MSP #2 IRS BUDGET: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance

DEFINITION OF PROBLEM

In fiscal terms, to be blunt, the mission of the IRS trumps the missions of all other federal agencies. The IRS's stated mission is to "[p]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all."[1] If the IRS lacks adequate funding to do its job effectively, the government will have fewer dollars available to fund all federal programs, including national defense, Social Security, Medicare, Veterans' benefits, medical research, and disaster relief — or simply to reduce the deficit.

Since fiscal year (FY) 2010, the IRS budget has been cut by nearly eight percent.[2] Over the same period, inflation has risen by about six percent, further eroding the IRS's resources.[3] Because of these budget reductions, the IRS has been significantly hampered in its ability to provide "top quality service" and maintain effective enforcement programs that minimize noncompliance.

Consider that in FY 2013:

- The IRS received about 109 million telephone calls. Only 61 percent of calls seeking to reach a customer service representative got through, and those callers had to wait an average of 17.6 minutes on hold.[4]
- The IRS received about 8.4 million letters from taxpayers responding to proposed adjustments to their tax accounts.[5] At the end of the fiscal year, 53 percent of the correspondence in open inventory had not been answered within the timeframes the IRS itself has established.[6]
- The IRS is continuing a trend of reducing and in some cases eliminating services to taxpayers who visit any of its nearly 400 walk-in sites. Ten years ago, it answered more than 1.4 million tax-law questions at its walk-in sites. In FY 2014, the IRS will answer only "basic" tax law questions during the filing season (January through April), and it will not answer any tax law questions at all (even basic ones) beyond April, including questions from the millions of taxpayers who obtain filing extensions and prepare their returns later in the year.[7] This new policy applies to taxpayers who seek assistance with tax law questions by phone as well. In addition, the IRS will discontinue

1 *See* IRS Policy Statement 1-1, IRM 1.2.10.1.1 (Dec. 18, 1993).

2 IRS Chief Financial Officer, Corporate Budget.

3 *See* Office of Management and Budget, *Fiscal Year 2014 Budget of the U.S. Government, Historical Tables*, Table 10.1, at 215 (showing Gross Domestic Product and year-to-year increases in the GDP (Chained) Price Index). Data has been re-based from FY 2005 to FY 2010.

4 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2013). The Accounts Management phones lines (previously known as the Customer Account Services phone lines) receive the significant majority of taxpayer calls and are used by the IRS to compute its "Level of Service." In this discussion, all phone data pertains to the Accounts Management lines, except where otherwise noted. Calls to compliance phone lines and certain other categories of calls are excluded from this total.

5 IRS, Joint Operations Center, *Adjustments Inventory Reports: FY13 July-September Fiscal Year Comparison*.

6 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 28, 2013).

7 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

In fiscal terms, to be blunt, the mission of the IRS trumps the missions of all other federal agencies.... If the IRS lacks adequate funding to do its job effectively, the government will have fewer dollars available to fund all federal programs, including national defense, Social Security, Medicare, Veterans' benefits, medical research, and disaster relief — or simply to reduce the deficit.

its longstanding practice of preparing tax returns for low income, elderly, and disabled taxpayers who seek help.[8]

- The IRS workforce has been reduced from nearly 95,000 full-time-equivalent employees in FY 2010 to about 87,000 in FY 2013, a decrease of eight percent.[9]
- The IRS training budget has been slashed from about $172 million in FY 2010 to about $22 million, a staggering 87 percent reduction.[10] Thus, the IRS not only has fewer employees than four years ago, but those who remain are less equipped to perform their jobs.[11]

Recent cuts to the IRS budget are shortsighted and counterproductive for two reasons.

- First, the requirement to pay taxes is generally the most significant burden a government imposes on its citizens. The National Taxpayer Advocate believes the government has a practical and a moral obligation to make compliance as simple and painless as possible. It is not acceptable that taxpayers seeking help cannot get through to the IRS nearly two-fifths of the time, and then when they do get through, they have to wait on hold for extended periods. The taxpaying public deserves better treatment.
- Second, each dollar appropriated for the IRS generates substantially more than one dollar in federal revenue. In FY 2013, the IRS collected about $2.86 trillion[12] on an appropriated budget of about $11.2 billion.[13] That translates to an average return-on-investment (ROI) of 255:1. The marginal ROI of additional funding will not be nearly so large, but virtually everyone who has studied the IRS budget has concluded that it is positive.

The reduction in taxpayer services is particularly concerning because the U.S. tax system is built on voluntary compliance. About 98 percent of the revenue collected by the IRS each year is paid timely and voluntarily. Only two percent comes from IRS enforcement actions.[14] The IRS's overriding goal is to

8 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

9 IRS Chief Financial Officer, Corporate Budget. Some calculations in this section are affected by rounding. Percentage changes were computed using actual numbers rather than rounded numbers.

10 IRS Chief Financial Officer, Corporate Budget. For a discussion about the impact of training reductions, see Most Serious Problem: *Employee Training: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill Its Mission, infra*.

11 For a discussion about the importance of taxpayer rights training, see Most Serious Problem: *Taxpayer Rights: Insufficient Education and Training About Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect Their Rights, infra; see also* National Taxpayer Advocate Report to the Acting Commissioner of Internal Revenue, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration: Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights* (Nov. 4, 2013).

12 Government Accountability Office (GAO), GAO-14-169, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statements* 76 (Dec. 2013), *available at* http://www.gao.gov/products/GAO-14-169.

13 IRS Chief Financial Officer, Corporate Budget.

14 In FY 2013, the IRS collected about $2.86 trillion in revenue. GAO, GAO-14-169, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statements* 76 (Dec. 2013). Of that total, enforcement revenue accounted for $53.3 billion. *Id*. at 24.

maximize voluntary compliance, because voluntary compliance is much more cost efficient; with enforced compliance, the government must devote significant resources to detecting and collecting amounts that are not voluntarily reported or paid.[15] In addition, several studies published in Volume 2 of this report find that top-quality taxpayer service is a more significant driver of overall tax compliance than IRS enforcement actions.[16]

The main reason the IRS is underfunded is because the congressional budget rules were written with classic spending programs in mind — namely, a dollar spent is treated as increasing the budget deficit by one dollar. As the government's revenue collector, the IRS is the only significant exception to that rule — a dollar spent generates substantially more than one dollar in additional revenue and thus *reduces* the deficit.

To address this anomaly, the National Taxpayer Advocate recommended seven years ago that Congress adopt new procedures to set the IRS's budget.[17] Because any change to the budget rules would require study and ultimately concurrence by the House and Senate budget committees, appropriations committees, potentially tax-writing committees, and other key players, making such a change will require a concerted effort.

The effects of applying across-the-board budget reductions to the IRS over the past three years underscore the importance of making this concerted effort. If the government continues to underserve its taxpayers, it risks further undermining public confidence in the fairness and integrity of the tax system, and thereby reducing tax compliance.

ANALYSIS OF PROBLEM

Over the past ten years, the workload of the IRS has increased significantly. The upward trend has continued during the last three years. Since FY 2010, however, IRS funding has declined. The combination of more work and less funding predictably has impaired the IRS's ability both to meet taxpayer needs and to collect tax.

A. Taxpayer Services: More Work and Less Funding Means Taxpayer Needs Are Not Being Met.

1. More Work

The increase in the IRS's workload can be demonstrated in several ways. For one, the IRS is receiving significantly more individual and business tax returns today than ten years ago.

For individual income tax returns, the number rose from about 131.3 million in FY 2004 to about 146.0 million in FY 2013, an increase of 11 percent. About one-third of that increase has occurred since FY 2010, when about 141.2 million returns were filed.[18]

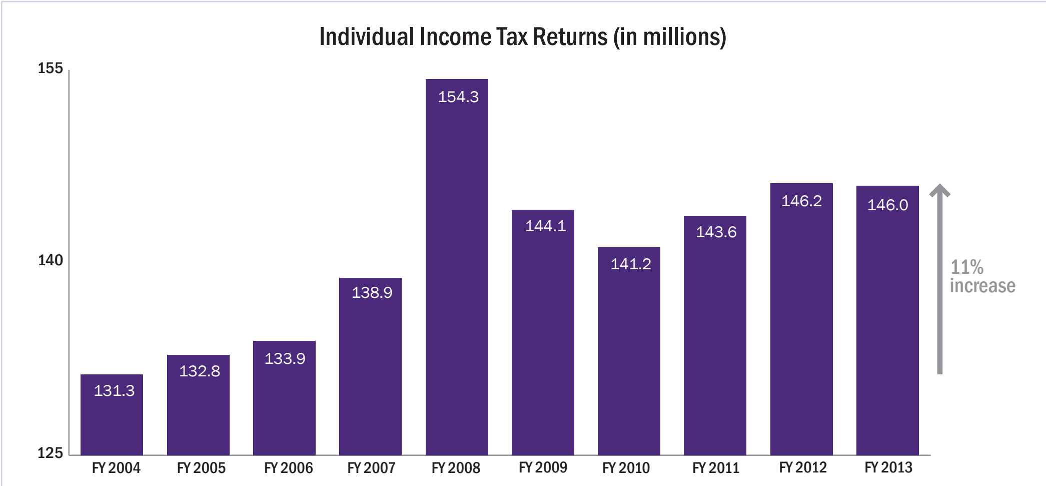
15 See IRS Strategic Plan 2009-2013 ("Goal 1: Improve service to make voluntary compliance easier").

16 *See* Volume 2: *Research Study: Small Business Compliance: Further Analysis of Influential Factors*, *infra*; Research Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*, *infra*.

17 *See* National Taxpayer Advocate 2006 Annual Report to Congress 442-457 (Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*).

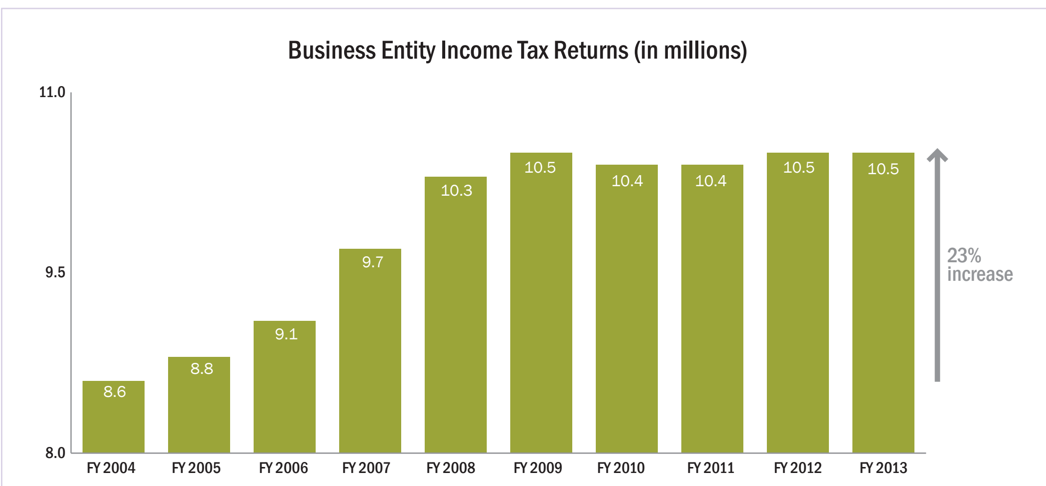
18 IRS Data Books, Table 2, for FY 2004 through FY 2012. Data for FY 2013 was provided by the IRS Office of Research, Analysis, and Statistics.

FIGURE 1.2.1



For business income tax returns, which include the returns of C corporations, S corporations, and partnerships, the number rose from about 8.6 million in FY 2004 to about 10.5 million in FY 2013, an increase of 23 percent.[19]

FIGURE 1.2.2



More tax returns mean more work for the IRS. The IRS must answer more taxpayer phone calls, process the additional returns, conduct more compliance checks, and in some cases conduct more audits or take more collection actions. To maintain its audit rate, the IRS would have to examine these additional returns at the same rate it examines other returns. Thus, an increase of ten percent in individual returns and 23 percent in business returns should translate to roughly the same percentage increases in taxpayer service demands, audits, and other processing and compliance activities.

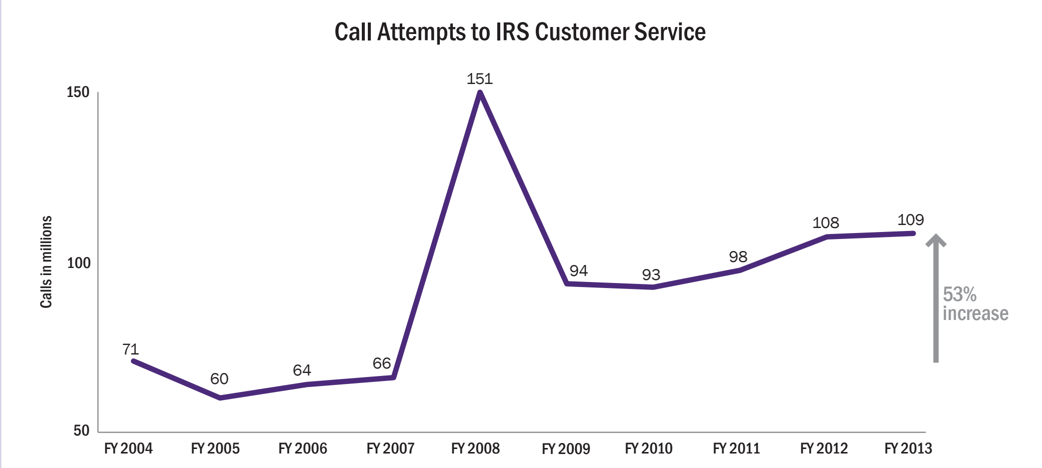
19 IRS Data Books, Table 2, for FY 2004 through FY 2012. Data for FY 2013 was provided by the IRS Office of Research, Analysis, and Statistics.

(As these charts and others in this section show, the increase in the IRS's workload has followed a fairly consistent path, with the notable exception of FY 2008, when the IRS was charged with administering the Economic Stimulus Act and was deluged with an unprecedented number of tax returns and phone calls.[20])

Another indicator of the workload increase is the number of phone calls the IRS receives, which has grown substantially.

From FY 2004 to FY 2013, the number of calls received on the IRS's Accounts Management telephone lines rose from about 71 million to about 109 million, or 53 percent. Notably, more than 40 percent of that increase has occurred since FY 2010, when the IRS received about 93 million calls.[21]

FIGURE 1.2.3



Answering taxpayer telephone calls effectively is labor-intensive. While some callers can be assisted through automation, tens of millions of taxpayers want to speak with an IRS customer service representative (CSR) each year. In FY 2013, CSRs handled some 30 million calls on the Accounts Management lines and another nine million phone calls in other parts of the agency.[22] Nearly 20 million calls to CSRs went unanswered because the IRS does not have enough employees to handle them. There is simply no way for the IRS to deal with this large and increasing volume of work without the funding to hire more CSRs.

20 The Economic Stimulus Act of 2008 required the IRS to make one-time payments to nearly 119 million taxpayers. *See* IRS News Release, IR-2009-10, *IRS Offers Tips to Avoid Recovery Rebate Credit Confusion* (Jan. 30, 2009), *at* http://www.irs.gov/uac/IRS-Offers-Tips-to-Avoid-Recovery-Rebate-Credit-Confusion. The procedures for claiming these "stimulus payments" required millions of individuals otherwise without a filing obligation to file a tax return. The stimulus payments were paid out over several months, and and taxpayers who did not receive their payments early in the process inundated the IRS with telephone calls. As a result, many IRS measures reflect the effects of this one-time event. The number of calls the IRS received on its Accounts Management telephone lines more than doubled, from FY 2007 to FY 2008 (from 66 million to 151 million), and the number of Form 1040-series returns jumped from 139 million to 154 million — the highest annual totals in the past ten years and probably ever.

21 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2004 through FY 2013).

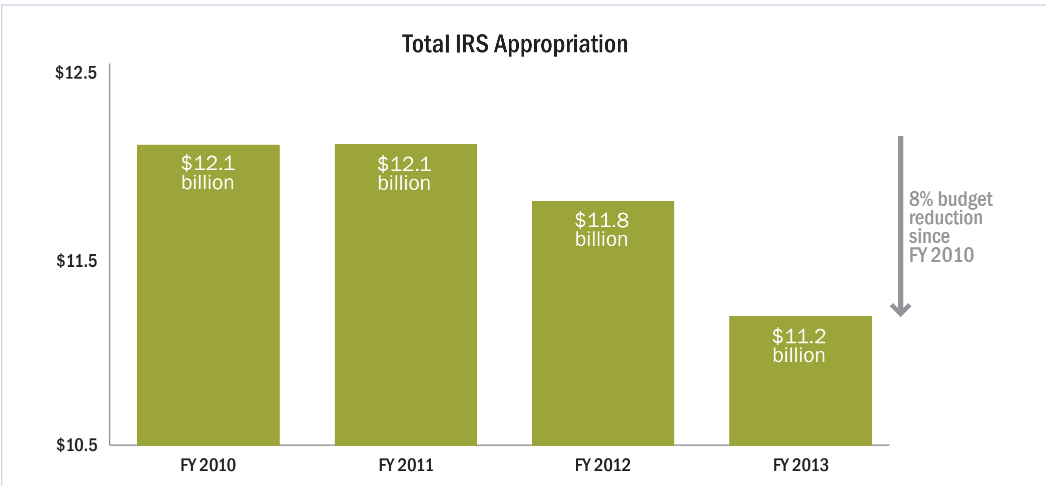
22 *Id.*

During the last few years, the IRS has also had to address a huge spike in tax-related identity theft and refund fraud. In FY 2013, the IRS assigned more than 3,000 employees to work on identity theft cases.[23] Because of the harm identity theft victims suffer, that was the right call to make.[24] But for an overworked agency absorbing budget cuts, the reassignment of so many employees has meant other work in crucial taxpayer service and enforcement areas could not be done.[25]

2. Less Funding and Reduced Resources

Since FY 2010, the IRS's budget has been reduced from about $12.1 billion to about $11.2 billion, or eight percent.[26] Over the FY 2010 through FY 2013 period, inflation has increased by an estimated six percent, and it is expected to increase by an additional two percent in FY 2014, further impacting IRS resources.[27]

FIGURE 1.2.4



These funding reductions translate to fewer employees and less training. The majority of the IRS's costs are employee-related, so not surprisingly, the eight percent drop in the budget has required a reduction in the number of full-time equivalent IRS employees from nearly 95,000 to some 87,000, or eight percent.[28]

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23 *Fiscal Year 2014 Treasury and IRS Budget: Hearing Before the Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations*, 113th Cong. (2013) (statement of Steven T. Miller, Acting Commissioner of Internal Revenue).

24 For a discussion about tax-related identity theft, see Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers, infra*.

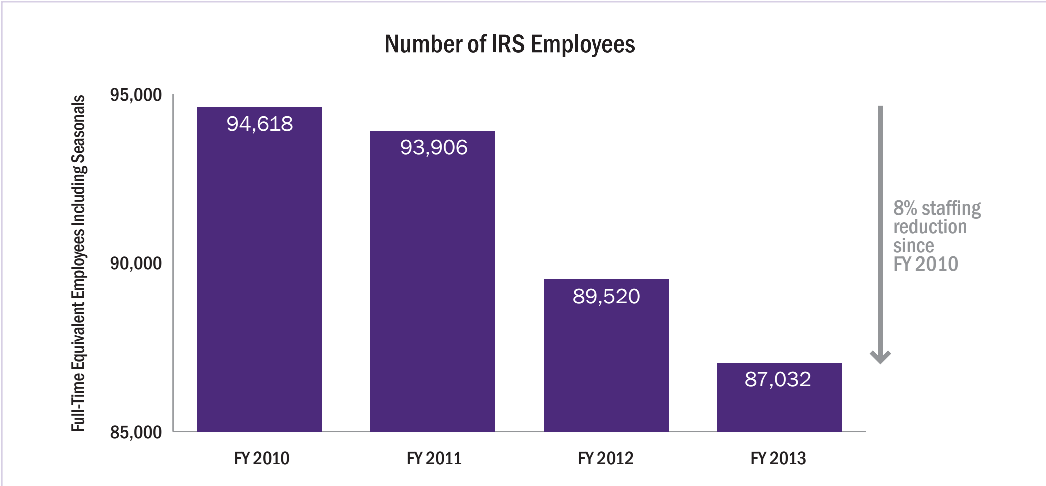
25 *See* Danny Werfel, Acting Commissioner of Internal Revenue, Address at the American Institute of Certified Public Accountants 2013 National Tax Conference (Nov. 5, 2013).

26 IRS Chief Financial Officer, Corporate Budget.

27 *See* Office of Management and Budget, *Fiscal Year 2014 Budget of the U.S. Government, Historical Tables*, Table 10.1, at 215 (showing Gross Domestic Product and year-to-year increases in the GDP (Chained) Price Index). Data has been re-based from FY 2005 to FY 2010. Because of the federal pay freeze, it is likely that the IRS's costs have risen by less than the amount of inflation. However, many employees continued to receive within-grade step increases each year (which translate to increases in pay), the costs of non-salary benefits continued to rise, and non-employee costs continued to rise as well. Thus, inflation since FY 2010 has had a significant impact on the IRS budget beyond the eight percent reduction in nominal dollars shown in the chart above.

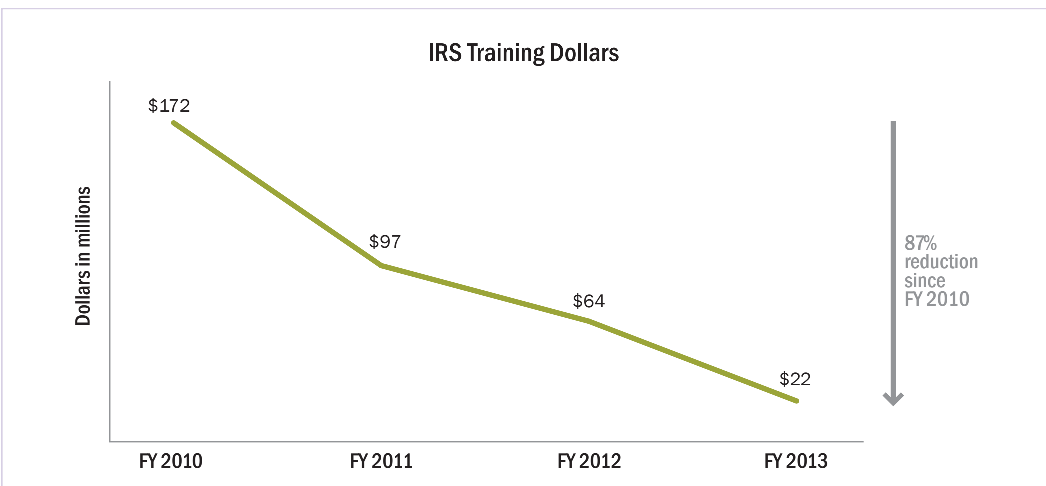
28 IRS Chief Financial Officer, Corporate Budget. This total includes seasonal employees apportioned on a full-time-equivalent basis.

FIGURE 1.2.5



Like most agencies, the IRS has been reluctant to terminate employees other than through attrition, so it has cut costs in other areas. One of the largest and most concerning cuts has been in training. From FY 2010 to FY 2013, the IRS reduced its training budget by 87 percent, from about $172 million to about $22 million.

FIGURE 1.2.6



A large complex organization cannot possibly cut its training budget by 87 percent without undermining the ability of its staff to perform their jobs effectively. This is particularly true at the IRS, where employees must administer an extraordinarily complex tax code and apply it to 146 million individual taxpayers and more than ten million business taxpayers, many of which present unique facts or special circumstances. If IRS customer service employees are not well trained, taxpayers calling for help are more likely to receive incorrect information or no information. If IRS enforcement employees are not well trained, auditors may make inappropriate adjustments and assessments, and collection employees may issue inappropriate levies or file inappropriate liens.

[T]he requirement to pay taxes is generally the most significant burden a government imposes on its citizens. The National Taxpayer Advocate believes the government has a practical and a moral obligation to make compliance as simple and painless as possible. It is not acceptable that taxpayers seeking help cannot get through to the IRS nearly two-fifths of the time, and then when they do get through, they have to wait on hold for extended periods. The taxpaying public deserves better treatment.

The stakes for taxpayers are simply too high to allow the IRS workforce to be undertrained.[29] In most years, workforce attrition exceeds five percent.[30] When employees leave, the IRS must identify existing employees or find new ones to pick up the slack — sometimes through internal promotions, sometimes with limited new hires. In addition, the IRS employed more than 11,000 seasonal employees during the last filing season and for other limited tasks throughout the year.[31] Even employees who do not change jobs face constant changes in the nature of their workloads. For example, as the problem of tax-related identity theft increased, the IRS trained at least 37,000 employees on various aspects of victim assistance.[32]

The IRS has tried to train employees at lower cost by replacing in-person training with remote or virtual instruction.[33] That is a constructive approach — to a point. Some virtual training can be effective. But other types of training, such as teaching taxpayer-facing employees how to interview taxpayers and working through case studies, do not lend themselves well to a remote setting. In addition, employees of many IRS functions are spread around the country, and it is difficult for managers to do their jobs properly if they cannot meet periodically — face to face — with the employees they supervise.

3. Taxpayer Needs Are Not Being Met

The combination of more work and less funding has left the IRS stretched too thin, compromising its capacity to meet taxpayer needs.

a. Taxpayer Telephone Calls

The IRS's ability to field taxpayer telephone calls has declined markedly over the past decade. In FY 2004, the IRS answered 87 percent of calls from taxpayers seeking to speak with a CSR (which, in IRS parlance, is referred to as the "Level of Service" or "LOS"). In FY 2013, the IRS answered only 61 percent of such calls, a reduction of 26 percentage points, or 30 percent, in the LOS. Meanwhile, the time successful taxpayers waited on hold rose from 2.6 minutes to 17.6 minutes, a nearly six-fold increase.[34]

29 For a discussion about the impact of training reductions, see Most Serious Problem: *Employee Training: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill Its Mission, infra*; Most Serious Problem: *Taxpayer Rights: Insufficient Education and Training About Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect Their Rights*, *infra*.

30 *See, e.g.*, Partnership for Public Service, *Beneath the Surface: Understanding Attrition at Your Agency and Why It Matters* 3 (Nov. 2010) (finding that attrition in the federal government, although "relatively low," was 7.6 percent in FY 2008 and 5.85 percent in FY 2009).

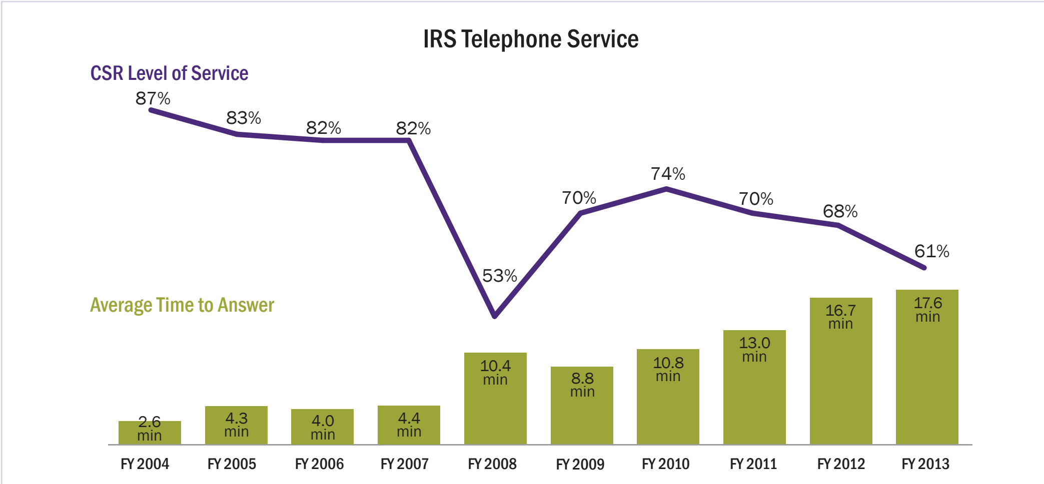
31 *See* data compiled for IRS 2013 Data Book, Table 30 (not yet published). This total reflects seasonal employees placed on a full-time-equivalent basis. The actual number of employees was higher.

32 *Fiscal Year 2014 Treasury and IRS Budget: Hearing Before the Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations*, 113th Cong. (2013) (statement of Steven T. Miller, Acting Commissioner of Internal Revenue) (stating that the IRS has assigned 3,000 employees to work on identity theft and has trained 37,000 employees who work with taxpayers to recognize identity theft and assist victims).

33 *See* Danny Werfel, Acting Commissioner of Internal Revenue, Address at the American Institute of Certified Public Accountants 2013 National Tax Conference (Nov. 5, 2013) (stating that the IRS has "expanded the use of alternative delivery methods for in-person meetings, training, conferences, and operational travel").

34 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2004 through FY 2013).

FIGURE 1.2.7



While the IRS's decline in the LOS and increase in hold times have been a long-term trend, it should be noted that a significant portion of the decline has occurred since FY 2010. Since FY 2010, the LOS has declined by 18 percent (from 74 percent to 61 percent) and the average hold time has increased by 63 percent (from 10.8 minutes to 17.6 minutes).

To try to improve its LOS, the IRS recently announced several "service changes" for FY 2014. During the filing season (January through April), it will answer only "basic" tax law questions; it will not answer "more detailed" questions. After April, it will not answer any tax law questions (even basic ones), including from the millions of taxpayers who obtain filing extensions and prepare their returns later in the year.[35] At the risk of vast understatement, it is a sad state of affairs when the government writes tax laws as complex as ours — and then is unable to answer any questions beyond "basic" ones from baffled citizens who are doing their best to comply.

b. Taxpayer Correspondence

The IRS's ability to timely process taxpayer correspondence has taken a similar hit. When the IRS sends a taxpayer a notice proposing to increase his or her tax liability, it typically gives the taxpayer an opportunity to present an explanation or documentation supporting the position taken on the return. Each year, the IRS typically receives around ten million taxpayer responses, known collectively as the "adjustments inventory."[36] The IRS has established timeframes for processing taxpayer correspondence, generally 45 days. During the final week of FY 2004, the IRS failed to process 12 percent of its adjustments correspondence within its timeframes. During the final week of FY 2013, the IRS was unable to process 53 percent of its adjustments correspondence within the timeframes.[37]

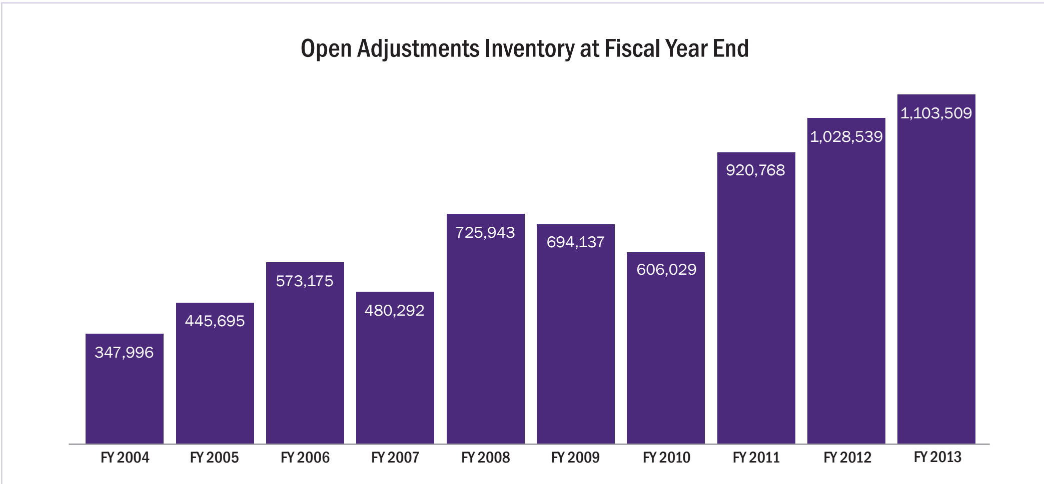
35 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

36 IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2004 through FY 2013)*. In FY 2013, receipts in the Adjustments Inventory were about 8.4 million, as compared with 10.4 million in FY 2012. We are not certain why the number declined. The Adjustments Inventory is one component of the Accounts Management function's overall Paper Inventory. In FY 2013, receipts in the Paper Inventory were about 20.8 million, and the percentage classified as overage at year-end was 47 percent. IRS, Joint Operations Center, *Account Management Information Report (AMIR) – National Summary* (week ending Sept. 28, 2013).

37 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 28, 2013).

As a corollary, the number of pending pieces of adjustments correspondence in open inventory increased as well. At the end of FY 2004, open inventory stood at about 348,000 letters.[38] At the end of FY 2013, it consisted of about 1.1 million letters.[39]

FIGURE 1.2.8



As with telephone performance, correspondence performance has declined since FY 2010. Comparing the final week of FY 2010 with the final week of FY 2013, the percentage of overage correspondence rose from 28 percent to 53 percent, and open inventory grew from about 606,000 to about 1.1 million — in both cases almost doubling.[40]

c. Taxpayer Walk-In Assistance

At the same time that taxpayers have encountered greater difficulty communicating with the IRS by phone and mail, their opportunities to communicate with the IRS in person have also been limited. As an alternative to telephone or correspondence interaction, the IRS maintains walk-in sites known as Taxpayer Assistance Centers, or "TACs." The TACs are designed to provide a "local presence." As we reported earlier this year, the number of TACs declined from 400 to 392 between the start of the 2012 and 2013 filing seasons, and the number of TACs with just one employee increased from 48 to 65.[41] TACs with one employee are subject to unexpected closure due to employee absence and subject to extended wait times when there are more-than-projected taxpayer visits.

We noted above that the IRS has adopted a new policy of declining to answer many tax-law questions — notably, any questions beyond "basic" ones — on its toll-free telephone lines. The same policy applies to

38 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 30, 2004).

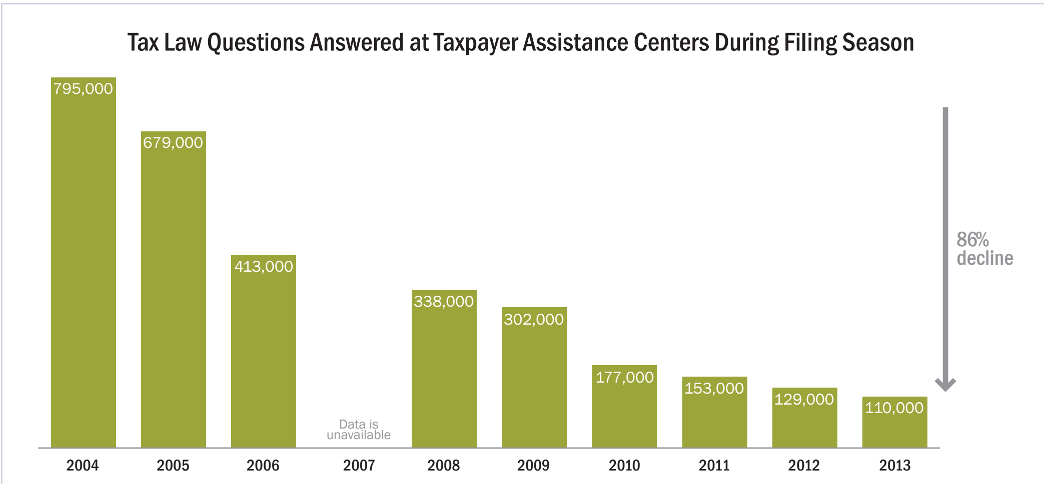
39 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 28, 2013).

40 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Oct. 2, 2010); IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 28, 2013).

41 For more detail, see National Taxpayer Advocate FY 2014 Objectives Report to Congress at 59.

the TACs.[42] This continues an unfortunate trend of service reductions for taxpayers who either do not have Internet access or otherwise require or prefer in-person assistance. According to data compiled by the GAO, the number of tax-law questions answered in the TACs over the last ten years during the filing season has declined by 86 percent — from about 795,000 questions to 110,000.[43]

FIGURE 1.2.9



The annual GAO filing season reports do not list the number of tax-law questions outside the filing season, but the numbers are significant. In FY 2004, for example, IRS data indicate that in addition to handling some 795,000 tax-law questions during the filing season, the IRS handled about 638,000 tax-law questions after the filing season. Thus, 45 percent of the 1.433 million questions received came outside the filing season.[44] None of those 638,000 questions would be answered under the IRS's new policy. It should be emphasized that the reduction in tax-law questions is not necessarily a function of reduced demand. Rather, the IRS has reduced TAC staffing and reduced the scope of the questions it is willing to answer, and wait times have often been unreasonably long. As a consequence, many taxpayers have probably given up.

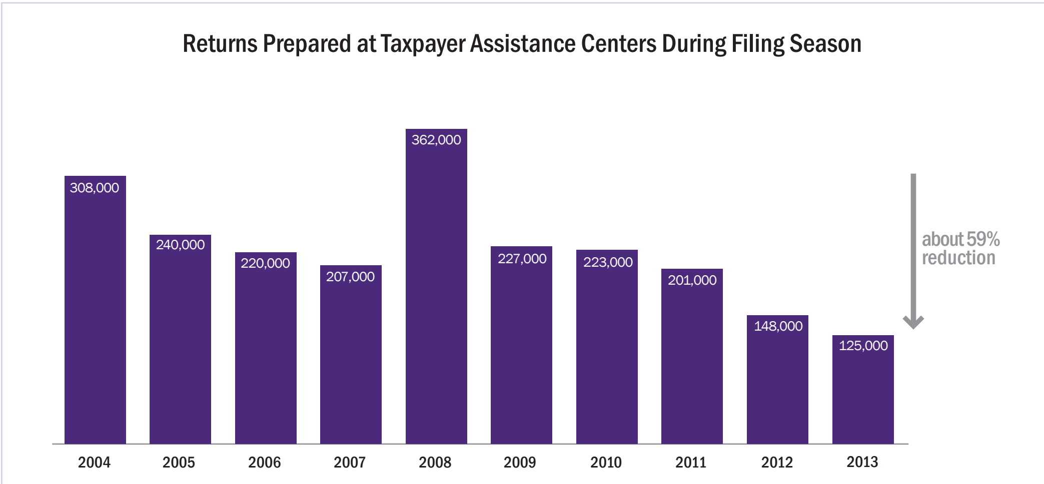
42 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

43 GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (Dec. 2013); GAO, GAO-11-111, *2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 45 (Dec. 2010); GAO, GAO-08-38, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should be Evaluated* 27-28 (Nov. 2007); GAO, GAO-07-27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (Nov. 2006) (supplemented with more precise IRS data provided to TAS by the IRS Wage & Investment Division for 2004 through 2006). TAS does not have data for 2007.

44 This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: *Service at Taxpayer Assistance Centers*). TAS does not have data on tax-law questions asked outside the filing season for more recent years.

Historically, the TACs have also prepared tax returns for taxpayers seeking assistance, particularly low income, elderly, and disabled taxpayers. According to the GAO filing season reports, the number of returns prepared during the filing season over the past decade has declined by 59 percent.[45]

FIGURE 1.2.10



As with tax-law questions, data covering solely the filing season understates the assistance the IRS has provided to taxpayers. In FY 2004, IRS data indicates that in addition to preparing some 308,000 returns during the filing season, the IRS prepared an additional 168,000 returns after the filing season. Thus, roughly 35 percent of the returns prepared by the TACs were prepared after April 15.[46] But with dwindling resources, the IRS has been placing increasing limits on return preparation assistance, and in its recent announcement, it made clear it will discontinue *all* return preparation assistance at the TACs beginning this filing season.[47]

d. Local Availability of Enforcement Personnel

The "local presence" of enforcement personnel has also declined. From FY 2010 through FY 2013, the number of Revenue Agents, who conduct field audits, decreased by 12 percent (from 13,879 to 12,270). The number of Revenue Officers, who perform field collection, declined by 21 percent (from 6,042 to 4,748).[48]

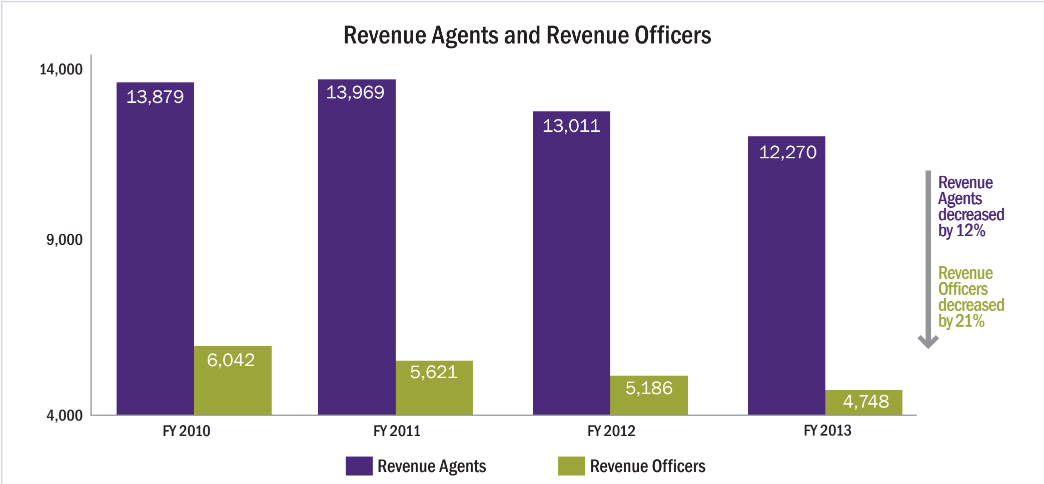
45 GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (Dec. 2013); GAO, GAO-11-111, *2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 45 (Dec. 2010); GAO, GAO-08-38, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should be Evaluated* 27-28 (Nov. 2007); GAO, GAO-07-27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (Nov. 2006) (supplemented with more precise IRS data provided to TAS by the IRS Wage & Investment Division for 2004 through 2006); GAO, GAO-05-67, *Tax Administration: IRS Improved Performance in the 2004 Filing Season, But Better Data on the Quality of Some Services Are Needed* 18 (Nov. 2004). The GAO filing season reports do not provide a total for 2007. However, the report on the 2007 filing season said the number of TAC-prepared returns was almost 74 percent less than the number of TAC-prepared returns in 2001, and the report on the 2004 filing season said the number of TAC-prepared returns in 2001 was about 790,000. We therefore have provided an approximate total for 2007 in the chart above.

46 This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: *Service at Taxpayer Assistance Centers*).

47 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

48 IRS Data Books, Table 30.

FIGURE 1.2.11



In addition, the number of Appeals Officers, with whom taxpayers historically have had the option of meeting personally, declined by four percent (from 847 to 811). Of particular concern, many taxpayers no longer have the practical option of meeting with Appeals Officers personally. Eleven states and Puerto Rico have no Appeals or Settlement Officers with a post-of-duty within their geographic borders.[49]

We find the sharp reduction in local enforcement personnel concerning. While no taxpayer wants to be audited or face collection action, it is important that taxpayers who find themselves in that position have the option of talking with an IRS employee face-to-face. On audit, a taxpayer may have documentation that is difficult to mail in and requires a conversation to explain. In collection, a taxpayer may have special circumstances or face hardships that are obvious in person but difficult to convey by email or over the phone.

A local presence is also important because economic conditions and types of noncompliance vary from community to community. A Revenue Officer (RO) who lives in a community typically is better equipped than employees in a centralized site to determine how to work with a delinquent taxpayer claiming financial hardship. The RO may, for example, know that a large local employer has just laid off workers or that a payroll service provider who kept payrolls for small businesses was just arrested for misappropriating funds. In Volume 2 of this report, we publish a study showing that ROs generally are more effective than the Automated Collection System in resolving employment tax delinquencies.[50]

49 IRS, *Discovery Directory* (searched on Dec. 30, 2013). Alaska, Arkansas, Delaware, Idaho, Kansas, Montana, North Dakota, Rhode Island, South Dakota, Vermont, Wyoming, and Puerto Rico are not listed as having either an Appeals Officer or a Settlement Officer. Settlement Officers hold Collection Due Process hearings under IRC §§ 6320 and 6330, and hear appeals of installment agreement denials and offer in compromise rejections under IRC § 7122(e). The IRS Restructuring and Reform Act of 1998 directed, among other things, that the Office of Appeals ensure that an Appeals Officer is regularly available within each state. *See* RRA 98 §§ 1001(a)(4); 3465(b). In recent years, the Office of Appeals has eliminated offices in some states and substituted a system of traveling Appeals Officers. Under this system, visits may not be sufficiently frequent or sufficiently spread throughout the state to make meetings accessible to taxpayers.

50 *See* Volume 2: *Research Study: A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies*, *infra*.

The bottom line is that reduced funding has left the IRS substantially less able to assist taxpayers across all service platforms other than the Internet — by phone, by mail, and in person.[51]

B. Revenue Collection: Reduced Funding Means Reduced Revenue Collection and a Larger Budget Deficit.

The reduction in the IRS's budget since FY 2013 has generally been made pursuant to government-wide cuts designed to reduce the imbalance between federal spending and federal revenue. However, the logic behind budget cuts simply does not apply to the funding of the IRS. The IRS collects more than 90 percent of federal revenue.[52] As noted above, the IRS in FY 2013 took in about $2.86 trillion[53] on an appropriated budget of about $11.2 billion,[54] which translates to an average return-on-investment of 255:1. While the marginal ROI of additional funding will not be nearly so large, virtually everyone who has studied the IRS budget has concluded that the ROI of additional funding is positive. This includes the most recent four IRS commissioners (two appointed by Democratic Presidents and two appointed by Republican Presidents).

At his confirmation hearing in December, IRS Commissioner John Koskinen said:

Because the IRS is the federal government's Accounts Receivable Department and generates a substantially positive return on investment, it is self-defeating to treat the agency like a pure spending program. With most spending programs, a dollar spent is simply a dollar spent from a budget perspective. With the IRS, a dollar spent generates many dollars in additional revenue.

> [W]e need to solve the funding problem of the IRS. This is not just my opinion. I have met with every IRS Commissioner from the past 20 years and the consensus was that a major challenge and constraint was the funding limitations they faced. This is a view shared today by the IRS Oversight Board, the Taxpayer Advocate and, most recently, the Treasury Inspector General for Tax Administration (TIGTA) and the Internal Revenue Service Advisory Council. As a TIGTA report this fall noted, the government has saved $1 billion in cuts to the IRS budget and lost $8 billion in compliance revenues.
>
> I don't know any organization in my 20 years of experience in the private sector that has said "I think I'll take my revenue operation and starve it for funds to see how it does." The IRS will have 11,000 fewer people working during this upcoming filing season while processing the largest number of returns in its history. I don't care how efficient you become, that is not a recipe for success or improved compliance and taxpayer service.
>
> This is not a new message. It has been delivered before. We often think that a discussion about a problem means we have dealt with it. Let me just say

51 In an effort to reduce costs, the IRS has been trying for years to persuade taxpayers to make greater use of the Internet in the hope it can reduce taxpayer demand for more costly telephone and walk-in services. While Internet usage has indeed increased, the 54 percent increase in telephone calls from taxpayers seeking to reach a CSR over the past decade demonstrates that the need for personal contact, far from decreasing, has risen substantially at the same time.

52 *See* GAO, GAO-14-169, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statements* 26 (Dec. 2013).

53 *Id*. at 76.

54 IRS Chief Financial Officer, Corporate Budget.

that we have not dealt with the problem and it is not going away. I look forward to working with you to find a solution.[55]

This issue arises because the federal budgeting rules generally treat the IRS in the same manner as all other federal agencies, giving it no "credit" for the revenue it collects. Once the House and Senate Appropriations Financial Services and General Government subcommittees receive their "Section 302(b) allocations" for the upcoming fiscal year, funding all of the agencies under their jurisdiction essentially becomes a zero-sum game — each dollar allocated to one agency reduces the pool of funds available for others.[56]

As we have noted in prior reports, this procedure makes little sense when applied to the IRS. For virtually every other spending program, a dollar spent is just that — it increases the budget deficit by one dollar. But a dollar spent on the IRS generates substantially more than one dollar in return — it reduces the budget deficit.

If the Chief Executive Officer of a Fortune 500 company were told that each dollar allocated to his company's Accounts Receivable Department would generate multiple dollars in return, it is difficult to see how the CEO would keep his job if he chose not to provide the department with the funding it needed. Yet that is essentially what has been happening with respect to IRS funding for years, and as Commissioner Koskinen indicated, there has been some discussion but little effort to fix this obvious problem.

In the National Taxpayer Advocate's 2006 Annual Report to Congress, we discussed the IRS funding challenge in detail and recommended, among other things, that Congress consider revising its budget rules in a manner that allows the relevant congressional committees simply to set IRS funding at whatever level they believe will maximize tax compliance, particularly voluntary compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden.[57]

In the course of developing and presenting that recommendation, the National Taxpayer Advocate or her senior advisor met with 14 separate congressional staffs — the House and Senate majority and minority staffs of the appropriations committees, budget committees, and tax-writing committees as well as tax counsel for the House and Senate majority leaders. In our discussions, there appeared to be no disagreement with the premise that the IRS generates a positive return on investment and is underfunded. However, we were repeatedly told that creating a new set of rules to establish IRS funding levels would be a "heavy lift" and would raise jurisdictional issues that have to be worked through.

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55 *Hearing to Consider the Nomination of John Andrew Koskinen to Be Commissioner of Internal Revenue, Hearing Before the S. Comm. on Finance*, 113th Cong. (Dec. 10-11, 2013) (citing Treasury Inspector General for Tax Administration, Ref. No. 2013-30-078, *Trends in Compliance Activities Through Fiscal Year 2012* (Aug. 2013)). *See also* Charles O. Rossotti, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America* 278 (2005) ("When I talked to business friends about my job at the IRS, they were always surprised when I said that the most intractable part of the job, by far, was dealing with the IRS budget. The reaction was usually 'Why should that be a problem? If you need a little money to bring in a lot of money, why wouldn't you be able to get it?'").

56 *See* Congressional Budget and Impoundment Control Act, Pub. L. No. 93-344, § 302(b)(1), 88 Stat. 297, 308 (1974) (providing that the Appropriations Committee of each House shall subdivide its allocation of funding under the annual budget resolution among its subcommittees). The "program integrity cap adjustment" mechanism, which we discuss in the text below, is a limited but in our view flawed exception to this rule.

57 *See* National Taxpayer Advocate 2006 Annual Report to Congress 442-457 (Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*).

In light of the IRS's increasing inability to meet the needs of the taxpaying public, we submit that the time for the "heavy lift" is now. Not only are cuts to the IRS budget harmful from a taxpayer service perspective, but to the extent they are designed to reduce the budget deficit, they are self-defeating.

C. The "Program Integrity Cap Adjustment" Mechanism Has Significant Drawbacks.

In a partial attempt to provide the IRS with additional funding within the existing budget rules, several Appropriations acts in recent years have given the IRS more funding by using a mechanism known as a "program integrity cap adjustment." Under this mechanism, new funding appropriated for IRS *enforcement* programs generally does not count against otherwise applicable spending ceilings provided:

1. The IRS's existing enforcement base is fully funded; and
2. A determination is made that the proposed additional expenditures will generate an ROI of greater than 1:1 (*i.e.,* the additional expenditures will increase federal revenue on a net basis).

For FY 2014, the Administration's budget proposal recommended a change to the Balanced Budget and Emergency Deficit Control Act of 1985 to provide program integrity cap adjustments for the next ten years.[58] While this cap adjustment mechanism may provide an easier path to providing the IRS with more resources than a fundamental change in congressional budget rules, we are concerned that taxpayer service activities have been excluded from this enhanced funding mechanism in the past and would continue to be excluded under the Administration's proposal. The rationale has been that the IRS can measure the direct ROI of its enforcement activities — *i.e.,* it can compute to the dollar the amounts collected by its Examination, Collection, and document-matching functions — but cannot quantify the ROI of taxpayer services. Thus, it is not possible to document whether or to what extent its taxpayer services generate an ROI greater than 1:1.

Creating a mechanism that allows more funding for enforcement actions, while excluding taxpayer service activities like outreach and education, would be a mistake for two reasons. First, common sense tells us that taxpayer services are a significant driver of tax compliance and generate a very high ROI. Publishing tax forms and instructions, conducting outreach and education, assisting taxpayers, tax preparers, and tax-software manufacturers, and otherwise administering the tax filing season are absolute prerequisites for tax compliance. In general, the ROI of these service activities is probably greater than the ROI of enforcement actions.

Three TAS research studies published in Volume 2 of this report illustrate the value of taxpayer service and the limitations of enforcement measures to improve tax compliance:

- A study regarding tax compliance by sole proprietors found that taxpayer service and social norms were the two most influential factors affecting compliance behavior. Contrary to expectation, it found that traditional deterrence theory did not play a significant role in promoting compliance, possibly because the taxpayers were motivated by short-term cash flow needs.[59]
- A study regarding the impact of penalties on tax compliance analyzed the future compliance behavior of two groups of sole proprietors who were audited and whose examinations were closed in 2007. One group faced tax adjustments and was subject to penalties. The other group faced

58 *See* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals* 187 (Apr. 2013).

59 *See* Volume 2: Research Study: *Small Business Compliance: Further Analysis of Influential Factors*, *infra*.

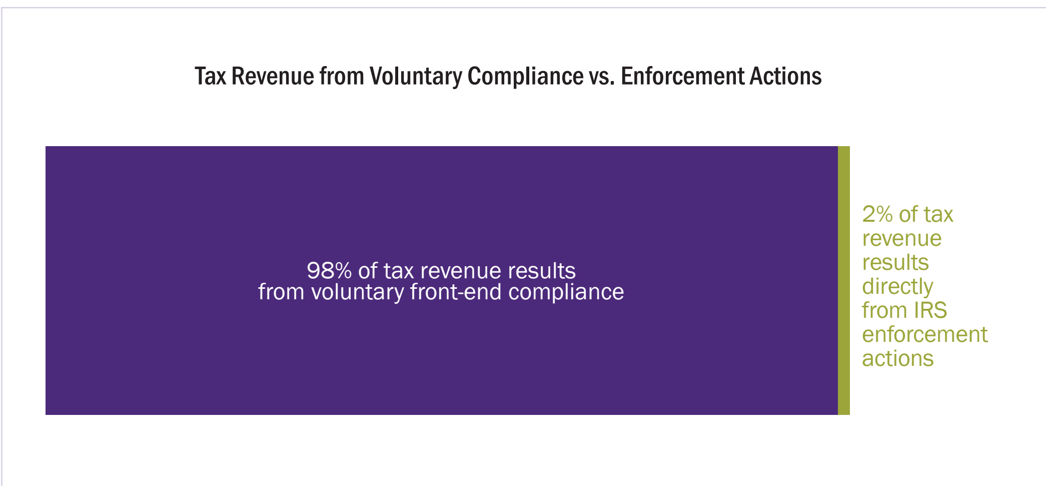
similar tax adjustments but was not subject to penalties. The study found that the future compliance behavior of the penalized group was no better than the future compliance behavior of the group that was not penalized.[60]

- A study regarding the relative effectiveness of Revenue Officers and the Automated Collection System in addressing delinquent employment tax liabilities found that neither ROs nor ACS affected future compliance.[61] That is a significant finding that should guide IRS strategic and resource-allocation decisions, because long-term revenue collection is much greater where IRS actions improve future voluntary compliance.

These studies underscore that the ROI of taxpayer service, despite being unquantifiable, is significant and should figure prominently in any strategy designed to improve tax compliance.

Second, an enforcement-only cap adjustment will inherently push the IRS to become more of a hard-core enforcement agency. It should be emphasized that in FY 2013, direct enforcement revenue amounted to only $53.3 billion,[62] or two percent of total IRS tax collection of $2.86 trillion.[63] The remaining 98 percent resulted from voluntary front-end tax compliance.

FIGURE 1.2.12



If cap adjustments are applied solely to bolster enforcement funding, the relative allocation of the IRS budget between enforcement and taxpayer service will shift over time in a direction that causes taxpayers to fear the IRS more and voluntarily cooperate less. Primarily because of the proposed cap adjustments, the Administration's ten-year funding projections showed that funding for the IRS Enforcement appropriation would increase by more than twice as much as funding for the IRS's Taxpayer Services

60 *See id*.

61 See Volume 2: *Research Study: A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies*, *infra*.

62 GAO, GAO-14-169, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statements* 24 (Dec. 2013).

63 *Id*. at 76.

appropriation.[64] In our effort to enforce the laws against noncompliant taxpayers, we must take care to avoid steps that may alienate compliant taxpayers and thereby jeopardize the existing tax base.

For that reason, if program integrity cap adjustments are used, we recommend that compliance initiatives be defined more broadly so they include both an enforcement component and a service component (*e.g.,* better outreach, education, and assistance for small businesses). Because the projected ROI of many enforcement programs is high, a more broadly constructed initiative could still produce a demonstrable ROI of greater than 1:1 even if it contained service components with ROIs that are unquantifiable.[65]

CONCLUSION

Because the IRS is the federal government's accounts receivable department and generates a substantially positive return on investment, it is self-defeating to treat the agency like a pure spending program. With most spending programs, a dollar spent is simply a dollar spent from a budget perspective. With the IRS, a dollar spent generates many dollars in additional revenue, and conversely, a dollar unspent translates to a greater decrease in revenue collection, thereby adding to the budget deficit. Recent cuts in the IRS budget have also limited the IRS's ability to meet the basic service needs of the taxpaying public, which erodes public confidence and trust in the tax system and may also lead to greater noncompliance. For these reasons, we believe the time has come for Congress to "fence off" decisions about IRS funding from the otherwise applicable spending ceilings that apply to discretionary appropriations under the budget rules.

64 Budget of the United States Government: Analytical Perspectives, Supplemental Materials, Fiscal Year 2014: Table 32-1, Federal Programs by Agency and Account, at 304-305, *available at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/32_1.pdf. Taxpayer service spending is shown on the top line, which is labeled "Taxpayer Services: Appropriations, discretionary . . . 803." Enforcement spending is the sum of the line labeled "Federal law enforcement activities: Appropriations, discretionary … 751" and the line labeled "Central fiscal operations: Appropriations, discretionary … 803." Over the FY 2014 through FY 2023 period, these projections show that Taxpayer Services spending would rise by 23 percent, while Enforcement spending would increase by 54 percent.

65 In our past annual reports, we have written about local compliance initiatives the IRS has undertaken that include integrated enforcement and outreach and education components. *See, e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 176-192 (Most Serious Problem: *Local Compliance Initiatives Have Great Potential but Face Significant Challenges*). One example: In the early 1990s, the IRS launched an initiative designed to address noncompliance by fishermen in Alaska that resulted from confusion as well as community norms and attitudes. The IRS combined stepped-up enforcement activities with an extensive outreach and education campaign in remote fishing villages and on fishing vessels that included assisting with tax return preparation and training local volunteers to assist taxpayers. By the end of the initiative, the number of nonfilers among the target population declined by 30 percent. *Id*. at 177-178.

RECOMMENDATIONS

The National Taxpayer Advocate reiterates her recommendations that Congress consider the following actions:

1. Revise the budget rules so that the IRS is "fenced off" from otherwise applicable spending ceilings and is viewed more like an accounts receivable department. It should be funded at a level designed to maximize tax compliance, particularly voluntary compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden.
2. In allocating IRS resources, keep in mind that tax compliance requires a combination of high quality taxpayer service, outreach and education, and effective tax-law enforcement, and the IRS should continue to maintain a balanced approach toward that end. We are concerned that the program integrity cap adjustment procedures used in the past skew this important balance and should be avoided, but if cap adjustments continue to be used, we recommend they be written in a manner that applies to broadly defined compliance initiatives that include both taxpayer service (including outreach and education) and enforcement components.

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