

The
BUDGET
IN BRIEF
FY 2006

Internal Revenue Service

February 2005

Internal Revenue Service

Program Summary by Appropriations Account

(Dollars in Thousands)

Appropriation	FY 2004	FY 2005	FY 2006		
	Enacted	Enacted	President's Budget	Increase/Decrease	% change
Tax Administration & Operations	\$9,762,024	\$9,998,165	\$10,460,051	\$461,886	4.6%
Assistance	\$1,828,373	\$1,829,190	\$1,805,965	(\$23,225)	(1.3%)
Outreach	\$544,146	\$500,329	\$466,217	(\$34,112)	(6.8%)
Processing	\$1,337,128	\$1,276,459	\$1,295,273	\$18,814	1.5%
Subtotal, Taxpayer Service	\$3,709,647	\$3,605,978	\$3,567,455	(\$38,523)	(1.1%)
Examination	\$3,214,410	\$3,477,623	\$3,711,889	\$234,266	6.7%
Collection	\$1,779,233	\$1,825,715	\$1,990,562	\$164,847	9.0%
Investigations	\$656,131	\$681,980	\$767,418	\$85,438	12.5%
Regulatory Compliance	\$256,248	\$252,993	\$264,855	\$11,862	4.7%
Research	\$146,355	\$153,876	\$157,872	\$3,996	2.6%
Subtotal, Enforcement	\$6,052,377	\$6,392,187	\$6,892,596	\$500,409	7.8%
Business Systems Modernization	\$387,699	\$203,360	\$199,000	(\$4,360)	(2.1%)
Health Insurance Tax Credit Administration	\$34,794	\$34,562	\$20,210	(\$14,352)	(41.5%)
Subtotal, All Appropriations Accounts	\$10,184,517	\$10,236,087	\$10,679,261	\$443,174	4.3%
Offsetting Collections - Reimbursables	\$165,635	\$159,000	\$103,000	(\$56,000)	(35.2%)
Mandatory Appropriations - User Fees	\$62,524	\$100,000	\$100,000	\$0	0.0%
Total Program Operating Level	\$10,412,676	\$10,495,087	\$10,882,261	\$387,174	3.7%

Explanation of Request

The Internal Revenue Service (IRS) budget request for FY 2006 is \$10,679,261,000, a \$443,174,088 increase, or 4.3 percent, over the FY 2005 enacted budget of \$10,236,086,912. This represents a 1 percent decrease in Taxpayer Service and a 2 percent decrease in Business Systems Modernization, respectively, and an 8 percent increase in Enforcement.

This budget request supports the IRS' five-year strategic plan. This plan, which guides the agency's operations from October 1, 2004, through September 30, 2009, underscores the IRS' commitment to provide quality service to taxpayers and enforce America's tax laws in a balanced manner. The three themes of the strategic plan guiding the future direction of the IRS are:

- *Improve Taxpayer Service.* Improve service by helping people understand their tax obligations and 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.
- *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.

Taxpayer service is improving in key areas. In FY 2004, almost 62 million individuals filed their returns electronically – up 16 percent over last year. Electronic filing is faster and more reliable, both for the taxpayer and the IRS. The IRS is moving forward on its modernization efforts. This year, the IRS is beginning to process 1040EZ returns and issue refunds from its

new computer system, the Customer Account Data Engine (CADE). At the same time, the IRS is modernizing its workforce including consolidating back-office operations to more efficiently and effectively deliver the IRS' taxpayer service and enforcement programs.

While our commitment to service continues, the IRS request includes \$264,632,000 for initiatives aimed at enhancing enforcement of the tax laws. The great majority of Americans pay their fair share of taxes, but there is still a significant tax gap – the difference between what taxpayers are supposed to pay and what they actually do – due to non-filing, underreporting and nonpayment. Combating this tax non-compliance is a top priority. Americans deserve to feel confident that when they pay their taxes their neighbors and competitors are doing the same. These new investments will yield substantial additional revenue. The \$264.6 million is above increases to fund the pay raise and other cost adjustments (\$182 million) – for a total of \$446 million for new enforcement investments and cost increases.

It is important that these cost increases and new enforcement investments be fully funded. The Administration is proposing to fund them as contingent appropriations. To ensure full funding of the new enforcement investments, the Administration

proposes to employ a budget enforcement mechanism that allows for an adjustment by the Budget Committees to the section 302(a) allocation to the Appropriations Committees found in the concurrent resolution on the budget. In addition, the Administration will also seek to establish statutory spending limits, as defined by section 251 of the Balanced Budget and Emergency Deficit Control Act of 1985, and to adjust them for this purpose. To ensure full funding of the cost increases, either of these adjustments would only be permissible if the base level for IRS enforcement was funded at \$6,446 million and if the use of the funds was clearly restricted to the specified purpose. The maximum allowable adjustment to the 302(a) allocation and/or the statutory spending limit would be \$446 million for 2006, bringing the total enforcement level in the IRS to \$6,893 million.

The IRS yields more than four dollars in direct revenue from its enforcement efforts for every dollar invested in its total budget. In FY 2004, the IRS brought in a record \$43.1 billion in enforcement revenue – an increase of \$5.5 billion from the year before, or 15 percent. Beyond the direct revenues generated by increasing audits, collection, and criminal investigations, IRS enforcement efforts have a deterrent effect on those who might be tempted to skirt their tax obligations.

Purpose of Program

The IRS administers America's tax laws and collects the revenues that fund most government operations and public services. Each year, IRS employees make hundreds of millions of contacts with the American taxpayers and businesses. The IRS and its employees represent the face of government to more U.S. citizens than any other agency.

The IRS provides service to millions of taxpayers to help them understand and meet their tax obligations. The IRS also deters people inclined to evade their responsibilities and vigorously pursues those who violate tax laws.

To facilitate full alignment and integration of the IRS's goals and measures with its resources, the IRS proposes to restructure its budget beginning in FY 2006. The new budget structure has a more direct relationship

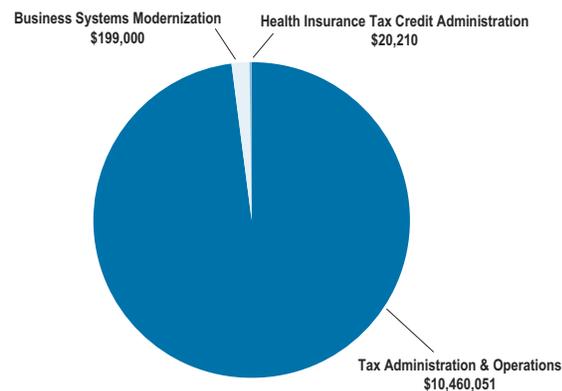
to major IRS program areas and its Strategic Plan. The proposed budget structure combines the three major appropriations – Processing, Assistance, and Management (PAM); Tax Law Enforcement (TLE); and Information Systems (IS), into one appropriation called Tax Administration and Operations (TAO). The Health Insurance Tax Credit Administration (HITCA) and Business Systems Modernization (BSM) appropriations remain unchanged.

The Taxpayer Service and Enforcement programs of the TAO appropriation are divided among eight critical program areas. These budget activities focus on Assistance, Outreach, Processing, Examination, Collection, Investigations, Regulatory Compliance and Research. Full funding for each activity will be reflected in the budget, along with key outcome measures. As the IRS continues to move toward the development and implementation of this new structure, these program areas and the associated resource distributions will be refined to provide more accurate costing.

Highlights of the IRS' appropriations follow:

IRS Budget by Account

(Dollars in Thousands)



Tax Administration and Operations (TAO)

For FY 2006, the IRS requests funding of \$10,460,051,000, an increase of 4.6 percent over the FY 2005 appropriation of \$9,998,164,640 for programs previously funded from the PAM, TLE and IS appropriations.

The TAO appropriation provides resources for the IRS' service and enforcement programs. The IRS is responsible for ensuring that each taxpayer receives prompt and professional service. To that end, the

IRS' assistance, outreach and processing activities funded in the TAO appropriation are dedicated to providing assistance to taxpayers in all forms – electronic interaction, published guidance, paper correspondence, telephone contact and face-to-face communication – so that taxpayers may fulfill their tax obligations timely and accurately. It also includes the resources the IRS requires to handle the processing and disposition of tax returns, refunds and other filing materials.

The IRS is also responsible for the fair enforcement of the nation's tax laws. Each year, a small percentage of taxpayers file erroneous returns or, for reasons both innocent and less benign, fail to file a return at all. The IRS conducts enforcement activities using a variety of methods, including correspondence audits, matching reporting documents (such as Forms W-2) to information on taxpayer returns, in-person audits, criminal investigations of those suspected of violating tax laws and participation in joint governmental task forces. The IRS' examination, collection, investigations, regulatory compliance and research activities funded in the TAO appropriation provide the resources required for equitable enforcement of the tax code and the investigation and prosecution of individuals and organizations that circumvent tax laws.

Business Systems Modernization (BSM)

For FY 2006, the IRS requests funding of \$199,000,000, substantially the same funding as the FY 2005 appropriated level of \$203,360,000. The BSM appropriation provides resources for the planning and capital asset acquisition of information technology systems to modernize the IRS' antiquated business systems.

The IRS collects \$2 trillion in revenues annually through a network of computer systems developed over a 40-year period. These outdated systems need to be replaced. Recognizing the long-term commitment needed to solve the problem of modernizing these antiquated systems, Congress created a special Business Systems Modernization account in FY 1998. Failure to modernize the IRS' tax administration business systems will result in a significant increase in the resources required to maintain the IRS' legacy systems – systems that no longer efficiently serve America's taxpayers.

The IRS' modernization program is providing real business benefits to taxpayers and IRS employees by delivering several modernized systems. For example, the Customer Account Data Engine (CADE) is a modern database, which will eventually house tax information for more than 200 million individual and business taxpayers, replacing the outdated legacy system. The IRS began using CADE to process 1040 EZ returns in late FY 2004. The IRS also implemented the first release of the Integrated Financial System (IFS), which replaces the core financial systems, including expenditure controls, accounts payable, accounts receivable, general ledger and purchasing controls. The IRS also fully deployed online e-Services functionality for tax practitioners and other third parties, such as banks and brokerage firms that file Form 1099s. Under P.L. 108-447, the IRS is permitted to use Private Collection Agencies (PCAs); the IRS plans to leverage the need to manage the use of PCAs with the first release of Filing & Payment Compliance (F&PC) (formerly known as Collection Contract Support). The IRS deployed Modernized e-File, which provides e-filing for the first time to businesses and exempt organizations.

Health Insurance Tax Credit Administration (HITCA)

For FY 2006, the IRS requests funding of \$20,210,000, a decrease of 41.5 percent below the FY 2005 appropriation of \$34,562,272. The Health Insurance Tax Credit Administration (HITCA) Appropriation funds the costs to administer a refundable tax credit for health insurance to qualified individuals. In August 2002, the President signed Public Law 107-210, the Trade Act of 2002, which, among other things, provides a refundable tax credit for the cost of health insurance for certain individuals who receive a trade readjustment allowance or a benefit from the Pension Benefit Guaranty Corporation (PBGC). The tax credit is equal to 65 percent of the health insurance premium paid by eligible persons for themselves and qualifying family members.

Offsetting Collections and User Fees

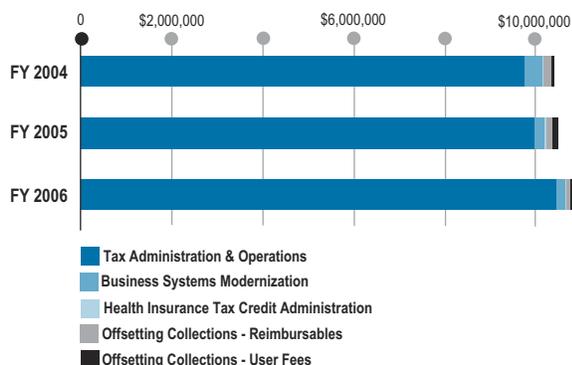
The FY 2006 budget includes an estimate of \$103,000,000 in offsetting collections from reimbursable agreements with other U.S. Government agencies, and an estimate of \$100,000,000 in spending from user fees.

Program Description

The IRS request of \$10,882,261,000 includes \$10,679,261,000 from appropriations and an estimated \$203,000,000 from offsetting collections and user fees.

IRS Funding History

(Dollars in Thousands)



Explanation of Budget Activities

Tax Administration and Operations (TAO)

The following Budget Activities support Taxpayer Service programs. These activities support the IRS' strategic goal to improve taxpayer service and Treasury's strategic objective to collect Federal tax revenue when due through a fair and uniform application of the law. Total direct resources for Taxpayer Service programs are \$3,567,455,000.

Assistance (\$1,805,965,000) The Assistance activity provides resources to taxpayers who have tax-related questions and need to resolve account inquiries via correspondence, face-to-face meetings, telephone calls and electronic communications. Resources provided by this activity enable taxpayers to fulfill their tax obligations timely and accurately, while minimizing taxpayer burden. Funds are also included for the Taxpayer Advocate Service to assure taxpayers' problems are resolved promptly and fairly. Cost for forms and other published documents are also paid from this activity.

Outreach (\$466,217,000) This activity funds proactive programs for taxpayers, businesses, non-profit organizations, tax practitioners and others to ensure that taxpayers understand their tax obligations

and have the information and materials necessary to fulfill their responsibilities. These resources are used to develop understandable notices, produce tax forms and publications, provide media services and develop published information for the visually impaired. Outreach manages educational programs such as Tax Counseling for the Elderly and Volunteer Income Tax Assistance, provides multi-lingual services and develops stakeholder partnerships.

Processing (\$1,295,273,000) The processing activity includes resources to track, process and resolve all electronic and paper returns. This activity also funds the issuance of refunds, payments and tax notices, and the receipt and processing of the information returns that permit the IRS to match data provided on a taxpayer's return.

The following Budget Activities support the IRS' Enforcement programs. These activities support the IRS' strategic goal to enhance enforcement of the tax laws and Treasury's strategic objectives to collect Federal tax revenue when due through a fair and uniform application of the tax law and to disrupt and dismantle the financial infrastructure of terrorists, drug traffickers, and to detect and deter other financial crimes. Total direct resources for Enforcement programs are \$6,892,596,000.

Examination (\$3,711,889,000) This activity supports the verification of information provided on tax returns as well as conducting audits at various levels of complexity. The IRS matches documents using computer databases which compare information reported on tax returns to information reported to the IRS by employers, banks and brokerage firms, ensuring the accuracy of tax returns. This activity also provides resources for tax auditors to conduct on-site examinations, for revenue agents to conduct business and corporate audits, and for cooperation with treaty partners and international organizations.

Collection (\$1,990,562,000) The collection activity provides resources to collect income tax due from all sources: individuals, small and large corporations, partnerships and the self-employed. Collection primarily occurs in field offices and compliance campuses. IRS uses a variety of approaches and techniques, including full payment demands, installment agreements, offers-in-compromise, liens, levies, bankruptcy procedures and property seizures.

Such activities may be related to correspondence, or notices, or may require litigation or more stringent collection efforts. Collection procedures help to ensure that the tax law is applied with integrity and fairness to all.

Investigations (\$767,418,000) Investigation funds the exploration of potential criminal violations of the tax laws in a manner that fosters confidence in the tax system. This function ensures the tax laws are applied with integrity and fairness to all. The major goal in a financial investigation is to identify and document the movement of money during the course of a crime. The link between the source of money, who gets it, when it is received and where it is stored or deposited, can provide proof of criminal activity. Resources are dedicated to combating abusive schemes and scams, curtailing fraudulent refund crimes, enforcing money laundering statutes, documenting financial transactions related to narcotics trafficking, dismantling the financial infrastructure of terrorists, exposing Bank Secrecy Act violations, and participating in various intra-governmental task forces. Beginning in FY 2006, this activity will also include organized crime and drug enforcement resources previously reimbursed by the Department of Justice.

Regulatory Compliance (\$264,855,000) The regulatory compliance activity provides resources for: the interpretation of and guidance on tax laws; the development of published guidance materials; the enforcement of regulatory rules, laws and approved business practices; and the monitoring of currency transaction reporting requirements for financial institutions. These resources also support the IRS' increased focus on offshore credit cards, abusive schemes, technical tax shelters and high-income taxpayers. This is accomplished through published guidance and acceleration of the issuance of notices identifying abusive tax avoidance transactions. Regulatory compliance protects the integrity of tax administration by resolving tax law issues before returns are filed. This increases taxpayer voluntary compliance and accelerates issue resolution.

Research (\$157,872,000) The research activity includes analyses of IRS-wide operations and performance, economic and demographic comparisons

related to taxpayer behavior, statistical evaluations of IRS' program activities and specialized studies in all areas of tax administration. This activity enables IRS and Treasury to access the necessary information to make decisions on tax policy and administration issues. Research ranges from multi-year studies to short-term program evaluations. In addition, this activity provides regular data sets to the Treasury Department, the Joint Committee on Taxation and other Federal agencies; publishes tax data for the general public; and provides research and reference tools for front-line IRS employees.

Business Systems Modernization (BSM)

Information Technology Investments (\$199,000,000)

The BSM appropriation provides resources for the planning and capital asset acquisition of information technology to modernize the IRS' business systems. Projects funded in FY 2006 include the Customer Account Data Engine, Modernized e-File, and Filing and Payment Compliance.

Health Insurance Tax Credit Administration (HITCA)

Health Care Tax Administration (\$20,210,000)

The Health Insurance Tax Credit Administration (HITCA) activity funds costs to administer a refundable tax credit for health insurance to qualified individuals.

Explanation of FY 2005 Current Estimate

The FY 2005 current estimate of IRS appropriations is a total of \$10,236,086,912. This is comprised of three appropriations:

- \$9,998,164,640 for Tax Administration Operations
- \$203,360,000 for Business System Modernization
- \$34,562,272 for Health Insurance Tax Credit Administration.

Explanation of FY 2006 Built-In Changes – Decreases

Tax Administration and Operations (TAO)

Savings from Increased Individual Master File (IMF) E-Filing – \$7,700,000/-190 FTE

These savings are based on the projected decrease in IMF paper returns and processing costs for electronically filed IMF returns

FY 2006 Budget Highlights

(Dollars in Thousands)

Appropriation	Tax Administration & Operations	Business Systems Modernization	Health Insurance Tax Credit Administration	Total
FY 2004 Enacted	\$9,762,024	\$387,699	\$34,794	\$10,184,517
FY 2005 Consolidated Appropriations	\$10,078,795	\$205,000	\$34,841	\$10,318,636
Rescission H.R. (4818)	(\$80,630)	(\$1,640)	(\$279)	(\$82,549)
FY 2005 Current Estimates	\$9,998,165	\$203,360	\$34,562	\$10,236,087
Current Services				
Adjustments to Base	\$331,457	(\$4,360)	(\$14,352)	\$312,745
Pay Inflation Adjustment	\$220,909		\$64	\$220,973
Non-Pay Inflation Adjustment	\$55,367		\$774	\$56,141
Transfer to TIGTA (FECA)	(\$201)			(\$201)
Adjustment for Full Costing of HITCA	(\$202)		\$202	\$0
Transfer from Justice	\$55,584			\$55,584
Business Systems Modernization		(\$4,360)		(\$4,360)
Reduce Health Insurance Tax Credit Administration			(\$15,392)	(\$15,392)
Base Re-Engineering	(\$230,096)			(\$230,096)
Taxpayer Service Re-Engineering	(\$134,103)			(\$134,103)
Savings from Increased Individual Master File (IMF) E-Filing	(\$7,700)			(\$7,700)
Consolidate Case Processing Activities to Maximize Resources Devoted to Front-Line Operations	(\$66,654)			(\$66,654)
Consolidate Insolvency Activities to Maximize Resources Devoted to Front-Line Operations	(\$14,928)			(\$14,928)
Detect and Deter Corrosive Corporate Non-Compliance	(\$6,711)			(\$6,711)
FY 2005 Current Services Level	\$10,099,526	\$199,000	\$20,210	\$10,318,736
Program Initiatives - Reinvestments	\$95,893			\$95,893
Increasing Returns Processing Efficiencies	\$7,600			\$7,600
Consolidate Case Processing Activities to Maximize Resources Devoted to Front-Line Operations	\$66,654			\$66,654
Consolidate Insolvency Activities to Maximize Resources Devoted to Front-Line Operations	\$14,928			\$14,928
Detect and Deter Corrosive Corporate Non-Compliance	\$6,711			\$6,711
Program Initiatives - Increases	\$264,632			\$264,632
Attack Corrosive Non-Compliance Activity Driving the Tax Gap	\$149,700			\$149,700
Detect and Deter Corrosive Corporate Non-Compliance	\$51,800			\$51,800
Increase Individual Taxpayer Compliance	\$37,900			\$37,900
Curtailing Fraudulent Refund Crimes	\$10,772			\$10,772
Combat Abusive Transactions by Special Tax Status Entities	\$14,460			\$14,460
FY 2006 President's Budget	\$10,460,051	\$199,000	\$20,210	\$10,679,261

in Submission Processing Centers. IMF e-filing rates rose from 31 percent in FY 2001 to 46.5 percent in FY 2004. The projected e-file rate in FY 2006 is 55 percent. In FY 2006, IMF paper return filings are projected to decrease by four million as a direct result of the increase in electronic filing.

Consolidate Case Processing Activities to Maximize Resources Devoted to Front-Line Operations - \$66,654,000/-649 FTE Case Processing activities support the IRS' examination, collection and lien processing programs. This initiative is a continuation of the project to consolidate the IRS' Case Processing operations currently performed

at over 86 field locations into four campus sites (Cincinnati, Memphis, Ogden and Philadelphia). These important processes will be standardized, efficiencies implemented and expertise enhanced to improve service to customers. Consolidation will ultimately allow improved response to peak demand and better management of the workload. (See offsetting program reinvestment under program initiatives.)

Consolidate Insolvency Activities to Maximize Resources Devoted to Front-Line Operations - \$14,928,000/-134 FTE Insolvency operations protect the government's interest in bankruptcy proceedings.

This initiative is a continuation of the project to consolidate administrative activities into the Philadelphia campus. The consolidation will retain professional employees in all existing offices while centralizing and standardizing clerical and para-professional processes. This effort will increase efficiencies, eliminate duplication of effort and provide clarity and convenience for taxpayers. Standardized workloads that correspond with appropriate job categories will provide improved work products with quality reviews. (See *offsetting program reinvestment under program initiatives*.)

Detect and Deter Corrosive Corporate Non-Compliance -\$6,711,000/-52 FTE By using improved issue management and risk assessment strategies for examining corporations, the IRS expects to realize productivity improvements for FY 2006. (See *offsetting program reinvestment under program initiatives*.)

Taxpayer Service Re-Engineering -\$134,103,000/-1,205 FTE IRS is working aggressively to improve productivity and achieve cost savings. Efforts such as expanded use of pay-for-performance incentives, legislative proposals to accelerate full growth, competitive sourcing and reducing dependence on walk-in taxpayer service will save \$134 million in taxpayer service programs in 2006.

Business Systems Modernization (BSM)

Business Systems Modernization Savings -\$4,360,000/0 FTE This reduction reflects a reduced portfolio of projects and scaled-back infrastructure and management activities associated with program-level operations.

Health Insurance Tax Credit Administration (HITCA):

Reduce Health Insurance Tax Credit Administration -\$15,392,000/0 FTE Costs for the HITCA program have declined since implementation due to the IRS' active program oversight and management and several cost-cutting initiatives currently in process since March 2004. A comprehensive action plan outlining cost reduction initiatives was developed and is being followed to achieve these savings. This plan

includes program improvements in customer service, reductions in information technology support, and space consolidation. The plan also includes protection of several key features of the program to assure continued delivery of high quality service while driving down program costs. For example, the plan assumes no extension of the current cycle for registration, maintenance of accurate and complete customer accounts, timely payments, and no increase in burden.

Explanation of FY 2006 Built-In Changes – Increases

Adjustments Necessary to Maintain Current Levels +\$276,913,000/0 FTE Funds are requested for pay raise and annualization of \$220,973,000 and non-labor items, \$56,141,000. It also includes a technical adjustment to Treasury Inspector General for Tax Administration (TIGTA) of \$201,000 for its share of unemployment costs currently funded by the IRS.

Transfer from the U.S. Department of Justice +\$55,584,000/+329 FTE The FY 2006 budget transfers the IRS' portion of the Interagency Crime and Drug Enforcement (ICDE) appropriation from the Department of Justice in FY 2006. Of this amount, \$53,913,000 is the 2005 enacted level transferred from Justice and \$1,671,000 is for maintaining current levels.

Explanation of FY 2006 Program Changes

Program Initiatives – Base Reinvestments

Increase Returns Processing Efficiencies +\$7,600,000/+12 FTE This initiative reinvests savings realized from processing efficiencies to enable the IRS to continue its consolidation of Individual Master File (IMF) returns processing into fewer Submission Processing sites. Funds will cover the costs associated with the ramp-down of the Memphis Submission Processing Site and include staff separation costs (e.g., buyouts and severance pay), real estate restacking costs, equipment and furniture relocation and costs related to information technology equipment. The IRS initiative to increase electronic filing will continue to have a significant impact on Submission Processing Centers as IMF paper volumes decline.

Consolidate Case Processing Activities to Maximize Resources Devoted to Front-Line Operations +\$66,654,000/+585 FTE This reinvestment is a continuation of the FY 2005 project to consolidate case processing activities. These resources are necessary to cover costs to consolidate front-line resources from 86 field locations to four campus sites. (See *offsetting program reductions under initiative decreases*.)

Benefits from the centralization of Case Processing operations will occur in FY 2006 and years forward. The reduced staffing levels necessary to maintain case processing in a centralized environment will create resource savings for redirection to front-line enforcement activities in FY 2006.

Consolidate Insolvency Activities to Maximize Resources Devoted to Front-Line Operations +\$14,928,000/+156 FTE This reinvestment is a continuation of the FY 2005 project to consolidate insolvency activities. This reinvestment initiative provides the required resources to centralize the Insolvency administrative processes. (See *offsetting program reductions under initiative decreases*.)

Benefits from centralizing Insolvency administrative functions will occur in FY 2006. Benefits include improved taxpayer service through the creation of a toll-free telephone service to answer questions from taxpayers who have filed or are contemplating filing bankruptcy. Hours of service will be extended to both taxpayers and employees, because the centralized site will operate day and swing shifts. This initiative will also provide taxpayers with a single point of contact for mail processing.

Detect and Deter Corrosive Corporate Non-Compliance +\$6,711,000/+52 FTE This initiative reinvests savings resulting from improved issue management and risk assessment strategies for examining corporations to fund front-line enforcement activities. This reinvestment will provide a pipeline of skilled and knowledgeable agents for addressing complex, high-risk issues, tax shelter promoter compliance and ensuring compliance among tax professionals. (See *offsetting program reductions under initiative decreases*.)

Program Initiatives – Increases

Attack Corrosive Non-Compliance Activity Driving the Tax Gap +\$149,700,000/+920 FTE The concern over the proliferation of abusive trusts and shelters, including offshore credit cards and organized tax resistance, require new and innovative approaches to combat noncompliance. Traditional approaches aimed at maintaining audit coverage and managing growing case inventories have failed to adequately address the complex enforcement issues associated with high-income individuals who use structured transactions to conceal tax liability and avoid payment of taxes owed. The increasingly global economy requires that the IRS devise strategies to assure that the worldwide revenues due the United States are assessed and collected. Audit closures by tax compliance officers will increase by approximately 3,000 units, and correspondence examiner hires will expect to close an additional 25,600 audits.

This enforcement initiative provides resources to increase coverage of the growing number of high-risk compliance problems and to address the largest portion of the tax gap – the underreporting of tax. The initiative includes a funding increase across all major domestic and international compliance programs to leverage new workload selection systems and case building approaches from continuing reengineering efforts.

This initiative will contribute to reducing reporting noncompliance by providing personnel to bolster coverage and presence in this area. Increased staffing will also provide enhanced compliance coverage of approximately 4.6 million Americans living abroad.

Detect and Deter Corrosive Corporate Non-Compliance +\$51,800,000/+236 FTE This initiative will allow the IRS to address complex, high-risk issues in abusive tax avoidance transactions, promoter activities, corporate fraud and aggressive domestic and off-shore transactions, resulting in increased corporate and high-income audit coverage and audit closures. This initiative strengthens enforcement and corporate governance for the largest corporate taxpayers by providing resources to combat corrosive non-compliance. It will enable the Service to attack complex abusive tax avoidance transactions on a global

basis and to challenge those who promote their use. Additionally, critical post-filing support provided by outside experts will facilitate increased resolution of issues at the field examination level, reducing taxpayer burden and increasing the credibility of the Service's positions on the most complex and potentially highest compliance impact issues sent to court.

Increase Individual Taxpayer Compliance +\$37,900,000/+417 FTE This initiative will bolster enforcement presence to address widespread concerns regarding the continued growth in non-compliance reported by the Treasury Inspector General for Tax Administration (TIGTA), the General Accounting Office (GAO), Congress and the media. It is comprised of four components aimed at addressing the tax gap: identifying and implementing actions to address non-compliance with filing requirements; increasing Automated Underreporter resources to address the reporting compliance tax gap; increasing audit coverage; and expanding collection work in Taxpayer Assistance Centers (TACs). The IRS expects to increase audit coverage by 81,800 cases and increase the verification of income through information matching by 362,000 cases.

Combat Abusive Transactions by Entities with Special Tax Status +\$14,460,000/+77 FTE This initiative strengthens the IRS' ability to address its strategic objective to deter tax avoidance of tax-exempt and governmental entities. The tools and resources funded by this initiative will improve the Service's ability to identify compliance risks and significantly expand coverage of regulated communities. Improved access to information will help focus on the most egregious cases of non-compliance and identify compliance risks sooner, reducing burden on compliant customers and enabling the development of new interventions to curtail the growth of abusive transactions.

Funding for this initiative will support the following activities: initiating examinations more promptly after the detection of a risk and equipping agents with better information prior to their first contact with taxpayers; safeguarding compliant customers from unscrupulous promoters through earlier detection of abusive schemes and heightened efforts to prevent their proliferation; and increasing vigilance to ensure that the assets of tax-exempt organizations are put to their intended tax-preferred purpose and

not misdirected to fund terrorism or for private gain, including enhanced processing of questionable exemption applications and increased technical support to the examination process. The IRS estimates an additional 1,050 cases will be closed.

Curtailing Fraudulent Refund Crimes +\$10,772,000/+22 FTE This initiative allows the IRS to attack questionable refunds and return preparer fraud identified through expanded operations of the Fraud Detection Centers located on IRS campuses. Fraudulent refund schemes are one of the most serious threats to voluntary compliance and an IRS investigative priority. The number of false claims for refunds has tripled since 2000 and is expected to again double by 2008. Additional investigative resources are needed to combat this threat. In addition, access to the Department of Health and Human Services' National Directory of New Hires will be used to more efficiently identify fraudulent refund crimes. This will reduce taxpayer burden by releasing legitimate refunds promptly, streamline the investigative process and ensure the integrity of the tax system.

The IRS estimates to initiate twenty new subject criminal investigations in FY 2006 and close four of these cases within the year.

Legislative Proposals

The proposals below reflect the IRS' ongoing effort to manage the agency efficiently and effectively. They reshape the IRS workload by: 1) allowing the IRS to concentrate its resources on high-income, high-risk areas; 2) automating a number of routine actions; 3) consolidating resources related to judicial and counsel review; 4) using electronically available data and resources to reduce manual actions; and 5) broadening administrative authorities and accesses to support further electronic administration and tax reform.

- Make Section 1203 of the IRS Restructuring and Reform Act of 1998 more effective and fair.
- Curb the use of frivolous submissions and filings made to impede or delay tax administration.
- Allow for the termination of installment agreements for failure to file returns and for failure to make tax deposits.

- Consolidate judicial review of collection due process cases in the United States Tax Court.
- Eliminate the monetary threshold for counsel review of offers in compromise
- Allow the Financial Management Service to retain transaction fees from levied amounts to recover delinquent taxes.
- Extend the due date for electronically filed returns to provide additional incentive for taxpayers to e-file and expand the authority to require electronic filing by businesses and exempt organizations.
- Allow IRS to access information in the National Directory of New Hires for tax administration purposes.



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