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**Written Statement of
Nina E. Olson
National Taxpayer Advocate**

Before the

**Subcommittee on Transportation, Treasury, and Housing and Urban
Development, the Judiciary, District of Columbia, and Related Agencies**

**Committee on Appropriations
U.S. House of Representatives**

Hearing on

Internal Revenue Service FY 2007 Budget Request

March 29, 2006

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Mr. Chairman, Ranking Member Olver, and distinguished Members of the Subcommittee:

Thank you for inviting me to submit testimony regarding the proposed budget of the Internal Revenue Service for Fiscal Year (FY) 2007.¹ My testimony today will focus principally on the importance of understanding and quantifying the downstream consequences of IRS programs when making resource allocation decisions.

Broadly speaking, the mission of the IRS is to perform two categories of activity designed to bring about tax compliance. First, it should make it as easy as possible for taxpayers to comply with their tax obligations voluntarily. In most cases, outreach, education, and taxpayer assistance are sufficient to produce complete or substantial compliance. Second, it should target its enforcement resources at those few taxpayers who are unwilling to comply with the tax laws.

Last month, the IRS released the results of its National Research Program study that estimates the net tax gap – *i.e.*, the amount of tax due that remains unpaid even after accounting for late payments and collection activity – was approximately \$290 billion in tax year 2001. That figure translates to a net compliance rate of 86.3 percent (*i.e.*, the IRS is not collecting 13.7 cents of each dollar owed).² The magnitude of the tax gap creates a challenge for everyone involved in tax administration – Congress, the IRS, tax professionals, volunteers, and the American people.

To meet the significant challenge presented by the tax gap, the IRS must work within its mission and budget to reduce the tax gap. To be successful, the IRS must recognize that some actions aimed at achieving cost reductions may ultimately result in a reduction in voluntary compliance. For example, inadequate taxpayer service could lead to inadvertent noncompliance.

In many respects, the IRS is doing a better job of performing its core mission than it did in years past. By the IRS's current objective measures, it is providing

¹ The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. The statute authorizing the position directs the National Taxpayer Advocate to present an independent taxpayer perspective that does not necessarily reflect the position of the IRS or the Treasury Department. Accordingly, Congressional testimony requested from the National Taxpayer Advocate is not submitted to the Commissioner or the Secretary for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

² The gross tax gap (*i.e.*, the amount of tax unpaid before accounting for late payments and collection activity) was estimated at \$345 billion in tax year 2001, which translates to a gross compliance rate of 83.7 percent. For additional information, see IRS News Release IR-2006-28, *IRS Updates Tax Gap Estimates* (Feb. 14, 2006).

customer service at a much higher level than it did a decade ago. On the enforcement side, it is performing more audits and aggressively pursuing corporate tax shelters and noncompliance by high-income individuals. However, the IRS's existing measures do not adequately capture costs associated with the "downstream consequences" of its programs and planning.³

To succeed, the IRS must conduct an analysis of downstream consequences, including their impact on taxpayer service, and incorporate the results of that analysis into its strategic plans. Without adequate analysis of the downstream consequences of its options, the IRS cannot make informed strategic decisions about how to allocate resources between taxpayer service and enforcement activities and cannot tell its appropriators that it is using its limited resources wisely. Moreover, problems with IRS technology create additional downstream consequences. The IRS must be funded sufficiently to correct problems *now* with its *existing* technology while it strives to modernize its computer systems.

The IRS Must Allocate Its Resources Properly in Order to Increase Overall Compliance

Over the last three years, in hearings before the Senate Finance, Budget, and Homeland Security and Governmental Affairs committees, I have testified about ways to close the tax gap, both by reducing opportunities for noncompliance and by enhancing traditional enforcement actions.⁴ In the National Taxpayer Advocate's 2005 Annual Report to Congress, I discussed in detail what the IRS can do administratively and what Congress can do legislatively to address the "cash economy," which is the largest component of the tax gap.⁵

The question remains, however, whether the IRS is focusing its resources in the right direction to close the tax gap. The answer to that question depends, in part, on how we measure success. Is the IRS's goal merely to increase enforcement

³ By "downstream consequences," I mean the cost of additional work that IRS or taxpayers must perform to correct problems or mistakes that result from an IRS action or failure to take an action. For example, inadequate taxpayer service may lead to inadvertent taxpayer noncompliance, limitations of IRS computer systems may lead to IRS rework and direct harm to taxpayers, and inadequate communication with taxpayers during the audit process may result in rework via audit reconsideration or work performed in Appeals or the Taxpayer Advocate Service.

⁴ See Written Statement of Nina E. Olson, National Taxpayer Advocate, Before United States Senate Committee on the Budget on The Causes of and Solutions to the Federal Tax Gap (Feb. 15, 2006); Written Statement of Nina E. Olson, National Taxpayer Advocate, Before the United States Senate Committee on Homeland Security and Governmental Affairs Subcommittee on Federal Financial Management, Government Information, and International Security (Oct. 26, 2005); Statement of Nina E. Olson, National Taxpayer Advocate, Before the United States Senate Committee on Finance on the Tax Gap (April 14, 2005); Testimony of Nina E. Olson, National Taxpayer Advocate, Before the Senate Committee on Finance on The Tax Gap and Tax Shelters (July 21, 2004).

⁵ National Taxpayer Advocate 2005 Annual Report to Congress 55-75, 381-396. See also National Taxpayer Advocate 2004 Annual Report to Congress 478-489; National Taxpayer Advocate 2003 Annual Report to Congress, 20-25, 256-269.

revenues? Or is the goal to increase compliance? Or is it to increase *voluntary* compliance?

Approximately 83.7 percent of the tax dollars known to be due and owing are voluntarily paid to the IRS. That figure is an IRS success, in and of itself. Now, what more can we do to achieve compliance by the remaining 16.3 percent of the tax dollars for which taxpayers need some “nudging” to pay up? What type of “nudging” should the IRS apply? What resources does the IRS need to help these taxpayers comply or, in some instances, make them comply? The answers to these questions should inform the IRS’s resource allocation decisions.

The IRS is properly focused on increasing its traditional enforcement resources, since some taxpayers won’t comply unless they are “helped” in that way. The IRS also needs an enforcement presence so that taxpayers are a bit nervous about fudging – or worse – on their taxes. Yet, although we may want slightly “nervous” taxpayers, we don’t want them intimidated. That is, when taxpayers have a problem or a question, we *want* taxpayers to call the IRS so they will not make mistakes and join the ranks of noncompliant taxpayers. Every time a taxpayer calls the IRS or visits a taxpayer assistance center (TAC), the resulting interaction gives the IRS an opportunity to help that taxpayer comply with the tax laws. Why would we try to minimize these opportunities and not make positive use of them when they occur?

In my view, then, the real challenge facing the IRS is determining how to allocate its resources to increase overall compliance, including voluntary compliance, and determining what actions it must take – whether service or enforcement – to increase the number of taxpayers who voluntarily comply. In order to answer these questions, we must start with an understanding of taxpayer service needs - - not what the *IRS* is willing or able to provide taxpayers, but what the *taxpayer* needs to have provided or available. The IRS mantra should be “know your taxpayer.”

The IRS Must Understand the Impact of Taxpayer Service on Compliance and the Way Taxpayers Need Services to be Delivered

It is true that the IRS has improved its delivery of many aspects of taxpayer service over the last decade. The challenge we face today, however, is that we cannot just rest on this improvement and say that we are doing “good enough.” The taxpayer population is constantly changing, with new needs and preferences as well as different abilities and geographic and demographic characteristics. The tax code itself becomes more complex from year to year. Notwithstanding these changes, the IRS’s central responsibility is to ensure that taxpayers comply with the tax laws. In fulfilling that responsibility, the IRS must provide taxpayers with the service, assistance, and education they need to comply. What we must consider now is just what level of service, assistance, and education is necessary

for compliance. And if we are to assist taxpayers in complying, the IRS cannot deny any one taxpayer segment the service, assistance or education it needs.

I define taxpayer service very broadly – it includes notice clarity, tax law assistance, account resolution, free tax preparation, free e-filing, short response time, clear forms, and excellent education initiatives. This broad definition of taxpayer service makes clear its impact on compliance. Where noncompliance is attributable to complexity or confusion, for example, better forms, notices, and education initiatives can reduce the need for enforcement action.

From the perspective of improving voluntary compliance, the IRS can do better, despite its recent improvements in taxpayer service. Indeed, with respect to the phones, the IRS *has* done better. Although the IRS is rightfully proud of its 83 percent level of service (LOS) for Fiscal Year (FY) 2005, it achieved an 87 percent LOS for FY 2004.⁶ Thus, the IRS's rate of answering taxpayer calls dropped by more than 4 percent from FY 2004 to FY 2005. The IRS lowered its goal for LOS without knowing the downstream consequence that failure to answer these calls would have on taxpayer compliance – and to date the IRS is not conducting any research to determine this impact. For all we know, by setting a LOS goal 4 percent below what we achieved in FY 2004, we may have eaten up our taxpayer service “savings” by increasing the number of errors taxpayers commit.

Similarly, as the Treasury Inspector General for Tax Administration (TIGTA) has noted, the impact of shutting down Telefile in FY 2005 has caused 3 million former Telefile users to find alternative methods of filing.⁷ There is no evidence that these former Telefile users will opt to file electronically; many former Telefile users may return to submitting paper returns. IRS made the decision to eliminate Telefile despite taxpayer preference and in the face of its own prediction that an increase in paper filings by taxpayers eligible to use Telefile in tax year 2004 might result from IRS's having announced the pending termination of the Telefile program prior to the 2004 filing season.⁸ The IRS's justification for discontinuing Telefile was that although it is considered a method of electronic filing, it was more expensive than e-filing.⁹ However, discontinuing Telefile was not the only option available to reduce the cost of Telefile returns, and the IRS should have

⁶ Statement by IRS Commissioner Mark W. Everson, *IRS Improves Enforcement and Services in 2005* (Nov. 3, 2005) (accompanying chart titled “Toll-Free Telephone Level of Service”), available at http://www.irs.gov/pub/irs-news/fy05_enforcement_and_service_chart.pdf.

⁷ Treasury Inspector General for Tax Administration, *Taxpayer Service is Improving, But Challenges Continue in Meeting Expectations*, Ref. No. 200640052 (Feb. 2006), 19.

⁸ ETA Part Year TeleFile Analysis Project 5-06-08-1-015N, W&I Research Group Phoenix-Los Angeles (Dec. 2005), 2.

⁹ In FY 2000, it cost \$3.00 to process an electronically filed Form 1040EZ, \$3.92 to process a paper-filed Form 1040EZ, and \$2.84 to process a TeleFile Form 1040EZ. For tax year 2001, Telefile return costs were reduced to \$2.53. Treasury Inspector General for Tax Administration, *Opportunities Exist to Expand the TeleFile Program* (March 2003), 6.

taken into account the possible downstream costs of processing more paper returns in its decision. Had IRS promoted Telefile more prominently so that more taxpayers moved from paper to Telefile, the cost per return would have declined and the cost savings would have increased significantly.¹⁰

IRS Needs to Include the Cost of Downstream Consequences in Its Return on Investment (ROI) Calculations

The Telefile program illustrates that the IRS needs to conduct more thorough and accurate analyses when measuring return on investment (ROI) in order to allocate future dollars appropriately. For example, although in the short run it may cost more to process and review an Offer in Compromise and it may appear that the government is writing off revenue, in the long run the taxpayer may pay more tax dollars into the system as a result of his promise to be fully compliant for the 5 succeeding years.¹¹ Five years is a long enough period to enable the taxpayer to “learn” a new norm of behavior, namely, compliance. And when you compare the 16 cents on the dollar that IRS receives from offers¹² to the virtually no cents it collects after year 3 of the 10-year collection period,¹³ the Offer in Compromise suddenly looks like a very efficient and productive program.

When computing ROI, the IRS should include the costs of the downstream consequences of its enforcement actions. Downstream consequences analysis tells us not only true ROI (*i.e.*, the true cost to the IRS) but also gives us clues as to how to improve our processes from an IRS *and* a taxpayer perspective. That is, downstream consequences analysis is a form of taxpayer service.

In the National Taxpayer Advocate’s 2005 Annual Report to Congress, for example, I identified the assessment and abatement of Exempt Organization penalties as a serious problem facing taxpayers.¹⁴ For FY 2004, the IRS assessed 81,154 penalties, totaling nearly \$236 million.¹⁵ However, during that

¹⁰ Treasury Inspector General for Tax Administration, *Opportunities Exist to Expand the TeleFile Program* (March 2003), 9.

¹¹ If a taxpayer fails to comply with all his tax obligations over the five-year period following IRS acceptance of an offer, the IRS may rescind the offer and reinstate the tax debt. See Form 656, Offer in Compromise.

¹² IRS Small Business/Self Employed Division, Offer In Compromise Program, *Executive Summary Report* (Jan. 2006).

¹³ IRS Automated Collection System Operating Model Team, *Collectibility Curve* (August 5, 2002).

¹⁴ National Taxpayer Advocate 2005 Annual Report to Congress, 292-314.

¹⁵ The IRS automatically assesses a “Daily Delinquency Penalty” (DDP) on Exempt Organizations that do not file a timely return or that file a return with incorrect or incomplete information for each day that the return is late or information is missing. The DDP is \$20 per day up to a maximum of the lesser of \$10,000 or five percent of the organization’s yearly gross receipts (for organizations with annual gross receipts exceeding \$1 million, the DDP is \$100 per day up to a maximum of \$50,000). I.R.C. § 6652(c)(1)(A); Internal Revenue Manual, Exhibits 3.12.12-12 – 3.12.12-16 and Exhibit 3.12.12-22.

same period, the IRS abated 45,903 penalties, or over \$143 million, with abatement rates of 57 percent and 61 percent, respectively. Assessing and later abating penalties consumes IRS administrative time as well as taxpayer time and expense. If the IRS actually quantified and costed the amount of time it spent abating penalties – including customer service representative calls, Appeals cases, and Taxpayer Advocate Service involvement -- the reduced ROI on enforcement actions would create an incentive for the IRS to identify the causes of these penalties and minimize the opportunities for mistakes and noncompliance. For example, are the forms confusing? Would more education initiatives help lower the number and amount of penalties?

The Criminal Investigation Division's Questionable Refund Program (QRP) is another recent example of the failure to capture an accurate return on investment. The QRP serves an important tax administration purpose by helping the IRS detect and prevent the payment of fraudulent refund claims.¹⁶ Criminal Investigation (CI) dedicates approximately 600 Full Time Equivalents (FTEs) to this program. As we described in the National Taxpayer Advocate's 2005 Annual Report to Congress, the QRP was freezing hundreds of thousands of refunds each year without notifying the affected taxpayers. This failure to notify taxpayers that their refunds were being held generated more taxpayer calls to the IRS toll-free lines and to the Taxpayer Advocate Service (TAS) than CI could respond to in a timely fashion.

In FY 2005, the Taxpayer Advocate Service (TAS) received over 28,000 QRP cases. In TAS's office in the Atlanta campus, approximately 65 percent of case inventory per case advocate involves QRP. Moreover, during FY 2005, the IRS Examination function reviewed 25,621 QRP cases, and some of those cases went on to the IRS Appeals function. This level of activity protected approximately \$2.2 billion in FY 2004, of which \$1.8 billion was attributable to just two returns that should have been discovered anyway, particularly since the Joint Committee on Taxation must review any refund over \$2 million. So, the maximum direct revenue protection generated by all that IRS activity was \$400 million. In addition, my office found in a study of the 28,000 QRP cases that came to TAS that fully 80 percent of taxpayers whose refunds were frozen as potentially fraudulent ultimately were found to be entitled to a full or partial refund. Had the IRS actually tracked the downstream consequences of the QRP and included these costs in the program's ROI, the IRS probably would have figured out a way to protect the same level of revenue with fewer FTE or developed a better method of identifying cases with the same CI FTE that did not generate the need for phone, exam, Appeals, and TAS FTE – not to mention interest the IRS is having to pay to tens of thousands of taxpayers whose refunds were frozen unnecessarily.

¹⁶ For a detailed discussion of the Questionable Refund Program, see National Taxpayer Advocate 2005 Annual Report to Congress 25-54.

IRS Strategic Planning and Resource Allocation Requires More and Better Research

The need for better research underlies all of these challenges. The IRS must conduct research, organized by taxpayer segment, to better understand taxpayer behavior and taxpayer response to IRS's various service and enforcement "touches." The absence of research about taxpayer needs enables the IRS to place its immediate resource needs over taxpayers' immediate and long-term needs.¹⁷ This approach may cause more taxpayers to become noncompliant, thereby requiring more expensive enforcement actions. Concern over the lack of research and taxpayer-centric strategic planning led Congress to enact Section 205 of the FY 2006 Appropriations Act funding the IRS and to direct the IRS to develop a five-year strategic plan for taxpayer service.¹⁸

I applaud the dedicated work of the IRS team that has labored over this strategic plan and gathered important information over the last five months. As one of three co-signers of that plan, known as the Taxpayer Assistance Blueprint (TAB), I am committed to ensuring that the plan does not start from the assumption that taxpayers' current usage of available services reflects taxpayer preferences. In fact, taxpayer usage might be quite different if our services were easier to use, more accessible, or more convenient. The *status quo* is not necessarily what taxpayers want – it is merely what the IRS has been willing (or able) to deliver.

¹⁷ The declining number of Taxpayer Assistance Center (TAC) visits is an example of IRS placing its resource needs over taxpayer needs. For FY 2006, IRS established a goal of preparing 20 percent fewer tax returns in TACs than in FY 2005. Not surprisingly, TAC visits for year-to-date FY 2006 have declined 14 percent compared with this time last year. Even though the decline in TAC usage appears to result from IRS-imposed limitations on service, the IRS is nonetheless citing this decline as a justification for making further reductions in service at the TACs. Wage & Investment, *2006 Filing Season Data: Cumulative Statistics Report* (Feb. 25, 2006).

¹⁸ Pub. L. No. 109-115, § 205, 119 Stat. 2396 (2005). Specifically, the statute provides:

None of the funds appropriated or otherwise made available in this or any other Act or source to the Internal Revenue Service may be used to reduce taxpayer services as proposed in fiscal year 2006 until the Treasury Inspector General for Tax Administration completes a study detailing the impact of such proposed reductions on taxpayer compliance and taxpayer services, and the Internal Revenue Service's plans for providing adequate alternative services, and submits such study and plans to the Committees on Appropriations of the House of Representatives and the Senate for approval: . . . *Provided further*, That the Internal Revenue Service shall consult with stakeholder organizations, including but not limited to, the National Taxpayer Advocate, the Internal Revenue Service Oversight Board, the Treasury Inspector General for Tax Administration, and Internal Revenue Service employees with respect to any proposed or planned efforts by the Internal Revenue Service to terminate or reduce significantly any taxpayer service activity.

The accompanying Joint Explanatory Statement of the Committee of Conference stated: "The conferees direct the IRS, the IRS Oversight Board and the National Taxpayer Advocate to develop a 5-year plan for taxpayer service activities. . . . The plan should include long-term goals that are strategic and quantitative and that balance enforcement and service." H. Rep. No. 109-307, 209 (2005).

Thus, as part of the TAB, the IRS must commit to conduct – or at least to attempt to conduct – the additional research necessary to enable it to establish a broad baseline identifying how well taxpayer needs and preferences are currently being met for each of the major types of services by customer segment and channel – and to quantify the impacts associated with not meeting those needs (*i.e.*, the downstream costs and taxpayer compliance impact). Moreover, we need to understand why certain taxpayer segments have difficulties with our various types of services and why they are reluctant to use lower cost channels (if indeed they are). Only then can we develop effective “migration” strategies to encourage and educate taxpayers about appropriate lower cost channels – ones that will not ultimately increase noncompliance and lead to greater downstream costs.

For example, it is true that computer ownership and Internet access have increased over the last decade.¹⁹ But those numbers do not necessarily mean that the computer owner is computer literate and can conduct site searches for complex tax information, much less understand how to apply that information once he finds it. In fact, in the financial services sector, banks have reversed the trend of closing branches in the hope of moving taxpayers to Internet banking.²⁰ Instead, they are developing migration strategies for customers to complete certain types of transactions on-line or by phone, and are retaining their in-person services for more complicated transactions or for those customers who really cannot navigate the phones or Internet. Banks are certainly not turning those customers away, and now recognize that those customer segments are a relatively untapped market in need of services. There are lessons here for the IRS.

Because taxpayer service and enforcement are the drivers of overall compliance, we need to measure taxpayer service needs concurrently with our efforts to measure the tax gap. Thus, the National Research Program should update its analysis of taxpayer service needs at the same time it is measuring taxpayer noncompliance for the particular taxpayer population it is studying. The IRS can make informed resource allocation decisions only if it is armed with both types of information.

What Is the Impact on Compliance or the Downstream Cost of an Increasingly Remote IRS?

The IRS conducts a majority of its enforcement contacts and service contacts from locations that are remote from the taxpayer. We do not know the impact on tax compliance or the downstream cost of a decreased IRS local presence.

¹⁹ Internal Revenue Service, Wage and Investment Office of Research, *Taxpayer of the Future* (June 2003), 11.

²⁰ Bruce C. Smith, *In Age of Online Banking, Lenders Branch Out*, Indianapolis Star (Oct. 2, 2005), available at <http://www.indystar.com/apps/pbcs.dll/article?AID=/20051002/BUSINESS/510020335>

Moreover, remoteness can have disparate impacts on certain taxpayer segments. Professors Nancy Abamowitz and Janet Spragens, discussing the impact of IRS modernization on low income taxpayers, have noted:

In many ways, the changes in agency structure under IRS modernization have generated significant efficiency gains and advancements for the IRS and for taxpayers. For many individual taxpayers whose returns are not accepted as filed, however, the changes brought about by the reorganization have almost uniformly made dealing with the agency more difficult, impersonal, frustrating, and costly. The changes have taken a particular toll on low-income taxpayers, many of whom do not speak English, are not connected to the Internet, and who do not have ready access to much of the technology on which IRS processes are often premised (for example, Web sites, telecopy communications, and so forth). Those taxpayers tend to be better helped through local walk-in offices and opportunities to resolve their controversies in face-to-face meetings rather than through an organizational structure based on geographically remote specialized campuses, computerized telephone trees with automated selections, computer-generated correspondence, and electronic transfers.²¹

Another aspect of the IRS distancing itself from its taxpayer base is its increasing reliance on partners to deliver core IRS services. Clearly, partners are very important to effective tax administration, and I applaud the efforts of dedicated professionals and volunteers in assisting taxpayers. However, this reliance raises several concerns. First, when the IRS relies on partners to deliver a message, we need to study what happens to the message in the course of delivery. Does the message change over distance and time? Is it less accurate? The worst result is a broad dispersion, through partners, of an incorrect or distorted message. Second, we need to measure the downstream consequences of this trend. What are the true costs of effective oversight over these partners? Who conducts such oversight and bears the cost? If taxpayers bear the cost, will they continue to comply if the cost is too great or the quality too poor? Will the IRS actually realize any savings or will it incur more expense through additional enforcement activity that could be avoided if the IRS itself delivered the assistance?

Finally, we don't know what the impact on compliance or what the downstream cost will be if most of the IRS's direct contact with taxpayers is in the form of enforcement actions and most taxpayer assistance and service is delivered by third parties. As the IRS becomes more remote, except with respect to

²¹ Janet Spragens & Nancy Abramowitz, *Low-Income Taxpayers and the Modernized IRS: A View from the Trenches*, 107 Tax Notes 1407 (June 13, 2005).

enforcement actions, will noncompliance increase because taxpayers feel less connection to their government?²²

IRS Business Systems Modernization Limitations Impact Both Taxpayer Service and Enforcement Initiatives

When I was in private practice as an attorney representing clients before the IRS, I did not have a full appreciation of how significant a role Business Systems Modernization (BSM) plays in both creating and solving problems for taxpayers and the IRS. As the National Taxpayer Advocate, I know that on a regular basis my office identifies systemic problems for which the complete solution requires some sort of BSM fix.

When Commissioner Everson began his tenure, he ordered three separate reviews – two external, one internal – of the state of IRS BSM projects. Based on these reviews, the Commissioner quickly – and, I believe, correctly – concluded that the IRS was spreading its internal BSM resources too thin. Project managers and experts charged with overseeing our key initiatives – such as the Integrated Financial System (IFS) and the Customer Account Data Engine (CADE) – were also managing scores of smaller projects, all more or less important but all detracting from our central progress on IFS and CADE.

For the past two years, the IRS has focused on its primary projects and strictly controlled the number of other BSM projects. This approach makes sense because it is critical to both effective service and enforcement that the IRS move forward with its primary initiatives. On the other hand, many projects cannot be deferred too much longer without significantly impacting taxpayer rights, accuracy of taxpayer data, and effective examination and collection initiatives. Indeed, improvements to TAS's own Systemic Advocacy Management System, our database for receiving, tracking, and managing taxpayer and IRS employee submissions of systemic problems in tax administration, were requested in November 2004, and although worked on intermittently, these changes are not yet completed or delivered. Until recently, this project was ranked number 33 on a list of 33 projects in terms of priority.

I will provide one illustration of the impact of the IRS's outdated computer systems. In the National Taxpayer Advocate's 2004 Annual Report to Congress, I reported that the IRS is miscalculating collection statute expiration dates on certain taxpayer accounts. The collection statute expiration date (CSED) represents the date beyond which the taxpayer is no longer obligated on a tax

²² See Leslie Book, *The Poor and Tax Compliance: Once Size Does Not Fit All*, 51 Kan L. Rev. 1145, 1151, 1175-1176 (2003). Professor Book discusses various studies that note that enforcement may be more effective in addressing intentional noncompliance where the taxpayer segment is disaffected from government and society at large. On the other hand, "taxpayers who felt a shared identity with authorities seem to be more concerned with the overall justice of the tax system and the fairness of their treatment, regardless of individual outcome." *Id.* at 1151 n. 21.

debt and the IRS must cease its collection efforts.²³ Miscalculations of CSEDs can negatively affect a taxpayer when the CSED on a particular tax erroneously appears on the IRS computer systems as being within the statute of limitations period, resulting in continued IRS collection activity, when in fact the statutory period for collections has expired. An incorrectly calculated CSED can also negatively impact the IRS when the CSED is miscalculated to reflect that the statute of limitations period has expired when in fact the debt is still collectible.²⁴ This problem continues today and harms tens of thousands of unsuspecting taxpayers. Where the IRS or the taxpayer identifies a case of unlawful collection, the taxpayer experiences delays in receiving a return of the unlawfully levied proceeds. In some instances, the IRS takes the position that the taxpayer will never receive the unlawfully levied funds because the refund is barred by the applicable statutory period of limitations.

In response to TAS's concerns, the IRS and TAS established a joint team that identified impacted taxpayers, developed additional guidance and training alerts, and submitted requests for systems improvements to eliminate the problem of incorrectly calculated CSEDs. Given the current demand on IRS programming personnel, the final system modifications are not now scheduled to occur until *some time in 2007*.

Internal Revenue Code Section 7433 permits the taxpayer to file a civil action for damages against the United States in federal district court where an IRS officer or employee disregards any provision of the Code or its regulations with respect to collection of tax. In general, damages under this provision are limited to \$1 million where the breach is attributable to reckless or intentional disregard and \$100,000 where it is attributable to negligence. Thus, the IRS's knowing failure to correct the CSED problem in a timely fashion exposes the government to potentially large damages.

Private Debt Collection and Return on Investment

The Private Debt Collection (PDC) initiative is another example of a program that might not be undertaken, or would be approached differently, if the downstream consequences were considered. The premise of the PDC initiative is essentially this: "There is a significant amount of tax debt that the IRS can't go after because it doesn't have the resources. If we simply turn those cases over to private collection agencies, they'll collect the debt for us and the government will get to keep 75 to 80 cent of every dollar the PDCs are able to collect."

The problem with that simple approach is that it fails to take into account the enormous amount of IRS resources that need to be devoted to creating and supporting the program. Once the program rolls out, the IRS estimates that only

²³ IRC § 6502(a)(1).

²⁴ National Taxpayer Advocate 2004 Annual Report to Congress 180-192.

a small percentage of taxpayers – perhaps on the order of 15 percent – will be resolved by the PDC unit itself. The rest of the cases will be sent back to the IRS “Referral Unit” for additional actions that only the IRS can constitutionally take on the account. Keep in mind that these are cases that the IRS currently considers too unproductive to devote resources to. Yet ironically, under the PDC initiative, the IRS will end up pulling employees off high-priority, high-return cases to work on these low-priority, low-return cases.

This approach makes little business sense, and on top of that, the program raises significant concerns about the adequacy of taxpayer rights protections and confidentiality of tax return information. In fact, to make the program profitable, the IRS will be under pressure to expand the authorized actions private collection agencies could take on a case so they can work higher dollar, more complex cases. This expansion would clearly raise constitutional concerns.²⁵

Thus, the PDC initiative is a paradigm example of how looking at the narrow justification for a program can make it look brilliant, while viewing the program in its totality paints a very different picture.

Trends in Taxpayer Advocate Service Inventory

I close with a reflection on the Taxpayer Advocate Service and its role in identifying and mitigating the downstream consequences of IRS actions and programs, and improving taxpayers’ attitudes toward the tax system. This recent March 1st marked my 5-year anniversary as the National Taxpayer Advocate. They have been quite remarkable years – I have watched my talented and dedicated employees achieve a quality rating of 91.6 percent through FY 2005, up from 71.6 percent in 2001. They achieved this quality despite a 15 percent decline in case advocates in our statutorily mandated offices around the country, from 1,325 case advocates in March, 2003 to 1,121 case advocates in February, 2006. And these successes were achieved despite a slight *increase* in TAS case receipts from FY 2003 to FY 2005.²⁶

In fact, TAS case receipts themselves provide an interesting study in downstream consequences. As IRS increases its enforcement activity, TAS compliance inventory increased to nearly 70 percent of our case receipts for first quarter FY 2006, up from 67 percent in first quarter FY 2005. In FY 2005, TAS cases involving liens and levies increased by 50 percent and 43 percent, respectively, over FY 2004. During first quarter FY 2006, TAS continued to see

²⁵ For a detailed discussion of the IRS Private Debt Collection initiative and its constitutional and taxpayer rights implications, see *Use of Private Agencies to Improve IRS Debt Collection*, Subcommittee on Oversight, House Committee on Ways and Means, 108th Cong., 1st Sess. (statement of Nina E. Olson, National Taxpayer Advocate, May 13, 2003); see also National Taxpayer Advocate 2005 Annual Report to Congress 76-93.

²⁶ In FY 2005, TAS received a total of 197,679 cases. In FY 2003, TAS received a total of 196,040 cases.

an increase in lien and levy cases. Lien and levy cases tend to involve economic urgency to the taxpayer. TAS procedures require case advocates to respond immediately to the taxpayer's request for assistance in these cases. With the increasing number, complexity, and urgency of our case load, TAS risks getting behind on cases that involve IRS system failure as we give priority to cases that involve economic harm. If the balance between our staffing and the number of cases we handle continues to deteriorate, TAS is in jeopardy of becoming part of the IRS problem rather than the advocate for the solution, as Congress intended.

Significantly, TAS Customer Satisfaction surveys provide some evidence that the quality and nature of taxpayer service has an impact on taxpayer attitudes toward the tax system. When a taxpayer brings an eligible case to TAS, he is assigned a case advocate who works with him throughout the pendency of the case. Taxpayers have a toll-free number direct to that case advocate, and each TAS office has a toll-free fax number. TAS employees are required to spot and address all related issues and to educate the taxpayer about how to avoid the problem from occurring again, if possible. This level and quality of service drives TAS's high taxpayer satisfaction scores,²⁷ which have averaged about 4.35 on a scale of 5.0 for the last two fiscal years. Most importantly, 57 percent of taxpayers stated that they feel better about the IRS as a whole after coming to TAS. Even among taxpayers who did not obtain the result they sought, an astonishing 41 percent reported that they had a more positive opinion of the IRS because of their experience with TAS.

Conclusion

Compared with ten years ago, the IRS today is a more responsive and effective organization. On the customer service side, the IRS Restructuring and Reform Act of 1998 and the IRS response has brought about fairly dramatic improvements. On the enforcement side, the IRS has been stepping up its enforcement of the tax laws over the past 5 years, particularly with regard to corporate tax shelters and high-income individuals.

But the IRS can, and should, do better. It should incorporate an ongoing taxpayer-centric assessment of taxpayer service needs into its strategic plans. It should conduct research into the causes of noncompliance and apply the resulting knowledge to IRS enforcement strategies, including those pertaining to the cash economy. Finally, it must have sufficient resources to move forward with its technological improvements, on both a short-term and a long-term basis.

²⁷ Taxpayer Advocate Service customer satisfaction survey data for the period from October 2003 through September 2005, as collected by The Gallup Organization.