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Testimony

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TAX ADMINISTRATION:

Compliance 2000 — A  
Worthy Idea that Needs  
Effective Implementation

Statement of  
Natwar M. Gandhi, Associate Director  
Tax Policy and Administration Issues  
General Government Division



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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to assist the Subcommittee in its inquiry into the Internal Revenue Service's (IRS) Compliance 2000 initiative to improve voluntary compliance with the tax laws. IRS began this initiative in 1988 to attempt a new approach to tax administration. This approach, which is still in the developmental stage, would shift the traditional emphasis away from catching noncompliant taxpayers and towards preventing the noncompliance from occurring.

Compliance 2000's goal is to discern the root causes of tax noncompliance and then apply the appropriate tools to improve voluntary compliance in the future. It is based on the assumption that taxpayers fail to comply for different reasons and therefore, IRS should be flexible in its approach to correcting the problem. This change has been reflected in IRS' strategic business plan for fiscal years 1992 to 1997. Rather than focusing on audits and other enforcement resources to maximize short-term revenue yield, IRS says it wants to improve tax compliance by more effectively meeting taxpayer needs.

IRS contends that Compliance 2000 is the better approach because it believes that much noncompliance is unintentional, resulting from complex tax laws and unclear instructions, forms, and regulations. While examination, collection, and criminal investigation are essential tools for addressing intentional

noncompliance, IRS believes that the time has come to shift its focus to taxpayer assistance, education, outreach, and simplification to deal with unintentional noncompliance.

#### CONCERNS WITH COMPLIANCE 2000

We believe that Compliance 2000 is a worthy idea. In an era of huge budget deficits, it makes a great deal of sense to address the underlying causes of noncompliance in order to prevent it as early as possible. We fully support IRS' efforts to educate taxpayers and simplify the tax system.

However, the Compliance 2000 concept is still in its early stages and will take further time to develop and implement. While IRS has heralded Compliance 2000 as a dramatic change in the way it does business, IRS has not given us the data to assess this change. We believe that IRS needs to take some critical steps to successfully implement Compliance 2000 service-wide.

First, IRS needs to develop a structure for planning, managing and monitoring Compliance 2000. Second, the Taxpayer Compliance Measurement Program (TCMP), IRS' primary program for measuring noncompliance, should be aligned with Compliance 2000. Finally, Compliance 2000 should not be used to further reduce already low audit rates.

### Management Structure Needed

Successful implementation of Compliance 2000 will require a structure to plan, manage, and monitor the effort. IRS officials plan to develop this structure but to date have provided no details on how and when it will be in place. Within this structure, IRS needs an action plan that contains identifiable and measurable objectives, timetables, and a budget plan for allocating resources. The action plan should also provide for such things as training in Compliance 2000 methodologies and access to resources such as computers and travel funds.

This plan is particularly important to guide the 70 Compliance 2000 projects, called prototypes, already underway. These prototypes were developed by district offices across the nation and submitted to IRS' National office for approval in the fall of 1991. Many of these prototypes were designed to improve compliance among homogeneous groups of taxpayers in limited geographical areas, such as drywall contractors in Houston, Texas.

Strong management of Compliance 2000 is essential in ensuring its successful implementation. IRS was slow in providing this leadership. A senior executive responsible for institutionalizing the Compliance 2000 philosophy and integrating it service-wide was not appointed until March 1992, even though

the approach was conceived several years ago. It has also taken until now for IRS to assign full-time field staff to manage this immense task.

It is imperative that the IRS explain Compliance 2000 to its staff and gain their support for implementing this dramatic new approach. Without such an effort, it will be difficult to change the mindset of thousands of existing IRS staff accustomed to using IRS' traditional enforcement strategies and who may perceive this new approach as a threat.

Finally, monitoring the progress of Compliance 2000 is critical to its success. Each prototype will attempt to improve voluntary compliance for a specific group of taxpayers, using the proper tool. IRS' objective should be to measure and monitor the compliance progress achieved under each of its prototypes. To do this, IRS needs to develop a management information system that will allow it to oversee each prototype and evaluate the results.

#### IRS Needs To Align TCMP and Compliance 2000

IRS does have a program to collect compliance data and objectively target pockets of noncompliance, but it needs to be aligned with Compliance 2000. The Taxpayer Compliance Measurement Program (TCMP) identifies noncompliance by auditing a

randomly-selected sample of taxpayers nationwide. These audits cover all line items on the tax return and allow IRS to make a statistically reliable estimate of nationwide voluntary compliance. These audits, however, do not identify the cause of the noncompliance.

IRS uses the TCMP results to develop formulas for selecting for audit those returns that have the greatest likelihood of errors. TCMP data are also used by Congress, the Department of Commerce, and other federal agencies for policy formulation, research, and revenue estimating.

IRS could use TCMP with Compliance 2000 in various ways. Initially, IRS could use TCMP data to identify nationwide or regional areas of noncompliance that need to be addressed. IRS officials told us that the 70 prototypes were generally selected based on employees' judgement and intuition. Use of TCMP data could help select the most noncompliant taxpayers for the Compliance 2000 prototypes. In addition, the TCMP process could be modified in the future to collect better data on the causes of noncompliance. TCMP officials acknowledged these potential uses and have started to use TCMP data in some of the prototypes.

Another possible way to use TCMP with Compliance 2000 involves setting a goal for improving compliance nationwide. This goal should be specific and measurable so that the progress of

Compliance 2000 can be assessed and mid-term corrections can be undertaken if needed. Using TCMP data, IRS has estimated that individual compliance for 1992 is 85 percent. IRS could establish a goal of increasing compliance (for example, about 5 percent) by the year 2000. Then, using TCMP results, IRS could track progress toward that goal.

TCMP is currently the most reliable tool IRS has to gauge the level of voluntary tax compliance in the country and it could be used to assess IRS' progress in improving compliance. However, in July 1991, IRS began a major re-design of TCMP that may adversely affect its usefulness. The re-design was undertaken because the program was considered by senior IRS officials to be too costly to operate and too big of a burden on compliant taxpayers. Also, they believed that the audit results were untimely for operational and research purposes. Currently, it is not clear how extensively TCMP will be changed. As an interim measure, IRS has decided to conduct a TCMP for 1992 returns in which it will reduce the sample size from 54,000 to 25,000 tax returns.

We are concerned that this smaller sample will produce inconsistent and less useful estimates of the voluntary compliance level. If this occurs, TCMP will be of less value in determining whether the overall goal of Compliance 2000--improving voluntary compliance--has been achieved. It certainly

will not allow estimates of compliance in many of the 70 prototypes. Moreover, TCMP may also be less useful to external users such as Congress in shaping tax policy and to the Department of Commerce as a barometer of the economy. Regardless of how TCMP is redesigned, we believe that IRS should continue to have consistent nationwide measures of voluntary compliance.

Compliance 2000 Should Not Be  
Used To Lower Audit Rates

Another issue IRS needs to consider in implementing Compliance 2000 is its effect on enforcement. A shift in emphasis towards taxpayer education and tax simplification, based on the assumption that much noncompliance is unintentional, should not be a reason to cut IRS' enforcement budget. A budget initiative of recent years provides a case in point. IRS' fiscal year 1993 budget request for Examination and the information returns program was reduced in anticipation of productivity savings resulting from tax system modernization. However, the budget reduction was more than the corresponding productivity gains, resulting in a net reduction in resources for these important enforcement programs.

We believe that IRS' public statements about Compliance 2000 should acknowledge the important role that audits must continue



to play in our voluntary tax system. The audit rate for individuals has already declined from 2.4 percent in 1976 to 1 percent in 1991. Any further reductions could begin to erode voluntary compliance just as Compliance 2000 is attempting to increase it.

In summary Mr. Chairman, we believe that, although Compliance 2000 is noble in its intent, it requires careful implementation. Specifically, IRS needs to develop a structure for planning, managing and evaluating Compliance 2000. IRS should be certain that any changes to TCMP are compatible with Compliance 2000 to provide a scorecard on its success. Finally, IRS should also be careful to ensure that the traditional enforcement functions are not compromised, and in particular that audit rates are not lowered.