

**2004 Annual Report to Congress:
The Most Serious Problems Encountered By Taxpayers**

2004 ARC – MSP A-2

TAXPAYER ACCESS: FACE-TO-FACE INTERACTION

Problem: The IRS is working to expand the electronic delivery of services to taxpayers, and reducing some of the face-to-face services available at Taxpayer Assistance Centers (TACs). The IRS is also shifting the focus of the TACs from pre-filing services to compliance activities, further diluting taxpayers' access to face-to-face interaction with IRS employees. The National Taxpayer Advocate recommends that the IRS conduct research to determine whether it is offering services to taxpayers through the appropriate means and ensure that taxpayers who do not utilize electronic services are receiving assistance elsewhere, including through face-to-face service.

NTA Recommendations

1. Continue to monitor taxpayer satisfaction with pre-filing services, as well as the number and types of taxpayers utilizing them, to determine whether the IRS is adequately reaching its entire customer base.
2. Examine how the Social Security Administration (SSA) is able to expand its electronic services without sacrificing customers' access to face-to-face service.
3. Monitor the effects of the change in return preparation services at TACs to ensure that taxpayers who are turned away are receiving the help they need.
4. Monitor the effects of the change in the transcript delivery system at TACs to ensure they have not increased burden on either taxpayers or other IRS functions.
5. Revisit the existing "extreme hardship" exception for the transcript delivery system to ensure that it is broad enough to cover those taxpayers in serious need of assistance.
6. Provide additional training to employees on the "extreme hardship" exception, including real life examples, so employees will know when they are presented with a request that meets the exception and take appropriate actions to assist the taxpayer.
7. Continue to monitor those small sites that are being forced to close either permanently or temporarily and ensure that additional assistance remains available in the area and that taxpayers are not forced to travel long distances in order to receive face-to-face assistance from the IRS.
8. Conduct research to identify what services should be offered at the TACs and kiosks and determine whether the existing service offerings at each location actually meets taxpayers' needs.

NTA Recommendations 1, 2 and 8

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2. Examine how the Social Security Administration (SSA) is able to expand its electronic services without sacrificing customers' access to face-to-face service.
8. Conduct research to identify what services should be offered at the TACs and kiosks and determine whether the existing service offerings at each location actually meets taxpayers' needs.

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IRS Response to Recommendations 1, 2 and 8

The IRS will continue to strive to incorporate technological changes, improve accuracy, provide better alternatives to customers, expand our scope, and better train our workforce, all in concert with the vision carefully and clearly depicted in our ConOps. Our ConOps is designed to deliver the best service possible to the widest range of customers who come through our TACs' doors day in and day out.

Closely associated with the ConOps is the Taxpayer Service Blueprint Project. This initiative was undertaken in response to Senate Appropriations Committee report language accompanying the Senate's FY-06 budget bill that directed IRS to conduct a comprehensive review of taxpayer services and develop a 5-year plan for delivery improvements. We appointed executive lead for the project that began September 6 with a report due to Congress in March, 2006. This will include a comprehensive review of IRS' current taxpayer services, evaluation of innovative new approaches to delivering services, how IRS can expand partnerships with state and private entities, and development of detailed plans for meeting taxpayer needs on a geographic basis.

NTA Recommendation 3

3. Monitor the effects of the change in return preparation services at TACs to ensure that taxpayers who are turned away are receiving the help they need.

IRS Response to Recommendation 3

IRS made a conscious decision to better manage Taxpayer Assistance Center walk-in operations, the most costly method of providing taxpayer services. This included reducing, and finally eliminating, reliance on Compliance details-in to support these operations, thereby freeing-up these resources to focus on their primary enforcement mission. In this context, return preparation assistance in the TACs was reduced by establishing income limits based on EITC eligibility to target this service to those most in need and by encouraging use of free and convenient alternatives. These include VITA and TCE for in person assistance, and "Free File" which is offered online through IRS.gov. In FY 2004, the TACs prepared 190,000 fewer returns than in the prior year. However, volunteers prepared 330,000 more returns than the prior year, more than offsetting the difference.

NTA Recommendations 4, 5 and 6

4. Monitor the effects of the change in the transcript delivery system at TACs to ensure they have not increased burden on either taxpayers or other IRS functions.

5. Revisit the existing "extreme hardship" exception for the transcript delivery system to ensure that it is broad enough to cover those taxpayers in serious need of assistance.

6. Provide additional training to employees on the "extreme hardship" exception, including real life examples, so employees will know when they are presented with a request that meets the exception and take appropriate actions to assist the taxpayer.

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IRS Response to Recommendations 4, 5 and 6

The demand for transcripts in some locations prevented our employees from being able to serve taxpayers with tax problems, which is our primary objective. The IRS Campuses include a unit (the Transcript Delivery System (TDS)) dedicated to the generation of transcripts and provides the service in a high volume, cost efficient manner. The TACs use of the term “extreme hardship” reference applies only to requests for non-tax related needs and will continue to provide requests for transcripts meeting this criterion.

Taxpayers or practitioners coming into our TACs needing transcript information to resolve tax issues are serviced as in the past. We will also continue efforts to provide easier direct access to such information for tax or non-tax purposes, as has been initially implemented in the TDS.

The Treasury Inspector General for Tax Administration (TIGTA) is currently auditing FA’s service delivery process. They also are using the ConOps as the starting point. Their approach includes interviews with FA leadership, visiting TACs, observing service delivery and interviewing customers. The TIGTA’s feedback to date is complimentary as it relates to the transcript delivery changes following a phased-in approach over several months. The customers stated they were pleased with the reasonable alternatives offered and the fact that it frees up time for customers needing assistance with more complex issues. We will consider any recommendations that result from the TIGTA audit.

NTA Recommendation 7

7. Continue to monitor those small sites that are being forced to close either permanently or temporarily and ensure that additional assistance remains available in the area and that taxpayers are not forced to travel long distances in order to receive face-to-face assistance from the IRS.

IRS Response to Recommendation 7

The IRS has made no permanent TAC office closures during FY 2004. Unfortunately, we are sometimes unsuccessful in recruiting for vacancies in certain geographic and relatively remote areas. We have announced some positions repeatedly, with various types of advertising efforts to reach potential candidates, to no avail. Temporary closures for training, leave or emergencies are unavoidable in small TACs with three or less full-time employees.

In May, the IRS announced its intent to close 68 of its 400 Taxpayer Assistance Centers later this year. But both the House and Senate Appropriations committee reports include provisions that would stop the IRS from moving ahead with the closures. As a result, on July 29, 2005, the Commissioner suspended the proposed closures until any related actions required by the Fiscal Year 2006 IRS appropriation have been completed.

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2004 ARC – MSP A-3

TAXPAYER ACCESS: REMOTE INTERACTION

Problem: As the IRS encourages more taxpayers to access customer service remotely, the agency faces significant challenges in providing taxpayers with the level and type of service that they require. While the IRS has significantly improved the toll-free telephone service, taxpayers still struggle with the menu system. The Kiosk program has given out old and incorrect information and, despite clear demand for the Electronic Tax Law Assistance (ETLA) program, the IRS has virtually hidden the ETLA link on its website. The National Taxpayer Advocate recommends that the IRS conduct research on why taxpayers perceive the need to make multiple phone calls; how taxpayers navigate the phone system; their experiences with the Referral Mail program; the use of artificial intelligence technology for ETLA; and the experience of other organizations with kiosks.

NTA Recommendations

1. The IRS must educate taxpayers on the advantages and short-comings of using remote assistance.
2. W&I should conduct a real-time study during filing season that would ask randomly selected Toll-Free customers whether they had called previously regarding the same issue.
3. Rather than merely conducting customer satisfaction surveys, the IRS needs to take a more proactive approach to determining the exact obstacles taxpayers face while they navigate through the Toll-Free system.
4. Conduct customer satisfaction surveys of those taxpayers who receive written responses through R-Mail.
5. Explore developing ETLA as it was originally intended – a more cost-effective self-help application.
6. Review the experience of federal, state and local organizations, as well as organizations in the private sector, which utilize kiosks as a delivery option.

NTA Recommendation 1

1. The IRS must educate taxpayers on the advantages and short-comings of using remote assistance.

IRS Response to Recommendation 1

The Internal Revenue Service recognizes the need for taxpayers to be aware of the various options to access available tax materials and services. The availability of assistance sources and the services one can receive will continue to be strategically promoted via IRS.gov, forms and publications, and outreach and education messages and products. One such product, Publication 910, IRS Guide to Free Tax Services, is updated each year and includes specific information ranging from Free Tax Services to Taxpayer Education and Assistance programs to IRS telephone numbers.

Field Assistance communicates the availability and location of kiosks on irs.gov (Contact My Local Kiosk) and localized messages are delivered through Stakeholder

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Partnerships, Education and Communication (SPEC) partners in areas where a kiosk is located. We also included a reminder in the filing season Congressional Update Newsletters.

NTA Recommendations 2 and 3

2. W&I should conduct a real-time study during filing season that would ask randomly selected Toll-Free customers whether they had called previously regarding the same issue.
3. Rather than merely conducting customer satisfaction surveys, the IRS needs to take a more proactive approach to determining the exact obstacles taxpayers face while they navigate through the Toll-Free system.

IRS Response to Recommendations 2 and 3

There are already several venues available for IRS to assess and improve the level of initial contact resolution, including current customer satisfaction surveys, Centralized Quality Reviews and Contact Recording. In light of these sources, we do not believe that the cost of an additional survey and attendant burden on taxpayers would be justified by the potential benefit.

The IRS upgraded the infrastructure used to screen customers for the FY 2005 filing season. Menus were moved from the AT&T prompter to Internet Service Node (ISN). This upgrade provides the capability of determining the exact point at which customers are abandoning, which is a necessary starting point in determining which portion of the menus need to be changed to better meet customer needs. The ISN infrastructure will also decrease the cycle time it takes to get changes implemented.

A multi-functional group was formed to analyze ISN data. As a result, data-driven changes have been implemented to improve the customer's experience at the menu level and reduce the occurrence of primary abandons. Usability testing is scheduled to determine the customer's reaction to additional proposed changes. Utilization of the usability lab will be increased for future planned changes.

We continually analyze:

- The reasons taxpayers are calling;
- The why and where in the menus they disconnect;
- The frequency and reasons for calling back.

NTA Recommendation 4

4. Conduct customer satisfaction surveys of those taxpayers who receive written responses through R-Mail.

IRS Response to Recommendation 4

The continuing use of R-Mail as a vehicle for answering routine customer inquiries on certain subjects was evaluated during filing season 05. For 2006, we plan to use R-Mail only for the most complex tax law questions that are beyond the training level of our Accounts Management employees. As a result of this change, we project the volume of

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R-Mail inquiries to decline from 360,000 in FY 05 to only approximately 35,000 in FY 06. Based on the relatively small number of inquiries projected to be handled via R-Mail, we do not intend to pursue this recommendation.

NTA Recommendation 5

5. Explore developing ETLA as it was originally intended – a more cost-effective self-help application.

IRS Response to Recommendation 5

We will continue our efforts to effectively use the Internet as a tool to deliver information and broad market-based interactive self-service assistance options. Web features such as Frequently Asked Questions, Tax Trails and access to forms and publications provide consistent and accurate tax law information to our customers in a cost effective manner.

We also continue to explore the potential of other technology tools that would enable us to provide a higher level of self-service assistance in the electronic media, including a Natural Language search engine. In addition, the re-engineering of the automated self-service applications is also planned as a future endeavor.

NTA Recommendation 6

6. Review the experience of federal, state and local organizations, as well as organizations in the private sector, which utilize kiosks as a delivery option.

IRS Response to Recommendation 6

We are in the process of reassessing our long-term strategy for kiosks and other initiatives designed to provide taxpayers with self-service delivery methods. When completed, our strategy will identify the long term goals, procedures, and measures needed to ensure taxpayers not requiring face-to-face assistance have alternative self-service tools.

We have developed guidelines and strategies to improve oversight of the program, and to develop a process to educate taxpayers on the benefits of the Kiosk Program, including the locations of kiosks.

We have implemented the corrective actions detailed below:

- Internal Control and Management Oversight
- Developed a standardized operational review guide for the Kiosk Program to ensure consistency in the review process.
- Developed guidelines for analyzing kiosk information to identify trends, issues and areas needing improvement.
- Developed a Kiosk Checklist requiring field personnel to certify annually that the information on the kiosks is current, accurate, and the kiosks are operating as intended.
- Kiosk Usage and Customer Satisfaction
- Developed guidelines for analyzing usage reports and other information on the kiosks to identify trends, issues and areas needing improvement.

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- Installed the newly developed Customer Satisfaction Survey on all kiosks. We will use the survey results to determine taxpayer satisfaction with the services received and to determine whether additional services or information is needed to help taxpayers meet their tax obligations.

2004 ARC – MSP A-4

ACCURACY OF TAX LAW AND ACCOUNTS ASSISTANCE

Problem: The toll-free telephone system experienced a decline in accuracy rates between fiscal years 2002 and 2004. During this time, the IRS increased the range of topics assigned to customer service representatives (CSRs) to reduce customer wait times and call transfers, but this occurred at the expense of accuracy. Another contributing factor was the failure of some CSRs to follow required scripts. The IRS has now increased the number of topics covered and reduced specialization. To devise a long-term solution, however, the National Taxpayer Advocate recommends that the IRS research the comparative effects of accuracy rates, call wait times, and call transfers on taxpayer compliance.

NTA Recommendations

1. The IRS needs to continually monitor tax law and account accuracy rates at the TACs and on the Toll-Free telephone service to determine the effectiveness of the corrective actions taken. The training provided to employees must be tailored to the findings of these reviews in order to sufficiently meet the changing needs of the employees and address emerging issues.
2. W&I should continue to explore ways to achieve other goals, such as lowering customer wait time and multiple transfers, without adversely impacting the accuracy of its responses.
3. W&I should consider sponsoring research to determine the comparative implications of various items, such as improved accuracy rates and shorter wait times, on taxpayer compliance.
4. Although the IRS believes that defects in the disclosure authentication process should not impact accuracy rates, authentication is essential to taxpayer privacy. Accordingly, the agency should commit to continually monitor this item on a regular basis.

NTA Recommendation 1

1. The IRS needs to continually monitor tax law and account accuracy rates at the TACs and on the Toll-Free telephone service to determine the effectiveness of the corrective actions taken. The training provided to employees must be tailored to the findings of these reviews in order to sufficiently meet the changing needs of the employees and address emerging issues.

IRS Response to Recommendation 1

The IRS has, and will continue to, monitor tax law and account accuracy rates at the TACs and on the Toll-Free telephone service. Toll-free tax law and account accuracy is

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monitored on a daily basis and weekly analysis of error trends is conducted. This analysis is shared with all sites and corrective actions are monitored on an ongoing basis. Application specific Probe and Response Guide Training was delivered and redesign of the Probe and Response Guide for FY 2005 has resulted in significant improvement.

NTA Recommendations 2 and 3

2. W&I should continue to explore ways to achieve other goals, such as lowering customer wait time and multiple transfers, without adversely impacting the accuracy of its responses.

3. W&I should consider sponsoring research to determine the comparative implications of various items, such as improved accuracy rates and shorter wait times, on taxpayer compliance.

IRS Response to Recommendations 2 and 3

As noted in the TAS report, the IRS has expended significant resources to increase tax law and account information accuracy in its' Toll-Free Telephone Assistance program, and this effort will continue. The report indicates that in FY 2004, tax law accuracy rates declined because CSRs were authorized to answer a broader range of topics and that accuracy rates were higher in FY 2002 when CSRs were allowed to answer only a limited set of topics. Specialization, however, created problems for the customer because one CSR could not answer a wide range of questions posed by a customer, and therefore, often had to transfer the call to another CSR for final resolution. Widening the scope of topics was done to address the high percentage of calls transferred and the resulting customer dissatisfaction. Having to be transferred to multiple CSRs and waiting in queue for the associated additional time were top customer complaints. This action, along with others aimed at improving service, resulted in increased customer satisfaction, less calls transferred, and more calls answered. The "Time to Get to the Right Person" category of the customer satisfaction survey improved from 4.29 (January – March 2003) to 4.51 (January – March 2004) with 5 being very satisfied.

The IRS has redesigned the Probe and Response (P&R) Guide to make it more user-friendly. It should be noted that after different models were considered and field validations conducted, the newly designed guide was made available to all employees for training purposes in October 2004. Mandatory topic-specific training was developed and delivered to all CSRs to ensure their familiarity with the new design and content prior to the beginning of the 2005 filing period. As a result of our improvements to the P&R Guide and our on-going emphasis on accuracy, our Tax Law Customer Accuracy rate improved from 79 percent in the 2004 filing season to over 89 percent in 2005. We also posed an increase in Account Customer Accuracy, climbing from 89 percent in the 2004 filing season to 91 percent in 2005.

NTA Recommendation 4

4. Although the IRS believes that defects in the disclosure authentication process should not impact accuracy rates, authentication is essential to taxpayer privacy.

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Accordingly, the agency should commit to continually monitor this item on a regular basis.

IRS Response to Recommendation 4

The IRS has, and will continue to, monitor the disclosure authentication process to protect taxpayer privacy.

2004 ARC – MSP A-5

EDUCATION AND OUTREACH ISSUES

Problem: Complexity in the tax law and its administration can easily baffle taxpayers and lead to compliance problems. The National Taxpayer Advocate is concerned that inadequate planning for taxpayer education and outreach may significantly impact compliance in an ever-changing, complex tax environment. With the IRS placing more emphasis on enforcement, and shifting resources from pre-filing to post-filing activities, taxpayers may not receive the education and assistance they require to comply with their tax obligations. The National Taxpayer Advocate believes that the IRS must set forth identifiable and quantifiable objectives, actively utilize available sources of research, and provide for a method of measuring the effectiveness of its initiatives.

NTA Recommendations

1. Utilize resources to research the type of information that taxpayers need to make them more tax compliant and share this information with program directors in W&I and SB/SE so that consistent strategies can be employed.
2. Enhance the tools used to measure the success and failures of outreach and education efforts, including the use of detailed surveys.

NTA Recommendation 1

1. Utilize resources to research the type of information that taxpayers need to make them more tax compliant and share this information with program directors in W&I and SB/SE so that consistent strategies can be employed.

IRS Response to Recommendation 1

The Service has concentrated on research-based compliance issues and has developed more focused outreach campaigns that target areas of non-participation and potential non-compliance in areas including but not limited to Earned Income Tax Credit (EITC)/Child Tax Credit (CTC), the TIP/TRAC (Tip Reporting Alternative Commitment) program, and Centralized Withholding Agreements as follows:

- National Operating Priority for FY 2005 – EITC outreach.

The strategy focuses on providing education and outreach to certain key market segments, such as low-income taxpayers, Hispanic LEP taxpayers and those located in rural areas on 1) the availability and eligibility rules of the EITC, 2) reduction in erroneous claims, and 3) the advance payment option. These activities are conducted

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with IRS partners, such as other Federal agencies, National partners' employers and with states that have similar credits for low-income taxpayers.

- **Employment Tax Strategy**

An agency-wide employment tax strategy addresses the information and assistance needs of both the individual taxpayer and the business taxpayer. Some initiatives are industry specific, i.e. restaurant and construction. These initiatives also provide information relative to employment tax returns, deposits, e-file and electronic payment options.

- **TIP/TRAC Program**

The TIP/TRAC program works with employers of those who receive tip income to conduct employee training on tax compliance. The TIP/TRAC agreements help both the employees and the employers meet their respective tax obligations without enforcement intervention

- **Centralized Withholding Agreements**

Centralized Withholding Agreements provide the opportunity to ensure income tax is collected from non-resident alien entertainers, athletes and similarly situated individuals who are subject to U.S. income tax withholding due to performances or participation in athletic events in the United States.

- **FERDI**

Military retirees make up the largest segment of the noncompliant federal employee/retiree population. Our research has shown that military retirees or those eligible to retire in the near future need more access to federal tax information. We developed a multi-year strategy that was implemented January 24, 2005, to provide outreach and education to assist this group with understanding their tax obligations and improving compliance.

In addition, the Service plans to use resources to research the type of information that taxpayers need to make them more tax compliant. When found this information will be shared with other interested Service organizations. Some of these planned or on-going efforts include:

- As part of the FY 2006 EITC Research Plan, IRS will begin an exploratory longitudinal research initiative that focuses, among other things, on why taxpayers move into, out of or remain in the EITC filer population.

- The Service will continue to look for opportunities to develop strategic research for customers. Part of the process will include developing a research strategy that helps make taxes easier by understanding where and why taxpayers are having difficulty. For example, can correlations can be drawn to a particular tax form line or publication that might be the catalyst for TAC visits, assisted or automated calls, e-mail inquiries or web inquiries. Then usability testing of potential changes to the form or publication could be done to reduce Taxpayer and/ or Service Burden.

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Behavioral research including environmental scanning will also become more prominent in methodologies as more knowledge is developed about what drives consumer behavior, e.g., why some taxpayers who are increasingly computer-literate choose to visit walk-in sites to resolve issues and complete transactions that could be accomplished via the Internet. New research efforts will continue to build on the research already garnered from previous experience in arranging and leading focus groups with taxpayers and from conducting

- Taxpayer attitudinal surveys. Vigilance in pursuing projects of risk-based compliance and examination systems will continue.
- The Service will continue its strategy of providing convenient access through e-service channels with particular attention given to an assessment of e-services “ease of use.” The feedback is being gleaned from an online survey taken by a sample of the system users.
- A project designed to learn how receptive taxpayers are to communicating with the IRS via e-mail is also underway. The crux of the business question is “how willing are taxpayers to provide their e-mail address to the IRS” as a means of using a new less costly method of service delivery?
- Additionally, the annual updating and profiling of the Individual ETA Marketing Database will continue. At present, data for Tax Year 2003 is being added. This annual mission enhances the ETA database and provides a baseline measure of the attributes of the six major e-file market segments and measures the progress in promoting electronic filing.

IRS has a data-driven approach to decision making relying on a multi-year research plan for issue development, market analysis, and impact assessment. Data is gathered from tax filing information, Census customer segment data, partner and customer satisfaction surveys, qualitative data, and compliance characteristics of returns prepared. Recognizing the need to make data driven decisions to target its outreach activities, IRS has designed and developed databases using both return and demographic information. These custom databases provide information at various geographic levels to identify issues, target specific areas, and measure impact. The databases (i.e. EITC and E-file) allow IRS to specifically target areas with the most need for outreach and educational services.

Partner and customer satisfaction survey results remain high on IRS products and services. For W&I, FY 2004 partner satisfaction survey results reflected an overall satisfaction rate of 4.25 on a scale of 5 points for services and products.

The IRS conducts an annual customer satisfaction survey for SB/SE products and services. The survey results are used to determine what products and services are being used as well as needed improvements. On a scale of 5, IRS continues to receive 4.5 or higher as an overall customer satisfaction rating.

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NTA Recommendation 2

2. Enhance the tools used to measure the success and failures of outreach and education efforts, including the use of detailed surveys.

IRS Response to Recommendation 2

IRS has undertaken extensive efforts to gauge the effect of outreach and education. Examples include:

In SB/SE, studies include: 1) internal study on outreach to innocent but fraudulent claims for slavery reparations. The study demonstrated IRS effectiveness in having an impact on taxpayer behavior; 2) a study which demonstrated a measurable impact on an employment tax project (The results showed relative improvements in 5 of the 7 areas measured due to general outreach.); and 3) a study tracking the significant increases in the TIP/TRAC agreements and potential revenue.

In W&I, several research assessment projects are being conducted to measure impact of education/outreach on EITC participation and compliance in 15 territories that focus on the Hispanic LEP population and those residing in rural populations. The projects involve comparing filing results and other indicators of impact based on multiple tax years of W&I outreach and volunteer preparation activities. The objectives are to determine the impact of IRS and IRS partner presence and involvement in outreach and return preparation activities on compliance metrics. In addition, we look to gain insight on the most effective ways of delivering outreach.

During FY 2004, the IRS initiated a number of multi-year behavioral and needs assessments qualitative research studies to better understand a particular market segment. For instance, W&I coordinated a needs and products assessment research project for Hispanic Limited-English Proficient taxpayers, working closely with the IRS Multilingual Project Office, the EITC Project Office, Taxpayer Advocate Services, and W&I Research. After receipt of the focus group results, the IRS convened a cross-functional group to develop and implement strategies to address the needs identified through the study. A second study involved focus group interviews with retired military personnel to understand reasons for payment noncompliance once these individuals retired from service. Again, the IRS used the results and convened a cross-functional group including W&I Compliance, and W&I Research to develop and implement education and outreach activities to both improve voluntary compliance and to measure the impact of pre-filing education and outreach to the retired military population. FY 05 and 06 methods of capturing measures are being refined to more accurately reflect outreach impact on voluntary compliance.

The EITC Program Office is committed to providing support to the functions that have direct contact with our customers through an approach that strengthens both compliance and outreach activities. For example the Office provided Electronic Toolkits for SPEC Partners in English and Spanish, and an Electronic Toolkit for Tax Preparers. Also, the Office developed two electronic applications to support both internal and external customers. The EITC Assistant is available in English and Spanish enables taxpayers

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who have basic information about their earnings to determine whether they're likely to be eligible for EITC and, if so, approximately how much they may be able to claim. Tax professionals use the EITC Assistant as a tool to help their clients understand their EITC eligibility. The EITC Certification Application (EITC-CERT) was developed to help taxpayers find out the status of their EITC Certification. Also, it will answer basic questions related to the certification process. Additionally, it will provide information such as the date (if available) the taxpayer can expect a response from the IRS, the IRS address that should use for mailing Certification documents, and other helpful web sites.

Each year the EITC Office meets with internal customers to discuss their needs and customer trends to assist for developing and delivering National Add Campaigns to support their operations. In addition to supporting other functions outreach and educations we coordinate the EITC Grassroots events, a series of tax forums that the EITC program office brought to the heart of the Hispanic community in Miami, Los Angeles, Houston and Chicago during the last filing season. The purpose of the forums is to inform Hispanic taxpayers with limited English proficiency about EITC benefits, requirements and compliance. Studies have shown that many Hispanics who are eligible don't claim the EITC, principally because of the language barrier. The success of the forums is a result of a sound communications strategy, effective internal and external relationships and media coverage. These events, designed to increase awareness of the EITC requirements and eligibility, were conducted in Spanish. Panel members informed the audience of general tax issues and available EITC and Child Tax Credits. Volunteers later assisted participants in completing their returns.

Also the IRS is testing new ways to reduce EITC error. The most well-known test involves asking a select group of EITC claimants to certify they meet a key requirement of the credit (they lived with their qualifying children for more than half the year) before they receive their EITC. The EITC-Cert Application mentioned above supports taxpayers in the test. We launched the first test of this concept for TY2003 and have provided two interim reports to Congress so far. Our final report is currently in clearance for submission to Congress. We have begun a second test for TY2004 which we believe will give us more information.

This year the ETIC Office developed a robust Return Preparer Strategy (RPS) that will go beyond FY2005. The first step in the strategy focused on improving the selection of noncompliant EITC preparers. The improved selection tool will result in a higher percentage of visitations to preparers who are noncompliant, thereby increasing the effectiveness of IRS resources used to conduct due diligence visits and reducing the burden on preparers who are in compliance with the Due Diligence Regulations IRC 6695(g). We will continue to refine our selection criteria and treatments of the practitioners to track their behavior changes and bring them into compliance with the Due Diligence Regulations. The FY06 Strategy incorporates in enhanced selection criteria and the use of the selections tool, and adds an outreach component of tax preparer education by leveraging Internal Partnerships to assist in education and outreach to communicate key messages to preparers.

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The FY05 Research Plan included seven EITC projects involving behavioral research and demographic and satisfaction surveys. For FY06 plans include a project to obtain feedback from taxpayers that have undergone EITC correspondence examinations, a survey to identify EITC taxpayer information needs and how effectively these needs are being met, and a project entitled "Soft Notice for Dup-TINs Measurement Study - Tax Year 2002, 2003, 2004." Additionally soft-notice research is planned that would involve measuring the effectiveness of different EITC related soft-notices on taxpayer behavior. We also plan to begin an exploratory longitudinal research initiative that focuses on why taxpayers move into, out of or remain in the EITC filer population. The demographic, behavioral, economic and tax filing characteristics that will be gleaned from this data will enable IRS to develop effective EITC marketing and education campaigns, and to more precisely target those campaigns to specific segments of the EITC claimant and EITC eligible populations.

The Service also plans to enhance the tools used to measure the success and failures of other outreach and education efforts. Some of these ongoing efforts include:

- In support of the Service's continuing effort to improve quality, efficiency and service delivery, Research is supporting the W&I SPOC in its efforts to gauge the effectiveness of the revised CP 2000 Notices. Research is collecting and analyzing the recipients' responses. The results will identify areas where improvement is needed in communicating why a CP 2000 notice was sent to the taxpayer, what taxpayers should do in response to receiving a CP 2000 notice, how do taxpayers perceive the tone and language of the CP 2000 notice, and how do taxpayers contact the IRS in relation to the CP 2000 notice.

W&I Research will continue to enhance the tools used to measure the success and failures of outreach and education efforts. W&I will do this by developing a research strategy that helps make taxes easier by understanding where and why taxpayers are having difficulty. This research will be coordinated research in several channels simultaneously to determine areas of correlation. The desired outcome is to improve taxpayer understanding of tax responsibilities and procedures (pre-filing) in order to reduce burden, reduce demand for assistance (particularly walk-in and telephone), improve the accuracy of returns filed and reduce involuntary non-compliance. W&I Research plans to develop measures to track the effectiveness of changes. These measures initially include Service Operating Costs, Taxpayer Burden and Compliance Inventories.

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2004 ARC – MSP B-6

OVERSIGHT OF UNENROLLED RETURN PREPARERS

Problem: Taxpayers' views on the fairness of the tax system are largely shaped by the totality of their interaction with the system, including their experiences with return preparers. If the IRS does not police the return preparation and filing profession, taxpayers are more likely to have bad experiences with unscrupulous or incompetent preparers, unquestionably tainting their impression of the system. The National Taxpayer Advocate continues to recommend the establishment of a federal program to regulate unenrolled tax preparers. The IRS has an obligation to research the scope of the problem and the regulatory experience of other states to design the most effective way to administer such a program.

NTA Recommendations

1. Research the preparer community to better design an approach to regulating unenrolled preparers.
2. Research the programs in California and Oregon to determine their effectiveness as well as learn from their experiences in administering similar programs. The IRS should also research the regulatory program administered by the National Association of Securities Dealers (NASD).
3. Explore integrating the required initial examination under the proposed program with the SEE (Special Enrollment Examination) of the enrolled agents program. In addition, the IRS should research the feasibility of subsequent periodic examinations or CPE requirements.
4. Explore the possibility of issuing a universal federal tax return preparer card or federal tax return preparer identification number to all categories of preparers, including attorneys, CPAs, enrolled agents and registered and certified preparers.
5. Prioritize both the assessment and collection of preparer penalties.
6. Conduct general compliance research to analyze the deterrent effect of the assessment and collection of civil and criminal penalties on preparers.
7. Revise the regulations under IRC § 7216 to address the outsourcing of tax return preparation services to foreign preparers, who should be subject to the same standards as domestic ones. In addition, domestic preparers should be held accountable for the wrongdoings of the foreign preparers as well as required to obtain the meaningful consent of their clients before releasing tax return information to the foreign preparers.
8. Include the Office of the Taxpayer Advocate in planning and evaluation of all research initiatives and strategic planning decisions regarding the oversight of tax return prep

NTA Recommendations 1, 2, 3, 4, 5, 6 and 8

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1. Research the preparer community to better design an approach to regulating unenrolled preparers.
2. Research the programs in California and Oregon to determine their effectiveness as well as learn from their experiences in administering similar programs. The IRS should also research the regulatory program administered by the National Association of Securities Dealers (NASD).
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6. Conduct general compliance research to analyze the deterrent effect of the assessment and collection of civil and criminal penalties on preparers.
8. Include the Office of the Taxpayer Advocate in planning and evaluation of all research initiatives and strategic planning decisions regarding the oversight of tax return prep

IRS Response to Recommendations 1, 2, 3, 4, 5, 6 and 8

The IRS continues to share the National Taxpayer Advocate's concern regarding the quality of services provided by paid return preparers and the competency and standards of professional conduct exhibited by all tax practitioners. The IRS continues to view the practitioner community, including unenrolled return preparers, as a key partner in fulfilling our Mission. The IRS has made it clear that it expects tax preparers and practitioners to be "the pillars of our tax system, not the architects of its circumvention". Our commitment in this area is specifically reflected in the IRS' Strategic Plan for 2005-2009.

The IRS recognizes that there is an impact on both taxpayers and tax administration from the actions of unscrupulous or incompetent return preparers. What is not yet clear is whether the regulation of return preparers as proposed by the National Taxpayer Advocate will result in improvements that are commensurate with the costs of such a program. The California and Oregon return preparer registration programs are cited as examples of successful regulation. Data received from California and Oregon indicates that neither State has conducted any research to measure the effect of preparer registration on compliance. California only monitors the number of registered preparers while Oregon monitors the accuracy of returns prepared by taxpayers vs. those of paid preparers. Based on this information, we intend to analyze error rates and compliance activity by State comparing California and Oregon with the rest of the country.

The IRS has focused significant resources over the past year aimed at developing and implementing a service wide strategy to improve our coordination and effectiveness in the return/preparer/practitioner arena. The development of this strategy reflects the IRS's commitment to examining and improving both our service and enforcement processes in this critical area. The IRS agrees that all taxpayers should be able to

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receive accurate return preparation assistance along with complete confidence that their confidential information is full protected and accessible by only those individuals defined by law. The IRS also agrees that preparers who violate this public trust should be identified and subjected to the full range of sanctions available, both civil and criminal.

The IRS is focusing substantial resources, in terms of enforcement as well as education and outreach, on the paid return preparers who assist the vast majority of taxpayers to comply with the tax laws. In November 2003, the IRS established a working group comprised of senior representatives of every IRS organization that deals with return preparer/practitioner issues. The group evaluated practitioner behaviors, existing tools for deterring or encouraging behaviors, and the coordination thereof. The group identified approximately 68 action items to improve internal coordination and effectiveness in the preparer/practitioner arena, including unenrolled return preparer issues. Although this is a long-term strategy, the IRS has completed work on, or is currently addressing, approximately 90 percent of these items, covering enforcement, education, and information outreach. As a result of the long-term strategy, the following three additional items have been identified and are now included in the strategy: (1) Joint visitations/reviews of the Return Preparer Program and other preparer related cross-functional enforcement activities; (2) Cross-functional quarterly meetings to address emerging issues and develop additional action items on a continuing basis; and (3) Development of a Preparer/Practitioner Database.

Several research initiatives have also begun to evaluate a wide range of issues involving the preparer/practitioner community. The research is intended to provide the IRS with data from which future business decisions may be made in terms of resources, enforcement, and education priorities. The primary focus of the most comprehensive initiative is preparer accuracy and compliance related issues. Data from these research initiatives could provide the initial platform to begin to answer some of the questions raised in the TAS report's research recommendations. For example, a comparison of the error and penalty rates for returns from California and Oregon with the rates for other States without preparer registration programs would provide some insight into the impact of those programs on tax administration. Without that data, statements about the success of State regulation of return preparers is based on anecdotes and a "belief" that the public awareness campaign in California is effective in deterring unregistered preparers from going underground. We anticipate receiving this data within the next six months from the Office of Research.

A federal return preparer regulation program faces substantial practical impediments to successful implementation. These include

- development of processes and systems to educate, test and register an unknown number of applicants, variously estimated at several hundred thousand to over one million,
- expansion of the public awareness campaigns regarding return preparers,
- changes to submission processing systems to (among other things) capture data regarding registered preparers from the returns,

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- creation of new enforcement processes, including a method for reimbursement of costs incurred by front-line tax administration related to enforcement of the return preparer registration program if enforcement is to be paid for from registration fees and penalties,
- ensuring that registration and renewal fees cover the full cost of program administration while not creating an excessive financial barrier to entry into the profession, and
- ensuring that the availability of enforcement revenue for program administration costs (as provided for in the most recent version of the legislation) does not create either the appearance or the reality of an incentive to take inappropriate enforcement actions.

The IRS response to previous National Taxpayer Advocate recommendations on return preparer regulation noted that additional research was needed before a determination can be made on the advisability of those recommendations. The IRS has undertaken that research, and discussed the methodology with representatives of the National Taxpayer Advocate as the research was planned. The IRS has also stepped up efforts to educate taxpayers and return preparers, and to use existing authorities more effectively to address abusive practices. These education and enforcement initiatives may have a relatively small impact on the overall problem of incompetent and unscrupulous return preparers, especially given the limited penalties available for paid preparers' failure to sign a return, or for negligent return preparation. However, the National Taxpayer Advocate has offered no empirical evidence that a program of Federal return preparer registration will have an impact on these problems that would be commensurate with the burdens it would impose on the IRS and on the large number of competent and ethical return preparers who provide high quality service to their taxpayer clients. Until that evidence is available, we believe it is not appropriate to support the National Taxpayer Advocate's recommendations.

NTA Recommendation 7

7. Revise the regulations under IRC § 7216 to address the outsourcing of tax return preparation services to foreign preparers, who should be subject to the same standards as domestic ones. In addition, domestic preparers should be held accountable for the wrongdoings of the foreign preparers as well as required to obtain the meaningful consent of their clients before releasing tax return information to the foreign preparers.

IRS Response to Recommendation 7

The IRS and the Treasury Department share the Advocate's concern that return preparers will keep their private information confidential and are committed to ensuring that return preparers honor these expectations. A project to revise the 7216 regulations is included on the Treasury Department and the IRS' current Guidance Priority List.

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2004 ARC – MSP B-7

ELECTRONIC RETURN PREPARATION AND FILING

Problem: The IRS needs an effective strategy to overcome obstacles such as cost and security that prevent taxpayers and return preparers from filing returns electronically. E-filing benefits both taxpayers and the IRS in many ways, including reduced transcription errors, faster refunds and lower processing costs. The IRS has not sufficiently planned for those paper filers who resist all efforts to convert them to e-file. The agency's plan to discontinue the TeleFile program will only increase this taxpayer population. The National Taxpayer Advocate recommends that the IRS explore the creation of an electronic return template and a direct filing portal, which would enable taxpayers to prepare and file their returns electronically without cost. To obtain some e-file benefits in the case of taxpayers who prepare their returns using software but are die-hard paper filers, the IRS should consider using bar-code technology on individual tax returns.

NTA Recommendations

1. Ensure that proper security measures are implemented during the entire e-file process. Once the IRS guarantees that electronically transmitted tax data is subject to stringent security measures, the agency should conduct an aggressive media campaign to inform taxpayers and preparers of these measures.
2. Explore creating an electronic tax return template, which would enable all taxpayers to prepare and file their returns through the official IRS website. The template would represent the electronic equivalent of a paper tax form. Once all data is entered, the template would transmit the completed return directly to the IRS at no charge. Similarly, the IRS should explore creating a portal to receive the electronic transmission of tax returns prepared by commercial software without charge.
3. Encourage taxpayers to ask their preparers to e-file their tax returns. Similarly, the IRS should encourage preparers to educate their clients about the benefits of e-filing.
4. Review the experience of several states that have imposed e-file requirements on certain preparers.
5. Consider implementing 2-D bar coding technology for individual income tax returns. This would afford some of the benefits of e-file to those taxpayers who refuse to e-file, and the IRS would benefit from reduced processing costs.
6. If the IRS is determined to discontinue the TeleFile program, it must specifically advise Congress of this decision and detail its strategy to accommodate TeleFile filers who will refuse to e-file. If the agency anticipates a certain percent will turn to services provided at VITA, TCE or TACs, it must sufficiently fund those programs to manage the overflow. In addition, the agency should further consider applying 2-D bar coding

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technology to individual income tax returns to accommodate those TeleFilers who return to paper filing.

NTA Recommendation 1

1. Ensure that proper security measures are implemented during the entire e-file process. Once the IRS guarantees that electronically transmitted tax data is subject to stringent security measures, the agency should conduct an aggressive media campaign to inform taxpayers and preparers of these measures.

IRS Response to Recommendation 1

IRS e-file systems meet or exceed all government security standards. The IRS has provided the ability for IRS E-file program participants, who transmit directly to the Electronic Management System (EMS), to use approved encryption methods for the 2005 and later filing seasons. The IRS will discontinue support of non-encrypted transmissions whether by dedicated or dial-up links on the Public Switched Telephone Network (PSTN) on December 29, 2005.

While the funding for ETA Marketing has been drastically decreased and does not allow for media campaigns, the IRS continues to develop and execute the IRS Nationwide Tax Forums and actively participates in industry conferences and seminars. The IRS also continues to develop and produce informational brochures and publications.

The IRS website has become a major component of marketing and communication to taxpayers. The IRS is constantly revising and updating the IRS website, IRS.gov. The IRS has recently completed major improvements to the look and feel of the IRS.gov website with an emphasis on content; the marketing of products and services; and IRS communication tools.

NTA Recommendation 2

2. Explore creating an electronic tax return template, which would enable all taxpayers to prepare and file their returns through the official IRS website. The template would represent the electronic equivalent of a paper tax form. Once all data is entered, the template would transmit the completed return directly to the IRS at no charge. Similarly, the IRS should explore creating a portal to receive the electronic transmission of tax returns prepared by commercial software without charge.

IRS Response to Recommendation 2

The IRS computers are not equipped to receive and process electronic transactions from individual taxpayers, neither an electronic return template nor commercially available software. To ensure the best processing possible, IRS relies on third party providers to batch electronic returns and send them in a format compatible with existing IRS computers. The template method of filing would be a vastly inferior product to the Free File programs state-of-the-art preparation software and customer support. The Free File Alliance is currently reporting 5.1 million returns – a 46 percent increase for

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the same period last year. Free File represents 7.6 percent of accepted Total E-file returns compared to the 5.8 percent from the same period last year.

NTA Recommendation 3

3. Encourage taxpayers to ask their preparers to e-file their tax returns. Similarly, the IRS should encourage preparers to educate their clients about the benefits of e-filing.

IRS Response to Recommendation 3

While the funding for ETA Marketing has been drastically decreased and does not allow for media campaigns, the IRS continues to develop and execute the IRS Nationwide Tax Forums and actively participates in industry conferences and seminars. The IRS also continues to develop and produce informational brochures and publications.

The IRS website has become a major component of marketing and communication to taxpayers. The IRS is constantly revising and updating the IRS website, IRS.gov. The IRS has recently completed major improvements to the look and feel of the IRS.gov website with an emphasis on content; the marketing of products and services; and IRS communication tools.

NTA Recommendation 4

4. Review the experience of several states that have imposed e-file requirements on certain preparers.

IRS Response to Recommendation 4

The IRS has reviewed the experience of states that have imposed e-file requirements in the document "The Effects of State Mandates on Federal Electronically Filed Returns" by Michelle Chu and Melissa Kovalick, Internal Revenue Service, U.S. Department of the Treasury. The mandates were imposed by the states and penalties are usually assessed for non-compliance. The study found that the states with mandated electronic filing requirements consistently have the highest electronic participation rates. The IRS Commissioner has stated that mandates are not an option for individual tax filers.

The IRS has mandated electronic filing for some types of business returns and will continue to consider additional requirements for business filers.

NTA Recommendation 5

5. Consider implementing 2-D bar coding technology for individual income tax returns. This would afford some of the benefits of e-file to those taxpayers who refuse to e-file, and the IRS would benefit from reduced processing costs.

IRS Response to Recommendation 5

Two-dimensional (2D) bar coded returns are paper returns that require the same resources and overhead as other paper returns, even though there are some processing savings. RRA 98 in § 2001(a) states that the policy of Congress is that "paperless filing" is the 80 percent goal for IRS to be achieved through private sector competition. The IRS believes that offering taxpayers a paper alternative to e-file is

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counterproductive to Congressional e-file goals and sends taxpayers a mixed message about the Service's goals for e-file.

NTA Recommendation 6

6. If the IRS is determined to discontinue the TeleFile program, it must specifically advise Congress of this decision and detail its strategy to accommodate TeleFile filers who will refuse to e-file. If the agency anticipates a certain percent will turn to services provided at VITA, TCE or TACs, it must sufficiently fund those programs to manage the overflow. In addition, the agency should further consider applying 2-D bar coding technology to individual income tax returns to accommodate those TeleFile filers who return to paper filing.

IRS Response to Recommendation 6

The Telefile program was discontinued by the IRS on August 16, 2005. Prior to the termination of the Telefile program, the IRS developed a Sunset Plan for Telefile program. This plan included Communications both internally and externally. The IRS has also notified the IRS Oversight Board and Congress. The IRS does not anticipate any significant impact to services provided at VITA, TCE or TACs as a result of the change.

2004 ARC – MSP B-8

PROBLEMS IN THE VOLUNTEER RETURN PREPARATION PROGRAM

Problem: The Volunteer Income Tax Assistance (VITA) Program provides an invaluable service – offering free tax return preparation services to low income taxpayers. Concerns are growing over VITA, the quality of the returns it prepares, and the relationship between the IRS and the volunteers and partners who carry out the program. Many of these concerns stem from ambiguity over the structure of the program and how it is run. The National Taxpayer Advocate recommends that the IRS engage in an open discussion about who bears ultimate responsibility for the program and clarify the IRS relationship with the volunteer organizations that operate VITA sites, including the extent and nature of support the IRS will provide to these organizations.

NTA Recommendations

1. Engage in an open discussion over who bears the ultimate responsibility for the VITA Program and clarify its relationship with the volunteer organizations that operate VITA sites.
2. Engage in strategic thinking regarding the future of the VITA Program and the support it is providing.
3. Reevaluate its current business model and develop a fair and equitable method of determining how resources are distributed among VITA sites.
4. Contract for an interview-based software program that meets the needs of the VITA Program.

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5. Partner with outside groups that can assist the IRS in providing training to VITA volunteers.
6. Eliminate any plans to use IRS employees or outside groups to conduct undercover “shopping visits” to VITA sites.
7. Partner with outside groups and encourage CPAs and attorneys to adopt VITA sites and provide tax expertise to the volunteers at that site.
8. Develop a program where experienced VITA sites will mentor new VITA sites.

NTA Recommendation 1

1. Engage in an open discussion over who bears the ultimate responsibility for the VITA Program and clarify its relationship with the volunteer organizations that operate VITA sites.

IRS Response to Recommendation 1

This is a partnership with joint responsibility. The IRS has established partnerships with more than 60 national organizations representing financial institutions, educational institutions, tribal governments, community and volunteer organizations and many others. At the local level, the IRS has formed over 265 coalitions, up from 6 coalitions in FY 2001, representing thousands of partners. Many of these coalitions are also underpinned by local affiliates of national partners. These partners choose to participate and invest in SPEC’s business model because it meets their specific organizational objectives of building assets for underserved populations.

The IRS provides partners with tax law and software training, marketing materials, educational products, research data for optimal site placement and effectiveness, supplies, technology support (software, computers and printers) and the necessary products, procedures and technical expertise for effective site operations. IRS administers the Tax Counseling for the Elderly grant program for non-profits who serve the age 60 and over taxpayer. Partners provide direct funding and in-kind contributions such as leadership, volunteers, marketing support, volunteer training and equipment to the business model equation.

The IRS relationship managers throughout the country work with each of their national and local partners to proactively communicate, listen, support and provide guidance when needed. The Partner Satisfaction Survey findings show clearly that the highest score for IRS is in relationship management as we received an average score of 4.38 on a 5-point scale from local partners and a 4.49 from national partners. Relationship management includes such components as Communicating Timely, Sharing and Updating Information and Listening and Responding to Partner Concerns/Questions, all of which scored 4.07 or higher.

To facilitate open communication throughout the year and provide forums for exchange, the IRS participates in numerous meetings and conferences with national and local

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partners. The IRS establishes Memoranda of Understanding with many national partners to clearly outline the roles and expectations of both the partner and the IRS.

NTA Recommendations 2 and 3

2. Engage in strategic thinking regarding the future of the VITA Program and the support it is providing.
3. Reevaluate its current business model and develop a fair and equitable method of determining how resources are distributed among VITA sites.

IRS Response to Recommendations 2 and 3: The IRS did not address these issues.

NTA Recommendation 4

4. Contract for an interview-based software program that meets the needs of the VITA Program.

IRS Response to Recommendation 4

IRS awarded a five year contract to Universal Tax Systems February 10, 2005. The contract includes the purchase of both a client-server based and a web-based software product for use in the electronic preparation and transmission of federal and state tax returns by IRS Volunteer Return Preparation Program sites (VITA/TCE), IRS TAC (Taxpayer Assistance Centers), IRS Employee e-file, and SB/SE Disaster Relief sites. In addition to providing the preparer with form based completion, the web-based product also allows interview based completion. Interview based completion provides the user with a series of questions, (similar to those provided in individual software applications), geared at helping the user draw an accurate conclusion and prepare a more accurate return. However, as with any computer software product, the results are only as good as the data entered. Users must still have a good working knowledge of tax law when using any of these products.

NTA Recommendation 5

5. Partner with outside groups that can assist the IRS in providing training to VITA volunteers.

IRS Response to Recommendation 5

Training materials have increased and evolved over the years. Partners have joined the IRS in developing training and reference materials that are tailored to partner/volunteer needs. Examples include:

- Understanding Taxes Online - for students or beginning volunteers
- Link and Learn Taxes Online - for new and returning volunteers
- Integrated (tax law and e-file instruction) VITA called Condensed-VITA or C-VITA - for volunteers with experience in tax law and computer skills
- Traditional VITA/TCE - modularized in three sections-- Basic, Wage Earner and Pension Earner

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- Foreign Student and Scholar VITA/TCE – for volunteers assisting foreign students at universities
- Military VITA

Available IRS resource and reference guides to be used at volunteer sites to reinforce training include:

- Publication 4012, Volunteer Resource Guide
- Publication 3189, Volunteer e-file Administrator Guide
- Publication 1084, Volunteer Coordinators Handbook
- Publication 4011, Volunteer Resource Guide for Foreign Students and Scholars

NTA Recommendation 6

6. Eliminate any plans to use IRS employees or outside groups to conduct undercover “shopping visits” to VITA sites.

IRS Response to Recommendation 6

The IRS and its partners are implementing a multi-year quality assurance program that will support and measure the tax law accuracy of return preparation. Plans include:

- Updating training products and strengthening volunteer certification procedures to ensure volunteers are qualified to prepare tax returns.
- Review – Three types

We continue to study the return preparation process to enhance procedures, processes and training. Three types of reviews will be conducted using an integrated approach. Site reviews are routinely conducted however; return and shopping are relatively new. All reviews (except Shopping) will be conducted at the same site, on the same day and by the same Tax Specialist. This will enhance our ability to correlate the various types of reviews, analyze quality and to maximize limited resources. The ultimate outcome that will mutually benefit all stakeholders is correct taxes and an accurate return.

- Site Reviews – Measure the administrative aspects of a volunteer site. These reviews are used to assess procedure and site readiness using Form 6729, Site Review.
- Return Reviews – Measure whether tax law was applied properly for critical items and resulted in the proper application of tax law and correct taxes. Review involves on-site review of the return for accuracy (after quality review and while the taxpayer is present) using Form 13614, Interview and Intake Sheet, Form 6729C, Return Review and Form 8158, Quality Review Checklist. Shopping Reviews – Measure the taxpayer’s qualitative experience. Review involves unannounced/anonymous visits to sites by a neutral third party reviewer playing the role of a taxpayer using made-up scenarios and Form 6729B, Shopping Review. Members of the American Institute of Certified Public Accountants (AICPA) and the office of the Treasury Inspector General for Tax Administration (TIGTA) will conduct shopping reviews on a limited basis.

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NTA Recommendation 7

7. Partner with outside groups and encourage CPAs and attorneys to adopt VITA sites and provide tax expertise to the volunteers at that site.

IRS Response to Recommendation 7

SPEC does engage a number of professionals and professional associations in VITA efforts and has ongoing and continuous efforts to increase existing partner participation, as well as to enter into new partnerships with additional professional organizations nationally. For example, SPEC partners at the national level with the Pro Bono Committee of the American Bar Association's Section on Taxation. Attorneys in good standing are afforded the opportunity to perform Pro Bono work to support the Volunteer Income Tax Assistance program nationwide. Each year, the Section on Taxation is provided with a VITA site listing and telephone listing of all SPEC Territory Managers to post on its website. Attorneys contact Territory Managers for Pro Bono opportunities in local coalitions across the US.

The Association of Latino Professionals in Finance and Accounting (ALPFA) is a professional association dedicated to enhancing opportunities for Latinos in the accounting, finance, and related professions. ALPFA has strong ties and is strongly committed to assisting the Hispanic community. Members are bi-lingual, trusted in their communities and are business professionals. ALPFA contains both professional members and student members. ALPFA currently has 21 chapters located around the US. Chapter locations closely parallel SPEC territories. During filing season 2004, the initial year of the ALPFA/IRS-SPEC partnership, seven chapters participated in SPEC coalitions. In FS 05, we anticipate increased chapter participation based on the success of the implementation year.

The American Institute of Certified Public Accountants (AICPA) partners with SPEC on a number of initiatives. In FS 04, AICPA conducted a limited number of shopping reviews in support of VRPP-Quality Assurance efforts in the initial implementation year. SPEC and AICPA anticipate an increase in subsequent years beginning with FS 05. AICPA funded and participated in the creation of training DVD for VITA volunteers on the client intake process that will be utilized with all VITA volunteers this fiscal year. AICPA will also co-produce a custom version of the DVD for seniors that will be utilized by TCE grantees this fiscal year.

Beta Alpha Psi (BAP) is a national scholastic and professional fraternity with at least 250 chapters on college campuses across the country. Its mission is to encourage and give recognition to scholastic and professional excellence in the business information field, which includes: promoting the study and practice of accounting, finance and information systems; providing opportunities for self-development, service and association among members and practicing professionals.

BAP and SPEC entered into a national partnership to encourage participation of BAP Chapters nationwide in the VITA program. In addition to student participation, faculty advisors also participate either via return preparation or tax law training. We estimate that approximately 40 percent of BAP chapters are engaged in the VITA program either

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by providing services on campus or participating in local coalitions. A couple of examples of chapter participation:

- Portland State University work at AARP sites
- Oakland University in Rochester, MI participates as part of the Michigan Statewide Coalition

A national partnership with The National Association of Black Accountants (NABA) is in development for VITA participation with initial implementation targeted for FS 05.

The Bank of America Employee Volunteer Program known as Team Bank America provides tax attorneys as volunteers at VITA sites. Participation has predominantly been in southeastern cities in the initial implementation year with broader participation to occur in support of FS 05 VITA efforts and beyond.

Food Change (formerly known as Community Resource Food Bank) in New York City exclusively employs certified professionals as site managers at area coalition VITA sites.

A partnership with the Native American Bar Association is in development.

NTA Recommendation 8

8. Develop a program where experienced VITA sites will mentor new VITA sites.

IRS Response to Recommendation 8

IRS continues to look for opportunities to link partners with coalitions that have experience operating one or more VITA sites. This enables new sites to have access to a variety of partners with extensive subject matter expertise and operate in a more efficient and effective manner.

2004 ARC – MSP C-9

INCONSISTENT CAMPUS PROCEDURES

Problem: The Internal Revenue Service Restructuring and Reform Act of 1998 reorganized the IRS into an agency comprised of business units and campuses, in part because the previous structure did not promote consistency and accountability. Although the IRS has instituted nationwide procedures for its campuses (formerly called service centers), TAS has identified areas where varying campus procedures can result in different treatment of similarly situated taxpayers. These include: (1) taxpayers whose Social Security numbers have been stolen, (2) taxpayers who demonstrate that a levy should be released due to economic hardships but are subjected to additional levies due to processing delays in the levy release procedure; and (3) the treatment of some taxpayers who file a delinquent tax return only after the IRS' Automated Substitute for Return unit files a substitute return on the taxpayer's behalf.

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NTA Recommendations

A. In the case of stolen identities, the IRS should:

1. Revise the Internal Revenue Manual (IRM) to require multiple attempts to contact each taxpayer using an SSN;
2. Revise the IRM to provide that scrambled procedures be used only after phone contact is attempted with the SSN users and only in those cases where available information clearly supports use of the SSN by both taxpayers; and
3. Standardize procedures for information required from taxpayers.

B. In the case of audit reconsiderations, the IRS should:

1. Take corrective action to require all campuses to afford all taxpayers access to the Office of Appeals.

C. With respect to addressing future inconsistencies among campuses, the IRS should:

1. Identify a responsible official for investigating inconsistent campus procedures;
2. Establish a portal on the IRS Intranet for employees to use to report inconsistent procedures; and
3. Perform follow-up audits on incorrect campus procedures to ensure that corrections have occurred.

NTA Recommendation A. In the case of stolen identities, the IRS should:

1. Revise the Internal Revenue Manual (IRM) to require multiple attempts to contact each taxpayer using an SSN;
2. Revise the IRM to provide that scrambled procedures be used only after phone contact is attempted with the SSN users and only in those cases where available information clearly supports use of the SSN by both taxpayers; and
3. Standardize procedures for information required from taxpayers.

IRS Response to Recommendation A

We have initiated contacts with the Social Security Administration (SSA) and Federal Trade Commission to collaborate on process improvements and develop consistency in communication and outreach efforts. One of the first steps we have taken toward process improvement was chartering the Scrambled Social Security Number (SSN) team. This team has been charged with developing a consistent and streamlined process for managing and resolving Scrambled SSN cases. The new process will focus on reducing lapse time for case resolution, achieving consistency among campus processing and centralizing inventory reporting. This team will also consider local practices/procedures for inclusion in IRM procedures. In addition, we developed standards for documentation to be used to validate the identity of the taxpayer, the taxpayer's address and the fact of the theft that are consistent with those established by FTC and SSA.

NTA Recommendation B. In the case of audit reconsiderations, the IRS should:

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1. Take corrective action to require all campuses to afford all taxpayers access to the Office of Appeals.

IRS Response to Recommendation B

Inconsistencies previously existed in Automated Substitute for Return (ASFR) reconsideration processing when there was unreported income on delinquent returns filed after an ASFR assessment. Those problems were corrected during FY 2004 as part of an overall initiative to improve ASFR current processes. Workload consolidation as a means of gaining consistency and improving overall service has been a continued focus in all programs, and accomplished for ASFR during FY-04. By placing this program in one site, we've witnessed equitable application of the procedures governing this process, and overall improvement.

NTA Recommendation C. With respect to addressing future inconsistencies among campuses, the IRS should:

1. Identify a responsible official for investigating inconsistent campus procedures;
2. Establish a portal on the IRS Intranet for employees to use to report inconsistent procedures; and
3. Perform follow-up audits on incorrect campus procedures to ensure that corrections have occurred.

IRS Response to Recommendation C

The IRS has instituted nationwide procedures to ensure uniformity in treatment of taxpayer accounts by the campus operations. With ten campuses handling millions of transactions each year, we recognize that instances of inconsistent application of procedures can occur. We have in place extensive mechanisms to identify and address inconsistencies through individual case reviews, campus operational reviews, and functional program reviews.

Campuses are not authorized to develop local procedures and should be submitting change requests (a standardized process) when procedures are unclear or missing from the Internal Revenue Manual (IRM). This process provides valuable feedback, identifies specific items needing clarification and allows for procedural modifications to be addressed consistently in the IRM for all campuses. Campuses have also been instructed that any locally developed job aids or tools, which supplement the learning experience on the "how to" complete case actions, should be submitted to the appropriate headquarters organization. This will allow consideration for national implementation of the job aid or tool. To ensure uniform treatment of taxpayers, the IRS will continue to emphasize the importance of procedural consistency and will continue to monitor adherence to standardized procedures during annual operational and program reviews.

Uniformity in the treatment of taxpayers is paramount. The Wage and Investment and SB/SE organizations have partnered under the umbrella of a "Workload Optimization" strategy to analyze each of the major compliance programs (Automated Collection System, Automated Underreporter, Compliance Services Collection Operations, and

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Correspondence Examination), and develop specific actions to standardized processes, procedures and organizational measures. In addition, we've successfully completed major summits on various compliance programs, which have resulted in a greater focus towards fair and equitable treatment of taxpayers and the identification of egregious situations that warrant the devotion on limited resources across the business operating divisions.

2004 ARC – MSP C-10

PROCESSING ITIN APPLICATIONS AND AMENDED INCOME TAX RETURNS

Problem: The IRS faces systemic problems in processing two types of taxpayer submissions: applications for Individual Taxpayer Identification Numbers (ITINs) and amended tax returns. With respect to the processing of ITIN applications, the IRS has implemented a new two-step process that that has caused a number of hardships to taxpayers, including delayed refunds, and resulted in conflicting procedural guidance. With respect to the processing of amended returns, a review of TAS cases suggests that there are systemic problems in this area, particularly relating to delayed refunds. The IRS needs to do a better job of tracking amended returns through the different stages of processing.

NTA Recommendations

- A.1. Allow and encourage applicants to file an ITIN application without a prior return prior to the filing season, when taxpayers submit proof with the application that a return will be required to be filed, e.g., proof of income (wages), withholding, or prior filing of return and ITIN needed for spouse or dependent.
- A.2. Ensure Publication 1915, Understanding Your IRS ITIN, provides accurate information.
- A.3. Revise the ITIN rejection notice to include Publication 4134, Low Income Taxpayer Clinic List, so that ITIN applicants are aware of a readily available resource to assist them.
- A.4. Ensure all Taxpayer Assistance Center (TAC) employees are trained in the procedures for reviewing and validating applications prior to forwarding to the ITIN processing unit.
- A.5. Establish procedures to assure that “family packs” are not separated when received by the IRS or during processing of the ITIN applications.
- A.6. Revise the ITIN Database to generate a copy of the notice issued to an applicant to the person submitting the application.
- B.1. Conduct customer satisfaction surveys of taxpayers who submit amended returns.
- B.2. Code and track the receipt of all amended returns.
- B.3. Acknowledge receipt all amended returns forwarded from Submission Processing to other functions for review.
- B.4. Collect data on the amount of interest paid on amended return refunds as a diagnostic measure.

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NTA Recommendation A.1

A.1. Allow and encourage applicants to file an ITIN application without a prior return prior to the filing season, when taxpayers submit proof with the application that a return will be required to be filed, e.g., proof of income (wages), withholding, or prior filing of return and ITIN needed for spouse or dependent.

IRS Response to Recommendation A.1

In 2003, the IRS completed an extended assessment of the ITIN program, including the possible dangers that can arise from the misuse of ITINs for the purpose of creating an identity and the associated possible threat to national security. We decided to make fundamental improvements to the program, including the two-step process, and believe these enhancements represent an appropriate balance to resolve ITIN program deficiencies without unduly burdening either taxpayers or the tax system. The current process ensures that ITINs are assigned only to taxpayers that have a legitimate need for tax purposes.

NTA Recommendation A.2

A.2. Ensure Publication 1915, Understanding Your IRS ITIN, provides accurate information.

IRS Response to Recommendation A.2

Publication 1915 was revised to reflect the process IRS instituted late in 2003. As improvements are made in the processing of ITIN applications, Publication 1915 will be updated to reflect these changes.

NTA Recommendation A.3

A.3. Revise the ITIN rejection notice to include Publication 4134, Low Income Taxpayer Clinic List, so that ITIN applicants are aware of a readily available resource to assist them.

IRS Response to Recommendation A.3

Revisions to the ITIN rejection notice including adding Publication 4134 will be considered for the 2007 filing season.

NTA Recommendation A.4

A.4. Ensure all Taxpayer Assistance Center (TAC) employees are trained in the procedures for reviewing and validating applications prior to forwarding to the ITIN processing unit.

IRS Response to Recommendation A.4

We make every effort to ensure the most current procedures are available to our TACs. ITIN procedures for TAC employees are outlined in IRM 21.3.4.20. When specific instances of non-conformance are observed, Field Assistance Headquarters contacts the appropriate Field Assistance Area Director for corrective action. If necessary, an alert is issued to remind TAC employees of correct ITIN procedures.

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NTA Recommendation A.5

A.5. Establish procedures to assure that “family packs” are not separated when received by the IRS or during processing of the ITIN applications.

IRS Response to Recommendation A.5

When identified in ITIN as a Family Pack, all application, 1040 returns and supporting documents are stapled together for processing. Family Packs are also subject to the same quality review procedures in the ITIN unit.

NTA Recommendation A.6

A.6. Revise the ITIN Database to generate a copy of the notice issued to an applicant to the person submitting the application.

IRS Response to Recommendation A.6

An Acceptance Agent is an individual, business or organization (college, financial institution, accounting firm, etc.) authorized by IRS to assist individuals in obtaining ITINs. Acceptance Agents review applicants' documentation, complete a certificate of accuracy and forward the certificate and application to the IRS for processing. Acceptance Agents are not generally authorized to receive tax information from the IRS. As a result, unless the ITIN applicant has granted power of attorney to the acceptance agents to receive such notices, IRS is not permitted to send them a copy.

NTA Recommendation B.1

B.1. Conduct customer satisfaction surveys of taxpayers who submit amended returns. IRS Response to Recommendation B.1 IRS currently has a quarterly Adjustments Customer Satisfaction Survey that includes taxpayers who submit amended returns and customer correspondence. The IRS carefully reviews customer feedback and takes actions to improve the service provided to taxpayers. One example of this is an initiative that is piloting ways to provide faster resolution to customer inquiries while also keeping taxpayers informed of the progress of case resolution.

NTA Recommendation B.2

B.2. Code and track the receipt of all amended returns.

IRS Response to Recommendation B.2

The current return processes used are efficient and cost effective. Any systemic method to track the exact location of a single document would be costly and require actions that would negatively impact the timely processing of the over 99 percent of returns that are not involved in any type of processing delays.

NTA Recommendation B.3

B.3. Acknowledge receipt all amended returns forwarded from Submission Processing to other functions for review.

IRS Response to Recommendation B.3

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Submission Processing received approximately 3.1 million Form 1040X's in 2004. About 2 million of those returns were referred to another area for review and processing, generally Accounts Management, due to the technical nature of the taxpayer's request for adjustment. A much small number are also referred to Examination or Criminal Investigation based on specific criteria. The process of sending 2 million acknowledgement letters to state that the return is being forwarded to another are of the processing center would be costly, time consuming and result in delays in processing taxpayers' claims.

NTA Recommendation B.4

B.4. Collect data on the amount of interest paid on amended return refunds as a diagnostic measure.

IRS Response to Recommendation B.4

Interest payments on amended returns resulting from referrals to other functions are not a major problem. For example, refunds requested on the majority of amended returns examined are not allowed. For FY 2003 and FY 2004, we closed approximately 59,000 and 54,000 individual amended returns resulting in revenue being protected in the amount of \$355 million and \$423 million, respectively. In addition, the amount of interest, if any, paid to a taxpayer is determined by a number of factors in addition to how quickly the IRS acted on the taxpayer's claim.

2004 ARC – MSP C-11

LACK OF NOTICE CLARITY

Problem: Too many of the more than 100 million IRS notices sent to taxpayers annually do not satisfy the standard set forth by Congress – that notices must be sufficiently clear to enable a taxpayer to understand an IRS question about a tax return or any adjustments or penalties applied to a return. The IRS has made many positive strides toward improving notices and has worked closely with external stakeholders to improve EITC notices, in particular. However, some notices are confusing per se and should not be used. Others are of vital importance to taxpayers but do not contain sufficient information for the taxpayer to make an informed decision. The IRS must try harder to provide the taxpayer with the why of its notices – to explain why a notice has been sent – the what's next of its notices – to explain to the taxpayer what is going to happen – and the how of its notices – to set forth the taxpayer's options.

NTA Recommendations

1. Establish a notice improvement learning lab through which the IRS can work directly with taxpayers and understand their perceptions and expectations at the time that notices are redesigned, thereby enabling the IRS to identify which parts of notices are confusing to taxpayers.
2. Expand avenues for taxpayers and their representatives to comment on the quality of specific notices, to include the dedication of a portal on the IRS Internet site on which

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taxpayers can describe confusing notices and provide timely reports of complaints to IRS teams working on notice issues.

3. Expand the criteria for determining which notices to redesign to include: (1) number of taxpayers affected, (2) impact on taxpayer compliance, (3) impact on taxpayer rights, (4) impact on taxpayer burden if implemented, (5) impact on other IRS operations downstream; (6) error rates on notices, and (7) costs to implement the proposal.
4. Eliminate notice formats which on their face fail to describe in detail why the IRS is issuing the notice.
5. Research the downstream consequences to the IRS and taxpayers of confusing and poorly drafted notices.
6. Enhance specificity in math error notices to conform to Congressional intent that math error notices provide sufficient detail and clarity so that taxpayers are able to determine precisely what items were changed, and why.
7. Eliminate the use of the Combination Letter in all correspondence audits.

NTA Recommendations 1 and 2

1. Establish a notice improvement learning lab through which the IRS can work directly with taxpayers and understand their perceptions and expectations at the time that notices are redesigned, thereby enabling the IRS to identify which parts of notices are confusing to taxpayers.
2. Expand avenues for taxpayers and their representatives to comment on the quality of specific notices, to include the dedication of a portal on the IRS Internet site on which taxpayers can describe confusing notices and provide timely reports of complaints to IRS teams working on notice issues.

IRS Response to Recommendations 1 and 2

The Taxpayer Advocate recognized some of the progress made to date by the IRS to improve notices and letters sent to taxpayers. The Treasury Inspector General for Tax Administration recognized some of the same progress in their May 2004 report *The Clarity and Accuracy of Notices*. In July 2001, the IRS Commissioner's Tax Administration Council approved the new notice governance structure. Simplifying and improving the clarity of notices and other communications to taxpayers is one of the top priorities in the IRS. In addition to notice simplification efforts, the IRS has developed notice strategies that include:

- Training employees to write to taxpayers in plain language,
- Testing simplified notices to determine whether they will meet customers' needs before placing them in production,
- Measuring the effectiveness of simplified notices,
- Incorporating tax practitioner and taxpayer input into the notice change process,
- Standardizing notice language and layout, and
- Developing tools that support and facilitate the Dynamic Project teams.

The IRS also developed and issued the first customer satisfaction surveys to taxpayers who received one of 13 different notices. The IRS designed the survey to assist in determining the effectiveness of the redesigned taxpayer notices. More than 7,500 taxpayers responded to the survey – a 33 percent response rate. Results from the

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survey demonstrated that, for the most part, taxpayers could understand the notices and could take the appropriate action requested but also identified areas that need further improvement.

The IRS currently utilizes vendor conducted testing to capture taxpayer observations and notice usability information as notices are developed. A study group is reviewing whether we have the internal expertise and resources to conduct such testing at the Usability Lab in Ogden. The group is expected to report in December 2005. We also conduct focus groups with the Taxpayer Advocacy Panels, the IRS Advisory Council, the Information Returns Advisory Council, and, depending on the issue, we also involve the Low Income Tax Clinics.

A major design effort is also underway to significantly improve the CP 2000 notice - We're Proposing Changes to Your Tax Return – annual volume 2.3 million - issued to taxpayers who have under-reported income on their tax return. The revised notice went into production in December 2004. The revised CP 2000 represents a significant effort to improve dramatically the notice to enhance taxpayer understanding of why they received the notice. We conducted numerous tests, focus groups, and discussions with many tax professionals during the development process, and included many of the comments received in the final product.

Finally, although issues can be input by taxpayers on www.irs.gov, there is not space specifically designated for notices. We are working with the IRS web site governing body to develop a portal dedicated specifically to notices. In the interim, we are considering the feasibility of obtaining relevant information from the TAS Systemic Advocacy Management System and from “Customer Connection”, a system that contains information regarding notices gathered by Tax Examiners during contact with taxpayers. The IRS is partnering with TAS to augment the data capturing instrument (DCI) to include the specific notice or letter number and more detailed information about the source of the problem.

NTA Recommendation 3

3. Expand the criteria for determining which notices to redesign to include: (1) number of taxpayers affected, (2) impact on taxpayer compliance, (3) impact on taxpayer rights, (4) impact on taxpayer burden if implemented, (5) impact on other IRS operations downstream; (6) error rates on notices, and (7) costs to implement the proposal.

IRS Response to Recommendation 3

Since October 2000, the IRS has redesigned and placed into production approximately 45 notices that have a combined annual volume of more than 38 million. We have developed a process for prioritizing the simplification of notices that are sent to individual taxpayers. The process incorporates the seven criteria as those criteria are available. This process also applies weighted criteria linked to the IRS' three balanced measures to determine the order of priority. Two external stakeholder groups provided input to the IRS during the prioritization process. The IRS plans to expand the

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prioritization process, including the seven criteria when available, for notices sent to businesses.

NTA Recommendation 4

4. Eliminate notice formats which on their face fail to describe in detail why the IRS is issuing the notice.

IRS Response to Recommendation 4

The TAS report describes the new process put into place to re-engineer notices. Under the new process, teams of IRS employees with subject matter expertise form a Dynamic Project Team (DPT) to analyze the current notice, determine the requirements for the notice with all internal and external stakeholders and then re-engineer the notice. Part of the training we give these teams stresses the importance of customizing the notice to an individual taxpayer's situation and providing a clear reason for the notice. Through this process, we have identified notice standards and are in the process of implementing them on re-engineered notices. Implementation for other notices will be incremental due to limited resources and the impact on the MITS organization.

NTA Recommendation 5

5. Research the downstream consequences to the IRS and taxpayers of confusing and poorly drafted notices.

IRS Response to Recommendation 5

The IRS welcomes any additional specific data-driven analysis and information the TAS organization can provide on problematic notices. As we plan our future simplification efforts we will consider the notices identified in the report and the information you provided about them. The TAS organization has a SPOC who has been part of the Notice Communication Advisory Group and can, in the future, assist the IRS in identifying notices that cause taxpayers problems.

We also continue to look at options to improve our ability to capture and quantify qualitative data that can be used to populate the Notice Management Information System (NIMS). This includes data from Customer Connection and SAMS. We are hopeful that when fully developed, NIMS will provide useful data on costing, notice effectiveness, notice content issues and taxpayer feedback.

NTA Recommendation 6

6. Enhance specificity in math error notices to conform to Congressional intent that math error notices provide sufficient detail and clarity so that taxpayers are able to determine precisely what items were changed, and why.

IRS Response to Recommendation 6

Providing sufficient detail and clarity to help taxpayers understand the changes is one of our primary goals, but the IRS needs to balance this need with the need for employees to be able to select the correct information for the notice. Providing more detail and clarity while increasing the possibility for inaccurate information will add to both taxpayer

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and employee burden. Adding additional information to the notices and creating new codes could increase expenditures resulting from the length of the notices and additional postage cost. We welcome the opportunity to work with TAS to identify the “vital few” items that are causing the biggest concerns for taxpayers in understanding why they received a math error notice and what items were changed.

Nevertheless, recent positive changes in notices include substantial revisions to the 13 math error and adjustment notices – combined annual volume 13 million - that inform taxpayers about changes the IRS made to their account. Another early effort included a redesign of the LT-11, Collection Due Process Notice – annual volume 1.2 million. In July 2004, the IRS started issuing the re-engineered CP 71 series notices – Reminder of Balance Due – annual volume 6 million. The TAS SPOC representative had identified these notices as problematic for taxpayers.

NTA Recommendation 7

7. Eliminate the use of the Combination Letter in all correspondence audits.

IRS Response to Recommendation 7

The IRS is committed to improving correspondence examination notices, including those containing EITC issues. Examination issues, especially those involving EITC are among the most complex issues facing taxpayers.

During FY 2004, a multi-functional Notice Reengineering Team, with Taxpayer Advocate Service representation, redesigned the initial contact letter, Letter 566B-EZ. The NTAs 2003 Annual Report refers to this letter as the Combination Letter in Most Serious Problem, Topic #6.

The team streamlined the current four-step process to provide taxpayers more information earlier in the process and an earlier opportunity to resolve the problem. The team created a new contact letter (CP75) that addresses the concerns raised by the NTA in 2003. New CP 75 and the streamlined process is a major step forward in effectively communicating the examination and appeal processes and the steps taxpayers must take to exercise their rights under the law.

The new CP 75 includes the following:

- A main heading definitively notifying the taxpayer of examination
- Explanations that include Why We’re Reviewing Your Return ; What You Need to Do Now; What We’ll Do Once We Hear from You; What Happens If You Don’t Reply; and How to Get Help.
- A table, “Follow These Steps,” that summarizes what needs to be done.

Direction to call the IRS toll-free number if the taxpayer cannot get the information within the 30 days.

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2004 ARC – MSP C-12

ERRONEOUS AND MISCALCULATED COLLECTION STATUTE EXPIRATION DATES

Problem: Generally, the IRS has 10 years from the date of assessment to collect a tax. With certain exceptions, when the 10-year collection period expires, the IRS can no longer legally enforce collection of the debt. The expiration of the 10-year collection period is referred to as the “collection statute expiration date” (CSED). Recent changes to the tax laws affecting CSEDs and misinterpretations of other tax laws have caused the IRS to miscalculate CSEDs on thousands of taxpayer accounts. These miscalculations can lead to unlawful collection on these accounts.

NTA Recommendations

1. The overhaul of the IRM should include descriptions of the legal or technical issues which have given rise to incorrect CSEDs, along with examples of each type of incorrect CSED category, and should include procedures for expedited managerial approval of CSED changes where the adjustment is attributable to one of these categories.
2. The IRS should develop training on CSED issues for IRS personnel who work on taxpayer accounts.
3. The IRS should ensure that taxpayers that have been negatively impacted by incorrect CSED calculations are identified, account problems are corrected and funds erroneously collected are returned. The cross functional team should follow through expeditiously with the account extracts needed to identify those taxpayer accounts that need correction.
4. To avoid situations where counsel guidance and revisions to counsel guidance do not filter down to all levels of employees who are impacted by the guidance, all counsel memoranda that impact taxpayer accounts should be accompanied by a summary description of the guidance in common sense terms, i.e. not in “legalese,” which should be e mailed to all affected personnel.

NTA Recommendations 1 and 2

1. The overhaul of the IRM should include descriptions of the legal or technical issues which have given rise to incorrect CSEDs, along with examples of each type of incorrect CSED category, and should include procedures for expedited managerial approval of CSED changes where the adjustment is attributable to one of these categories.
2. The IRS should develop training on CSED issues for IRS personnel who work on taxpayer accounts.

IRS Response to Recommendations 1 and 2

The IRS agrees that there are systemic and manual complexities surrounding Collection Statute Expiration Date (CSED) calculations, and we are actively engaged with all stakeholders in efforts to correct the problems. We have requested several systemic modifications and upgrades and are working with programmers to address these concerns. In the interim, we have partnered with the Taxpayer Advocate Service (TAS) and have established cross-functional teams to develop mechanisms to correct affected taxpayer accounts and to prevent future incorrect CSEDs.

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Through these teams, the IRS is taking the following actions to correctly identify problems:

- Develop an interactive CSED tool to ensure uniformity in calculations across all functions.
- Conduct a complete overhaul of Internal Revenue Manual (IRM) CSED procedures.
- Continue case identification and procedures for correcting accounts with incorrect CSEDs.
- Prepare additional training on CSED issues.

To date, a new IRM 5.1.19 was created as a comprehensive source for description of the correct CSED rules and procedures. Incorrect methods and corrective procedures will be addressed in the training environment.

In addition, Collection has submitted a training recommendation for a module on CSED issues and procedures. This training would include all collection field and campus employees. The training recommendation is in the process of being evaluated.

The IRS is committed to correcting CSED problems that can be quantified, addressing the root causes contributing to the incorrect CSED calculations, and providing cross-functional procedures and training for the prevention of future errors.

NTA Recommendation 3

3. The IRS should ensure that taxpayers that have been negatively impacted by incorrect CSED calculations are identified, account problems are corrected and funds erroneously collected are returned. The cross functional team should follow through expeditiously with the account extracts needed to identify those taxpayer accounts that need correction.

IRS Response to Recommendation 3

We have made great strides in identifying those taxpayers whose accounts were negatively impacted by incorrect CSED calculations. Accounts have been identified with potentially erroneous CSEDs in the areas of Substitute for Return (SFR), Offer in Compromise (OIC), Installment Agreement (IA) and overlapping CSED situations.

A systemic fix has been implemented for most of the accounts affected by a manipulated CSED in the SFR area. The fix corrected the CSED on 42,237 modules. Of these modules there were 9474 with potential expired CSEDs. An analysis of these modules is currently underway to determine if there are any credits that may have been the result of monies collected after the CSED expired.

At this time it appears that few cases will result in a credit balance and those that due will be manually worked and refunds issued if appropriate. All incorrect procedures that were being followed have been abolished and the IRM dealing with SFR program have been updated to reflect current policies and procedures.

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In the area of OIC cases, a corrected programming requirements package (PRP) was submitted to our information technology programmers for implementation by January 1, 2007. When implemented this program will systemically correct the majority of OIC cases with incorrect CSEDs as well as prevent future occurrences.

Beginning January 1, 2006, cases that have a pending IA indicator, which suspends the CSED until another action takes place, will be systemically reversed on cases where the indicator was input with no open control or follow up due to employee error. The CSED will return to the original CSED. An immediate systemic fix was run on over 1,000,000 modules that had pending IA indicators with at least 6 months of non activity.

We continue to conduct analysis on the current inventory to verify that proper procedures are being followed. The Service also recognizes that the systemic fixes will take care of the majority of the cases with incorrect CSEDS, but there are cases that do require manual corrections. Many of these cases have been identified and we continue to identify those cases. Procedures are being developed to facilitate manual correction of the CSED and once perfected will be distributed to the campuses for implementation. In all cases of credit balances that reflect monies collected after the CSED expired; refunds will be issued.

NTA Recommendation 4

4. To avoid situations where counsel guidance and revisions to counsel guidance do not filter down to all levels of employees who are impacted by the guidance, all counsel memoranda that impact taxpayer accounts should be accompanied by a summary description of the guidance in common sense terms, i.e. not in "legalese," which should be e mailed to all affected personnel.

IRS Response to Recommendation 4

The IRM is the official authority for policy and procedures and is kept updated to reflect Chief Counsel Opinions with general applicability. Many opinions Counsel issues are case specific and should not be relied upon in other situations due to differences in facts or local law. Consequently, employees should rely on the IRM as updated to reflect relevant Chief Counsel opinion.

2004 ARC – MSP C-13

APPLICATION AND FILING BURDENS ON SMALL TAX-EXEMPT ORGANIZATIONS

Problem: Tax-exempt organizations must go through a long, complex process to apply for tax-exempt status. With current IRS procedures and staffing levels, this sometimes takes six months or longer. Once they receive tax-exempt status, these organizations must file complex annual information returns. These complexities and delays can place significant burdens on small organizations, which typically have very limited resources and rely on the services of volunteers who have limited experience navigating the tax system. The National Taxpayer Advocate notes that the IRS is taking steps to reduce

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these burdens. She also believes the IRS should more accurately measure application processing times to help reduce delays, further simplify the information return filing process, and better target outreach and education to tax-exempt organizations.

NTA Recommendations

1. Notify applicants by letter in cases where the determination process will take longer than the 120 days specified in the Acknowledgement Letter.
2. Discontinue the practice of blending Merit and Non-Merit determination processing times and begin to monitor them separately.
3. For expedited application requests, more closely follow the procedures set forth in Rev. Proc 2004-4, IRM 3.45.1.23, and IRM 7.21.3.4.1 rather than the current practice of granting expedited treatment only in cases when the applicant has a “grant pending” or has been “promised an asset worth a specific dollar amount.”

NTA Recommendation 1

1. Notify applicants by letter in cases where the determination process will take longer than the 120 days specified in the Acknowledgement Letter.

IRS Response to Recommendation 1

The IRS agrees that it is important to keep applicants apprised of processing times, and has developed a new “Interim Letter” that will be sent to all applicants if the processing time is expected to exceed 120 days. The IRS has also taken steps to improve the time required to process determination applications. Most importantly, the IRS hired 26 new Determination agents in June 2005 to enhance the screening program. In addition, through various design improvements, the number of applications awaiting screening and the time waiting to be screened has been reduced.

NTA Recommendation 2

2. Discontinue the practice of blending Merit and Non-Merit determination processing times and begin to monitor them separately.

IRS Response to Recommendation 2

The IRS is in the process of replacing its current determination processing system (EDS) with a new system – the TEGE Determination System (TEDS). The ability to track merit and non-merit processing times separately is included as a requirement for the new system.

NTA Recommendation 3

3. For expedited application requests, more closely follow the procedures set forth in Rev. Proc 2004-4, IRM 3.45.1.23, and IRM 7.21.3.4.1 rather than the current practice of granting expedited treatment only in cases when the applicant has a “grant pending” or has been “promised an asset worth a specific dollar amount.”

IRS Response to Recommendation 3

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The IRS does not limit approvals of expedited requests to those applicants who have a “grant pending” or those “promised an asset worth a specific dollar amount.” The IRS follows the procedures in Rev. Proc. 2004-4 and the Internal Revenue Manual. This includes consideration of requests that have demonstrated a need because of a business emergency.

2004 ARC – MSP D-14 IRS EXAMINATION STRATEGY

Problem: The IRS estimates that the annual net tax gap is about \$255 billion. If examinations (audits) are to reduce the gap, the IRS must allocate its limited examination resources to most effectively promote compliance. Studies show that examinations reduce the tax gap primarily through an indirect effect on voluntary compliance rather than direct collection from the taxpayer under audit. However, the IRS does not know whether its current examination strategy is maximizing voluntary compliance and minimizing the tax gap. The IRS should research how the indirect effect of examinations on voluntary compliance varies by taxpayer population, issues examined, and type of examination, and should use this research to determine which returns and issues to examine and what type of examination to use.

NTA Recommendations

1. Conduct further research into the “indirect” effect if examinations on voluntary compliance. Conduct research to estimate how such indirect effects vary by taxpayer segments, issues examined, and type of examination (e.g., face to face or correspondence). Use this research to determine which returns to examine, which issues to examine, and what type of examination to use, as well as when non-audit contacts may result in greater compliance. Use partnerships with state taxing authorities, local databases (such as property tax records that indicate property disproportionate to reported income) and improved computer screening tools to identify taxpayer segments and communities where noncompliance is the norm. Conduct additional examinations in communities where compliance is low.
2. Develop procedures for quickly estimating how effectively a given strategy increases voluntary compliance in a given community. Use such estimates to evaluate examination initiatives in lieu of dollars assessed, which may have no correlation with the effectiveness of an initiative in achieving tax gap reduction goals.
3. Adopt a policy of routinely auditing information reporting compliance, even though such procedures may be unlikely to significantly increase assessments.
4. Conduct research into the national and local causes of noncompliance. Consider giving local areas more research tools, latitude and incentives to address non-compliance among local taxpayers, and then evaluate the success of such local approaches so that successful strategies can be replicated elsewhere.

NTA Recommendations 1, 2 and 4

1. Conduct further research into the “indirect” effect if examinations on voluntary compliance. Conduct research to estimate how such indirect effects vary by taxpayer segments, issues examined, and type of examination (e.g., face to face or

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correspondence). Use this research to determine which returns to examine, which issues to examine, and what type of examination to use, as well as when non-audit contacts may result in greater compliance. Use partnerships with state taxing authorities, local databases (such as property tax records that indicate property disproportionate to reported income) and improved computer screening tools to identify taxpayer segments and communities where noncompliance is the norm. Conduct additional examinations in communities where compliance is low.

2. Develop procedures for quickly estimating how effectively a given strategy increases voluntary compliance in a given community. Use such estimates to evaluate examination initiatives in lieu of dollars assessed, which may have no correlation with the effectiveness of an initiative in achieving tax gap reduction goals.

4. Conduct research into the national and local causes of noncompliance. Consider giving local areas more research tools, latitude and incentives to address non-compliance among local taxpayers, and then evaluate the success of such local approaches so that successful strategies can be replicated elsewhere.

IRS Response to Recommendations 1, 2 and 4

The tax gap is a serious problem. To address this problem, the IRS has many efforts underway to develop and enhance an examination strategy for more effective allocation of resources and improved selection of cases relative to the examination program. Most of the discussion in the TAS report is based on selected, observed IRS actions and the findings of various research studies conducted over many years. However, the conclusions and recommendations reached in the report do not reflect a full understanding of the examination function in tax administration.

The IRS uses a three-pronged strategy to accomplish its mission relative to examinations and address the reporting compliance tax gap. These prongs are not mutually exclusive and the resources allocated to each prong depend to a great degree on management judgment. From year to year, the IRS balances its examination resources to address these three prongs, as part of its strategy to close the tax gap.

Provide Audit Coverage – Maintaining an effective level of audit coverage provides a broad enforcement presence and encourages the annual voluntary net collection of approximately \$1.7 trillion in revenue. This examination “presence” promotes the fairness of the tax system by ensuring that taxpayers are paying the correct amount of tax. Audit coverage also provides stability to voluntary compliance by preventing erosion of the voluntary reporting and payment of taxes owed.

Mitigate Risk to the Tax System – Directing examination resources to those segments of the population that use egregious tax avoidance strategies or fail to file returns is another important dimension of the examination strategy. Specific programs to deal with these forms of noncompliance are critical if the IRS is to assure the taxpaying public that the tax system is fair, i.e., all taxpayers are expected to pay their "fair share,"

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and those who don't will be detected. Taxpayers who believe the system is fair are far more likely to correctly report and pay their taxes.

Generate Enforcement Revenue – Focusing on potential enforcement revenue is an integral part of the IRS strategy to address underreporter non-compliance and select returns for examination, whether for audit coverage or risk mitigation. Higher potential for tax adjustments (enforcement revenue) signals a higher degree of noncompliance. Giving priority to these cases not only impacts direct and indirect compliance, but is also an effective use of IRS resources.

Conducting probes for unreported income is a standard element of both business and non-business examinations. In addition, the IRS continues to conduct research into improved methods to detect unreported business income. In particular, the IRS is using selection formulas based upon the DIF system to select and audit returns showing high probabilities for unreported income.

Every year, the IRS invests significant resources, both internally and externally, to research tax compliance behavior. Currently, SB/SE Research is conducting approximately 50 projects regarding examination issues. In addition to these smaller, more targeted efforts, the IRS recently completed the National Research Project (NRP) 1040 (Individual). The IRS dedicated significant resources to this program, examining approximately 46,000 returns and spending more than \$100 million. Information gathered from this effort will allow the IRS to improve its audit selection formulas, develop more current tax gap estimates, and update the measures on taxpayer compliance. This information will be used as a benchmark in future years to direct the allocation of resources to address compliance issues. Next year, the IRS will begin the NRP for 1120-S (S Corporations). Expanded reporting requirements, such as the new Schedule M-3 and Form 8858, increase the information available to the IRS to pinpoint non-compliance, particularly in the large corporate population.

The TAS report recommends that the IRS plan its examination strategy to take advantage of the indirect effect of its audits and to maximize the collectibility of the resulting assessments. The indirect effect of examinations is a component in establishing audit coverage each year. Our focus on areas of non-compliance and high risk, such as abusive schemes and offshore initiatives, is intended to create a ripple effect. While there are no proven quantitative measurements regarding the indirect effect, the IRS continues to enhance workload identification selection systems to maximize indirect benefits across broad groups of taxpayers.

NTA Recommendation 3

3. Adopt a policy of routinely auditing information reporting compliance, even though such procedures may be unlikely to significantly increase assessments.

IRS Response to Recommendation 3

In accordance with IRM 4.10.5.6, required filing checks include minimum audit checks of information returns. As part of the examination process of business audits (i.e.

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schedule C, corporate, S corporate, partnerships, etc) we routinely, as a matter of policy, determine if all required information documents (i.e. 1099s, etc) and other required returns (i.e. payroll tax returns, etc.) have been filed.

2004 ARC – MSP D-15 IRS COLLECTION STRATEGY

Problem: Our tax administration system faces two serious threats: expansion of the tax gap (the amount of tax imposed by law for a given tax year but not paid voluntarily or timely) and the decline in voluntary compliance by taxpayers. The IRS collection strategy has shifted in emphasis many times, but the IRS has not incorporated the best practices of the private collection industry with strategies to enhance tax compliance. The National Taxpayer Advocate believes the IRS must focus not just on today's delinquent tax dollars but also on tomorrow's tax obligations. An effective collection strategy must: (1) be based on research; (2) understand the why of noncompliance; (3) identify the appropriate collection touch for each particular cause of noncompliance; (4) reduce opportunities for noncompliance; and (5) ensure prompt human contact with delinquent taxpayers.

NTA Recommendation

1. Develop a collection strategy that harmonizes the best practices of private collection agencies with policies and procedures designed to enhance tax compliance by emphasizing:
 - a. Person-to-person contact, where appropriate, early on in the collection process;
 - b. The importance of focusing on the why of taxpayer noncompliance;
 - c. Identification of the appropriate collection touch for the particular cause of noncompliance;
 - d. Utilization of a research-based approach to collections; and
 - e. Reduction of the opportunities for noncompliance.
2. Since tax debts that are older than three years are on average nearly uncollectible, IRS should prioritize its collection resources by:

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- a. Emphasizing the use of predictive dialer systems that efficiently contact taxpayers and automatically transfer calls to trained tax professionals; and
- b. Utilizing trained IRS collection professionals, the IRS's most valuable tool, earlier in the collection process.

NTA Recommendation 1

1. Develop a collection strategy that harmonizes the best practices of private collection agencies with policies and procedures designed to enhance tax compliance by emphasizing:
 - a. Person-to-person contact, where appropriate, early on in the collection process;
 - b. The importance of focusing on the why of taxpayer noncompliance;
 - c. Identification of the appropriate collection touch for the particular cause of noncompliance;
 - d. Utilization of a research-based approach to collections; and
 - e. Reduction of the opportunities for noncompliance.

IRS Response to Recommendation 1

The scope of the problem involving unpaid taxes is large and complex. This recommendation is based on several aspects of modern collections theory and practice, such as prompt person-to-person contact with debtors, focusing on the "why" of debtor noncompliance, and applying the appropriate collection "touch" to the cause of noncompliance. We agree that these aspects are important in an effective collection program. While our efforts, both past and current, to address these aspects have been constrained by budget, resource, legislative, and technology limitations, we have made significant improvement in our processes and productivity continues to increase.

Once an assessment is made, the IRS attempts to collect the amount due in the most efficient manner. The IRS contacts taxpayers through notices and phone calls before utilizing enforcement treatments. If the taxpayer chooses not to interact with IRS, enforcement may be pursued. Over 50 percent of taxpayers pay upon receipt of the first notice and nearly 70 percent of delinquent accounts are collected via notices. We refer to these taxpayers as self-correcting and this negates the need for a person-to-person contact that could cause undue taxpayer burden. Although early personal contact would be ideal for identifying the reasons for the delinquency at hand and going beyond that to foster future compliance, we must use our limited resources to address the most egregious cases, which are usually those who do not respond to the early and phone calls.

NTA Recommendation 2

2. Since tax debts that are older than three years are on average nearly uncollectible, IRS should prioritize its collection resources by:
 - a. Emphasizing the use of predictive dialer systems that efficiently contact taxpayers and automatically transfer calls to trained tax professionals; and
 - b. Utilizing trained IRS collection professionals, the IRS's most valuable tool, earlier in the collection process.

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IRS Response to Recommendation 2

As the IRS has continued to enhance its collection strategy, we have implemented several initiatives to deter the growth of accounts receivable and to maximize our effectiveness in identifying and collecting unpaid taxes. Recent performance indicators show that these efforts are having a positive impact on compliance. In January 2003, the IRS began using collection models to identify accounts likely to be full paid or currently not collectible, with the intent to direct resources to those cases deemed to be more collectible. The Federal Tax Deposit (FTD) Alert system was enhanced in 2004 to more accurately detect in-business accounts where tax deposits have fallen behind. The system's new criteria are expected to reduce the number of nonproductive FTD alerts and free valuable resources to work delinquent accounts in a more proactive manner.

SBSE and S&I have emphasized and utilized the predictive Dialer system to enhance servicing taxpayers with collection issues. SBSE recently deployed a new system in an effort to expand coverage. We have also developed specialized teams within geographical sites to address the more complex and special needs of the taxpayers. A Collection Governance Council that is designed to provide executive oversight and guidance on the collection process has been put into place. This cross-divisional council is responsible for managing Accounts Receivable, ensuring the proper allocation of resources.

The Federal Payment Levy Program was expanded to more efficiently address Federal contractor noncompliance. In addition, legislation was enacted in November 2004 to allow the IRS to proceed with the Private Debt Collection Initiative. This new provision recognizes that the IRS will benefit from the assistance of outside contractors in collecting outstanding taxes. A multi-functional project team has been working on implementation since December 2004 with deployment of the initial phase scheduled in June/July 2006. The National Taxpayer Advocate has representatives on the project team. Private debt collection will provide many resources to reach accounts at the earliest stages of delinquency. They will provide outbound calling capabilities and person-to-person contact to help taxpayers resolve their accounts.

Private Debt Collection is just the beginning of the Filing and Payment Modernization effort which will full modernize our collection systems by employing decision analytics, business rules and inventory management software. To support that effort, we have engaged in a multi-stages research efforts to develop additional analytical models to incorporate a rules based approach to routing delinquent taxpayers to the most appropriate treatment. In January 2003, the IRS began using analytical models to identify accounts likely to be full paid or currently not collectible with the intent to direct resources to those cases deemed to be more collectible. It is envisioned that through decision analytics we will be able to distinguish early the "can't" pay from the "won't" pay taxpayer and treatment strategies will be applied accordingly. Our limited resources must be used to address the most egregious cases, which are usually those that do not respond to notices and phone calls.

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The IRS also continues to expand its pre-filing activities, especially in stakeholder and taxpayer partnership programs. We encourage new and innovative ways to increase taxpayer compliance through more effective communication and outreach before returns are prepared and filed. Examples of such initiatives include penalty relief to promote compliance and improved websites to assist taxpayers and to promote IRS messages.

2004 ARC – MSP D-16 FEDERAL CONTRACTORS AND THE FEDERAL PAYMENT LEVY PROGRAM

Problem: The GAO reported that in 2002, more than 27,000 Department of Defense contractors owed more than \$3 billion in Federal taxes, yet many of these noncompliant contractors continued to receive Federal contract awards and payments. This noncompliance contributes to the tax gap, unfairly disadvantages compliant contractors, and allows the noncompliant to reap the benefits of contracts while refusing to fulfill tax obligations. Although the tax law contains provisions aimed at preventing such noncompliance by Federal contractors, the IRS and other responsible agencies are not effectively implementing these provisions. IRS problems include a breakdown in the information return filing process, failing to effectively utilize available information, and problems employing the Federal Payment Levy Program against noncompliant contractors. The National Taxpayer Advocate understands that the IRS is taking steps to remedy these problems, and recommends that the IRS work to solve the remaining problems and implement a system that will more effectively use Federal contract and payment information to curb future noncompliance.

NTA Recommendations

1. Ensure that the IRS receives all Forms 8596 that were filed with the FPDC since the 2001 tax year.
2. Actively monitor Form 8596 compliance and act quickly to correct any future electronic transmission or filing problems.
3. Update applicable Revenue Procedures, forms, instructions and IRM sections to reflect elimination of paper filing option for Form 8596.
4. Implement procedures to compare applicable information on Forms 8596 and 1099-MISC to the extent possible in order to monitor Federal Contractor compliance.

NTA Recommendation 1

1. Ensure that the IRS receives all Forms 8596 that were filed with the FPDC since the 2001 tax year.

IRS Response to Recommendation 1

The IRS Wage and Investment Operating Division administers the Federal Payment Levy Program (FPLP) jointly with the Department of Treasury's Financial Management Services (FMS). The Office of Federal State and Local Government (FSLG) in the Tax Exempt and Government Entities Operating Division is responsible for federal tax

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administration issues relating to Federal agencies, state and local government units and their subordinate agencies.

We appreciate the TAS report's acknowledgment that the IRS has increased collections through the FPLP and that the IRS has numerous efforts underway to resolve remaining issues with contractor noncompliance.

The TAS report notes that, in the past, there was substantial noncompliance with the requirement to report Federal contracts in excess of \$25,000 under section 6050M of the Internal Revenue Code. The IRS has addressed this issue. Effectively, there are two entities that file quarterly returns related to Federal contracts (Forms 8596). One of these is the United States Postal Service, which files on its own behalf. The other is the Federal Procurement Data Center (FPDC), which files on behalf of other Federal agencies. Past filing problems arose for two principal reasons. First, the USPS was unable to file with the IRS after January 1, 2000, because the USPS did not conform its file format to the IRS's post-Y2K format. This situation has been corrected and the USPS has resumed filing. Second, the FPDC's filings were interrupted in tax year 2002 due to outsourcing of certain of its data-gathering processes and other considerations. This situation also has been corrected and filing resumed in February, 2005.

NTA Recommendation 2

2. Actively monitor Form 8596 compliance and act quickly to correct any future electronic transmission or filing problems.

IRS Response to Recommendation 2

The IRS will continue to pursue noncompliance in this area. For example, as part of its FY 2005 strategic initiatives, FSLG will examine Federal agency compliance with the information reporting requirements of sections 6050M and 6041A. Among other things, the examinations will enable FSLG to determine the extent of noncompliance by Federal agencies, and then respond with appropriate enforcement and educational strategies.

Improving tax compliance by Federal contractors is a goal that requires the combined efforts of the IRS and the responsible Federal agencies. Recognizing this, the IRS, joined by the Department of Defense (DoD), the Defense Finance and Accounting Service (DFAS), the Financial Management Service (FMS), the General Services Administration (GSA), the Office of Management and Budget (OMB), and the Department of Justice (DOJ) established the Federal Contractor Tax Compliance Task Force (FCTC) in March 2004. The FCTC has identified improvements that would enhance the effectiveness of the FPLP, and these improvements are now being implemented.

NTA Recommendation 3

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3. Update applicable Revenue Procedures, forms, instructions and IRM sections to reflect elimination of paper filing option for Form 8596.

IRS Response to Recommendation 3

FSLG proposed a change in the regulations to eliminate the paper filing option. Counsel raised concerns over the elimination of this option because they believe a statutory change is needed to effectuate it. Due to Counsel's response, the proposal was not included in the 2005-2006 Guidance Priority Plan. FSLG is discussing with Counsel the statutory changes that are needed to eliminate the paper filing option.

NTA Recommendation 4

4. Implement procedures to compare applicable information on Forms 8596 and 1099-MISC to the extent possible in order to monitor Federal Contractor compliance.

IRS Response to Recommendation 4

The TAS report's discussion of filing requirements under section 6041A (Form 1099-MISC) indicates a misunderstanding of the different requirements under sections 6050M and 6041A. Section 6050M requires reporting all contracts entered into by a Federal agency relating to goods and services. Section 6041A requires reporting payments made for services only. Reporting under section 6050M is triggered by the execution of a contract. Reporting under section 6041A is based on the timing of the payment for services made under the contract.

Due to these differing requirements, reports on Form 8596 filed on behalf of a Federal agency by the FPDC will not necessarily match the Forms 1099-MISC filed by the Federal agency itself. For example, suppose the FPDC files a Form 8596 on behalf of Federal agency A with regard to a contract with Corporation B under which Corporation B will provide paper goods to Federal agency A during calendar years 2002-2005. Under section 6041A, during each tax year, Federal agency A is required to file Forms 1099-MISC only for payments it makes for services received. Thus, no Form 1099-MISC would be filed for the payment made by Federal agency A to Corporation B for the paper goods received.

2004 ARC – MSP E-17 INDEPENDENCE OF THE OFFICE OF APPEALS

Problem: The IRS Appeals division plays a vital role in tax administration by providing taxpayers a forum to resolve tax controversies without litigation. But because Appeals procedures are voluntary, taxpayers will not use Appeals unless they believe that they can reasonably access the Appeals system and that their cases will receive a fair review independent of the IRS enforcement function. Certain Appeals policies limit taxpayers' reasonable access to Appeals and compromise its independence. These policies include case processing delays, eliminating oral appeals, centralizing appeals in IRS campuses, eroding the prohibition on ex parte communications, and actively participating in the planning of IRS tax shelter initiatives. The National Taxpayer Advocate recommends that the IRS revise any policies that lead taxpayers to believe

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their cases will not receive fair consideration, and take steps to ensure that all taxpayers have reasonable access to Appeals.

NTA Recommendations

1. Appeals should permit oral appeals to be requested as provided by existing regulations. It should electronically document such requests and prepare computer generated acknowledgement letters.
2. Appeals should revise its procedures to ensure that Appeals officials verbally inform every taxpayer making an appeal that they have the right to a face-to-face appeals conference upon request and ensure that there is sufficient staffing in the field offices to promptly handle cases in which a local hearing is requested.
3. IRS should research the effectiveness of its tax shelter global settlement initiatives to determine whether, in fact, they resolve taxpayer cases, from assessment to collection of tax due, in a more expeditious and less expensive manner than the traditional controversy approach that allows for access to Appeals as well as litigation.
4. Appeals should limit its participation in enforcement oriented partnerships with IRS operating divisions, including the development of tax shelter settlement initiatives, to an advisory role and ensure that the right to an administrative de novo appeal is not curtailed in such cases. Moreover, Appeals officials should avoid public statements indicating that it has prejudged any cases or issues.
5. In connection with its mediation programs, Appeals should revise its ex parte rules to prohibit Appeals from discussing the substantive issues with compliance before Appeals has discussed them with the taxpayer or, alternatively, the parties have discussed them jointly. This approach may reduce the perception that Appeals has prejudged the case.
6. Appeals should rapidly follow through with its plans to develop measures to evaluate the effectiveness of its CSI and Right Work/Right Employee Strategies, and implementation of its mentoring program.
7. Appeals should re-evaluate its definition of complexity to ensure that complex cases are worked by appropriately trained and skilled personnel, regardless of whether the case originates in a campus or involves a low income or EITC taxpayer.

NTA Recommendation 1

1. Appeals should permit oral appeals to be requested as provided by existing regulations. It should electronically document such requests and prepare computer generated acknowledgement letters.

IRS Response to Recommendation 1

W&I has agreed to hold cases based on an oral request until a simple, streamlined request for an Appeal is received. The other Operating Division cases are more complex and require a clearer statement from the taxpayer than just "I disagree." Taxpayers are better served by both the IRS and themselves having to articulate their disagreement in terms that each can understand. This statement should be in writing; by doing so taxpayers have a greater opportunity to resolve the dispute at the lowest level. We therefore do not agree with the principle recommendation to permit an oral request for an Appeal.

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Appeals does agree with working to make it easier for a taxpayer to request a small case appeal and to ensure its timely consideration, Appeals has developed Form 12203, Small Case Request, a very brief, easily completed document. This “tear off” form will be included in publications sent to the taxpayer with each proposed adjustment. Form 12203:

- Verifies that the taxpayer indeed wants to go to Appeals;
- Frames the issues so both Compliance and Appeals understand the reasons for the protest;
- Enables Compliance to consider and perhaps even concede the issues based on the taxpayer’s stated position; and
- Allows Appeals to assign the work and plan for our conferencing immediately upon receipt of the case rather than waiting for taxpayer contact.

The small case request form is a much more reliable way to request an appeal. Many taxpayers do not respond nor provide any documentation regarding their issues. While the small case request doesn’t guarantee the presentation of documentation, it helps to articulate the disagreement. The Advocate supports implementation of the small case request (Form 12203). This process protects the small case taxpayer much more than any potential concern raised by eliminating the oral request for appeal.

The IRS believes that the current procedures and the recent addition of the Form 12203 are appropriate and protect taxpayers’ rights to easy access to Appeals. In addition, the IRS has had success with similar appeal request forms specific to collection due process and collection appeals cases.

The Publication 5 was reprinted in 1999 after it was cleared by all operations including TAS. Appeal rights were made consistent with the intended rewrite of CFR 601.106; therefore, taxpayers have not had the right to an oral request for an appeal since that time. The IRS believes the actions already taken are sufficient to protect taxpayer rights.

Appeals does agree that documentation of any request should be electronically captured. Appeals believes that the future state should include a taxpayer kiosk where they can electronically request the appeal, document their concerns and begin the process to move the case to Appeals. We will work with the Operating Divisions to create such a kiosk approach and we will work with MITS to enhance the interoperability of systems. For taxpayers without access to such a kiosk we can work with the Operating Divisions and functions to determine how best to provide such a service to all taxpayers. This approach might meet in part the basic concern raised by TAS. These are long term projects for which we cannot give an estimated implementation date at this time.

NTA Recommendation 2

2. Appeals should revise its procedures to ensure that Appeals officials verbally inform every taxpayer making an appeal that they have the right to a face-to-face appeals

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conference upon request and ensure that there is sufficient staffing in the field offices to promptly handle cases in which a local hearing is requested.

IRS Response to Recommendation 2

Appeals believes the right to a face to face conference is best communicated in a standard written format rather than left to inexact oral delivery of the message. Appeals has altered its appointment letters and all initial communication with taxpayers planned to be worked in a Appeals campus unit to include information informing them of the right to a face to face conference. The IRS believes this written notification will ensure taxpayers are appropriately and consistently informed. Current trends indicate to us that requests for face to face conferencing are not a significant concern to most taxpayers.

Appeals has had experience managing campus operations successfully since 1988 with all conferencing being conducted by telephone or correspondence. Employees at those campuses have long resolved centralized "S" docketed cases very effectively. The current Appeals campus strategy builds on this success.

By creating a flexible conferencing approach all taxpayers are better served--both because their own case is resolved more effectively and because Appeals' enhanced efficiency enables it to handle all cases effectively. The campus strategy means Appeals can have the resources ready and available to handle and resolve each and every case.

Ensuring sufficient field staffing to handle face to face conferencing of campus cases when requested is clearly in Appeals and the taxpayers' best interest. Our campus operations are just completing the initial roll out. The next phase of operations is to clearly monitor caseload and the deployment of our staffing. As we are only just beginning this phase of operations we think that TAS' concern is more appropriately a wise warning, but not a "most serious problem."

Appeals began capturing data on the type of conference held in February 2004. In reviewing this data, we have found that only 11 percent of taxpayers request a face-to-face conference to resolve their case.

NTA Recommendation 3

3. IRS should research the effectiveness of its tax shelter global settlement initiatives to determine whether, in fact, they resolve taxpayer cases, from assessment to collection of tax due, in a more expeditious and less expensive manner than the traditional controversy approach that allows for access to Appeals as well as litigation.

IRS Response to Recommendation 3

The scope of this recommendation is broader than just tax shelters and requires IRS wide adoption of the recommendation across all programs rather than just focusing on tax shelter resolution. It should not be adopted without such service-wide consideration.

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At this time we do not disagree with the concept of tracking all programs from cradle to grave—in effect from assessment to collection.

Appeals maintains a record of settlement initiatives and settlement solicitations for tax shelters and reports regularly to the Commissioner on their success, normally as measured by the number of taxpayers who accept the initiative and the tax dollars involved. Our general belief is that if the settlement position offered reflects the true hazards of litigation, then acceptance by taxpayers will be high. Appeals also supports a strategy of giving taxpayers the opportunity for a regular appeal if they believe that their facts and circumstances justify a different outcome. This strategy has been used with every initiative to date except in the Son of Boss initiative, which did not involve either a hazards-based settlement or an opportunity for appeal rights for those not accepting the initiative.

That being said, we are uncertain as to whether this recommendation will produce a meaningful difference in operations. We agree that this approach is appropriate in comparing different collection alternative programs such as offers in compromise versus an installment agreement; however, this recommendation mixes a liability determination process with a collection process. We are uncertain whether an extensive study of two such processes will be meaningful. Additionally, if such an approach is applicable to tax shelters then it's applicable to all examination or returns processing initiatives; therefore, the core of the recommendations is much broader than to just tax shelters. Typically, the Service collects more money if collection action happens earlier than if delayed. The global tax shelter initiatives afford taxpayers and the Service an opportunity to resolve disputes at an earlier point and therefore potentially an earlier opportunity for the Service to collect amounts due.

This recommendation is made as part of a “most serious problem” related to Appeals' Independence. Although not part of this specific recommendation we believe it's important to restate our objection to its premise. Appeals' participation in developing global tax shelter settlement initiatives does not prevent Appeals from maintaining its independence or satisfying the goals of the provision restricting ex parte communications with Appeals. First, the issue management process focuses the IRS's attention and resources on selected transactions and issues generally, not on the facts of any particular taxpayer's case. This enables the IRS to share its collective expertise and knowledge, increasing the likelihood of achieving both the right result and consistent treatment. Appeals' participation provides the process with needed information and technical expertise that helps evaluate the IRS's hazards of litigation and make informed decisions regarding settlement guidelines. Also, it allows Appeals to provide meaningful input into formulating the IRS's strategy for handling various types of tax shelters.

Second, and perhaps more importantly, including Appeals in the process furthers the chances that the IRS's global tax shelter settlement initiatives will be successful. When Appeals is not part of the global tax shelter settlement initiatives, taxpayers have less incentive to participate because they may anticipate a “better deal” by going to Appeals.

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This would undermine this approach's usefulness for handling tax shelter cases, depriving the IRS of an opportunity to resolve large numbers of these cases using fewer resources. This would also result in Appeals working at cross purposes to the objectives of the IRS as a whole. Appeals would not be functioning within the IRS, as contemplated and required by Congress. In short, an independent Appeals office is intended to assist the IRS in meeting its responsibilities to fairly and impartially administer the internal revenue laws, not undercut the Service's efforts to do so. When it participates in the issue management process, Appeals can positively influence the IRS's decision making from its unique vantage point. If Appeals were to operate completely outside of the system, as advocated in the TAS report, it would lose the ability to be part of the solution, as Congress envisioned.

Certainly, the current tax shelter settlement initiatives represent a new cross-functional effort by Appeals, Counsel and Compliance to carrying out their respective roles in tax administration. However, the critical piece to recognize is that within an "Issue Management Team" each function maintains its unique role (i.e. Compliance develops the facts, Counsel articulates the applicable legal arguments, and Appeals assesses the respective litigating hazards). The roles, procedures and operation of the team are clearly outlined in the "Process Guide for Combating Abusive Tax Transactions". It confirms that Appeals has neither assumed the roles and responsibilities of another function nor delegated or ceded its own.

The Issue Management Team is an excellent forum in which to review the roles and responsibilities of the respective IRS functions participating in the process. Appeals routinely uses the opportunities afforded by these cross functional meetings to emphasize its independence and remind other functions of its mission to resolve disputes fairly and impartially.

In September 2005, TIGTA concluded its review of the issue of Appeals Independence and its conformance to the intentions of RRA '98. We currently believe such participation is not only appropriate it is desirable. Appeals does represent taxpayer interest when it ascertains "hazards of litigation."

NTA Recommendation 4

4. Appeals should limit its participation in enforcement oriented partnerships with IRS operating divisions, including the development of tax shelter settlement initiatives, to an advisory role and ensure that the right to an administrative de novo appeal is not curtailed in such cases. Moreover, Appeals officials should avoid public statements indicating that it has prejudged any cases or issues.

IRS Response to Recommendation 4

See response to recommendation 3.

NTA Recommendation 5

5. In connection with its mediation programs, Appeals should revise its ex parte rules to prohibit Appeals from discussing the substantive issues with compliance before Appeals

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has discussed them with the taxpayer or, alternatively, the parties have discussed them jointly. This approach may reduce the perception that Appeals has prejudged the case.

IRS Response to Recommendation 5

The IRS asked the Treasury Inspector General for Tax Administration (TIGTA) to review Appeals to ensure the modernized structure and processes adhere to the intent of RRA98. TITGA issued a final report in September 2005 that concluded that the overall independence of Appeals appears to be sufficient.

NTA Recommendation 6

6 Appeals should rapidly follow through with its plans to develop measures to evaluate the effectiveness of its CSI and Right Work/Right Employee Strategies, and implementation of its mentoring program.

IRS Response to Recommendation 6

Appeals is using a combination of business results, customer satisfaction results, and quality measurement results to measure the effectiveness of the campus operations. The IRS believes that the same measure should apply to both the Appeals and field and campus operations. The initial findings of this comparison are favorable to the campus operations.

Appeals began capturing data on the type of conference held in February 2004. In reviewing this data, we have found that only 11 percent of taxpayers request a face-to-face conference to resolve their matter.

The IRS is analyzing the quality of Appeals case resolution through the Appeals Quality Measurement System (AQMS). Those results are being separately measured for campus operations so that the IRS can ensure the same level of quality as field operations. Here are some results.

	Score
Current overall Appeals score	79
Range for campus operations	73-86
Range for field operations	71-86

This data shows that the Appeals' campus strategy not only allows all the offices to concentrate on the cases they do best, they do it with the same quality.

NTA Recommendation 7

7. Appeals should re-evaluate its definition of complexity to ensure that complex cases are worked by appropriately trained and skilled personnel, regardless of whether the case originates in a campus or involves a low income or EITC taxpayer.

IRS Response to Recommendation 7

Appeals grades its casework based on the complexity of the issues found in each individual case. Managers carefully review each case and determine if their employees have the knowledge and skills to handle the particular issues found in that case. Where

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cases are more complex than the technical skills available then Appeals does transfer those cases to our field operations for review and consideration. Our campus operations are just completing the initial roll out. The next phase of operations is to clearly monitor caseload and the deployment of our staffing—proper grading of the work and ensuring the resources are in the right place to deliver them is something Appeals will be constantly addressing. As we are only just beginning this phase of operations we think that TAS' concern is more appropriately a wise warning, but not a “most serious problem.”

2004 ARC – MSP E-18 IRS MEDIATION PROGRAMS

Problem: The IRS mediation programs, Fast Track Mediation and post-Appeals mediation, are rarely used. Unless these programs are utilized in every appropriate case, the IRS will not reap the full benefits of mediation identified by Congress, including: (1) reducing the time and costs required to resolve disputes, (2) improving the outcomes of the dispute resolution process, and (3) improving participants' satisfaction with the process and outcomes. If these potential benefits are to be realized, the IRS must minimize the number of taxpayers and issues excluded from the programs, effectively communicate their existence and utility to taxpayers and IRS employees, and eliminate potential concerns about confidentiality and conflict of interest.

NTA Recommendations

1. Survey eligible taxpayers who did not use IRS mediation programs to determine the reasons they did not use them.
2. Continue its outreach and education efforts to expand the use of the programs. Measure the relative effectiveness of various types of outreach and education so that such efforts can be focused most efficiently.
3. Revise the quality review process to measure whether IRS employees offer the programs to eligible taxpayers.
4. The IRS should not exclude taxpayers from mediation without a clear written justification for why mediation would not resolve the dispute more quickly and cost effectively than the alternatives. If processing cases in a centralized location is a barrier to the availability of mediation in cases where mediation would be effective, the IRS should reconsider whether such cases should be processed in a centralized location. Appeals' proposal to consider testing mediation via videoconferencing may be one way of addressing this problem, provided the use of videoconferencing does not dilute the effectiveness of mediation.⁸² In connection with any such test, IRS should evaluate whether mediation effectiveness is impaired by the lack of a physical presence.
5. When the IRS expands the availability of its mediation programs (such as to certain campus cases), such changes should be widely publicized and incorporated into existing published guidance. Appeals should regularly publish updated guidance that clearly identifies (in a single publication) the cases and issues that are eligible and ineligible for its various mediation programs.
6. Include in its published guidance Appeals' informal practice of allowing taxpayers to request an Appeals mediator be assigned to hear an appeal involving issues not

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resolved through FTM. This guidance should also make clear that an Appeals mediator in FTM will not be assigned to the case when it reaches Appeals except upon the taxpayer's request.

7. Permit the use of qualified private sector mediators as either sole mediators or as co-mediators in both FTM and post-Appeals mediation, upon request.
8. Revise the form mediation agreements to clarify that oral statements to the mediator outside of a joint session will not be disclosed to the other parties and will be kept confidential by the mediator. Reiterate these confidentiality rules at the start of each mediation session.
9. Appeals should only allow the use of mediators who have received continuing mediation training or have obtained a significant amount of recent mediation experience. Appeals should rapidly implement the continuing education program that it is developing so that Appeals mediators can satisfy such requirements.

NTA Recommendation 1

1. Survey eligible taxpayers who did not use IRS mediation programs to determine the reasons they did not use them.

IRS Response to Recommendation 1

We agree with the National Taxpayer Advocate that the evaluation of Alternate Dispute Resolution (ADR) programs is a critical component of a government mediation program, especially for gaining insight about ADR program utilization. Appeals has a distinguished history of publishing IRS Announcements with new ADR procedures for a test period, so that they can be evaluated before and during implementation. Through this innovation, Appeals publishes the final revenue procedure at the end of a validation process, rather than at the beginning. Additionally, internal and external customer satisfaction surveys are given to participants in ADR programs to provide feedback to Appeals. Participants rate their overall satisfaction with the ADR process, along with other specific criteria, including whether the process and the mediator were impartial and whether the parties saved time and money. Finally, Appeals expects to finalize performance measures for its mediation programs in Fiscal Year 2005.

Appeals and SB/SE monitor the effectiveness of the Fast Track Mediation (FTM) program on a monthly basis and conducted site visitations at the Atlanta and Philadelphia Appeals offices. SB/SE subsequently issued a memorandum in May 2004 to all SB/SE field examiners, "Guidance to the Field on the Effective Use of Fast Track Mediation for Unagreed Examination Cases." For the evaluation of Fast Track Settlements, Rev. Proc. 2004-40 established the position of the FTS Program Manager in both Appeals and LMSB to monitor and facilitate acceptance of Applications for Fast Track Settlement. Monthly reports are submitted to Appeals and LMSB. In addition, a customer satisfaction survey was conducted by LMSB; for the 105 taxpayers who responded to the FTS survey through November 1, 2004, the average rating of overall satisfaction with the process is 4.11 on a scale of 1 to 5. One of the most important aspects of the FTS process is the taxpayer's rating of Appeals' independence. In the survey, customers expressed an average agreement rate of 4.08 when asked if "The Appeals representative was fair and impartial."

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NTA Recommendation 2

2. Continue its outreach and education efforts to expand the use of the programs. Measure the relative effectiveness of various types of outreach and education so that such efforts can be focused most efficiently.

IRS Response to Recommendation 2

We agree with the National Taxpayer Advocate that education and publicity for all stakeholders is fundamental to the success of any ADR program. Appeals believes that this is vital to the expansion of the ADR programs.

From the implementation of the FTM Pilot Program to date, Appeals has promoted FTM to internal and external stakeholders on a widespread basis. During the pilot program, FTM was marketed to over 13,000 internal and external stakeholders, including 3,000 direct contacts. A joint memorandum of emphasis and support for the FTM program was signed by Appeals and Compliance executives in October 2000 and May 2002. The IRS prepared a comprehensive written communication plan under the direction of the Communications and Liaison office with joint participation from representatives of Small Business/Self Employed (SB/SE) Compliance, Stakeholder Partnership, Education & Communication and Taxpayer Education & Communication. Prior to the nationwide roll out, a task force team was formed to revise the procedures and the team shared them with the tax practitioner community to obtain their feedback and comments. Marketing campaigns in Congressional Newsletters, IRS Headlines and IRS News Releases were conducted when FTM was implemented nationwide in June 2002. Information regarding the ADR programs was posted on the Appeals Intranet and IRS Internet Web sites.

Other actions taken include:

- External stakeholders are educated with nationwide outreach presentations to key professional associations (American Institute of Certified Public Accountants, American Bar Association and Tax Executives Institute) via tax practitioner symposiums.
- Internal stakeholders are educated via compliance Continuing Professional Education (CPE) training sessions and group meetings. A professionally developed PowerPoint presentation was distributed to CPE instructors and front-line managers to utilize as a teaching tool.
- A FTM video was produced and copies were distributed to local Appeals offices for marketing to internal and external stakeholders.
- Appeals tasked their Customer Service Representatives with promoting the program in their local areas. IRS Offices hosted FTM Open House meetings for tax practitioners.
- Appeals distributed a CD-ROM for tax practitioners' use, Publication 3771: Taxpayer Rights & Alternative Dispute Resolution.

A similar process is followed for Fast Track Settlement, including public presentations at IRS Tax Forums, Interactive Video Training teleconferences and Continuing

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Professional Education training sessions for external stakeholders, such as the American Bar Association and Tax Executives Institute. Over the years, Appeals has publicized the availability of the post-Appeals mediation program to tax practitioner groups across the country by making presentations at their meetings. Through increased education and publicity efforts, we expect that more taxpayers will consider using an ADR program to resolve their dispute when settlement negotiations are stalled in Appeals.

NTA Recommendation 3

3. Revise the quality review process to measure whether IRS employees offer the programs to eligible taxpayers.

IRS Response to Recommendation 3

Communication is the key element in fostering the utilization of the ADR programs. Appeals will continue to solicit both taxpayer and Compliance interest in these programs. The FTS program has proven to be successful in the Large and Mid-Size Business (LMSB) Operating Division because taxpayers have tried the program, experienced success and spread the news to other tax practitioners that it helped to resolve their case. Over 20 percent of the large case disposals in Fiscal Year 2004 were FTS. Most important is the fact that out of 480 new case assignments, 122 were Fast Track Settlement cases.

NTA Recommendation 4

4. The IRS should not exclude taxpayers from mediation without a clear written justification for why mediation would not resolve the dispute more quickly and cost effectively than the alternatives. If processing cases in a centralized location is a barrier to the availability of mediation in cases where mediation would be effective, the IRS should reconsider whether such cases should be processed in a centralized location. Appeals' proposal to consider testing mediation via videoconferencing may be one way of addressing this problem, provided the use of videoconferencing does not dilute the effectiveness of mediation.⁸² In connection with any such test, IRS should evaluate whether mediation effectiveness is impaired by the lack of a physical presence.

IRS Response to Recommendation 4

As a matter of sound policy for tax administration, Appeals exercised its authority to apply reasonable restrictions on the availability of mediation and excluded collection cases. Furthermore, it should be noted that Appeals developed the mediation procedures with the review and concurrence of the Office of Chief Counsel, the Commissioner of Internal Revenue and the Assistant Secretary of Treasury for Tax Policy. Appeals is constantly considering the expansion of its ADR programs, and we are in the process of finalizing procedures to allow for post-Appeals mediation of Offers-in-Compromise (OIC) cases. Until then, Appeals is accepting OIC cases for mediation on a case-by-case basis.

The Collection Appeals Program (CAP) is the ADR process for most collection cases and has a five-day turn-around goal to resolve them. Although CAP is not an ADR

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process since we do not utilize a neutral third party, it gives the taxpayers an alternative to traditional Appeals. The Collection Due Process cases qualify for Fast Track Mediation and Appeals would like to expand the ADR techniques available for collection issues, as appropriate. Regarding the Automated Collection System cases, Appeals believes that the timeframes for formally requesting an administrative appeal are such that ADR would not be practical for them. Field collection cases may have some ADR application, and Appeals will continue to explore resolution opportunities with SB/SE.

For the FTM program, the IRS established a design team with a cross-functional group of six Small Business/Self Employed and Appeals specialists. The team conducted a thorough review of the relevant factors for inclusion in, or exclusion from, the program. A consensus opinion for the current eligibility standards was reached, based in part on the results captured from the pilot program, feedback obtained from managers and examiners in the field, and the experience of the team members. The team established the initial eligibility requirements, intending to revisit them for future expansion.

Appeals and SB/SE will continue to explore ways to expand ADR techniques within campus operations. For example, the FTM program now includes Electronic Fund Transfer Deposit penalty cases within campus operations. In addition, Appeals initiated four Payroll Provider cases from campus sites in situations where each payroll provider represented one hundred or more taxpayers; these cases were all resolved successfully. Currently, discussions are underway to use Fast Track Settlement for these types of cases. Mediation techniques are an integral part of that process, as Appeals is attempting to get both the taxpayer and the Compliance manager to hear and understand the positions being put forth by the other party. The FTM program was also expanded to include tax-exempt bond cases on a pilot basis. Only one request was made from the IRS Tax Exempt/Governmental Entities Operating Division (TE/GE) to utilize FTM; this case was successfully resolved. Appeals and TE/GE agreed to expand the FTM program to include Credit Counseling cases.

NTA Recommendation 5

5. When the IRS expands the availability of its mediation programs (such as to certain campus cases), such changes should be widely publicized and incorporated into existing published guidance. Appeals should regularly publish updated guidance that clearly identifies (in a single publication) the cases and issues that are eligible and ineligible for its various mediation programs.

IRS Response to Recommendation 5

We agree with the National Taxpayer Advocate that education and publicity for all stakeholders is fundamental to the success of any ADR program. Appeals believes that this is vital to the expansion of the ADR programs.

NTA Recommendation 6

6. Include in its published guidance Appeals' informal practice of allowing taxpayers to request an Appeals mediator be assigned to hear an appeal involving issues not resolved through FTM. This guidance should also make clear that an Appeals mediator

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in FTM will not be assigned to the case when it reaches Appeals except upon the taxpayer's request.

IRS Response to Recommendation 6

In Fast Track Mediation, an Appeals manager assigns the case to an Appeals Official trained in mediation. If the taxpayer and the Compliance officer do not reach agreement and the taxpayer requests that the case be forwarded to Appeals, a different Appeals officer will be assigned the case. In some cases, a taxpayer may request that the Appeals mediator for the FTM be assigned the case in Appeals. While Appeals would consider the taxpayer's request, we would not make such a case assignment on our own initiative. We believe that the mediation procedures contain essential confidentiality protections by referencing the expectations set forth in the Administrative Dispute Resolution Act of 1996. In addition, Appeals and Settlement Officers are subject to confidentiality and disclosure of returns and return information rules under section 6103 of the Internal Revenue Code. Further, any records or documentation received by the Appeals mediator are destroyed by shredding at the conclusion of the mediation sessions.

NTA Recommendation 7

7. Permit the use of qualified private sector mediators as either sole mediators or as co-mediators in both FTM and post-Appeals mediation, upon request.

IRS Response to Recommendation 7

Regarding the use of IRS employees as mediators, we note that the Administrative Dispute Resolution Act of 1996 provides that a neutral may be a permanent or temporary officer or employee of the federal government or any other individual who is acceptable to the parties to a dispute resolution proceeding. In complex tax cases, it is an advantage to have co-mediators. During the post-Appeals mediation test periods, a variety of mediator options were used, including a single non-IRS mediator, Appeals mediators and non-IRS and Appeals co-mediators. Those cases with Appeals and non-IRS co-mediators were very effective for the most complex Coordinated Industry cases.

Inherent in the post-Appeals mediation procedure is the ability for a party to reject a mediator based on a conflict of interest. We note that the election by the taxpayer to use a non-IRS co-mediator at the taxpayer's expense was first proposed by a tax practitioner at the February 1995 mediation public hearing. Taking budget and other considerations into account, since Appeals is assuming the costs of the Appeals co-mediator, it is a reasonable administrative practice for the taxpayer to assume the costs of the non-IRS co-mediator. The mediation procedure also includes mediator conflict safeguards, including a conflict statement to be provided by the mediator.

The major advantage of using an Appeals mediator is their technical knowledge and expertise in tax law. This factor was addressed by the Fast Track Mediation design team prior to implementation of the program. During the policy formulation stage, a suggestion was received to include Equal Employment Opportunity mediators, from inside and outside of the IRS, in the FTM program. In reviewing this suggestion, the

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team referred to the FTM pilot results which revealed that one of the key components of a successful (agreed outcome) mediation session was the mediator's technical and legal credentials. The high ratio of agreed outcomes to total FTM mediation sessions appears to support the team's conclusion that the value of the technical and legal expertise of trained IRS Appeals mediators outweighs any conflict of interest or confidentiality concerns. In our experience administering the mediation programs, the mediator conflict of interest provisions are not controversial.

NTA Recommendation 8

8. Revise the form mediation agreements to clarify that oral statements to the mediator outside of a joint session will not be disclosed to the other parties and will be kept confidential by the mediator. Reiterate these confidentiality rules at the start of each mediation session.

IRS Response to Recommendation 8

We agree with the National Taxpayer Advocate that a dispute resolution communication made available to the other party, such as a mediation submission distributed by a party to the other party in a joint session, would not be protected from disclosure. However, we note that the parties may agree upon alternative confidential procedures in writing, for disclosures by a neutral. Presumably, the parties could also sign the alternative confidential procedures. To date, we are not aware that any parties to post-Appeals mediations have expressed the need to enter into an alternative confidentiality agreement. Appeals will consider making available to mediators draft confidentiality statements to use if the need arises, and additional confidentiality information highlighting the disclosure requirements.

NTA Recommendation 9

9. Appeals should only allow the use of mediators who have received continuing mediation training or have obtained a significant amount of recent mediation experience. Appeals should rapidly implement the continuing education program that it is developing so that Appeals mediators can satisfy such requirements.

IRS Response to Recommendation 9

Over four hundred Appeals and Settlement Officers are trained as mediators. We agree that continuing education is essential for full-time mediators to maximize their effectiveness; however, we do not agree with the conclusion that IRS mediators are not gaining significant experience.

One of the basic techniques in mediation training is that of negotiation. The most creative aspect of negotiation consists of the development of options that enable both sides to a dispute to resolve issues. Appeals personnel are engaged in these negotiations on a daily basis while meeting with taxpayers in carrying out the Appeals mission of resolving controversies without litigation. We did not view the mediation training that we provided to Appeals personnel as solely to enable these individuals to mediate cases for Appeals, but also to enhance their negotiation skills. Our employees are in fact maintaining the skills they learned through mediation training through their

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daily interaction with taxpayers and representatives. Appeals is developing an Appeals mediator Continuing Professional Education program for future implementation.

2004 ARC – MSP E-19 OFFERS IN COMPROMISE

Problem: Since August 2001, when the IRS began centralized processing of offers in compromise (OICs), it has reduced inventory and processing time primarily by returning more offers to taxpayers, rather than by fully evaluating them and then accepting or rejecting them. In addition, the number and percentage of offers rejected by the IRS have been increasing. Unnecessary OIC returns and rejections are inconsistent with OIC program goals of providing taxpayers with a legitimate alternative method of resolving their tax liabilities (i.e., an alternative to the use of “protracted installment agreements” or classification as “currently not collectible”) and a fresh start toward maintaining future compliance, as well as the IRS’ overall goal of “improving customer service.” In addition, it is not efficient for the IRS to unnecessarily return or reject OICs because returned OICs are often resubmitted again for processing, and many rejected OICs will be processed again by Appeals. Moreover, a recent study found that in a majority of cases when an OIC is rejected or returned to the taxpayer, the IRS eventually collects less than the amount that was offered.

NTA Recommendations

1. The IRS should contact taxpayers and allow a reasonable period of time for them to file delinquent returns before returning OICs on that basis.
2. The IRS should make at least two attempts to contact taxpayers before returning any OIC, and otherwise encourage employees to contact taxpayers by telephone or using face-to-face meetings where appropriate, especially with taxpayers for whom other modes of communication are unlikely to be successful. Calls should be made to taxpayers and their representatives only at times when they are most likely to be available.
3. The IRS should give employees discretion to determine that an OIC should not be returned in cases where required documentation is missing if they believe that additional communications would likely produce such documentation. If the IRS determines that it cannot accept an OIC based upon insufficient documentation from a cooperative taxpayer, guidance should emphasize that it should be rejected rather than returned so that the taxpayer has an opportunity to appeal the decision.
4. The IRS should process OICs received from taxpayers in bankruptcy. IRS standards for evaluating such offers should deviate from standard OIC criteria only when there is a clearly articulated reason for such a deviation.
5. The IRS should work with taxpayers and practitioners to reduce taxpayer (and IRS employee) burden and make it easier to understand OIC requirements by revising the Form 656 and its accompanying collection information statements.
6. The IRS should review the OIC submissions received before and after implementation of the OIC application fee to determine which types of submissions have been deterred by the fee or returned for failure to include it. The IRS should consider abolishing the fee if it has not significantly reduced frivolous submissions and

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submissions from uncooperative taxpayers or if it presents a significant barrier to taxpayers who are legitimately trying to comply.

7. The IRS should revise its Offer in Compromise form (Form 656) to clarify what it means by “doubt as to liability” so that taxpayers know that items such as innocent spouse relief, and interest and penalty abatement requests are made on other forms. However, when the IRS receives such requests on Form 656, it should immediately contact the taxpayer and route the taxpayer’s request to the area responsible for processing it.

8. The IRS should research the reasons why OIC rejections have increased and acceptances have declined. It should determine how increased communications could increase acceptance of reasonable offers.

9. The IRS should revise the current methods of determining Reasonable Collection Potential (RCP) by:

a. Allowing expenses for delinquent state tax payments. Ignoring such expenses is likely to result in minimum offer requirements that leave taxpayers without the ability to meet “basic living expenses,” notwithstanding regulatory guidance suggesting that offers should not do that, even in cases where IRS would not use involuntary collection tools. If IRS believes that other policies produce similar results those policies should also be reexamined; and

b. Estimating future income based upon the best estimates available, rather than rigidly adhering to an income-averaging approach. The IRS believes that IRS’ policy providing for the use of collateral agreements provides flexibility. However, IRS is prohibited from accepting an offer for an amount less than would be permitted based on an income-averaging calculation using a collateral agreement. Thus, IRS policy allows the use of collateral agreements only in cases where it would benefit the government, but not in cases where it would benefit a taxpayer. Many taxpayers would undoubtedly characterize this policy as rigid. Moreover, it ignores the reality faced by taxpayers whose future income will be less than it was in the past.

10. The IRS should revise the IRM and job aids to more clearly state that the months of future income to be used in determining the offer amount should never extend beyond the statute of limitations expiration date.

11. The IRS should more clearly communicate the forms of documentation that will be acceptable for purposes of deviating from the expense guidelines, especially in cases where receipts are unlikely to be available or where estimates of future expenditures are involved. However, IRS should be careful not to eliminate an employee’s discretion to accept alternative documentation.

12. Appeals should promptly execute its plan to routinely and systematically identify areas where Appeals and SB/SE have frequent disagreements so that SB/SE can focus its training and guidance efforts accordingly. Appeals should track the reasons for reversing SB/SE’s OIC rejections on a computer database so that SB/SE can quickly identify problem areas and take immediate corrective action. This feedback loop should not be used to eliminate Appeals’ ability to reach common sense outcomes, which may sometimes be inconsistent with IRM provisions.

13. The IRS should evaluate ETA offers and doubt as to collectibility offers with special circumstances using the analysis described in the Key Legislative Proposal entitled

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Offer In Compromise: Effective Tax Administration in the 2004 National Taxpayer Advocate Annual Report to Congress. Similarly, the bases for offers submitted on more than one basis (combination offers) should be analyzed in the order requested by the taxpayer, as provided in the legislative proposal.

14. The IRS should survey taxpayers and practitioners who submit OICs to determine how to best to improve the OIC program.

15. The IRS should measure cycle time by type of disposition (e.g., return, acceptance, rejection, withdrawal or termination). Its cycle time measures should also systemically track the time wasted by the IRS and taxpayers when the IRS returns an OIC that is later resubmitted. If this is not possible, IRS Research should conduct a study to estimate such periods.

16. The IRS should evaluate whether the new Embedded Quality Measurement System (EQMS) provides the proper incentives to employees and enables it to rapidly identify specific systemic problems that could be addressed through training or guidance. IRS should also determine ways of converting the Collection Quality Measurement System (CQMS) quality measures into EQMS measures so that it can track recent quality trends.

NTA Recommendation 1

1. The IRS should contact taxpayers and allow a reasonable period of time for them to file delinquent returns before returning OICs on that basis.

IRS Response to Recommendation 1

“Returns” generally fall into two categories - those returned before and those returned after the initial processability determination. For an offer to be processable, it must meet the following conditions:

- 1) the taxpayer must have filed all legally due and required tax returns;
- 2) a business taxpayer must be in full compliance with employment tax filing and payment requirements for the two quarters immediately preceding the submission of the OIC, as well as the current quarter;
- 3) the taxpayer cannot be involved in an open bankruptcy proceeding;
- 4) the OIC must include the \$150 OIC application fee (or a Form 656-A requesting a waiver of the fee); and
- 5) the OIC must be submitted with the most current OIC application forms.

An OIC which does not meet all of these conditions is returned to the taxpayer, along with any associated application fee. If taxpayer resolves the problem conditions, he/she submits a new OIC for consideration. The recently revised OIC application package, Form 656, gives considerable direction and guidance to taxpayers to help them avoid submitting OICs that are not processable. Through July 2005, OICs returned as not processable have declined 41 percent from the same time period in FY 2004. This is a clear indication that the revised form, along with our ongoing outreach efforts, has had a positive impact in this area.

NTA Recommendations 2 and 3

2. The IRS should make at least two attempts to contact taxpayers before returning any OIC, and otherwise encourage employees to contact taxpayers by telephone or using

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face-to-face meetings where appropriate, especially with taxpayers for whom other modes of communication are unlikely to be successful. Calls should be made to taxpayers and their representatives only at times when they are most likely to be available.

3. The IRS should give employees discretion to determine that an OIC should not be returned in cases where required documentation is missing if they believe that additional communications would likely produce such documentation. If the IRS determines that it cannot accept an OIC based upon insufficient documentation from a cooperative taxpayer, guidance should emphasize that it should be rejected rather than returned so that the taxpayer has an opportunity to appeal the decision.

IRS Response to Recommendations 2 and 3

Generally, a processable offer is returned when the taxpayer fails to provide complete and timely responses to the IRS requests for additional information. Since the IRS has already invested considerable resources in the processability determinations, application fee processing and initial financial analysis of the OICs, the IRS retains the application fee. If a taxpayer chooses to submit another OIC at a later date, another application fee is required.

The IRS has made a number of processing changes this year to ensure that processable returns are handled reasonably and responsibly. For example, in situations where taxpayers have made substantially complete responses to additional information requests, the IRS will now attempt an additional contact with the taxpayers to obtain the missing information, prior to returning the OICs. Return reconsideration procedures have been developed and implemented to address situations where the taxpayers could not respond timely due to circumstances beyond their control. As a result, OICs returned following acceptance for processing declined 34 percent in FY 04.

NTA Recommendation 4

4. The IRS should process OICs received from taxpayers in bankruptcy. IRS standards for evaluating such offers should deviate from standard OIC criteria only when there is a clearly articulated reason for such a deviation.

IRS Response to Recommendation 4

In 1998, the IRS decided to exclude from OIC consideration any taxpayer in bankruptcy. The IRS' temporary change of policy in 1999, to again allow some taxpayers in bankruptcy to file OICs, stemmed from an assumption that this reversal in policy was legally mandated. When the Office of Chief Counsel subsequently disagreed with this interpretation of section 525 of the Bankruptcy Code, the IRS reversed its policy to once again exclude taxpayers in bankruptcy from the OIC process. More recently, courts have held that the IRS's policy does not violate section 525.

Taxpayers who file bankruptcy are protected by the automatic stay while their non-exempt assets are liquidated for the benefit of creditors or, in the case of a Chapters 11, 12, or 13, until a payment plan is approved whereby all creditors are paid over a period of time. In exchange for the protections and benefits provided by the Bankruptcy Code,

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taxpayers must abide by Congressional choices that balance a taxpayer's need for a financial fresh start against the competing concerns of various creditors. By filing bankruptcy, taxpayers make a deliberate choice to follow the Bankruptcy Code's scheme for resolving their debts. Taxpayers who receive a discharge, or otherwise complete a bankruptcy proceeding, are entitled to avail themselves of the OIC process to resolve tax debts that were not discharged or paid through the bankruptcy case.

NTA Recommendation 5

5. The IRS should work with taxpayers and practitioners to reduce taxpayer (and IRS employee) burden and make it easier to understand OIC requirements by revising the Form 656 and its accompanying collection information statements.

IRS Response to Recommendation 5

During the past year, timeliness of processing OICs has continued to improve and backlogs of unassigned OIC cases have been virtually eliminated. Currently, the inventory of open OIC cases is at its lowest level since late 1997. In addition, the OIC application package, Form 656, has been revised to improve the clarity of communications with taxpayers and practitioners regarding the requirements for submitting complete, processable OICs. Feedback from the practitioner community regarding this revision has been very positive. We believe the revised Form 656, implemented in July 2004, has been a contributing factor to the 42 percent decrease in OICs returned as not processable through July 2005.

NTA Recommendation 6

6. The IRS should review the OIC submissions received before and after implementation of the OIC application fee to determine which types of submissions have been deterred by the fee or returned for failure to include it. The IRS should consider abolishing the fee if it has not significantly reduced frivolous submissions and submissions from uncooperative taxpayers or if it presents a significant barrier to taxpayers who are legitimately trying to comply.

IRS Response to Recommendation 6

In November 2003, the IRS implemented the OIC application fee to help offset the significant costs of the OIC program and to discourage inappropriate or frivolous OIC submissions. The IRS believes that the implementation of the fee was a contributing factor in the 25 percent reduction in OIC submissions experienced in FY 04, immediately after the fee became mandatory. In their June 2005 report TIGTA concluded that the IRS' implementation of the OIC application fee successfully reduced frivolous filings from taxpayers at all income levels. The inclusion of detailed instruction regarding the fee in the 2004 revision of Form 656 has reduced the burden this additional processing requirement has had on taxpayers.

The number of OICs returned to taxpayers as not processable increased significantly due to the implementation of the OIC application fee, peaking in December 2003 at 64 percent of OIC receipts (44 percent involved the application fee issue). By July 2005

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only 5 percent of OICs returned as not processable were due solely to application fee issues.

NTA Recommendation 7

7. The IRS should revise its Offer in Compromise form (Form 656) to clarify what it means by “doubt as to liability” so that taxpayers know that items such as innocent spouse relief, and interest and penalty abatement requests are made on other forms. However, when the IRS receives such requests on Form 656, it should immediately contact the taxpayer and route the taxpayer’s request to the area responsible for processing it.

IRS Response to Recommendation 7

The IRS recently completed a pilot project regarding the processing of “combination” OICs where the taxpayers have requested consideration on the basis of both doubt as to collectibility (DATC) and doubt as to liability (DATL). The IRS found that very few DATL OICs actually involve true liability issues, i.e., there are no disagreements that the tax assessments are valid. Generally, these cases involve requests for interest and/or penalty abatements, or other adjustments to the balances due that do not require re-examination of the tax returns.

In order to address these combination OICs in a timely manner, the IRS routinely processes the DATC offers first. If the DATC offer is recommended for rejection, the DATL OIC is forwarded to Examination for consideration. The pilot project confirmed that most of these DATL claims can be processed efficiently by a campus collection unit. Two such units have been implemented in FY 05, in Brookhaven and Memphis. In the near future, all OICs submitted on the basis of DATL will be initially processed through these units. The relatively rare DATL claims that involve actual liability issues will continue to be forwarded to Examination for consideration. Additionally, the IRS has developed a new Form 656 that will be used exclusively for DATL offers. The new form will provide clear and more detailed direction to taxpayers regarding the proper submission of DATLs.

NTA Recommendation 8

8. The IRS should research the reasons why OIC rejections have increased and acceptances have declined. It should determine how increased communications could increase acceptance of reasonable offers.

IRS Response to Recommendation 8

Less than 1 percent of all IRS collection cases are resolved through the OIC process and only about 2 percent of cases worked by the Taxpayer Advocate Service (TAS) involve OIC matters. During the past year, timeliness of processing OICs has continued to improve and backlogs of unassigned OIC cases have been virtually eliminated. Currently, the inventory of open OIC cases is at its lowest level since early 1999.

The IRS has made a number of adjustments to the manner in which OIC submissions are evaluated. Some of these are discussed in more detail in the responses to

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recommendations 10 – 12. The percentage of processable OICs that were accepted has increased by 22 percent in FY 05, primarily as a result of these changes.

NTA Recommendation 9

9. The IRS should revise the current methods of determining Reasonable Collection Potential (RCP) by:

a. Allowing expenses for delinquent state tax payments. Ignoring such expenses is likely to result in minimum offer requirements that leave taxpayers without the ability to meet “basic living expenses,” notwithstanding regulatory guidance suggesting that offers should not do that, even in cases where IRS would not use involuntary collection tools. If IRS believes that other policies produce similar results those policies should also be reexamined; and

b. Estimating future income based upon the best estimates available, rather than rigidly adhering to an income-averaging approach. The IRS believes that IRS’ policy providing for the use of collateral agreements provides flexibility. However, IRS is prohibited from accepting an offer for an amount less than would be permitted based on an income-averaging calculation using a collateral agreement. Thus, IRS policy allows the use of collateral agreements only in cases where it would benefit the government, but not in cases where it would benefit a taxpayer. Many taxpayers would undoubtedly characterize this policy as rigid. Moreover, it ignores the reality faced by taxpayers whose future income will be less than it was in the past.

IRS Response to Recommendation 9

When determining RCP, payment of current tax obligations is considered a necessary expense and always is allowed. In contrast, delinquent state or local tax obligations are treated like other debts and are deducted from reasonable collection potential only to the extent the state tax obligations take priority over the federal tax debt. Affording special status to state and local taxes as allowable expenses would result in taxpayers with the same collection potential being treated differently based solely on the identities of their other creditors. The IRM encourages offer specialists to consult with Counsel if the relative priorities are unclear.

The IRS does not agree that the OIC IRM “maintains a rigid income-averaging calculation as the basis for determining future income for sporadic earners, even though other estimates may prove to be more accurate.” The IRM (5.8.5.5) allows for alternative methods in appropriate situations:

“In some instances, a future income collateral agreement may be used in lieu of including the estimated value of future income in reasonable collection potential (RCP). When investigating an offer where current or past income does not provide an ability to accurately estimate future income, the use of a future income collateral agreement may provide a better means of calculating an acceptable offer amount. Future income collateral agreements should not be used to enable a taxpayer to submit an offer in a lesser amount than the current or past financial condition dictates. However, if the future is uncertain, but it is reasonably expected that the taxpayer will be receiving a substantial increase in income, it may be appropriate.

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The IRS does agree that a few more examples may be helpful regarding this issue, and has expanded the IRM direction on this issue accordingly in the September 2005 revisions.

NTA Recommendation 10

10. The IRS should revise the IRM and job aids to more clearly state that the months of future income to be used in determining the offer amount should never extend beyond the statute of limitations expiration date.

IRS Response to Recommendation 10

The IRS recently analyzed its practice of including the “plus five years” in the analysis of the taxpayer’s ability to make future payments and issued direction to discontinue that practice. The IRS believes this change should significantly improve both the accuracy of our RCP calculations and the overall quality of our OIC disposition decisions, and also result in more accepted offers. The percentage of processable offers that have been accepted increased by 22 percent through July 2005.

NTA Recommendation 11

11. The IRS should more clearly communicate the forms of documentation that will be acceptable for purposes of deviating from the expense guidelines, especially in cases where receipts are unlikely to be available or where estimates of future expenditures are involved. However, IRS should be careful not to eliminate an employee’s discretion to accept alternative documentation.

IRS Response to Recommendation 11

National and local standards were developed to promote consistency among the IRS collectors in the amounts routinely allowed for taxpayer expenses. The IRS employees are, however, authorized to deviate from these standards in certain situations.

The IRS reemphasizes this direction to OIC personnel on a regular basis. Earlier this year, the IRS issued additional guidance in the area of reasonable allowances for transportation expenses. During the past year, the IRS has also asked TAS and the American Institute of Certified Public Accountants (AICPA) to provide examples of any unreasonably rigid adherence to the national standards in OIC casework for evaluation. To date, the IRS has received very few examples of problems in this area, but continues to review its policies and procedures to ensure that OIC case decisions reflect reasonable expectations and sound judgment.

NTA Recommendation 12

12. Appeals should promptly execute its plan to routinely and systematically identify areas where Appeals and SB/SE have frequent disagreements so that SB/SE can focus its training and guidance efforts accordingly. Appeals should track the reasons for reversing SB/SE’s OIC rejections on a computer database so that SB/SE can quickly identify problem areas and take immediate corrective action. This feedback loop should

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not be used to eliminate Appeals' ability to reach common sense outcomes, which may sometimes be inconsistent with IRM provisions.

IRS Response to Recommendation 12

Appeals already is proceeding with plans to provide systemically driven feedback reports to all IRS operating divisions. For the OIC program, Appeals already has conducted one informal Offer program review through the Automated Quality Measurement (AQMS) staff and one joint review with the SB/SE Offer program on Appeals' accepted offers. Based on those reviews Appeals has agreed to strengthen its discussion and documentation surrounding our acceptance of offers for two reasons: 1) to enhance guidance and, 2) to ensure Appeals decisions comport with the IRM policies and procedures thus providing credibility to any recommendations we might make for program improvement.

NTA Recommendation 13

13. The IRS should evaluate ETA offers and doubt as to collectibility offers with special circumstances using the analysis described in the Key Legislative Proposal entitled Offer In Compromise: Effective Tax Administration in the 2004 National Taxpayer Advocate Annual Report to Congress. Similarly, the bases for offers submitted on more than one basis (combination offers) should be analyzed in the order requested by the taxpayer, as provided in the legislative proposal.

IRS Response to Recommendation 13

In FY 04, a joint review of the "non-hardship" ETA process was conducted with participants from SBSE, TAS, Counsel and Appeals. This group reviewed the work of all referrals into the centralized ETA group which works these OICs. As a result of this review, opportunities were identified to improve the referral process, and documentation of case decisions. These adjustments were made. Additionally, the joint review team recognized that a combination of factors could lead the IRS to accepting "non-hardship" ETA offers and additional guidance in this area is being developed and evaluated.

Generally, experience shows that the inequitable conditions that contribute to the tax delinquencies also tend to create economic hardship on the affected taxpayers. The IRS routinely accepts ETA OICs based on economic hardship, as well as doubt as to collectibility (DATC) OICs involving special circumstances. These OIC categories are worked within all OIC field groups, as well as COIC. Because DATC OICs with special circumstances do not involve situations where the taxpayers can clearly full pay the tax debts, the ETA group does not control them. Rather, the IRS handles them as routine cases, and local management has the authority to approve these case decisions.

NTA Recommendation 14

14. The IRS should survey taxpayers and practitioners who submit OICs to determine how to best to improve the OIC program.

IRS Response to Recommendation 14

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The IRS has recently developed a customer satisfaction survey, designed specifically for the OIC program. The initial distribution of this survey is planned for the first quarter of FY 06. Feedback from the survey will be analyzed to determine where opportunities may exist to improve OIC policies and procedures.

The IRS devoted considerable time and attention in FY 04 to outreach activities designed to increase the public's awareness of the proper role of the OIC as a collection alternative and to clarify the expectations and requirements for taxpayers to submit processable OICs that can be evaluated and resolved in a timely manner. In particular, the OIC page on the IRS web site is updated regularly and is now much easier for the public to find and navigate. The IRS executives and senior managers participated in numerous outreach sessions specifically addressing the OIC program, including the 2004 National Tax Forums. Additionally, the SB/SE Collection and the Taxpayer Education and Communication (TEC) cadre of speakers, who have been trained to address OIC issues, provided similar presentations at local and regional tax practitioner forums.

NTA Recommendation 15

15. The IRS should measure cycle time by type of disposition (e.g., return, acceptance, rejection, withdrawal or termination). Its cycle time measures should also systemically track the time wasted by the IRS and taxpayers when the IRS returns an OIC that is later resubmitted. If this is not possible, IRS Research should conduct a study to estimate such periods.

IRS Response to Recommendation 15

During the past year, timeliness of processing OICs has continued to improve and backlogs of unassigned OIC cases have been virtually eliminated. Currently, the inventory of open OIC cases is at its lowest level since October 1997. The IRS does not believe the NTA's recommendations for expanded cycle time measures would provide sufficient new and useful information to justify the costs of systemically obtaining it. The IRS emphasis in this area is to provide timely case resolutions for all taxpayers who submit OICs. We have seen steady improvement in OIC cycle time over the last several years. Currently, 71 percent of all OICs are resolved in 6 months or less. As recently as FY 01, only 32 percent of OICs were resolved within 6 months. The IRS believes the improvements in this area have been significant.

NTA Recommendation 16

16. The IRS should evaluate whether the new Embedded Quality Measurement System (EQMS) provides the proper incentives to employees and enables it to rapidly identify specific systemic problems that could be addressed through training or guidance. IRS should also determine ways of converting the Collection Quality Measurement System (CQMS) quality measures into EQMS measures so that it can track recent quality trends.

IRS Response to Recommendation 16

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EQMS was implemented in the COIC operations in FY 04. It is currently being implemented in the Field OIC program and should be operational in FY 06. We believe the new quality measurement system provides more detailed feedback to IRS managers and employees on issues related to case quality. This information is useful to IRS managers in identifying performance problems that may exist with individual employees, as well as systemic issues that should be addressed through policy or procedural changes. EQMS feedback regarding COIC has consistently reflected high levels of quality in all measured areas. The implementation of EQMS in the Field OIC program will crosswalk key measurements from the prior quality measurement system (CQMS) to the new EQMS measures to allow for ongoing trend analysis.

2004 ARC – MSP E-20 TAXPAYER RIGHTS TRAINING IN A COMPLEX AND CHANGING ENVIRONMENT

Problem: As the IRS intensifies its enforcement efforts, the training of both newly selected and experienced compliance employees is especially critical. Current instructional materials do not fully explore the role of the Taxpayer Advocate Service in assisting taxpayers. The IRS does little to ensure that its employees clearly understand both the concept and application of taxpayer rights as they relate to their enforcement activities. It increasingly relies upon rote formulas that do little to expand the employees' ability to apply both the spirit and meaning of the law. The IRS must revise the content, placement and techniques for training employees about the Taxpayer Advocate Service, and integrate consideration of taxpayer rights into each case study or scenario to emphasize its importance.

NTA Recommendations

1. The IRS must revise the content, placement and techniques of training employees about the Taxpayer Advocate Service.
2. Course offerings for both newly selected and experienced employees must include serious discussions of the mission, referral criteria, scope of authority, and statutory mandates of TAS.
3. Requirements under the Service Level Agreements between TAS and operating divisions must be described and explained.
4. IRS should routinely integrate questions concerning the possible involvement of TAS into the case studies and scenarios of each compliance module. Employees should be taught that making appropriate referrals to TAS is their responsibility as IRS employees.
5. Consideration of taxpayer rights must be integrated into each case study or scenario or directed discussion to emphasize to employees that it is a firm expectation. Practitioners and other professionals should be invited to teach certain aspects of technical issues in order to provide IRS employees with other views of issues in context.
6. Training material, through case studies and examples, must also encourage employees to identify and evaluate alternatives that achieve compliance objectives without unnecessarily burdening taxpayers.
7. Modules should identify and provide an overview of all applicable statutory or due process rights of taxpayers as they pertain to the IRS procedures being taught.

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8. IRS should ensure that all training courses include among their course objectives a goal of encouraging critical thinking skills and enhancing the judgment employees will use when discharging their duties.
9. The IRS must maintain an appropriate ratio of on-the-job instructors to new hires in all situations. While LMSB has every right to test an 8:1 ratio, the standard ratio of between 3:1 and 5:1 should not change unless the test makes clear that the higher number does not impair the learning process.
10. IRS should ensure that an external panel of stakeholders, education authorities and tax professionals periodically evaluates its training curriculum, to assess how well the issues of taxpayer rights, the Taxpayer Advocate Service, critical thinking skills and judgment are integrated into the content of compliance training. The Taxpayer Advocacy Panel (TAP), the Low Income Taxpayer Clinic (LITC) program and the Internal Revenue Service Advisory Council (IRSAC) should all be part of this evaluation, with members rotating on an annual or biannual basis.

NTA Recommendations 1, 2, 3 and 4

1. The IRS must revise the content, placement and techniques of training employees about the Taxpayer Advocate Service.
2. Course offerings for both newly selected and experienced employees must include serious discussions of the mission, referral criteria, scope of authority, and statutory mandates of TAS.
3. Requirements under the Service Level Agreements between TAS and operating divisions must be described and explained.
4. IRS should routinely integrate questions concerning the possible involvement of TAS into the case studies and scenarios of each compliance module. Employees should be taught that making appropriate referrals to TAS is their responsibility as IRS employees.

IRS Response to Recommendations 1, 2, 3 and 4

Starting this year, all new hires and experienced employees with customer contact will receive the Annual Mandatory TAS Briefing.

IRS concurs with this recommendation but we do not believe that this training is applicable to “each” Compliance module. IRS would benefit by partnering with TAS to identify which Compliance modules and case studies/scenarios are appropriate and also to integrate questions concerning the involvement of TAS.

NTA Recommendation 5

5. Consideration of taxpayer rights must be integrated into each case study or scenario or directed discussion to emphasize to employees that it is a firm expectation. Practitioners and other professionals should be invited to teach certain aspects of technical issues in order to provide IRS employees with other views of issues in context.

IRS Response to Recommendation 5

The IRS agrees that it is imperative that employees are trained on the importance of protecting taxpayer rights.

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The IRS integrates consideration of taxpayer rights into case studies and scenarios where appropriate. In some instances, however, course content is strictly technical in nature. IRS welcomes TAS assistance in identifying additional case studies or scenarios in which to discuss taxpayer rights.

The IRS currently receives input and insights from practitioners groups and through Practitioner Forums which are attended by key IRS officials. We do not believe that is it practical to invite practitioners and other professionals to teach technical issues for IRS training courses due to the need for consistency in training, the volume of classes, the geographic dispersion of classes, the timing of course delivery, and the potential contract/compensation issues that may arise.

NTA Recommendation 6

6. Training material, through case studies and examples, must also encourage employees to identify and evaluate alternatives that achieve compliance objectives without unnecessarily burdening taxpayers.

IRS Response to Recommendation 6

IRS course developers currently develop training materials to achieve compliance objectives with consideration of taxpayer burden and taxpayer rights. IRS welcomes TAS' assistance and input to ensure that appropriate examples and scenarios are developed and incorporated in training materials to achieve this objective.

NTA Recommendation 7

7. Modules should identify and provide an overview of all applicable statutory or due process rights of taxpayers as they pertain to the IRS procedures being taught.

IRS Response to Recommendation 7

IRS concurs with the recommendation and would welcome TAS' suggestions with respect to the content and delivery scope (target audience, content objectives, timing of delivery, placement within IRS materials, etc.)

NTA Recommendation 8

8. IRS should ensure that all training courses include among their course objectives a goal of encouraging critical thinking skills and enhancing the judgment employees will use when discharging their duties.

IRS Response to Recommendation 8

The concepts of enhancing judgment and encouraging critical thinking skills are already integral parts of IRS course development standards.

NTA Recommendation 9

9. The IRS must maintain an appropriate ratio of on-the-job instructors to new hires in all situations. While LMSB has every right to test an 8:1 ratio, the standard ratio of

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between 3:1 and 5:1 should not change unless the test makes clear that the higher number does not impair the learning process.

IRS Response to Recommendation 9

Structured on-the-job training programs and qualified on-the-job instructors are used to ensure that new hires receive quality and timely guidance and that knowledge is effectively transferred from experienced personnel. On-the-job training programs include numerous training and procedural workshops that are taught by Subject Matter Experts in the job setting. These workshops enable new hires to work with “live” cases and “real situations” under the guidance of on-the-job instructors.

Appropriate on-the-job instructor ratios are determined by analyzing the work performed by new hires and through consultation with specialized Learning and Education staff. Although general guidelines are established for new hire to on-the-job instructor ratios (typically from 3:1 to 5:1), these ratios are frequently adjusted to account for, among other factors, job complexity and requirements, degree of support needed, geographical dispersion of the new hires, and student experience levels. The on-the-job training period can approach a one-year time period for some highly technical or procedurally intensive occupations. During the on-the-job training periods, new hires work cases under the supervision of on-the-job instructors/Subject Matter Experts and receive regular feedback and counseling.

Information regarding the effectiveness of on-the-job training is frequently gathered during the Level III evaluation process, which is typically conducted more than six months after training activities are conducted. This information, along with additional interviews, focus group discussions with new hires and on-the-job instructors, and managerial feedback, is used to revise and improve on-the-job training programs.

NTA Recommendation 10

10. IRS should ensure that an external panel of stakeholders, education authorities and tax professionals periodically evaluates its training curriculum, to assess how well the issues of taxpayer rights, the Taxpayer Advocate Service, critical thinking skills and judgment are integrated into the content of compliance training. The Taxpayer Advocacy Panel (TAP), the Low Income Taxpayer Clinic (LITC) program and the Internal Revenue Service Advisory Council (IRSAC) should all be part of this evaluation, with members rotating on an annual or biannual basis.

IRS Response to Recommendation 10

The IRS agrees with and acknowledges the importance of ensuring that Compliance training contains appropriate content to protect taxpayer rights and to enable employees to exercise sound judgment. The IRS evaluates the training curriculum for its content and effectiveness on an ongoing basis and will continue to take into account any comments or suggestions from interested parties. To do that, however, we do not believe that a formal, external panel is required.

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2004 ARC – MSP E-21 ACCESS TO THE TAXPAYER ADVOCATE SERVICE

Problem: TAS's Case Advocacy function, which helps taxpayers resolve specific problems with the IRS, has seen its caseload consistently and significantly decline since its inception in March 2000. While this may be viewed as a positive development, market research indicates that TAS is reaching just four percent of approximately 5.25 million taxpayers eligible for TAS assistance, and only a small percentage of these eligible taxpayers have ever heard of us. As a consequence, taxpayers are harmed because they do not receive the assistance they need to resolve their IRS problems. The National Taxpayer Advocate urges the IRS to fully commit to formal training of IRS employees each year on TAS case criteria and assist TAS in publicizing itself through external media, to ensure that the almost six million taxpayers eligible for our services actually know that TAS exists and is available.

NTA Recommendations

1. With respect to the training of its employees, the IRS should:
 - a. Ensure that management instructs IRS employees on the importance of taxpayer rights, including the what, when, how and where of making referrals to TAS.
 - b. All IRS toll-free assistors should be made aware of the TAS criteria.
 - c. Open up training agendas to TAS employees who will assist the IRS in better understanding the services that TAS provides.
 - d. Local IRS managers should be encouraged to invite the Local Taxpayer Advocate to meetings to discuss examples of TAS cases and TAS criteria for referrals and systemic IRS problems observed by TAS caseworkers.
 - e. Require that the TAS web based training program (that describes TAS' mission, statutory and delegated authorities, and criteria for case referrals, and includes teaching examples) become a part of the mandatory annual training for IRS employees, along with the Unauthorized Access (UNAX) and Prevention of Sexual Harassment (POSH) training.
2. With respect to providing taxpayers more information about TAS through IRS publications, the IRS should expand public access to Form 911 (Application for Taxpayer Assistance Order) by providing it in the laminated forms package, IRS Publication 3194 (Reproducible Copies of Federal Tax Forms). [Currently, Form 911 is available through Publication 1796, IRS Federal Tax Products CD-ROM; however, this publication is available only to taxpayers with computer access.]
3. With respect to providing more information about TAS through the IRS website, the IRS should:
 - a. Not bury references to TAS on www.irs.gov; rather, the IRS should better assist taxpayers in understanding that TAS may be an available resource for them.
 - b. Add information pages about TAS on IRS web pages, such as on the Partner Products and Volunteer Center web page.
4. With respect to providing a greater overall commitment to actively promoting TAS, the IRS should commit to publicizing information about TAS externally beyond the passive communications media (i.e. currently, taxpayers must search to find out about TAS rather than having information about TAS readily available or non-TAS employees informing taxpayers about TAS.).

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NTA Recommendations 1 and 4

1. With respect to the training of its employees, the IRS should:
 - a. Ensure that management instructs IRS employees on the importance of taxpayer rights, including the what, when, how and where of making referrals to TAS.
 - b. All IRS toll-free assistors should be made aware of the TAS criteria.
 - c. Open up training agendas to TAS employees who will assist the IRS in better understanding the services that TAS provides.
 - d. Local IRS managers should be encouraged to invite the Local Taxpayer Advocate to meetings to discuss examples of TAS cases and TAS criteria for referrals and systemic IRS problems observed by TAS caseworkers.
 - e. Require that the TAS web based training program (that describes TAS' mission, statutory and delegated authorities, and criteria for case referrals, and includes teaching examples) become a part of the mandatory annual training for IRS employees, along with the Unauthorized Access (UNAX) and Prevention of Sexual Harassment (POSH) training.
4. With respect to providing a greater overall commitment to actively promoting TAS, the IRS should commit to publicizing information about TAS externally beyond the passive communications media (i.e. currently, taxpayers must search to find out about TAS rather than having information about TAS readily available or non-TAS employees informing taxpayers about TAS.).

IRS Response to Recommendations 1 and 4

The IRS agrees with the TAS report that all front-line contact employees should be knowledgeable of the role of TAS in the organization and ensure that taxpayers have access to TAS resources as appropriate. Knowledge of TAS can be acquired through various means – training material, IRM guidance, face-to-face meetings or group presentations. The IRS will continue to review technical training materials to ensure that courses, regardless of the method of delivery, incorporate a concern for taxpayer rights and the role of TAS. The IRS is committed to maintaining a close, cooperative, inter-functional relationship between TAS and all other business units at all levels. Examples of this commitment include the following:

- Regular participation by TAS representatives in various SB/SE Stakeholder Liaison (SL) activities, including Tax Practitioner Institutes, Practitioner Liaison meetings, local CPA seminars, state Bar Association meetings, SL 'phone forums', and e-file seminars.
- In most SL Areas, TAS representatives are actively engaged in the Stakeholder Relationship Management Leadership Council (SRMLC) and collaborate on common Service and stakeholder concerns.
- The June 3, 2005 SB/SE Headline News mentioned the 2005 TAS Briefings, which were required of all employees with public contact, including Taxpayer Compliance Officers (TCOs), Revenue Agents (RAs) and Revenue Officers (ROs).
- The second January edition of IRS e-News for Tax Professionals led with an article about the National Taxpayer Advocate Report to Congress, including a link to the report on IRS.gov

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- Government Liaison (GL) employees also interact regularly with TAS: As external contact employees GLD staff members are required to take the TAS on-line briefing. Governmental Liaisons (GLs) work closely with the local Taxpayer Advocate when scheduling briefings for congressional offices; they frequently attend each other's briefings, adding to their knowledge of the criteria for referring cases to TAS. In cases where the TAS staff is not available for a congressional meeting, GLs frequently take TAS material with them, including brochures on criteria for referral to TAS.
- The IRS would welcome the opportunity to include articles about TAS in Managers' Messages or Headline News to ensure employees are aware of the role of TAS. In addition, TAS could create a simple presentation for use by Compliance managers in staff meetings to remind employees of the TAS resources available to them.
- The various IRS business units will continue to meet with TAS employees at national and local levels as time and resources permit.
- Through the IRS Toll-Free telephone services, Accounts Management Customer Service Representatives will continue to provide triage-like service for taxpayers by analyzing a particular taxpayer's situation, resolving the issues if possible, and initiating a referral to TAS if the appropriate criteria are met. This procedure was previously coordinated with TAS to ensure that taxpayers who are referred to TAS satisfy the appropriate criteria. The IRS would be happy to work with TAS to explore enhancements to these services.
- W&I Compliance included the TAS web based training program as part of the 2005 annual training.

NTA Recommendation 2

2. With respect to providing taxpayers more information about TAS through IRS publications, the IRS should expand public access to Form 911 (Application for Taxpayer Assistance Order) by providing it in the laminated forms package, IRS Publication 3194 (Reproducible Copies of Federal Tax Forms). [Currently, Form 911 is available through Publication 1796, IRS Federal Tax Products CD-ROM; however, this publication is available only to taxpayers with computer access.]

IRS Response to Recommendation 2

Form 911, Application for Taxpayer Assistance Order, is included in Publication 1796, Federal Tax Products CD-ROM, which approximately 60 percent of the IRS's 12,000 participating libraries order and make available to their customers. Most libraries allow their customers to directly link to the Internet, where they can download IRS products on irs.gov. Publication 1796 is also sent to more than 6,000 community Based Outlet Program participants (e.g., local governments, corporations, credit unions), who provide electronic access to their customers and employees. Finally, the publication is also purchased by more than 25,000 tax professionals, providing them with electronic access to Form 911. Form 911 is also available on the Small Business Resource Guide, Publication 3207. Approximately 500,000 of these CDs are produced and distributed to small businesses each year.

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The IRS would be happy to work with TAS to consider other options for making Form 911 readily available to taxpayers.

NTA Recommendation 3

3. With respect to providing more information about TAS through the IRS website, the IRS should:

- a. Not bury references to TAS on www.irs.gov; rather, the IRS should better assist taxpayers in understanding that TAS may be an available resource for them.
- b. Add information pages about TAS on IRS web pages, such as on the Partner Products and Volunteer Center web page.

IRS Response to Recommendation 3

In December, 2004, the IRS's Stakeholder Partnerships, Education and Communication (SPEC) organization introduced its' Partner/Volunteer web page on irs.gov with resources for all SPEC external stakeholders and volunteers. The web page is accessible and frequently used by all SPEC employees and SPEC partners who consist of over 60 national partners, 265 coalitions that represent thousands of local partners, and over 70,000 volunteers. The web page links directly to both the TAS web page and the Taxpayer Rights Publication 1.

2004 ARC – MSP KLR-6 COLLECTION DUE PROCESS HEARINGS

Problem: We believe that Collection Due Process (CDP) hearings are an important vehicle for ensuring that the IRS follows the appropriate and required administrative and legal procedures and considers all reasonable collection alternatives in the course of collecting outstanding tax liabilities. To keep the focus on collection activity, we recommend that taxpayers continue to be permitted to raise concerns about the underlying liability during the administrative CDP hearing but propose repeal of the ability to have de novo judicial review of the underlying liability. We also recommend a number of technical legal and administrative improvements, including proposing forms

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and notices to help taxpayers navigate and prepare for CDP hearings and create a more accurate administrative hearing record.

NTA Recommendations

1. The Office of Appeals should review publications of other administrative bodies, such as the Board of Veterans' Appeals (BVA) publication, Understanding the Appeals Process, and reassess whether the 1-page IRS Publication 4165, An Introduction to Collection Due Process Hearings, is sufficient to inform taxpayers about CDP hearings.
2. With its initial contact letter, the Office of Appeals should provide useful information about the nature of a CDP hearing by answering basic questions, such as: What will occur at the CDP hearing? Will the CDP hearing be in a court room setting? How does the process work and what are the rules? How can taxpayers learn more about collection alternatives?
3. Revise Form 4165, An Introduction to Collection Due Process Hearings, to include a clear and concise description of all collection alternatives, including installment agreements (partial pay and full pay), offers-in-compromise, lien subordination, and partial discharge or withdrawal of liens.
4. Form 4165 should be sent to the taxpayer immediately upon receipt of a hearing request, along with a "CDP Hearing Memorandum," modeled after the Tax Court's Pretrial Memorandum. The memorandum would require the taxpayer to set forth the collection alternatives and reasons to be considered at the hearing.
5. The Office of Appeals should cease the practice of presumptively establishing CDP hearings as telephonic hearings. If the Office of Appeals does not cease this practice, it should clearly inform the taxpayer of his or her right to a face-to-face hearing in its initial contact letter and provide the taxpayer sufficient time to make an informed and thoughtful decision.
6. The Office of Appeals should notify taxpayers of their right to record CDP hearings.

NTA Recommendation 1

1. The Office of Appeals should review publications of other administrative bodies, such as the Board of Veterans' Appeals (BVA) publication, Understanding the Appeals Process, and reassess whether the 1-page IRS Publication 4165, An Introduction to Collection Due Process Hearings, is sufficient to inform taxpayers about CDP hearings.

IRS Response to Recommendation 1

The 52 page BVA Publication titled "Understand the Appeals Process" was reviewed as suggested. It contains an in-depth explanation of the VA appeal process for those not satisfied with the results of a claim for veterans' benefits. It answers the Who, What, When, Where and How questions and includes an index and glossary.

While this document is very thorough, the same questions (Who, What, Where, When and How) regarding the Collection Process is answered in a series of IRS Publications, beginning with:

- Publication 1 – Your Rights as a Taxpayer,
- Publication 594 – The IRS Collection Process,
- Publication 1660 – Collection Appeal Rights,

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- Publication 4165 – Introduction to Collection Due Process Hearings.

These publications are included in balance due letters sent to taxpayers and contain the relevant information needed at the appropriate time in the collection process. We will continue to look for other examples that might help improve our products, but we do think they are currently adequate and should meet most taxpayers' needs.

NTA Recommendation 2

2. With its initial contact letter, the Office of Appeals should provide useful information about the nature of a CDP hearing by answering basic questions, such as: What will occur at the CDP hearing? Will the CDP hearing be in a court room setting? How does the process work and what are the rules? How can taxpayers learn more about collection alternatives?

IRS Response to Recommendation 2

Appeals has implemented the substantive contact letter which restates for taxpayers what happens during a CDP hearing. This letter was initially not mandatory but used at the election of the Appeals employee assigned the case; however, they were required to provide the information verbally if they did not use this substantive contact letter. Use of this letter will become mandatory with the rewrite of IRM 8.7.2. This rewrite will be published by 10/1/05.

Additionally, Appeals is working with Collection to explore additional opportunities for Collection employees to also communicate similar information to taxpayers as the case is being closed out of that function and that process would advise taxpayers of when their case is being sent to Appeals.

NTA Recommendation 3

3. Revise Form 4165, An Introduction to Collection Due Process Hearings, to include a clear and concise description of all collection alternatives, including installment agreements (partial pay and full pay), offers-in-compromise, lien subordination, and partial discharge or withdrawal of liens.

IRS Response to Recommendation 3

Publication 4165, mailed with the acknowledgement letter, explains what taxpayer's can expect while the case is in Appeals and also the taxpayer's responsibility while the case is in Appeals. Publication 4165 also gives the taxpayer an overview of the Appeals Process. We will continue to review the publication. However, a clear and concise discussion of all alternatives each of which has complicated legal and procedural rules and requirements cannot be completely discussed in a simple, straight forward manner in one publication. We believe such a document would be unwieldy for taxpayers.

We do not believe Publication 4165 – Introduction to Collection Due Process - requires a revision to include information on the various collection alternatives such as installment agreement and Offer in Compromise or resolutions to lien issues such as withdrawal, subordination, discharge, etc. for the following reasons:

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1. Detailed information on collection alternatives/lien certificates is already included in various publications (Publication 594, Form 656 with instructions (for OICs), Publication 783 (Lien Discharge) and Publication 784 (Lien Subordination)). To include all the information on the various resolutions in one publication would make it an unwieldy publication. Once the Settlement Officers determines the taxpayer's issue, the SO can provide the taxpayer with the appropriate publication that will assist in gathering the documents needed for consideration. The purpose of our substantive contact letter is to identify all such issues apparent in the case file so that the SO can provide this needed information.

2. The purpose of Publication 4165 is to provide the taxpayer with pertinent and timely information about Collection Due Process. Taxpayers are more likely to read a one page document with clear and concise information than a voluminous document that may or may not address the taxpayer's issues.

NTA Recommendation 4

4. Form 4165 should be sent to the taxpayer immediately upon receipt of a hearing request, along with a "CDP Hearing Memorandum," modeled after the Tax Court's Pretrial Memorandum. The memorandum would require the taxpayer to set forth the collection alternatives and reasons to be considered at the hearing.

IRS Response to Recommendation 4

Appeals believes taxpayers should be notified as soon as possible when Appeals receives their hearing request. With this in mind, Appeals sends taxpayers an acknowledgment letter upon assignment of the case to the hearing officer. Publication 4165 is included as an enclosure in the acknowledgement letter for all CDP cases.

Appeals would like to expedite this notification with Collection field cases and are working with field Collection to have it notify taxpayers when they send their CDP case to Appeals. Appeals and field Collection are working on a joint project to change the focus from retention of the CDP case for up to 45 days to an immediate transmittal of that case to Appeals.

We would like taxpayers to list the specific issues they dispute on their request for a CDP hearing, just as the instructions for completing the Form 12153 requests them to. The taxpayer's failure to list the specific issues they dispute causes delay in Appeals working the case.

NTA Recommendation 5

5. The Office of Appeals should cease the practice of presumptively establishing CDP hearings as telephonic hearings. If the Office of Appeals does not cease this practice, it should clearly inform the taxpayer of his or her right to a face-to-face hearing in its initial contact letter and provide the taxpayer sufficient time to make an informed and thoughtful decision.

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IRS Response to Recommendation 5

Within its campus strategy, Appeals intends to create an environment that resolves disputes correctly and timely. If challenges come with these efforts, the IRS is confident Appeals can overcome them. Creating a quality and effective conferencing environment is an issue Appeals is addressing.

Appeals agrees with the NTA that taxpayers need to know they have a right to a face to face conference. Appeals believes the right to a face to face conference is best communicated in a standard written format and has altered its Substantive Contact Letter and all initial communication with taxpayers planned to be worked in a Appeals campus unit to include information informing them of the right to a face to face conference. The IRS believes this written notification will ensure taxpayers are appropriately and consistently informed. Current trends indicate to us that requests for face to face conferencing are not a significant concern to most taxpayers.

When CDP was first initiated we required a face to face conference and found many taxpayers were “no shows” for this conference. As we began suggesting telephone conferencing we experienced greater responsiveness from taxpayers. Since recent trends indicate most of our conferencing even in our field offices has been by telephone or correspondence we believe the NTA’s recommendation should not be implemented. The IRS has kept statistics on the type of conference held only since 2/20/04. In reviewing this data we have found only 11 percent of taxpayer’s request a face to face conference to resolve their matter.

Another factor is Appeals’ experience in managing campus operations successfully since 1988. Employees at those campuses have long resolved centralized “S” docketed cases very effectively. The current campus strategy builds on the success of these operations to resolve disputes through telephone or correspondence conferencing.

By creating a flexible conferencing approach, all taxpayers are better served--both because their own case is resolved more effectively, and because Appeals’ enhanced efficiency enables it to handle all cases in a timely and quality manner. The campus strategy means Appeals can have the resources ready and available to handle and resolve each and every case.

NTA Recommendation 6

6. The Office of Appeals should notify taxpayers of their right to record CDP hearings.

IRS Response to Recommendation 6

From our experience, requests to record CDP hearings are made almost exclusively by taxpayers offering only frivolous arguments. As such, we do not adopt this recommendation.

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2004 ARC – MSP KLR-8 TAX GAP RECOMMENDATIONS

Problem: The final discussion in the section on taxpayer rights relates to the tax gap. The most recent IRS estimate of the net tax gap, for 2001, was \$255 billion. Last year, 128 million taxpayers filed individual income tax returns. Thus, every taxpayer is forced to pay an average of about \$2,000 extra in taxes each year to subsidize noncompliance. At a Senate Finance Committee hearing on the gap last July, virtually all witnesses agreed that the cash economy and other types of income not currently subject to document matching are the biggest sources of the tax gap. The mere fact that honest taxpayers are paying so much extra in taxes due to noncompliance constitutes an extraordinary abridgement of taxpayer rights and raises fundamental issues of fairness. To help alleviate the tax gap's burden, we present an extensive list of options that Congress and the IRS should evaluate. At the same time, any new or enhanced enforcement measure has the potential itself to abridge taxpayer rights. For that reason, we must analyze these options from the perspective of taxpayer rights. In a chart describing possible options, we note the obvious benefits and burdens of each option.

NTA Recommendations

1. Use education and outreach to encourage service recipients and independent contractors to enter into voluntary withholding agreements.
2. Allow self-employed taxpayers to voluntarily increase the frequency of estimated tax payments.
3. Increase "Required Filing Checks" (a.k.a., package audits).
4. Provide a system that would:
 - a. Allow the IRS to automatically withdraw estimated taxes from a self-employed taxpayer's business checking account; and
 - b. Allow self-employed taxpayers to electronically submit estimated tax payments on a monthly basis.
5. Implement local audit initiatives that are focused on income reporting for specific groups of taxpayers with demonstrated histories of noncompliance (for example, contractors in a particular city).
6. Implement national market and industry segment compliance initiatives (including audits, research, education, outreach, and other compliance initiatives) aimed at increasing voluntary compliance within specific market or industry segments nationwide.
7. Fully utilize IRS Financial Status Analysis and Financial Status Audit techniques to the extent permitted by IRC § 7602(e).
8. Revise Form 1040, Schedule C, to include a line item showing the amount of self-employment income that was reported on Forms 1099-MISC, in addition to a line reporting "other" gross receipts.
9. Supplement Form 1099-MISC with a required statement that the issuer must sign, under penalties of perjury, declaring that all required Forms 1099-MISC have been issued for the tax year.
10. Revise the corporation and partnership income tax returns, Form 1040 (Schedule C), and tax-exempt entity information returns to include a statement by the taxpayer, under penalties of perjury, as to

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- a. Whether the taxpayer paid an unincorporated business \$600 or more in non-employee compensation during the year; and
- b. Whether the taxpayer filed all required information returns to the IRS reporting such non-employee compensation

11. Establish local Compliance Planning Councils, involving the IRS (including both compliance and customer service division chiefs and local research offices) and state and local taxing authorities, which would focus on improving self-employed and cash economy compliance in their respective areas.

12. Increase information sharing between the IRS and state and local taxing, compliance and licensing authorities. These sharing efforts could involve such information as business license and property tax records.

NTA Recommendation 1

1. Use education and outreach to encourage service recipients and independent contractors to enter into voluntary withholding agreements.

IRS Response to Recommendation 1

Worker classification (Employee vs. independent contractor) is a topic included in several of our stakeholder liaison outreach events in including the Small Business Fairs (OR, WA) and the SSA Wage Reporting Seminars, American Payroll Association Seminars, etc. During FY05, Seattle was part of the construction 1099-MISC pilot program, along with Nashville, TN. We conducted 4 1099-MISC seminars for the construction industry in the Seattle metro area. 71 construction small business owners attended these seminars. We also worked with the Franchise Tax Board to develop a tri-fold on 1099 reporting that contained basic education information, who needed to file, the dollar threshold, how to file, etc.

NTA Recommendation 2

2. Allow self-employed taxpayers to voluntarily increase the frequency of estimated tax payments.

IRS Response to Recommendation 2

All taxpayers, including self-employed, can voluntarily increase the frequency of estimated tax payments through EFTPS.

NTA Recommendation 3

3. Increase "Required Filing Checks" (a.k.a., package audits).

IRS Response to Recommendation 3 The IRS already requires examiners as part of an examination to conduct package audits.

NTA Recommendation 4

4. Provide a system that would:

- a. Allow the IRS to automatically withdraw estimated taxes from a self-employed taxpayer's business checking account; and
- b. Allow self-employed taxpayers to electronically submit estimated tax payments on a monthly basis.

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IRS Response to Recommendation 4

IRS already has a system that provides these capabilities. The system is EFTPS.

NTA Recommendation 5

5. Implement local audit initiatives that are focused on income reporting for specific groups of taxpayers with demonstrated histories of noncompliance (for example, contractors in a particular city).

IRS Response to Recommendation 5

Local audit initiatives have been implemented to address specific areas of noncompliance. Such initiatives will continue to be implemented as long as the business case demonstrates this will be an effective use of resources.

NTA Recommendation 6

6. Implement national market and industry segment compliance initiatives (including audits, research, education, outreach, and other compliance initiatives) aimed at increasing voluntary compliance within specific market or industry segments nationwide.

IRS Response to Recommendation 6

Technical Advisor (TA)/Analysts are designated by industries and return types. These TAs provide industry and return type specific guidance to auditors through both direct one-on-one case assistance and broader national coverage. Auditors have access to the Technical Guidance website that is configured by industry and return type. Guidance posted to the website includes issue guidance in the form of memos, articles and Audit Technique Guides (ATGs). Based on various information sources, Compliance Initiative Projects are initiated to uncover emerging issues or identify other noncompliance areas specific to industries and return types. Guidance, including ATGs, is also available to the public on IRS.gov. In addition, our Stakeholder Liaison office in the Communications, Liaison & Disclosure business unit works with industry representatives on outreach including their participation in drafting the ATGs.

NTA Recommendation 7

7. Fully utilize IRS Financial Status Analysis and Financial Status Audit techniques to the extent permitted by IRC § 7602(e).

IRS Response to Recommendation 7

Examiners have the discretion to use all appropriate audit tools, including financial status analysis examination techniques, when conducting an examination. Examiners are trained on the various techniques and provided guidance on the limitations under IRC 7602(e) on using financial status analysis examination techniques.

NTA Recommendation 8

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8. Revise Form 1040, Schedule C, to include a line item showing the amount of self-employment income that was reported on Forms 1099-MISC, in addition to a line reporting “other” gross receipts.

IRS Response to Recommendation 8

Most schedule C filers would not use this line item as their gross receipts are not subject to information reporting. All non-employee compensation reported on Form 1099 MISC is not reported on Schedule C. For example, non-employee compensation, such as director’s fees, is reported as other income on the 1040.

NTA Recommendation 9

9. Supplement Form 1099-MISC with a required statement that the issuer must sign, under penalties of perjury, declaring that all required Forms 1099-MISC have been issued for the tax year.

IRS Response to Recommendation 9

Forms 1096 and 4804 that are used to transmit Forms 1099 to IRS already contain penalties of perjury statements that the filer must complete. There is no current authority under the statute or regulations to require the supplemental document with signature as described.

NTA Recommendation 10

10. Revise the corporation and partnership income tax returns, Form 1040 (Schedule C), and tax-exempt entity information returns to include a statement by the taxpayer, under penalties of perjury, as to

- a. Whether the taxpayer paid an unincorporated business \$600 or more in non-employee compensation during the year; and
- b. Whether the taxpayer filed all required information returns to the IRS reporting such non-employee compensation.

IRS Response to Recommendation 10

The instructions for Schedule C, 1120, and 1065 already discuss information returns that these filers might be required to file, including those for non-employee compensation. These instructions, in part, state: Every [corporation] [partnership] [sole proprietor] must file Forms 1099 MISC if, in the course of its trade or business it makes payments of rents, commissions, or other fixed or determinable income [see section 6041) totaling \$600 or more to any one person during the calendar year. The 1040, 1120 and 1065 are already signed under penalties of perjury; therefore, we do not believe that adding another statement under penalties of perjury will increase compliance.

NTA Recommendation 11

11. Establish local Compliance Planning Councils, involving the IRS (including both compliance and customer service division chiefs and local research offices) and state and local taxing authorities, which would focus on improving self-employed and cash economy compliance in their respective areas.

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IRS Response to Recommendation 11

We currently have in place established procedures to deal with emerging issues and non-compliance trends as they are identified in a multi-functional process. We have established relationships with other federal and state taxing authorities that provide forums for discussing emerging issues and compliance trends and allow us to leverage their resources, knowledge and information. In addition, we have Issue Management Teams (IMTs) to deal with abusive transactions. The IMTs include members from the field compliance staff of our various divisions, counsel and Stakeholder Liaison. The teams play a key role in creating alternative resolution strategies, monitoring field participant/promoter inventories and coordinating with campus activities. Each team provides a focal point which enables a consistent approach to treatment of the scheme or issue with which it is charged. These many existing approaches give us the most flexibility in allowing us to efficiently target our resources.

NTA Recommendation 12

12. Increase information sharing between the IRS and state and local taxing, compliance and licensing authorities. These sharing efforts could involve such information as business license and property tax records.

IRS Response to Recommendation 12

The IRS is continually exploring new ways to cooperate with states to reduce duplication, improve taxpayer service and intensify the fight against noncompliance with the state and federal tax systems. Some recent example of our efforts follows:

- Over the past year, GLD has spearheaded the exchange of State income tax investigation reports with the IRS with a goal of generating federal tax assessments based on State audit results. These reports are received on a monthly basis.
- In addition, GLD coordinated the exchange of a number of audit reports pertaining to several abusive tax schemes with State agencies generating millions in revenue for the States.
- GLD has successfully piloted and is in the process of enrolling all State tax agencies in the Transcript Delivery System to allow State tax agencies access to transcript and other information provided to the IRS for administering State tax administration programs, projects and audits.
- GLD has conducted numerous outreach activities related to reenergizing the exchange of tax information with several State Unemployment Tax Agencies and successfully enrolled several new agencies in the exchange program.
- GLD supported the Service's Internet EIN program by promoting to states the ability to provide on-line EINs at state business registration web sites.
- GLD coordinated the efforts with state Money Service Business oversight agencies to partner with IRS to receive investigative leads on potentially fraudulent transfers of money, thus supporting compliance activities at both the State and Federal level.
- GLD is testing the use of state data to identify federal non-filers in New York.