

**Remarks of Steven T. Miller
Commissioner, Tax Exempt and Government Entities
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I am pleased to be here. The AICPA historically has played an important role in helping the public comply with the Internal Revenue Code, and in helping us understand the practical aspects of administering the tax law. We have had a long and fruitful association with you, and appreciate your good counsel and dedication to sound tax administration.

I have not had the opportunity to speak to this group before—so today I would like to discuss who we regulate and the general direction that we in TE/GE are taking.

Our regulated community touches each of your lives almost daily, and it forms a vital part of the economy. In TE/GE we work with charitable organizations, pension and retirement plans, tax-exempt bonds, governmental entities as taxpayers, and Indian tribal governments. Commissioner Everson recently characterized our work as richly diverse. I certainly agree, and this diversity presents special challenges to us in TE/GE.

Our sector is large and continues to grow. Let me give you some numbers: We regulate over 3 million entities, with over \$8 trillion in assets (this doesn't include governmental pensions or property). These organizations pay over \$300 million in employment tax and income tax withholding and have gross revenues in the \$1.9 trillion range. (For comparison – the U.S. is at around \$9.3 trillion.) One in four non-farm workers in the country works in our sector. I could go on, but you get the point.

We regulate this piece of the economic pie with fewer than 2,400 people.

So our sector is large. I believe it also is still largely compliant. But there are signs of problems – 14 of 30 listed transactions use, or could use, members of our regulated community.

The press is replete with stories raising issues of corporate governance in our area – whether it involves executive compensation in the charitable area, use of proceeds of Indian casinos, or the alarming state of under-funding in the pension system.

In the Congress, the tax-writing committees have been growing increasingly interested in our area. There has been a series of hearings on our sector and there is no sign that this interest will abate.

This, in a nutshell, is the TE/GE world today. It is a sensitive time for the community we serve. The tax-exempt sector is in the spotlight.

So it is no wonder that the IRS Strategic Plan for 2005-2009 singles out our area. The Strategic Plan sets out Commissioner Everson's four key enforcement objectives for the next five years. One of them directly concerns our sector. It is to:

Deter abuse within tax-exempt and governmental entities and misuse of such entities by third parties for tax avoidance and other unintended purposes.

Just as important, the Commissioner has backed up these words with money. In 2005 he increased TE/GE's budget and redirected scarce resources to these problems. TE/GE staffing went from 2,170 at the end of FY 2004, to 2,370 at the end of FY 2005, an increase of 9%. That is a very significant increase. And virtually all of this new hiring is for enforcement.

That fact too should come as no surprise, since I am sure you are aware of Commissioner Everson's determination to re-balance the Service's program to increase enforcement.

So what I want to do is talk a little about what we are doing across TE/GE in this environment.

Let's talk about what it means to re-balance – both to our results and in our approach.

What do I mean when I talk about re-balancing? Well, in all our functions it means returning to the beat and at the same time letting the public know that we are back – letting everybody know that the IRS has a meaningful enforcement presence again.

In Exempt Organizations and Employee Plans, this presence had been severely weakened because our resources were being used up by our determination letter programs – the programs where we review applications from a pension plan or a charitable organization seeking tax-exempt status. Those days are over now because we have separated the staffing of those who do determinations work from those who conduct examinations. And, as noted, we have added staff to our examination function.

Our presence was also lacking in Government Entities. Before the creation of TE/GE, the Service did not have focused or meaningful examination programs for Indian tribal governments, or federal, state and local governments in their

role as payers of employment taxes. In this area, we started from scratch, but we certainly have a focused and meaningful examination program now.

And what has been the result so far? Well, I can tell you that from 2003 to 2005 what we will call enforcement contacts went up more than 50% across TE/GE. We expect to boost those results another 20% in 2006.

Now let's be clear about terms here. I will say that these numbers include new sorts of contacts other than just traditional examinations. But even if we look at the numbers for just traditional examinations, our closures will be up around 30% over the same time period. And the enforcement contact figures are very real for the taxpayers involved, representing one-on-one interactions requiring a response. I will be talking about some examples shortly.

Not only have we increased the number of contacts and examinations, we have increased them while improving the types of cases we have in inventory – and the quality of the cases is probably more important than sheer numbers.

In Exempt Organizations, we are moving to more complex cases for our agents. An increasingly large percentage of cases are now project cases involving areas of abuse rather than garden-variety general program cases. This is how we do business now.

In Employee Plans, almost a third of our cases coming into 2006 will be follow-up cases in market segments where we did studies, found problems, and now are drilling down. In EP we are also rolling out a new examination process that we think will improve the quantity and quality of our time with you.

In Government Entities, we are focusing an increasing amount of our energy in the area of large governmental organizations – which employ more than 90% of all government employees. So I believe our case selection and our focus is getting sharper.

How have we done this? First of all, added staffing obviously helps, but that is not all we have done. We have built flexibility into our compliance program. TE/GE now has the ability to respond differently depending upon the particular compliance problem that is presented. And this new capability is paying off in terms of efficiency.

To deal with issues that may not require a traditional field examination, we have set up compliance units in both Exempt Organizations and Employee Plans. These units employ well-trained but lower graded employees, and they attack particular compliance problems via correspondence. This was the method we used in Exempt Organizations to execute our initiative on questionable compensation, which involved 2,000 individual cases. We could not have undertaken this project using traditional examination techniques Alone.

In Employee Plans, the EP Compliance Unit is serving as the first point of contact and development in the many pension funding deficiency cases we are looking at. The compliance units also permit us to review a great number of returns and to correspond with taxpayers on problems contained in the returns. We need to convince the TE/GE community that it really does matter what you say on the returns. That is how we will increase our presence and that is how effective tension is built. In addition, to better focus our resources we have built another unit that does nothing but mix and match data sets. For example, we have compared a state's licensing database for bingo with our filings of gaming returns and have found that the reporting is somewhat wanting. That's when the compliance unit goes to work.

With respect to the most complex cases, Exempt Organizations has now built its new financial transactions unit. Schooled in money tracking, forensic accountants and other experts will focus on money laundering, fraud and terrorist financing. Government Entities has a new unit to pursue compliance by federal agencies and a new process for larger cases. So we are working to build out both ends of the compliance spectrum. The compliance units for the least complex contacts – these new office and processes for the most complex cases.

I mentioned our movement to work on nationwide projects. This trend exists across TE/GE and is the natural evolution of the nationwide examination programs that were created when TE/GE stood up in 2000. We cannot afford to select cases one at a time, at the group manager level, and never learn anything from our efforts. That is incredibly wasteful. So we are pursuing project work where there is coordinated training, coordinated case work and knowledge management.

Let me give you some examples from 2005 when we rolled out a number of successful projects:

In Exempt Organizations I will mention two.

The first is our compensation initiative. We contacted almost 2,000 organizations on various subjects – seemingly high compensation, seemingly problematic loans, admission or omission on the question about whether they had an inurement problem during the year. We are not finished with the project, but this shows how we will be doing initiatives into the future – using our data people, our compliance unit and, as necessary, our agents and Washington specialists. We have found some problems and continue to find more in the on-going examinations. We will report out in 2006 as well as do some follow-up work in some areas and industries.

The second project I will mention is credit counseling. We have found real problems with credit counseling organizations, and our work in the area has been

made all the more important by the passage of the bankruptcy act, which requires people seeking bankruptcy protection to go to counseling. I raise this project as another model of how we will do business into the future, a very coordinated and strategically planned effort which will, by year end, have led to our proposing or revoking the tax-exempt status of 20 to 25 organizations, representing perhaps as much as half the gross receipts of the credit counseling industry. We will finish this project in 2006. This is how we will pursue industry-wide projects.

In Employee Plans, we have dedicated increasing resources to abusive tax transactions -- including efforts in insurance funded plans, ESOPS, and other listed and unlisted transactions. By the way, we hope to be quite busy processing cases under the settlement initiative the Commissioner announced last week.

Let me expand on that for a moment.

The IRS did something very significant last Thursday. We announced a major settlement initiative that gives taxpayers who enmeshed themselves in certain abusive transactions a way to get out of them and return to good graces with us. Announcement 2005-80 contains the details. This is a program with a limited life -- taxpayers need to respond promptly, by January 23 -- and we are insisting, rightfully, on full payment of tax. But we are also providing some incentives, such as reducing some penalties. So check it out on the IRS web site, irs.gov.

The initiative is of interest to TE/GE customers because many of the eligible transactions involve TE/GE entities, directly or indirectly.

Please give this announcement serious consideration. It is an important program that can help seal the lid on abusive tax situations, let taxpayers who are now in trouble come clean, and restore integrity to the tax system.

Now, back to what I was saying about project work.

In Employee Plans we are also dedicating increasing resources to pension under-funding -- working with our colleagues at the Department of Labor and the Pension Benefit Guaranty Corporation to detect problems and to take coordinated enforcement action earlier with respect to troubled plans.

In Government Entities, an example of our project work is our work on tribal casino gaming. This sector of the gaming industry is growing faster than any other and is approaching \$20 billion in revenues. We are working to ensure that the funds flow appropriately in the system, and we will continue to make this an increasing part of our work in 2006. Also in the tribal area, we will begin work on a banking initiative to look at the recent trend of tribal governments to create and maintain financial institutions.

Now I want to wind up – but I want to discuss a second aspect of re-balancing that is particular in some respects to TE/GE. We have a tradition we must continue that predates the current re-balancing and even the 2000 restructuring of the Service.

Part of that tradition is that we at TE/GE – I believe – have the best stakeholder relationships at the Service. We have worked with you and with similar groups to broker an honest and open discussion of the issues, and it has helped both of us time and time again. A second piece of that tradition is that TE/GE has always been concerned first about compliance and regulation, and not necessarily about revenue. We have always had an abiding respect for the public work our sector does, and that has always led to appropriate treatment for those we work with. This has also led to robust education programs and to an exceptional group of voluntary compliance programs.

I want to assure you that we treasure this tradition, and that we intend to protect it as we re-balance. We do not intend to let the momentum to re-balance go too far. We keep firmly in mind what it is that has made TE/GE such a special place over the years, and will insure that taxpayer rights and service remain paramount.

Thank you.