. Unfortunately, as the economy has changed, more taxpayers have found themselves pulled into an AMT trap. Quick examples of people that are affected this year, which you may have seen in some of the media:

A senior citizen who had to take money out of a pension plan to pay for medical expenses to care for his wife with Alzheimer's. He found himself in AMT because the AMT does not allow a complete deduction for medical expenses as the regular tax system does, nor does it allow the deduction for his property taxes or his State income taxes.

We saw taxpayer farmers affected. A few years ago, Congress saw the need to help balance out their income when they have volatile income from year to year by offering what is called a 3-year special income averaging. Unfortunately, there was no provision when income averaging using that method dipped below the AMT to allow the benefit. The taxpayer pays the AMT.

U.S. citizens residing outside our country who are encouraged to file in the U.S. and use the credits for foreign taxes paid are allowed to offset 100 percent of their regular tax but not all of their alternative minimum tax. In essence, they are double taxed.

Chairman HOUGHTON. Ms. Hill, could I just interrupt just a minute? Your time has expired, so if you could wind up your testimony as fast as possible, I would appreciate it. Thank you.

Ms. HILL. OK. We have seen numerous issues on this. I will just name two other complexity issues and then be available for questions.

More complexity having to do with phase-outs and the earned income credit. There are over 20 commonly encountered aspects of individual returns that require phase-outs. These add complexity and they give a perception of unfairness with the law. When it comes to the EIC, the fraud in this program is an embarrassment to practitioners, the public, to Congress, and the IRS.

We believe that this might be addressed by dealing with whether or not there should be regulation of all commercial preparers, at least registration of them, as is done with the electronic return originator program.

That concludes my testimony, and I would be happy to answer any questions.

[The prepared statement of Ms. Hill follows:]

Statement of Claudia Hill, Chair, Government Relations Committee, National Association of Enrolled Agents, Cupertino, California

I am honored Mr. Chairman to present this testimony on behalf of the National Association of Enrolled Agents (NAEA). There are approximately 35,000 Enrolled Agents, more than 10,000 of whom are members of our organization. Enrolled Agents represent over 5 million taxpayers and small businesses at all administrative levels of the IRS, including tax preparation. In order to be enrolled before the Department of Treasury, a practitioner must pass a detailed exam covering the administrative procedures and practical tax laws affecting real people and small businesses, or have significant experience working at the IRS. In addition to demonstrating ongoing competency each year through continuing education requirements, our members must undergo a thorough background check and abide by a strong code of conduct. Our members are proud to be the federal tax code specialists.

The Subcommittee has asked us to comment on the state of the filing season, and we are happy to report that from the perspective of frontline practitioners the state of the filing season is generally good. The IRS seems to be providing a basic level of service to more taxpayers with generally fewer resources at the same time that they manage annual tax code changes. They seem to be making progress with their strategic initiatives such as 80 percent electronic filing and business organization restructuring, while technology modernization has yet to materialize in terms of deliverables to taxpayers or frontline IRS employees. On the other hand, as there are in any undertakings as complex as filing season, there are some problems.

Before I touch on a number of specific problems our members have discovered with the current filing season, I would like to discuss a number of issues that affect the job IRS is doing with the filing season and with taxpayers service and compliance in general.

Resources

Over the last decade, the IRS has been asked to do more with fewer resources. While the overall budget for the agency has grown in recent years, by many measurements it has declined.

First of all, the number of full time employees available to handle the workload for more taxpayers and more transactions has gone down over the last 10 years. At the same time, Congress has demanded and the Commissioner has delivered a greater emphasis on taxpayer service. While much of the technology infrastructure for a modern accounts management system is yet to be delivered, the IRS is generally doing a more professional job of handling case management issues and general tax questions from taxpayers. For example, our members continue to experience helpful and knowledgeable IRS employees. Generally, we have seen a strong positive change in attitude with employees at the agency.

Unfortunately, we also have witnessed a corresponding decline in service at the audit and collection functions. Experienced IRS employees in these areas are being reassigned to "cover the phones" and help with tax returns during filing season.

While at first glance, audits and collections activities do not seem to fit into the definition of "service," resources available in these areas often assure the timely resolution of costly disputes for middle-income and small business taxpayers. An enrolled agent from North Carolina recently wrote to us telling of an incident where the single remaining auditor in Durham has been reassigned temporarily to customer service and will not be able to complete any ongoing audits until after April 16th. Without adequate resources, audits, which should take hours, spread out to days and even weeks. Meanwhile taxpayers are left with the uncertainty of knowing where they stand with the IRS. Other relief measures such as offers in compromise and innocent spouse claims are delayed to the point that many taxpayers are harmed needlessly.

It is our belief that adequate resources for the IRS make a difference in the public's satisfaction with the IRS specifically, and the federal government in general. We also believe it is essential that IRS be given adequate resources to maintain an enforcement presence. Honest taxpayers need to know that there are consequences for non-compliance. When audit and collection efforts are reduced as greatly as they have been in recent years, it sends an ambiguous message about our voluntary tax system. Keep in mind, more citizens interact with the IRS than any other agency of the federal government. Their budget should reflect this reality.

Modernization

This is the first filing season since the IRS finished its business reorganization. The purpose behind this complex and expensive undertaking is to organize the IRS around its customers so that they can better respond to the needs and track noncompliance of particular taxpayer groups. NAEA members are beginning to see some positive returns:

- Access to information has been dramatically enhanced with the continued improvement of the IRS web site. The incredible number of taxpayers and professionals visiting and using this site attests to the needs it has met.
- The Small Business/Self Employed Web site is a marvel of accessibility and usefulness. We hope to see it expanded and that other divisions will embrace this concept of providing information out where taxpayers and tax practitioners can access it easily.
- More forms are capable of being e-filed than ever before. We expect 99% of all forms to be capable of being e-filed by next filing season. Changes in the number of occurrences in which a form may be e-filed have also had a positive impact on the ability of taxpayers to e-file.
- Two hundred NAEA members are currently working with the IRS on a secure messaging system pilot program. It has taken longer than we expected for a variety of reasons, among them security concerns and the meshing of various

computer systems and software, but this has been a project to which NAEA has been committed for a long time. It is meeting certain needs effectively for the practitioner community and we are gratified with the progress made thus far.

- The Communications and Public Liaison effort at IRS has been greatly enhanced. We are seeing the leveraging of the information systems of practitioner groups, the small business community and other business organizations to inform and advise the public on a broad range of issues. This is smart thinking and we applaud those who have run counter to the old IRS culture of "no comment."
- Partnerships between IRS and professional societies and trade associations are making it possible for us to develop solutions to long-standing issues in a timely and cost-effective manner.

While the business modernization seems to be taking its first tentative steps toward delivering value to taxpayers, it is clear that its full promise will not be delivered until the IRS and its contractors complete the information systems modernization. Our understanding is that a great deal of the initial planning and designing stages for the first projects are almost completed, and that IRS and its private sector partners are about to begin building key elements of the project. Unfortunately, we have yet to see benefits delivered in the field.

The ability of the agency to collect more accurate data more efficiently and then to be able to better manage taxpayer data is key to the future of the IRS. Taxpayers will see their refunds faster. Practitioners and individual taxpayer will be able to resolve more problems with one or two calls instead of dozens. Additionally, the new system will allow taxpayers and practitioners more options for solving problems like 800 lines and on-line access and management of accounts. The IRS will be able to spot non-compliance faster making it cheaper for both taxpayers and the IRS to resolve these problems. Currently, it takes the IRS over 18 months to reconcile tax returns with information from 3rd parties such as W–2 and 1099 information. Modern systems and business practices should shorten this cycle considerably.

Our message to Congress is stay the course in these investments and make sure the IRS and its partners begin delivering benefits to taxpayers on schedule.

Complexity and the "Tax Headache of the Year"

Every year, we survey our members on problems with the filing season. Separate from this effort, we ask our members to choose the most complex item in the Internal Revenue Code. We have dubbed their selection the "Tax Headache of the Year." For the second time in two years, the overwhelming response in both cases has been the same—the individual alternative minimum tax. We believe the message is clear: *Complexity* is the number one tax filing season problem.

Why is the AMT the "Tax Headache of the Year?" Our members tell us of increasing numbers of their clients who were blindsided this year by falling into this insidious alternative tax system. Here are a few examples:

One of our enrolled agents in Youngstown, Ohio wrote to us to say how deeply troubled she was to see an elderly client "clobbered by the AMT." The taxpayer was caring for his wife with Alzheimer's, and had to withdraw extra pension money to pay medical bills. The AMT calculation required him to add-back into AMT a portion of his otherwise deductible medical bills and his state income and property taxes. This caused the AMT to exceed the regular tax. He didn't think it was a good alternative!

In my state of California, I find that many middle-income taxpayers fall unwittingly into the AMT because of the high cost of property taxes on their homes and equally high state income taxes. When these taxpayers also happen to be employees who incur ordinary and necessary business expenses and whose employers either do not reimburse expenses or use "not accountable plans," they are injured even more, since those miscellaneous deductions are also added back to the AMT base. None of these items, normally allowable deductions, are permitted against AMT.

Our members are reporting that more and more farm families are being hit with the AMT. Congress saw a need to provide farmers a special income averaging method a few years ago. Unfortunately, when that method lowers the regular tax below AMT, the taxpayer loses the benefits, and must pay the higher AMT.

U.S. taxpayers living outside our country are provided in the law a means to avoid double taxation through the use of foreign tax credits (FTC). Once again, AMT undermines the intent of fairness Congress intended with the credit system, by allowing the FTC to offset no more than 90% of the AMT while the regular tax can be completely offset. The taxpayer is injured once again.

Although Congress may be considering an extension allowing use of non-refundable child and education related credits against AMT, general business credits still cannot be used against the AMT. In example, for taxpayers that are affected, the benefits of the low-income housing credit are not allowed against the AMT—a Code provision that is essential for providing affordable houses in high-cost states.

With increasing emphasis on equity-based compensation, the use of employee stock options as part of a worker's compensation package has become mainstream. Nearly 30 percent of those surveyed as part of the 35th Index of Investor Optimism reported that they or their spouse had received options at some point in their career. Of this group, 43 percent said options were part of their 2000 compensation and comprised approximately 11 percent of their total income last year. However, during this past year a hidden danger of employee stock options became apparent. When an employee exercises their right to acquire incentive stock options at a price below the fair market value of the shares on the date of exercise, the "virtual income" (difference in values) is included in the AMT base but not in the regular tax base. The date of exercise value sets the preference—regardless of what eventually happens with the value of the shares if they are not disposed of in the same calendar year as exercise. If the employee chooses to hold the stock for the one year period prescribed in the law to obtain capital gains treatment of the income, they may find themselves expected to pay taxes on income they never really receive.

There have been many accounts in the media recently of taxpayers that have been injured by this "preference" because of dramatic volatility in the stock market this past year. We have heard from taxpayers and their advisors with egregious examples of phantom income far exceeding any economic benefit the taxpayers will ever receive, being taxed due to the provisions of the Alternative Minimum Tax (specifically IRC 55 and 56 and Regs. Sections 1.421 and 1.422). A taxpayer from San Luis Obispo, CA wrote,

> "Ideally, ISOs works for both employer and employee. It gives the employee an incentive to stay with the company and it gives the company ways to reward the employee without increasing salary costs—I exercised the stock options not realizing that the price of the stock on the day I exercise will be used to figure out my income WHETHER I ACTUALLY SELL THE STOCK OR NOT. Now that the value of our stock has been depressed over 60%, I am being taxed on income that was never realized and have what is call a PHANTOM INCOME. This made my effective tax rate to be 290%!"

This certainly was not what Congress intended. We hear of people mortgaging or selling their homes to pay their year 2000 AMT. Others are so distraught they fear filing their 2000 tax returns because they cannot pay the liability. This certainly was not what Congress intended.

Over three years ago, the National Commission on Restructuring the IRS found a direct connection between the complexity of the Internal Revenue Code and the difficulty of tax law administration and taxpayer frustration. The AMT tops our list of complex provisions, but our members cited two more that definitely cause problems each filing season and need your intervention to resolve.

As frontline practitioners, we believe Congress could provide significant relief and make the job of the IRS easier by making immediate changes in three areas. First, Congress needs to repeal the alternative minimum tax for individuals. Second, phase-outs and phase-ins need to be standardized. And finally, it needs to simplify the rules for qualifying for the Earned Income Credit.

There are over twenty commonly encountered aspects of individual returns that require phase-out calculations. To mention a few: limits for deductible IRA contributions, limitations on the use of education credits, child credits, elderly credits, personal exemptions, itemized deductions, passive activity losses and credits. When taxpayers are told Congress has provided incentives or rate reductions for their benefit, and realize when they actually file their returns that they don't "qualify" for the benefits, they feel deceived.

Each year the IRS lists the top errors in filed returns. Earned Income Credit issues make up almost half their list. Our members concur, and express dismay at the number of taxpayers that come to them asking for their assistance in "working the system" to obtain benefits to which they are not entitled. Our members don't participate in such activities. They are held to strict codes of professional conduct, from our own organization and from the IRS. This is not the case for the vast number of paid-preparers in this country.

These three changes would provide significant relief to taxpayers, as well as allow the IRS to free up resources within the agency for other purposes. In addition to improving tax administration, reducing taxpayer burden by simplifying the tax laws will lower taxpayer frustration and improve voluntary compliance.

Finally, we urge you to consider registration of all commercial tax preparers. This would level the playing field so that return preparers who submit paper returns are held to the same high standards as Electronic Return Originators and as Circular 230 practitioners—Enrolled Agents, CPAs and attorneys.

Electronic Filing and the Current Filing Season

In an effort to make electronic filing "paperless" IRS offered a program that would eliminate the need for taxpayers to send in a signature document through the use of an electronic signature Personal Identification Numbers (PIN). The program is not truly "paperless" since the practitioners that offer this service must retain a signature document and copies of the W–2 forms. However, numerous problems have been experienced this filing season with the PIN. Although most of the issues could be categorized as related to the start-up of the program, many of our members have pointed out that the current requirements for using taxpayer PINs are complicated enough that it is often easier to have taxpayers sign the form 8453 instead. Additionally, some practitioners report that as many as 10 percent of their e-filed returns have been rejected this year because of PIN problems.

A new addition to the individual tax forms this year is the "check the box" limited authorization for paid preparers. We believe this addition will be beneficial for taxpayers and the IRS as their telephone assistors become better informed as to the types of inquiries it is to permit. An important step in streamlining the ability to resolve issues with the largest account management intensive organization in the country, the IRS. This leads into the final point I would like to raise today. Despite the recent reorganization efforts and technology improvements, and sometime because of them, the IRS continues to have severe problems with basic account management. Simple problems with client returns often entails hours or days of senseless struggle to get the right information to the right person at the agency. Faxed information is never received. Phone calls go unanswered. Valuable time is spent on hold waiting to talk to a person at the agency, who then has difficulties resolving problems quickly for lack of training and basic technology tools. The IRS is doing better, but it is a long way from resolving this basic problem first identified by the National Commission on Restructuring the IRS. Congress needs to stay the course with adequate resources for technological enhancements and strong oversight.

I appreciate the Committee giving the National Association of Enrolled Agents the opportunity to talking about the 2001 filing season today. Commissioner Rossotti has a tough job and the organization is generally doing the best it can with the limited resources it has.

Thank you.

Chairman HOUGHTON. Thank you very much, Ms. Hill.

I would like to ask a brief question of Mr. Ernst, so thank you very much for being here. We have talked a lot about security. We talked about it with the Commissioner. We talked about it amongst ourselves. And we know that the e-filed returns are a tough area to keep secure. How do you keep those returns secure in your office?

Mr. ERNST. Well, we use a number of different methods to submit returns, both on the Internet and through our software products at retail and through our offices. In our office network, we have differing levels of restricted access and security controls for individuals who work for us. All returns go through a private network to a central location that is secure that we maintain. We do extensive testing of security at that facility as it aggregates returns from around the country from our various offices. Annually, we test our online electronic filing system for what we call "hacker attacks" or by attempting to break into the system ourselves in advance of the filing season and then on a random basis during the filing season to ensure that people cannot access our electronic filing system before or at the point we submit returns to the IRS filing centers.

In addition to that, we maintain client records in a central data warehouse for ongoing storage purposes, and from that we have extensive controls around who within our organization can even access those records. And we keep it separate from our e-file system so that people can't get through our e-file system into those records.

So we have built a fairly elaborate security system around the return data, both at the point of access initially when we acquire the data and when it is transmitted to our central repository before submission to the IRS.

Chairman HOUGHTON. Thanks very much. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Ms. Hill, as you know, too often people who file for the EIC have their returns completed by practitioners that are paid filers. It is a very high percentage, I believe 44 percent. And also too often these filers, when there is a mistake, it is pointed out that it is fraud and abuse on behalf of the filer, the taxpayer that causes these mistakes and is not attributable in many instances to the fact that such an overwhelming number are filed by practitioners.

Is it your testimony—I think I heard you say that one way to correct that is to make practitioners register?

Ms. HILL. Well, first of all, a few years ago Congress did respond to the issue of preparers by having a special penalty for preparers of the EIC returns for due diligence. I believe the issue with electronic filing—not electronic filing but earned income credit has to do with the complexity of the provisions. There is a built-in incentive in the way that it is currently structured to falsify one's filing status. We have numbers of letters from our Members who say that people come into their office and expect them to play a game where two people who may be married to each other, at least parents of children, each want to file as head of household and reap maximum benefits to the earned income credit, when if they were filing as married, they would not get the same dollar amount or possibly not even be entitled to it. So there is a built-in incentive in the way it is structured to encourage people to falsify their status.

Now, when someone comes into an office and tells a preparer here is their position, preparers that are regulated, CPAs and attorneys and enrolled agents, have a due diligence standard both to the IRS and to their professions that they cannot prepare those returns. And our Members complain that they are injured by the number of other paid preparers who are willing to do this, because the people leave the office and have it done somewhere else.

Mr. COYNE. So do you think that there is a way to help out here by requiring registration beyond what already is required?

Ms. HILL. I believe that if there was a registration similar to what is used with the electronic return originators, IRS would have a much quicker access in instances where they find lack of diligence with preparers. They would be able to encourage education where currently in most States—there are only two States that even encourage education of paid preparers.

Mr. COYNE. Thank you.

Chairman HOUGHTON. Mrs. Thurman.

Mrs. THURMAN. Ms. Hill, just maybe to follow up on Mr. Coyne's question, because you make it sound like a lot of the earned income tax credit people that are trying to get these benefits are out here trying to game the system. What do you think is the real percentage of people trying to do that?

Ms. HILL. I believe there are errors both directions, really. I believe there are a lot of honest mistakes with misinterpretations. A major misinterpretation that was available in January of this year when the preparers were trying to understand was called the high income and the household decision as to whether or not—who could take the child as a dependent and claim the EIC.

I am not convinced that that was adequately resolved. So we may have returns in the system this year that expect it to not be available, but they were.

Mrs. THURMAN. Mr. Ernst, what is your feeling about this issue?

Mr. ERNST. Well, I agree. This is a very complicated area of the law, and, in fact, much of what the IRS now requires in terms of due diligence has been modeled after the work that we originated in trying to address this issue at the front lines of our own system working with clients.

Number one, many households in America do not fit the neat requirements that the tax law tries to describe. You know, household formation and deformation occurs with fluidity in America in a number of these situations. And so the issue often is not one of people trying to game the system per se, although that certainly occurs. Often it is about honest differences in households that don't fit neatly inside of the definitions that practitioners are asked to help our clients comply with.

Mrs. THURMAN. So would you say, then, on the other side of this, since we don't hear as much about this, the complexity of some of the tax shelter issues, some of the things that were brought up in the Wall Street Journal and some of the other issues, is it the same kind of situation?

Mr. ERNST. I certainly don't think it is a situation where there is a loophole that practitioners are out helping taxpayers exploit, which is I think what you allude to. I think it is more of a situation of who qualifies as the primary support for a child, which is a key element in determining who gets to claim that child, and, therefore, who qualifies for the EITC can change because different family situations and differences of opinion of who is providing what kind of support are often dumped on our desks, and we are asked to sort that out and figure out who qualifies for what kind of credits.

Mrs. THURMAN. So there is kind of a difference going on on the other side.

First of all, let me suggest to you that I thank you for doing what you have done with the Department of Health and Human Services on the SCHIP program. I think that is a wonderful thing that you have done there. We need—Ms. Hill, you might want to let your folks know about that, because I think it really was a really good way to get across to low-income folks that need this program that that is available to them.

Ms. Hill, I thought your testimony particularly on the AMT and your—you know, you kind of gave us an outline of several different people and how they interacted with the AMT. If we were not able to do anything about the AMT, which is looking less and less this year in some of these tax bills, some of the areas that you described—the medical issue and some of those—if there were something we could do, because certainly these stories are just really very compelling. Could you give us, besides the one that you mentioned on the health care, the gentleman that took money out, where some others areas with AMT are where you can see some extreme problems that we are facing that we might be able to help in maybe a separate kind of bill? And, Mr. Ernst, if you would like to jump in there, too, I would appreciate it, because I think these examples are extremely—just kind of pull at your heart when you read this as compared to what is going on right now in total repeal.

Ms. HILL. A lot of the media coverage right now has to do with incentive stock options. The taxpayers who did not understand equity-based compensation, who thought that this was the best thing in the world, and all of a sudden they find out later that the amount of value on the day they exercised stock got to be included in their alternative minimum taxable income, even though the stock may have little or no value currently. I don't think the law ever intended this. The concept of the alternative minimum tax, back when it was restructured in 1986, had to look at the economic income, and the concept is it realized or recognized. And when you never realize it, should it ever be recognized gets to be the issue on this.

I don't know that there is something that can quickly be done to resolve that. I think to affect the largest number of people—and I certainly wouldn't want to eliminate equity-based compensation and incentive stock options from the system. But I think you can affect the largest number of people by looking at the benefits of eliminating those Schedule A itemized deduction type preferences.

For example, medical expenses, people don't do them to create a tax shelter. Having children and not being able to take the exemption for your children against alternative minimum tax, children are not a tax shelter.

So small steps, eliminating the children—putting the children back into the exemption base for AMTI, allowing the non-refundable credits to be used, that provision sunsets at the end of this year. If something isn't done, all the talk of families who are benefiting from the child credit, the dependent care credit, will get no benefit at all. They will see their taxes increase.

Mr. ERNST. You know, we would be happy to offer you a number of those types of situations that we think could have the greatest impact at the least amount of cost.

Mrs. THURMAN. Mr. Chairman, I noticed in their testimony—and it is one of the things that I am very concerned about, and maybe Ms. Hill said it—the credibility that we have, and when you take something, what you have been promised or what you believe is out there to be promised, and then to run up against this, we have a problem in what we are saying to folks at home. And I think that is a real concern for some of us, and especially in some of these situations that I think have been described today. So we thank you for bringing those to our attention.

Ms. HILL. Thank you.

Chairman HOUGHTON. Well, thanks. Yes, AMT started out as a beauty queen, and now it has ended up as a monster. Obviously, this whole wave is coming in, and we have got to be careful.

Any ideas, any thoughts you have on this, because we are going to be wrestling with this, whether it is this year or this month or maybe next year, and we have got to have the best advice you possibly can give.

Ms. HILL. It is insidious. It mutated.

Chairman HOUGHTON. Yes.

Ms. HILL. That is what happened.

Chairman HOUGHTON. Absolutely. Well, thank you very, very much. We certainly appreciate it.

[Whereupon, at 4:05 p.m., the hearing was adjourned.]

[Submission for the record follows:]

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS,
WASHINGTON, DC 20004–1081
April 17, 2001

The Honorable Amo Houghton, Jr.
Chairman
Subcommittee on Oversight
Committee on Ways and Means
1136 Longworth House Office Building
Washington, D.C. 20515

RE: Hearing on the 2001 Filing Season Held on April 3, 2001

Dear Mr. Chairman:

The American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to submit this letter for inclusion in the Subcommittee on Oversight's record for the hearing on the 2001 filing season, held on April 3, 2001.

The AICPA is the national, professional organization of certified public accountants comprised of more than 350,000 members. Our members advise clients on federal, state, local, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, and small and medium-sized businesses, as well as America's largest businesses. It is from this broad base of experience that we offer our comments on the 2001 filing season.

There has been a great deal of discussion during the 2001 filing season surrounding the recent lack of IRS enforcement activity. We are concerned with the negative impact this publicity is likely to have on voluntary compliance. As we have said before, it is vital to our voluntary compliance tax system that this reduction of audit and collection activity must be reversed immediately, and that the resulting increase in enforcement be widely publicized. If the IRS is unable to actively administer and enforce the tax law, serious damage to the effectiveness of our tax system results. Those who normally flaunt the law will continue to do so at no risk; those who in the past have reluctantly complied only because of a fear of enforcement may become noncompliant; and, normally compliant taxpayers will lose faith in the system and may be tempted to become noncompliant as well. For our voluntary tax compliance system to operate effectively, taxpayers must perceive that everyone pays their fair share, and that if they do not do so voluntarily, they will be forced to do so by the IRS.

To date the AICPA has heard very little from our members regarding the 2001 filing season. It appears that this year's filing season is progressing without any major problems. Historically we have not solicited input from our members regarding the positives and negatives of a filing season until after the season has ended; and therefore, it is not unusual to receive little feedback at this point unless a major systemic problem has occurred. However, one issue of concern that has come to our attention revolves around the electronic filing of partnership returns. We discuss this issue in greater detail below. In addition, for the benefit of the Subcommittee, we are pleased to provide some general observations on filing season issues related to electronic filing of individual returns, the Service Center realignment, fiscal year reform for small businesses, and tax simplification.

Electronic Filing of Partnership Returns

As you are aware, section 1224 of the Taxpayer Relief Act of 1997 modified section 6011(e) to require partnerships with more than 100 partners to file their returns on magnetic media (which the IRS and Treasury have interpreted to mean electronically). The effective date of this provision applied to partnership tax years beginning after December 31, 1997. However, the final regulations are effective for partnership taxable years ending on or after December 31, 2000. Thus, returns for partnerships with more than 100 partners with December 31, 2000 year-ends will be the first returns required to be filed electronically under this provision.

Unfortunately, the AICPA and its members have been frustrated in our efforts to resolve a myriad of issues that have developed as CPAs prepare to file these Forms 1065 electronically. Although we acknowledge and appreciate the efforts of the IRS's Electronic Tax Administration (ETA) personnel during this process, these employees do not appear to have the authority or the ability to resolve many of the issues we have raised in a timely manner. For example, many issues will require systems changes that cannot be made at this time, or even in the near future. Furthermore, there was already insufficient coordination between the Service, practitioners and the major software developers, resulting in software that does not support all forms and schedules necessary for electronic filing. This leaves practitioners and partnerships in a position where they cannot file the entire return electronically, raising the question of whether or not the IRS will allow unsupported forms and schedules to be filed on paper while the bulk of the return is filed electronically. The answer we are given by the IRS, quite simply, is "it depends on which form or schedule is involved."

The confusion and uncertainty revolving around the electronic filing of partnership returns has led to a great deal of frustration on the part of our members. Many have applied for extensions of time to file for partnership returns that would have otherwise been timely filed. Of greater concern, however, is the impact of these problems on future electronic filing programs for business returns. Taxpayers should not be expected to, much less required to file returns electronically until the IRS has a system in place to handle these returns. The IRS should work closely with the practitioner community and the software developers to ensure that future programs can satisfy those needs. Without effective decision making, adequate resources, and a good working partnership with the practitioner community, we believe that the future of electronic filing of business returns will be disappointing and mutually frustrating to the business community and the IRS.

Electronic Filing of Individual Returns

Commissioner Charles O. Rossotti testified at the Subcommittee's hearing on April 3, 2001 that "Electronically-filed returns improve service for taxpayers and boost productivity by reducing errors, speeding refunds, and reducing labor costs."

He also described improvements the IRS has made, or expects to make, in the electronic filing area, including (1) expansion of the types of forms and schedules accepted by the 1040-e-file program for next year; (2) the Service's apparent success in testing of a Personal Identification Number (PIN) code as to the taxpayer's signature, eliminating the need to file the paper jurat; and (3) the testing of an Internet-based pilot program for businesses to pay federal taxes on line.

Although Commissioner Rossotti feels confident that expansion of the 1040-e-file program will open up eligibility to 99.1 percent of all individual taxpayers by the 2002 filing season, we must remain cautious in an environment where the experiences of AICPA members with electronic filing have historically been disappointing. During prior filing seasons, we have expressed disappointment in the inability of the electronic filing program to accept all forms and all schedules. This inability to accept all forms and all schedules, including white paper schedules, elections and related compliance disclosures, has been seen by us as the greatest barrier to widespread use of electronic filing by AICPA members (who tend to prepare the most complex returns). Given that effective disclosure is key to the modern tax reporting system, it is unrealistic to believe that electronic filing can be used for complex returns until *all* forms and *all* schedules, including white paper schedules, elections and compliance disclosures, can be filed electronically.

Many CPA tax return preparers cannot be certain that all of the individual returns they prepare can be filed electronically. Given that uncertainty, the vast majority of these preparers have elected not to use the electronic filing system at all, because to file some returns electronically, but not all, would require two separate return processing, review and filing procedures in their offices, increasing their workloads and costs. Only when it is clear that all forms and all schedules can be accurately filed electronically will most CPAs begin the natural migration from filing paper returns to filing electronic returns.

The AICPA fully supports expanding electronic filing. However, we remain concerned that electronic tax administration in general, and electronic filing in particular, fall short of the IRS's long range goals of converting manual processes to electronic format. We are dissatisfied with attempts both to partner with the IRS in promoting electronic filing to our membership and in explaining to the IRS the effects of the current system's limitations on our constituency. As the Service shifts its focus from the electronic filing of individual returns to the electronic filing of business returns, involving, listening to, and responding to the various stakeholder groups will be all the more critical. Unfortunately, our experience to date as a stakeholder group in this matter has not been positive.

Service Center Realignment

The Internal Revenue Service Centers are in the throes of a massive realignment, with redistribution of the Service Centers' workload scheduled to be completed by 2002. On October 1, 2000, the Service Centers were converted to "campuses." Individual master filing submission processing will eventually be handled by Andover, Atlanta, Austin, Fresno, Kansas City, Memphis, Brookhaven, and Philadelphia. The Ogden and Cincinnati campuses are scheduled to become processing centers for business master file submissions. Five of the campuses will handle account management and compliance service functions for the IRS Small Business/Self-Employed Division, and the remaining five will handle similar functions for the IRS Wage and Investment Division.

It is extremely important that the ongoing transition of Service Center workflow should appear as seamless as possible to the taxpaying public. However, the preliminary feedback we are receiving from CPAs during the 2001 filing season indicate that the realignment is causing some confusion among some taxpayers and practitioners. Part of this confusion arises from the largely unexplained changes in IRS filing addresses. We believe that the Service Center realignment, like the future of electronic filing, is a matter that the Subcommittee on Oversight should closely monitor.

Fiscal Year Reform for Small Businesses

There is an unintended problem created by the current tax rules requiring year-end conformity for a majority of businesses reporting their results to owners for inclusion in the owner's annual tax calculation. Because they apply to every small business in the country, these rules create unnecessary, disruptive and unproductive demands on the majority of businesses and their advisors during a few months every year. The unevenness of the workload during December and the traditional January–April filing season is substantial. This "workload compression" often negatively affects those who can least afford it—start-up businesses and small businesses that create a solid foundation for the American economy. The requirement that these entities use a calendar year end for tax purposes means that in addition to other unavoidable calendar year-end responsibilities, they must also close their books, produce annual financial statements for their banks, conclude financial statement audits or reviews, and prepare tax returns and tax information for their owners (partners and S corporation shareholders) by April 15.

Workload compression is an unnecessary burden on small businesses, and can be alleviated with modest changes to the tax system. In order to mitigate this burden, the AICPA recommends amending the Internal Revenue Code to allow qualified small businesses to elect a year-end with any-month ending from April through December.

Tax Simplification

For many years, the AICPA has been outspoken with respect to the need to reduce tax law complexity, especially from the perspective of the administrability of the tax law. We believe that these issues have a direct impact on the nation's filing season each year. Congress recognized the tax administrability issue when it wrote section 4021 of the IRS Restructuring and Reform Act of 1998 (RRA '98) which states "It is the sense of Congress that the Internal Revenue Service should provide the Congress with an independent view of tax administration, and that during the legislative process, the tax-writing committees of Congress should hear from front-line technical experts at the Internal Revenue Service with respect to the administrability of pending amendments to the Internal Revenue Code of 1986." As the Subcommittee on Oversight reviews the results of the 2001 filing season, we urge the panel to remain cognizant of the difficult task Congress imposes on the Service through the enactment of complex and constantly changing tax laws.

* * * * *

The AICPA appreciates this opportunity to offer our comments on the 2001 filing season. We would be pleased to discuss this letter with the Subcommittee on Oversight. If you have any questions, please contact me at (661) 663–8815 or ppecar@aol.com; Deborah J. Pflieger, Chair of our Relations with IRS Committee, at (202) 414–1018, or deborah.j.pflieger@us.pwcglobal.com; or Benson S. Goldstein, AICPA Technical Manager, at (202) 434–9279 or bgoldstein@aicpa.org.

Sincerely,

PAMELA J. PECARICH
Chair, Tax Executive Committee