

## Internal Revenue Service

### Program Summary by Appropriations Account

(Dollars in thousands)

Appropriation	FY 2006	FY 2007		FY 2008		
	Enacted	President's Budget	CR-rate	President's Budget	\$ Change over CR-rate	% Change over CR-rate
Taxpayer Services	\$2,142,042	\$2,079,151	\$2,046,908	\$2,103,089	\$56,181	2.74%
Pre-filing Taxpayer Assistance and Education	577,425	575,694	556,693	578,078	21,385	3.84%
Filing and Account Services	1,564,617	1,503,457	1,490,215	1,525,011	34,796	2.33%
Enforcement	4,708,441	4,797,126	4,660,572	4,925,498	264,926	5.68%
Investigations	579,555	591,090	579,883	602,872	22,989	3.96%
Exam and Collections	3,919,275	4,054,760	3,932,599	4,165,233	232,634	5.92%
Regulatory	209,611	151,276	148,090	157,393	9,303	6.28%
Operations Support	3,461,205	3,488,404	3,519,228	3,769,587	250,359	7.11%
Infrastructure	864,403	873,146	873,146	908,095	34,949	4.00%
Shared Services and Support	1,176,202	1,129,617	1,163,846	1,223,351	59,505	5.11%
Information Services	1,420,600	1,485,641	1,482,236	1,638,141	155,905	10.52%
Business Systems Modernization	242,010	212,310	196,810	282,090	85,280	43.33%
Health Insurance Tax Credit Administration	20,008	14,846	14,846	15,235	389	2.62%
Subtotal, Internal Revenue Service	\$10,573,706	\$10,591,837	\$10,438,364	\$11,095,499	\$657,135	6.30%
Offsetting Collections - Reimbursable	137,110	125,723	125,723	133,498	7,775	6.18%
Mandatory Appropriation - User Fees	100,000	242,000	242,000	180,000	(62,000)	-25.62%
<b>Total Program Operating Level</b>	<b>\$10,810,816</b>	<b>\$10,959,560</b>	<b>\$10,806,087</b>	<b>\$11,408,997</b>	<b>\$602,910</b>	<b>5.58%</b>

FY 2006 Enacted is presented in the new budget structure for comparability across fiscal years. This differs from the FY 2008 President's Budget Appendix which presents FY 2006 as it was executed. The FY 2006 enacted level excludes rescission of unobligated balances (\$29 million from Taxpayer Services and \$9 million from HITCA). In addition, FY 2007 CR-rate includes proposed interappropriation transfers.

### Explanation of Request

The FY 2008 President's Budget for the Internal Revenue Service (IRS) includes funding to implement Treasury's tax strategy (see <http://www.treasury.gov/press/releases/hp111.htm>) to increase tax compliance while minimizing additional taxpayer burden. Also, the IRS will continue its efforts to increase and improve the delivery of services offered to taxpayers by expanding its research and implementing new technology (e.g., Spanish "Where's My Refund?" and an estimated calling wait time feature). The IRS will invest in information technology to give its employees the tools they need to administer and improve both taxpayer service and enforcement programs.

Total resources to support the IRS' activities for FY 2008 are \$11,408,997,000. This includes \$11,095,499,000 from direct appropriation, \$133,498,000 from reimbursable programs, and \$180,000,000 from user fees. The direct appropriation is a \$657,135,000 increase, or 6.3 percent, over the FY 2007 Continuing Resolution (CR) rate of \$10,438,364,000.

The IRS administers America's tax laws and collects the revenue that funds most government operations and public services. The IRS' taxpayer service programs provide assistance to millions of taxpayers to help them understand and meet their tax obligations. The

IRS' enforcement programs are aimed at deterring taxpayers inclined to evade their responsibilities while vigorously pursuing those who violate tax laws. Delivering these programs demand a secure and modernized infrastructure capable to fairly, effectively, and efficiently collect taxes while minimizing taxpayer burden. The IRS FY 2008 President's Budget request supports its five-year strategic plan and Treasury's compliance improvement strategy. These documents underscore the Treasury Department commitment to provide quality service to taxpayers while enforcing America's tax laws in a balanced manner. The IRS' strategic plan goals are:

- *Improve Taxpayer Service.* Help people understand their tax obligations, making it easier for them to participate in the tax system;
- *Enhance Enforcement of the Tax Law.* Ensure taxpayers meet their tax obligations, so that when Americans pay their taxes, they can be confident their neighbors and competitors are also doing the same; and
- *Modernize the IRS through its People, Processes and Technology.* Strategically manage resources, associated business processes and technology systems to effectively and efficiently meet service and enforcement strategic goals.

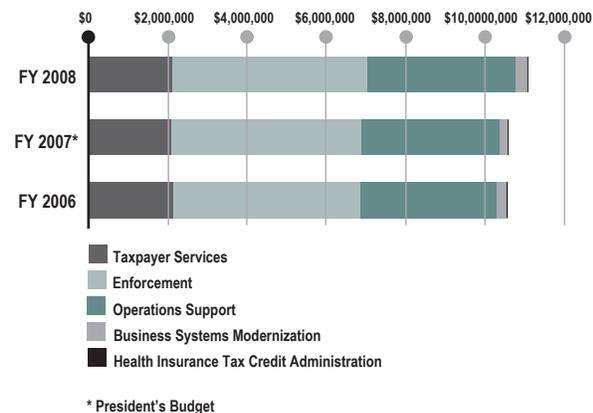
In FY 2007, Congress implemented a new appropriations structure for the IRS which realigned resources from its three major operating appropriations into three new accounts – Taxpayer Service (TS), Enforcement (ENF), and Operations Support (OS). In addition, funding for the IRS’ staffing associated with direct management of its Business Systems Modernization (BSM) program was realigned from the previous Information Systems appropriation to the BSM appropriation to reflect full program funding.

The FY 2008 President’s Budget request for the IRS increases funding as part of a strategy to improve compliance by:

- Implementing legislative and regulatory changes;
- Increasing front-line enforcement resources;
- Increasing voluntary compliance through improved taxpayer service options and enhanced research; and
- Investing in technology to reverse infrastructure deterioration, accelerate modernization, and improve the productivity of existing resources.

### IRS Funding History

[Dollars in Thousands]



**Tax Enforcement Program:** The IRS continues its emphasis on tax enforcement, increasing collections of delinquent tax debt from \$34 billion in 2002 to \$49 billion in 2006, an increase of 44 percent. Since 2003, federal government receipts have also increased by over \$600 billion, with revenue growth the greatest in the areas of corporate taxes and high-income individual taxes. In FY 2008, the President’s Budget increases funding for enforcement by \$440,264,000, which includes \$291,332,000 for new enforcement initiatives and \$148,932,000 in cost increases. As in 2006 and 2007, the Administration proposes to include enforcement increases as a Budget Enforcement Act program integrity cap adjustment (see chapter 15, Budget Reform Proposals in the Analytical Perspectives volume of the 2008 Budget). The IRS’ enforcement resources are funded in the Enforcement and Operations Support appropriations.

Increased resources for the IRS’ exam and collection programs yield direct measurable results. Once the new staff proposed in this request are trained and gain more experience, the enforcement revenue generated each year will be \$699 million. However, this estimate excludes the likely larger revenue impact from the deterrence value of these and other IRS enforcement programs (e.g., criminal investigations). It also excludes the impact of taxpayer services on voluntary compliance.

The IRS cannot currently measure either the impact of deterrence or service, but they are positive. The complexity of the nation’s current tax system is a significant reason for the tax gap, and even sophisticated taxpayers make honest mistakes on their tax returns. Accordingly, helping taxpayers understand their obligations under the tax law is a critical part of improving voluntary compliance. To this end, the IRS remains committed to a balanced program assisting taxpayers in both understanding the tax law and remitting the proper amount of tax.

## Taxpayer Service and Enforcement Programs

(Dollars in thousands)

Programs	FY 2006	FY 2007	FY 2008	
	Enacted	CR-rate	President's Budget	% Change over CR-rate
Taxpayer Service	\$3,498,473	\$3,438,758	\$3,569,960	3.8%
Direct Appropriation	\$2,142,042	\$2,046,908	\$2,103,089	
Operations Support	\$1,356,431	\$1,391,850	\$1,466,871	
Enforcement	\$6,813,215	\$6,787,950	\$7,228,214	6.5%
Direct Appropriation	\$4,708,441	\$4,660,572	\$4,925,498	
Operations Support	\$2,104,774	\$2,127,378	\$2,302,716	
<b>Total</b>	<b>\$10,311,688</b>	<b>\$10,226,708</b>	<b>\$10,798,174</b>	<b>5.6%</b>

**Taxpayer Service Program:** Helping the public understand its tax reporting and payment obligations is a cornerstone of taxpayer compliance. In FY 2008, the President's Budget increases funding for taxpayer service by \$131,202,000. This includes \$56,055,000 for new service initiatives and \$75,147,000 in cost increases. The IRS' taxpayer service resources are funded in the Taxpayer Service and Operations Support appropriations.

### Purpose of Program

The IRS and its employees represent the face of the Federal Government to more American citizens than any other government agency. The IRS collects 95 percent of the revenues that fund the Federal Government. The IRS FY 2008 President's Budget request will help strengthen the government's ability to collect more of taxes that are legally owed.

The great majority of Americans pay the tax they owe on time, but there is still significant non-compliance due to non-filing, underreporting, and non-payment. The IRS' latest estimate shows that the net tax gap for Tax Year 2001 was approximately \$290 billion.

The FY 2008 President's Budget request supports improving compliance by funding activities that promote better tax administration and compliance with the tax laws and focus on the following program priorities and objectives:

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

## IRS FY 2008 Budget Highlights

(Dollars in thousands)

Appropriation	Taxpayer Services	Enforcement	Operations Support	Business Systems Modernization	Health Insurance Tax Credit Administration	Total
FY 2006 Enacted	\$2,142,042	\$4,708,441	\$3,461,205	\$242,010	\$20,008	\$10,573,706
FY 2007 President's Budget	\$2,079,151	\$4,797,126	\$3,488,404	\$212,310	\$14,846	\$10,591,837
CR-rate Adjustment	(20,000)	(88,721)	(29,252)	(15,500)		(153,473)
FY 2007 CR-Rate	\$2,059,151	\$4,708,405	\$3,459,152	\$196,810	\$14,846	\$10,438,364
Interappropriation Transfer Corrections to Budget Restructure	(12,243)	(47,833)	60,076			0
FY 2007 Operating Plan at CR-rate	\$2,046,908	\$4,660,572	\$3,519,228	\$196,810	\$14,846	\$10,438,364
Changes to Base						
Technical Adjustments to FY 2007 Base due to CR	\$0	\$0	\$5,687	\$21,886	\$0	\$27,573
Base Adjustment	0	0	5,687	21,886	0	27,573
Maintaining Current Levels (MCLs)	\$71,500	\$162,373	\$104,500	\$1,245	\$389	\$340,007
Pay Annualization	10,190	23,083	6,970	226	15	40,484
Pay Inflation Adjustment	58,424	131,573	41,532	1,019	82	232,630
Non-Pay Inflation Adjustment	2,886	7,717	55,998		292	66,893
Efficiency Savings	(23,407)	(60,166)	(36,408)			(119,981)
Subtotal FY 2008 Changes to Base	\$48,093	\$102,207	\$73,779	\$23,131	\$389	\$247,599
FY 2008 Base	\$2,095,001	\$4,762,779	\$3,593,007	\$219,941	\$15,235	\$10,685,963
Program Changes	\$8,088	\$162,719	\$176,580	\$62,149	\$0	\$409,536
Program Decreases/Savings:	(\$5,968)	\$0	(\$511)	\$0	\$0	(\$6,479)
Increased e-File Savings	(5,968)		(511)			(6,479)
Program Reinvestments:	\$5,968	\$0	\$511	\$0	\$0	\$6,479
Increase Efficiency through Submission Processing Site Consolidations	5,968		511			6,479
Program Increases:	\$8,088	\$162,719	\$176,580	\$62,149	\$0	\$409,536
Infrastructure Initiatives	\$0	\$0	\$81,000	\$62,149	\$0	\$143,149
Upgrade Critical IT Infrastructure			60,000			60,000
Enhance Computer Security Incident Response Center (CSIRC) and Network Infrastructure Security			21,000			21,000
Fund Business Systems Modernization				62,149		62,149
Enforcement Initiatives	\$4,235	\$162,719	\$79,433	\$0	\$0	\$246,387
Improve Compliance Estimates, Measures, and Detection of Non-Compliance		29,054	11,968			41,022
Improve Compliance Among Small Business and Self-Employed Taxpayers	2,437	55,480	15,248			73,165
Implement Tax Gap Legislative Proposals to Improve Compliance			23,045			23,045
Increase Compliance for Large Multinational Businesses	1,055	19,916	5,229			26,200
Expand Document Matching in Existing Sites		18,536	9,422			27,958
Establish New Document Matching - Kansas City	248	15,669	7,536			23,453
Increase Individual Filing Compliance	495	3,806	2,243			6,544
Increase Tax-Exempt Entity Compliance		11,794	3,206			15,000
Increase Criminal Tax Investigations		8,464	1,536			10,000
Taxpayer Service Initiatives	\$3,853	\$0	\$16,147	\$0	\$0	\$20,000
Research Effect of Service on Taxpayer Compliance			5,000			5,000
Expand Volunteer Income Tax Assistance	3,853		1,147			5,000
Implement Taxpayer Assistance Blueprint			10,000			10,000
Subtotal FY 2008 Program Changes	\$8,088	\$162,719	\$176,580	\$62,149	\$0	\$409,536
<b>Total FY 2008 President's Budget Request</b>	<b>\$2,103,089</b>	<b>\$4,925,498</b>	<b>\$3,769,587</b>	<b>\$282,090</b>	<b>\$15,235</b>	<b>\$11,095,499</b>

## FY 2008 Budget Adjustments

The IRS' total funding increase for FY 2008 is \$657,135,000, which includes \$27,573,000 for a technical adjustment to the FY 2007 base; \$340,007,000 for maintaining current levels; \$119,981,000 from efficiency savings; and a net program increase of \$409,536,000 to enhance the IRS' infrastructure, modernization, enforcement, and taxpayer service programs that focus on improving compliance, and implement tax compliance improvement legislation. By 2010, these investments are projected to increase annual enforcement revenue by \$699 million dollars a year. In addition, the tax compliance improvement legislative proposals will generate \$29 billion over the next ten years.

The IRS' program initiatives focus on the most significant needs for FY 2008:

- \$143,149,000 to improve the IRS' information technology (IT) infrastructure, including \$62,149,000 for the BSM program and \$81,000,000 for security and infrastructure enhancements;
- \$246,387,000 to expand enforcement activities targeted at improving compliance; and
- \$20,000,000 to enhance taxpayer service through expanded volunteer tax assistance, increased funding for research to determine the most effective means to help taxpayers, and implementing new technology to improve taxpayer service.

### FY 2007 Continuing Resolution (CR) Rate

The FY 2007 CR-rate for the IRS is \$10,438,364,000, supporting an estimated 91,718 FTE. This amount reflects a reduction of \$153,473,000 and 1,318 FTE from the FY 2007 President's Budget request.

### Adjustments

*Technical Adjustments to the FY 2007 Base Attributed to the CR +\$27,573,000/0 FTE* This adjustment restores \$21,886,000 for BSM projects and management costs and \$5,687,000 for critical IT and other supporting infrastructure.

*Maintaining Current Levels +\$340,007,000/0 FTE* Funds are requested for annualizing the cost of the January 2007 pay increase (\$40,484,000), the proposed January 2008 pay raise (\$232,630,000), and non-pay inflation for items such as contracts,

travel, supplies, equipment, and rent adjustments (\$66,893,000).

*Efficiency Savings -\$119,981,000/-1,184 FTE* The IRS continues to improve the efficiency of its taxpayer service and enforcement programs. Enhancement of technology; improved workload selection models; on-going productivity and efficiency improvements; and streamlining, centralizing, and consolidating of work processes and programs will lead to operational efficiencies resulting in significant savings in FY 2008.

### Program Decreases/Savings

*Increased e-File Savings -\$6,479,000/0 FTE* This program decrease is a result of savings from increased electronic filing (e-File) and a projected decrease of 4.2 million paper returns filed (3.7 million individual and 0.5 million business) in FY 2008. This budget request proposes to reinvest these savings toward related cost associated with the ramp down of the Philadelphia Processing Center.

### Program Reinvestments

*Increase Efficiency through Submission Processing Site Consolidations +6,479,000/ 0 FTE* Increased e-File savings will be reinvested to fund \$5,968,000 in severance pay and \$511,000 for support costs associated with the ramp down of the Philadelphia Processing Center. However, the IRS will maintain a large staff of service and enforcement personnel in Philadelphia. Increased use of e-File continues to have a significant impact on Submission Processing Centers as individual paper return volumes decline. As a result, the IRS is consolidating the processing of individual paper returns at fewer submission processing sites.

### Program Increases

*Upgrade Critical IT Infrastructure +\$60,000,000/0 FTE* This infrastructure initiative will provide funding to upgrade the backlog of the IRS' equipment that has exceeded its life cycle. Failure to replace the IRS' IT infrastructure will lead to increased maintenance costs and increase the risk of disrupting business operations. Planned expenditures in FY 2008 include procuring and replacing desktop computers; automated call distributor hardware; mission critical servers; and Wide Area Network/Local Area Network routers and switches.

*Enhance Computer Security Incident Response Center (CSIRC) and Network Infrastructure Security +\$21,000,000/0 FTE* This infrastructure initiative will provide \$13,100,000 to fund enhancements to the CSIRC necessary to keep pace with the ever-changing security threat environment through enhanced detection and analysis capability, improved forensics, and the capacity to identify and respond to potential intrusions before they occur. The remaining \$7,900,000 will fund enhancements to the IRS' network infrastructure security, providing the capability to perform continuous monitoring of the security of operational systems, using security tools, tactics, techniques and procedures to perform network security compliance monitoring of all IT assets on the network.

*Fund Business Systems Modernization +\$62,149,000/0 FTE* This initiative will provide funding to continue the development and deployment of the IRS' modernization program in line with the recommendations identified in the IRS' Modernization, Vision, and Strategy. This increase will allow the IRS to continue progress on modernized projects, such as the Customer Account Data Engine (CADE), Account Management Services (AMS), Modernized e-File (MeF), and Common Services Projects (CSP).

CADE is the IRS' lynchpin modernization project that will replace the antiquated master file system, which is based on 1960s architecture. The IRS is developing CADE in stages and expects to retire the Individual Master File in 2012. When fully operational, the CADE database will house tax information for more than 200 million individual and business taxpayers.

AMS will provide a Common User Interface for access and update of taxpayer accounts managed by CADE and Individual Master File, Corporate Files on Line, and the Integrated Data Retrieval System. AMS will provide immediate access to integrated account data, which improves the ability to resolve account inquiries with minimal taxpayer interaction and facilitates the taxpayer's ability to self assist or self correct.

MeF is the future of electronic filing. It provides a single Extensible Markup Language-based standard

for filing electronic tax returns. Standardizing the formats/ structures for all filings will allow transmitters to submit multiple return types in the same transmission, something that restrains e-file growth currently. In FY 2008, the IRS will start development and implementation of the 1040 on the MeF platform, which is expected to take two years.

CSP will provide funding for new portals, which are technology platforms that meet many IRS business needs through web-based front-ends and provide secure access to data, applications, and services. The portals are mission-critical components of the enterprise infrastructure required to support key business processes and compliance initiatives.

The benefits accruing from the delivery and implementation of BSM projects not only provide value to taxpayers, the business community, and government, but also contribute to operational improvements and efficiencies within the IRS.

*Improve Compliance Estimates, Measures, and Detection of Non-Compliance +\$41,022,000/ +258 FTE* This enforcement initiative will fund research studies of compliance data for new segments of taxpayers needed to update existing estimates of reporting compliance. Unlike the past, the IRS will conduct an annual study of compliance among 1040 filers based on a smaller sample size than the 2001 National Research Program study. This will provide some fresh compliance data each year, and by combining samples over several years will provide a regular update to the larger sample size needed to keep the IRS' targeting systems and compliance estimates up to date. The data captured during the studies will enable the IRS to develop strategies to combat specific areas of non-compliance, improve voluntary compliance, and allocate resources more effectively. This initiative benefits taxpayers by significantly improving workload selection formulas that reduce the burden of unnecessary taxpayer contacts. This initiative will produce almost \$9 million in additional annual enforcement revenue, once the new hires reach full potential in FY 2010.

*Improve Compliance Among Small Business and Self-Employed Taxpayers +\$73,165,000/ +485 FTE* This enforcement initiative will address and improve compliance among small business and self-employed

taxpayers in the elements of reporting, filing, and payment compliance by increasing audits of high-risk tax returns, collecting unpaid taxes from filed and unfiled tax returns, and investigating and, where appropriate, prosecuting persons who have evaded taxes. This request will produce \$144 million in additional annual enforcement revenue, once new hires reach full potential in FY 2010,

*Implement Legislative Proposals to Improve Compliance +\$23,045,000/0 FTE* While the IRS continues to address compliance problems by improving customer service and using traditional methods of enforcement, the FY 2008 President's Budget includes several legislative proposals that would provide the IRS with additional enforcement tools to improve compliance. It is estimated that these proposals could generate approximately \$29 billion in revenue over the next ten years. These proposals would expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties (see Receipts in the Analytical Perspectives volume of the 2008 President's Budget). This enforcement initiative includes funding for purchasing software and making modifications to the IRS' IT systems necessary to implement these legislative proposals.

*Increase Compliance for Large Multinational Businesses +\$26,200,000/+158 FTE* This enforcement initiative will increase examination coverage for large, complex business returns; foreign residents; and smaller corporations with significant international activity. The initiative addresses risks arising from the rapid increase in globalization, and the related increase in foreign business activity and multi-national transactions where the potential for non-compliance is significant in the reporting of transactions that occur across differing tax jurisdictions. With this funding, coverage for large corporate and flow-through returns will increase from 7.9 to 8.2 percent in FY 2008, and produce over \$74 million in additional annual enforcement revenue, once the new hires reach full potential in FY 2010.

*Expand Document Matching in Existing Sites +\$27,958,000/+214 FTE* This enforcement initiative will increase coverage within the Automated Underreporter (AUR) program by minimizing revenue loss through increased document matching of individual taxpayer account information. The

additional resources will result in an increase in AUR closures from 2.05 million in FY 2007 to 2.64 million in FY 2010 and \$208 million of additional enforcement revenue per year, once the new hires reach full potential in FY 2010.

*Establish New Document Matching – Kansas City +\$23,453,000/+208 FTE* This enforcement initiative will fund a new AUR site within the existing IRS space in Kansas City to address the misreporting of income by individual taxpayers. The establishment of this new AUR site will result in over \$183 million in additional enforcement revenue per year, once the new hires reach full potential in FY 2010.

*Increase Individual Filing Compliance +\$6,544,000/+61 FTE* This enforcement initiative will help address voluntary compliance. The Automated Substitute for Return Refund Hold Program minimizes revenue loss by holding the current-year refunds of taxpayers who are delinquent in filing individual income tax returns and are expected to owe additional taxes. This initiative will result in securing more than 90,000 delinquent returns in FY 2008 and produce \$82 million of additional enforcement revenue per year, once the new hires reach full potential in FY 2010.

*Increase Tax-Exempt Entity Compliance +\$15,000,000/+109 FTE* This enforcement initiative will deter abuse within tax-exempt and governmental entities (TEGE) and misuse of such entities by third parties for tax avoidance or other unintended purposes. The funding will aid in increasing the number of TEGE compliance contacts by 1,700 (6 percent) and employee plan/exempt organization determinations closures by over 9,000 (8 percent) by FY 2010.

*Increase Criminal Tax Investigations +\$10,000,000/+37 FTE* This enforcement initiative will help the IRS aggressively attack abusive tax schemes, corporate fraud, non-filers, employment tax fraud, and other tax and financial crimes identified through Bank Secrecy Act related examinations and case development efforts, which includes an emphasis on the fraud referral program. The IRS' robust pursuit of tax violators and the resulting publicity, foster deterrence and enhance voluntary compliance.

*Research Effect of Service on Taxpayer Compliance* +\$5,000,000/+8 FTE This taxpayer service initiative will provide additional resources to enhance understanding of the role of taxpayer service on compliance by undertaking new research on the needs of taxpayers. The research will focus on four areas:

- Meeting taxpayer needs by providing the right channel of communication;
- Better understanding of taxpayer burden;
- Understanding taxpayer needs through the errors they make; and
- Researching the impact of service on overall levels of voluntary compliance.

*Expand Volunteer Income Tax Assistance* +\$5,000,000/+46 FTE This taxpayer service initiative will help expand the IRS' volunteer return preparation, outreach and education, and asset building services to low-income, elderly, Limited English Proficient, and disabled taxpayers.

*Implement Taxpayer Assistance Blueprint (TAB)* +\$10,000,000/0 FTE The IRS conducted a comprehensive review of its current portfolio of services to individual taxpayers to determine which services should be provided and improved. Based on the findings of the TAB study, the funding for this initiative will implement the following telephone service and Web site interaction enhancements:

- *Contact Analytics* – a tool for evaluating contact center recordings for the purpose of identifying improvements.
- *Estimated Wait Time* – this enhancement will inform taxpayers about their expected wait time in queue.
- *Expanded Portfolio of Tax Law Decision Support Tools* – this will enable users to conduct key word and natural language queries to get answers to tax law questions through the Frequently Asked Questions database accessed on IRS.gov.
- *Spanish "Where's My Refund?"* – this feature adds the refund status to the Spanish web page on IRS.gov, enabling the Spanish-speaking community to receive the same level of customer service on the web as available to the English web page.

Continued technological advancements offer significant opportunities such as the initiative for the IRS to improve the efficiency and effectiveness of call center services. Website enhancements are designed to maximize the value of IRS.gov, making the website taxpayers' first choice for obtaining the information and services required to comply with their tax obligations.

## Explanation of Budget Activities

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### Taxpayer Services (TS)

The FY 2008 President's Budget request is \$2,103,089,000 in direct appropriation, \$27,414,000 from reimbursable programs, and \$108,000,000 from user fees, for a total operating level of \$2,238,503,000. The direct appropriation level is an increase of 2.7 percent from the FY 2007 CR-rate. This appropriation funds the following budget activities.

*Pre-Filing Taxpayer Assistance and Education* (\$578,078,000 in direct appropriation, \$1,059,000 from reimbursable programs, and \$76,000,000 from user fees) This budget activity provides funds for services to assist with tax return filing, including interpretation of the tax laws, media, and publications. In addition, funding for these programs continues to emphasize taxpayer education, outreach, increased volunteer support time and locations, and enhancing pre-filing taxpayer support through electronic media.

*Filing and Account Services* (\$1,525,011,000 in direct appropriation, \$26,355,000 from reimbursable programs, and \$32,000,000 from user fees) This budget activity funds programs that provide filing and account services to taxpayers, process paper and electronically submitted tax returns, issue refunds, and maintain taxpayer accounts. The IRS continues to make progress in decreasing paper returns and increasing the use of electronic filing and payment methods. The IRS is also increasing both the capacity and effectiveness of its telephone and in-person taxpayer support.

### Enforcement (ENF)

The FY 2008 President's Budget request is \$4,925,498,000 in direct appropriation and \$49,353,000 from reimbursable programs, for a total operating level of \$4,974,851,000. The direct appropriation level is an increase of 5.7 percent from

the FY 2007 CR-rate. This appropriation funds the following budget activities.

*Investigations (\$602,872,000 in direct appropriation and \$37,716,000 from reimbursable programs)* This budget activity funds the criminal investigations programs that explore potential criminal violations of the internal revenue tax laws, enforce criminal statutes relating to these violations, and recommend prosecution as warranted. These programs identify and document the movement of both legal and illegal sources of income to identify and document cases of suspected intent to defraud. It also includes investigation and prosecution of tax and money laundering violations associated with narcotics organizations.

*Exam and Collections (\$4,165,233,000 in direct appropriation and \$11,637,000 from reimbursable programs)* This budget activity funds programs that enforce the tax laws and compliance through examination and collection programs that ensure proper payment and tax reporting. The budget activity also supports appeals and litigation activities associated with exam and collection.

*Regulatory (\$157,393,000 in direct appropriation)* This budget activity provides resources for the development and print of published guidance materials; interpretation of and guidance on tax laws; enforcement of regulatory rules, laws, and approved business practices; and supporting taxpayers in the areas of pre-filing agreements, determination letters, and advance pricing agreements. The Office of Professional Responsibility is also funded within this budget activity and is responsible for identifying, communicating, and enforcing the Treasury Circular 230 standards of competence, integrity, and conduct of professionals representing taxpayers before the IRS.

### **Operations Support (OS)**

The FY 2008 President's Budget request is \$3,769,587,000 in direct appropriation, \$56,731,000 from reimbursable programs, and \$72,000,000 from user fees, for a total operating level of \$3,898,318,000. The direct appropriation level is an increase of 7.1 percent from the FY 2007 CR-rate. This appropriation funds the following budget activities.

*Infrastructure (\$908,095,000 in direct appropriation)*

This budget activity provides resources for administrative services related to space and housing, rent and space alterations, building services, maintenance, guard services, and non-automated data processing equipment.

*Shared Services and Support (\$1,223,351,000 in direct appropriation, \$50,990,000 from reimbursable programs, and \$10,000,000 from user fees)*

This budget activity funds policy management and IRS-wide support for research, strategic planning, communications and liaison, finance, human resources, and equal employment opportunity and diversity services and programs. It also funds printing and postage, business systems planning, security, corporate training, legal services, procurement, and specific employee benefits programs.

*Information Services (\$1,638,141,000 in direct appropriation, \$5,741,000 from reimbursable programs, and \$62,000,000 from user fees)*

This budget activity provides funding for staffing, equipment, and related costs to manage, maintain, and operate the information systems critical to the support of tax administration programs. The IRS' business programs rely on these systems to process tax and information returns, account for tax revenues collected, send bills for taxes owed, issue refunds, assist in the selection of tax returns for audit, and provide telecommunications services for all business activities including the public's toll-free access to tax information.

### **Business Systems Modernization (BSM)**

The FY 2008 President's Budget request is \$282,090,000 in direct appropriation. This is an increase of 43.3 percent from the FY 2007 CR-rate. This appropriation funds the following budget activity.

*BSM (\$282,090,000 in direct appropriation)*

This budget activity provides resources for the planning and capital asset acquisition of information technology to modernize the IRS' business systems. The program combines best practices and expertise in business solutions and internal management from the IRS, business, and technology to develop a world-class tax administration system that fulfills the revenue collection requirements of the United States as well as taxpayers' needs and expectations.

## Health Insurance Tax Credit Administration (HITCA)

The FY 2008 President's Budget request is \$15,235,000 in direct appropriation. This is an increase of 2.6 percent from the FY 2007 CR-rate. This appropriation funds the following budget activity.

*HITCA (\$15,235,000 in direct appropriation)* This budget activity provides resources to administer a refundable tax credit for health insurance to qualified individuals, which was enacted as part of the Trade Adjustment Assistance Reform Act of 2002.

### Legislative Proposals

The FY 2008 President's Budget includes a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. When implemented, these proposals will generate \$29 billion over ten years. The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

- *Expand information reporting* – Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific proposals to expand information reporting would:
  - 1) require information reporting on payments to corporations;
  - 2) require basis reporting on security sales;
  - 3) expand broker information reporting;
  - 4) require information reporting on merchant payment card reimbursements;
  - 5) require a certified taxpayer identification number (TIN) from non-employee service providers;
  - 6) require increased information reporting for certain government payments for property and services; and
  - 7) increase information return penalties.
- *Improve compliance by businesses* – Improving compliance by businesses of all sizes is important. Specific proposals to improve compliance by businesses would:

- 1) require electronic filing by certain large businesses;
  - 2) implement standards clarifying when employee leasing companies can be held liable for their clients' Federal employment taxes; and
  - 3) amend collection due process procedures applicable to employment tax liabilities.
- *Strengthen tax administration* – The IRS has taken a number of steps under existing law to improve compliance. Specific proposals to enhance tax administration would:

- 1) expand IRS access to information in the National Directory of New Hires database;
  - 2) permit the IRS to disclose to prison officials return information about tax violations; and
  - 3) make repeated failure to file a tax return a felony.
- *Expand penalties* – Penalties play an important role in discouraging intentional non-compliance. Specific proposals to expand penalties would:
    - 1) expand preparer penalties;
    - 2) impose a penalty on failure to comply with electronic filing requirements; and
    - 3) create an erroneous refund claim penalty.

### Improve Tax Administration and Other Miscellaneous Proposals

The Administration has four proposals relating to IRS administrative reforms.

The first proposal modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations.

The second proposal allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities.

The third proposal eliminates the requirement that the IRS Chief Counsel provide an opinion

for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding \$50,000. This proposal requires that the Secretary of the Treasury establish standards to determine when an opinion is appropriate.

The fourth proposal modifies the way that Financial Management Services (FMS) recovers its transaction

fees for processing the IRS' levies by permitting FMS to add the fee to the liability being recovered, thereby shifting the cost of collection to the delinquent taxpayer. The offset amount would be included as part of the 15-percent limit on continuous levies against income.

### IRS Performance by Programs

Programs	Performance Measure	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	
		Actual	Actual	Actual	Target Met?	Target <sup>1</sup>	Target
Taxpayer Service	Customer Service Representative (CSR) Level of Service (%) Oe	87.3%	82.6%	82.0%	✓	78.0%	81.0%
	Customer Accuracy - Tax Law Phones (%) - Ot	80.0%	89.0%	90.9%	✓	91.0%	91.2%
	Percent of Individual Returns Processed Electronically (%) - Oe (L)	46.5%	51.1%	54.1%	✗	57.0%	61.6%
Enforcement	Collection Coverage - units (%) Ot (L)	**	53.0%	54.0%	✓	54.0%	54.0%
	Examination Coverage-Individual (%) Oe (L)	0.8%	0.9%	1.0%	✓	1.0%	1.0%
	Automated Underreporter Efficiency E (L)	1,514	1,701	1,832	✓	1,932	1,808

Key: Oe - Outcome Measure, E - Efficiency Measure, Ot - Output/Workload Measure, L - Long-Term goal

<sup>1</sup> Changes to the FY 2007 performance targets are attributed to funding adjustments under the Continuing Resolution, the implementation of new tax legislation, and improvements resulting from program efficiencies

\*\* Prior performance reported as 39 percent under old methodology

### Description of Performance

The following is a summary, outlined by the IRS' strategic goals, of significant program performance improvements.

#### Improve Taxpayer Service

Assisting the public to understand their tax reporting and payment obligations is the cornerstone of taxpayer compliance and is vital for maintaining public confidence in the tax system. The IRS continues to meet this challenge by improving the quality and accuracy of responses from its call centers and Taxpayer Assistance Centers (TACs) and expanding electronic self-service options. The following information highlights the IRS' taxpayer service achievements in FY 2006.

- The IRS delivered the first phase of the Taxpayer Assistance Blueprint, a comprehensive study that reviewed the IRS' current taxpayer service options provided to taxpayers and identified areas for improvements, including expanded taxpayer education and awareness, optimized use of partner services, increased self-service options, and expanded training and support tools for taxpayers.

The Phase II report, which will be delivered in early 2007, includes additional research and establishes the framework to develop short and long-term outcome goals and metrics for measuring the IRS' progress on service improvements for taxpayers.

- Electronic filing for individuals continued to increase and, for two years in a row, more than half of all individual returns were filed electronically. The American Customer Satisfaction Index (ACSI) shows that e-File taxpayers are significantly more satisfied with their interaction with the IRS than paper filers. Also, in FY 2006, nearly 14,000 large corporate taxpayers subject to the electronic filing mandate successfully e-filed their returns without delay or backlog.
- Overall customer satisfaction with the award-winning IRS.gov website increased five percentage points based on the ACSI and use continued to grow. More than 1.3 billion web pages were viewed on IRS.gov and over 24 million taxpayers used the web application "Where's My Refund?" to check the status of their refunds. The IRS also introduced a set of web-based business products, such as

Internet-Employer Identification Number service and Transcript Delivery System, for practitioners and other third parties.

- The IRS provided a high level of service for taxpayers seeking traditional phone-based or in-person assistance. In FY 2006, the IRS' customer assistance call centers answered 32.7 million assistor telephone calls and met the 82 percent level of service goal, with an accuracy rate of 91 percent for tax law questions. The accuracy of responses to tax law questions at the TACs increased to 83 percent, compared to 75 percent in FY 2005. Waiting time at the TACs was minimized with more than eight out of ten customers being served in 30 minutes or less.
- The IRS provided unprecedented tax relief in the wake of the hurricanes that occurred along the Gulf Coast in August and September of 2005. In addition to direct support for FEMA call centers, the IRS provided assistance to the Small Business Administration and the Department of Labor to expedite income verification for disaster loans and unemployment benefits.

### **Enhance Enforcement**

In FY 2006, enhancing the IRS' enforcement presence remained a top priority. The IRS also focused its efforts on improving business processes and modernizing its information systems, both powerful enablers of the IRS' business goals. Focusing more on limited scope examinations and productivity enhancements including improved analytics, workload identification, and selection systems that targeted high-risk cases, resulted in the completion of more individual, high income and small business audits in FY 2006 compared to FY 2005. The following information highlights the IRS' enforcement achievements in FY 2006.

- Reached a record level of \$48.7 billion in enforcement revenue in FY 2006, as a result of the IRS' focus on corrosive activities of corporations, high income taxpayers and other major areas of non-compliance.
- Increased high income audits (audits of taxpayers earning \$100,000 or more) 18 percent over FY 2005.

- Increased collection case closures by 15 percent, with a 9 percent increase in revenue received from collection activities.
- Increased the use of substitute for return authority by 66 percent (substitute for return authority allows the IRS to file a tax return for an individual or business when it does not file a required return). Examiners prepared and filed 665,000 returns for individuals and 182,000 returns for businesses classified as non-filers.
- Continued to improve quality of the largest corporate examinations. In FY 2006, Examination Quality for Industry and Coordinated Industry Examinations exceeded targets and increased to 85 percent and 96 percent, respectively.

In addition, the IRS strengthened its enforcement presence among entities with special tax statuses that may attract fraud and abuse. For example, in response to changes in the credit counseling industry and new bankruptcy requirements, the IRS halted the growth in abusive credit counseling agencies and undertook audits of the largest credit counseling agencies that resulted in the revocation of exemption for a substantial share of this industry.

### **Modernize the IRS through its People, Processes, and Technology**

The IRS must manage its resources, business processes, and technology systems optimally to effectively and efficiently support its service and enforcement mission. The IRS strives to become a "first choice" employer where talented people want to work and can excel in a culture of high performance, empowerment, and a quality work environment. The following information highlights the IRS' modernization achievements in FY 2006.

- For the seventh consecutive year, the IRS achieved an unqualified audit opinion from the Government Accountability Office on all financial statements.
- The IRS completed and introduced its Human Capital (HC) Strategic Implementation Plan which focuses on promoting a highly productive and engaged workforce. The plan aligns Treasury's HC Strategic Goals, the IRS' Strategic

Goals, and the IRS' HC Strategic Goals, and establishes performance monitoring against objectives, processes, and projects.

- Successful BSM program delivery during the past two years demonstrates that the IRS has established a foundation of disciplined project delivery and accomplishment. Overall, the program delivered within the target of +/- 10 percent variance for both cost and schedule components for major release and sub-release milestones, a significant achievement that validates BSM program management effectiveness. This accomplishment is especially noteworthy because it was achieved while transitioning from a contractor-led program to an IRS-led program.

Modernization efforts will continue to focus on four key tax administration systems that provide additional benefits to taxpayers and IRS employees: CADE, AMS, MeF, and Filing and Payment Compliance (F&PC).

- CADE will ultimately replace the IRS' antiquated Master File system. CADE allows faster refunds (processing refunds on a daily basis), improved taxpayer service, faster issue detection, more timely account settlement, and a robust foundation for integrated and flexible modernized systems. New capabilities were introduced in January 2006,

which increased the number of returns processed to over 7.3 million and generated refunds in excess of \$3.4 billion. CADE is expected to process between 25 million to 30 million returns in 2007.

- AMS will enable real-time access to taxpayer account information in order to support faster resolution of taxpayer issues by the IRS' customer service representatives. The first release of the AMS is due the summer of 2007 to support real-time address change capability in CADE and enable faster notice processing for a number of math error notices.
- MeF expanded the electronic filing of both federal and state corporate income tax returns and will begin efforts to automate partnership income tax forms enabling nearly 2.7 million small business and self-employed taxpayers to benefit from electronic filing. MeF processed 550,000 corporate returns for the 2006 filing season.
- F&PC delivered the first release, which analyzes tax collection cases and separates cases that require direct IRS involvement from those that can be handled by Private Collection Agencies (PCAs). The system identified and delivered the first 12,500 cases to three PCAs in September 2006.

