

**INTERNAL REVENUE SERVICE
ADVISORY COUNCIL**

REPORT TO THE COMMISSIONER

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GENERAL REPORT OF THE INTERNAL REVENUE SERVICE ADVISORY COUNCIL

INTRODUCTION

The purpose of the Internal Revenue Service Advisory Council (hereinafter “IRSAC” or the “Council”) is to provide an organized public forum for discussion of relevant tax administration issues between Internal Revenue Service (hereinafter “IRS” or the “Service”) officials and representatives of the public. Membership on the IRSAC for the year ending 2002 consists of twenty-four individuals who bring a wide breadth of experience, disparate expertise, and diverse backgrounds to bear on the Council’s activities.

The IRSAC has organized itself into three subgroups, corresponding to three of the four IRS’ Operating Divisions: the Large & Mid-Size Business Subgroup (hereinafter the “LMSB Subgroup”); the Small Business/Self-Employed Subgroup (hereinafter the “SBSE Subgroup”); and the Wage & Investment Subgroup (hereinafter the “W&I Subgroup”). The reports of these subgroups that follow this general report are a result of three working sessions held in Washington during the year and numerous conference calls between IRSAC members and key IRS personnel. The members of the IRSAC would like to thank representatives of the Service for their time and commitment to the work of the Council. Special thanks must go to the staff of the Office of National Public Liaison for ensuring that Council members had the resources necessary to function properly as an advisory body.

This year, for the first time, members of the IRSAC attended the four mega-sites of the IRS Nationwide Tax Forums: Atlantic City; Atlanta; New Orleans; and Reno. Together with representatives of the Information Reporting Program Advisory Committee (hereinafter “IRPAC”), IRSAC members participated in focus groups intended to gather input from the practitioner and taxpaying communities with respect to issues the Council is and/or should be considering. We found that not only did our attendance

heighten Council members' awareness regarding problematic issues encountered by practitioners, but further, our attendance increased practitioner and taxpayer community awareness regarding the existence of and work performed by advisory groups such as the IRSAC. Accordingly, the IRSAC recommends that the Council's participation in the Nationwide Tax Forums continue in the future.

ISSUE ONE: ADEQUATE FUNDING

The IRSAC has strongly supported the need for consistent and adequate levels of funding for purposes of enabling the IRS to implement its programs. We again provide that support. The workload of the Service continues to increase each year. While the recently completed reorganization will help manage the increasing workload, only an increase in resources will permit the IRS to truly keep pace. Further, the IRSAC believes that the IRS must continue to improve its technology and increase its full-time staff to operate effectively.

The Service will continue to face difficult decisions with respect to allocating limited resources as between the compliance and service functions. While we recognize the importance of service to taxpayers, we believe that increased compliance efforts are critical to the proper functioning of our voluntary tax system. The IRSAC recommends that resource allocation decisions focus on ensuring that the compliance efforts of the IRS are maximized.

ISSUE TWO: K-1 MATCHING

The K-1 Matching Program has been a focal point of the work of this year's IRSAC. The IRSAC strongly supports the development of a K-1 Matching Program, believing such a program to be necessary. However, the IRSAC likewise believes that a K-1 Matching Program should not increase taxpayer/practitioner burden or needlessly consume precious IRS resources. While results from the compilation of K-1 matching data are not yet complete, the IRSAC believes that a matching program should focus on taxpayers who have omitted K-1's from their returns. Further, the IRSAC believes that an effective

matching program can be devised without imposing undo burdens on any party. If, however, the compiled data results indicate the need for a more extensive program, the IRSAC believes that the IRS should include representatives from all effected stakeholder groups in the design of such a paradigm.

The IRSAC was disappointed that the IRSAC K-1 Task Force recommendations included in our last Public Report were not considered (K-1 Task Force Report attached herein as Exhibit A), noting in particular the critical importance that attached to ensuring a viable K-1 Matching Program - before implementation - to avoid erosion of IRS' credibility. However, recent discussions with IRS executives have been straightforward and open. Members of the IRSAC were invited to visit the Ogden Service Center for the purpose of reviewing and discussing K-1 Matching Program operations with front-line employees having responsibility for administering the program. The openness of those discussions and the dialog that currently exists between the IRSAC and IRS executives demonstrate the sincere desire of all parties to create a viable, effective, properly administered program.

For purposes of emphasis, the IRSAC must restate its support for a viable, equitably administered K-1 Matching Program that does not impose undo burdens on any party or needlessly consume limited IRS resources. The SBSE Subgroup Report attached herein addresses the issues underlying the K-1 Matching Program in detail.

ISSUE THREE: THE NATIONAL RESEARCH PROGRAM

The IRSAC would like to offer its support for the National Research Program (hereinafter "NRP") that will begin this year. While most people recoil at so much as the thought of an audit, such exams are nevertheless a necessity if the integrity of our voluntary tax system is to survive. Accordingly, as long as audits are necessary, the selection of returns for examination is critically important given the limited resources that give rise to IRS' decisions with respect to how such resources will be allocated. As has been said by others before us, the IRSAC believes this program makes good business sense.

To date, the IRSAC has been briefed on the extensive planning that has gone into developing the NRP. It is apparent that a great deal of work has been done to ensure that the program yields contemplated results. As of our last meeting, the training program designed for the cadre of hand-selected auditors who will conduct NRP audits had just begun. Proper training, implementation, and communication are critical for this program to succeed. Members of the IRSAC were pleased to learn that representatives from external practitioner groups participated in training these IRS' auditors. The solicitation of external stakeholders' assistance with this training program demonstrates the importance placed on making the NRP a success within the IRS. The Council will continue to monitor this program as implementation begins in the field, and anticipates providing commentary on the progress of the NRP in its next report.

ISSUE FOUR: THE FILING SEASON AND ELECTRONIC FILING

The IRSAC is pleased to report that the past filing season appears to have gone well, and is particularly pleased to note the increase in electronic filing. While electronic filing numbers are encouraging, the Congressional mandate that eighty percent of all returns be electronically filed by fiscal year 2007 will not be met at the current rate of increase. The IRSAC hopes that the IRS will continue to work with external stakeholders, particularly practitioner groups, to accelerate electronic filing at rates that will reach the Congressionally mandated goal. The IRSAC believes that efforts focused on practitioners and practitioner groups will yield greater benefits than efforts directed at motivating/incentivizing individual taxpayers. As we look at programs such as K-1 Matching, it is readily apparent that increased electronic filing will facilitate more effective IRS' operations. Accordingly, the IRSAC looks forward to partnering with the IRS in the coming year to effect changes that will help reach this important goal.

CONCLUSION

The 2002 IRSAC is the last Council to have had the pleasure of working with Commissioner Rossotti. The Commissioner has always been accessible to IRSAC members and has unfailingly encouraged

us to provide honest input. We have also had the opportunity to personally view the improvement his leadership has made in the performance of the Service. A common theme emanating from virtually everyone is that the IRS is a much better organization today than it was five years ago. Much of the credit for this improvement goes to Commissioner Rossotti and his leadership. We would like to thank Commissioner Rossotti on behalf of the IRSAC, IRS employees, and all taxpayers for his leadership, vision, and dedicated service these past five years. The Commissioner will be sorely missed and we wish him and his family the best in the coming years.