

Statement of  
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On behalf of the  
Internal Revenue Service Advisory Council (IRSAC)  
IRS Oversight Board Hearing  
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Panel 1: Strategic Planning: Where Is the IRS Headed Over the Next Five Years?

Good afternoon. My name is Tracy Hollingsworth, Director of Tax Affairs for the Manufacturers Alliance/MAPI. I appear today as Chair of the Internal Revenue Service Advisory Council (IRSAC). On behalf of the IRSAC, I appreciate the opportunity to share in discussions about strategic plans for IRS over the next five years.

IRSAC advises the Internal Revenue Service (IRS) on tax administration policy, programs, and initiatives. Conveying the public's perception of IRS activities to the Commissioner and the Service as a whole, the Council comprises individuals who bring substantial, disparate experience and diverse backgrounds to the Council's activities. Membership is balanced to include representation from the taxpaying public, the tax professional community, small and large businesses, state tax administration, and the payroll community.

The Service's strategic plan for 2000-2005 described three broad goals that continue to be relevant:

- Top-quality service to each taxpayer in every interaction
- Top-quality service to all taxpayers through fair and uniform application of the law

- Productivity through a quality work environment.

In pursuing these goals, Commissioner Everson has indicated that he is emphasizing service, modernization, and enforcement. The IRSAC in its public report this fall expressed agreement with the Commissioner's goals and priorities. IRSAC believes that efforts must be made to enhance enforcement and to assure taxpayers that all are being treated equally and all are paying their fair share. IRSAC commends Commissioner Everson for recognizing the need to find a proper balance between service and enforcement.

The group did offer one cautionary note that the "e" word must be used with care lest the IRS create the impression that it is returning to the "old" ways that led to the Restructuring and Reform Act of 1998. That said, we do recognize that compliance improves when the public is aware that there is a real risk that underreporting will be detected. Moreover, the Service might want also to publicize that the majority of taxpayers do conscientiously meet their federal tax obligations, even when the complexity of the tax law makes that a challenge.

IRS statistics show and a September 2002 assessment report to this Board highlights that audit coverage rates across all categories of taxpayers plummeted in recent years. It goes almost with out saying that low levels of audit coverage promote noncompliance. One theme that emerges from the September report and from the IRSAC public report is that IRS must continue to hone its risk assessment and containment skills. As the September 2002 report pointed out, the IRS does not have the resources to attack every case of noncompliance. Instead, it must focus resources where the risk of noncompliance is the greatest while maintaining adequate coverage generally.

Business systems modernization (BSM) offers an important key to effective risk management. At one level, it allows IRS to shift resources from processing paper to providing service and

enforcement (IR-204-03). At another, higher level, BSM should assist the IRS in risk assessment activities—identifying the taxpayers and the issues that should be examined, spotting compliance trends, and focusing in on specific categories of transactions. As an example, the ability to generate an organization chart of linked pass-through entities using tax identification numbers would assist an auditor in determining her audit plan.

The National Research Program (NRP) that is now underway will provide data that the Service will use in identifying individual returns that present compliance risks. Plans are underway to conduct separate NRP projects for pass-through entities and for corporations. As is pointed out in the IRSAC public report, great care must be devoted to designing NRP projects and to ensuring that the revenue agents who participate are well trained. The potential benefits of these programs are great, particularly when combined with the promise of BSM. Screening returns electronically for the criteria developed under NRP should allow the IRS to apply its audit resources more effectively.

In the past two years, the IRS has begun to use new tools to attack high-risk compliance exposures. The multi-pronged corporate tax shelter compliance initiative has virtually shut down abusive transactions in larger companies. It is slowing them at mid-size companies. Similar efforts with respect to trusts and offshore accounts and underreporting by higher-income individuals are bearing fruit. The combination of guidance, publicity, and enforcement is a model that the IRS can apply to other areas of compliance concern. The IRSAC believes that all the Operating Divisions should be challenged to identify high risk areas and develop innovative techniques to identify and deter noncompliance.

Two techniques the Service used effectively are worth highlighting—vigorously seeking out the promoters and advisors and educating taxpayers about schemes and problematic transactions. Going

directly to the promoters chills their practices and provides a road map to the taxpayers who used the techniques they promoted. This approach should be extended to other areas where preparers and promoters take advantage of taxpayers by, for example, persuading them to over claim benefits. Members of the IRSAC were very disturbed by reports of taxpayers who have been victimized by EITC promoters. Taxpayers need to be protected from the purveyors of schemes. Moreover, they need to be educated through guidance and public notices about the risks of some of these schemes and their compliance obligations.

The Taxpayer Advocate in her annual report to Congress recommended that IRS should enhance its oversight of preparers, and we agree with this goal. She, also, suggested that IRS should provide a mechanism for taxpayers to file complaints about preparers and should conduct research on problems and compliance risks associated with return preparers.

The IRSAC for many years has recommended that the IRS receive adequate funding. The September, 2002 report states, “We are winning the battle, but losing the war.” This he attributes to an imbalance in the size and complexity of the tax system relative to the size of the Service, which has declined in recent years. The report argues that addressing this imbalance—winning not the battle, but the war—means 2 percent annual net increases in IRS staffing over five years. It also means adequately funding computer modernization programs. IRSAC welcomes the Treasury Department announcement on January 13, 2004 that the President’s FY 2005 Budget proposes to increase the total IRS budget by 4.8 percent to \$10.674 billion (JS-1096). It also would provide an installment of \$285 million for business systems modernization.