
V. Organization and Management

Previous IRS structure did not adequately support taxpayer demands

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 was built around districts and service centers, the basic organizational units established many years ago and evolved over decades. There were 33 districts and ten service centers. Each of these 43 units was charged with administering the entire tax law for every kind of taxpayer, large and small, in a defined geographical area. Consequently, every taxpayer was serviced by both a service center and a district, sometimes more than one. Within each of these units, work was 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 performed these functions for the same taxpayer, the responsibility shifting depending on whether the work was 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 were four regions and a national office, which also operates three large computing centers. There were 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 had responsibility over all aspects of service to any particular taxpayer.

This structure no longer enabled the IRS to achieve its strategic goals. The cumbersome structure, matched by an inadequate technology base, represented 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

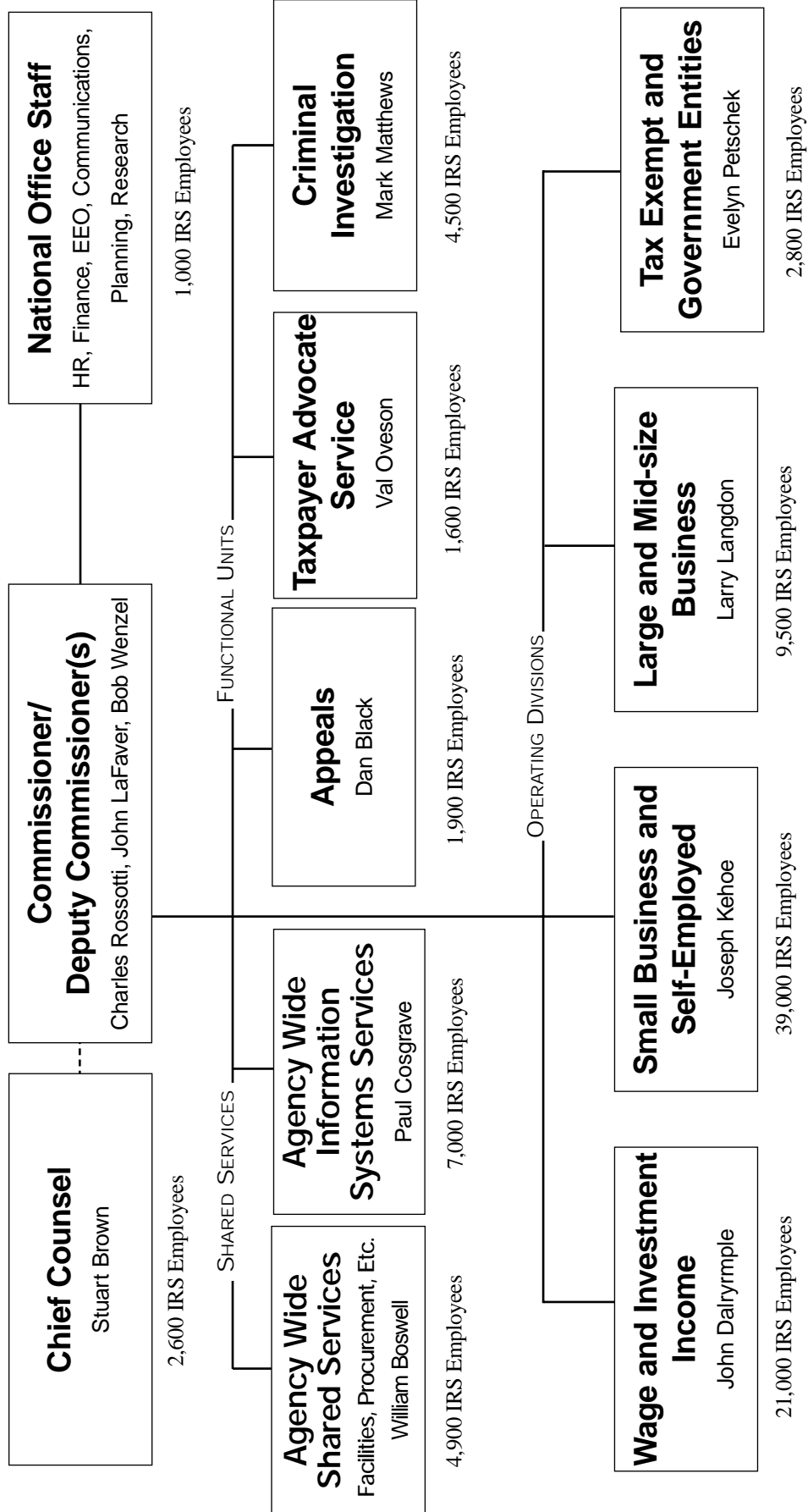
The IRS' modernized structure is similar to one widely used in the private sector: organized around customers' needs, in this case taxpayers. Just as many financial institutions have different divisions that serve retail customers, small to medium businesses and large multinational businesses, the taxpayer base falls naturally into similar groups. This concept has been closely studied since it was first proposed in early 1998. While some 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 are four operating divisions, each charged with full end-to-end responsibility for serving a set of taxpayers with similar needs. These operating divisions are supported by two service organizations: Information Systems and Agency Wide Shared Services (providing common services such as facilities and procurement). Appeals and the Taxpayer Advocate are nationwide organizations that provide separate specialized independent channels for taxpayers. Criminal Investigation will have sole responsibility for investigation of criminal violations of the tax law and, for the first time, will operate as a line unit within the IRS. Chief Counsel provides tax advice, guidance and legislative services to all components of the IRS. 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 on the next page, and consequently

Exhibit D: IRS Future Organization

Internal Revenue Service Future Organization



Taxpayer Characteristics (Estimates)

	Wage & Investment	Small Business & Self-Employed	Large & Mid-size Business	Tax Exempt & Government Entities
Number of filers	88 million	45 million	210,000	2.4 million
Number of individual taxpayers	116 million	—	—	—
Total tax liability (billions)	\$380	\$790	\$466	\$103
Average tax liability per filer	\$4,310	\$20,231	\$2,231,274	\$42,698
Gross cash paid (billions)	\$46	\$915	\$712	\$221
Average # of transactions with IRS per filer/year	1-4	4-60	60+	60+
Percent preparing own returns	59%	20%	—	—
Assets regulated	—	—	—	\$7 trillion
Average number of returns filed per filer	1.1	2.7	3.5	1.7

* Please note numbers are estimated and subject to change.

servicing them effectively and efficiently requires different services and different ways of delivering that service.

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 \$46 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 45 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 \$915 billion in cash, representing nearly 44 percent 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 210,000 filers, pay the IRS \$712 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 and government entities sector, including pension plans, exempt organizations and governmental entities, represents a large economic sector with unique needs. Comprising 2.4 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 \$220 billion in cash in employment taxes and income tax withholdings and controls about \$6.7 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.

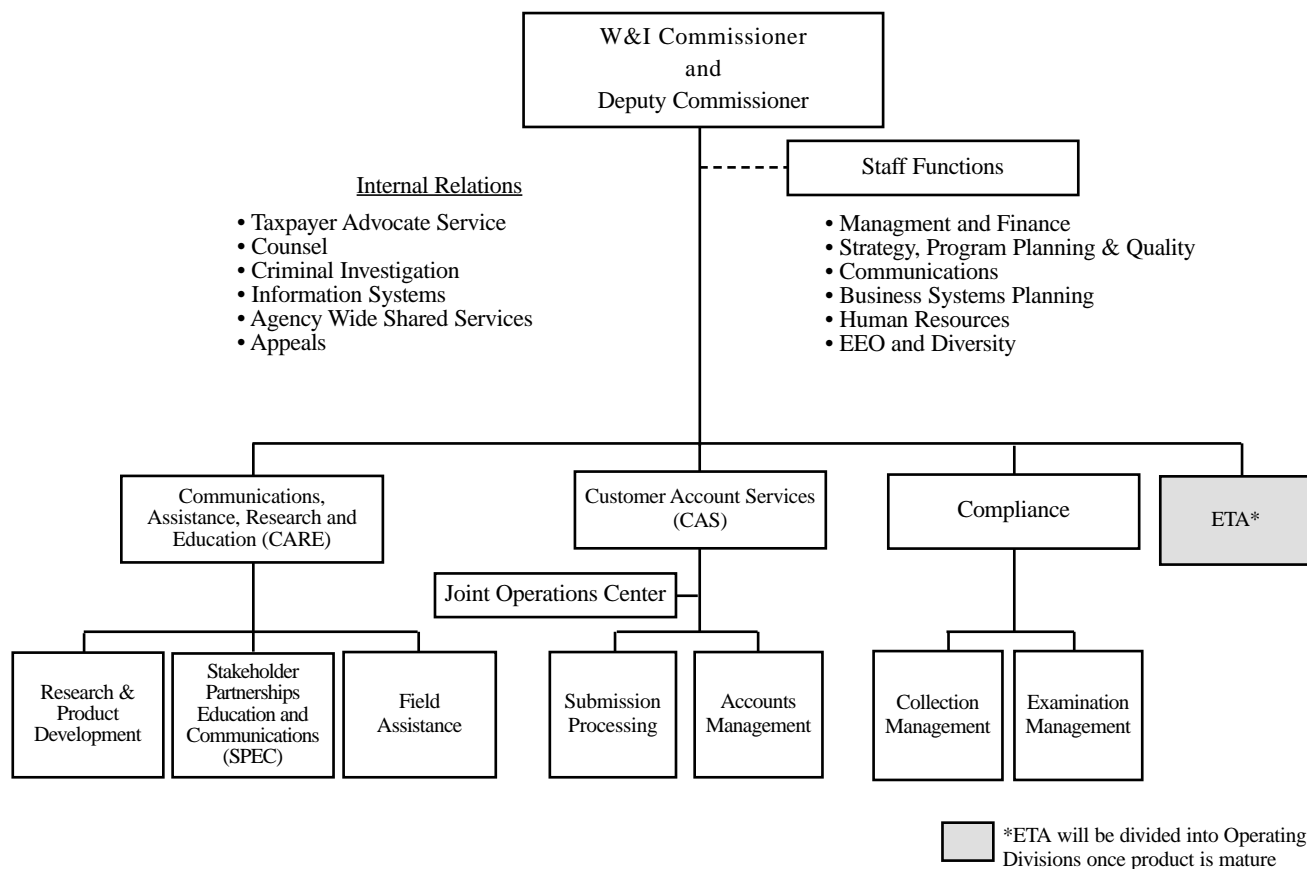
An example: The Wage and Investment Division

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.

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.

Wage And Investment Operating Division



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- 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. Over time, these local taxpayer assistance centers will be situated in locations convenient for taxpayers, such as shopping malls, and may be co-located with other Federal or State agencies. Several pilot projects of this kind, including one with the State of Utah and one in a shopping mall in Sacramento, have been started in 1999.
 - 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 and Government Entities 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 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 Service 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.

Following the recommendations of the year-long study by Judge William Webster, Criminal Investigation (CI) will become a line unit reporting directly to the Commissioner and Deputy Commissioner. Operating as a nationwide line unit with 35 Special Agent in Charge (SAIC) offices, CI will closely

coordinate its activities and strategies with the operating divisions and will be supported by dedicated attorneys from Chief Counsel.

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. For example, the management of the Wage and Investment Division, although responsible for serving 75 percent of all taxpayers, will generally not have to be concerned with the 83 percent of the tax code that ordinarily does not apply to taxpayers for which it is responsible. 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. Mr. 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. Mr. LaFaver is an experienced state tax administrator known for improving state tax agencies' customer focus through effective use of technology.
- Paul Cosgrave, appointed Chief Information Officer. Mr. Cosgrave had 25 years of experience in the information technology industry prior to joining the IRS.
- Val Oveson, appointed National Taxpayer Advocate. Mr. 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.

During 1999, additional appointments to this top management team were made, including:

- Evelyn Petschek, appointed Commissioner of the Tax Exempt and Government Entities division. Ms. Petschek previously served in the IRS as Assistant Commissioner for EP/EO, and had prior experience in the Treasury Department and as a partner in the law firm of Patterson, Belknap, Webb and Tyler.
- Larry Langdon, appointed Commissioner of the Large and Mid-Size Business division. Mr. Langdon recently retired as Senior Vice-President of the Hewlett-Packard Corporation, where he had worldwide responsibility for tax, licensing and customs.
- William Boswell, appointed Chief, Agency Wide Shared Services. Mr. Boswell had 30 years of experience in management, finance and administration with major oil companies, including reorganization of one company's services into a shared-services function.
- Mark Matthews, appointed Chief, Criminal Investigation. Mr. Matthews has experience as a federal prosecutor of financial crimes, Deputy Assistant Attorney General for Criminal Tax in the Justice Department, Special Assistant in the FBI and CIA, and a private criminal defense attorney.
- Dan Black, appointed Chief, Appeals. Mr. Black is an experienced IRS executive who has served as Regional Director of Appeals, District Director and site executive.
- Joseph Kehoe, appointed Commissioner of the Small Business and Self-Employed Division. Mr. Kehoe has extensive experience in service sector consulting with Pricewaterhouse Coopers.
- John Dalrymple, appointed Commissioner of the Wage and Investment Division. Mr. Dalrymple is an experienced IRS executive who has served as Chief Operations Officer and Chief Compliance Officer.

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.