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TAX ADMINISTRATION

Status of Tax Systems Modernization, Tax Delinquencies, and the Tax Gap

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STATUS OF TAX SYSTEMS MODERNIZATION, TAX DELINQUENCIES, AND THE TAX GAP

SUMMARY STATEMENT OF
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Three of the most critical issues facing the Internal Revenue Service (IRS) are (1) managing the $23 billion Tax Systems Modernization (TSM) program, (2) collecting $30 billion of delinquent taxes, and (3) reducing a $114 billion tax gap. These issues are related. IRS would be better able to collect delinquent taxes and reduce the tax gap if its employees had on-line access to information they need when they need it. That is the basic goal of TSM. Existing IRS systems do not provide ready access to needed information and consequently do not support modern work processes.

IRS and taxpayers have begun to realize some benefits from various interim systems that IRS implemented as part of TSM--the most well known being electronic filing. While making progress with some interim systems, IRS has progressed slower than GAO would have expected in completing steps that are critical to the long-term modernization. For example, decisions on how IRS will structure its operations have not been finalized; yet these decisions could alter the technical and procurement plans for TSM. IRS has also been slow in developing the technical foundation for TSM. After 6 years, IRS still does not have a complete set of system and data standards needed to guide the software development for TSM. In addition, IRS has not yet completed detailed security, privacy, and telecommunications requirements for TSM. IRS has also only recently begun to address the human resource implications of TSM--an issue of immense proportions in an agency of over 100,000 employees.

IRS has put more emphasis on collecting delinquent taxes, but the results have not been encouraging. Several factors, such as inadequate records, an antiquated and inefficient collection process, and ineffective staff allocation practices, have hindered IRS' collection efforts. IRS also needs to reduce the tax gap. To do that, IRS has to improve voluntary compliance. IRS' data show, for example, that voluntary compliance for small corporations plummeted from 81 percent in 1980 to 61 percent in 1987, the latest year for which data are available. To improve compliance, IRS should, among other things, rethink its enforcement approach, including the appropriate level of audit coverage, and ensure that it has reliable data with which to effectively target its efforts to increase voluntary compliance.

Mr. Chairman and Members of the Subcommittee:

In our recent transition report on the Internal Revenue Service (IRS), we discussed nine issues facing the agency, Congress, and the new administration.[1] We are pleased to be here today, at your request, to talk about three of those issues--managing the $23 billion Tax Systems Modernization (TSM) program, collecting $30 billion in delinquent taxes, and reducing a $114 billion tax gap.

These three issues are related. It should be easier for IRS to collect delinquent taxes and reduce the tax gap once its employees have the right information, at the right time, in the right place--the basic goal of TSM. Existing systems do not provide ready access to needed information or allow for modern work processes.

Today, I have four major points.

-- TSM is a good investment. IRS' antiquated systems must be modernized. Electronic filing provides evidence of the kinds of benefits we can expect from modernization--better service to taxpayers and more efficient IRS work processes.

-- While making progress in implementing interim TSM systems like electronic filing, IRS has progressed more slowly than we would have expected in completing steps that are basic to a successful modernization. Those steps include such things as planning for business changes to take advantage of the new technology, developing detailed security and telecommunications requirements, and addressing the major human resource implications of TSM.

-- IRS has put more emphasis on collecting delinquent taxes, but the results have not been very encouraging. Several factors, such as inadequate records, an antiquated and inefficient collection process, and ineffective staff allocation practices, have hindered IRS' collection efforts.

-- If IRS is to reduce the tax gap it needs to, among other things, rethink its enforcement approach, including the appropriate level of audit coverage, and ensure that it has reliable data with which to effectively target its efforts to increase voluntary compliance.

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[1]Transition Series: Internal Revenue Service Issues (GAO/OCG-93-24TR, December 1992).

TAX SYSTEMS MODERNIZATION

As we said in our recent transition report, systems modernization is IRS' most pressing challenge. The need for modernization is undeniable. Current systems are paper- and tape-based, labor-intensive, and inefficient. IRS has done well in getting the most that it can out of existing systems, but the potential for further improvement lessens dramatically as each tax year passes.

IRS intends to achieve this much-needed modernization through TSM, which is scheduled to become fully operational by the beginning of the 21st century at an estimated cost of about $23 billion. Through TSM, IRS expects to use new business processes that will enable it to significantly reduce taxpayer burden, collect more revenue, and increase productivity and efficiency. IRS expects greater efficiencies to come from reduced paper filings of tax returns through electronic filing and other nonpaper approaches, greater access to taxpayer information by IRS staff, electronic transfer of data between IRS locations, and greater reliance on telephone contacts with taxpayers to resolve problems.

Current Status of TSM

There are two kinds of processing systems being funded as part of TSM: interim and long-term. Interim systems are stand-alone systems that do not share data with other systems. They were generally initiated in the mid- to late-1980s to make immediate improvements in IRS' tax processing and compliance operations. They are designed to support current business practices and workload volumes. Long-term systems are intended to provide the final TSM processing capability. They are to replace the interim systems and form an integrated electronic environment in which all systems share data automatically.

Many interim systems have experienced difficulties. In particular, the three interim systems that are now at least partially operational--the Electronic Filing System (EFS), Automated Underreporter (AUR), and Corporate Files On-Line (CFOL)--experienced significant problems and delays.[2] While we have not examined the causes of all of these difficulties, we know from previous work that EFS was plagued by analysis, design,

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[2]EFS enables taxpayers to transmit their returns over communication lines to an IRS service center, where they are automatically edited, processed, and stored. AUR provides on-line access to information returns and automates case analysis and processing. CFOL provides on-line access to information currently transcribed from tax returns and obtained from existing master files.

and performance problems;[3] and AUR was delayed by management mistakes early in the project.[4] We also note that CFOL's full implementation is now running about 2 years later than expected.

As shown in figure 1, IRS is experiencing schedule slippages in other interim systems, such as the Integrated Collection System and the Totally Integrated Examination System. These slippages will delay the realization of operational benefits. In addition, as a result of these slippages, the later phases of several interim systems now significantly overlap with the development of several long-term TSM systems that will replace them.

Figure 1 also shows that most of the long-term systems--what we consider the "real TSM"--are in the early stages of design and development. Most of these systems will not be fully operational until the beginning of the 21st century.

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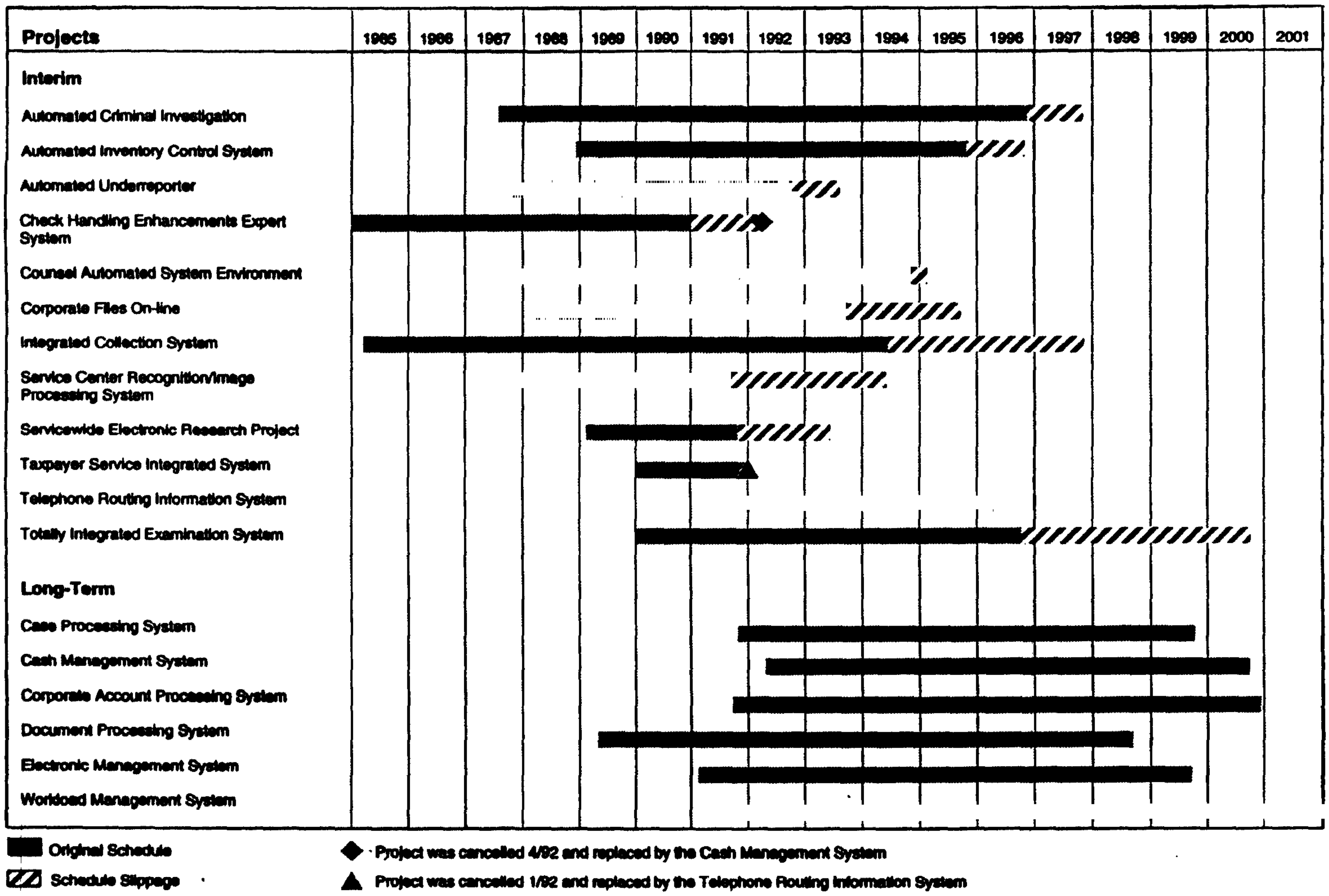
[3] ADP Modernization: IRS Needs to Assess Design Alternatives for Its Electronic Filing System (GAO/IMTEC-89-33, May 5, 1989).

[4] Tax System Modernization: Management Mistakes Caused Delays in Automated Underreporter System (GAO/IMTEC-90-51, July 10, 1990).

Figure 1: Original and Current Schedules for TSM Projects



Note: A timeline for another project, the Electronic Filing System, is not shown due to a lack of detailed information. This project began in 1986 and was made available to taxpayers nationwide in 1990.

Source: IRS' Quarterly Performance Tracking System Reports for the 4th quarter of fiscal year 1992 and other IRS documents. We did not verify the accuracy of these data.

Assessing TSM's Progress

IRS has produced a technical plan for the modernized environment and is implementing interim systems, some of which are beginning to show concrete benefits. However, IRS has made slower than expected progress in completing the foundation for TSM. In particular, 6 years after the start of TSM, we find (1) unfinished studies of IRS' business operations that we previously reported should have been done before issuance of TSM's master plan in May 1991;[5] (2) the lack of development standards and procedures needed to control and oversee the details of the modernization; and (3) procurements that seem to be proceeding in advance of the business plan and the necessary supporting technical requirements and infrastructure. Also, IRS has only recently begun to consider the human resource implications of TSM to ensure that its more than 100,000 employees are ready for the major changes that are forthcoming.

Early Interim Systems Benefit IRS and Taxpayers

Despite some schedule slippages, IRS and taxpayers have begun to realize significant tangible benefits from the interim TSM projects that IRS has implemented. Probably the best known of those projects is the Electronic Filing System. In 1992, about 11 million taxpayers filed their returns electronically. For them, filing electronically generally meant faster refunds than if they had filed paper returns and greater assurance that their returns were received and accepted by IRS and that their computations were correct. For IRS, electronic filing meant that returns could be processed and stored more efficiently and with less rework. IRS data showed, for example, that the error rate for electronic returns during the 1992 filing season was 2.8 percent compared to 18 percent for paper returns. IRS expects to receive about 14 million electronic returns in 1993.

CFOL is another example. We understand that this project, which makes information from IRS' existing tape-based master files available to IRS employees through on-line terminals, is increasing the quality and efficiency of IRS operations in a number of areas. It is also helping taxpayers get information from IRS more quickly. Last year, for example, CFOL enabled IRS to respond to requests for tax return information from Hurricane Andrew victims in a matter of days rather than weeks.

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[5] Tax System Modernization: IRS' Challenge for the 21st Century (GAO/IMTEC-90-13, Feb. 8, 1990).

Business Planning for TSM Has Not Been Completed

In 1992, IRS began to review the way it will do business (i.e., assist taxpayers and identify, collect, and account for taxes due) under TSM. These business reviews respond to our recommendations and are critical if the government is to realize maximum benefit from its investment in TSM. However, IRS did not undertake the reviews until TSM was well underway. If these ongoing reviews result in fundamental changes to IRS' business operations, as we expect, they could require that the TSM systems architecture and Design Master Plan be changed.

In addition, there are procurements underway, such as the Document Processing System and the Service Center Support System, that were initiated before IRS began its business reviews. Some of the assumptions on which these acquisitions were based may be outdated. If IRS proceeds with these procurements before completing the business plan and revalidating requirements, it may be faced with costly contract modifications after award. In the worst case, IRS may become wedded to hardware and software that will not meet its needs for the modernization. Therefore, to minimize schedule and cost impacts, IRS needs to finalize its business plans soon and make appropriate adjustments to its technical plans.

Management and Technical Infrastructure Initiatives are Lagging Behind Procurements

The technical foundation for TSM is vital to the management and development of all TSM systems. That foundation includes (1) management tools, such as standards and configuration management; and (2) an infrastructure of key building blocks, such as security and privacy, telecommunications, and facilities. Our analysis of the work done in these critical areas suggests limited progress.

For example, 6 years after TSM began, IRS has yet to establish a complete set of system and data standards for the TSM architecture. Such standards are necessary to ensure that the many TSM projects and subprojects are designed and developed as compatible and integratable system components. IRS also does not have, at this point, a firm configuration management process in place to track and control the design specifications and implementation of TSM systems.

Turning to the infrastructure, IRS has not developed detailed security and privacy requirements for the TSM processing and telecommunications systems. Despite the absence of these requirements, IRS is preparing to issue a request for proposals for a major telecommunications contract. This contract is intended to provide the hardware to support service center telecommunications including security. In addition, IRS has yet to define detailed TSM telecommunications requirements or make site-specific telecommunications plans, even though the Department of the Treasury has recently issued a request for proposals for a Treasury Communications System, which will support TSM. We also found that responsibility for critical facilities planning is fragmented and poorly coordinated at a point in TSM's development where the management and planning structure should be solid.

Human Resource Implications of TSM Require Emphasis

TSM's technical implications have received most of the emphasis in IRS. It is critical that IRS also pay attention to the significant human resource implications. The changes that are sure to come as IRS redesigns the way it does business will transform the agency into one that depends less on manual labor and more on technology-based skills. IRS must develop human resource strategies that support the new business direction and technical environment. As part of that effort, IRS needs to determine workforce levels, reassess skill needs, identify strategies for meeting those needs, and manage workforce adjustments.

Fulfilling IRS' policy of protecting employees' jobs from modernization-generated staff reductions will be a formidable challenge. IRS must bridge the gap between existing workforce capabilities and those that will be needed in the modernized environment. By planning well in advance and using the intervening years for such things as training and selective recruitment, IRS should be better equipped to meet that challenge. IRS has recently taken a critical step toward that end by drafting a much-needed human resources plan. It is critical now that IRS start taking steps to prepare its workforce for modernization.

TSM Spending Levels and Benefits

We have had trouble determining the exact spending levels and benefits for TSM projects because expenditures and associated benefits, both budgeted and actual, are not tracked for all efforts nor with sufficient precision through IRS' project tracking system. As of September 30, 1992, IRS had spent about $831 million on the TSM program since its inception in 1986. Of that amount, as shown in table 1, about $240 million could be identified from IRS' data as having been spent on interim projects and about $290 million on the long-term effort.

Table 1: Fiscal Year Expenditures for TSM
(Dollars in thousands)

Project category	Pre-1990	1990 to 1992
Interim projects		$239,698
Long-term projects		290,475
Management		62,889
No-year funds appropriated in prior years		103,418
Total	$134,929[a]	$696,480

[a]We were unable to obtain a complete breakout of the pre-1990 expenditures.

Source: IRS data.

With the funds expended to date, IRS has worked on the interim systems we discussed earlier in our testimony. As we noted, a few of these systems have produced operational benefits, but many are still in the prototype and pilot stage. With these funds, IRS has also staffed the Office of the Assistant Commissioner for Information Systems Development and produced two key TSM plans--a Systems Architecture and a Design Master Plan--that have driven the modernization's overall development.

The true value of the initial TSM investment may not be obvious until systems are fully implemented and their performance evaluated. Given that TSM is perhaps the most complex federal information systems program undertaken outside the Department of Defense, it is hard to say at this point that it has not been a worthwhile return on the TSM investment.

That being said, we would be remiss if we did not return to the lack of concrete progress in building the technical foundation for TSM. Further delay by IRS in developing standards and other management tools, building the infrastructure, and completing projects puts both the current investment and future investments at risk.

The overlap between interim and long-term projects brings into question the advisability of continuing all of the interim projects in their current form. Delays in the interim projects mean delays in the realization of benefits from them. While one could speculate that the long-term projects will also experience delays, the interdependencies among those projects make it important that IRS manage them to established schedules. Hence, due to the overlap, total benefits from some interim projects may be less than expected due to shorter operational lives. Once the technical plans are validated, IRS should reassess and rejustify each of the interim projects.

It is also important to note that IRS' estimates of TSM costs and benefits will probably change. Those estimates, as shown in the appendix, indicate that future TSM costs (from fiscal year 1993 through 2008) will be about $21 billion with benefits of about $26 billion. IRS anticipates that those estimates, which are as of March 1992--the date of IRS' latest approved Design Master Plan--will change for two reasons. First, a contractor is completely reevaluating the Plan's underlying economic analysis to validate its basic assumptions. Second, the business studies that IRS is completing are expected to lead to organizational and operational changes that could increase TSM benefits and decrease future TSM costs due to reduced systems needs.

Pressing TSM Issues

As our discussion has indicated, there are several issues that need IRS' immediate attention and Congress' careful oversight. First and foremost is the need for IRS to complete its business studies and decide how the IRS of the future will look and operate. Those decisions must be made soon because they will provide a basis for guiding the future direction of TSM.

Second, IRS needs to pay more attention to critical aspects of the modernization. IRS does not have essential building blocks like security, privacy, and telecommunications requirements and plans in place. IRS also does not have essential management tools and processes like standards and configuration management. Given these shortcomings, we do not believe that IRS is currently postured to successfully oversee and direct the details of the technical implementation of TSM.

Third, many interim projects once justified by the rapid realization of operational benefits continue to fall behind and are beginning to overlap with long-term projects. Some of these interim projects may still be good investments, but each should be reevaluated.

Fourth, IRS should reexamine its long-term TSM priorities given the business decisions it is now making. For example, current long-term priorities emphasize increased efficiency in service center and compliance operations over making more information available to IRS staff--even though this latter objective is the ultimate goal of TSM. As we emphasized in our transition report on IRS, we believe that complete, on-line information is the key to improving tax administration and taxpayer service. IRS should consider giving higher priority to those long-term projects that are intended to provide such information and implement them as soon as possible.

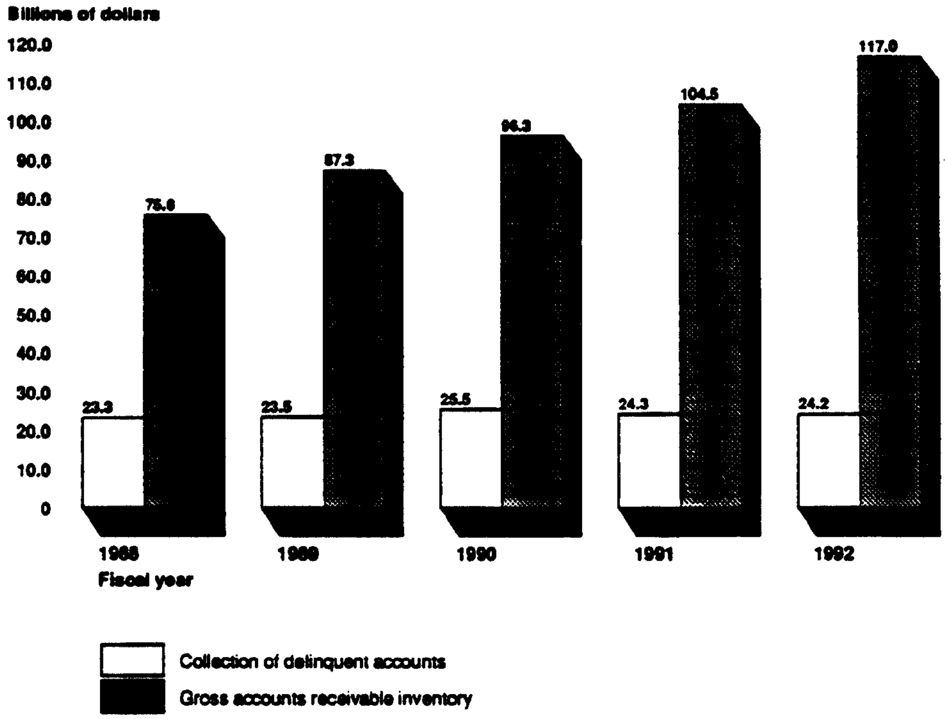
Fifth, IRS should examine whether it has an adequate skill base to manage and integrate the various TSM projects and initiatives. This is a difficult and sensitive issue that has been with us since the early days of TSM. It is an area that is highly subjective, but the evidence before us today points to a need for stronger TSM technical management. In our opinion, IRS needs a senior executive solely responsible for leading the technical development of TSM. The National Research Council similarly recognized the need to improve accountability for TSM's technical management when it recently recommended that IRS appoint a Chief Architect. Furthermore, at this stage of a well-run modernization, we would not expect to see pervasive schedule slippages and serious deficiencies in technical management and infrastructure initiatives. These are problems that have been brought to IRS' attention before. Therefore, it seems reasonable to expect that a strong management team would have concrete, detailed action plans for resolving these problems and keeping projects on track. A Chief Architect at the senior executive level would strengthen IRS' management team and provide the necessary technical leadership to achieve that end.

Sixth, because TSM and the business changes associated with it will significantly alter the nature of IRS' work and the skills required of its workforce, IRS needs to give increased attention to the human side of the modernization effort.

COLLECTING DELINQUENT TAXES

One area that could benefit from modernization and a change in the way IRS does business is accounts receivable. Although IRS has been placing increased emphasis on reducing those accounts, its results are not very encouraging. As shown in figure 2, collections of delinquent taxes over the past 5 years have not changed very much; they actually declined in 1991 and again in 1992. Over the same 5 years, the gross accounts receivable inventory, adjusted to eliminate the increase caused by the change in the statutory collection period in fiscal year 1991 from 6 to 10 years, has been growing at a steady pace.

Figure 2: Comparison of Total Accounts Receivable and Collection of Delinquent Accounts, Fiscal Years 1988 Through 1992



Note 1: Accounts receivable values for fiscal years 1991 and 1992 have been adjusted from a 10-year to a 6-year statutory collection period.

Note 2: In 1992, IRS redefined the gross accounts receivable inventory by excluding certain amounts previously included. The 1992 inventory value was calculated on the basis of the old definition and, therefore, is comparable to prior years.

Source: IRS data.

In reality, however, IRS' gross accounts receivable balance does not mean much. Because of overstatements in the inventory and because of errors by IRS and taxpayers, much of the gross balance is invalid and does not reflect the amount of delinquent taxes actually owed. In addition, many of the valid accounts in the inventory are considered uncollectible because the delinquent taxpayers cannot pay or IRS cannot find them. After considering all of the above, IRS estimates that only about $28.1 billion of the September 30, 1992, accounts receivable balance of more than $100 billion is collectible.

We and the Office of Management and Budget have each designated IRS' accounts receivable as a high-risk area. In a December 1992 report, one of a series on the 17 GAO-designated high-risk areas, we discussed five conditions that have interfered with IRS' ability to collect delinquent taxes.[6]

First, IRS' records are inaccurate and insufficient. As noted earlier, many of the recorded debts do not exist because of errors and duplications in IRS' accounts. Because collection employees do not know which amounts are valid, they waste time and money pursuing nonexistent debts. And because IRS cannot tell which of its many collection tools will produce the best results, it does not know how best to direct its resources. For example, IRS has specific tools to deal with employers who fail to pay withheld income and Social Security taxes as well as their own share of Social Security taxes. Although such delinquencies are about a third of the accounts receivable, IRS does not know how often these tools are used or how effective they are.

Second, the collection process is lengthy, antiquated, rigid, and inefficient. Good business practice dictates that after a debt arises, efforts should be made to quickly secure some type of payment agreement. However, IRS operates under a rather slow and rigid process that starts with a series of written bills that can take up to 6 months. In the private sector, most delinquent accounts are closed within that time. Next, IRS attempts telephone contact and, if unsuccessful, uses more experienced collection employees to make face-to-face contact with the taxpayer. This process varies little regardless of the taxpayer's compliance history. Private sector collection companies are moving to more sophisticated approaches and designing collection actions specifically suited to different delinquent characteristics.

Third, IRS has had difficulty maintaining the delicate balance between collecting delinquent taxes and protecting taxpayers' rights. Because of the fear that IRS would abuse its collection power, Congress has passed various laws to strengthen taxpayer protections. However, these laws may have had the unintended effect of hampering tax collection. For example, IRS is prohibited from using dollars collected as a criterion to evaluate individual collection staff. As a result, under IRS' system for evaluating collection staff performance, accounts that are closed as "currently not collectible" are given the same weight as accounts that are collected. We continue to believe that collections should be used in some fashion to judge the performance of someone whose job it is to collect taxes, as long as other criteria, such as fair and courteous treatment of taxpayers, are also evaluated.

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[6] High Risk Series: Internal Revenue Service Receivables (GAO/HR-93-13, December 1992).

Further, IRS collection staff may be reluctant to use some of the stronger enforcement tools available to them. For example, the number of cases in which IRS seized physical property dropped from 25,000 in 1985 to less than 10,000 in 1991. Also, IRS staff have stopped collection action, even when taxpayers earn a substantial income, if the taxpayers have reported an equal amount of expenses to maintain their existing lifestyle.

As IRS struggles to balance the need to protect the rights of taxpayers with the need to collect tax debts, IRS must be fair. Its employees should follow appropriate laws and procedures and not harass taxpayers. But, on the other hand, taxpayers need to know that IRS is serious about collecting taxes.

Fourth, IRS' decentralized organization has impeded its ability to implement nationwide changes. All 7 regional offices, 63 district offices, and 10 service centers share responsibility for collecting tax debts. Each has a great deal of independence in carrying out general guidance set forth by National Office officials who have no line authority over IRS employees in the field. Recognizing this problem, IRS established an accounts receivable executive officer in 1991 who reports to the Chief Financial Officer. IRS has also initiated various multifunctional task forces to study specific aspects of the accounts receivable problem. But the executive officer and the task forces also face the challenge of operating in a decentralized organization in which they have no line authority over the people directly responsible for activities affecting collections.

And fifth, IRS does not have enough information to allocate collection staff effectively. The staff available relative to the delinquency workload varies dramatically among district offices, and IRS' staffing policies and practices do not ensure maximum collections. In some district offices, enough staff are available to pursue small debts as well as large ones. In other district offices, large debts go uncollected because staff are not available. Considering the backlog of cases, it is imperative that IRS ensure that it is making effective use of its staff.

Traditionally, the solution to collection problems has been to add more staff, but the results of these additions have been inconclusive. We believe that real long-term improvement will come only with improved collection operations and more emphasis on actions to prevent delinquencies from arising in the first place.

IRS' ability to collect delinquent accounts should become easier as TSM is implemented. With TSM, IRS employees should have better and more timely information on such things as the nature of the taxpayer's delinquency and the taxpayer's history, which should enable IRS to take more efficient and effective action to resolve that delinquency.

THE TAX GAP

Since 1964, IRS has regularly measured compliance by thorough audits of a sample of filed tax returns. However, it was not until 1979 that IRS used the results of those audits to publish an estimate of the tax gap. IRS defines the tax gap as the difference between the amount of taxes owed for a given year and the amount voluntarily paid for that year. The size of this gap offers a rough measure of the success of our voluntary tax system.

IRS' tax gap estimates have focused on income taxes. For 1992, IRS estimated an income tax gap of $114 billion--$83 billion for individuals and $31 billion for corporations. According to IRS' estimates, over half of the gap, or $63 billion, arose because individuals failed to report income--such as capital gains, wages, and payments to self-employed persons--on their tax returns. IRS' estimate does not include nonincome taxes, such as employment and excise taxes; and it excludes taxes associated with income derived from illegal activities, such as prostitution and gambling. Neither we nor IRS know how much bigger the tax gap would be if those areas were included.

To close the tax gap, IRS needs to improve voluntary compliance. IRS' data show that voluntary compliance for small corporations plummeted from 81 percent in 1980 to 61 percent in 1987 (the latest year for which data are available) while individual compliance has stayed at about the mid-80 percent level. In an attempt to reduce the tax gap, IRS recently announced a goal to increase individual voluntary compliance to 94 percent in 8 to 10 years.

To help achieve that goal, IRS has embarked on a new strategy called Compliance 2000. Recognizing that many taxpayers are noncompliers not because of an intent to cheat but because of an inability to decipher confusing laws and regulations, Compliance 2000 would put more emphasis on the role of taxpayer education and assistance in improving compliance.

Even with an increased emphasis on assistance and education, IRS' efforts to improve compliance will still require a strong enforcement presence. Traditionally, IRS has relied on audits to encourage taxpayers to comply and detect those who do not. In the past few years, however, IRS has audited only about 1 percent of the approximate 100 million tax returns filed by individuals. The audit rate was about 5 times greater in the 1960s. We do not know what the "right" level of audit coverage is, but 1 percent appears so low as to encourage what some researchers have called the "audit lottery"--filing an erroneous return on the assumption that there is little chance that IRS will select your return for audit and find the errors.

Besides determining the appropriate level of audit coverage and how to achieve that level, now would seem a good time, in light of the opportunities afforded through TSM, for IRS to rethink its entire enforcement approach. Among other things, IRS needs to ask the following questions: (1) Is there a need for more withholding at the source or simplified ways to file returns and pay taxes? (2) Does everyone have to file a tax return? (3) How could compliance checks be designed into TSM? and (4) Are there more opportunities to improve compliance through additional information reporting or increased information-sharing among governmental entities?

If IRS is to effectively target its efforts toward increasing compliance and reducing the tax gap, it needs reliable data on the nature of noncompliance and the impact of its efforts to deal with that problem. The only reliable measure of compliance IRS now has is the Taxpayer Compliance Measurement Program (TCMP), under which IRS does detailed audits of returns filed by a random sample of taxpayers. IRS' current direction appears to be toward eventual elimination of TCMP on the grounds that it is too costly, too intrusive, and untimely. IRS believes that it can produce information systems that will approximate TCMP's benefits in a less costly and time-consuming way. While we support efforts to decrease costs and reduce burden, we are opposed to changes that would make TCMP virtually useless for measuring compliance--at least until IRS has proven that any new system works at least as well as TCMP.

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In conclusion, although each of the three areas discussed in this testimony is critical, the most critical is TSM. We cannot overemphasize the importance of modernizing IRS' outdated systems. IRS cannot function effectively otherwise. Dramatic improvements in IRS' ability to collect delinquent taxes and reduce the tax gap, for example, will only come about, in our opinion, through dramatic changes in the way IRS does business. Central to such change will be the capability of IRS employees to obtain on-line access to accurate, up-to-date information whenever they need it--the ultimate goal of TSM. As our testimony noted, however, there are several issues that could impede successful implementation of TSM. Those issues need IRS' immediate and persistent attention.

That concludes my statement. I would be pleased to respond to any questions.

IRS' ESTIMATED TSM COSTS AND BENEFITS[1]
(In thousands of fiscal year 1992 dollars)

Category	Subtotal FY 1990-1992	Subtotal FY 1993-1997	Subtotal FY 1998-2008	Total
<u>Costs</u>				
Long-term Systems	$155,321	$3,346,757	$8,834,407	$12,336,485
Infrastructure	387,945	2,109,199	2,322,968	4,820,112
Interim Systems	184,092	1,124,700	208,183	1,516,975
Program Management	39,389	163,959	166,427	369,775
Costs to Phase Out Current Systems[2]	1,267,265	2,226,837	519,628	4,013,730
Total Costs[3]	$2,034,012	$8,971,452	$12,051,613	$23,057,077
<u>Benefits</u>				
Savings from not Operating Current Systems	$1,393,713	4,644,098	$9,466,702	$15,504,513
Reduced/Avoided Costs	46,515	766,247	7,967,313	8,780,075
Interest Savings	0	710,810	2,358,784	3,069,594
Increased Revenue--Direct	0	36,042	121,676	157,718
Total Benefits[4]	$1,440,228	$6,157,197	$19,914,475	$27,511,900
Net Benefits	($593,784)	($2,814,255)	$7,862,862	$4,454,823

[1]We have not fully reviewed the assumptions behind these IRS estimates. The estimates are expected to change, however, after (1) a contractor finishes reevaluating IRS' economic analysis and (2) IRS decides on changes to its business operations.

[2]These include costs to operate and maintain current systems while transitioning to the new systems architecture.

[3]Costs do not agree with expenditures for fiscal years 1990-1992 as shown in table 1 because costs include funds that were appropriated but not yet spent and estimated phase out costs.

[4]Does not include reduction in taxpayer burden for taxpayer hours saved (1,075,450 hours) and related benefits.

Sources: IRS' Design Master Plan Economic Analysis, March 1992, and IRS' TSM Quarterly Performance Tracking System, November 1992, for many of the fiscal year 1992 through 1997 costs.

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