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IRS RESTRUCTURING ACT

Implementation Under Way but Agency Modernization Important to Success

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GAO

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Statement

IRS Restructuring Act: Implementation Under Way but Agency Modernization Important to Success

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the Internal Revenue Service's (IRS) progress in implementing the taxpayer rights and protections mandates of the IRS Restructuring and Reform Act of 1998 (Restructuring Act).[1] I will also discuss a related topic--the challenges IRS faces in its ongoing efforts to modernize. The connection is important, as was recognized by Congress in the Restructuring Act. As my statement today underscores, modernization is key to improving the way IRS interacts with taxpayers, including protecting their rights.

Passage of the Restructuring Act signaled strong congressional concern that IRS had been overemphasizing revenue production and compliance at the expense of fairness and consideration of taxpayer interests. To deal with this concern, Congress mandated that IRS make numerous changes. Many of these changes, such as provisions governing the seizure of delinquent taxpayers' assets and innocent spouse relief, were designed to address specific taxpayer protection issues. Others, like the mandate to reorganize IRS into units serving specific groups of taxpayers, were broader in scope. In their totality, the Restructuring Act's provisions were aimed at fundamentally changing the way IRS interacts with taxpayers and otherwise conducts its business.

My statement is based on our past work, principally our reviews of IRS' reorganization process, performance management system, systems modernization efforts and use of collection enforcement authority. My statement makes the following points regarding IRS' progress in implementing the act's requirements.

- First, IRS has embarked on a concerted effort to implement the taxpayer protection provisions. In some instances, implementation is not complete, and in some others, it is too early to tell if implementation is successful.
- Second, IRS has experienced difficulties in implementing some aspects of the mandates. These difficulties included determining when enforced collection actions, such as the seizure of delinquent taxpayers' assets, are appropriate and dealing with requests for relief under the innocent spouse provisions.
- Third, we believe that IRS' ongoing efforts to modernize its organizational structure, performance management system, and information systems are

[1] Public Law 105-206, July 22, 1998.

heading the agency in the right direction. IRS' modernization is a long-term effort that, if successful, should help IRS create a culture focused on serving the public and generate efficiency improvements throughout the agency. Both are necessary—a culture change to institutionalize taxpayer service as a core value, and efficiency gains to allow IRS to better target its resources to promote compliance and taxpayer service.

Implementation Under Way but Work Remains

IRS has made a concerted effort to implement the Restructuring Act's taxpayer rights and protections mandates. Not surprisingly, given the magnitude of change required by these provisions, work remains in completing, and in some instances expanding on, current implementation efforts.

To manage Restructuring Act implementation, IRS delegated lead responsibility for each of the provisions to the affected organizational unit and required those units to develop detailed implementation plans. For example, IRS assigned to its Collections unit the lead responsibility for implementing the 22 collection-related taxpayer protection provisions in title III of the act. Our review of each of these plans identified numerous action items, such as developing tax regulations, forms, instructions, and procedures, as well as milestones for completing the actions. According to IRS officials, although IRS has met all of the legal requirements of the provisions whose effective dates have passed, it is still in the process of completing several actions or implementation steps. For example, in order to meet the effective dates of some provisions, IRS issued temporary procedures until the final rulemaking could be completed.

Despite the rather detailed nature of the implementation plans, in some instances we have questions concerning the sufficiency of those plans. For example, with respect to selling assets seized from delinquent taxpayers to resolve their tax debts, the Restructuring Act mandated IRS, by July 2000, to remove revenue officers from any participation in such sales and to consider "outsourcing." In our November 1999 report on IRS seizures, we reported on IRS' implementation efforts, including establishment of a study group to develop implementation plans.[2] Given the study group's preliminary work, however, we concluded that removing revenue officers from the sales process was not, by itself, sufficient to ensure that some basic problems that we identified in the sales process would be corrected. These problems involved the sale of taxpayer assets without competitive biding, sales based on unreliable minimum prices, and

[2] See IRS Seizures: Needed for Compliance but Processes for Protecting Taxpayer Rights Have Some Weaknesses (GAO/GGD-00-4, Nov. 29, 1999).

insufficient controls to establish accountability and control over assets. Accordingly, we made a number of recommendations to IRS regarding these problems and are awaiting a final response concerning its plans to implement the recommendations.

In another instance, IRS has made changes to meet the Restructuring Act's mandate but does not have information necessary to determine whether the implementation steps have been sufficient. The act prohibits IRS from using enforcement statistics to impose or suggest production quotas or goals for any employee, or to evaluate an employee based on such enforcement quotas. IRS has taken a number of actions to implement this mandate, such as issuing a handbook on the appropriate use of performance measures and conducting agencywide training sessions. IRS has also taken action on our recommendations,[3] such as by clarifying the requirements for IRS managers to certify that they have not used enforcement statistics inappropriately. In its spring 1999 survey, IRS found that about 7 percent of Collections employees and 9 percent of Examination employees reported that their supervisors had either discussed enforcement statistics with them or used statistics to evaluate their performance. Until it has more recent comparison data, IRS will not know if its actions were sufficient to fulfill the Restructuring Act's mandate.

IRS' Difficulties in Implementing the Restructuring Act

IRS has also experienced some difficulty in implementing the Restructuring Act. Two notable examples are the decline in enforcement actions, particularly liens, levies, and seizures and the backlog of "innocent spouse" cases.

IRS' use of enforcement actions to collect delinquent taxes has declined significantly since passage of the act. Comparing pre-Restructuring Act data on IRS' use of liens, levies and seizures, with fiscal 1999 data shows that lien filings were down about 69 percent, levies down about 86 percent, and seizures down about 98 percent. Moreover, according to IRS, collections from delinquent taxpayers were down about $2 billion from fiscal year 1996 levels.

We do not know the appropriate number of enforcement actions that IRS should take because such decisions necessarily involve the use of judgment by IRS officials. However, based on our review of fiscal year 1997 seizure cases, the current number of seizures is probably too low. In

[3] See IRS Personnel Administration: Use of Enforcement Statistics in Employee Evaluations (GAO/GGD-99-11, Nov. 30, 1998).

fiscal year 1997, the last full year before passage of the Restructuring Act, about 42 percent of seizures resulted in the tax debt being fully resolved. In most cases, the debt was resolved when the taxpayers produced funds to fully pay their tax liabilities and have their assets returned. Prior to the seizures, the involved taxpayers had been unresponsive to other IRS collection efforts, including letters, phone calls, personal collection visits, and levies of bank accounts and wages. We concluded from these observations that there was little likelihood that the tax debts would have been paid without the seizure actions.

At the conclusion of our seizure work in 1999, it was clear to us that neither IRS management officials nor front line employees believed that seizure authority was being used when appropriate. Front line employees expressed concerns about the lack of guidance on when to make seizures in light of Restructuring Act changes. Accordingly, we made recommendations aimed at (1) clarifying when seizures ought to be made, (2) preventing departures from process requirements established to protect taxpayer interests, and (3) delineating senior managers' responsibilities for ensuring that seizures are made when justified. Effective use of tax collection enforcement authority, such as seizing delinquents' property to resolve their tax debts, plays an important role in ensuring voluntary compliance---a practice dependent on taxpayers having confidence that their neighbors or competitors are complying with the tax law.

A second example of IRS difficulty in implementing the Restructuring Act is related to "innocent spouse" cases. The Restructuring Act expanded innocent spouses' right to seek relief from tax liabilities assessed on jointly filed returns. IRS published forms and temporary guidance to implement this provision and has just recently issued permanent guidance on equitable relief provisions.[4] However, as Commissioner Rossotti has acknowledged, IRS was administratively unprepared to deal with the volume of requests for relief because its data systems did not allow the separation of single tax liability for spouses into multiple liabilities. Thus, IRS established manual processes and controls to deal with the requests, a measure requiring about 330 additional staff. As of October 1999, of the 41,000 relief requests received, only about 12 percent had been processed to the point where at least a preliminary determination had been reached. IRS considers the remaining relief requests to be a significant backlog that will require an average of about 12 staff hours per case to resolve.

[4] See Revenue Procedure 2000-15 issued January 18, 2000.

To Make Lasting Process and Efficiency Improvements, IRS First Needs to Address Systemic Barriers

Underlying the Commissioner's modernization strategy is the understanding that fulfilling the Restructuring Act's mandate to place greater emphasis on taxpayer rights and needs while ensuring compliance depends on two key factors. First, IRS must make material improvements in the processes and procedures through which it interacts with taxpayers and collects taxes due. Second, IRS must make efficiency improvements that will allow reallocation of its limited resources. Historically, however, IRS has not had much success designing and implementing these kinds of process changes. The Commissioner has argued, and we agree,[5] that this difficulty is due in large part to systemic barriers in IRS' organization, management, and information systems. Accordingly, and in compliance with the Restructuring Act, the Commissioner has begun to implement a multifaceted modernization strategy, the first stages of which are designed to address these systemic barriers.

Creating a Taxpayer-Focused Structure and Clearer Lines of Authority and Accountability

Notwithstanding a reduction in the number of its field offices, IRS' organizational structure has not changed significantly in almost 50 years. Under this structure, authority for serving taxpayers and administering the tax code is decentralized to 33 districts and 10 service centers, with each of these geographic units organized along functional lines—such as collection, examination, and taxpayer service. This has resulted in convoluted lines of authority. In the collection area, for example, IRS has three separate kinds of organizations spread over all 43 operational units that use four separate computer systems to collect taxes from all types of taxpayers. This decentralized structure has also allowed disparity among districts in their compliance approaches and, as a result, inconsistent treatment of taxpayers. To illustrate, in our review of IRS' use of its seizure authority, we found that seizures were as much as 17 times more likely for delinquent individual taxpayers in some district offices than in others.[6] Similar variations exist in other IRS programs as well.

To streamline its management structure and create a more taxpayer-focused organization, IRS is in the midst of instituting a major reorganization. IRS' new organizational structure is built around four operating units, each with end-to-end responsibility for serving a group of taxpayers—such as individuals or small businesses—with similar needs

[5] See IRS Management: Business and Systems Modernization Pose Challenges (GAO/T-GGD/AIMD-99-138, Apr. 15, 1999) and IRS Management: Formidable Challenges Confront IRS as It Attempts to Modernize (GAO/T-GGD/AIMD-99-255, July 22, 1999).

[6] Our comparisons among district offices showed differences in the likelihood of seizure ranging from 1.25 times to 17 times.

and tax issues.[7] Through its new taxpayer-focused operating divisions, IRS is centralizing management of key functions and creating narrower scopes of responsibility. For example, IRS estimates that individual taxpayers account for 75 percent of all filers, yet only 17 percent of the tax code is ordinarily relevant to them. By creating a division devoted solely to individual taxpayers, IRS is creating a situation in which managers and employees in that division will be able to focus on compliance and service issues related to individual taxpayers and will need expertise in a much smaller body of tax law.

Creating a simpler, more coherent organization and management structure is an important step, but it does not guarantee good management. IRS' managers, at all levels, need to be skilled in results-oriented management, including planning, performance measurement, and the use of performance data in decisionmaking. Without these skills, IRS cannot be assured that its employees and the agency as a whole are performing as expected with regard to both taxpayer rights and enforcement. Our work has shown that ensuring that IRS has the capacity it needs in this area will be a challenge.

For example, in our recent work on IRS seizures, we found that IRS did not generate information sufficient for senior managers to use in monitoring the program. IRS did not have a fully developed capability to monitor the quality of seizure work in terms of the appropriateness of seizure decisionmaking or the conduct of asset management and sales activity. In addition, collection managers were not systematically provided with information on the type of problems experienced by taxpayers involved in a seizure or on the resolution of those problems. We concluded that IRS managers were not collecting the information needed to effectively oversee the program and made recommendations to improve oversight. Our point today, however, is that generating and using basic management information needs to be routine among IRS managers at all levels and across all taxpayer groups and functions.

[7] IRS' four operating divisions are: (1) Wage and Investment, serving individual taxpayers; (2) Small Business and Self-Employed, serving fully or partially self-employed individuals and small businesses with assets under $5 million; (3) Large and Mid-Size Business, serving businesses with assets over $5 million; and (4) Tax Exempt and Government Entities, serving pension plans, exempt organizations, and governments.

Developing Performance Measures and Evaluation Systems That Support Agency Goals

The organizational and management changes I've described, while significant, will not be sufficient to achieve IRS' mission. As an agency still dealing with the repercussions of a performance system that was, for many years, based on enforcement statistics, IRS well knows that performance measures can create powerful incentives to influence both organizational and individual behavior. Consequently, IRS needs to develop an integrated performance management system that aligns employee, program, and strategic performance measures and creates incentives for behavior supporting agency goals, including that of giving due recognition to taxpayers' rights and interests.

Developing and implementing performance measures are difficult tasks for any organization, but especially for an organization like IRS that must ensure both quality taxpayer service and tax law compliance. At the operational level, IRS is measuring its progress toward these goals through customer satisfaction surveys and through the business results measures of quality and quantity. Mindful of concerns that the Service had focused on revenue production as an end in itself, IRS established what it believes are outcome-neutral quantity measures. For example, instead of measuring the revenue generated by compliance employees, IRS is generally monitoring the total number of cases closed, regardless of how those cases were closed.

We have reported in the past that IRS employees' performance focused more on IRS' objectives of revenue production and efficiency than on taxpayer service.[8] Guided by these concerns and the Restructuring Act's explicit prohibitions against using enforcement statistics to evaluate employees, IRS now recognizes that employees must have a clearer line of sight between their day-to-day activities, their resulting performance evaluations, and the agency's broader goals. IRS is still exploring several different approaches for revising its employee evaluation system to make the relationship between employee performance and agency performance more transparent.

Modernizing Information Systems to Support Business Modernization

IRS' system difficulties hinder, and will continue to hinder, efforts to better serve taxpayer segments. IRS has dozens of discrete databases that are function specific and are designed to reflect transactions at different points in the life of a return or information report—from its receipt to disposition. As a consequence, IRS does not have any easy means of

[8] IRS Personnel Administration: Use of Enforcement Statistics in Employee Evaluations (GAO/GGD-99-11, Nov. 30, 1998) and IRS Employee Evaluations: Opportunities to Better Balance Customer Service and Compliance Objectives (GAO/GGD-00-1, Oct. 14, 1999).

accessing comprehensive information about individual taxpayer accounts or summary data on groups of taxpayers. Without this type of data, IRS managers will continue to have a difficult time monitoring and managing program outcomes—including identifying taxpayer needs and evaluating the effectiveness of programs to meet those needs. In doing our work on small business compliance issues, for example, we found that IRS could not reliably provide data on the extent to which small businesses filed various required forms, when they made tax deposits, or the extent to which they were involved in a variety of enforcement processes.

For years, IRS has struggled to modernize its information systems to support high quality taxpayer service and management information needs. In 1995, we made over a dozen recommendations to correct management and technical weaknesses that jeopardized the modernization process.[9] In February 1998, we made additional recommendations to ensure, among other things, that IRS develops a complete systems architectural blueprint for modernizing its information systems.[10] Subsequently, in fiscal years 1998 and 1999, Congress provided IRS funds for systems modernization and limited their obligation until certain conditions, similar to our recommendations, were met.[11] While IRS has made progress in addressing our recommendations and complying with the legislative conditions, the Service has not yet fully implemented our recommendations.[12] As a result, at the direction of the Senate and House appropriation subcommittees responsible for IRS' appropriation, we have continued to monitor and report on IRS' system modernization efforts.

IRS Is Relying on Successful Modernization to Create Greater Opportunity for Frontline Improvements

We believe that IRS' modernization efforts to date are heading the agency in the right direction. Without integrated improvements to its organization, management, performance measures, and information systems, IRS is at risk of being unable to achieve the Restructuring Act's overall mandate. If successful, however, IRS will be better able to create a culture focused on serving the public and to generate efficiency improvements throughout the agency. Both are necessary—a culture change to institutionalize taxpayer service as a core value, and efficiency

[9] See Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is To Succeed (GAO/AIMD-95-156, July 26, 1995).

[10] Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems (GAO/AIMD/GGD-98-54, Feb. 24, 1998).

[11] Public Law 105-61, October 10, 1997, and Public Law 105-277, October 21, 1998.

[12] See Tax Systems Modernization: Results of Review of IRS' Initial Expenditure Plan (GAO/AIMD/GGD-99-206, June 15, 1999) and Major Management Challenges and Program Risks: Department of the Treasury (GAO/OCG-99-14, Jan. 1999).

gains to allow IRS to better target its resources to promote compliance and taxpayer service.

Mr. Chairman, this concludes my prepared statement. I would be happy to answer any questions you or other Members of the Committee may have.

Contact and Acknowledgments

For future contacts regarding this testimony, please contact James R. White at 202-512-9110. Thomas M. Richards, Deborah Parker Junod, Charlie Daniel, and Ralph Block made key contributions to this testimony.