

**Written Statement of
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Before the

**Subcommittee on Transportation, Treasury, the Judiciary, Housing
and Urban Development, and Related Agencies**

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Mr. Chairman, Ranking Member Murray, and distinguished Members of the Subcommittee:

Thank you for inviting me to testify today regarding the proposed budget of the Internal Revenue Service for Fiscal Year (FY) 2007.¹

The overriding objective of the Internal Revenue Service should be to maximize voluntary compliance with the tax laws. In general, the IRS seeks to achieve compliance through two main types of activity. First, it seeks to enable taxpayers to comply with their tax obligations voluntarily. In most cases, outreach, education, and taxpayer assistance are sufficient to produce complete or substantial compliance. Second, it targets its enforcement resources at taxpayers who are unwilling to comply with the tax laws.

While a variety of measures can be applied to measure the IRS's performance, one of the best measures is the percentage of taxes that taxpayers pay voluntarily. The IRS's most recent estimate of the gross tax gap (*i.e.*, the amount of tax unpaid before accounting for late payments and collection activity) was \$345 billion in tax year 2001, which implies a compliance rate of 83.7 percent.² The IRS recently established a long-term performance goal of increasing the compliance rate to 85 percent by 2009.³ In my view, this is a laudable goal.

What steps is the IRS currently taking to maximize voluntary compliance? What additional steps should it take? Can the IRS do more to reduce the tax gap without intruding unduly on fundamental taxpayer rights? These are the key questions I would ask in determining whether the IRS is making optimal use of its resources.

In many respects, the IRS is doing a better job of performing its core mission than it did in years past. By the IRS's current objective measures, it is providing customer service at a much higher level than it did a decade ago. On the enforcement side, it is performing more audits and aggressively pursuing corporate tax shelters and noncompliance by high-income individuals. However,

¹ The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. The statute establishing the position directs the National Taxpayer Advocate to present an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Accordingly, Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

² See IRS News Release IR-2006-28, *IRS Updates Tax Gap Estimates* (Feb. 14, 2006).

³ Office of Management and Budget, Proposed Budget of the United States Government for FY 2007, at 232.

the IRS's existing measures do not adequately capture costs associated with the "downstream consequences" of its programs and planning.⁴

To improve, the IRS must conduct an analysis of downstream consequences, including their impact on taxpayer service, and incorporate the results of that analysis into its strategic plans. Without adequate analysis of the downstream consequences of its options, the IRS cannot make informed strategic decisions about how to allocate resources between taxpayer service and enforcement activities and cannot tell its appropriators that it is using its limited resources wisely. Moreover, problems with IRS technology create additional downstream consequences. The IRS must be funded sufficiently to correct problems *now* with its *existing* technology – while it simultaneously strives to modernize its computer systems.

In the balance of my testimony, I will identify key issues I believe the IRS should address to get the biggest compliance bang for its buck.

The IRS Could Do a Better Job of Allocating Its Resources Properly in Order to Increase Overall Compliance

Over the last three years, in hearings before the Senate Finance, Budget, and Homeland Security and Governmental Affairs committees, I have testified about ways to close the tax gap, both by reducing opportunities for noncompliance and by enhancing traditional enforcement actions.⁵ In the National Taxpayer Advocate's 2005 Annual Report to Congress, I discussed in detail what the IRS can do administratively and what Congress can do legislatively to address the "cash economy," which is the largest component of the tax gap.⁶

The question remains, however, whether the IRS is focusing its resources in the right direction to close the tax gap. The answer to that question depends, in part,

⁴ By "downstream consequences," I mean the cost of additional work that IRS or taxpayers must perform to correct problems or mistakes that result from an IRS action or failure to take an action. For example, inadequate taxpayer service may lead to inadvertent taxpayer noncompliance, limitations of IRS computer systems may lead to IRS rework and direct harm to taxpayers, and inadequate communication with taxpayers during the audit process may result in rework via audit reconsideration or work performed in Appeals or the Taxpayer Advocate Service.

⁵ See Written Statement of Nina E. Olson, National Taxpayer Advocate, Before United States Senate Committee on the Budget on The Causes of and Solutions to the Federal Tax Gap (Feb. 15, 2006); Written Statement of Nina E. Olson, National Taxpayer Advocate, Before the United States Senate Committee on Homeland Security and Governmental Affairs Subcommittee on Federal Financial Management, Government Information, and International Security (Oct. 26, 2005); Statement of Nina E. Olson, National Taxpayer Advocate, Before the United States Senate Committee on Finance on the Tax Gap (April 14, 2005); Testimony of Nina E. Olson, National Taxpayer Advocate, Before the Senate Committee on Finance on The Tax Gap and Tax Shelters (July 21, 2004).

⁶ National Taxpayer Advocate 2005 Annual Report to Congress 55-75, 381-396. See also National Taxpayer Advocate 2004 Annual Report to Congress 478-489; National Taxpayer Advocate 2003 Annual Report to Congress 20-25, 256-269.

on how we measure success. Is the IRS's goal merely to increase enforcement revenues? Or is the goal to increase compliance? Or is it to increase *voluntary* compliance?

As I noted above, approximately 83.7 percent of the tax dollars known to be due and owing are voluntarily paid to the IRS. That figure is an IRS success, in and of itself. Now, what more can we do to achieve compliance with respect to the remaining 16.3 percent of the tax dollars for which taxpayers need some "nudging" to pay up? What types of "nudging" should the IRS apply? What resources does the IRS need to help these taxpayers comply or, in some instances, make them comply? The answers to these questions should inform the IRS's resource allocation decisions.

The IRS is properly focused on increasing its traditional enforcement resources, since some taxpayers won't comply unless they are "helped" in that way. The IRS also needs an enforcement presence so that taxpayers are a bit nervous about fudging – or worse – on their taxes. Yet, although we may want slightly "nervous" taxpayers, we don't want them intimidated. That is, when taxpayers have a problem or a question, we *want* taxpayers to call the IRS so they will not make mistakes and join the ranks of noncompliant taxpayers. Every time a taxpayer calls the IRS or visits a taxpayer assistance center (TAC), the resulting interaction gives the IRS an opportunity to help that taxpayer comply with the tax laws. Why would we try to minimize these opportunities and not make positive use of them when they occur?

In my view, then, the real challenge facing the IRS is determining how to allocate its resources to increase overall compliance, including voluntary compliance, and determining what actions it must take – whether service or enforcement – to increase the number of taxpayers who voluntarily comply. In order to answer these questions, we must start with an understanding of taxpayer service needs – not what the *IRS* is willing or able to provide taxpayers, but what the *taxpayer* needs to have provided or available. The IRS mantra should be "know your taxpayer."

The IRS Should Understand More About the Impact of Taxpayer Service on Compliance and the Ways in Which Taxpayers Need Services to be Delivered

It is true that the IRS has improved its delivery of many aspects of taxpayer service over the last decade. However, we cannot just rest on this improvement and say that we are doing "good enough." The IRS's central responsibility is to ensure that taxpayers comply with the tax laws. In fulfilling that responsibility, the IRS must provide taxpayers with the service, assistance, and education they need to comply. What we must consider now is just what level of service, assistance, and education is necessary for compliance.

I define taxpayer service very broadly – it includes notice clarity, tax law assistance, account resolution, free tax preparation, free e-filing, short response time, clear forms, and excellent education initiatives. This broad definition of taxpayer service makes clear its impact on compliance. Where noncompliance is attributable to complexity or confusion, for example, better forms, notices, and education initiatives can reduce the need for enforcement action.

Acknowledging the impact taxpayer service has on compliance, Congress directed the IRS, its Oversight Board, and the National Taxpayer Advocate to develop a 5-year plan for taxpayer service that includes long-term goals that are strategic and quantitative and that balance enforcement and service.⁷ I have previously voiced my concerns about the IRS's need to study the trends in taxpayer service in order to understand the impact of taxpayer service on compliance and how taxpayers need services to be delivered.⁸

The IRS is facing a challenge. It has a responsibility to serve all taxpayers with limited resources. Thus, it must decide by taxpayer segment how to deliver needed services in the most effective and efficient manner possible, and in a way that does not negatively impact taxpayers' ability to comply with the tax laws. Toward this end, the IRS must gather data and develop criteria to make those decisions. The recently released report on Phase I of the Taxpayer Assistance Blueprint (TAB) is the first step toward developing a comprehensive five-year plan for taxpayer service that will establish a long-term strategy for delivering needed taxpayer services within existing resource limitations.

In Phase I, we gathered both primary and secondary data about taxpayer needs and preferences. We also collected some information about our current level of services offered to taxpayers. From this and other information, we developed five hypotheses or "themes" that we think will improve service to taxpayers. However, Phase I is only the beginning. Phase II of the TAB will be even more critical because the goal of Phase II should be to test those hypotheses. To determine whether any of the hypotheses is correct, we must collect more primary source data about taxpayer service needs. We must then identify the gaps between taxpayer service needs and our present service offerings by analyzing how well our current level and type of service is actually serving different taxpayer segments. We will then see whether our hypotheses would improve service to different taxpayer segments.

⁷ S. Rep. No. 109-109, at 133-134 (2005).

⁸ Statement of Nina E. Olson, National Taxpayer Advocate, Before the United States House Appropriations Subcommittee on Transportation, Treasury, and Housing and Urban Development, the Judiciary, District of Columbia, and Related Agencies (March 29, 2006); National Taxpayer Advocate 2005 Annual Report to Congress 2-24; Statement of Nina E. Olson, National Taxpayer Advocate, Before the United States Senate Appropriations Subcommittee on Transportation, Treasury, the Judiciary, Housing and Urban Development, and Related Agencies (Apr. 7, 2005).

I applaud the dedicated work of the IRS team that has labored over this strategic plan and gathered important information over the last five months. While we embark on the next phase of the TAB, we must focus on a number of areas that could have significant impact on Congressional or IRS decisions about service delivery to taxpayers.

We must develop a baseline of services. This baseline should consist of specific numbers addressing how well the IRS is currently meeting customer service preferences and needs by service, taxpayer segment, and delivery method. Although the TAB Phase I report states that the current baseline of taxpayer services is one item on which the strategic improvement themes of the report are predicated, I do not believe this statement is completely accurate. Throughout the TAB Phase I report, we examine the current usage and volume of current IRS services. However, these current usage statistics do not serve as a proxy for taxpayer preference. We cannot assume that the current level of service reflects taxpayer preferences. The *status quo* is not necessarily what taxpayers want – it is merely what the IRS has been willing (or able) to deliver. Instead, during Phase II, we must conduct research to develop this baseline of services. Only after this research is completed will we be able to measure how effective we are in improving our ability to meet taxpayer needs.

We must identify what we don't know. Before we can move forward with our research in Phase II, we need to understand what we still need to know and what questions we need to ask in order to find the right answers. It is important that the TAB not rely on pre-conceived decisions, but instead identify what we are doing now, what we still do not know about taxpayer needs, and what we need to do to address those needs or educate taxpayers and move them to other channels.

We must identify the best channels through which to deliver services to taxpayers. While electronic and self-assistance channels may be growing in popularity, mere use or access to these services does not necessarily mean that taxpayers are able to frame questions, conduct complex searches, and process or use the information correctly. Additionally, we must always remain cognizant that there is a segment of the population that cannot and will not avail itself of self-service options. However, by providing more self-service opportunities for taxpayers, the IRS should be able to reserve its in-person (face-to-face or telephone) interaction for those issues and taxpayers that need such engagement.

Thus, as part of the TAB, the IRS must commit to conduct – or at least to attempt to conduct – the additional research necessary to enable it to establish a broad baseline identifying how well taxpayer needs and preferences are currently being met for each of the major types of services by customer segment and channel – and to quantify the impacts associated with not meeting those needs (*i.e.*, the downstream costs and taxpayer-compliance impact). Moreover, we need to

understand why certain taxpayer segments have difficulties with our various types of services and why they are reluctant to use lower cost channels (if indeed they are). Only then can we develop effective “migration” strategies to encourage and educate taxpayers about appropriate lower cost channels – ones that will not ultimately increase noncompliance and lead to greater downstream costs.

For example, it is true that computer ownership and Internet access have increased over the last decade.⁹ But those numbers do not necessarily mean that the computer owner is computer literate and can conduct site searches for complex tax information, much less understand how to apply that information once he finds it. In fact, in the financial services sector, banks have reversed the trend of closing branches in the hope of moving taxpayers to Internet banking.¹⁰ Instead, they are developing migration strategies for customers to complete certain types of transactions on-line or by phone, and are retaining their in-person services for more complicated transactions or for those customers who really cannot navigate the phones or Internet. Banks are certainly not turning those customers away, and now recognize that those customer segments are a relatively untapped market in need of services. There are lessons here for the IRS.

The IRS Should Work with “Partners” But Not Rely on Them Excessively

The IRS is increasingly relying on partners to deliver core IRS services. Clearly, partners are very important to effective tax administration, and I applaud the efforts of dedicated professionals and volunteers in assisting taxpayers. However, this reliance raises several concerns. First, when the IRS relies on partners to deliver a message, we need to study what happens to the message in the course of delivery. Does the message change over distance and time? Is it less accurate? The worst result is a broad dispersion, through partners, of an incorrect or distorted message. Second, we need to measure the downstream consequences of this trend. What are the true costs of effective oversight over these partners? Who conducts such oversight and bears the cost? If taxpayers bear the cost, will they continue to comply if the cost is too great or the quality too poor? Will the IRS actually realize any savings or will it incur more expense through additional enforcement activity that could be avoided if the IRS itself delivered the assistance?

On the other hand, if we begin to rely more heavily on our partners for the delivery of services, we must also ensure that we are providing our partners with adequate support and assistance. Without a sufficient support system in place,

⁹ Internal Revenue Service, Wage and Investment Office of Research, *Taxpayer of the Future* (June 2003), 11.

¹⁰ Bruce C. Smith, *In Age of Online Banking, Lenders Branch Out*, Indianapolis Star (Oct. 2, 2005), available at <http://www.indystar.com/apps/pbcs.dll/article?AID=/20051002/BUSINESS/510020335>.

we cannot expect our partners to act as a delivery channel for services we are unable or unwilling to provide.

Finally, we don't know what the impact on compliance or what the downstream cost will be if most of the IRS's direct contact with taxpayers is in the form of enforcement actions and most taxpayer assistance and service is delivered by third parties. As the IRS becomes more remote, except with respect to enforcement actions, will noncompliance increase because taxpayers feel less connection with their government?¹¹

The IRS Should Not Impose Unreasonable Burdens on Volunteer Income Tax Assistance (VITA) Programs

As the IRS struggles with the challenge of serving all taxpayers with limited resources, we have already begun to reduce free tax preparation assistance previously provided to taxpayers. Over the past three years, the IRS has reduced the number of tax returns prepared in Taxpayer Assistance Centers (TACs) from 665,868 tax returns in FY 2003 to a proposed 305,000 tax returns in FY 2006.¹² Instead, the IRS has increased its reliance on the Volunteer Income Tax Assistance (VITA) Program to fill the gap and provide free tax preparation assistance to taxpayers.¹³ As IRS service has decreased, the VITA Program continues to expand. However, this expansion may have come too fast.

The VITA Program provides a vital service to an underserved segment of taxpayers, but there are limits to what volunteers and volunteer-staffed organizations can do. Although there are a number of successful volunteer organizations around the world, hallmarks of these success stories are that they are year-round organizations supported by a large, paid infrastructure dedicated to the support of the volunteers. The VITA Program primarily operates for four months during the tax season and receives limited resources and support from

¹¹ See Leslie Book, *The Poor and Tax Compliance: Once Size Does Not Fit All*, 51 Kan L. Rev. 1145, 1151, 1175-1176 (2003). Professor Book discusses various studies that note that enforcement may be more effective in addressing intentional noncompliance where the taxpayer segment is disaffected from government and society at large. On the other hand, "taxpayers who felt a shared identity with authorities seem to be more concerned with the overall justice of the tax system and the fairness of their treatment, regardless of individual outcome." *Id.* at 1151 n. 21.

¹² Wage and Investment, *Business Performance Review, Wage and Investment Operating Division, FY 2006*; Wage and Investment, *Business Performance Review, Wage and Investment Operating Division, FY 2005*; Wage and Investment, *Business Performance Review, Wage and Investment Operating Division, FY 2004*; Wage and Investment, *Business Performance Review, Wage and Investment Operating Division, FY 2003*.

¹³ The VITA Program was designed to provide free tax preparation to individuals who are unable to afford professional assistance. Stakeholder Partnerships, Education and Communication, *VITA Celebrates Its Thirtieth Year of Service*. VITA is a diverse program comprising several segments, including community-based VITA, academic VITA, military VITA, Tax Counseling for the Elderly (TCE), and co-located VITA, each serving a different taxpayer population.

the IRS. This makes it hard to ensure quality and consistency in the returns prepared at VITA sites.

While the service VITA provides is critical, the IRS cannot rely entirely on these volunteers to provide a service the IRS has deemed too costly or time consuming to provide itself. Instead of concentrating on expanding the VITA Program, the IRS should concentrate on developing a fundamental support structure for the program, including site management, training, and quality review.¹⁴ Once the IRS has developed a strong infrastructure for the VITA Program and has established consistent quality in the returns prepared by volunteers, then the IRS can work to expand the program. However, the IRS must remain cognizant that VITA, or any volunteer program, cannot and should not be expected to serve as a substitute for IRS-provided service.

The IRS Should Make It Possible for Taxpayers to Prepare and File Their Tax Returns Electronically Without Paying a Fee

Electronic filing of tax returns brings benefits to both taxpayers and the IRS.¹⁵ From a taxpayer perspective, e-filing eliminates the risk of IRS transcription errors, pre-screens returns to ensure that certain common errors are fixed before the return is accepted, and speeds the delivery of refunds. From an IRS perspective, e-filing eliminates the need for data transcribers to input return data manually (which could allow the IRS to shift resources to other high priority areas), allows the IRS to easily capture return data electronically, and enables the IRS to process and review returns more quickly.¹⁶

In my view, the IRS should place a basic, fill-in template on its website and allow any taxpayer who wants to self-prepare his or her return to do so and file it directly with the IRS for free.¹⁷

Some representatives of the software industry have taken the position that such a template would place the IRS in the position of improperly competing with private industry or, worse, create a conflict of interest between the IRS's role of tax preparer and tax auditor.

¹⁴ The IRS has taken a step in the right direction with the development of the Link & Learn training site which allows volunteers to receive training and become certified online. According to IRS data, the new training program has proven successful and the number of certifications issued for 2006 was 11,885, compared with 10,402 certifications issued as of the same time last year.

¹⁵ See S. Rep. No. 105-174, at 39-40 (1998).

¹⁶ The IRS Restructuring and Reform Act of 1998 directed the IRS to set a goal of having 80 percent of all returns filed electronically by 2007. See Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685 (1998). The 80 percent e-filing goal is probably not achievable by 2007. However, we believe Congress should reiterate its commitment to seeing the IRS increase the e-filing rate as quickly as possible.

¹⁷ See National Taxpayer Advocate 2004 Annual Report to Congress 471-477 (Key Legislative Recommendation: Free Electronic Filing for All Taxpayers).

This is nonsense. Since the inception of the tax system, there have always been two categories of taxpayers – those who are comfortable enough with the rules to self-prepare their returns and those who turn to paid professionals for assistance. In the paper-filing world, the IRS has always made its forms and instructions universally available without charge to all taxpayers, and those taxpayers who require help have always been free to seek the assistance of paid preparers.

Imagine that, shortly after the income tax was enacted, a large group of bricks-and-mortar tax preparers had launched a lobbying campaign to try to persuade Congress to prohibit the IRS from making forms and instructions available to the public on the ground that the availability of these materials improperly placed the government in the position of competing with private industry. Or on the ground that it created a conflict between the government's role as preparer and auditor. Congress almost certainly would have rejected such arguments as ludicrous. Yet those are exactly the same conceptual arguments being raised today by those who contend that the government's provision of a basic web-based, fill-in form to all taxpayers would undercut the private sector.

The answer to these arguments in today's electronic environment should be the same answer that Congress would have provided 80 years ago in a paper environment. For those taxpayers who are comfortable preparing their returns without assistance, the government will provide the means to do so without charge. For those taxpayers who do not find a basic template sufficient and would prefer to avail themselves of the additional benefits of a sophisticated software program, they are free to purchase one.

A brief personal anecdote. Although I prepared tax returns professionally for 27 years before I became the National Taxpayer Advocate and don't need assistance from others to prepare my return, my government salary places me above the income cap to qualify to use Free File products. To prepare my return electronically last month, I therefore spent \$19.99 to purchase tax preparation software. When I completed preparing my return, the software program informed me that, to file electronically, I would have to pay a fee of \$14.95. If I wanted this fee deducted from my refund rather than charged to a credit card, an even higher fee would apply. Although I deeply believe that e-filing is best for both taxpayers and the IRS for a host of reasons, I resented the notion that I would have to pay separate fees to prepare my return and to file it, so I printed out my return and mailed it in.

I am hardly alone. IRS data shows that about 40 million returns are prepared using software yet are mailed in rather than submitted electronically.¹⁸ This is a shame, because the practice delays the length of time for processing refunds, it requires the IRS to devote additional resources to entering the data manually when it receives the return, and it creates a risk of transcription error.

¹⁸ IRS Tax Year 2004 Taxpayer Usage Study (Aug. 26, 2005).

There is no reason why taxpayers should be required to pay transaction fees in order to file their returns electronically. A free template and direct filing portal would go a long way toward addressing this problem and would result in a greater number of taxpayers filing their returns electronically. Both taxpayers and the government would stand to benefit.¹⁹

The IRS Can and Should Do a Better Job of Measuring the Impact of Taxpayer Service on Compliance

The Taxpayer Assistance Blueprint notes that it is difficult to measure the impact of taxpayer service on compliance. Of the private sector and government entities that the TAB team surveyed, all had concluded that customer service at least indirectly impacts their organizations, but only one had attempted to empirically measure that impact.

Although little has been done in this area, I believe the IRS does have the capability to develop useful estimates, and am suggesting a general framework for conducting this research. Measuring the compliance impact of customer service would entail identifying a group of taxpayers who received a particular service (the “treatment group”) and an otherwise comparable group that did not receive that service (the control group). Compliance of both groups could then be measured on returns filed subsequent to the receipt of service by the treatment group. The three measures used to estimate the tax gap could be applied: payment compliance, filing compliance, and reporting compliance.

We can determine the payment compliance of survey respondents by simply observing whether the full tax liability was paid at the time of filing. We can estimate their filing compliance by determining whether non-filers appeared to have a filing requirement. To determine reporting compliance, by far the biggest component of the tax gap, we could use IRS developed algorithms for estimating reporting compliance. These algorithms have been updated based on results from the recently completed National Research Program (NRP) and should provide good preliminary estimates. The estimates could subsequently be validated during the next NRP by comparing actual reporting compliance against predicted reporting compliance based on the IRS algorithms.

¹⁹ In addition to benefiting taxpayers and the IRS, I believe this proposal would be good for the software industry. Under the existing Free File arrangement, the industry is making its federal tax products available for free to tens of millions of taxpayers. By itself, that is hardly a recipe for business success. If industry is able to make a profit under this arrangement, it is only because it is aggressively marketing ancillary products to taxpayers and making money on the sale of those ancillary products. The provision of a basic preparation and filing option would enable taxpayers who don’t want to pay a fee and know how to prepare their tax returns to do so, but all taxpayers who want the benefits of a question-and-answer format and checks to ensure they do not overlook any tax benefits to which they are entitled would have to pay to purchase the tax product. Moreover, the IRS would be unlikely to develop a template itself. The IRS almost certainly would contract with the private sector to develop it. In that respect, the IRS would be utilizing the innovation of the private sector – not competing with it.

Measuring the Direct Effect

If we accept the above proposed framework as a valid means of estimating compliance, surveys could then be designed and administered to identify groups of taxpayers who did or did not receive certain services, such as telephone or Internet assistance with tax law questions, Internet or TAC assistance obtaining forms, etc. Subsequent compliance of those who receive the service could then be compared to compliance for a comparable group who do not. Taxpayer satisfaction with services received might also be an interesting variable to examine.

Measuring Indirect Effects

It is possible that taxpayer compliance behavior may be influenced by knowledge and attitudes about IRS customer service offerings, even if the affected taxpayers have not used those services. The same basic proposed framework could be used to measure these indirect effects. We would have to determine a set of relevant attributes to identify taxpayer groups indirectly affected by IRS customer service offerings. It seems to me that such attributes would probably include use, awareness, access and general satisfaction level:

- Use – To be indirectly affected, a taxpayer could not have used the service in question (at least during the year being studied).
- Awareness – A taxpayer would have to be aware of the existence of a service to be influenced by it.
- Access – It seems likely that taxpayers who could access the service if they chose to are more likely to be influenced (e.g., those living close to a TAC).
- Satisfaction Level – It seems likely that taxpayers having a generally favorable level of satisfaction with our services are more likely to be positively influenced (and vice versa).

Surveys could be administered to determine whether compliance was impacted based on the values for the above attributes (or others suspected of indirectly affecting compliance).

Return Preparation

The IRS has data that enable us to estimate compliance for the entire population of returns by type of preparation: IRS prepared, VITA/TCE, commercial, taxpayer prepared. I think it would be interesting to compare estimated reporting compliance for IRS prepared returns against comparable returns (i.e., low income, especially EITC) prepared by the other methods. We might find that IRS

prepared returns are substantially more compliant – especially when EITC is claimed. If so, this would provide strong support for continuing and perhaps expanding return preparation in the TACs.

The IRS Should Include the Cost of the Downstream Consequences of its Actions in Its Return on Investment (ROI) Calculations

The IRS needs to conduct more thorough and accurate analyses when measuring return on investment (ROI) in order to allocate future dollars appropriately. For example, although in the short run it may cost more to process and review an Offer in Compromise and it may appear that the government is writing off revenue, the taxpayer in the long run may pay more tax dollars into the system as a result of his promise to be fully compliant for the five succeeding years.²⁰ Five years is a long enough period to enable the taxpayer to “learn” a new norm of behavior, namely, compliance. And when you compare the 16 cents on the dollar that IRS receives from offers²¹ to the virtually no cents it collects after year 3 of the 10-year collection period,²² the Offer in Compromise suddenly looks like a very efficient and productive program.

When computing ROI, the IRS should include the costs of the downstream consequences of its enforcement actions. Downstream consequences analysis tells us not only true ROI (*i.e.*, the true cost to the IRS) but also gives us clues as to how to improve our processes from an IRS *and* a taxpayer perspective. That is, downstream consequences analysis is a form of taxpayer service.

The Criminal Investigation Division’s Questionable Refund Program (QRP) is a recent example of the failure to capture an accurate return on investment. The QRP serves an important tax administration purpose by helping the IRS detect and prevent the payment of fraudulent refund claims.²³ Criminal Investigation (CI) dedicates approximately 600 Full Time Equivalents (FTEs) to this program. As we described in the National Taxpayer Advocate’s 2005 Annual Report to Congress, the QRP was freezing hundreds of thousands of refunds each year without notifying the affected taxpayers. This failure to notify taxpayers that their refunds were being held generated more taxpayer calls to the IRS toll-free lines and to the Taxpayer Advocate Service (TAS) than CI could respond to in a timely fashion.

²⁰ If a taxpayer fails to comply with all his tax obligations over the five-year period following IRS acceptance of an offer, the IRS may rescind the offer and reinstate the tax debt. See IRS Form 656, Offer in Compromise.

²¹ IRS Small Business/Self Employed Division, Offer In Compromise Program, *Executive Summary Report* (Jan. 2006).

²² IRS Automated Collection System Operating Model Team, *Collectibility Curve* (August 5, 2002).

²³ For a detailed discussion of the Questionable Refund Program, see National Taxpayer Advocate 2005 Annual Report to Congress 25-54.

In FY 2005, the Taxpayer Advocate Service (TAS) received over 28,000 QRP cases. In TAS's office in the Atlanta campus, approximately 65 percent of case inventory per case advocate involves QRP. Moreover, during FY 2005, the IRS Examination function reviewed 25,621 QRP cases, and some of those cases went on to the IRS Appeals function. This level of activity protected approximately \$2.2 billion in FY 2004, of which \$1.8 billion was attributable to just two returns that should have been discovered anyway, particularly since the Joint Committee on Taxation must review any refund over \$2 million. So, the maximum direct revenue protection generated by all that IRS activity was \$400 million. In addition, my office found in a study of the 28,000 QRP cases that came to TAS that fully 80 percent of taxpayers whose refunds were frozen as potentially fraudulent ultimately were found to be entitled to a full or partial refund. Had the IRS actually tracked the downstream consequences of the QRP and included these costs in the program's ROI, the IRS probably would have figured out a way to protect the same level of revenue with fewer FTE or developed a better method of identifying cases with the same CI FTE that did not generate the need for phone, exam, Appeals, and TAS FTE – not to mention interest the IRS is having to pay to tens of thousands of taxpayers whose refunds were frozen unnecessarily.

The QRP is a prime example of an IRS program that grew up over time without the benefits of true strategic planning or proper oversight. Despite the volume of taxpayer calls coming in on our toll-free lines about these refunds, the Fraud Detection Centers have limited capacity to make or receive phone calls. Thus, their processes are designed to avoid any direct or interactive contact with taxpayers or others. As TIGTA noted in several reports,²⁴ the QRP has inadequate management oversight processes, including inadequate reports of inventory levels and case status. Further, the little taxpayer correspondence generated by QRP was uninformative and intimidating. Today, the IRS is scrambling to meet the terms of its agreement with my office as to how it will correct these program deficiencies. Each day we face challenges, primarily arising from system limitations in reprogramming.²⁵

²⁴ Treasury Inspector General for Tax Administration, *The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners* (Ref. No. 2005-10-164) (September 2005); Treasury Inspector General for Tax Administration, *Improvements Are Needed in the Monitoring of Criminal Investigation Controls Placed on Taxpayers' Accounts When Refund Fraud Is Suspected* (Ref. No. 2003-10-094) (March 31, 2003); Treasury Inspector General for Tax Administration, *Revised Questionable Refund Program Procedures Were Not Consistently Implemented* (Ref. No. 2001-40-025) (Jan. 2, 2001); Treasury Inspector General for Tax Administration, *The Internal Revenue Service Can Improve the Effectiveness of Questionable Refund Detection Team Activities* (Ref. No. 2000-40-018) (Dec. 22, 1999).

²⁵ The National Taxpayer Advocate believes that the QRP will only function properly, productively, within the norms of taxpayer rights, and without creating excessive downstream consequences if it is moved out of the sole jurisdiction of CI and into a collaborative arrangement between CI and either the Wage & Investment or Small Business/Self-Employed Operating Division. This approach reflects the current model for the Frivolous Filer program.

IRS Strategic Planning and Resource Allocation Decisions Should Be Based on More and Better Research

The need for better research underlies all of these challenges. The IRS must conduct research, organized by taxpayer segment, to better understand taxpayer behavior and taxpayer response to IRS's various service and enforcement "touches." The absence of research about taxpayer needs often leads the IRS to place its immediate resource needs over taxpayers' immediate and long-term needs.²⁶ This approach may cause more taxpayers to become noncompliant, thereby requiring more expensive enforcement actions. Concern over the lack of research and taxpayer-centric strategic planning led Congress to enact Section 205 of the FY 2006 Appropriations Act funding the IRS and to direct the IRS to develop a five-year strategic plan for taxpayer service.²⁷

I have written at length elsewhere on the need to understand the causes of noncompliance so that the IRS doesn't adopt a one-size-fits-all enforcement approach.²⁸ Each year, academics and other scholars propose many ideas that

²⁶ The declining number of Taxpayer Assistance Center (TAC) visits is an example of IRS placing its resource needs over taxpayer needs. For FY 2006, IRS established a goal of preparing 20 percent fewer tax returns in TACs than in FY 2005. Not surprisingly, TAC visits for year-to-date FY 2006 have declined 14 percent compared with this time last year. Even though the decline in TAC usage appears to result from IRS-imposed limitations on service, the IRS is nonetheless citing this decline as a justification for making further reductions in service at the TACs. Wage & Investment, *2006 Filing Season Data: Cumulative Statistics Report* (Feb. 25, 2006).

²⁷ Pub. L. No. 109-115, § 205, 119 Stat. 2396 (2005). Specifically, the statute provides:

None of the funds appropriated or otherwise made available in this or any other Act or source to the Internal Revenue Service may be used to reduce taxpayer services as proposed in fiscal year 2006 until the Treasury Inspector General for Tax Administration completes a study detailing the impact of such proposed reductions on taxpayer compliance and taxpayer services, and the Internal Revenue Service's plans for providing adequate alternative services, and submits such study and plans to the Committees on Appropriations of the House of Representatives and the Senate for approval: . . . *Provided further*, That the Internal Revenue Service shall consult with stakeholder organizations, including but not limited to, the National Taxpayer Advocate, the Internal Revenue Service Oversight Board, the Treasury Inspector General for Tax Administration, and Internal Revenue Service employees with respect to any proposed or planned efforts by the Internal Revenue Service to terminate or reduce significantly any taxpayer service activity.

The accompanying Joint Explanatory Statement of the Committee of Conference stated: "The conferees direct the IRS, the IRS Oversight Board and the National Taxpayer Advocate to develop a 5-year plan for taxpayer service activities. . . . The plan should include long-term goals that are strategic and quantitative and that balance enforcement and service." H. Rep. No. 109-307, 209 (2005).

²⁸ See National Taxpayer Advocate 2004 Annual Report to Congress 211 (Most Serious Problem: IRS Examination Strategy) and 226 (Most Serious Problem: IRS Collection Strategy); National Taxpayer Advocate 2005 Annual Report to Congress 55 (Most Serious Problem: The Cash Economy); Written Statement of Nina E. Olson, National Taxpayer Advocate, Before the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, United States Senate, on *The Tax Gap* (Oct. 26, 2005); Written Statement of Nina E. Olson, National Taxpayer Advocate,

a 21st century tax administrator should be examining and testing. In fact, the IRS has such a vehicle for partnering with academics in the Intergovernmental Personnel Act (IPA) program. Unfortunately, this program is underutilized. The IRS must conduct and underwrite such applied research, just as other world-class tax administration systems do.

Because taxpayer service and enforcement are the drivers of overall compliance, we need to measure taxpayer service needs concurrently with our efforts to measure the tax gap. Thus, the National Research Program should update its analysis of taxpayer service needs at the same time it is measuring taxpayer noncompliance for the particular taxpayer population it is studying. The IRS can make informed resource allocation decisions only if it is armed with both types of information.

The IRS Should Address the Impact of IRS Business Systems Modernization Limitations on Both Taxpayer Service and Enforcement Initiatives

When I was in private practice as an attorney representing clients before the IRS, I did not have a full appreciation of how significant a role Business Systems Modernization (BSM) plays in both creating and solving problems for taxpayers and the IRS. As the National Taxpayer Advocate, I know that on a regular basis my office identifies systemic problems for which the complete solution requires some sort of BSM fix.

When Commissioner Everson began his tenure, he ordered three separate reviews – two external, one internal – of the state of IRS BSM projects. Based on these reviews, the Commissioner quickly – and, I believe, correctly – concluded that the IRS was spreading its internal BSM resources too thin. Project managers and experts charged with overseeing our key initiatives – such as the Integrated Financial System (IFS) and the Customer Account Data Engine (CADE) – were also managing scores of smaller projects, all more or less important but all detracting from our central progress on IFS and CADE.

For the past two years, the IRS has focused on its primary projects and strictly controlled the number of other BSM projects. This approach makes sense because it is critical to both effective service and enforcement that the IRS move forward with its primary initiatives. On the other hand, many projects cannot be deferred too much longer without significantly impacting taxpayer rights, accuracy of taxpayer data, and effective examination and collection initiatives. Indeed, improvements to TAS's own Systemic Advocacy Management System, our database for receiving, tracking, and managing taxpayer and IRS employee submissions of systemic problems in tax administration, were requested in November 2004. Although worked on intermittently, these changes are not yet

Before the Committee on the Budget, United States Senate, on *The Causes of and Solutions to the Federal Tax Gap* (Feb. 15, 2006).

completed or delivered. Until recently, this project was ranked number 33 on a list of 33 projects in terms of priority.

I will provide one illustration of the impact of the IRS's outdated computer systems. In the National Taxpayer Advocate's 2004 Annual Report to Congress, I reported that the IRS is miscalculating collection statute expiration dates on certain taxpayer accounts. The collection statute expiration date (CSED) represents the date beyond which the taxpayer is no longer obligated on a tax debt and the IRS must cease its collection efforts.²⁹ Miscalculations of CSEDs can negatively affect a taxpayer when the CSED on a particular tax erroneously appears on the IRS computer systems as being within the statute of limitations period, resulting in continued IRS collection activity, when in fact the statutory period for collections has expired. An incorrectly calculated CSED can also negatively impact the IRS when the CSED is miscalculated to reflect that the statute of limitations period has expired when in fact the debt is still collectible.³⁰ This problem continues today and harms tens of thousands of unsuspecting taxpayers. Where the IRS or the taxpayer identifies a case of unlawful collection, the taxpayer experiences delays in receiving a return of the unlawfully levied proceeds. In some instances, the IRS takes the position that the taxpayer will never receive the unlawfully levied funds because the refund is barred by the applicable statutory period of limitations.

In response to TAS's concerns, the IRS and TAS established a joint team that identified impacted taxpayers, developed additional guidance and training alerts, and submitted requests for systems improvements to eliminate the problem of incorrectly calculated CSEDs. Given the current demand on IRS programming personnel, the final system modifications are not now scheduled to occur until *some time in 2007*.

Internal Revenue Code Section 7433 permits a taxpayer to file a civil action for damages against the United States in federal district court where an IRS officer or employee disregards any provision of the Code or its regulations with respect to collection of tax. In general, damages under this provision are limited to \$1 million where the breach is attributable to reckless or intentional disregard and \$100,000 where it is attributable to negligence. Thus, the IRS's knowing failure to correct the CSED problem in a timely fashion exposes the government to potentially large damages.

²⁹ IRC § 6502(a)(1).

³⁰ National Taxpayer Advocate 2004 Annual Report to Congress 180-192.

The IRS's Filing and Payment Compliance (F&PC) Initiative Should Be Made a Priority

Filing and Payment Compliance (F&PC) is one of the IRS's most important business modernization initiatives.³¹ The F&PC initiative was designed to offer the IRS a modernized collection system with a focus on applying the right collection "touch" to suit the characteristics of the case. Instead of the automatic three-stage IRS collection process that does not differentiate among the causes of non-compliance,³² the implementation of F&PC was going to establish four treatment streams for collection cases:

- **Self-Assist/Self-Correct** – Using enhanced systems, the IRS would allow for electronic payment, Internet-based payment, and payment via telephone application. Thus, taxpayers would have more payment options to resolve delinquency issues.
- **Assisted Correction** - Using commercially available decision analytic software, the IRS would select the appropriate treatment for taxpayers depending on factors such as payment history and other actions taken by the taxpayer. Modernized systems would provide up-to-date taxpayer information so that decisions would be made on the most recent data.
- **Private Collection Agencies** – The IRS proposed using private collectors to locate and contact taxpayers, request that full payment be sent to the IRS, and in appropriate cases, request taxpayer financial information. While we are extremely concerned about the use of private collectors and about the structure being put in place to support the initiative,³³ its use in conjunction with other appropriate treatment streams provided some assurance that the IRS would narrowly tailor the use of private collectors.³⁴

³¹ Testimony of Internal Revenue Service Commissioner Mark W. Everson, Before the Senate Committee on Appropriations Subcommittee on Transportation, Treasury, the Judiciary, Housing and Urban Development and Related Agencies (April 7, 2005).

³² In the 2004 Annual Report to Congress, we set forth a critique of the IRS's traditional approach to collection and identified the elements of a modern collection strategy, including the ability to identify the appropriate collection touch for the particular cause of noncompliance. National Taxpayer Advocate 2004 Annual Report to Congress 226.

³³ We have addressed numerous concerns about the initiative, including the limited training of frontline private collection employees on issues such as taxpayer rights. See National Taxpayer Advocate 2005 Annual Report to Congress 76. We are also skeptical that the PDC initiative will produce a positive return on investment. See discussion, *infra*.

³⁴ In testimony last month before a House Appropriations subcommittee, IRS Commissioner Mark Everson acknowledged that tax debts to be assigned to private collection agencies could be collected more efficiently by additional IRS collection personnel. See Dustin Stamper, *Everson Admits Private Debt Collection Costs More, Defends Return Disclosure Regs*, 2006 Tax Notes

- **Enforcement** – For those cases that cannot be resolved through communication efforts with the taxpayer, traditional enforcement efforts would be used.³⁵

Release 1 of the F&PC initiative involves the use of private collectors.³⁶ Release 2 will employ commercial off-the-shelf software to assist in case selection for the private collection effort as well as the development of the Self-Assist treatment. In Release 3, the case selection software will be augmented with additional decision analytics software for the development of Assisted Correction treatments.³⁷

The F&PC initiative has not been adequately funded to ensure that the most useful, taxpayer-friendly, and forward-thinking treatments, *i.e.* Self-Assist and Assisted Correction, will be funded. While it appears that the IRS is fully committed to privatizing collection, having already reached Release 1,³⁸ cuts to F&PC funding will endanger the prospects of achieving F&PC's other objectives – objectives that do not raise the significant taxpayer rights concerns of the Private Debt Collection initiative.³⁹ Thus, the failure to fund F&PC Releases 2 and 3 ensures that the only legacy of F&PC will be private debt collection.

We are also concerned that the lack of funding for F&PC systems not only deprives taxpayers of a sophisticated collection approach but also encourages the IRS to take actions to reduce collection cycle time without adequate consideration for taxpayer rights or taxpayer compliance.⁴⁰

Today 61-1 (March 30, 2006); Rob Wells, *US Rep. Rothman Calls IRS Pvt Tax Collection Pact Wasteful*, Dow Jones Newswires (March 29, 2006).

³⁵ Filing and Payment Compliance Concept of Operations, Filing and Payment Compliance Project Office, April 18, 2005, 75-80.

³⁶ Treasury Inspector General For Tax Administration, Ref. No. 2006-20-026, *The Alternatives for Designing and Developing the Filing and Payment Compliance Project Should be Revalidated* (Dec. 2005); *see also* Capital Asset Plan and Business Case, Business Systems Modernization, Exhibit 300 (2005).

³⁷ *Id.*

³⁸ Challenges to the procurement process have delayed implementation of the initiative. Dustin Stamper, *IRS Orders Private Debt Collectors to Stop Work*, Tax Notes Today (March 24, 2006).

³⁹ Testimony of James R. White, Director of Tax Issues, General Accountability Office, Fiscal Year 2007 Budget Request, Committee on House Ways and Means Subcommittee on Oversight (April 6, 2006).

⁴⁰ By way of example, the IRS has undertaken several initiatives to hasten the issuance of taxpayers' Collection Due Process (CDP) notices in order to reduce collection cycle time. Pursuant to Code sections 6320 and 6330, taxpayers are entitled to a collection due process hearing after the filing of the first Notice of Federal Tax Lien and before the imposition of the first levy on a tax account. One such initiative, termed the "Initial Contact Initiative," required revenue officers to issue CDP rights to taxpayers on initial contact with the taxpayers instead of when a levy was the next planned action. Because we believed this initiative makes CDP hearings less

The Return-on-Investment of the Private Debt Collection Initiative Will Probably Be Lower Than Expected

The Private Debt Collection (PDC) initiative as envisioned under Phase I of F&PC is another example of a program that might not be undertaken, or would be approached differently, if its downstream consequences were considered. The premise of the PDC initiative is essentially this: “There is a significant amount of tax debt that the IRS can’t go after because it doesn’t have the resources. If we simply turn those cases over to private collection agencies, they’ll collect the debt for us and the government will get to keep 75 to 80 cent of every dollar the PDCs are able to collect.”

The problem with that simple approach is that it fails to take into account the enormous amount of IRS resources that need to be devoted to creating and supporting the program. Once the program rolls out, the IRS estimates that only a small percentage of taxpayers – perhaps on the order of 15 percent – will be resolved by the PDC unit itself. The rest of the cases will be sent back to the IRS “Referral Unit” for additional actions that only the IRS can constitutionally take on the account. Keep in mind that these are cases that the IRS currently considers too unproductive to devote resources to. Yet ironically, under the PDC initiative, the IRS will end up pulling employees off high-priority, high-return cases to work on these low-priority, low-return cases.

This approach makes little business sense, and on top of that, the program raises significant concerns about the adequacy of taxpayer rights protections and confidentiality of tax return information. In fact, to make the program profitable, the IRS will be under pressure to expand the authorized actions private collection agencies can take on a case so they can work higher dollar, more complex cases. This expansion would clearly raise constitutional concerns.⁴¹

Thus, the PDC initiative is a paradigm example of how looking at the narrow justification for a program can make it look brilliant, while viewing the program in its totality paints a very different picture.

meaningful, we opposed the initiative. After discussions with the IRS, it was agreed that the Initial Contact Initiative would only apply to business taxpayers and to certain individual taxpayers who also have business tax delinquencies. Recently, the IRS planned to move the CDP notice up even further in the collection process to the second notice issued to business taxpayers. After discussion with my office, the IRS agreed that this latest initiative would not be undertaken at this time. We believe that the IRS has been attempting to implement broad collection initiatives because its current business systems do not adequately differentiate among taxpayers based on their compliance history.

⁴¹ For a detailed discussion of the IRS Private Debt Collection initiative and its constitutional and taxpayer rights implications, see *Use of Private Agencies to Improve IRS Debt Collection*, Subcommittee on Oversight, House Committee on Ways and Means, 108th Cong., 1st Sess. (statement of Nina E. Olson, National Taxpayer Advocate, May 13, 2003); see also National Taxpayer Advocate 2005 Annual Report to Congress 76-93.

Trends in Taxpayer Advocate Service (TAS) Case Inventory

I close with a reflection on the Taxpayer Advocate Service and its role in identifying and mitigating the downstream consequences of IRS actions and programs, and improving taxpayers' attitudes toward the tax system. This recent March 1st marked my 5-year anniversary as the National Taxpayer Advocate. They have been quite remarkable years – I have watched my talented and dedicated employees achieve a quality rating of 91.6 percent through FY 2005, up from 71.6 percent in 2001. They achieved this quality despite a 15 percent *decline* in case advocates in our statutorily mandated offices around the country, from 1,325 case advocates in March 2003 to 1,127 case advocates in February 2006. And these successes were achieved despite a slight *increase* in TAS case receipts from FY 2003 to FY 2005.⁴²

In fact, TAS case receipts themselves provide an interesting study in downstream consequences. As IRS increases its enforcement activity, TAS compliance inventory increased to nearly 70 percent of our case receipts for the first quarter FY 2006, up from 67 percent in first quarter FY 2005. In FY 2005, TAS cases involving liens and levies increased by 50 percent and 43 percent, respectively, over FY 2004. During first quarter FY 2006, TAS continued to see an increase in lien and levy cases. Lien and levy cases tend to involve economic urgency to the taxpayer. TAS procedures require case advocates to respond immediately to the taxpayer's request for assistance in these cases. With the increasing number, complexity, and urgency of our case load, TAS risks getting behind on cases that involve IRS system failure as we give priority to cases that involve economic harm. If the balance between our staffing and the number of cases we handle continues to deteriorate, TAS is in jeopardy of becoming part of the IRS problem rather than the advocate for the solution, as Congress intended.

Significantly, TAS Customer Satisfaction surveys provide some evidence that the quality and nature of taxpayer service has an impact on taxpayer attitudes toward the tax system. When a taxpayer brings an eligible case to TAS, he is assigned a case advocate who works with him throughout the pendency of the case. Taxpayers have a toll-free number direct to that case advocate, and each TAS office has a toll-free fax number. TAS employees are required to spot and address all related issues and to educate the taxpayer about how to avoid the problem from occurring again, if possible. This level and quality of service drives TAS's high taxpayer satisfaction scores,⁴³ which have averaged about 4.35 on a scale of 5.0 for the last two fiscal years. Most importantly, 57 percent of taxpayers stated that they feel better about the IRS as a whole after coming to TAS. Even among taxpayers who did not obtain the result they sought, an

⁴² In FY 2005, TAS received a total of 197,679 cases. In FY 2003, TAS received a total of 196,040 cases.

⁴³ Taxpayer Advocate Service customer satisfaction survey data for the period from October 2003 through September 2005, as collected by The Gallup Organization.

astonishing 41 percent reported that they had a more positive opinion of the IRS because of their experience with TAS.

Conclusion

Compared with ten years ago, the IRS today is a more responsive and effective organization. On the customer service side, the IRS Restructuring and Reform Act of 1998 and the IRS response has brought about fairly dramatic improvements. On the enforcement side, the IRS has been stepping up its enforcement of the tax laws over the past 5 years, particularly with regard to corporate tax shelters and high-income individuals.

But the IRS can, and should, do better. To increase voluntary compliance, it should incorporate an ongoing taxpayer-centric assessment of taxpayer service needs into its strategic plans. It should conduct research into the causes of noncompliance and apply the resulting knowledge to IRS enforcement strategies, including those pertaining to the cash economy. Finally, it must have sufficient resources to move forward with its technological improvements, on both a short-term and a long-term basis.