Modernizing America's Tax Agency

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IRS

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Quotes...

"As a guiding principle, the Commission believes that taxpayer satisfaction must become paramount at the new IRS . . . ."

"Customer satisfaction must be a goal in every interaction the IRS has with taxpayers, including enforcement actions. Taxpayers expect quality service in all interactions with the IRS, including taxpayer assistance, filing tax returns, paying taxes, and examination and collection actions."

"The Commission developed a vision . . . of a new, customer-focused IRS for the next century. This vision embraces an efficient, service-oriented institution dedicated to collecting the proper amount of tax through the use of taxpayer education, modern customer service practices, and effective law enforcement techniques. The motivated, skilled employees of the new IRS would receive the proper training, incentives, authority, tools, and management oversight to get the job done."

Report of the National Commission on
Restructuring the Internal Revenue Service (June 25, 1997)

"For the vast majority of Americans who want to do the right thing, the IRS should do right by them, and that means treating them with respect and trust. And, it means recognizing that taxpayers are its customers."

Vice President Gore, Reinventing Service at the IRS
(NPR Report - 1998)

"The report of the Task Force contains more than 200 actions which share a clear goal: to ensure that every taxpayer is treated with fairness and respect and that IRS customer service begins to meet the same standards that characterize private sector firms."

"Most of the IRS is organized around internally-defined functions, rather than the needs of customers . . . . The IRS should begin to refine customer segments and key events for each of those segments as they relate to those customers' tax responsibilities."

Reinventing Service at the IRS (NPR Report - 1998)

"Agencies seek to understand noncompliance and other problems as the public sees them, and to produce organizational responses that make sense from the outside, rather than disjointed sequences of specialist functional responses."

"For any particular kind of identified noncompliance, the choice between using the "service arm" and the "enforcement arm" or something else [is] a matter of crucial professional judgement on which the public image and credibility of the agency depend."

Imposing Duties (Malcolm Sparrow)

"The Internal Revenue Service shall review and restate its mission to place a greater emphasis on serving the public and meeting taxpayers' needs."

"The Commissioner of Internal Revenue shall develop and implement a plan to reorganize the Internal Revenue Service. The plan shall establish organization units serving particular groups of taxpayers with similar needs."

IRS Restructuring and Reform Act of 1998

Foreword to Modernizing America's Tax Agency

In the last several years, the Internal Revenue Service (IRS) has been the subject of much study and criticism, including a Presidential commission, several congressional committees and the Vice President's National Partnership for Reinventing Government. Many problems were identified and many solutions proposed, dealing with virtually every dimension of the IRS – from electronic filing to employee discipline. This process culminated with the overwhelming passage of the IRS Restructuring and Reform Act in July 1998.

In the mass of detail and complexity that this intense scrutiny of the IRS produced, it is easy to get lost in the trees and fail to see the forest. What the IRS was told in this process is that it is expected to do a far better job serving the public based on a much better understanding of the taxpayers' point of view. The quotes on the facing page – extracted from some of the principal observers of the IRS in recent years – summarize the direction the IRS was told to take.

Responding to this mandate, the IRS has the opportunity to rise to a new and much higher level of performance. If we are successful, millions of American taxpayers and thousands of IRS employees will benefit for years to come: the taxpayers because they will have a tax agency serving them the way they expect to be served; the employees because they will work in an agency that people internally and externally trust.

Rising to the challenge is not a simple task. It will require fundamental change in almost all aspects of the IRS and will affect the way almost all employees work with taxpayers and with each other. The required changes range from performance measures to technology, but they are all necessary for success and are very much interdependent.

The purpose of this paper is to provide an overview of the entire process of change that the IRS is undertaking to meet the public's expectations. This process will take years and carries with it considerable risk that progress will not happen as planned or expected, and that setbacks will occur. But there is no low risk plan for the IRS. Therefore, it is essential to identify and manage the risks by confronting them, and honestly communicating what the IRS is doing and why.

While recognizing the enormous challenge and the long road ahead, we are nevertheless convinced of the necessity and value to America's taxpayers of reaching the higher level of performance for the IRS. With the continued support of the Treasury, the Congress and the public, we are confident we can succeed.

Charles O. Rossotti

Charles O. Rossotti
Commissioner
Internal Revenue Service

I. Public Expectations and Mission

In the wake of corruption scandals and a Presidential Commission, the Internal Revenue Service was established in its current form in 1952. The objective was to create an agency that would collect federal taxes according to the law without political or corrupt influence. The IRS mission statement, written in the 1960s and in effect until 1998, reflected the way the agency saw itself and was seen by the public. Its operative words were "collect the proper amount of tax."

Over the last 47 years, the IRS succeeded remarkably in achieving the purpose established in 1952. The IRS today collects $1.7 trillion, more than the total GDP of the United Kingdom and 26 times its collections in 1952. Corruption cases are few and are vigorously investigated and prosecuted, and the agency is strongly insulated from political influence.

At the same time, the volume and complexity of IRS operations expanded tremendously. Since 1952, the number of returns filed has more than doubled, and the number of pages in the Tax Code has expanded from 812 to approximately 3,500. The rate of change, in the tax system and the economy, is also great. In the last 12 years, there have been approximately 9,500 changes to the Tax Code. The IRS today deals directly with more Americans than any other institution, private or public. Even the tax-exempt sector with over $5 trillion in assets – including pension funds, charities, and other non-governmental organizations – must comply with rules administered by the IRS.

For an agency that fulfilled its established purpose so well, the IRS has been the subject of a great deal of study and criticism in the last several years. The studies identified a wide range of problems: inadequate technology and failure of technology modernization programs, poor service to taxpayers, violations of taxpayer rights, failure to follow established procedures, lack of adequate training and resources for IRS employees, and inappropriate use of enforcement statistics, to name some of the most prominent. The public itself expressed its dissatisfaction by its response to surveys and ratings comparing the IRS to other public and private institutions. In such surveys the IRS usually ranked last among public and private institutions.

What is noteworthy about the problems identified in all the recent studies is that they are not the same ones identified in 1952. Instead, they focus on a different but equally fundamental issue: how the IRS affects the people who pay the tax—America's taxpayers. What the public told the IRS, both directly and through various groups who studied the agency, is that it expects more from the IRS in the way it serves them. The public today has a legitimate expectation that the IRS will do its job in a manner that is no less effective than high-quality private and public sector organizations. After all, every taxpayer is also a customer of many other businesses and institutions, many of which provide consistently high-quality service to customers while also providing excellent results for shareholders and other stakeholders.

The IRS Restructuring and Reform Act of 1998 (RRA '98), which passed the House, 402-8, and the Senate, 96-2, incorporated many of the recommendations found in the studies that preceded it. The direction given to the IRS was clear: it must do a better job in meeting the needs of taxpayers. As required by the RRA '98, this direction is expressed in the new IRS mission statement:

> *Provide 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.*

This mission statement accurately describes the role of the IRS as well as the public's expectations as to how the IRS should perform it. In the United States, the Congress passes tax laws and requires taxpayers to comply with them. It is the role of taxpayers to understand and meet their tax obligations, and most do since roughly 98 percent of the taxes collected are paid without active intervention by the IRS. It is the role of the IRS to help the large majority of taxpayers who are willing to comply with the tax law, while seeing to it that the minority who are not willing to comply are not allowed to burden their fellow taxpayers. The IRS must perform this role to a top quality standard, which means that all of its services should be seen by the people who receive them as comparable in quality to the best they get elsewhere.

Just as the best companies produce excellent shareholder returns by providing high-quality products and services to customers, the successful execution of this new IRS mission will also be expected to produce tax revenues for the Treasury in accord with the tax law without political or corrupt influence. This new mission statement does not, in any sense, negate the intent of the previous one; rather it builds on it and sets a broader and higher performance standard. Only an institution that has been successful at one level can aspire to a higher level of performance.

Establishing a new mission for the IRS and clarifying the public's expectations are essential and meaningful steps in meeting those expectations. However, achieving this mission requires fundamental change in many aspects of an institution that has been built over many years. This change must produce success in the new mission, while retaining the essential elements that created success in the past. Further, this change must take place while the IRS continues to administer a very large, complex and ever-changing tax system. Since the IRS will strive to perform at a level of quality achieved elsewhere in the economy, a major part of this change is guided by proven private and public sectors' best practices.

We refer to this whole process of change as "modernization," because it involves building on the essential components that made the IRS successful in the past while bringing them up to date in a way designed to achieve the new mission. This entire process is summarized on the following page.

Internal Revenue Service

MISSION STATEMENT

Provide 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.

GUIDING PRINCIPLES

- Understand and solve problems from taxpayer's point of view
- Enable managers to be accountable - knowledge, responsibility, authority, action
- Align measures of performance at all organizational levels
- Foster open, honest communication
- Insist on total integrity

GOALS

Service to Each Taxpayer:

- Make filing easier
- Provide first quality service to each taxpayer needing help with his or her return or account
- Provide prompt, professional, helpful treatment to taxpayers in cases where additional taxes may be due

Service to All Taxpayers:

- Increase fairness of compliance
- Increase overall compliance

Productivity Through a Quality Work Environment:

- Increase employee job satisfaction
- Hold agency employment stable while economy grows and service improves

Revamped Business Practices

Four Operating Divisions

Management Roles with Clear Responsibility

Balanced Measurement of Performance

New Technology

II. Goals and Benefits

While the new mission statement and clarification of the public's expectations of the agency are fundamentally important, it is critical in any large institution to define specific goals needed to achieve the mission. In a practical sense, these goals represent what the agency is striving to achieve and how it judges its success. It is important to have both quantitative and qualitative indicators of how well the agency is progressing to achieve these goals.

The IRS has formulated three strategic goals. If progress is made on all three of these goals, we can be confident that the IRS is moving forward to achieve its mission and to meet the public's expectations for the agency. Many operational goals for components of the agency can also be formulated in support of the achievement of these strategic goals.

Top quality service to each taxpayer.

The first strategic goal is to provide top quality service to each taxpayer with whom the IRS deals, one at a time.

The IRS has millions of interactions with taxpayers each year, from the very simple to the very complex. The IRS provides forms, information and filing procedures to taxpayers who must file a return. This process should be made ever easier and clearer, reducing the chances of error and the time and effort required by taxpayers. Millions of taxpayers require information about their tax accounts with the IRS, or need assistance to know how much or how to pay. Taxpayers should be able to obtain information and have appropriate adjustments made to their accounts accurately, quickly and conveniently. In other instances, the IRS may intervene, in the form of an audit or a collection action, and may inform the taxpayer that the agency believes more taxes are owed. In these cases, taxpayers should be informed promptly and treated professionally and with full consideration of their rights.

Whenever the IRS deals with a taxpayer, the taxpayer should receive first-quality service and treatment that is helpful based on the particular situation and needs. Having a clear understanding of the facts and situation is critical to providing top quality service, since the proper application of the tax law is determined by the particular facts and circumstances of each taxpayer's case. This requires understanding both the taxpayer's situation and the law.

We will measure success in achieving this goal by the response of taxpayers to the service they receive from the IRS. As part of the new IRS performance management system, taxpayers who receive specific kinds of service will be surveyed and asked to rate the service. These transactional surveys can then be summarized to measure the overall trend in taxpayer satisfaction with IRS service. In addition, the overall ratings given to the IRS by taxpayers, as compared to other private and public sector institutions with which they deal, will be a key long-term strategic measure of success in achieving this goal. Finally, taxpayer dissatisfaction, as measured by taxpayer complaint and compliment trends, will be an important indicator.

None of these measures are yet in place at an acceptable level. Therefore, one of the major modernization components is improvement of performance measures, at both the strategic and operational levels.

While we do not yet have adequate strategic measures of performance in our *service to each taxpayer* goal, the indicators we do have of taxpayer views on IRS service show much room for improvement. A University of Michigan survey of people who had dealt recently with various public and private sector organizations ranked the IRS last for a number of years. The most recent summary of this survey, known as the American Customer Satisfaction Index (ACSI), is as follows:

Sector/Industry	1997 ACSI Rating	1998 ACSI Rating
Manufacturing/Durables	78.4	77.9
Automobiles, vans & light trucks	79	79
Consumer electronics (TV & VCR)	80	79
Major household appliances (washer, dryer, stove, refrigerator, dishwasher)	80	83
Personal computers	70	71
Public Administration/Government	62.4	64.6
Solid waste disposal service (suburban)	77	78
Solid waste disposal service (city)	73	75
Police service (suburban)	67	71
Police service (city)	63	63
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On the other hand, more limited surveys of taxpayer satisfaction with particular IRS services, such as Problem Solving Days, show consistently high ratings despite many taxpayers not receiving the outcome they sought. In fact, taxpayers attending Problem Solving Days consistently rated the IRS 6.5 on a 7.0 scale, regardless of whether they received the answer they wanted. This is a clear indication that taxpayers, as a whole, distinguish between the tax result and the quality of service they receive.

Top quality service to all taxpayers.

The second strategic goal is service to all taxpayers. We must apply the law with integrity and fairness to all so taxpayers who do not comply are not allowed to place a burden on those who comply. This aspect of IRS service is for taxpayers collectively and is important both to protect revenues flowing to the Treasury and as a matter of fundamental fairness. Our tax system depends on each person who is voluntarily meeting his or her tax obligations having confidence that his or her neighbor or competitor is also complying.

The overall measure of success in this goal is the total collection percentage. The collection percentage is the fraction of taxes that are actually paid as compared to those that would be paid if everyone paid what was due under the law. Another indicator of success for this goal is the uniformity of compliance, representing the relative degree of compliance among various economic sectors, different geographic areas, and different demographic segments. This is important for actual and perceived fairness of the tax administration system.

While we do not have reliable, up-to-date measures of overall compliance, the best extrapolations of previous studies suggest that noncompliance of all kinds was about $195 billion in FY 1997, which works out to about $1,600 per individual tax return. This same data indicates compliance is also quite uneven. For example, taxpayers who have primary income reported by third parties have, on the whole, a higher compliance than those who rely mostly on self reporting of income. Thus, there is ample opportunity for improvement on this strategic goal.

Noncompliance is not necessarily deliberate, but can stem from a wide range of causes, including lack of knowledge, confusion, poor recordkeeping, differing legal interpretations, unexpected personal emergencies and temporary cash flow problems. On the other hand, some noncompliance is willful, even to the point of criminal tax evasion. In the interest of fairness, it is vital that all parts of the noncompliance spectrum be addressed by the IRS.

Enforcement revenue is not a measure of success

It is important to distinguish the goal of *service to all taxpayers* by increasing overall compliance from the notion of "enforcement revenue." Enforcement revenue is any tax, penalty, or interest gained from a specific taxpayer by an IRS enforcement action, usually an examination or a collection. This revenue represents about 2 percent of the revenue collected by the IRS.

Historically, the IRS placed great emphasis on direct enforcement revenue, in part because it is precisely measurable and in part because it showed an indirect deterrent effect that increases compliance. However, there are many techniques other than direct enforcement that increased compliance at the IRS and elsewhere, such as better and more targeted taxpayer education, better reporting, voluntary agreements, improved regulations, and earlier intervention through notices and phone calls. Since 98 percent of the revenue comes in without enforcement action, an increase of 1 percent in voluntary compliance would be roughly equivalent to a 50 percent increase in enforcement revenue. Also, enforcement actions are expensive because they are labor intensive and often lengthy, sometimes extending for years after the tax was due. Therefore, *enforcement activity is a vital component of a strategy for achieving overall compliance, but it is not the only component.* Moreover, *enforcement revenue is not a good measure of success in achieving the strategic goal of service to all taxpayers.*

Measuring compliance is essential

The IRS does not have reliable, up-to-date measures of overall compliance, nor of compliance by major sectors. The last major study on the subject was performed in 1988, and it relied in part on a previous study done in the 1970s. In order to measure progress on this critical goal and to avoid reliance on the more easily measured but flawed concept of enforcement revenue as a strategic measure, it will be essential for the IRS to develop regular and up-to-date measures of overall compliance.

As part of the Service's new balanced performance measurement system, business results will be measured as a function of both quality and quantity of work.

Productivity through a quality work environment.

The third strategic goal of the IRS is to increase productivity by providing a quality work environment for its employees. The IRS must not only provide top quality service to taxpayers, but it must do so efficiently, using the fewest possible resources.

Many private sector organizations demonstrated that to succeed in this area requires providing employees at all levels with high-quality technology tools, adequate training, effective management and active engagement in the goals of the organization. This is especially true in service organizations in which most front-line employees interact directly with customers. It is essential that employees clearly accept ownership of the goals of the organization, are given the support they need to provide good service to their customers, and are able to communicate upward effectively about the problems and obstacles they perceive stand in the way of good service. A December 23, 1998, article in *The Wall Street Journal* summarized prevailing views on this subject, describing a leading company, Sun Microsystems, as follows:

> *Sun polls its workers as often as monthly via an e-mail questionnaire about 'performance inhibitors' that have gotten in their way in the past month. The result, which Sun calls an 'employee quality index,' is part of a broader quality initiative that also gauges customer loyalty.*
>
> *'This isn't about an employee feel-good thing, but about the things Sun does that inhibit performance,' says Jim Lynch, Sun's director, corporate quality. Sun has found a strong link between the likelihood that employees will recommend Sun as a place to work, and the likelihood that customers will recommend it as a place to do business.*

The right work environment will help unlock employee potential. Companies and organizations that excel in customer service invariably have employees who feel respected as individuals and valued by management for the contribution they make to the overall service effort. A positive work place is free of discrimination, does not tolerate artificial ceilings and barriers to advancement, affords equal opportunity, and recognizes employee performance and potential. It is also a work place that is highly inclusive and seeks to make use of the diverse experience and talents of all employees.

The IRS budget is a small part of tax administration

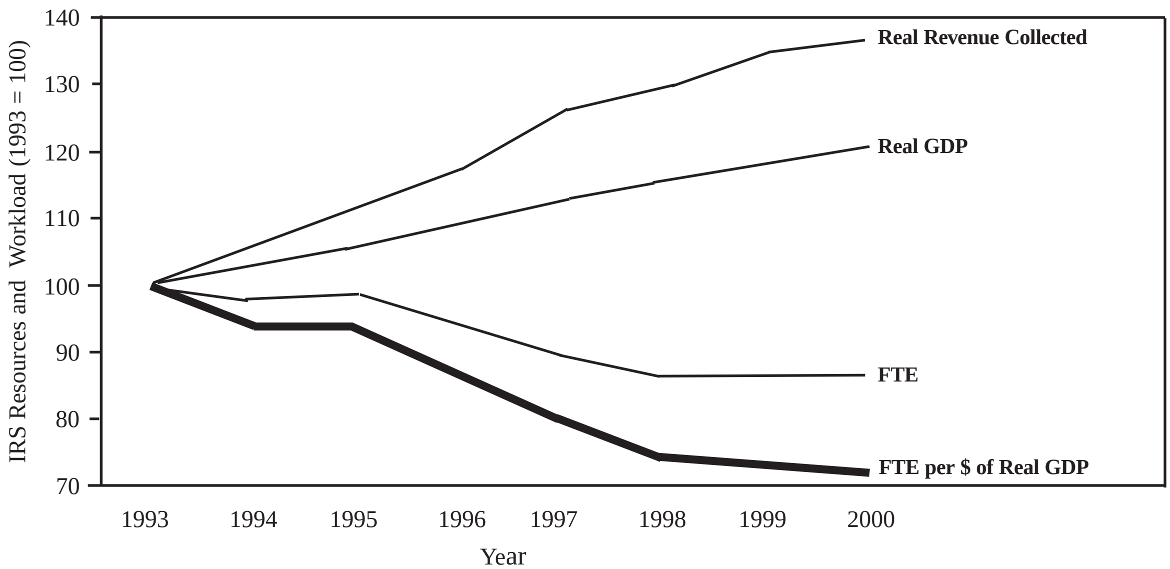
Looking solely at gross numbers, one might assume that the IRS was succeeding in recent years in achieving higher productivity. From 1993 through 1998, the number of IRS employees decreased from 115,000 to 98,000 while the economy grew in real terms by 17 percent and the number of tax returns grew by 8.2 percent. However, this reduction in the size of the IRS was achieved only in part by the increased real productivity. A greater part of the reduction was achieved by the failure to meet the public's service expectations as to how they should be served, which in part accounts for the concerted criticism leveled at the IRS in recent years. When considering the resources used in tax administration, it is important to consider all resources, recognizing that most of the costs, both direct financial costs and indirect costs of inconvenience, are incurred by taxpayers in complying with the tax laws. While measures are not precise, most estimate that the IRS internal budget represents perhaps 5 percent of total costs of tax administration in the economy.

Thus, a very small increase in the costs borne by taxpayers can easily offset any reduction in the on-budget costs of the IRS if service declines.

The IRS is shrinking compared to the economy

One measure of productivity success will be to hold the IRS workforce approximately level, while handling the increased workload from a growing economy, and improving performance on the other two service goals. Should the IRS be able to accomplish this ambitious goal, it will increase productivity at a rate greater than the private financial sector, and it will continue to shrink the size of the agency significantly in relation to the size of the economy, as shown below.

IRS Shrinks as a Fraction of the Economy



While the size of the IRS in terms of employment, and hence most operating costs, should be relatively stable in absolute terms and declining in relation to the economy, the agency will require investments over the next several years in order to implement the modernization program. The greatest part of this investment will be for replacement of technology, but some will also be required for redesign of the organization and business practices, training and facilities replacement.

As a part of the third strategic goal, measurement of employee satisfaction with the quality of the work environment should increase. Since 1993, the IRS has used employee surveys to measure these attitudes, but they need to be refined and included directly in our measures of performance.

If the IRS is able to achieve these three strategic goals, the benefits to taxpayers and employees should be concrete and noticeable, although they will take time to become apparent. The following three pages list some of the benefits that should be visible to individual taxpayers, small business and self-employed taxpayers and employees as the IRS succeeds in meeting its three strategic goals.

Modernizing America's Tax Agency

Benefits for Individual Taxpayers

- More useful help in understanding and filing your taxes
  - Special programs for retired people, students, homeowners, parents, low-income people, and other groups with special needs
  - Easier access to help through many more store-front locations; faster, easier access to telephone service, Internet access and e-mail
  - Expansion of easy filing programs like TeleFile
  - Expansion of cooperative programs with State revenue agencies to make joint filing easier

- Fast, accurate service if you have a question about taxes you owe or your refund
  - Service quality equivalent to the best private sector companies
  - Reliable, prompt access over the phone or in person with assurance of prompt follow-through on actions promised
  - Trained representatives who understand your problem and are committed to solving it
  - Clear acknowledgment of the resolution of your problem

- Professional, courteous help if you fall behind in paying your taxes
  - Representatives trained to help you find the best way of meeting your obligations and staying current in the future
  - Prompt attention to your account so you do not fall too far behind
  - Clear explanations of your obligations and rights
  - Prompt access to independent channels if you disagree about the amount you owe or how it should be paid
  - Well-defined, rigorous process for applying and relieving liens and levies when these actions are required to protect the public interest

- Professional, courteous treatment if your return is selected for examination
  - Representatives trained to help you understand any issues identified in your return and how to report accurately
  - Earlier attention to your return so you do not fall too far behind
  - Help in finding the best way of paying any additional obligations you may have
  - Prompt access to independent channels if you disagree about the amount you owe or how it should be paid

- Greater confidence that your fellow citizens are paying their taxes as required by the tax law in the same way you are, regardless of their occupation, location, type of business or income level

- Clear, effective means of identifying problems of law or regulation that cause unfairness or disproportionate administrative burdens on particular groups of taxpayers and communicating these to the right level of authority to fix the problem
  - To IRS headquarters if regulations need change
  - To Treasury and Congress if tax law needs change

Modernizing America’s Tax Agency

Benefits for Small Business and Self Employed

- More useful help in understanding and filing your income, employment and excise taxes
  - Special programs for occupations like farmers, taxi and truck drivers, doctors, artists, and independent software programmers
  - Special programs for each industry, like garment manufacturers, franchise retailers, start-up technology companies and many others
  - Easier access to help through many more store-front locations, faster and easier access to telephone service, Internet access and e-mail
  - Expansion of easy filing programs like TeleFile for 941s
  - Expansion of cooperative programs with State revenue agencies to make joint filing easier
  - Expansion of cooperative programs with your industry association to help you understand your taxes and simplify how you file and pay

- Fast, accurate service if you have a question about taxes you owe
  - Service quality equivalent to the best private sector companies
  - Reliable, prompt access over the phone or in person with assurance of prompt follow-through on actions promised
  - Trained representatives who understand your problem and are committed to solving it
  - Clear acknowledgment of the resolution of your problem

- Professional, courteous help if you fall behind in paying your taxes
  - Representatives trained to help you find the best way of meeting your obligations and staying current in the future
  - Prompt attention to your account so you do not fall too far behind
  - Special service for start-up companies
  - Clear explanations of your obligations and rights
  - Prompt access to independent channels if you disagree about the amount you owe or how it should be paid
  - Well-defined, rigorous process for applying and relieving liens and levies when these actions are required to protect the public interest

- Professional, courteous treatment if your return is selected for examination
  - Representatives trained to help you understand any issues identified in your return and how to report accurately
  - Earlier attention to your return so you do not fall too far behind
  - Help in finding the best way of paying any additional obligations you may have
  - Prompt access to independent channels if you disagree about the amount you owe or how it should be paid

- Greater confidence that your competitors are paying their taxes as required by the tax law in the same way you are, regardless of their occupation, location, type of business or income level
  - Close working relationships with your preparers and industry associations to identify problems and confusion and to clear them up in a cooperative way so as to ensure everyone is reporting and interpreting the law in the same way
  - Prompt identification and communication of compliance problems that affect an industry or group so that people do not fall behind and end up owing taxes they did not expect

- Clear, effective means of identifying problems of law or regulation that cause unfairness or disproportionate administrative burdens on small business and communicating these to the right level of authority to fix the problem
  - To IRS headquarters if regulations need change
  - To Treasury and Congress if tax law needs change

Modernizing America's Tax Agency

Benefits for IRS Employees

- Greater respect from the public
  - More cooperative, less adversarial relationship, similar to Problem Solving Day
  - Respect for an agency committed to change and improvement
  - Respect for quality of service provided
  - Public who believes you are a competent professional

- Balanced measurements comprising three categories
  - Customer satisfaction: customer view of service provided
  - Employee satisfaction: your view of service and satisfaction with your job
  - Business results: accomplishment of business goals
  - Emphasis on compliance, not only enforcement
  - Emphasis on quality as well as quantity

- Flatter organization structure will connect you better
  - Better communication of what and why things are happening
  - Better opportunity for you to be heard and influence the way things are done
  - Less time for "micro-management"
  - Managers are better able to provide you help and support

- Stabilization of work force
  - Reduce anxiety over downsizing
  - Provide some new opportunities

- Increased emphasis on training and quality
  - Clearer definition of jobs for service reps
  - More tailored training
  - Better tools (e.g., voice mail, e-mail, tax law access)
  - Exam and collection work force with renewed and clarified mission: not only what you do but why you do it
  - Training and tools comparable to private sector

III. Guiding Principles

In order to achieve the IRS' strategic goals, many changes and actions over many years will be required. Actions will be taken at all levels, from front-line employees to top managers. While each change and each action that moves the IRS toward its goals is valuable, it is useful in the midst of such great change to articulate some principles that guide as well as link our efforts. Articulating a list of principles does not imply that there were no principles guiding the IRS in the past or that this list is all inclusive. Instead, it serves to ensure the importance of the principles that are especially useful in the IRS today to guide our actions toward our strategic goals. These principles are a link between our strategic goals and the tangible changes we make and actions we take to achieve the goals.

Understand the customer's point of view and use this understanding to prevent and solve problems and provide quality service.

This principle is especially important at this point in IRS history, as it represents a significant shift in emphasis. This shift, from an internal focus to a customer focus, is one that many organizations undertook in the last 15 years, and has powerful and pervasive implications. As the IRS began to adopt this focus in recent years, practical examples of this principle have already had important effects.

For example, the IRS phone service improved a great deal, with level of service rising from 51 percent to 70 percent in one year, without actually answering significantly more calls. How? By recognizing that taxpayers typically call at certain times of the day or week and by adjusting the schedules of customer service representatives to be available at those peak times. Previously, call schedules were arranged mainly on internal convenience.

IRS Problem Solving Days are another example of this principle. They have been very highly rated by taxpayers and have cleared up many longstanding problem cases by understanding the customer's point of view. Some taxpayers needed to meet face to face with an IRS representative and needed convenient times to do this, and oftentimes the taxpayers' issues crossed IRS functional boundaries. By providing all the necessary expertise in one place at one convenient time, these taxpayers' needs were met.

Even the IRS quality measures for answering calls are changing to better reflect the taxpayers' point of view. Instead of rating the quality of answers against a test list of IRS-developed tax law questions, quality of actual taxpayer calls is rated.

Nearly every IRS activity and every employee's way of doing his or her job will be affected by adopting this principle. It should guide internal IRS activities as well. For example, those within the IRS organization who provide information systems services, facilities services or accounting services have internal customers, and it is vital to understand their needs to solve their problems.

While this principle has much potential to improve service to each particular taxpayer, it can also improve overall compliance. Since the IRS intervenes directly with only a very small percentage of taxpayers, gaining a clear understanding of what causes compliance problems in particular circumstances and situations is essential to address those problems effectively.

Enable managers to be accountable, with the requisite knowledge, responsibility and authority to take action to solve problems and achieve IRS goals.

This principle, while almost universally accepted as essential in any well-managed organization, is important to stress at the IRS at this time.

As the IRS grew and became more complex over the years, it has sometimes been difficult for managers to fulfill this principle, to the frustration of taxpayers, managers and employees alike. Lack of adequate knowledge by managers of the substance of a problem, or lack of authority to solve a problem, fuels this frustration. Taxpayer cases that remain unresolved for many years, overreliance on statistics as a management tool, and poor response from surveyed employees on questions about "trust of management" all indicate that commitment to this principle must be renewed at the IRS.

The proper application of this principle in the future means that managers at all levels will be expected to understand the substance of the matters for which they are responsible, see that quality work is performed, take action on solving problems within their domain, and participate actively with upper management to solve problems which require higher level action. Higher management must provide appropriate guidance, structure, training, management support and tools so that their subordinate managers can be accountable, and then, expect them to rise to the challenge.

A much greater level of meaningful communication between those responsible for policy and those responsible for execution will also be essential. It is not possible to be accountable for making policy without having an accurate and up-to-date knowledge as well as accountability for how policy is being implemented with actual taxpayers. Likewise, the valuable knowledge gained from work with taxpayers must be used to make constant improvements in policy and business practices. And if they understand the basis for the decisions that guide their operations, front-line employees charged with executing policy decisions through daily operations will be able to perform their duties more effectively and make more reasonable decisions.

Align measures of performance at all levels.

Everyone in the IRS shares responsibility for fulfilling the mission and making progress toward the IRS' strategic goals. Every employee is also evaluated against some standard of performance, which in turn is the basis for awards and promotions. It is vital that the standards used to measure and evaluate performance at all levels be aligned so as to encourage and reward performance that advances the IRS' strategic goals. It is equally important to avoid measures or standards that reward inappropriate actions or are subject to manipulation.

The lack of alignment of performance measures between managers and employees in recent years has been one of the sources of IRS problems in service to taxpayers and has undermined trust between employees and managers.

Because of the complexity and diversity of IRS operations, it is essential to have performance measures that are meaningful for each type and size of organizational unit. The operational measures for a call site answering tax law questions are different from those for a large-case exam group. The performance standards of an individual employee in these units must also be tailored to what is appropriate and measurable at each level. It is vital that whatever measures are used, they should, in the behavior that they encourage and discourage, be aligned at all levels, as well as with the three strategic goals of the IRS.

Foster open, honest communication.

It is not possible to solve problems that one does not know about or refuses to acknowledge. The more difficult or important the problem, the more essential it is for those at higher levels to come to grips with it as soon as possible. Open, honest communication at all levels is one of the most powerful principles of management for a large organization like the IRS. Problems should be identified, acknowledged, addressed and used as a learning tool for the future.

While this principle seems obvious and is well proven, it is often hard to live by, especially in a large organization. The well-known tendency to "shoot the messenger bringing bad news" undermines this principle. The often-desirable managerial trait to "present solutions, not just problems" can produce situations where major problems are not raised until too late. The natural tendency of preferring good news to bad works against this principle. And, the fear of negative public reaction can also suppress or delay acknowledgement of problems.

Notwithstanding the difficulties of following the principle of open, honest communication, this is an essential principle for the IRS, especially at this time. The massive degree of change being undertaken and the commitment to address fundamental problems mean that progress will be slowed and risk will be elevated to unacceptable levels unless this principle is embraced at all levels.

To foster open and honest communication, it is essential for top managers at the IRS to demonstrate their receptiveness to hearing real problems, and to avoid any hint of adverse consequences for those who raise up legitimate issues.

Insist on total integrity.

The modern IRS was formed with the fundamental objective of collecting taxes according to the law without corruption or political influence. As an agency that succeeded admirably in this purpose, the principle of integrity is not new to the IRS.

What is important at this time is to stress the breadth of this concept of integrity, hence the term "total integrity." Total integrity means each employee should perform all of his or her duties in accord with the public interest and not with regard to any personal interest. This concept includes but is broader than avoiding traditional offenses of corruption or political influence. It encompasses all matters of public interest, such as taxpayer rights, use of government resources, access to confidential information, internal and external reporting, personnel practices, procurement and travel activities, acceptance of gifts, and conflicts of interest while employed or afterwards.

While many matters relating to IRS integrity are codified in rules and regulations, adherence to the principle of total integrity means that each employee should not only observe the rules but also embrace the spirit of acting in the public interest. When there is doubt as to the right thing to do, there is a failsafe technique: ask for help from a qualified source and do not act alone.

IV. Business Practices and Strategies

The way the IRS interacts with taxpayers is defined by its business practices, such as how filing is done, what notices are sent under what circumstances, the way phones are answered, the way collections of balances due are carried out, and the way examinations are conducted. These business practices are carried out by the IRS' functional disciplines, principally Examination, Appeals, Collection, Criminal Investigation, Submissions Processing and Customer Service (the latter being an amalgam of functions, including examination and collection, which have in common that they deal with the taxpayer by phone or mail).

Closely related to business practices are IRS strategies that guide such practices, such as how returns are selected for examination, what kinds of compliance issues to emphasize, and how to encourage electronic filing. Strategies are ways of deciding how best to use limited resources to achieve defined goals.

Many IRS practices are codified in the Internal Revenue Manual and in various rulings and regulations. Both strategies and practices are also constrained by, and to a considerable degree, determined by, the established organization structure and the installed technology base, the two principle instruments through which the IRS executes its business practices and strategies. These interacting factors - business practices, strategies, organization and technology - are so tightly joined and interdependent that it is not possible to make fundamental improvements in any of them without addressing all of them in an integrated fashion. This is a key reason why past efforts to adopt very promising improvements in compliance and customer service practices have not been fully implemented, despite important successes on a limited basis. Conversely, programs to improve technology, while accomplishing important incremental improvements, have not succeeded in replacing the old and inadequate base of technology on which the IRS depends.

By revamping its business practices and strategy in ways that were successful in the private and public sectors (and often on a limited basis at the IRS), the IRS can make major strides toward all three of its strategic goals. These changes are discussed below in summary, but full implementation of these changes is a major undertaking and will take place over a period of years, depending heavily on requisite changes in organization and technology.

Prevent taxpayer problems or address them as early as possible.

One of the overriding themes in improving IRS business practices is to shift from addressing taxpayer problems well after returns are filed to addressing them as early in the process as possible, and in fact prevent problems wherever possible.

Malcolm Sparrow, of Harvard's Kennedy School of Government and one of the world's leading analysts of government compliance programs, said it simply:

> *Speed of reaction after the fact is considered second best; prevention is considered better, but is harder to quantify.*

This approach follows the well-established quality principle that it is far better for the customer and far less expensive to eliminate defects than to fix them. In making cars, for instance, it is very expensive to issue a recall because of a defect; it is less expensive to fix a defect before the car leaves the factory; and it is best of all to improve the design and manufacturing process so no defect occurs. So it goes with tax returns. As a rule, if a taxpayer files a correct return, no further costs are incurred by the taxpayer or the IRS. If the taxpayer makes an error, it is highly beneficial for both the IRS and the taxpayer to find and fix the error as soon as possible. If the taxpayer fails to pay the correct amount due, the sooner the issue is addressed, the lighter the burden on the taxpayer and the greater the likelihood that the IRS will receive payment. Interacting with taxpayers is a three-part process:

1. **Pre-filing:** services provided to a taxpayer before the return is filed to assist in filing a correct return.

2. **Filing:** services provided to a taxpayer in the process of filing returns and paying taxes.

3. **Post-filing:** services provided to a taxpayer after a return is filed, to identify and correct possible errors or underpayment.

Some of the services provided by the IRS in each of these categories, and the approximate distribution of IRS resources in each category, are shown on the following page.

IRS Activities

PRE-FILING
Customer Education and Assistance

- Forms
- Publications
- Web site
- Taxpayer education programs
- Public service announcements
- Volunteer tax assistance sites
- Toll-free tax law assistance
- Advanced pricing agreements
- Published tax law guidance
- Private letter rulings
- Determination letters
- Tip rate determination and education
- Letters advising taxpayers of potential problems:
  - Duplicate SSNs
  - Self-employment tax
  - Cash vs. accrual accounting methods

8%

FILING
Customer Account Services

- Processing paper returns
- Processing electronic returns
- Crediting payments
- Advising taxpayers of errors and balances due
- Arranging installment agreements
- Answering taxpayer inquiries about their accounts
- Making corrections and adjustments to taxpayer accounts
- Abating penalties on taxpayer accounts when appropriate
- Paying refunds

19%

POST-FILING
Compliance

- Auditing returns
- Recommending assessments if additional tax is due
- Arranging methods of paying off balances due
- Evaluating offers in compromise
- Taking collection actions, such as liens, levies and seizures
- Handling taxpayer appeals on assessments and collection actions
- Litigating disputes
- Detecting and investigating possible fraud
- Resolving complex taxpayer account and collection situations
- Evaluating and addressing "hardship" situations

73%

Percent of IRS Budget

NOTE: Budget figures exclude support programs such as IS and facilities.

The chart shows that the balance of IRS resources is heavily weighted to intervention after problems occur while relatively little is devoted to preventing problems, with 73 percent of the budget allocated to post-filing activities. In fact, nine times as much is spent addressing problems after the fact than is spent in preventing them.

Experience at the IRS and elsewhere shows that there are many opportunities to improve service and compliance and increase productivity by pursuing more aggressive use of techniques to prevent errors and address recurring and systematic compliance problems. (See Appendix 1.)

In addition, when taxpayer problems occur, it is important to intervene as quickly as possible, particularly in the case of underpayment or nonpayment. The key to effective collection anywhere is to identify as quickly as possible the potential risks of nonpayment and obtain an agreement to settle the debt.

However, today's IRS practices produce very late intervention in most cases. Over 90 percent of the working cases of IRS telephone and field collection personnel are more than six months old, and most are several years old. Examination of individual and small business returns often occurs six months to one year after filing, and completion of the examination requires an additional five to 12 months. Resolution of assessments which go into accounts receivable often does not occur for an additional two to four years. In effect, the majority of IRS resources today are being applied to address taxpayer errors or issues that arose three to seven years ago. One of the implications is that 64 percent of the amounts shown as owed by taxpayers in the GAO report on IRS financial statements is for interest and penalties, and only 36 percent is the original tax due.

While great gains in both service and compliance can be anticipated from changing these practices, implementing them fully is dependent upon changes in organization and technology that will require significant investments of time and money.

Improve communications with taxpayers.

The IRS communicates with millions of taxpayers each year through multiple channels: mail, telephone, Internet and in person. The communications have a wide subject range, from tax forms and publications describing how to file, to phone calls setting up installment agreements, to in-person meetings to resolve longstanding issues and disputes. Communications can be initiated by either the taxpayer or the IRS, and it is common for the same issue or subject to be addressed through multiple channels, e.g., when the taxpayer calls in response to a notice sent by mail.

IRS communications with taxpayers are not only diverse, they are extremely voluminous as well as complex in subject matter. The IRS currently provides 479 different tax forms, including 11 new and 177 modified forms as a result of recent tax law changes, and 105 publications. In 1998, the IRS mailed over 100 million tax packages to taxpayers and distributed an additional 650 million forms and publications, including over 40 million downloaded from our Web site. In 1998, the IRS sent taxpayers 105 million notices, received between 20 to 30 million incoming pieces of correspondence, and 143 million incoming phone calls on toll-free numbers, and served over ten million taxpayers in walk-in sites. Over 20,000 employees are dedicated solely to these tasks, and in total, over 70,000 employees regularly communicate with taxpayers.

The issues communicated through correspondence and phone calls are often more complex than those handled by typical commercial call centers. The average length of a call with a customer service representative on the IRS 800-number to respond to notices is eight to ten minutes, while the average talk time at a typical commercial credit corporation is 3.5 minutes.

Looked at from the taxpayer's point of view, the quality of service the IRS provides through these various forms of communications has been well below expectations. Since almost every taxpayer also deals with leading commercial companies in credit, direct mail and other similar operations, a comparison is readily available. Typically, such operations have a level of service such that a customer has a 90 to 95 percent chance of getting through on a given telephone call. As recently as 1997, the chances of getting through on the IRS toll-free number were 51 percent.

IRS written communications, such as notices, are widely criticized as hard to understand. Furthermore, the topics on which taxpayers are calling are often of great importance, creating high anxiety if the matter cannot be resolved quickly. For example, a taxpayer who calls in response to a balance due notice is subject to accumulating interest and penalties and levy of property if the matter is not resolved.

Improving convenience and quality of communications with taxpayers is one of the most important areas of improvement in business practices in a modernized IRS.

Some significant progress was made in 1998 and more is planned for 1999. This includes expansion of hours of phone service to 24 hours a day, seven days a week, improved scheduling and routing of phone calls to increase the chances of getting through, Saturday hours at 250 walk-in sites throughout the country, and rewriting of some notices to make them easy to understand. Also, the IRS Web site has been very successful, providing immediate access to all forms and publications and answers to many tax questions. In 1998, the IRS Web site had over 600 million "hits" during which taxpayers downloaded more than 40 million forms and publications.

In the longer term, the concept of a modernized IRS is to organize communications so that taxpayers can get accurate and prompt information and correct resolution of issues in a time and manner most convenient for them, whether by letter, phone, Internet or in person.

Given IRS operations' scale and complexity, this is a long-term task requiring fundamental change in all aspects of IRS operations, including organization and management, training of front-line personnel, internal and external distribution of information, information technology and performance measurements. Following are some examples of impediments to improving communications with our taxpayers that require fundamental change:

- Improving the level of phone access and providing 24-hour service requires managing calls and schedules on a nationwide basis, yet today most of the IRS' 24 call sites report to local service center or district directors who are responsible for a geographic area and who have differing technology and management practices.

- Improving the quality of call responses requires having front-line people who are properly trained and equipped to handle the subject matter. The complexity and diversity of the subject matter of the calls requires constant management of the way agents are organized and trained and the way calls are routed. This in turn depends on having management that is highly knowledgeable of the specific needs of the taxpayers being served as well as the ability to make constant improvements in the communications process. Yet because of their geographic focus, most call sites today attempt to manage communications for every taxpayer type on a wide range of subject matters, but do not have control over many aspects of the communications process.

- Improving the quality of all communications depends critically on providing the front-line employees access to accurate, up-to-date information about taxpayers' accounts and the ability to adjust accounts immediately when needed. IRS computer systems usually do not have this capacity.

- Improving the quality of communications requires an accurate system for measuring quality, from both a technical point of view and the taxpayer's point of view. In 1999, such a system of measures is beginning to be introduced.

- Improving the quality of written communications (including forms, publications and notices) requires incorporating user-friendly, educational, helpful, easy-to-understand language and complete data that helps taxpayers comply with their tax obligations. This requires a complete rewrite of most notices and often depends on displaying taxpayer account data that IRS systems cannot provide.

The modernization program is designed to address all of these impediments in order to improve dramatically the convenience and quality of communications with taxpayers.

Expansion of taxpayer rights.

Taxpayer rights include a wide range of protections and procedural safeguards designed to ensure that taxpayers get a fair hearing on their cases before the IRS takes any adverse action against them. In certain cases, the law requires that the taxpayer's personal circumstances must also be considered so that the taxpayer will not suffer undue hardship from an IRS action.

Taxpayer rights were considerably expanded in the IRS Restructuring and Reform Act of 1998, which included over 70 provisions concerning taxpayer rights. For example, some of the provisions in the bill are:

- "Due process in collections" provisions, which provide taxpayers facing collection action the right to have their case heard by the IRS Appeals office and potentially a court, prior to levies being made.

- Expanded “innocent spouse” provisions, that under certain circumstances, provide increased authority for the IRS to relieve spouses of liabilities incurred on joint returns.

- Expanded authority for the IRS to reduce taxes owed under certain circumstances.

- Change in “burden of proof” in certain court cases.

- Extension of privileged communications between taxpayers and attorneys to certain other advisors.

While the taxpayer rights provisions are now law and being implemented by the IRS, they are also consistent with and reinforce the direction of the overall modernization effort. Many of the modernization changes will increase the quality and effectiveness of the IRS in administering these rights. Of particular importance are the organizational changes that establish the National Taxpayer Advocate’s office as an independent structure within the IRS, and the revamping of performance measures to include taxpayer rights.

Broaden use of electronic tax administration.

Electronically-filed returns improve service for taxpayers and boost productivity by reducing errors, speeding refunds and reducing labor costs. While electronic filing has been increasing rapidly, 80 percent of returns are still filed on paper. Reaching the congressionally-mandated goal of 80 percent electronically-filed returns will require many improvements within the organization, such as enhanced IRS technology to allow filing of a full range of returns, resolution of security issues to eliminate requirements for separate signature documents, tailoring of marketing and education programs to attract taxpayers and practitioners with varying needs, and broadening the number of effective payment options in conjunction with filing.

The opportunities to improve business practices through electronic communications with customers and practitioners go far beyond filing of returns. Customer education and assistance programs through the IRS Web site, such as distribution of forms and publications and answers to tax law questions, are growing rapidly. Eventually, secure communication over the Internet with practitioners and taxpayers will be used more effectively to resolve taxpayer account issues, facilitating resolution of examinations, providing taxpayer authorized transcripts of their accounts, and generally improving the timeliness and quality of the full range of IRS interactions with taxpayers.

To date, IRS electronic tax administration programs were developed as specialized “add-on” programs. To realize the potential, they must be integrated into the basic ways of doing business throughout the organization, as well as into new technology programs.

Leverage IRS resources through effective partnerships.

There are many organizations and groups that are actively involved in tax administration and deal regularly with taxpayers. Among the most notable are State revenue agencies, tax practitioners of many kinds, industry associations, small business associations, federal agencies such as the Small Business Administration, hundreds of community and volunteer groups, services for low income and disadvantaged taxpayers, and large businesses and institutions offering tax filing assistance to their employees.

Historically, the IRS worked with many of these organizations to share information about IRS programs and taxpayer concerns and, in the case of States, to exchange information for compliance purposes. The IRS also has some joint electronic filing programs with States.

In the future, the IRS must place far greater emphasis on working in partnership with all of these groups to reach solutions on taxpayer issues, and especially to improve taxpayer education and assistance. Many of these groups established communications channels to millions of taxpayers and are enthusiastic about working with the IRS to help their members avoid tax problems. Many taxpayers are also more likely to listen to and trust information that comes to them from organizations with which they regularly deal and depend on rather than from the IRS directly.

The IRS has much to learn about specific taxpayer problems and concerns from the groups that are intimately knowledgeable about the taxpayer's point of view. Such an approach is very much in keeping with our guiding principle of "understanding and solving problems from the taxpayer's point of view." It is also a way of improving productivity, since a small investment of time and money in supporting a partnership with an organization of thousands of members is much more efficient than attempting to communicate directly to individual taxpayers.

The States offer special opportunities for using resources and improving service to taxpayers. Since most taxpayers deal with at least one State as well as the IRS, there is a great deal of overlapping information, providing significant opportunities for reducing the burden on taxpayers.

In order to implement improvements in business practices, the principle of effective partnership must be integrated into the basic structure of the organization and given sufficient management attention and support.

Tailor practices and strategies based on specific taxpayer needs and problems.

Just as companies develop particular products and marketing programs to reach customers with differing needs, most IRS business practices offer the opportunity for dramatic improvement by tailoring them to address particular taxpayer needs and problems. These needs and problems vary enormously, as just a few examples illustrate:

- Individual taxpayers with income reported predominantly by third parties have a much more limited set of reporting and payment problems than those with business income, but prompt payment of refunds is very critical to them.

- College students, whose returns can often be filed by telephone, have different service needs and preferences than senior citizens with retirement income.

- Large businesses, with extensive international activities, have a different set of tax problems that require much different service than small, start-up businesses.

An IRS working group recently studied taxpayers with only wage and investment income and identified groups of individual taxpayers with particular circumstances and needs (Exhibit A). To serve these taxpayers effectively, it is essential to understand their particular needs and circumstances and to meet them with appropriate services and programs.

Tailoring IRS services to particular groups of taxpayers is a cornerstone of how we can dramatically improve our service to taxpayers as well as increase productivity within the organization. Virtually all IRS services can be improved using this principle. Pre-filing assistance programs, such as customer education and telephone and Internet assistance, and publications and forms design, all represent obvious opportunities for more clear and effective communications. Filing-related programs, such as electronic filing, telephone account assistance and notices also need to be tailored to suit the needs of individual, small business and large business taxpayers. In addition, post-filing compliance programs offer major opportunities to allocate resources more effectively based on knowledge of specific issues affecting taxpayers in particular industries or

W&I TAXPAYER CHARACTERISTICS

Examples of Special Needs of Individual Taxpayer Market Segments

SEGMENT	PROFILE	KEY NEEDS	PROPOSED STRATEGY TO ADDRESS NEEDS
Segment I	• Simple returns; low income (<$30K); low tax understanding; language assistance; urban; possible dependents; possible compliance issues	• Face-to-face contact required; tax education; needs hand-holding; language assistance	• Focus on education about taxes; reach through walk-in centers; bi-lingual assistance
Segment II	• Simple returns; low to middle income; educated and computer proficient; understands taxes; prepare own returns; compliant	• Need for accurate and fast access to IRS (through Internet); answers to specific questions	• Aggressive marketing of e-commerce products; education on forms to file and taxation issues pertaining to them; greater access to electronic sites (e.g., through schools and universities)
Segment III	• Middle income families; average return complexity; familiar with taxation; typically paper filers; prepare own returns; compliant	• Reliable information on tax law changes, new forms and procedures; prompt and accurate response to queries	• Provide information on tax laws through direct mail; marketing of e-commerce products--migrating them toward e-commerce; provide more accessibility through new channels
Segment IV	• Complex returns, investment and schedules; high income; professionals and wealthy retirees; paid preparers; compliant	• Customized assistance through preparers; need help with complex problems; easy access to tax information through preparers	• No direct assistance required from IRS; focus on providing high-quality assistance to practitioners; leverage partnerships with practitioners to provide better service
Segment V	• Divorced/separated individuals; simple/average complexity of returns; low/middle income; low understanding of taxation; possible compliance problems	• Increased understanding of tax system; recognition of their circumstances--possible hardship assistance; accessibility to someone who will solve their problems; clear explanation of child support test	• Basic tax education (e.g., seminars on return preparation); hardship programs; outreach through divorce courts, single parent associations
Segment VI	• Balance due and non-filers; some understanding of taxes; possible fear of the tax system; low understanding of collection options; financial problems; withholding (W-4) problems; frequently ignoring notices, contact attempts; prepare own returns	• Understanding of the collection process, options and implications; understanding of withholding; accessibility to tax help; reduction of penalties for honest mistakes	• Aggressive marketing/clinics on collection options (installment agreements, offers in compromise and credit card settlement); information on reasonable cause incentives; providing specific help on the phone; quicker response to non-filing situations
Segment VII	• Elderly/retired; low to middle income; Social Security/pension-based incomes; simple/middle complexity returns; prepare own returns; not computer literate; value face-to-face contact; easy to reach through retirement communities	• Face-to-face assistance/education; information on Social Security/pension changes; desire to volunteer; increased awareness of investment tax law changes; assistance on return preparation	• Increased coordination with AARP and other relevant stakeholders; seminars and assistance on filing through community organizations; reach through VITA and TCE; joint ventures with Social Security, investment firms, banks, etc.

business situations. In turn, the post-filing knowledge gained from working with taxpayers in examination and collection can be used to develop improved guidance and education programs to prevent future problems, thus reinforcing the problem prevention strategy.

Understanding taxpayer problems and needs and tailoring and improving programs to meet these needs is so fundamental to meeting IRS strategic goals that it must be a key organizing principle for the way the IRS is managed.

Apply risk-based compliance intervention techniques.

Regardless of how successful the IRS is in preventing taxpayer errors, it will always be necessary to intervene through examinations, collection actions and investigations when noncompliance or nonpayment is found or suspected to be occurring. Since the IRS has limited resources, it is essential to apply resources where they will be of most value in reducing noncompliance, both in specific cases and in patterns of noncompliance. Strategies that target resources effectively benefit individual taxpayers by reducing the need to burden those taxpayers who comply. For example, the IRS was a pioneer in using statistical techniques in selecting tax returns for audits that were likely to contain an understatement of tax.

With the advent of many new best private sector practices, the IRS has an important opportunity to use the information it has to use compliance resources more efficiently. This is especially the case with respect to collections, where great progress in developing more effective collection techniques and practices has been made in both private and public agencies. The proven keys to effective collections are: (1) to identify as promptly as possible, using all available information, customers who may present a risk of nonpayment; and (2) to intervene in the most effective way, whether through mail, phone calls or in-person visits, to work out a payment program that addresses that particular customer's payment problem. This helps the customers as well as the collecting agencies, and limits the need for enforcement actions.

Although risk-based compliance techniques offer great opportunities for progress on all three of IRS' strategic goals, they are dependent upon clear, centralized management of compliance resources for relatively homogeneous sets of taxpayers. In addition, accurate, up-to-date data about taxpayers' returns and accounts, and modern technology such as constantly updated decision models, telephone dialing equipment that assists the operator in making calls and collection support systems are essential. Long-established business practices must be modified and updated.

Integrate compliance strategies.

The greatest payoff in progress on all three of IRS' strategic goals will come when all of the improved business practices can be implemented through effective and integrated compliance strategies. An integrated strategy is one in which the needs and problems of a set of taxpayers are clearly understood and all the techniques and resources from all the disciplines of the IRS are applied appropriately to solve those problems over a period of time.

Again, to quote Malcolm Sparrow:

> *In both Australia and California, renewed attention was paid to service functions, to public education programs and provision of timely and well-targeted information. But attention never wavered from the central mission of making sure taxpayers paid up, in full and on time. For any particular kind of identified noncompliance, the choice between using the "service arm," and the "enforcement arm," or something else became a matter of crucial professional judgment on which the public image and credibility of the agency depended.*

An example of such an approach was one successfully used in central California, which addressed a business segment that historically was highly noncompliant and where the taxpayers were often in an adversarial relationship with the IRS. This business segment is made up of agricultural farm labor contractors who supply temporary farm workers to farm operators. Before the new program began, relatively few contractors were compliant with employment tax and withholding obligations, as well as various State tax obligations. Working with an association of farm contractors and the State agencies, the IRS team was able to develop agreements as well as educational programs that persuaded most members to comply early, while working out acceptable arrangements for meeting past obligations. In particular, the IRS team forged an agreement with the State of California that made the issuance of State business licenses for farm contractors contingent on compliance with all federal and State tax laws. Only a very few taxpayers who blatantly refused to comply were investigated and prosecuted. The leader of this particular association was very vocal in his praise of this program because it eliminated in a practical way a major ongoing problem for most of his members, many of whom wished to be compliant but had difficulty doing so when the majority of their competitors were not complying. In 1993, businesses in the team's jurisdiction owed the government $11.1 million. As of 1997, that figure was down to $240,000.

The development and implementation of such integrated strategies on a large scale depends on having a clear understanding of taxpayer problems, an organization structure that permits comprehensive addressing of these problems, and appropriate performance measures to encourage and quantify progress.

As is evident from the above example, there are major opportunities for progress on all three of the IRS' strategic goals by revamping business practices and strategies and there are hundreds of specific actions that are required to implement these improvements. The National Performance Review study titled *Reinventing Service at the IRS* made 295 specific recommendations, most of which fall into one of the six categories discussed above, and many more have been identified from other sources. While some of these actions can and are being implemented quickly, the most important changes are dependent upon other fundamental changes in the organization, management and technology.

Through a rigorous prioritization process, 162 near-term initiatives to improve business practices have been identified; of these, about half are mandates. These near-term priorities are shown in Exhibit B.

Exhibit B: Near Term Improvement Priorities

Service to Each Taxpayer

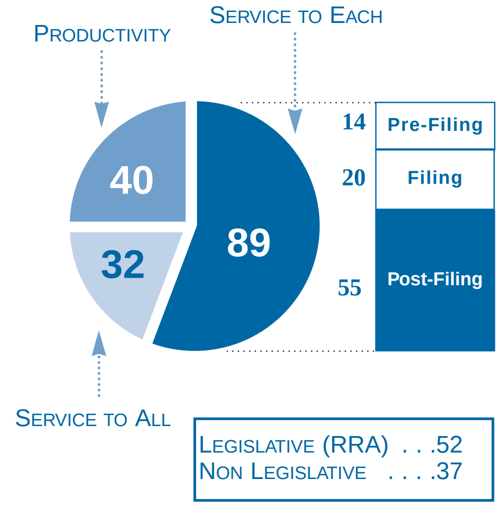
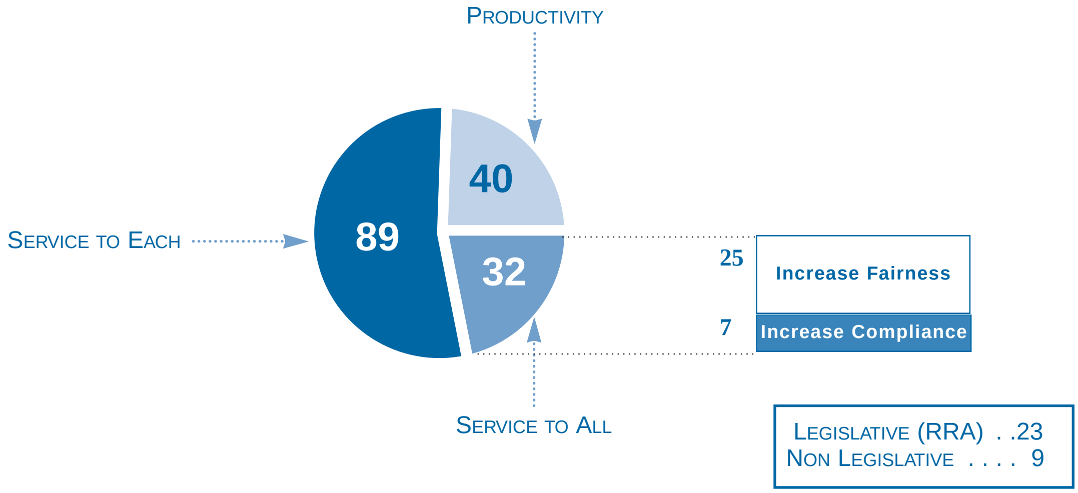
Making Filing Easier (Pre-Filing)	Improve taxpayer assistance by meeting demand and increasing accuracy. 1. Expand telephone service to 24 hours a day, 7 days a week. 2. Use call-routing technology to ensure better management of phone traffic. 3. Provide bi-lingual service on the telephone. 4. Provide nationwide access to the SERP, Servicewide Electronic Research Project.	Increase use of, and offer easy-to-use alternatives to, paper filing. 1. Implement actions to mandate electronic filing of Form 1065. 2. Accept alternative methods of payment. 3. Increase marketing of all e-file products. 4. Increase electronic options for businesses.		
Providing First-Quality Service to Each Taxpayer Needing Help with a Return or Account (Filing)	Meet customer demand for fast responsive account assistance by telephone. 1. Arrange for each local District Office to publish addresses and phone numbers in local telephone directories. 2. Complete Automated Collection System (ACS) redesign study. 3. Monitor and assess the Atlanta Consolidated Call Site Pilot (ACCSP) to determine if concepts merit Servicewide implementation.	Simplify notices and correspondence. 1. Improve written communications by rewriting notices in plain language. 2. Reduce volume of undelivered mail. 3. Flatten the notice issuance pattern throughout each year. 4. Include the name, telephone number and unique identifying number of an IRS employee on any manual correspondence.	Meet demand for walk-in assistance. 1. Expand and standardize hours of operation. 2. Improve availability of forms and publications. 3. Install Q-Matic at 15 additional sites.	Provide specialized products and services for small businesses. 1. Make technical correction to clarify the small business exemptions from the corporate alternative minimum tax. 2. Provide relevant information to new employers when they apply for a federal employer identification number (EIN). 3. Encourage the use of the EFTPS and STWRS. 4. Mentor and monitor New Employers prototype.
Providing Prompt, Professional, Helpful Treatment to Taxpayers in Cases Where Additional Taxes May Be Due (Post-Filing)	Protect taxpayer rights. 1. Place burden of proof on IRS in certain cases. 2. Expand innocent spouse relief, separate liability election and equitable relief. 3. Limit circumstances in which a taxpayer's residence or business assets may be seized. 4. Hold employees responsible for identifying any improper conduct affecting taxpayers. 5. Notify the taxpayer when a notice of federal tax lien has been filed. 6. Maintain records of taxpayer complaints of misconduct by individual employees.	Improve access to problem solving help. 1. Expand the circumstances under which the Taxpayer Advocate may consider issuing a Taxpayer Assistance Order. 2. Create Citizen's Advocacy Panels. 3. Inform public about the Taxpayer Advocate and publicize the Taxpayer Advocate's toll-free number. 4. Hold local Problem Solving Days (PSDs) at least through April 1999. Institutionalize PSDs into daily operations.	Broaden taxpayer payment options whenever appropriate. 1. Allow taxes paid by check or money order to be made payable to the United States Treasury. 2. Offer credit card payment for balances due. Seek credit industry partners to pilot test credit cards for taxpayers who file electronically in 1999. 3. Test Direct Debit Installment Agreement improvements (option to exclude "user fee" with direct debit of payments). 4. Change offer in compromise procedures to reduce taxpayer burden.	Identify systemic causes of account problems and develop solutions. 1. Address systemic causes of Audit Reconsideration issues by: A) Revising statutory notice processing. B) Reducing processing delays. 2. Obtain access to Financial Management Service's Check Information. 3. Implement Non-Master File (NMF) action plan. 4. After December 31, 1999, authority is given to extend 10-year collection period in certain circumstances.

Exhibit B: Near Term Improvement Priorities

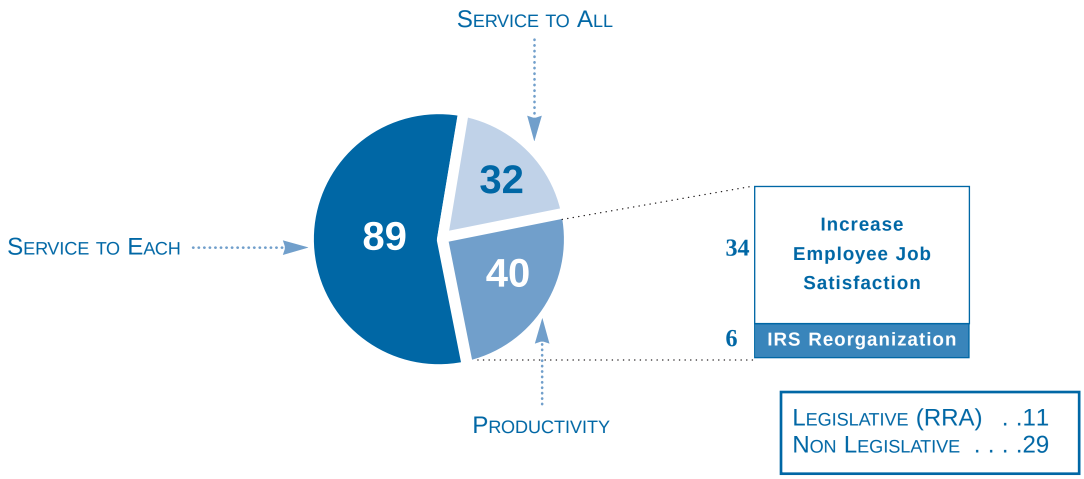
Service to All Taxpayers



Increase Fairness of Compliance	Pursue penalty reform. 1. Reduce the FTP penalty by 50% for individuals who timely file returns and pay by installment agreements. 2. Redesign all penalty notices and train Exam, Collection and Customer Service employees on who is authorized to approve initial assessments. 3. Investigate the appropriate level for penalty abatement via telephone. 4. Send a letter to business customers who have made first-time deposit errors to tell them the penalty has been waived and how to avoid mistakes in making their next deposit.	Ensure appropriate, fair and consistent use of compliance resources. 1. Develop and implement an approval process under which any lien, levy or seizure is approved by a supervisor. 2. Determine a minimum bid price below which the seized property must not be sold. 3. Establish a sunset date of 180 days for notices of intent to levy. 4. Revenue officers shall determine there will be sufficient net proceeds from the sale to apply to unpaid tax liabilities.
Increase Overall Compliance	Improve and increase use of "upstream" education and delinquency prevention techniques. 1. Award matching grants up to $100,000 per year to develop, expand or continue qualifying low-income taxpayer clinics. 2. Provide proactive education to taxpayers to inform them of potential issues that could create delinquent tax situations. 3. Improve the EITC program by implementing the EITC action plan, which includes: education, communication and assistance, prevention and identification, research, and math error programming for secondary TIN, age-related checks, etc.	Use research to identify potential areas of noncompliance and develop effective treatments. 1. Each year, conduct an analysis of the sources of complexity in administration of the federal tax laws. 2. Design a national compliance survey as an effective alternative to TCMP. 3. Continue to develop and refine alternative treatment revenue (ATR) methodologies to measure the effectiveness of non-enforcement compliance initiatives.

Exhibit B: Near Term Improvement Priorities

PRODUCTIVITY THROUGH A QUALITY WORK ENVIRONMENT



Increase Employee Job Satisfaction

Provide a quality work environment.

1. Establish a new workforce performance management system.
2. Replace existing workstations as required by the National Workspace and Occupancy Standards.
3. Increase top grade level for customer service representatives.
4. Change and continuously improve supervisory practices to enhance employee satisfaction at call centers.
5. Implement enhancements to e-mail and VMS.

Provide tools and training to enhance customer service.

1. Submit a comprehensive customer service employee-training plan to Congress.
2. Provide adequate number of telephone, fax and e-mail capabilities at each post of duty.
3. Create a training module on customer service for all functional areas.
4. Develop procedures to include user-friendly job aids as part of IRM 2100 to assist front-line Customer Service employees.
5. Provide electronic research tools to front-line employees.
6. Use capabilities of Performance Development System (PDS) to assess competencies and determine training needs.

Create an IRS culture that values employees and rewards top quality service.

1. Prohibit the use of records of tax enforcement in evaluating employees.
2. Revise IRS mission to focus on taxpayer needs.
3. Establish, as a standard practice, that all executives overseeing taxpayer contact functions will interact with taxpayers on a regular basis.
4. Use internal and external feedback systems to improve culture by:
   A) Improving customer feedback.
   B) Implementing tests in 4-8 field offices to improve operations based on customer satisfaction surveys.
   C) Implement customer satisfaction measures.

Ensure Successful Reorganization of IRS Structure and Management While Maintaining a Stable Workforce

Improve service by reorganizing and refocusing along customer segments.

1. Reorganize the IRS by establishing organizational units servicing groups of taxpayers with like needs.

Measure progress and performance against a balanced measurement system.

1. Develop a balanced measurement system that measures customer service, employee satisfaction and business results by:
   A) Aligning all IRS review systems (e.g., business review, peer review, etc.);
   B) Aligning critical elements of personnel standards into a balanced measures approach;
   C) Aligning the balanced measurement system into the modernized IRS.
2. Develop and implement a Centralized Quality Review System to improve quality measures and provide better feedback to CSRs and managers.

V. Organization and Management

Current IRS structure no longer meets our needs.

The organization structure is the vehicle through which decisions are made and actions carried out. The IRS structure as of September 1, 1998, is shown in Exhibit C. It is built around districts and service centers, the basic organizational units established many years ago, and evolved over decades. Today, there are 33 districts and ten service centers. Each of these 43 units is charged with administering the entire tax law for every kind of taxpayer, large and small, in a defined geographical area. Consequently, every taxpayer is serviced by both a service center and a district, sometimes more than one. Within each of these units, work is actually carried out by functional disciplines, principally Examination, Appeals, Collection, Criminal Investigation, Submissions Processing and Customer Service, the latter being an amalgam of collections, examination and general tax law and account information services provided by mail and telephone.

Service centers and districts each perform these functions for the same taxpayer, the responsibility shifting depending on whether the work is done by phone, mail or in person. For example, in the Collection area there are three separate kinds of organizations spread over all 43 operational units that use four separate computer systems to collect taxes. Each of these three units and four systems collects from every kind of taxpayer, from individuals to businesses.

Overseeing these operational units are four regions and a national office, which also operates three large computing centers. There are eight intermediate levels of staff and line management between a front-line employee and the Deputy Commissioner, who is the only manager besides the Commissioner who has responsibility over all aspects of service to any particular taxpayer.

This structure no longer enables the IRS to achieve its strategic goals. The cumbersome structure, matched by an inadequate technology base, represents the principal obstacles to modernizing IRS business practices and strategies and to delivering dramatic improvements in service and productivity.

A modernized structure built around taxpayer needs.

The IRS' modernized structure is similar to one widely used in the private sector: organize around customers' needs, in this case taxpayers. Just as many financial institutions have different divisions that serve retail customers, small to medium businesses and large multinational businesses, the taxpayer base falls naturally into similar groups. This concept has been closely studied since it was first proposed in early 1998. While many details remain to be worked out, the top-level structure is shown in Exhibit D. Please note all numbers are approximate and subject to change.

The key operational units will be organized into four operating divisions, each charged with full end-to-end responsibility for serving a set of taxpayers with similar needs. These operating divisions will be supported by three agency-wide service organizations: Counsel, Information Systems, and agency-wide Shared Services (providing common services such as facilities and procurement). Appeals and the Taxpayer Advocate will be nationwide organizations that provide separate specialized independent channels for taxpayers. (The placement of the Criminal Investigation

Exhibit C: IRS Current Organizations

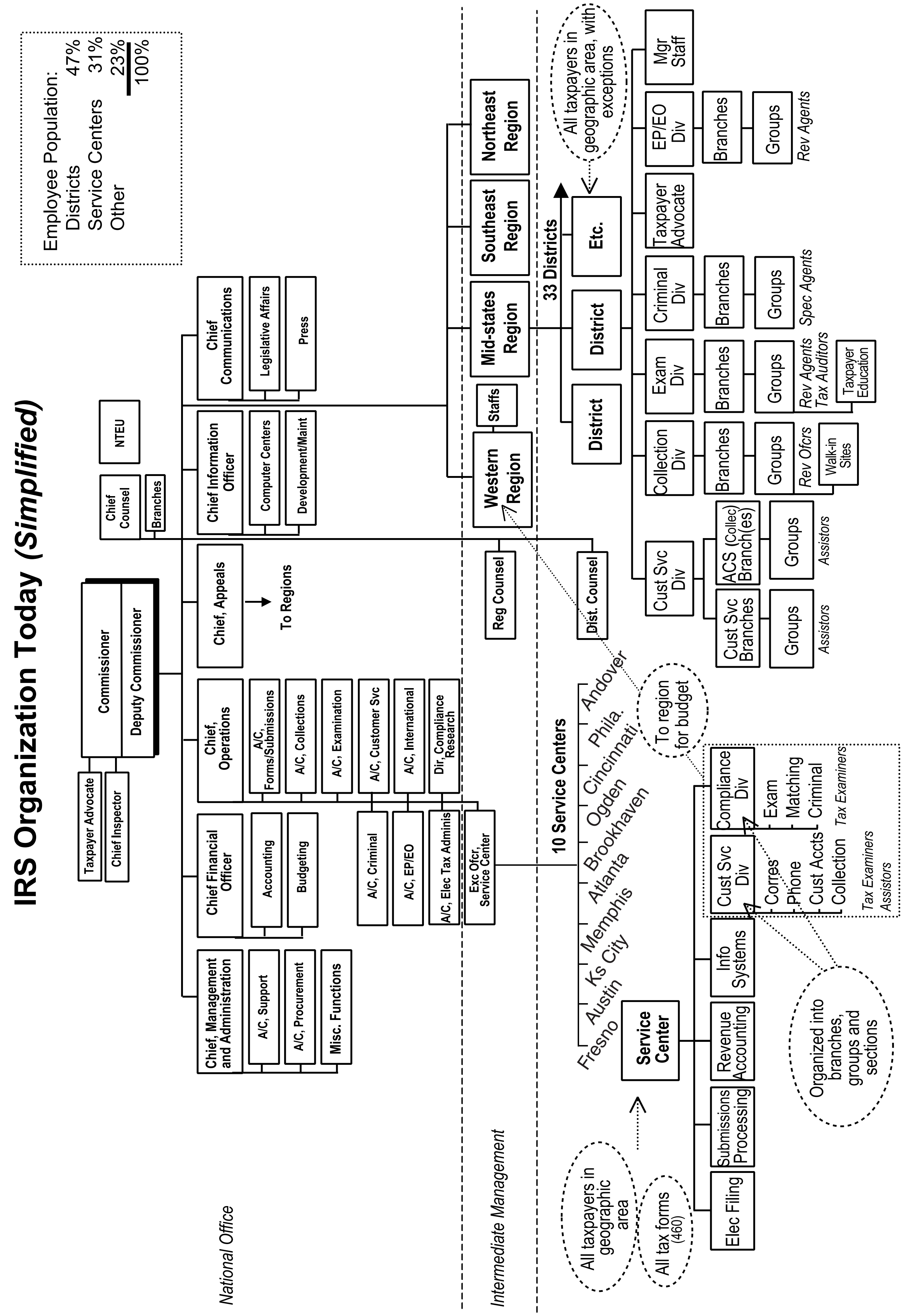
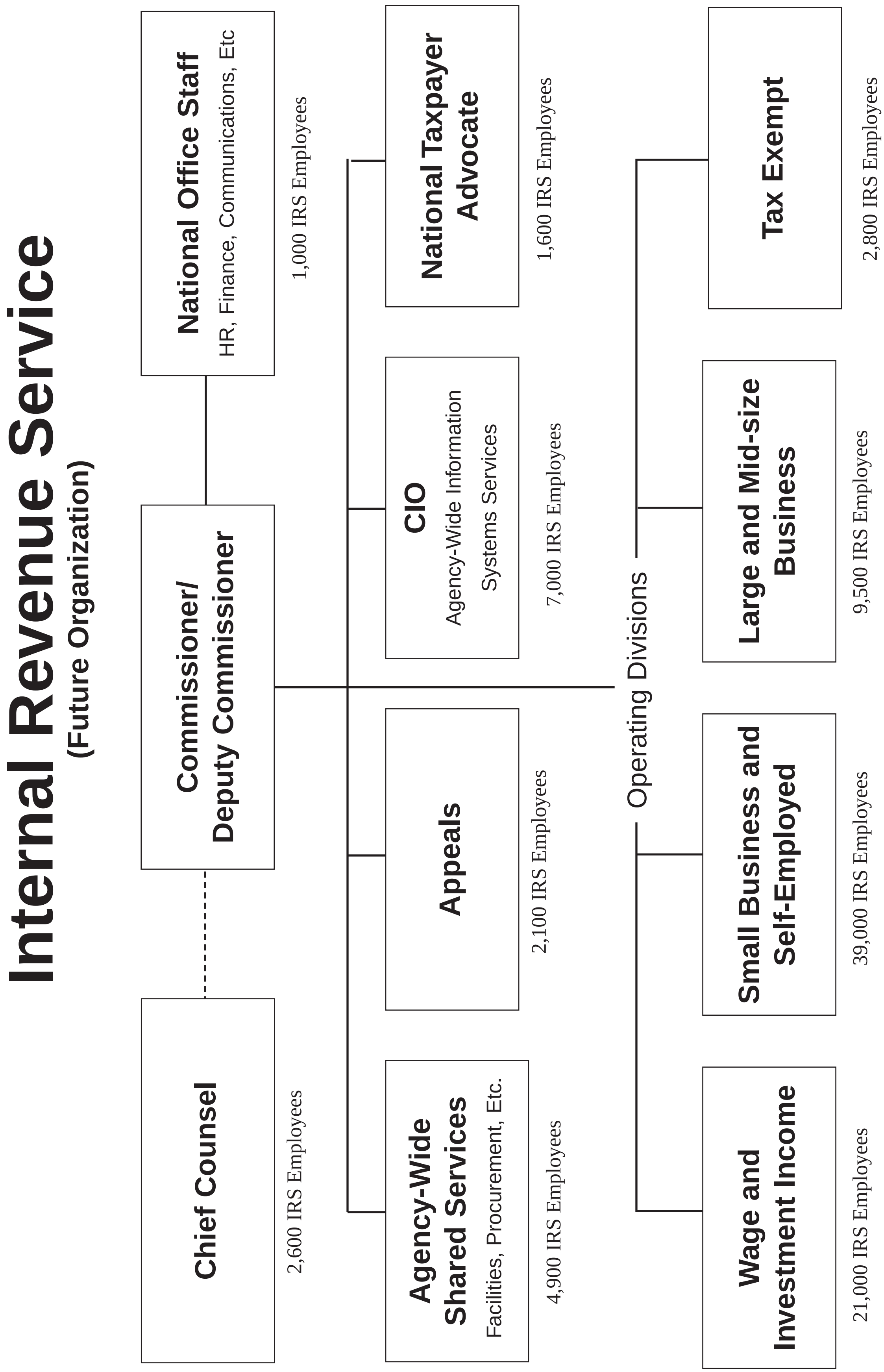


Exhibit D: IRS Future Organization



(NOTE: All numbers are approximate and subject to change.)

(NOTE: Placement of Criminal Investigation pending completion of Webster review.)

function has not yet been determined, pending recommendations from the ongoing review by Judge William Webster.) A smaller national office will assume an overall role of setting broad policy, reviewing plans and goals of the operating units, and developing major improvement initiatives.

The needs and problems of the taxpayers served by each of these operating divisions are very different, as shown in the table below, and consequently serving them effectively and efficiently requires different services and different ways of delivering that service.

Taxpayer Characteristics (Estimates)

	Wage & Investment	Small Business & Self-Employed	Large & Mid-size Business	Tax Exempt
Number of filers	88 million	40 million	170,000	1.9 million
Number of individual taxpayers	116 million	—-	—-	—-
Total tax liability (billions)	$258	$690	$352	$70
Average tax liability per filer	$2,928	$17,119	$2,073,300	$36,842
Gross cash paid (billions)	$38	$559	$689	$198
Average # of transactions with IRS per filer/year	1-4	4-60	60+	60+
Percent preparing own returns	59%	20%	—-	—-
Assets regulated	—-	—-	—-	$5 trillion
Average number of income tax forms	1.7	4	—-	—-

** Please note numbers are estimated and subject to change.*

The first of the four operating divisions will serve some 88 million filers. This group represents 116 million individual taxpayers, including those who file jointly, with wage and investment income only, almost all of which is reported by third parties. Most of these taxpayers deal with the IRS only once a year, when filing their return, and most receive refunds. Collection problems are limited since they pay only $38 billion in cash directly to the IRS, the balance of their liability being paid through withholding by their employers. Compliance issues are focused on a relatively limited range of issues, concentrated on dependent exemptions, credits, filing status and deductions. Roughly 60 percent of these taxpayers file their own returns, depending directly on the IRS or volunteer groups for education and assistance.

The second group of taxpayers includes fully or partially self-employed individuals and small businesses. This includes about 40 million filers. This group has much more complex dealings with the IRS than the wage and investment taxpayers. They have four to 60 transactions with the IRS per year and pay the IRS directly $559 billion in cash, representing nearly 40% of the total cash collected by the IRS. This amount includes personal and corporate income taxes, employment taxes, excise taxes and withholdings for employees, each of which has filing and technical requirements. Since business income and a range of taxes are involved, compliance issues are also complex. The possibilities for errors, resulting in collection and compliance problems, are greatest in this group because of lack of withholding or information reporting and the large amount of cash paid. The result is much more frequent dealings with IRS compliance functions.

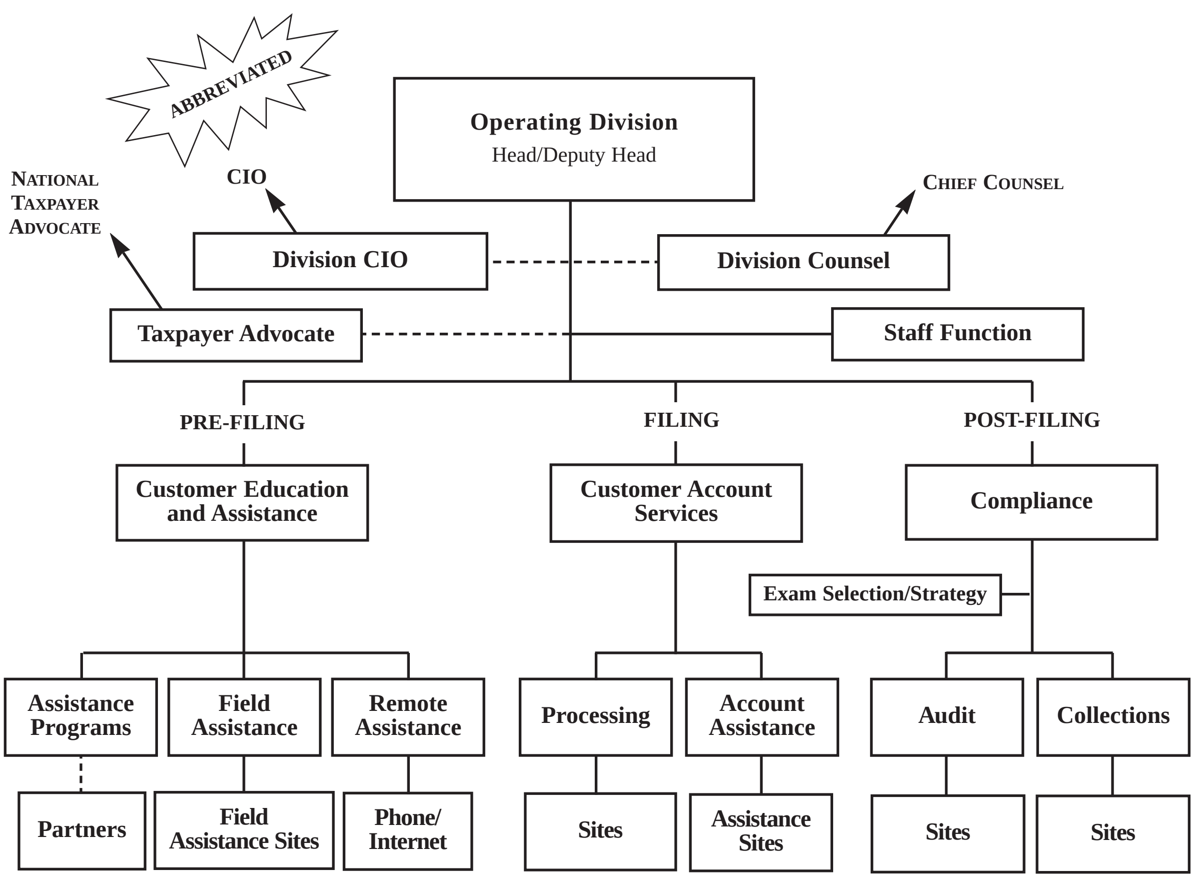
Large and mid-size businesses, comprising only about 170,000 filers, pay the IRS $689 billion in cash. This group includes corporations with assets over $5 million. While collection issues are rare, many complex issues such as tax law interpretation, accounting, and regulation, many with international dimensions, frequently arise. At least 20 percent of these taxpayers interact with IRS compliance functions each year, and the largest taxpayers deal with the IRS continuously.

The tax-exempt sector, including pension plans, exempt organizations and governmental entities, represents a large economic sector with unique needs. Comprising 1.9 million filers, this sector ranges from small local community organizations to major universities and huge pension funds. Although generally paying no income tax, this sector pays over $198 billion in cash in employment taxes and income tax withholding and controls about $5 trillion in assets. The IRS is charged with administering detailed and complex provisions of law that are generally not intended to raise money, but rather to ensure that these entities stay within the policy guidelines that enable them to maintain their tax-exempt status.

An example: The Wage and Investment Division.

By dedicating a separate unit with full responsibility for serving each set of taxpayers, the best internal structure and business practices to achieve our strategic goals can be developed based on the specific taxpayer needs and problems. For example, an overview of the proposed structure for the Wage and Investment operating division is shown below.

Wage And Investment Operating Division



Some key elements shown in this chart are as follows:

- A management team of about six top executives will oversee all aspects of service to these taxpayers. This team will be supported by dedicated senior executives from Information Systems, Counsel and Taxpayer Advocate. Thus, a team of manageable size will have the authority, responsibility and expertise to both oversee current operations and revamp and improve business practices and strategies to achieve our overall strategic goals.

- Internally, the division is structured around the three main areas where taxpayers require service: customer education and assistance, helping the taxpayers understand the law as it applies to them and to prepare correct returns; assistance in filing and gathering information about their accounts; and compliance interaction in the event of a reporting or payment issue.

- This structure facilitates proper emphasis on prevention of problems and service to those customers who are attempting to comply. One of the three major line executives would be dedicated to customer education and assistance, tailoring it with even more specific programs to meet the needs of various subgroups of taxpayers.

- The structure provides for serving taxpayers in the manner most convenient and appropriate for them. For this group of taxpayers, most transactions can be done by phone, mail and eventually e-mail. All aspects of electronic tax administration hold great promise for improving service and productivity, especially to this group of taxpayers. However, a local field assistance organization is also provided for those taxpayers who need service in person. In addition to serving taxpayers directly, this field service organization would work to build partnerships with practitioners and other groups who assist this group of taxpayers.

- In the compliance area, development and execution of effective, risk-based strategies are made easier by the management of all collection and examination resources directly under a single compliance executive.

- In general, there are only about four levels of management, half the current number, between the top official and the front-line employee, facilitating effective two-way communication.

Each operating division will have a tailored structure.

Each of the operating divisions will be structured in a way to most effectively meet the needs of the taxpayers they serve. The Small Business and Self-Employed operating division, dealing more frequently with taxpayers on more complex issues, will have a compliance field organization including both examination and collection groups, reporting to a multi-functional manager. The Large and Mid-size Business operating division, which deals regularly with taxpayers on complex issues, will be predominantly a field organization that will be structured into five industry groups. The Tax-Exempt operating division will have support structures for each type of taxpayer it will serve: exempt organizations, pension plans and governmental entities, with common supporting elements.

The centralization of management of information systems resources under the Chief Information Officer and of other common services under a shared services organization will provide for efficient and standardized common services where appropriate.

The Chief Counsel will establish a senior legal executive as the Division Counsel for each operating division to participate fully in the plans and activities of the operating division management and to provide high-quality legal advice and representation.

The Appeals organization will remain an independent channel for taxpayers who have a dispute over a recommended enforcement action.

The Taxpayer Advocate organization will be geographically distributed to provide local contact with taxpayers, and also have a taxpayer advocate in each operating division to identify systematic problems in the division.

The reduction in layers of management and the number of separate major units will free up some personnel resources to increase support for customer education and assistance programs. Similarly, the reduction of separate operational units and the centralization of management of key functions such as processing, customer assistance and collection within each division, will ease standardization of business practices and introduction of new technology.

Modernized organization conforms to our guiding principles.

As seen through our guiding principles, the benefits of this new organization structure as compared to the current structure are apparent.

The modernized organization is built around specific groups of taxpayers with relatively similar needs. It is an inherently customer-focused organization with each operating division responsible for creating and executing business practices and strategies to meet those needs.

The modernized organization sets forth clear, end-to-end responsibility and authority for a top official, supported by a small top-management team, to serve a set of taxpayers. Equally important, since the taxpayers served are reasonably homogeneous in their needs, it will be possible and expected for the managers at all levels to be knowledgeable in the substantive problems and issues that arise in administering the tax law in their division. In the modernized organization structure, much of our complex tax law will not be relevant or important for the particular issues in each division, allowing the managers to focus on that which is important for their taxpayers. Therefore, we can expect managerial accountability for understanding the problems in their area of responsibility and for taking effective action to reach our strategic goals. The Commissioner, Deputy Commissioners and the national office staff, in turn, will be better able to perform their proper role of helping the operating units set appropriate strategic goals and overseeing their performance in meeting them, rather than engaging in detailed operational issues.

This structure is specifically designed to facilitate direct and meaningful two-way communication, both vertically and horizontally, within the organization.

The top management of the agency and of each major division will consist of a set of teams, each of which will be linked to the next level. For example, the agency top management will consist of the Commissioner, Deputy Commissioners, key staff executives and the heads of each major operating division, while top management of each major operating division will consist of its head, deputy head and its top four to six staff and line executives. The total number of management layers from the front-line employee to the top official in the operating unit will generally be about half the number found today. In addition, many cross-unit councils and networks of individuals with special expertise will be created (e.g., human resources, finance, collections, examination, research, public affairs, etc.), further helping an interchange of best practices.

Development of meaningful measures of performance that relate directly to achieving our overall strategic goals is difficult in the current structure because the operational units are too small and too heterogeneous. For example, it is not meaningful to measure overall compliance at the district level. On the other hand, the IRS as a whole is too large and diverse for such overall measures to be useful except as broad indicators. The modernized organization structure will ease the development of strategic measures for each major operating division that are both meaningful and aligned with each of the three overall strategic goals. In addition, the clear separation in the compliance functions of responsibility for compliance strategy, including selection of returns for audit, from execution will advance the use of appropriate operational measures.

Integrity in any organization is achieved primarily by clearly articulating shared values and expectations, reinforced by consistent leadership and decision-making, rather than by structure. Nevertheless, the modernized structure will contribute to achieving the principle of total integrity in two ways: by clarifying the role of the national office as one of oversight rather than operations and by establishing the Inspector General for Tax Administration as a totally independent agency within the Treasury Department.

Clear management roles redefined to achieve goals.

Closely related to the modernization of the organization structure is defining the skills and experience required for senior executives. The IRS has been a leader in the federal government in developing executives. The demanding process by which executives are selected and developed is very successful in producing leaders who thoroughly understand the IRS organization and practices. The drawback is that almost all executives have gained all their principal experience within the IRS.

There are many similarities between IRS activities and those of other private and public sector organizations, and the IRS has much to gain by synchronizing our best practices with the best of these organizations. Doing this effectively requires some selective recruiting of executives from outside the IRS. The current IRS organization makes it difficult to recruit and to assimilate outside executives and also makes it hard for IRS executives to fully learn and draw upon best practices from the outside.

The modernized organization, modeled after well-established structures and practices in other organizations, creates roles that are more comparable to those on the outside. This increases the possibility of selectively recruiting external executives with appropriate skills and experience. This model also makes the IRS more attractive to potential executive recruits. Their skills and experience will complement the essential skills and experience of executives developed internally, to the benefit of both. For example, there has historically been a Commissioner and a Deputy Commissioner at the top of the agency. We expect that there will be a similar senior management team for each operating division, with the possibility that one might be an executive recruited from the outside and one drawn from the inside.

In September 1998, a new top-management team for the IRS was constituted. This team included:

- Bob Wenzel, appointed Deputy Commissioner for Operations with responsibility for overseeing all IRS current operations. Wenzel is a veteran IRS executive who co-chaired the IRS Customer Service Task Force, a partnership effort between IRS, the Department of Treasury, the National Treasury Employees Union and the White House, which produced the much-acclaimed book, *Reinventing Service at the IRS.*

- John LaFaver, appointed Deputy Commissioner for Modernization with responsibility for planning and implementing the transition to the modernized IRS. LaFaver is an experienced State tax administrator known for converting State tax agencies to a customer focus through effective use of technology.

- Paul Cosgrave, appointed Chief Information Officer. Cosgrave had 25 years of experience in the information technology industry prior to joining the IRS.

- Val Oveson, appointed National Taxpayer Advocate. Oveson has experience in tax administration and public accounting, most recently serving as Chairman of the Utah State Tax Commission.

- Stuart Brown, continuing in his role as Chief Counsel.

- David Williams, continuing in his role as Chief Communications and Liaison.

As the new operating divisions are established, an important task will be forming top management teams. These management teams must include individuals with the broad range of experience and track record needed to lead each unit in the challenging dual task of managing current operations while modernizing business practices and technology to achieve our new mission and strategic goals.

A modernized structure with redefined management roles is one of the essential components needed to achieve our mission and strategic goals. This new structure will make it possible to modernize our business practices and our technology in order to deliver improved service and higher productivity.

VI. Information Technology

For any information-intensive service-oriented enterprise, such as the IRS, Information Technology has become and will continue to be a key resource on which all organizational performance depends. Hardly any large-scale business can sustain itself without effective, efficient information systems. The IRS is no different, yet is faced with some truly unique, world-class challenges that it must overcome in order to fulfill its mission.

Information technology currently in use.

The IRS' installed inventory of information technology is the principal tool that IRS front-line workers and managers use to deliver services to taxpayers and to manage the organization. Nearly all IRS employees depend on the IRS computer systems every day to do their jobs, including over 70,000 individuals who use these systems to provide direct service to taxpayers. In terms of resources, the cost of IRS staff and information technology makes up nearly the entire budget, with staff costs comprising 70 percent and information technology making up 18 percent.

The IRS technology inventory is very large and diverse, comprising at present approximately 84 mainframe computers from 4 vendors (IBM, Unisys, Hitachi and National Advance Systems), approximately 1,500 mid-range computers from 23 vendors, and over 100,000 individual computers. These computers run over 18,000 vendor-supplied software products and 50 million lines of IRS-maintained computer code. There are three major wide area data networks and 1,182 local area networks. The IRS voice network processes 143 million phone calls per year.

As in any information-intensive organization, the current IRS computer systems are a reflection and codification of IRS' established business practices and organization structure, as well as specific tax code provisions. For example, there are three different systems to support collection activities because there are three different kinds of organizational units that perform collection activities, each using particular business practices. The IRS inventory of hardware and software products is very heterogeneous, in part because each service center and region would sometimes procure different products and, even when using the same products, would use them in slightly different ways. In addition, IRS technology inventory includes many specific programs and systems that have evolved in response to specific provisions of the tax code. This process of change continues, with over 800 tax code changes and many procedural changes being implemented for the FY 99 filing season alone.

The large and extremely fragmented nature of the IRS technology inventory creates many problems, including high cost and poor service to end users, high costs and long timelines to implement changes and improvements, and difficult control and security issues.

IRS core data systems are fundamentally deficient.

While large in size, many of the IRS' information technology problems are similar to those of other large organizations that have installed technology piecemeal over a long period of time without a strong focus on professional management of information technology resources from the top. However, the IRS also has a very special problem that is a serious, on-going risk and a fundamental barrier to achieving its strategic goals. This problem is that the core data systems that keep records on taxpayers' tax accounts are fundamentally deficient.

The essential system on which all taxpayer accounts are maintained is called the Master File system. This system was developed in the 1960s in order to provide the first consolidated records of taxpayer accounts. It consists of a series of very large tape files, one set for individual taxpayers and another for business taxpayers. Since it is a sequential tape file, it cannot be updated directly. It is updated once a week based on input from other systems, a process that takes three days. From the Master Files tape system, some records are extracted weekly and are placed on a separate on-line system, the Integrated Data Retrieval System (IDRS), in each of 10 service centers. This IDRS system is used by most IRS customer service representatives and many other front-line employees. Dozens of other specialized systems extract and feed data back and forth through these two basic data systems.

Some of the implications of this situation are:

- Because of the delays in updating files and the lack of synchronization of data among different systems, IRS employees frequently have inconsistent and out-of-date data about a given taxpayer. For example, if a taxpayer calls in response to a notice with a correction to his or her account, the adjustment might not take effect for up to 16 days. In the meantime, additional notices might be generated or the taxpayer might call again without the IRS employee knowing what previous adjustments were already in process.

- The Master File computer programs are written to a design and in a language seldom employed anywhere today, and which have the severe limitations of 30-year-old technology. In addition, thousands of changes to the files and the computer code were made over the years, many of which are highly specific to particular sections of the tax code or to IRS procedures. Consequently, very few highly specialized programmers understand this system. Under these circumstances, the ability to maintain and change the system, even in response to mandatory tax law changes, is severely limited. Implementing revamped business practices, including electronic tax administration programs, is slow or even impossible.

- Because of the limitations of the core systems and the difficulty of changing them, many separate systems grew up to perform specialized functions. In addition to the problems of data synchronization, this situation leads to complex operational problems, great difficulty in making consistent changes to the system as a whole, and increases the chances of errors.

- Some tax law requirements and IRS practices simply cannot be accommodated within the limits of the Master File system, leading to situations where some essential taxpayer data is not even reflected on it. For example, the RRA provision for providing "innocent spouse" relief requires separating a single tax liability on a joint return for the spouses into multiple liabilities that must be tracked separately over time. As the Master Files were not designed for such situations and are limited by 30-year-old sequential file technology, it is not practical to keep such records on the Master Files. So, administration of separate files, and other programs, imposes additional costs and greatly increases the likelihood of error and delays in serving taxpayers. Several of the most severe taxpayer problem cases reported in the Senate Finance Committee hearings stemmed in part from the Master File system limitations.

- Although the Master File system holds the IRS' authoritative financial record for every taxpayer, it does not conform to accepted accounting standards. For example, a record of every transaction that affects a financial account should be maintained and be traceable to an original source entry. Amounts due for any taxpayer should be clearly identified as to the source and cause that produced the liability. The Master File system does not maintain this information because it was not designed to do so.

- By putting together information from various sources, the IRS was able to provide sufficient back-up to gain a clean GAO opinion on its 1997 audited custodial financial statements, but the GAO report cited as a material weakness the lack of a system that is able "to routinely generate reliable and timely financial information for internal and external users." In addition, the GAO cited as a material weakness the lack of a subsidiary ledger that tracks and accumulates unpaid assessments (i.e., amounts potentially due from taxpayers) on an ongoing basis. The lack of such standard accounting tools imposes on-going costs, impedes the ability of the IRS to serve taxpayers adequately and prevents the IRS from effectively addressing material weaknesses cited by GAO.

Since nearly all IRS systems and procedures require data on taxpayer accounts, the entire IRS inventory of systems is built on a fundamentally deficient foundation. The size of this inventory and databases is comparable to the largest in the world.

Given this situation, the IRS must replace nearly its entire inventory of computer applications and convert its data on every taxpayer to new systems. This must be done in conjunction with redesigned business practices, while continuing to provide service to taxpayers and to respond to ongoing tax law and other changes. This is a vast, complex and risky undertaking that will require many years to accomplish.

Modernizing IRS systems.

It is important to understand the kind of process needed to modernize IRS' systems. This process has sometimes been compared to designing and building a new airliner or a huge office building. While there are some similarities, this comparison fails to adequately convey the nature of the IRS technology modernization program. A better metaphor would be a project to redesign and rebuild a large, densely populated city, such as New York City, complete with rebuilding all the subways, utility lines, surface transportation and tall buildings, all without delaying or injuring any residents or businesses and while accommodating ongoing growth and changes in the daily pattern of living and working. Such a program is far too big, dynamic and complex to be implemented or even designed in detail all at once.

The approach that the IRS is taking to deal with this monumental task is to establish an overall architecture for a set of new systems that will accommodate all essential tax administration functions according to modern standards of technology and financial management. Achieving this new system architecture must then be accomplished by defining a sequence of targeted and manageable size projects (known as "releases") that meet important and specific needs while, at the same time, working to complete the overall architecture. During this process, the new and old systems must co-exist and must exchange data accurately for an extended period of time until data is gradually converted from old systems to new ones.

Given this situation, the existing inventory of installed operational systems, commonly called the "legacy systems," must not only be maintained to reflect annual tax law and other business changes. They must also accommodate additional changes in order to bridge to and from new technology systems and convert taxpayer data from old to new formats. **Therefore, the demands on the resources and management of the legacy systems staff will increase, not decrease, for the coming years as a result of technology modernization.**

In 1997, the IRS published a "technology modernization blueprint" which described a detailed target architecture, including technical, functional and data architecture. It also included a preliminary sequencing plan. This blueprint was an important and valuable step in the process of technology modernization.

The speed of implementation of the technology modernization blueprint is subject to three major limiting factors:

- Capacity to design and develop new business practices and systems;
- Capacity of the organization to manage the process; and
- Capacity to make changes in the legacy systems needed to support ongoing operations and temporary integration with new systems.

Of the three factors, the capacity to change the legacy environment is the most constraining. Hence, planning of the technology modernization with the ongoing management of the existing environment is critical.

Organizing to manage information technology.

Because of the close inter-relationships, programs to modernize IRS technology both depend on and enable modernization of the organization and business practices. With respect to organization, there are two important dimensions: how the IRS is organized to manage information technology itself, and how the operational units that manage IRS programs work with information technology to improve business practices and achieve our strategic goals. Improvements in both dimensions are essential in order for modernizing IRS technology to succeed.

Improvements in information technology organization are essential to achieve professional, high-quality results in resource use and in managing technology programs, including modernization of core business systems and management of the legacy systems.

Improvements in IRS business organization are essential to create business owners who have the knowledge, authority and commitment to develop improved and consistent business practices. This will also enable them to work in partnership with the information technology organization to develop and deploy appropriate technology that supports modernized business practices.

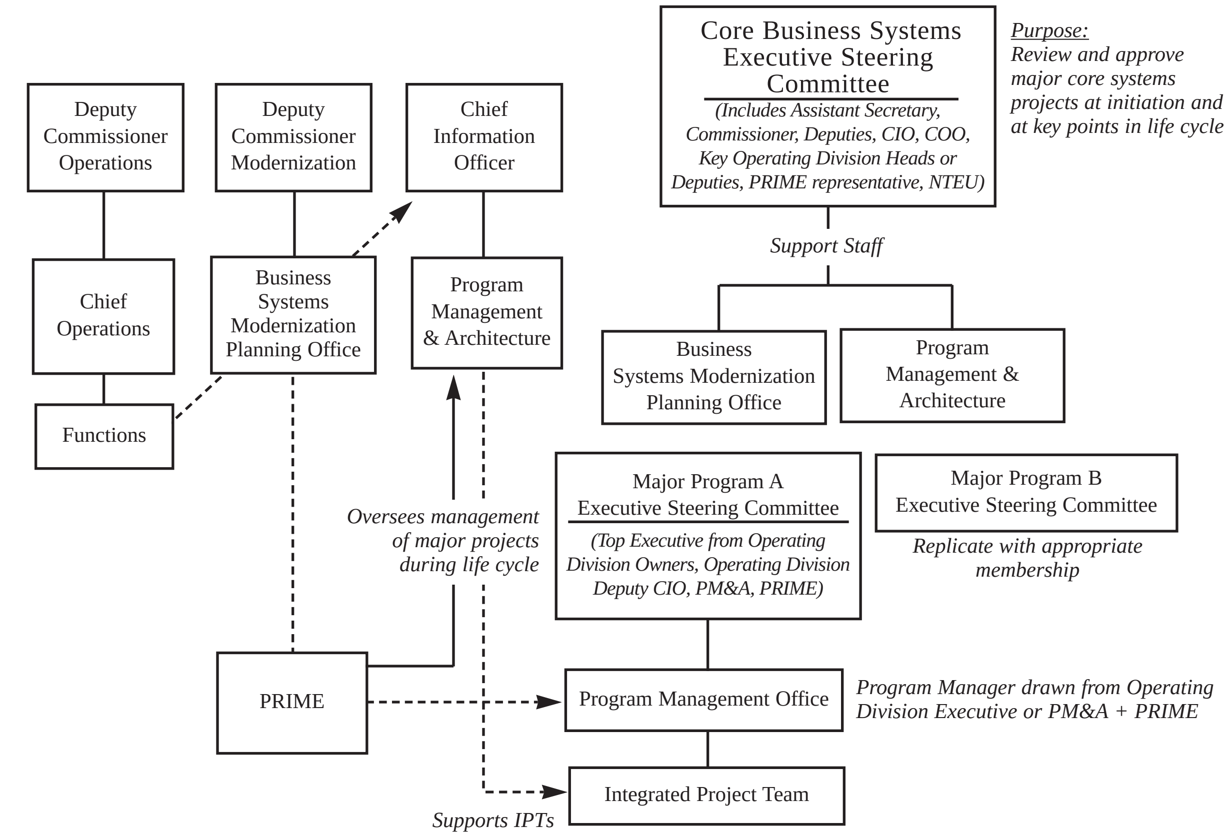
As part of the IRS overall modernization program, management of essentially all information systems resources was centralized under the Chief Information Officer in October 1998. This was a first step toward creating a professionally managed information technology organization that will provide high-quality, efficient service to all IRS operating units, treating the IRS operating units as customers.

The establishment of IRS operating divisions, as described in the previous section, will enable the appropriate business owner to revamp business practices and work with the information technology organization to modernize supporting technology.

In December 1998, the IRS awarded a PRIME contract to Computer Sciences Corporation and a team of leading technology and consulting firms to be a major partner in managing the modernization of IRS' core business and technology systems.

The modernization of IRS' core systems requires sustained leadership from the top leaders of the entire organization. To provide a framework for the overall management of this process, the IRS established in December 1998 a Core Business Systems Executive Steering Committee, chaired by the Commissioner and including top executives, supported by key staff groups, as shown on the next page.

Core Business Systems Management Structure



Some key operating guidelines about technology modernization were also established, including the following:

- All new systems, large and small, must henceforth conform to the target architecture or get an approved variance. The Program Management and Architecture office within the Chief Information Officer's organization will manage this process.
- All major projects must have committed, engaged business owners, an executive steering committee and an integrated project team. In addition, they should be designed to last a maximum of about 24 months from approval to proceed with development to initial operational deployment.
- Each project will require an approved business case before proceeding to the next phase.
- The process of developing solutions and approaches for each major project will include finding the best practices and products available from the private and public sectors as a basis for the proposed solution.

Initial objectives for technology modernization.

During calendar year 1999, the technology modernization program will focus on three major objectives:

1. Establishing a clear working governance and management process for core business systems modernization;
2. Launching the first releases for development and deployment; and
3. Creating a top-level, longer-range strategy for developing and deploying core business systems envisioned by the blueprint and for supporting modernized business practices in the new organization structure.

VII. Performance Measures

The techniques that an organization uses to measure its performance go to the heart of what the organization really values. In the IRS, as elsewhere, what the organization values is communicated through a variety of means, both explicit and implicit, including what behavior is rewarded, ignored or punished. Quantitative measures, being apparently precise and objective, are an extremely powerful device with great influence on behavior.

For many years, the IRS used statistics and measurements at all levels as part of its management process. A real strength of the organization is that people are used to dealing with hard data as an indicator of how things are working or not working, and they respond to and manage using this information.

For many years, enforcement statistics, especially enforcement revenue, were a key issue in measuring performance at the IRS. Enforcement statistics are counts of actions taken, such as number of levies or seizures, and enforcement revenues are counts of revenue gained from enforcement activities, such as audits or collection actions. Although the revenue that is actually collected (98% of which comes in voluntarily and 2% of which comes in through enforcement) is measurable on a fairly current basis, the total amount owed that is not collected is less easily measured and, in fact, has not been measured since 1988. In addition, enforcement action has been shown to have a deterrent effect that induces additional revenue from taxpayers other than those directly affected.

For these reasons, enforcement revenue has been a key measure of success at the IRS. Enforcement revenues have been used to justify the overall budget and have been a very important internal measure of performance. The chart below shows a one-page excerpt of the President's Budget for the IRS for fiscal year 1997. As highlighted, there are four references to enforcement revenues on this one page, three of them measuring a particular category of enforcement revenue per FTE (or per full-time employee).

Excerpts from President's Budget

Internal Revenue Service

Servicewide Performance Measures

	1996 actual	1997 est.	1998 est.
Objective Measures:			
Increase Compliance			
Total Collection Percentage (TCP)	86	86.7	87.3
Total Net Revenue Collected	$1.38T	$1.47T	$1.57T
Servicewide Enforcement Revenue Collected	**$38B**	**$34.7B**	**$35.2B**
Performance Measures By Budget Activity			
Telephone and Correspondence:			
Number of Calls Answered (in millions)	99.1	111.4	111.4
Telephone Level of Access	46%	60.2%	60.2%
Telephone Tax Law Accuracy Rate	91.6%	92%	92%
Automated Collection System (ACS) Dollars Collected per FTE	**N/A**	**1.4M**	**1.4M**
Tax Law Enforcement Performance Measures By Budget Activity			
Examination:			
Field Examination Dollars Recommended (in billions)	26.0	22.83	22.83
Field Examination Dollars Recommended per FTE	**1,089,661**	**1,008,348**	**1,008,348**
Appeals Non-Docketed Cycle Time (days)	234	238	238
Appeals Staff Days per Disposal	2.14	2.14	2.14
Collection:			
Field Collection Dollars Collected (in billions)	5.63	4.87	4.92
Field Collection Dollars Collected per FTE	**486,000**	**462,000**	**476,000**

The importance of enforcement revenue as a measure of IRS performance created a dilemma and a controversy that persisted for years. The dilemma was created by the fact that each specific enforcement action must be guided by law as applied to the specific facts and circumstances of the case and, therefore, it has long been considered inappropriate to give “quotas” or quantitative enforcement goals to an individual enforcement officer. For example, in 1959, in the wake of hearings by the House Ways and Means Committee, the IRS issued a policy statement that said:

> *If the duties of the position require the exercise of judgment based on detailed knowledge of laws and regulations or involve material factors of technical or professional judgment, performance must be evaluated in the light of the actual cases or other assignments handled, and no quantitative measurement may be utilized which does not take such differences into account. Dollar production shall not be used as the measurement of any individual’s performance.*

For the ensuing 40 years, this dilemma persisted, a history that is recapped in the preamble to the proposed regulation on balanced measurement, issued by the IRS in January 1999. (A copy of the regulation is attached as Appendix 2.)

In the 1990s, an attempt was made to increase the emphasis on enforcement revenue by establishing a quantitative performance index to rank the performance of the IRS district offices, an index in which enforcement statistics comprised about 70 percent of the weight of the index. This index was a very important factor in evaluating the performance of the district management. However, by law and regulation, these same measurements were not supposed to be used to evaluate front-line employees. As is now known, this approach resulted in a misalignment of measures for managers and employees, in turn causing a range of serious problems including widespread violations of the regulations on use of statistics.

Establishing a balanced measurement system.

Despite this difficult history, it is essential to establish appropriate quantitative performance measures for the IRS and its major component operations. This is required by the Government Performance and Results Act and is essential to the proper operation of any large organization. For this reason, an integral part of the overall IRS modernization program is the establishment of balanced performance measures which support and reinforce achievement for the IRS’ restated mission and overall strategic goals.

A critical aspect of establishing an appropriate balanced measurement system is establishing the measurements based on what we need and want to measure in order to achieve our strategic goals and mission, rather than simply what is most easily measured. This balanced measurement system must define quantities that are relevant to each of the strategic goals and that indicate in total, progress on all three goals. As in most good organizations, the process of measurement can be constantly refined, but the concept of what is being measured remains stable.

Also critical to the measurement system is following the guiding principle that measures must be aligned at all levels, from the top to the front-line employee. This creates a commonality of interest and binds the organization around a common goal, rather than creating conflict and mistrust at different levels. This principle does not mean that all levels and all components of the organization have precisely the same measurements, which would obviously be impossible. Rather, it means that the measures or evaluations are aimed at encouraging the type of behavior that will advance the organization’s overall strategic goals, and do not encourage inappropriate behavior.

In developing measures for each organizational level, it is important that each component of the balanced measurement system reflect responsibility at that organizational level. At the top of the organization, management has control over strategies and allocation of resources. At the mid-levels, managers have less control over these variables but do have control over the effectiveness of training, coaching and guidance of employees. At the individual level, each employee has control over his or her own individual work and self-development.

An overview of the balanced measurement system being implemented at the IRS is shown below. As seen in the matrix, there will be quantitative measurements keyed to each of the three strategic goals for each of three major levels of the organization.

Measuring Performance at the IRS.

Measures that measure what we really want.
Balanced Measures derived from three corporate goals.
Measures aligned at all organizational levels.

Goals	Strategic Management Level	Operational Management	Front-line Employees
Service to Each Taxpayer • Make filing easier • Provide first-quality service to each taxpayer needing help with his or her return or account • Provide prompt, professional, helpful treatment to taxpayers in cases where additional taxes may be due	• Overall customer satisfaction with service/treatment • Customer dissatisfaction (complaints) • Customer satisfaction compared to other organizations	• Satisfaction with particular service • Dissatisfaction with particular service	• Service to taxpayers and treatment of taxpayers incorporated in critical elements
Service to All Taxpayers • Increase fairness of compliance • Increase overall compliance	• Overall compliance percentage • Increase in compliance • Uniformity of compliance • Allocation of compliance resources - dollars vs. resources	• Quality of particular cases/events (EQMS/CQMS) • Quantity of particular cases/events	• Case quality and time management incorporated in critical elements
Productivity Through a Quality Work Environment • Increase employee job satisfaction • Hold agency employment stable while economy grows and service improves	• Overall employee satisfaction with working environment • Overall workload vs. size of workforce	• Employee satisfaction with particular working environment	• Now: None • Future: Contributes to improving service (TQO)

Measuring at the strategic level.

The strategic level is designed to measure overall performance for delivering on the overall mission and three strategic goals. This level is only meaningful for the organization as a whole or for an organizational component that is responsible for full service to a large set of taxpayers. In today's organization structure, strategic measures would only be meaningful for the agency as a whole. (A district, for example, is too small and heterogeneous to have a meaningful measure of overall compliance and does not have responsibility for the activities in the service centers in its district.) In the future organization structure, these strategic measures will be applicable for each of the four major operating divisions.

In the future, it will also be essential for the IRS to develop regular and meaningful measures of overall compliance. This is important not only for effective management but also for fundamental fairness, to assure taxpayers who pay their taxes that others are also complying. In the absence of such measures, informed decisions on strategies to encourage voluntary compliance, such as those discussed in the earlier section of this paper, Business Practices and Strategies, will be impossible, and the historic tendency to fall back on enforcement revenue as a measure of performance may reoccur.

In the balanced measurement system we are implementing, enforcement revenues are not a measure of performance at either the strategic or operational level. The sole use of enforcement revenue at the strategic level is to measure the effectiveness of case selection for compliance activities.

Measuring at the operational level.

The operational management level focuses on the effective execution of particular aspects of the organization. Today, these activities are mainly carried out by the "functions," such as Customer Service, field Collection and field Examination. A large percentage of employees work in these important components of the organization, and it is critical to develop appropriate measures of performance for them.

At this level, the balanced measures of organizational performance are derived as follows:

- The "service to each" goal at the operational level is measured from the taxpayer's point of view. Taxpayer satisfaction with the particular service is measured by surveying a sample of taxpayers who have transacted business with a particular IRS organizational component. As noted earlier in this paper, taxpayers have shown that, generally, they do distinguish between the professionalism and quality of the interaction and the tax result. Eventually, taxpayer dissatisfaction in the form of complaints will also be considered.

- The "service to all" or business results goal at the operational level is measured by a combination of case quality and neutral quantities such as number and mix of cases handled. Case quality is measured by a peer review that determines whether the appropriate issues were raised and appropriate actions were taken in light of the circumstances of the case. Enforcement revenue is not used at the operational level. Thus, if the appropriate result of an audit is that the taxpayer's return was correct, this "no change" audit would be measured as appropriate and high quality.

- The "productivity through a quality work environment" goal is measured at the operational level by employee surveys of work environment satisfaction. The purpose of these surveys is to determine, from the employee's point of view, whether they are receiving the tools, training and management support necessary to provide quality service to customers.

Measuring at the individual level.

All quantitative measurements are assessments of organizational performance, not of individual employees. This is always true because it is impossible to capture in any quantitative measurement system all that is important in evaluating an individual. For managers responsible for an organizational component, the quantitative measurements of the balanced measurement system are one of the factors that should inform a performance appraisal.

For front-line employees, quantitative measurements are not used to evaluate performance, except in certain submissions processing functions. This is because, in most cases, it is not practical to quantify the performance of an individual employee in a meaningful and appropriate way. Instead, the desired activities and behavior consistent with the strategic goals are incorporated into the "critical elements" of each employee's position description and should be evaluated by the manager based on informed observation of that employee's job performance. Thus, the front-line employee's evaluation, although not quantified, is directly aligned with that of the management chain.

Operational measures will be implemented first

The IRS is beginning to implement the balanced measurement system in 1999 with new operational measurements for three key functions within the organization: Customer Service, Exam and Collection. This level has the most direct effect on employees and taxpayers, and can practically be implemented within the current organizational structure and with data that can be assembled in the near-term. The new strategic measures depend on assembling data on overall compliance, which will take much longer to develop, and on establishment of the new organizational structure, which will have responsibility for more similar sets of taxpayers.

Implications for the way people work with each other and with taxpayers

The new balanced measurement system at the operational level is much more than a change in measurements. The measurements should never be used as an end in themselves, but as an indicator of organizational performance and a guide to improve performance. This requires an effort, every day, to "get behind the numbers" to understand what is really happening. It also implies profound changes in the way people work with each other within the organization and with taxpayers.

Concerning work with taxpayers, the changes implied are directly related to the restated mission. All actions must be looked at from the taxpayer's point of view and, in particular, must insist on observation of taxpayer's rights. This criterion is a strategic goal, a guiding principle of our modernization effort, and a direct element in measuring and evaluating the performance of every manager and employee. Good quality work is the result of understanding the taxpayer's point of view and the law, not one or the other.

The way managers and employees work with each other also will change. Their goals are aligned, even though the specific roles may be different, and achievement of the goals should always be viewed as a team effort. The managers' role is to develop a meaningful understanding of the work of their direct reports and to assist them in achieving the highest possible performance in contributing to the strategic goals. At the front-line level, since performance of quality case work is central to achieving the goals, it is vital for managers to work with employees and their customers to develop a true understanding of the strengths and weaknesses of the work and to assist in making the quality as high as possible. At higher levels of management, it is also vital to understand the taxpayers' and employees' point of view by direct communication with them about issues of importance in their work and to help them resolve difficult issues and remove obstacles.

Development of the balanced measurement system and, even more so, learning the new ways of working will take years. By focusing our attention on what is important for achieving our strategic goals, we will be on the right path and will make progress step by step.

VIII. Planning, Priorities and Risks

This paper has set forth major changes that the IRS is undertaking to achieve a restated mission and strategic goals that closely follow the expectations of Congress and the American people. Recapped earlier in the chart on page 4, these changes are comprehensive and are made up of business practices and strategies, organization and management, information technology and performance measures. This process, referred to as "modernization," represents a fundamental redesign of the way the agency works, a challenging process for any organization. These changes must take place while current, large-scale operations continue uninterrupted, including ongoing changes to implement new tax laws. In 1999, completion of the large amount of work to comply with the century date change is also essential.

Risks.

The amount of change required for modernization, coupled with current complex operations, means that there is significant risk that unanticipated problems will arise, particular plans or milestones may have to be changed, and operational errors will occur. When these events occur, time and money will be needed to address them.

Given the current situation at the IRS, there is no low-risk plan. Any attempt to retain the status quo or make modest incremental changes would increase the gap between the IRS' ability to deliver required services and what the public and Congress expect, while imposing increasing direct and indirect costs on the public for administering the tax system. In addition, the information technology on which the IRS critically depends is fragile and deficient and cannot be fixed short of a near total replacement. Yet, success in modernization of technology can only be achieved with the appropriate management and organization structure and a program to modernize business practices.

Although there are inherent risks in the modernization process, knowing that they exist means that they can be managed and mitigated so that no setback is fatal and we can be reasonably confident of ultimate success. In this regard, two items are critical:

- Setting overall priorities in light of the limited organizational capacity; and
- Establishing effective management over each major change process.

Organizational capacity and priorities.

The IRS, like any organization, has limited capacity to manage and absorb change. These limitations arise from such things as the capacity of the top managers to understand, plan and make correct decisions about the many complex issues that arise; the capacity of managers and employees throughout the organization to learn many new ways of doing business, new practices and technology; limitations on the number of subject-matter experts in highly specialized areas, ranging from tax law to technology; time required to consult outside and inside stakeholders; and time required to resolve disagreements. Because the IRS is a public agency that provides an essential service, capacity to make change rapidly is further limited by the need to ensure that essential services, such as the filing season, are never jeopardized and the financial integrity of the revenue stream is maintained. The inherent limitations of organizational capacity and the need to manage risk make it essential to set overall priorities in light of the overall goals.

Even before the redefined mission and modernization program were undertaken, the IRS organizational capacity was stressed to the maximum in an attempt to respond to thousands of individual recommendations from studies and proposals, as well as legislative mandates and tax law changes. This reactive process used up all available capacity without addressing the fundamental problems.

In order to deal with this issue, a set of programs was established to manage activities and priorities in an orderly way in each major area of change with an overall sequence that attempts to maximize the use of available organizational capacity, while gradually expanding it. This sequence aims at delivering on essential near-term operational requirements and improvements in service delivery while carefully planning and implementing longer-term changes. At a very high level, the strategy for each major change program is as follows:

- Century date change and essential filing season-sensitive changes are top priorities and are managed as one program.

- Near-term taxpayer treatment and service improvements are rigorously prioritized based on those that are either mandated or deliver maximum benefit to the taxpayer in 12-18 months, and are subject to the limitations of the existing operations and information services organization capacity.

- Organizational modernization is carefully designed, and a transition plan is being developed that phases in pieces of the new organization as rapidly as possible in light of the limitations in information systems and management.

- As the new organization is implemented, organizational capacity to manage business process and technology change will increase. There will be four management teams, each with full responsibility for a major part of the operation, as well as a new information systems organization.

- The new balanced measures are first introduced at the operational level, since operational measures depend less on the new organizational structure. As the new organizational structure is implemented, new balanced strategic measures will be developed.

- Technology modernization is phased in slowly during 1999. It will initially support near-term business process changes in customer service, and then ramp up as the new organization structures and management teams get in place. These teams are the responsible business owners who will revamp business processes and technology.

In 1999, the major milestones expected from this change program are:

- Complete and test changes to accommodate the century date change.

- Implement taxpayer rights provisions of IRS Restructuring and Reform Act of 1998.

- Complete 1999 filing season implementing high-priority service improvements, and plan for the year 2000 filing season improvements.

- Introduce new balanced measures for most operational field functions.

- Complete the blueprint for the new organization.

- Recruit and set up management teams for first two operating divisions and shared services unit. Begin operational implementation.

- Recruit heads of remaining operating divisions.

- Complete revised strategic plan for technology modernization and begin implementation of initial releases.

Risks and schedules.

An essential aspect of managing risk in this change program is properly managing and communicating the schedules and dates for accomplishing particular change events.

In this huge change process, there will be hundreds of specific changes implemented on particular dates. For example, an organizational change occurred when the field Taxpayer Advocates began reporting to the National Taxpayer Advocate instead of a district or service center; a new business system and process implementation occurred when the centralized call routing software began to route incoming telephone calls to call sites around the country; and a technology change occurred when the mainframe computer programs for the Brookhaven Service Center began executing on a consolidated computer in Martinsburg rather than on local computers in Brookhaven.

Every change of this kind carries with it risk, and the decision as to when and how to proceed must be carefully evaluated and reevaluated in light of all information available at each point in time. Every specific project that comprises the overall change program should be recognized as a learning experience in which more detailed and complete information becomes available over time. Proper risk management depends on constantly using this information to set and reset schedules. Failure to manage risks and schedules in this flexible way enormously increases the likelihood of failures and frequently ends up delaying, rather than accelerating, actual progress.

The role of high-level planning and the presentation of overall milestones, such as those presented in this paper, are to allow for the setting of priorities and the initiation of more detailed planning and implementation projects.

Given the nature of this change process, it is extremely important for management to keep all key stakeholders informed on a regular basis and to explain the intent of presenting various milestones and schedules. It is important for stakeholders to understand the nature of this process, and to evaluate the program based on overall progress towards the strategic goals, rather than placing undue significance on the date on which particular events occur.

Management process.

Since the IRS is undergoing extensive change in each of the dimensions described above while current operations continue uninterrupted, an appropriate management process must be established. Each of the dimensions of change affects various parts of the existing operations and requires both high-level leadership and decision making to address major issues and intensive daily management of massive levels of detail and analysis. Finally, each dimension of change requires special expertise and knowledge of best practices used in other private and public sector organizations around the country.

To manage these changes, the IRS established a tailored management process for each area of change. In each change area, an executive steering committee acts as the top-level governing body. The executive steering committee consists of the Commissioner and the senior executives responsible for all the major areas affected by the change. In addition, the Assistant Secretary of the Treasury for Management and the President of the NTEU are members of each committee.

The purpose of these executive steering committees is to provide consistent direction and prompt decision making on all major issues that affect progress in the change areas. Under the general direction of the executive steering committee, there is a program office headed by a senior executive that manages the on-going program and also provides staff support to the committee. The program office maintains plans, performs analyses and provides detailed management and guidance to whatever organizational components within the IRS are necessary for implementation of changes. In most of the change areas, organizational capacity is augmented and knowledge of best practices is provided by an experienced lead contractor.

The following table shows the top-level change processes in effect in 1999:

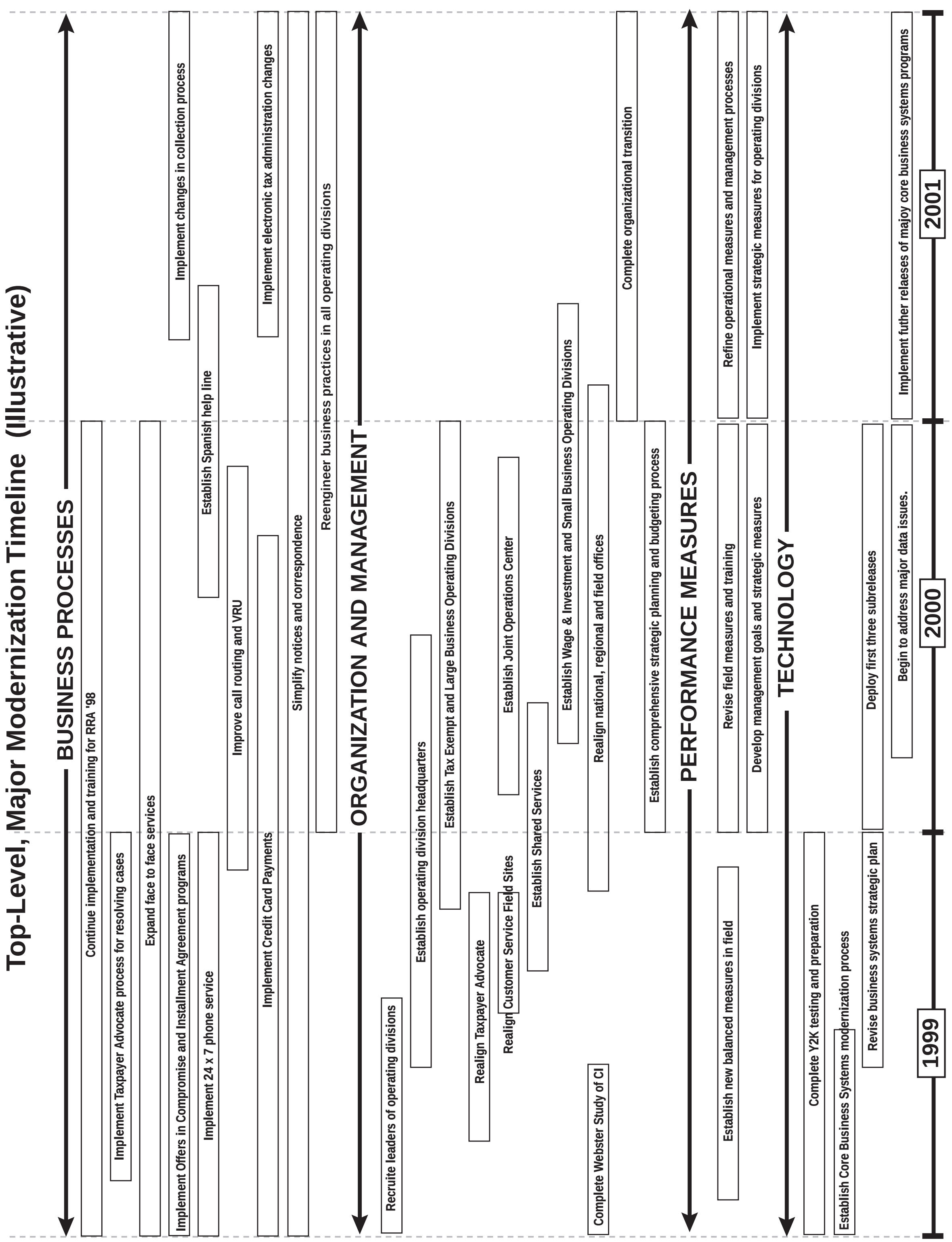
Executive Steering Committee	Top Executive	Program Office	Lead Contractor
Y2K/Filing Season	Chief Information Officer-Cosgrave	Y2K-Albicker/Yost	Various
Taxpayer Treatment & Service Improvement	Deputy Commissioner Operations-Wenzel	TTSI-Tomaso/Ross	None
Organization Modernization	Deputy Commissioner Modernization-LaFaver	Modernization Program Management-Stocker	Booz-Allen
Measures	Deputy Commissioner Operations-Wenzel	Measures Executive-Smith	Booz-Allen
Technology Modernization	Chief Information Officer: Program Management Deputy Commissioner Modernization: Strategic Planning	Program Management & Architecture-Mazei Core Business Systems Planning-Songy	CSC & PRIME team

Since the Commissioner, the two Deputy Commissioners and the Chief Information Officer are common members of these executive steering committees and also supervise all ongoing operations, high-level communications and coordination are facilitated.

An essential aspect of this change program is very active, ongoing, two-way communications within the organization at all levels and with outside stakeholders, including Congress, Treasury and numerous outside groups with an interest in IRS matters. In each change program, an important function of the program office and of the top executives is developing communications materials and personally meeting with many individuals and groups. This activity is coordinated through an overall modernization communications program managed by the Chief Communications and Liaison.

IX. Milestones

A timeline depicting the high-level milestones for the overall modernization effort is shown below.



Appendices

Appendix 1: Examples of Compliance Strategy

Duplicate SSN Project:

The Duplicate SSN market segment consists of individual taxpayers filing Forms 1040, 1040A, 1040EZ and 1040PC. It is made up of several distinct subgroups, involving duplicate use of SSNs for dependents, qualifying children for earned income credit and dependents filing a return and claiming themselves (dependent/ primary). Analysis revealed this compliance problem resulted in an estimated $1.8 billion revenue loss on 1993 returns.

The North Florida DORA profiled the duplicate SSN population, and as a result of its research, recommended a combination of treatments that included prevention, intervention and enforcement. It tested the use of soft notices to taxpayers as a treatment. The test showed a significant increase in compliance at a minimal cost.

Based on the promising results of the test, Customer Service implemented the soft notice treatment in December 1997 with the mailout of 2.1 million notices. Total costs were $1.7 million; revenue resulting from amended returns amounted to more than $67 million. Estimates of revenue protected are being developed.

Research has been expanded in FY 99 to study taxpayers with duplicate EITC claims and to study the duplicate SSN population that involves invalid SSNs. Plans are underway to develop treatments for the invalid SSN population similar to those used with the duplicate SSN population.

State and Local Government Employee FICA Coverage (Section 218) Strategy:

A report by the Social Security Administration Inspector General indicated a high level of public employer noncompliance with FICA and other related laws covering 86,000 State and local public employers. This report estimated a $17 billion loss in revenue each year — although follow-on discussions with SSA proved that this estimate had no firm basis in fact. As a result of this report, SSA requested that IRS mount an enforcement campaign to address the problem. However, a purely enforcement approach would have

- involved a substantial investment of high-cost enforcement staff,
- risked bankrupting many small public entities with one-year funding and
- created a new set of problems in collecting the deficiencies.

The Rocky Mountain DORA has been conducting a project to test a broad-based non-enforcement approach to bringing public employers into compliance and to provide a more accurate estimate of the associated tax liability. So far it has found that within its district's boundaries, public employers' noncompliance with the 1991 law accounted for $2.4 million in missing payments to Medicare and FICA. Research indicates a major reason for this noncompliance is the complexity of the rules associated with the public entities' responsibilities.

A task group comprised of representatives of IRS, SSA, Government Finance Association and National Conference of State Social Security Administrators developed an extensive outreach package for IRS district offices, which was distributed in November 1996. A national strategy of broad and focused outreach also has been developed to educate and improve compliance of public employers. The Rocky Mountain DORA is evaluating the results of its program currently, by measuring the compliance impact of its low-cost wholesale treatment approaches.

Self-Employment Tax (SET) National Strategy:

The purpose of the Self-Employment Tax (SET) Inventory project has been to test an educational letter as a means to improve compliance of the self-employment tax inventory, i.e., Forms 1040 with reported income that appears to be subject to self-employment tax. IRS estimates total noncompliance in this taxpayer market segment costs $105 million in uncollected revenue every year.

The Kansas-Missouri DORA worked with the Kansas City Service Center to test a compliance treatment on their center's unworked tax year 1993 SET inventory. The test consisted of sending an educational letter to a sample of these taxpayers, tracking responses and measuring the letter's impact on compliance.

The test showed that over half of the taxpayers determined to be liable responded to the educational letter by voluntarily amending their income tax returns and paying the additional tax in full. It was also determined that at least 43% of the taxpayers were not liable. Based on this successful test, Customer Service went to nationwide implementation in August 1998. Total notices mailed over a five-week period were 260,000. An additional 72,000 notices will be mailed January 14, 1999.

Tip Rate Agreements And Education Program:

In 1995, IRS estimated that the amount of tip income voluntarily reported was less than 50% of the true tip amount, leaving approximately nine billion dollars of unreported tip income in the food and beverage industry annually. Proper reporting would result in increases in both withholding tax liabilities and FICA liabilities of the employees and employers. This project is aimed at addressing noncompliance in this market segment nationwide.

The Tip Rate Determination/Education Program (TRD/EP), begun in October 1993, directed Examination field personnel to make contact with individual restaurants and secure Tip Rate Determination Agreements (TRDA). Under the program, the IRS works with restaurants to determine a fair tip rate to be reported by all tipped employees. These tips are reported to the IRS. The restaurant industry raised concerns about the accuracy of the established average tip rates. As an answer to the industry's stated concerns, the IRS worked with a coalition of representatives from the food and beverage industry to develop the Tip Rate Alternative Commitment (TRAC), which became available in June 1995.

Under TRDA/TRAC, in addition to one-on-one contacts with restaurants, the IRS has sent trained IRS personnel to speak to interested groups, such as local restaurant associations and practitioner groups. These personnel also teach workshops on tip reporting to tipped employees and write articles for local publications.

The number of employers filing Form 8027 under tip agreements increased from 12,421 in 1993 to 19,000 in 1996, a 53% increase. Total tips reported on Forms 8027 increased by more than $2 billion dollars from $3.9 billion in 1993 to $5.9 billion in 1996. During this period average tip rates increased from 8.2% in 1993 to 9.2% in 1996.

Cash vs Accrual Accounting Methods For Wholesale Market Segment:

The impetus for this project came from the New Jersey DORA and Examination Divisions who worked together to identify wholesalers who were improperly using the cash instead of the accrual accounting method. The District found a substantial compliance problem. Initial review of data by Exam indicated that there were over 70,000 wholesalers nationwide who may have a cash versus accrual accounting issue. Instead of starting with auditing a large number of returns, Exam decided to test an educational outreach program to change the accounting method used by wholesalers.

Letters were sent to 222 taxpayers in two states, asking them to review their accounting method. The letters included material to help evaluate whether cash or accrual was the appropriate accounting method and the name and number of a contact in Chief Counsel to answer questions. Initial findings showed that about 25% of these taxpayers voluntarily requested a change from cash to accrual resulting in significant Section 481(a) income adjustments.

Appendix 2:
Department of the Treasury
Internal Revenue Service

26 CFR Part 801

[REG 119192-98] RIN 1545-AW80

Establishment of a Balanced Measurement System

AGENCY:
Internal Revenue Service (IRS), Treasury.

ACTION:
Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the adoption by the IRS of a balanced system to measure organizational performance within the IRS. These proposed regulations further implement a requirement that all employees be evaluated on whether they provided fair and equitable treatment to taxpayers and bar use of records of tax enforcement results to evaluate or to impose or suggest goals for any employee of the IRS. These regulations implement sections 1201 and 1204 of the Internal Revenue Restructuring and Reform Act of 1998. These regulations affect internal operations of the IRS and the systems that agency employs to evaluate the performance of organizations within IRS and individuals employed by IRS. This document also provides notice of public hearing on these proposed regulations.

DATES: Written comments and electronic comments must be received by March 8, 1999. Outlines of oral comments to be presented at the public hearing scheduled for Thursday, May 13, 1999 at 10 a.m. must be received by Thursday, April 22, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-119192-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-119192-98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax__regs/comments.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Julie Barry (202) 401-4013; concerning submission of comments, the hearing, or to be placed on the building access list to attend the hearing, Michael Slaughter, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:
Background
This document contains proposed regulations to establish a Balanced System for Measuring Organizational and Individual Performance Within the Internal Revenue Service (26 CFR Part 801).

Section 1201 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA), Public Law 105-206 (112 Stat. 685, 713 et seq. (1998)), requires the Internal Revenue Service to establish a performance management system for those employees covered by 5 U.S.C 4302 that, inter alia, establishes "goals or objectives for individual, group, or organizational performance (or any combination thereof), consistent with the Internal Revenue Service's performance planning procedures, including those established under the Government Performance and Results Act of 1993, division E of the Clinger-Cohen Act of 1966 * * *, Revenue Procedure 64-22 * * *, and taxpayer service surveys.'' It further requires the IRS to use "such goals and objectives to make performance distinctions among employees or groups of employees,'' and to use "performance assessments as a basis for granting employee awards, adjusting an employee's rate of basic pay, and other appropriate personnel actions * * *'' Finally, section 1201 expressly requires that any performance management system adopted by the IRS conform to the requirements of section 1204 of RRA. Section 1204 of RRA provides that the IRS shall not use "records of tax enforcement results'' in the evaluation of IRS employees or to suggest or impose production goals for such employees. It further provides that the IRS shall use the "fair and equitable treatment of taxpayers by employees as one of the standards for evaluating employee performance.'' Finally, section 1204 requires that "each appropriate supervisor'' certify quarterly in a letter to the Commissioner "whether or not tax enforcement results are being used in a manner prohibited by'' that section.

Antecedents to Sections 1201 and 1204

Until the recent change, the Mission Statement for the IRS had provided, in part: "The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost * * *'' Consistent with this Mission Statement, the IRS has long adhered to the principle that all IRS officials with discretion to make decisions regarding enforcement matters in individual cases should do so only on the basis of the correct application of the law to the facts of each individual case. It has also sought to give the taxpayers maximum efficiencies in its day-to-day operations and has applied many modern management techniques to measure and encourage such efficiencies. In order to achieve these dual goals, the IRS has adopted a number of systems by which it sets goals for and measures the success of its various operating units, and directs the activities of its employees. The ultimate objective of these measurement systems is to help the IRS achieve its overall mission.

Measuring Organizational Performance

In General. The Government Performance and Results Act of 1993, Public Law 103-62 (107 Stat. 285 (Aug. 3, 1993)) (GPRA), requires the IRS and other federal agencies to establish a hierarchy of performance measures and goals applicable to various organizational units within their agencies. These performance measures and goals should be expressed in objective, quantifiable and measurable forms to define the level of performance to be achieved by a program activity. As indicated by the General Accounting Office ("Executive Guide: Effectively Implementing the Government Performance and Results Act,'' (GAO/GGD-96-118 at 24)):

[L]eading organizations * * * strive to align their activities and resources to achieve mission-related goals[;] they also seek to establish clear hierarchies of performance goals and measures. Under these hierarchies, the organizations try to link the goals and performance measures for each organizational level to successive levels and ultimately to the organization's strategic goals. They have recognized that without clear, hierarchically linked performance measures, managers and staff throughout the organization will lack straightforward roadmaps showing how their daily activities can contribute to attaining organizationwide strategic goals and mission.

The legislative history underlying passage of GPRA indicates that not only must performance goals be established on an hierarchal basis throughout an organization, but those goals must reflect the full range of the organization's objectives. As the Senate Report accompanying the Act indicates (S. Rep. No. 103-58, 103d Cong., 1st Sess. at 29 (1993)):

The Committee believes agencies should develop a range of related performance indicators, such as quantity, quality, timeliness, cost, and outcome. A range is important because most program activities require managers to balance their priorities among several subgoals. * * * Reliance on any single one of these measures could create a perverse incentive for managers to achieve one subgoal at the expense of the others.

As a government agency responsible for collecting 95 percent of the nation's revenues, the IRS adopted, pursuant to GPRA and other statutes \1\, a number of performance measures that focus on the amount of adjustments proposed by examination units or the dollars collected by collection offices. For example, the budgets submitted by the IRS since the mid-1990's have contained performance measures that were heavily focused upon enforcement revenue collected or protected. The two performance measures for field examination units contained in the FY 1997 budget request were examination dollars recommended and examination dollars recommended per employee (FTE). A similarly enforcement-focused set of measures applied to field collection functions: dollars collected, dollars collected per FTE, and average cycles per TDA/TDI (tax delinquency account/tax delinquency investigation) disposition.

\1\ Both the Chief Financial Officers Act of 1990, Pub. L. 101-576, 104 Stat. 2838 (1990), and Division E, National Defense Authorization Act for Fiscal Year 1996 (the Clinger-Cohen Act of 1996), Pub. L. 104-106, 110 Stat. 186, 679 (1996), also contain requirements that federal agencies establish performance measurement systems.

Measures of Special Compliance Programs

The IRS, apart from requirements imposed upon it by statutes and regulations of general applicability, has periodically been required by Congress to establish and to report on other performance measures. For example, in connection with expected additional funding promised for FY 1995 through FY 1999 pursuant to a Compliance Initiative, the IRS made a commitment to generate $9.179 billion in additional enforcement revenues. It was expected both to track how those additional funds were employed and to provide "quarterly reports * * * identifying the progress being made through these enhanced activities to collect taxes due.'' S. Rep. No. 103-286, 103d Cong., 2d Sess. at 40 (1994); see H.R. Rep. No. 103-534, 103d Cong., 2d Sess. at 33 (1994); "IRS FY 1995 Compliance Initiatives Final Report,'' Document 9383 (Rev. 1-96), Catalog Number 21508R. More recently, the appropriation for the IRS for FY 1998 provided additional monies for "funding essential earned income tax credit compliance and error reduction initiatives.'' The Conference Report accompanying that appropriation bill stated (H.R. Conf. Rep. No. 105-284, 105th Cong.,1st Sess. at 64 (1997)) that "the IRS should establish a method to track the expenditure of funds and measure the impact [of the additional funding] on compliance. The IRS shall submit quarterly reports to the Committee on Appropriations which identify the expenditures and the change in the rates of compliance.'' In the absence of accurate information regarding compliance rates, the IRS has attempted to comply with this congressional requirement by reporting, inter alia, on amounts of revenue protected or collected by various EITC compliance programs. See, e.g., "IRS Tracking Earned Income Tax Credit Appropriation,'' Document 9383 (Rev. 6-98), Catalog Number 21508R.

Measuring the Performance of Employees

The IRS also must comply with a variety of government-wide mandates to measure the performance of individual employees. The civil service rules require that the IRS evaluate the performance of employees on an annual basis. Performance evaluations also figure in recommendations for awards, incentives, allowances or bonuses, an assessment of an employee's qualifications for promotion, reassignment or other change in duties, and the ranking of other than full-time permanent personnel for purposes of release/recall schedules. While these individual performance ratings are based upon the elements set forth in various workplans and job elements, a manager's success in achieving organizational goals will inevitably play an important role in any evaluation of his or her performance. Other employees' performance with respect to items set forth in their job elements will be viewed in light of these goals.

Past Criticisms

Over the years, the IRS has been repeatedly criticized for placing too much reliance upon tax enforcement measures it has adopted. The critics have charged that front-line personnel have felt pressured by performance measures that were focused on tax enforcement outcomes, such as dollars assessed per FTE or dollars collected per FTE, to take inappropriate enforcement actions in order to achieve perceived enforcement goals. The bulk of this criticism has focused on the impact such tax enforcement measures have had upon field personnel in the examination and collection functions. For example, in 1955, a report by an advisory group appointed by the Chairman of the Joint Committee on Internal Revenue Taxation (The Internal Revenue Service: Its Reorganization and Administration, July 25, 1955, at 6) describes a 1954 initiative by the IRS to "establish specific office standards of production [for examination personnel in regional and district offices], so that both supervisors and employees know what is considered normal.'' This advisory group reported that imposition of these standards "appears to have caused a worsening of the enforcement picture.''

[U]nder the established production quota system proper standards of individual performance and proper standards of examination are ignored in favor of number of returns examined. The established production quota procedure has too frequently reduced the agent's investigation to a cursory examination of readily available records and a quick look for a few obvious items on which a change can be made so as to close the case and meet the quota set.

In 1957 and again in 1959, questions were raised during hearings before the House Ways and Means Committee regarding IRS production quotas. "Reorganization and Administration of the Internal Revenue Service,'' Hearings before the Subcommittee on Internal Revenue Taxation of the Committee of Ways and Means, 85th Cong., 1st Sess., at 118-119 (1957); "Income Tax Revision, Panel Discussions before the Committee on Ways and Means, House of Representatives,'' 86th Cong., 1st Sess. at 805, 808 (1959); "Compendium of Papers on Broadening the Tax Base Submitted to the Committee of Ways and Means,'' 86th Cong., 1st Sess. at 1527, 1533 (1959).
In November of 1959, the IRS issued a revised policy statement that provided, in part:

If the duties of the position require the exercise of judgment based on detailed knowledge of laws and regulations or involve material factors of technical or professional judgment, performance must be evaluated in the light of the actual cases or other assignments handled, and no quantitative measurement may be utilized which does not take such differences into account. Dollar production shall not be used as the measurement of any individual's performance.

Policy Statement P-1200-9, Approved Nov. 24, 1959

Questions regarding "the rating of revenue agents on the basis of numbers of examinations made and amounts of additional tax recommended'' were again raised during the 1961 confirmation hearings held for Commissioner-designate Caplin. Hearings Before the Committee on Finance, United States Senate, 87th Cong., 1st Sess., at 14-15 (1961).
Following his confirmation, Commissioner Caplin announced in July of 1961 that the IRS was embarking on a "New Direction,'' which was designed to counter what he described as the "undue emphasis'' placed upon production statistics and the "adverse effect'' the perception that production statistics formed the "main basis'' for evaluation of offices and individuals had upon examination quality. Under this "New Direction,'' production goals and statistics would be de-emphasized, statistical data would be given more limited circulation and qualitative measures of performance would be adopted. "New Audit Program Concepts: Views of Commissioner Caplin on Evaluation of Individuals, Programs and Offices in the Audit Activity.''
The following year, Commissioner Caplin issued a Special Message to All Audit Personnel, discussing some misunderstandings that had arisen regarding the new audit program. The Commissioner indicated that while supervisors were not allowed to evaluate performance on the basis of statistics or to pressure agents to produce deficiencies at the cost of inadequate audits or inequities to the taxpayer, nothing in the new audit program prohibited supervisors from keeping track of

the quality and amount of work produced by agents. Indeed, "this is exactly what the supervisor of a group of agents is expected to do.'' The Message went on to state "Special Message from the Commissioner,'' dated September 7, 1962, at 2:

More serious than these misunderstandings, is the fact that enforcement results have fallen off very substantially. Despite having 1,022 more agents and office auditors in FY 62 than in FY 61, the number of returns examined decreased by 13,000, while additional taxes and penalties recommended decreased by $66 million. You can readily see how this drop-off endangers our Long Range Plan for gradually increasing our manpower and doing our work more effectively. Under this plan, we have been allowed almost 10,000 additional people over the last three years, and it calls for the addition of about 24,000 more by 1968. Yet, when a substantial increase in staff is followed by this kind of a drop in our enforcement results, the appropriating authorities naturally begin to wonder about the wisdom of financing the rest of our proposed expansion.

Issues regarding the IRS' use of production statistics also came up during Commissioner Alexander's 1973 confirmation hearings before the Senate Finance Committee. When questioned about his opinion toward production quotas, Commissioner Alexander responded that he was completely opposed to their use. Hearings Before the Committee on Finance, United States Senate, 93d Cong., 1st Sess., at 4-5 (1973).

In November of 1973, the IRS adopted the current version of Policy Statement P-1-20, revising its policies regarding the use of records of tax enforcement results and prohibiting absolutely the use of enforcement statistics to evaluate the performance of enforcement personnel; this statement permitted the accumulation and use of enforcement statistics only for "long-range planning, financial planning, allocation of resources, work planning and control, effective functional management, or other related staffing utilization systems and plans.'' In an accompanying Special Message to all Enforcement Personnel, Commissioner Alexander stated that this prohibition was applicable to all personnel who exercised judgment in determining tax liability or the ability to pay. Commissioner Alexander further declared, "[i]ndividual case or dollar goals—formal, informal, or implied—are not permitted and will not be tolerated.''

During 1974, Senate Appropriations Committee hearings again focused on allegations that taxpayers were being mistreated as a result of production quotas (both case closings and dollar amounts). A number of witnesses and the Committee chairman expressed concerns that individual production statistics were being used to evaluate field employees, notwithstanding the existing policy. Testimony during those hearings also indicated that pressure to increase the number of cases closed in Collection directly led to inappropriate seizures. Hearings Before the Subcommittee on the Department of the Treasury, U.S. Postal Service, and General Government Appropriations of the Committee on Appropriations, United States Senate, 93d Cong., 2d Sess., at 2-25, 520, 543-546, 574-584, 586-601, 653-670 (1974); see also, "Taxpayer Assistance and Compliance Programs,'' Hearings before the Senate Committee on Appropriations, 93d Cong., 1st Sess. at 41-46, 568-569, 642-643, 680-681 (1974).

In 1988, the Senate Appropriations Committee held hearings focusing again on allegations that the IRS' use of enforcement statistics to evaluate programs and personnel had led to inappropriate enforcement actions. Treasury, Postal Service and General Government Appropriations, Fiscal Year 1989, Before the Committee on Appropriations, 100th Cong., 2d Sess. at 588-590 (1988). On November 10, 1988, the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647 (102 Stat. 3734 (1988)) (TBOR 1) was enacted. Section 6231 of that measure prohibits the use of records of tax enforcement results:

(1) To evaluate employees directly involved in collection activities and their immediate supervisors, or

(2) To impose or suggest production quotas or goals [for such employees and supervisors].

During the appropriation hearings for FY 1989, Commissioner Gibbs testified about the TBOR 1 prohibition (Treasury, Postal Service and General Government Appropriations, Fiscal Year 1989, Before the Senate Committee on Appropriations, 100th Cong., 2d Sess. at 589 (1988)):

The problem that I have with our policy statement—that policy statement, by the way, being in the taxpayer bill of rights—is that it tells our people what not to do. It says, "Don't use enforcement statistics.'' * * * I don't think that this helps someone on the front line very much to tell them what not to do.
What we have started, within the last 18 months that I have been the Commissioner, is to begin to develop at the working level criteria as to what constitutes a quality collection action, what constitutes a quality examination action. It is an entirely different approach to collection and examination, trying to train the people as to how to approach what they are doing so that if they do it the right way, the numbers will flow. The idea is to get away from simply dollar amounts, comparing one another in terms of how they are doing with respect to collections, or seizures, or anything like that.

The General Accounting Office has expressed a somewhat different view of the appropriate use of enforcement results to measure IRS performance. Its December 10, 1991, report on "IRS' Implementation of the 1988 Taxpayer Bill of Rights'' stated (GAO/GGD-92-23 at 14-15):

In an October 1987 letter to the Chairmen of the House Committee on Ways and Means and the Senate Committee on Finance, we commented on various proposals to prohibit the use of collection statistics in performance evaluations. Our position then and now is that collection statistics should not be the only indicator of performance but, along with other factors, could very well be a useful tool in evaluating employees. We pointed out that relying on a single factor can place more emphasis on that factor than on overall performance. We said that it is not totally inappropriate to generally consider the amount of revenues collected as part of an employee's evaluation if that consideration is only one of several factors under review. We added that setting arbitrary quotas for amounts collected, property seized, or cases closed cannot be justified in evaluating performance, particularly because of the negative impact that trying to achieve those quotas can have on taxpayers.

In its May 11, 1993, report on "Tax Administration: New Delinquent Tax Collection Methods for IRS'' (GAO/GGD093-67 at 9), GAO reiterated this view:

As we have stated in the past, IRS should be able to use collection performance as a criterion in determining compensation and rewards for individual collectors. We believe that information such as taxes collected is a reasonable basis on which to judge the performance of employees whose job it is to collect taxes as long as other criteria, such as fair and courteous treatment of taxpayers, are also evaluated.

In a similar vein, a December 23, 1993, report by the GAO on the offer in compromise program ("Tax Administration: Changes Needed to Cope with Growth in Offer in Compromise Program'' (GAO/GGD-94-47 at 24) indicated:

The Commissioner of Internal Revenue should develop the indicators necessary to evaluate the Offer in Compromise Program as a collection and compliance tool. The indicators should be based on accurate data and include (1) the yield of the program in terms of costs expended and amounts collected, (2) the amount of revenues collected that would not have been collected through other collection means. * * *

In September 1997, the Senate Finance Committee held three days of widely-publicized oversight hearings on the Internal Revenue Service. During these hearings, several IRS employees testified that IRS' performance measurement system was creating an environment in which they felt pressured to achieve certain quantitative goals for

tax enforcement results (such as dollars recommended or collected). In his testimony at the conclusion of these hearings, the Acting Commissioner responded to the concerns that had been raised about the negative impact of the IRS performance measurement system by announcing a number of immediate changes in the system. In particular, he announced that IRS would suspend the comparative ranking of its 33 district offices and suspend distribution of any goals related to revenue production to field offices. "Practices and Procedures of the Internal Revenue Service,'' Hearings before the Committee on Finance, United States Senate, 105th Cong., 1st Sess., at 3, 105-106, 123-128, 153, 155- 156, 162-163, 206-209, 212-213, 303-304, 310, 317-318, 320-322, 325-326, 330, 333, 351-356.
Following these hearings, the IRS Office of Chief Inspector undertook three management audits to determine how enforcement statistics were then being used as part of the IRS performance measurement system. See, "Review of the Use of Statistics and the Protection of Taxpayer Rights in the Arkansas-Oklahoma District Collection Field Function,'' Internal Audit Reference Number 380402 (December 5, 1997); "Use of Enforcement Statistics in the Collection Field Function,'' Internal Audit Reference Number 081904 (January 12, 1998); "Examination Division's Use of Performance Measures and Statistics,'' Internal Audit Reference Number 084303 (July 7, 1998). These three inquiries generally confirmed that IRS performance measures were focused largely on enforcement goals and productivity as defined by statistics relating to dollars recommended, assessed or collected, or other enforcement actions taken. They found a lack of corresponding emphasis on quality casework, adherence to law, and protection of taxpayer rights.

In order to deal with specific allegations of misconduct made during the September hearings, or discovered in the course of the management audits described above, the IRS Office of Chief Inspector also undertook a number of individual investigations. The Commissioner then established a Special Review Panel of career executives from outside the IRS to review the evidence and to recommend appropriate personnel actions. The Special Review Panel issued a Report to the Commissioner in August 1998. In its Report, the Special Review Panel agreed with earlier conclusions that IRS had responded to external pressures to close the revenue gap through improved productivity by shifting management emphasis to goals and measures that placed a heavy emphasis on use of enforcement statistics. See also "IRS Personnel Administration: Use of Enforcement Statistics in Employee Evaluations'' (GAO/GGD-99-11, November 30, 1998).

Internal Revenue Service Restructuring and Reform Act of 1998

Sections 1201 and 1204 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA) represent the most recent legislative action regarding performance measures used by the IRS. Section 1201 directs the IRS, consistent with its current performance planning procedures, including those established under the GPRA, to establish a performance management system that will establish "goals or objectives for individual, group, or organizational performance.'' The IRS is directed to use this performance system in the evaluation of employees or groups of employees, in determining salary adjustments and awards, and in other personnel matters. The Conference Report accompanying RRA (H. R. Conf. Rep. No. 105-599, 105th Cong., 2d Sess., at 228 (June 24, 1998) indicates that "in no event would performance measures be used which rank employees or groups of employees based solely on enforcement results, establish dollar goals for assessments or collections, or otherwise undermine fair treatment of taxpayers.'' Section 1204 of RRA repealed section 6231 of TBOR 1 and replaced TBOR 1's prohibition on the use of "records of tax enforcement results'' to evaluate or to impose or suggest goals for personnel directly involved in collection activity with a prohibition against using such records of tax enforcement results to evaluate, or to impose or suggest production quotas or goals for, any IRS "employee.''

Explanation of Provisions

Proposed Effective Date

These regulations are proposed to be effective thirty days after the date of publication in the Federal Register of the final regulations.

Balanced Measurement System

These proposed regulations provide guidance and direction for the establishment of a balanced performance measurement system for the Internal Revenue Service. They also provide guidance for implementing the restrictions on the use of "records of tax enforcement results'' in evaluating, or imposing or suggesting goals for employees and for establishing "fair and equitable treatment of taxpayers'' as one of the standards for evaluating employees. These proposed regulations establish a new balanced system for measuring the performance of and establishing performance goals for various operational units within the Internal Revenue Service. The three elements of this balanced measurement system are (1) Customer Satisfaction Measures, (2) Employee Satisfaction Measures and (3) Business Results Measures. These measures will, consistent with GPRA, be based on "quantifiable and measurable'' data, and will be numerically scored. The proposed regulations do not provide procedures for certifying whether or not records of tax enforcement results have been used in a manner prohibited by section 1204. Subsequent guidance will provide that information.

a. Customer Satisfaction

To measure customer satisfaction, the IRS will develop data from customer satisfaction surveys it receives from a statistically valid sample of taxpayers with whom it has dealt. Among other things, taxpayers will be asked to provide information regarding whether they were treated courteously and professionally, whether they were informed of their rights and whether they were given an opportunity to voice their concerns and adequate time to respond to IRS requests. Using data derived from these surveys, the IRS will derive quantitative indices of customer satisfaction which will be used to measure progress in achieving customer satisfaction goals.

b. Employee Satisfaction

To measure employee satisfaction, the IRS will utilize an employee survey that permits employees to provide, on an anonymous basis, their assessment of the wide variety of factors that determine whether employees believe that the work environment permits them to perform their duties in a professional manner. Among other items included in the employee survey, the questionnaires should elicit information regarding employees' assessment of the quality of supervision and the adequacy of training and support services. As in the case of the Customer Satisfaction measures, the goals and the accomplishments of units subject to the balanced measurement system will be expressed in quantified form.

c. Business Results

The IRS will employ two parallel avenues to measure business results.

1. Quality Measures

The first of these approaches will focus on the quality of the work done in a sample of cases that were worked on by employees. Such reviews will be conducted of a statistically valid sample of cases worked on by units designated by the Commissioner, such as a collection or examination unit. A staff of personnel specially dedicated to the task will review and numerically score the quality of work done by IRS personnel. These reviews will focus on such factors as whether IRS personnel provided proper and timely service to the taxpayer, properly analyzed the facts, correctly applied the law, protected taxpayer rights by following applicable IRS policies and procedures, devoted an appropriate amount of time to the case, made appropriate judgments regarding liability for tax and ability to pay and provided accurate answers to tax law or account questions posed by callers.

2. Quantity Measures

The quantity measures element of the business results measure will focus exclusively on outcome-neutral production data. Accordingly, as described in the regulation, data concerning the enforcement outcome in cases, such as the dollar amount of audit adjustments, the numbers of liens filed or levies served, and the number of referrals for criminal investigation, would be excluded from the production data used in the quantity measures. On the other hand, outcome-neutral production data, such as cases closed, time per closing or cycle time, which do not reflect the outcome produced by any IRS official's exercise of judgment in determining liability for tax or the collection mechanism to be employed may be used in determining the production element of the business results measures. The IRS has determined, however, that as a matter of policy such outcome-neutral production data may not be used to set goals for or for evaluating any non-supervisory employee with tax enforcement responsibilities.

Further, an organization with enforcement responsibilities may not be given a goal or an evaluation based on enforcement-neutral production data regarding matters calling for the exercise of judgment with respect to tax enforcement results unless that goal or evaluation constitutes only one element in a set of goals or one element in an evaluation based also upon the balanced measurement system.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulation and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Thursday, May 13, 1999, beginning at 10 a.m. in room 2615 of the Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit comments and an outline of the topics to be discussed and the time to be devoted to each topic by Thursday, April 22, 1999. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Julie A. Barry, Office of Assistant Chief Counsel (General Legal Services). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 801

Government employees, Organization and functions (Government agencies).

Proposed Amendments to the Regulations

Accordingly, 26 CFR Chapter I is proposed to be amended by adding part 801 to Subchapter H to read as follows:

PART 801— BALANCED SYSTEM FOR MEASURING ORGANIZATIONAL AND INDIVIDUAL PERFORMANCE WITHIN THE INTERNAL REVENUE SERVICE

Sec. 801.1 Balanced performance measurement system; in general. 801.2 Balanced performance measurement system. 801.3 Customer satisfaction measures. 801.4 Employee satisfaction measures. 801.5 Business results measures.

Authority: 5 U.S.C 9501 et seq.; secs. 1201, 1204, Pub. L. 105-206, 112 Stat. 685, 715-716, 722 (26 U.S.C. 7804 note).

Sec. 801.1 Balanced performance measurement system; in general.

(a) In general. The regulations in this part 801 implement the provisions of sections 1201 and 1204 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Pub. L. 105-106, 112 stat. 685, 715-716, 722) and provide rules relating to the establishment by the Internal Revenue Service of a balanced performance measurement system.

(b) Effective date. This part 801 is effective thirty days after the date these regulations are published as final regulations in the Federal Register.

Sec. 801.2 Balanced performance measurement system.

(a) In general. Modern management practice and various statutory and regulatory provisions require the IRS to set performance goals for organizational units and to measure the results achieved by those organizations with respect to those goals. To fulfill these requirements, the IRS has established a balanced performance measurement system, composed of three elements: Customer Satisfaction Measures; Employee Satisfaction Measures; and Business Results Measures. The IRS is likewise required to establish a performance evaluation system for individual employees.

(b) Measuring organizational performance—
(1) In general. The performance measures that comprise the balanced measurement system will, to the maximum extent possible, be stated in objective, quantifiable and measurable terms and, subject to the limitation set forth in paragraph (b)(2) of this section, will be used to measure the overall performance of various operational units within the IRS. In addition to implementing the requirements of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, 112 Stat. 685, the measures described here will, where appropriate, be used in performance goals and performance evaluations established, inter alia, under Division E, National Defense Authorization Act for Fiscal Year 1996 (the Clinger-Cohen Act of 1996), Pub. L. 104-106, 110 Stat. 186, 679; the Government Performance and Results Act of 1993, Pub. L. 103-62, 107 Stat. 285; and the Chief Financial Officers Act of 1990, Pub. L. 101-576, 108 Stat. 2838.
(2) Limitation—quantity measures (as described in Sec. 801.5) will not be used to evaluate the performance of or to impose or suggest production goals for any organizational unit with employees who are responsible for exercising judgment with respect to tax enforcement results (as defined in Sec. 801.5) except in conjunction with an evaluation or goals based also upon Customer Satisfaction Measures, Employee Satisfaction Measures, and Quality Measures.

(c) Measuring individual performance. All employees of the IRS will be evaluated according to the critical elements and standards or other performance criteria established for their positions. In accordance with the requirements of 5 U.S.C. 4312 and 9508 and section 1201 of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206 (112 Stat. 685), (as is appropriate to the employee's position), the performance criteria for each position will be composed of elements that support the organizational measures of Customer Satisfaction, Employee Satisfaction and Business Results; however, such organizational measures will not directly determine the evaluation of individual employees.

(1) Fair and equitable treatment of taxpayers. In addition to all other criteria required to be used in the evaluation of employee performance, all employees of the IRS will be evaluated on whether they provided fair and equitable treatment to taxpayers.
(2) Senior Executive Service and special positions. Employees in the Senior Executive Service will be rated in accordance with the requirements of 5 U.S.C. 4312 and employees selected to fill positions under 5 U.S.C. 9503 will be evaluated pursuant to workplans, employment agreements, performance agreements or similar documents entered into between the Internal Revenue Service and the employee.
(3) General workforce. The performance evaluation system for all other employees will: (i) Establish one or more retention standards for each employee related to the work of the employee and expressed in terms of individual performance; and— (A) Require periodic determinations of whether each employee meets or does not meet the employee's established retention standards; and (B) Require that action be taken, in accordance with applicable laws and regulations, with respect to employees whose performance does not meet the established retention standards. (ii) Establish goals or objectives for individual performance consistent with the IRS's performance planning procedures; and— (A) Use such goals and objectives to make performance distinctions among employees or groups of employees; and (B) Use performance assessments as a basis for granting employee awards, adjusting an employee's rate of basic pay, and other appropriate personnel actions, in accordance with applicable laws and regulations.
(4) Limitations. (i) No employee of the IRS may use records of tax enforcement results (as defined in Sec. 801.5) to evaluate any other employee or to impose or suggest production quotas or goals for any employee. (A) For purposes of the limitation contained in this paragraph (c)(4), employee has the meaning as defined in 5 U.S.C. 2105(a). (B) For purposes of the limitation contained in this paragraph (c)(4), evaluate includes any process used to appraise or measure an employee's performance for purposes of providing the following:
(1) Any required or requested performance rating. (2) A recommendation for an award covered by Chapter 45 of Title 5; 5 U.S.C. 5384; or section 1201(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105 206 (112 Stat. 685, 713-716). (3) An assessment of an employee's qualifications for promotion, reassignment or other change in duties. (4) An assessment of an employee's eligibility for incentives, allowances or bonuses. (5) Ranking of employees for release/recall and reductions in force. (ii) Employees who are responsible for exercising judgment with respect to tax enforcement results (as defined in Sec. 801.5) in cases concerning one or more taxpayers may be evaluated with respect to work done on such cases only on the basis of information derived from a review of the work done on the taxpayer cases handled by such employee. (iii) Performance measures based in whole or in part on Quantity Measures (as described in Sec. 801.5) will not be used to evaluate the performance of or to impose or suggest goals for any non-supervisory employee who is responsible for exercising judgment with respect to tax enforcement results (as defined in Sec. 801.5).

Sec. 801.3 Customer satisfaction measures.

The customer satisfaction goals and accomplishments of operating units will be determined on the basis of data derived from questionnaires, surveys and other types of information gathering mechanisms. Surveys designed to measure customer satisfaction for a particular work unit will be distributed to a statistically valid sample of the taxpayers served by that operating unit and will be used to measure whether those taxpayers believe that they received courteous, timely and professional treatment by the IRS personnel with whom they dealt. Taxpayers will be permitted to provide information requested for these purposes under conditions that guarantee them anonymity.

Sec. 801.4 Employee satisfaction measures.

The numerical ratings to be given operating units within the IRS for employee satisfaction will be determined on the basis of information derived from a questionnaire which will be distributed to all employees of the operating unit; the employees will be permitted to provide information on an anonymous basis. Data from these surveys will measure, among other factors bearing upon employee satisfaction, the quality of supervision and the adequacy of training and support services.

Sec. 801.5 Business results measures.

(a) In general. The business results measures will consist of numerical scores determined under the Quality Measures and the Quantity Measures described elsewhere in this section.

(b) Quality measures. The quality measure will be determined on the basis of a review by a specially dedicated staff within the IRS of a statistically valid sample of work items handled by certain functions or organizational units determined by the Commissioner or his delegate such as the following:

(1) Examination and collection units and Automated Collection System units (ACS). The quality review of the handling of cases involving particular taxpayers will focus on such factors as whether IRS personnel devoted an appropriate amount of time to a matter, properly analyzed the issues presented, developed the facts regarding those issues, correctly applied the law to the facts, and complied with statutory, regulatory and IRS procedures, including timeliness, adequacy of notifications and required contacts with taxpayers.

(2) Toll-free telephone sites. The quality review of telephone services will focus on such factors as whether IRS personnel provided accurate tax law and account information.

(3) Other work units. The quality review of other work units will be determined according to criteria prescribed by the Commissioner or his delegate.

(c) Quantity measures. The quantity measures will consist of outcome-neutral production and resource data, such as the number of cases closed, work items completed, hours expended and similar inventory, workload and staffing information, that does not contain information regarding the tax enforcement result reached in any case involving particular taxpayers.

(d) Definitions—(1) Tax enforcement result. A tax enforcement result is the outcome produced by an IRS employee’s exercise of judgment recommending or determining whether or how the IRS should pursue enforcement of the tax law with respect to any assessed or unassessed tax.

(i) Examples of data containing information regarding tax enforcement results. The following are examples of data containing information regarding tax enforcement results: number of liens filed; number of levies served; number of seizures executed; dollars assessed; dollars collected; full pay rate; no change rate; and number of fraud referrals.

(ii) Examples of data that do not contain information regarding tax enforcement results. The following are examples of data that do not contain information regarding tax enforcement results: number of cases closed; time per case; direct examination time/out of office time; cycle time; number or percentage of overage cases; inventory information; toll-free level of access; talk time; and data derived from a quality review or from a review of an employee’s or a workunit’s work on a case, such as the number or percentage of cases in which correct examination adjustments were proposed or appropriate lien determinations were made.

(iii) Records of tax enforcement results. Records of tax enforcement results are data, statistics, compilations of information or other numerical or quantitative recordations of the tax enforcement results reached in one or more cases, but does not include information, including the tax enforcement result, regarding an individual case to the extent the information is derived from a review of an employee’s or a workunit’s work on individual cases.

(e) Permitted uses of records of tax enforcement results. Records of tax enforcement results may be used for purposes such as forecasting, financial planning, resource management, and the formulation of case selection criteria. (f) Examples. The following examples illustrate the rules of this section:

Example 1: In conducting a performance evaluation, a supervisor may take into consideration information showing that the employee had failed to propose an appropriate adjustment to tax liability in one of the cases the employee examined, provided that information is derived from a review of the work done on the case. All information derived from such a review of individual cases handled by an employee, including time expended, issues raised, and enforcement outcomes reached may be considered in setting goals or evaluating the employee.

Example 2: A supervisor may not establish a goal for proposed adjustments in a future examination, even though the goal was derived from analyses of previously-handled cases, because such enforcement goals are not based upon an analysis of the newly-assigned case.

Example 3: A headquarters unit may use records of tax enforcement results to develop methodologies and algorithms for use in selecting tax returns to audit.

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