

OVERSIGHT ON RESTRUCTURING AND REFORM OF THE IRS

HEARING BEFORE THE COMMITTEE ON FINANCE UNITED STATES SENATE ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

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WEDNESDAY, APRIL 14, 1999

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:13 a.m., in Room SD-215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Grassley, Hatch, Mack, Baucus, Conrad, Graham, Bryan, Kerrey, and Robb.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please be in order.

It is indeed a pleasure for me to welcome Commissioner Rossotti here today. We will try to limit, if we can, opening statements to Senator Baucus and myself so we can proceed with the questioning of the Commissioner, but as I said, welcome, Commissioner.

I feel compelled to begin this hearing by asking: Do you still want this job? There is no question that you are in the eye of the storm. But as I've been saying, I can think of no one better qualified than you to lead this important agency into the new millennium. I am impressed by your vision, your management skills, and your sincere desire to implement the revolutionary new changes that were passed into law in the IRS Restructuring and Reform Act of 1998.

While the IRS has been the subject of intense focus by this committee, the purpose of our hearing today is to ensure that Congress and the Administration continue to move ahead to implement the IRS restructuring bill and reform the IRS. The IRS restructuring bill provides the blueprint for change. The law requires the Commissioner to reorganize the IRS into functional divisions rather than on a geographic basis. It provides for additional accountability and oversight with the establishment of an Oversight Board, the creation of a new Treasury Inspector General for Tax Administration, a more independent National Taxpayer Advocate, as well as a more independent appeals function.

The law also includes a new arsenal of taxpayer protections. These include due process protections, expanded innocent spouse relief, examination and collection protections, as well as penalty and interest protections. To help the Commissioner reform the IRS and oversee this major changes, the law allows for additional per-

sonnel flexibilities to allow the Commissioner to hire and retain experts in their fields.

There is no question that the IRS restructuring bill was enormous and will take time to implement. The purpose of our hearing today is to discuss where the IRS is and where it is going—how the legislation has been embraced and what we can do to push forward. I appreciate the open and frequent dialogue between us, Commissioner Rossotti, and the fact that we share many similar concerns. As you know, we have discussed allegations of retaliation against witnesses who testified before this committee. We have discussed our concern that some within the agency and administration are reluctant regarding the changes mandated by Congress, and may even be working against the reforms.

I am disappointed that the IRS Oversight Board nominees have not been submitted by the President to the Senate as required by law. Nominees were required to be submitted by January 22, 1999. But today we are still waiting.

I will say, Commissioner Rossotti, that despite these obstacles you are moving forward. You have begun to reorganize the IRS into functional groups based on taxpayer needs, eliminating the archaic geographically based system. While you first mentioned this concept less than 15 months ago, the IRS recently announced the future headquarters of each of the divisions and hopes to have the Small Business & Self-Employed Operating Division and Tax Exempt Operating Division groups in operation sometime later this year.

This is a step in the right direction. This structure will provide better expertise, information, and service capabilities.

Likewise, I am impressed with the new National Taxpayer Advocate who has enhanced authority to assist taxpayers in their dealings with the IRS. I appreciate the way that he, too, has embraced the spirit as well as the letter of the '98 law. Tomorrow, the new Taxpayer Advocate will testify before our committee on the complexity of the individual income tax, as we begin to look at what can be done to make it simpler for Americans everywhere.

I will be interested in your thoughts regarding the Taxpayer Advocate and what we can do to make that position even more meaningful in meeting the needs of taxpayers.

Likewise, I want to hear your views concerning the newly created office of Treasury Inspector General for Tax Administration. It is extremely important to have an independent auditor and investigator to keep an eye on the IRS and ensure that the law is being followed. Independence is the key. And we want to be sure that that is what we are getting with the new organization in this area.

These are all positive changes. But they will only have relevance if they are appropriately implemented—if they are effective in changing the culture of the agency to one that is intolerant of abuses—abuses of taxpayers and abuses of employees. I am concerned about reports that I'm hearing that much of the culture remains the same—that many have a wait and see attitude—concerning the changes included in the restructuring and reform legislation. I am concerned that the important new laws concerning innocent spouse, offers in compromise, installment agreements—and

even practices related to due process protections—are not being adequately instructed and embraced in the field.

The bill included numerous provisions relating to interest and penalties to prevent taxpayers from being buried in debt to the extent that they cannot pay their tax liability. While more needs to be done in this area, the bill required Joint Tax and Treasury to each conduct studies on the administration of penalties and interest. I look forward to receiving the report in July and hope to pursue legislation to ensure that unfair penalties and interest are eliminated.

These, I realize, Commissioner Rossotti, represent a full plate. And I have not even mentioned the need to prepare for Y2K. Nor have I addressed the concerns about the Criminal Investigation Division that were raised in Judge Webster's review of that organization. These also need our best attention, and I look forward to our addressing them today.

For now, let me express my gratitude to you and to the countless others within the Internal Revenue Service who are working constructively with Congress to bring about needed change. This is an historic moment. The work that is done in the months ahead will have a profound influence on the future. It will demonstrate what can be accomplished to make even the largest bureaucracies more effective, more efficient, fairer, and more civil in their interaction with the people who matter most—the taxpayers who pay for them. To those who may yet wonder if Congress is serious, let me say that, "Yes. We are serious. And yes. We are here to stay." This work shall be finished. It's what Congress intends; it's what the people deserve.

Senator Baucus?

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Commissioner, we all welcome you to the committee, and I first want to thank you for coming to Montana very recently.

For the benefit of the members of the committee, I might say that Commissioner went above and beyond service when he flew to Montana and had to ensure the airline schedules we have in our State, arriving at 4:00 in the morning on Monday in Helena. We spent the rest of the morning promoting and touting the STAWRS Project. The STAWRS Project is the Montana Simplified Tax and Wage Reporting System that this Congress authorized in 1997 in a pilot project. Essentially, it helps reduce paperwork for small businesses, while at the same time making sure the Government gets the information that it needs to get the job done.

The Commissioner came out to highlight this and to give Montana the Commissioner's Award. Small business organizations also were present to give awards to the IRS, commending them and thanking them for all the work that they have done in making this pilot project work, and I hope that other States can adopt it as well.

Mr. Commissioner, I, like the chairman, am impressed with the project that you are making. You obviously have one of the most difficult jobs in the country, but I also think it is appropriate that

Congress itself not drop the ball on oversight of IRS operations. I hope that we will do the job that we need to do in order to let you do the job that you need to do.

For example, as mentioned, we need to get that Oversight Board in place. That is not your responsibility at this point. It is the White House, and I very much urge the White House to submit the names so that we can get that board up and running, and fulfill a lot of the promise that a lot of American taxpayers are looking forward to when we get that Oversight Board in place.

Another concern on my part, frankly, is the lack of integration between the demands that we place on you as a tax-writing committee and your ability to meet those demands. I am not sure that we in the Congress are fully aware of and sufficiently sensitive to that tension.

We, for example, in this committee normally do not deal with budget issues. Yet, our actions that we take in this committee very directly impact the effect of the budget on your operations.

For example, we have enacted tax provisions requiring thousands of changes in your computer programs, your regulatory action, the training of your employees. Yet, we never have to deal with the consequences of the budgetary pressures that our actions place upon you.

Here we are again. We are going to pass a budget resolution that assumes we will be enacting tax changes that become effective in the year 2000. During the question period, I hope to discuss with you just what implications that has for your agency.

Finally, I will be very interested to hear the progress you are making with your reorganization, particularly as it relates to the cultural changes that we have talked about so often. I know you are working hard on that. I would like to see where you are with it. This is going to take time, as has been mentioned, and while we are pushing vigorously, I think at the same time we all have to remind ourselves to be patient because nothing happens overnight that is good. It generally takes a consistent time and effort and follow-up and focus, and I just urge all of us to keep that in mind. I just urge you to do the same, and I know you will do very well.

Thank you.

The CHAIRMAN. Max, I have to say I am disappointed. I thought when the Commissioner went to Helena, Montana, he went to see where you and I were raised.

Senator BAUCUS. I might say, Mr. Chairman, he did. In fact, I took him to the Parrot Confectionery in Helena.

The CHAIRMAN. Good. He saw the best, then.

Senator BAUCUS. Yes. I told him that you were probably one of the best patrons of the Parrot Confectionery in Helena, Montana.

The CHAIRMAN. No question about that.

I was going to try to limit opening statements, but I would ask each of you to limit your statements. If you would, limit them to 3 minutes, please.

Senator Grassley is next.

**OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S.
SENATOR FROM IOWA**

Senator GRASSLEY. Mr. Chairman, I very much appreciate the fact that you are having this hearing as part of our continuing oversight role, and one of the things we found out over our Commission hearings, as well as this committee's hearings last year, is that probably we and Congress have not done a good enough job of our Congressional constitutional responsibilities of oversight. So this ongoing oversight is very, very important, and just to keep a relationship between IRS leadership and this committee.

As one of the two Senate members of the IRS Oversight Commission, along with Senator Kerrey, I have a very strong interest in seeing that the restructuring law works. If there is one thing that I have learned over the years as a former chairman of the IRS Oversight Subcommittee and a sponsor of two taxpayer bill of rights legislation and the newest law that we are discussing today, it is that we in Congress have to be constantly vigilant because even if we pass a law that is good and strong on its face and well intended, we still find that bureaucracies are not just the IRS, but for any committee this is a problem. They can ignore it or undermine it through its own internal regulatory powers.

One of the best examples of this concerns the use of the IRS monetary goals and quotas. We outlawed these in a first taxpayer bill of rights back in 1988, but last year in our hearings, we found that the IRS management was still using these measurements that were actually illegal. Those disclosures were before Commissioner Rossotti was in place.

I do want to commend the Commissioner, Mr. Rossotti, for his efforts and sincerity in making the IRS more customer friendly. I think you have brought the IRS a long way, Commissioner, and I thank you for that, but, of course, that does not mean that there is not still a long ways to go because I think there is. I just hope that you have the patience, the tenacity, and the commitment to stick to it. If you will, we will be there to support you.

Mr. Chairman, this hearing is very timely with tax day coming tomorrow, but, more importantly, it sends a signal that we on this committee remain committed to this effort, and one of the main parts of restructuring is the Oversight Board. You have already talked about that.

The question before us is where are the nominees for this board. We passed this law 9 months ago, and we are still waiting to just get the cement poured for one of the pillars of the new law.

I had a conversation with Secretary Rubin on this, 2 or 3 weeks ago, and he said that the nominees were at the White House. So I do not know really what is taking it so long. They ought to be coming to us, it seems like.

Thank you very much.

The CHAIRMAN. Thank you, Senator Grassley, and now it is my pleasure to call on Senator Conrad.

**OPENING STATEMENT OF HON. KENT CONRAD, A U.S.
SENATOR FROM NORTH DAKOTA**

Senator CONRAD. Thank you, Mr. Chairman, and thank you, Commissioner Rossotti.

I believed when you were appointed that you were the right man at the right time, and I am even more convinced of that today. I think you have done a superb job in a very difficult circumstances, and we very much appreciate your public service. We know you could be doing a lot of things that would be much easier and far more lucrative back running the company you so successfully started. So we do appreciate the sacrifice that you are making to make the governmental system work better.

Our goal, I think our collective goal, was to end the abuse of taxpayers that we saw occurring when we held hearings last year. I think the Congress was absolutely united in that. I think the administration felt strongly on it as well.

At the same time, we have got to make sure we collect what is owed. We do not want somebody out there getting by as a free-loader and letting the vast majority of honest taxpayers pay what they owe and then let somebody slide by and avoid paying what they legitimately owe. That would not be fair.

So it is a difficult balancing act to make certain that people are treated fairly, but at the same time, we collect what is due, and I think you have got a very good sense of striking that balance.

The Webster report that has been referred to, I found in many ways to be encouraging. He found there was no systemic abuse by the Criminal Investigation Division. He did find isolated instances where they had crossed the line, and those are, of course, totally unacceptable.

He also indicated that their mission has kind of drifted. I think that was perhaps an amber light, at least to us, indicating that we need to take a hard look at the mission of Criminal Investigation and make certain that they are not out there kind of as a separate entity on an agenda that is separate and apart from the rest of the organization. I would be very interested to hear your reactions and what you intend to do to make certain that this drift of mission that Judge Webster has identified is dealt with.

The CHAIRMAN. Thank you, Senator Conrad.
Senator Kerrey?

OPENING STATEMENT OF HON. J. ROBERT KERREY, A U.S. SENATOR FROM NEBRASKA

Senator KERREY. Thank you very much, Mr. Chairman.

Mr. Rossotti, I share the high regard that this committee has already expressed for your talents and your willingness to serve in this tough job.

I wrote the bill actually in 1994 that was attached to an appropriations bill that created the restructuring commission and did so because at that time I was on the Appropriations Committee and was on the committee that had the responsibility for the IRS. The IRS had come up and asked for money for a variety of things, including at that time tax system modernization. That was one of the efforts that had been evaluated by the GAO as not having been done very well, and we were very frustrated. Things did not seem to be improving, and so we created this commission to evaluate the IRS.

The vision at the heart of the legislation was that the IRS itself needed to be restructured and have more independence, and, thus,

this board was created and more authority given to this board, more independence from Treasury itself.

But there was also a need for restructuring of Congress. We did not go as far as I think we probably need to go. Probably, the idea would be if the Finance Committee was also appropriating money. I am sure every staff member of the Appropriations Committee that is watching this has said to their boss, "Do not give Kerrey any money because he just suggested to make a change that is going to jeopardize our committee," but it would be a lot easier.

We are not familiar with the details of your budget. Your budget request, as I understand it, is about \$8.1 billion. You collect about \$1.7 trillion. So it is less than half-a-percent. It is the most efficient tax collection system in the world, and one of the reasons, by the way, is it is a voluntary system.

In my line of questioning, I am going to ask you some questions about the training requirements and are you having to take money away from compliance in order to do training. I would like to ask you questions as well about the technology, the challenges of bringing this new technology on board, and I am also going to ask some questions about compliance because I am very much concerned. I do not want to take money away from compliance because I think one of the things that happens when you do that is it may decrease the voluntary compliance that is critical to our efficient operation.

So, as I said, the vision of the restructuring legislation was restructuring not just at the executive branch, but also the legislative branch. We would have been better off having this committee and the Ways and Means Committee appropriate your budget. So you could come up with one-stop shopping in the Senate and one-stop shopping in the House. We did not get that, but we did create a single opportunity for a consolidated appropriations finance oversight, and the chairman is working on getting that done. I think it is going to be an extremely important thing to do as well. We need to accelerate that, and it is going to be difficult for us to do that until we get a board fully vetted and confirmed by the Senate.

In short, Mr. Rossotti, we are not going to be able to make this work unless we work with you to make certain that you have the resources necessary, the political support necessary, and I think the training resources necessary.

You are having to train a new mission, which is difficult to do, a new code, 1,200 new provisions of the code just from 1997, new practices that we are all asking you to do. That takes time and money. Any private sector company that talks about being able to get the job done emphasizes the training and skills of its employees being able to carry out its mission.

So we have to make certain that we are providing the short and the long term, you with the resources, to train your people. Otherwise, I think it is very unlikely that the intent of this law is going to be implemented.

Thank you.

The CHAIRMAN. Thank you, Senator Kerrey.
Senator Mack?

**OPENING STATEMENT OF HON. CONNIE MACK, A U.S.
SENATOR FROM FLORIDA**

Senator MACK. Thank you, Mr. Chairman, and I was informed we have 3 minutes.

The CHAIRMAN. That is right.

Senator MACK. I certainly do not intend to take all of that.

Welcome, Mr. Rossotti. You and I have had the opportunity to have some discussions in the past. I appreciate the effort that you are making, but let me just say I remain skeptical as to whether there really is going to be change. I am hopeful that it will, but I am truly skeptical.

One of the things that has come to my attention is that Dennis Crawford indicated that there are actually more arms search-and-seizure raids than before. I have had questions about the Oversight Board, with the makeup of the Oversight Board, that indicated to me kind of business as usual in Washington, where the intent was to give the taxpayer the ability to be the dominant feature of an oversight board. Now we have the Secretary of the Treasury, a representative from the employee union. I think that they will dominate that board.

I am skeptical based on the hearings and the testimony that we had when we put this legislation together, the concern about systemic problems with IRS, with the Webster report basically saying that it just did not exist. It does not feel right. It just does not feel right, but I am hopeful. My mind is open to being convinced that I should not be concerned. —

So I thank you for the opportunity to make those few brief comments.

The CHAIRMAN. Senator Robb, please. Thank you.

**OPENING STATEMENT OF HON. CHARLES S. ROBB, A U.S.
SENATOR FROM VIRGINIA**

Senator ROBB. Thank you, Mr. Chairman.

Mr. Rossotti, thank you for being with us this morning.

I want you to know that I spent about 4 hours last night attending the businesses related to the agency over which you preside. If I look a little the worse for wear this morning, it is because I was not able to resolve all of the difficulties that I was trying to resolve, and you have made enough changes in the various schedules and forms each year. I think this is one of the most important undertakings that the Congress has involved itself in, in a long time. That is purely on the basis of vested interest, but in any event, this is my first year on the committee. This is my first attempt to deal with this in a structured way.

I applaud you for what you are attempting to do and those who are attempting to assist you in this regard, and I can assure you that as a representative of all of us who are out there attempting to deal with the present code, including a daughter who took some tax law in her law background so that she could eventually help her father double-check some of the things that he thought he learned, but has obviously forgotten in the intervening years. That is a very personal interpretation of the need for this hearing and for the good work that you are doing and proposed to do.

With that, Mr. Chairman, I look forward to the hearing.

The CHAIRMAN. Thank you, Senator Robb.

I would say to you that we are going to have our first hearing on complexity tomorrow. In view of your experience last night, you may want to attend.

Senator ROBB. Mr. Chairman, I will be prepared to provide expert witness testimony.

The CHAIRMAN. So it is now a pleasure to call on the Commissioner.

I do hope your speech is not those six volumes on your right. If so, we will include as if read.

Please proceed.

STATEMENT OF HON. CHARLES O. ROSSOTTI, COMMISSIONER OF INTERNAL REVENUE

Commissioner ROSSOTTI. Thank you, Mr. Chairman, and I thank the members of the committee. Thank you for all of your gracious comments.

In my opening statement I will first make some brief overview comments, and then I will respond to some of the specific concerns during the question-and-answer period.

Of course, the man priority on our agenda is responding to the Restructuring and Reform Act, which Congress passed almost unanimously last year. Of course, this bill has many specific provisions in it designed to enhance taxpayer rights and to deal with specific aspects of the IRS, and each of these provisions is very important. Collectively, however, I believe this bill said something even more important than any individual provision, and that is that it told the IRS that we must fundamentally change our direction. Not only must we continue to collect taxes, but we must think about our jobs as serving the people who are paying the taxes, the American taxpayers.

I must say that in approximately one year since I last appeared before the committee, I have become even more convinced that we can succeed in the mandate that Congress gave us, and I believe succeeding means providing each taxpayer with the service that he or she expects and the rights that he or she deserves, and all taxpayers with the confidence that the tax law is being fairly administered.

I also believe that we now have a much clearer idea of the many and fundamental changes that we must make in all parts of the agency that will be necessary in order for us to proceed.

Some of these changes are intangible, such as redefining our mission, our goals, and our principles, but many are very tangible such as how we measure performance, train people, organize, and rebuild our technology. Collectively, these changes affect the skills, attitudes, tools, and processes which comprise the way that we serve taxpayers every day.

I do not believe that there is any quick fix, silver bullet, or low-risk plan for reforming the IRS; major and fundamental change necessarily carries with it the risk that plans and time tables and proposals sometimes may need to be altered. Indeed, we may make some errors along the way. In fact, frankly, we have already made some in trying to implement the many provisions of the Restructuring

ing and Reform Act, but we are quickly fixing them when we find them.

I believe one of the most important mandates of the Restructuring and Reform Act bill was actually the provision that called for the IRS to rewrite our mission statement, to change our focus, to set a broader and higher standard of performance. So I appreciate this Congress and the committee adding that provision.

As you know, our new mission statement is: "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." I believe if we properly execute this mission, we will serve the public properly, and we will also generate the tax revenue that the Government requires.

Of course, there are many new provisions and expansions of taxpayer rights in RRA. These provisions deal with rules such as protecting innocent spouses, offers in compromise, and greater power for the Taxpayer Advocate. We are finding the taxpayers are already beginning to benefit from this array of options.

Implementing this new law, the other changes in the Tax Code, and our organization is an enormous task. At the moment, we are implementing 157 near-term specific initiatives that are designed to improve treatment of taxpayers. About half of these initiatives are mandated by the Act. The rest are our own initiatives. There are about 1,260 Tax Code changes. Many of these require some rather complex interpretations that we need to issue in order to guide taxpayers and our employees.

I agree with the comments of members who stated that training our 100,000 employees in these complex provisions is a very essential part of complying with RRA '98. I really want to stress that training is one of the really essential near-term and immediate challenges that we have in order to deliver on these mandates and to deliver the service that the Congress and the people expect.

About 70 percent of our employees deal directly with taxpayers as the main part of their job every day, and we think the taxpayers have every right to expect that in every such encounter the employee will understand the tax law and have the skills and the training to understand the facts and circumstances of that taxpayer's case. That is what training is all about, and that is a big part of our near-term emphasis.

RRA 98 also directed us to place greater emphasis on meeting taxpayer needs in other ways. In this filing season, we opened up our phones, 24 hours a day, 7 days a week, and opened up 250 of our offices on Saturdays. I will say that phone service is particularly important to small business, because many small business owners do not have time to deal with tax issues during the day. Providing this assistance was not a small undertaking.

We have also made progress on our electronic tax administration strategy which reduces the burden for people to file.

By the way, there is a list here of some of our major milestones for this year which is on this chart. You can see that each one of these is a rather large undertaking.

One of the most important milestones has to do with the issue that was identified very strongly in some of the hearings in this committee; the way the IRS measures performance internally with-

in the IRS. After a great deal of work for a year and a half, we have begun to implement a whole new system of measurement which we call a balanced measurement system. I believe this system is a balanced approach, which puts emphasis on approach, customer satisfaction, business results, and employee satisfaction, without the use of enforcement revenue in the field as a measure of performance. We are currently in the process of going through a roll-out and a training of most parts of the IRS in this new balanced measurement system.

We are also working on the proposal that I made to the committee and which was incorporated in the law concerning the reorganization of the IRS to more clearly reflect accountability for meeting needs of specific groups of taxpayers. We are completing the planning for that and have already begun implementing parts of it.

We are also redesigning other parts of our operation, such as our collections process, and we are beginning the very long process of replacing what is really a very major problem in the IRS, our antiquated base of technology. So we have many challenges, as listed here on this chart. These are just the ones for 1999.

In preparing our budget request for fiscal year 2000, we were also, aware of the stringent budget ceilings that exist. So we put together what we think is a bare-minimum request that would allow us to meet and continue to make progress on these modernization challenges, balancing the limitations of the budget ceilings as best as we could.

The budget request for fiscal year 2000 is \$8.1 billion, which is essentially a flat budget over the prior year. There are some particular provisions that give us some ability to make progress because we had some advanced funding on some of our technology, and the year 2000 money is not as great this year as it was the previous year, but the budget is tight.

I do believe that the IRS is fundamentally changing in the direction that is mandated by RRA. I believe that through these changes, we can succeed in producing an IRS that better serves America's taxpayers both individually and collectively. I believe what we need most of all is the sustained support of Congress and the public while we make these changes, even while, of course, we have to go about the day-to-day business of administering this huge system.

I have been very pleased with the support, as indicated by the opening comments of the members here. However, we will also need your continued support on a sustained basis because this is an enormous challenge that will go on for a number of years.

One forecast that I made at my confirmation hearing before this committee is that it would take the better part of a decade to reach our goals for the IRS. Now I have been in office for 17 months and I will still stand by that initial forecast. I believe it will take the better part of a decade, but the destination is worth that long journey.

Thank you.

[The prepared statement of Commissioner Rossotti appears in the appendix.]

The CHAIRMAN. Thank you, Commissioner Rossotti.

Let me ask a question on your closing remarks because there are comments that I hear that give me great concern.

Typically, so-called bureaucracy says we will just wait them out, it is just a matter of time before the Commissioner will leave for greener pastures, might even say the chairman will be gone. We are talking about changing culture. I have heard it said that about 20 percent of the employees support what you are doing, 40 percent are opposed to the changes, and the other 40 percent wait and see.

My question to you is how do we answer that. How do we make the employees recognize this is for real, that this is serious, that we are talking about changing the culture from top to bottom?

Commissioner ROSSOTRI. Well, let me just say that I think believe that within the agency at this point, there is very little doubt that the changes are for real because many of them, as you can see on this chart, are being implemented, and many of them are incorporated into law, but, nevertheless, of course, continuity is a very important element.

I believe the Congress did a number of things in the Restructuring and Reform Act that contribute a great deal to that. One of them, of course, is establishing a 5-year term for the Commissioner, which means that unlike the previous situation, the term would not end with the Presidential administration, which I think under the current circumstances is pretty important because the end of the Presidential term is less than 2 years away.

Likewise, I believe when the Oversight Board does get appointed, it has staggered terms, and I think continuity is one of the reasons why that was put into the bill. Finally, of course, many of the provisions that are in the law are going to stay in the law.

I think the other aspect of this is that we are as part of our internal change program really addressing all aspects of this agency, all key aspects. I mean, we have redefined the mission. We have redefined the goals. We are changing the job descriptions of virtually all front-line employees. We are changing the internal measurement system.

We have behind me here a new top management team, and we are continuing to recruit other people, some from outside the agency, which has not been the case as in the past, thanks to the authority this committee gave us. When we have the new organization structure in place, we will have a number of management teams, one for each of the units that will have a great deal of responsibility and commitment to continue the improvement process, and, of course, we are addressing the issue of technology. So, when you put all of that together, that is just about everything there is, other than the tax law itself, everything there is with respect to tax administration.

While I think we are now at the point where we were in somewhat of a wind-up phase, we are now at the point where we are really in an implementation phase. The reason I brought these books is because I did intend to read them, but they do show some of the training material, albeit a very small amount. These books here, for example, are just the training material, the reference material just for the telephones, people that answer the telephones.

There are books here that show, for example, one section of the code, and there are 71 different taxpayer rights sections.

At this point in time, just this fiscal year, we have invested 2.2 million hours of training, and that is only in the first half of this fiscal year, just on the Restructuring and Reform Act, about another 4 million hours on other things. That is an enormous amount, and it is not even really scratching the surface. We are going to continue at that pace, and in fact, in our budget request, we have asked for additional funding.

So these are some of the activities I think that are underway and some of the things that I think perhaps address the concerns that you raised in your question, Mr. Chairman.

The CHAIRMAN. Let me carry forward on this thought because I cannot stress how important I think it is that the employees understand this is for real and it is going to be a continued effort.

Of course, in large measure, that does depend on you, and we intend to keep you there because we think you are doing a good job.

As you point out the Oversight Board is also important. I am concerned that the administration has not come forth with nominations, but when it does, it is important that we have the kind of people that will genuinely be interested in this kind of reform. I would assure the administration that when those nominees come up for confirmation, we will be taking a hard look at them from that standpoint.

You also mentioned your new team, which I think is critically important to bring new blood into the organization, particularly at the top, to bring the kind of change in policy we want.

We provided in the restructuring legislation considerable authority for you to hire people, to pay them relatively well as far as the Government is concerned. Would you care to comment? What is your experience with this authority? How will you use it in the future?

Commissioner ROSSOTTI. Mr. Chairman, as you recall, that was one of the provisions that I particularly argued for very strongly. I very, very much appreciate that this committee and the Congress gave us that authority because I really think that is one of the cornerstones, one of the key items that we needed to have, and we have been using that authority.

I will not take the time right at the moment, but after the hearing, I could introduce you to some of the members that are here, including the Taxpayer Advocate, Deputy Commissioner, Chief Information Officer, and others that have been recruited from outside the agency, as well as some that have been recruited from inside the agency.

I found that because, interestingly enough, of all the reform that is going on, we are in the eye of the storm, but, nevertheless, I think people realize that this is a unique time in this important agency that there are people who are interested in public service at this point and see an opportunity to have a lasting effect on something that is really important for the country. I think that has been probably the most important attraction.

We have only begun. We are continuing to recruit. For example, we have actually three major recruitments underway right now to head three of the other units that we are setting up, and we have search firms helping us. We have, I think, a very, very good list of candidates, and over the next few months, we will probably be

making some more announcements of some additional people coming in.

We have also been able to recruit some highly qualified people in the information systems section because that is an enormously important area. Even though we are working with outside contractors, we need some inside managers to help manage that program.

So we will continue to use that authority, I think, to very good avail, and I have to say I am very pleased at the response that we have gotten. Many people asked who is going to come in and join the IRS at this point in time, and certainly, that is the response we did get from some people who said, "Join the IRS? I am not interested," but, on the other hand, we have gotten some people, I think very qualified people, who see the public service opportunity and are willing to join us.

The CHAIRMAN. As we both have said, there is no question that it is going to take time to implement the many changes mandated by the recent legislation.

Let me point out that I am concerned that there are continuing reports of taxpayer and employee abuse. For example, I am deeply disturbed by the allegations of retaliation.

Among the things I have heard is that one witness received nothing but excellent ratings. Since this person appeared as a witness, the ratings have collapsed, and the person has received only failing grades, very strange.

Another witness was subject to sitting among colleagues as the witness manager replayed the witness' Finance Committee testimony in a way to ridicule and demonstrate that the witness was not a team player, and that has been very important in the past that you be a team player.

Yet, another was escorted from the office by armed individuals and not allowed to return to work.

Commissioner Rossotti, these matters concern me. What can we do about it?

Commissioner ROSSOTTI. Let me just say that they concern me, also. Any reports like that concern me.

I think you remember when I first came to my confirmation hearing, in my short statement, one of the main principles that I said I have always lived by and tried to foster in the IRS is the idea of open and honest communication so that anyone that has a problem, that has wrongdoing to report, or an error to surface, can do that without any fear of being retaliated against, and, of course, that includes appearing before this committee.

In countless communications inside, I have stressed that point, and I think we have seen some turnaround, some significant turnaround, because I am getting a lot more information internally than perhaps I would have earlier.

After the last series of hearings that you had, we took some special steps. One of them, of course, was that we agreed that we would have the GAO Office of Special Investigations do the investigations of those issues so there would be no question that the results were independent of the IRS. In addition, internally, I sent out a memo to all the managers in the chain of command of those witnesses, telling them that the GAO is going to launch an investigation and asking that we not investigate anything ourselves, less

that be misinterpreted, and to insist that those witnesses be treated fairly, just like any other employee.

Since I heard the reports that you told me about, I have been very concerned and have taken an additional step. I have actually written a letter to the head of the Office of Special Counsel, which is a special agency in the Federal Government that has been set up to look into matters such as whistle-blowers and retaliation, and I have asked their assistance to come in and look to see if these concerns of these witnesses are substantiated. If there are any of those substantiated, I can assure you, we will take action accordingly. I took this step just within the last week.

I also want to mention this issue of retaliation, not only applies to witnesses that come here, but anybody that reports any kind of a complaint or a wrongdoing. Retaliation has a lot of subtleties to it because, if a person goes back into the work force, they still are subject to the normal assignment process and evaluation process. It is difficult sometimes to sort out what is and is not retaliation.

I took the step, working with my EEO officer, who is a very good person, last year, to send out a specific memo, which I can give to you here, which actually dealt specifically with the issue of reprisal and retaliation, not with respect to your witnesses, but in all cases, and gave examples of what we consider to be, you might say, subtle kinds of retaliation or reprisal that could exist and to illustrate for people that these kinds of things should not be done. We are working hard to make sure that anybody that has a complaint or a report of misconduct can come forward with that, without fear of retaliation, and if any of the particular incidents are substantiated, I can assure you that we will take action on those matters.

The CHAIRMAN. It is my understanding that you announced yesterday the creation of a new complaint process.

Commissioner ROSSOTTI. Yes. That is another issue that I had mentioned.

One of the other reviews that I did, if you remember, was the report by Mr. Bowsher, the former head of the GAO, and he had done a whole series of recommendations for me related to the Inspection Service and the processing of complaints.

One of his recommendations was in two parts. One is that we set up a more centralized process to track complaints, and the other was that we publicize in some form, subject to the rules of privacy, the disciplinary actions that we took when they were acted on, which was part of the problem I think internally.

Following on that report, we did a study with the help of one of Mr. Bowsher's colleagues, Mr. Layton, who is a former Inspector General himself. He was the one that came up with this plan to have a centralized complaint unit, which we just announced last week. Actually, there was another part of that which was a central adjudication unit to actually look and evaluate disciplinary actions for certain kinds of disciplinary concerns as well.

We have now got that unit in place. I hired a gentleman named Mr. Whitlock who actually had experience in the Defense Department in this area, and we just this week finally got that unit fully established. This unit will have the responsibility for tracking all of these different kinds of complaints, including those that come

back to us from the investigations of the new Tax Administration IG.

We have put a lot of these things in place, but, again, it does take some time to see the effect of these actions.

The CHAIRMAN. I appreciate that.

I do intend to have oversight hearings on these matters, but I think those are important initiatives.

Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman.

First, Commissioner Rossotti, I want to just tell you how much I am impressed thus far with your testimony. Many times, I tell people that we have got a good opportunity in the United States to reform the IRS because we have a businessman as the head of the IRS, not a tax attorney, not an accountant, but a businessman. It is clear that the way you have tackled these problems that you are approaching it from a businessman's perspective, and I think, therefore, we have a much better chance of solving a lot of it.

With all due respect to my colleague from Florida, I do have a sense that things are progressing, that we are turning the corner, that a lot of the problems we have with the IRS are being addressed and they are being solved, and, of course, there is a lot more to do, but my sense is that finally there is a positive change. We have talked about change for a long time with the IRS, and a lot of us on this committee for many years have complained. We never stuck with it. We have never had the focus, but I want to compliment Senator Kerrey and to hers for the legislation that got us on this track, also the President for naming you, and also you for doing what you are doing, as well as you, Mr. Chairman, in following up. So much of this is follow-up, and it is persistence. It is just sticking with it, and it is clear that that is something that you are attempting to do.

I noticed a couple of days ago that the FAA did a test run of the Y2K problem with the Denver airport. I know that you have your own schedule of phasing in your Y2K testing. I wonder if you could tell us a little bit about that, and also the degree to which Congress passing tax legislation this year is going to add a burden to that schedule and what effect that might have, that is, the tax legislation that we may pass this year on your attempt to be sure you are Y2K-free.

Commissioner ROSSOTTI. Just to briefly update where we are, I believe, we just this week, we are passing an enormous milestone. It is hard to describe a milestone where nothing happens, but that is the most important milestone. Nothing bad happened during the filing season after we put back all of the new systems into operation, having made them Y2K-compliant. So we have got most of our application systems now fixed.

We are now doing the kind of thing that the FAA did, which is what is called an end-to-end test, where we have actually rolled the clocks forward to simulate the environment as it will exist after the turn of the date.

We have already done two of those tests on a limited basis, and they have worked well, but that is one of the biggest jobs we have for the remainder of this year. We will have two more major end-to-end tests with the clocks rolled forward, the last one of which

will be in the fourth quarter of this year when we will have incorporated at that point not only the year 2000 changes, but any additional Tax Code changes that need to be incorporated.

So I feel at this point that we have made some very important progress in terms of milestones, but, of course, there is still risk ahead given the magnitude of Y2K. The whole project is about \$1.3 billion, just to give a sense of it, which is one of the biggest, I think, anywhere.

With respect to your second question about the Tax Code, and I think the chairman and I and others have talked about this. We need to consult very, very carefully with the tax-writing committees, both this committee and the Ways and Means Committee, on any proposals this year with respect to the effective dates of any provisions. Because of these testing schedules that I mentioned, we have very limited capacity to make additional changes that will have effect during the 1999 tax year. Once we get beyond that, then the situation is different, but in anything that would be effective this tax year, we do have a very limited capacity. Therefore, I think what would be the best approach is simply when there are proposals in the Congress to consult very carefully on the effective dates, and then we can work with the committee to make sure that we can get them in at the appropriate time.

Senator BAUCUS. I assume that that would be more of a problem than writing tax bills later on this year, where provisions are in effect in 1999.

Commissioner ROSSOTTI. To make them effective in 1999 and if they are not known until late this year, it really bumps into this final end-to-end test.

Senator BAUCUS. Do you have kind of a cutoff point, a drop-dead date?

Commissioner ROSSOTTI. I think you have got to look at the individual case because there are some things that are really very simple to do, not very many, but things like extending existing provisions sometimes can easily be done. I think the only real solution is to consult very carefully on any provision, and especially with respect to the effective dates. We are prepared to do that with the committee and the staff.

Senator BAUCUS. While I have you here, there have been recent reports about audit decline and the effect it might have on compliance, for example. Your thoughts?

Commissioner ROSSOTTI. There have been reports this week, and really, all they are is summing up the statistical effect of two very important trends over the last 10 years, actually. One is that the economy has been growing rapidly and is particularly growing even faster at the upper end, at the more complex end.

For example, at the other side, our staff has been going down.

Senator BAUCUS. The number of staff going down?

Commissioner ROSSOTTI. The number of staff have been going down.

For example, if you just take the number of high-income returns, those over \$100,000, in the last 10 years, we have had an increase of 139 percent, more than double in the number of those returns. The number of examiners has gone down. So you have had a dra-

matic decrease in the fraction of those returns that are audited. That is just a simple mathematical reflection of those two trends.

What I believe is that unless we were to totally change the whole budget and the whole staffing pattern of the IRS and add a large number of people, which we are not proposing to do and we do not have money to do in the appropriations, what we have to do is to make better use of the resources we have, with better targeting, and use things like audits and enforcement actions as one of the important tools, but not the only tool to help ensure compliance.

For example, things like better reporting, matching of Social Security numbers, those kinds of things can be done through technology that conserve our scarce audit resources. Whereas, before, we might have had to do an audit to check on a return. If we can get those problem checked through the computer up front, we can eliminate that need. That is just a simple example.

The whole modernization process, both the organizational changes and the technology changes, are designed to allow us to do a more effective job with the resources we have to both provide service to taxpayers and also ensure that the tax laws are administered fairly, with the limited resources that we have.

Senator BAUCUS. My time has expired, but I think this is a subject that we are going to have to explore. Of course, it is the other side of the coin that prompted these hearings, but the last date I have is a tax gap based on a 1988 analysis which was \$192 billion.

My guess is that the more the public knows, there are fewer audits, and whether it is individual or corporate, and there are fewer criminal investigations, that people are going to try to cut corners a little bit. It is a fine line, the compliance and enforcement and so forth, on the one hand, with the voluntary nature of the American system on the other, but my sense is that more people are going to take advantage of this and the like. That is a problem we are going to have to address.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Commissioner, let me go beyond what our distinguished chairman has talked about in regard to whistle-blowers with a little more specific request for action or determination if any action has been taken.

Specifically—and then before you answer, I will talk a little bit about it—what are you doing to protect whistle-blowers and encouraging people to actually come forward with evidence, encouraging whistle-blowers to come forward.

Let me suggest that one of the best things to do is to make sure that those who did wrong are punished. For instance, if somebody retaliated against a staff member, higher up in the organization, retaliated against a staff member, it seems to me that would be one person that should be punished, or somebody that has been accused of abusing a taxpayer, that person should be punished. Has anyone been punished, for instance, since our hearings? If so, I would like some specifics.

Commissioner ROSSOTTI. With respect to the issues that were raised in the first set of hearings—that was last fall in September, September a year ago in 1997, just before I took office—a lot of those issues revolved, as we have learned subsequently, but also at

the hearings, around some misguided policies, some wrong policies about the misuse of quotas and enforcement statistics that ended up not being in accord with policy and the law. Those were very, very extensively investigated.

As you may recall, we appointed a special panel to actually look at the higher-level people who were involved in those investigations. As a matter of fact, there were 12 managers and executives and 2 employees that were given disciplinary action as a result of these investigations. These results were publicized in a report last year. The report did not, however, mention the disciplined individuals by name. In addition to the specific discipline, there were a number of people who were either reassigned or left the agency. Again, these actions dealt with higher-level employees.

Since then, with the aid of Mr. Layton, who I had mentioned that I had brought in, and with the aid of the IG, we have continued to look at other aspects at middle and lower levels related to those kinds of charges. As a matter of fact, we are just right now finishing that piece. Within the next 30 or 45 days, we should have the next part of that completed. In fact, we have already issued some additional disciplinary actions, but we would like to report on that as a whole when we finish that piece, and we will actually report publicly on the results of those additional follow-up actions. I think that will pretty much complete all of the investigations and all of the actions related to those issues that were raised.

When you look at the finished product, people inside the agency and myself believe that it was a very, very thorough and frankly difficult series of investigations. We took action that really involved more high-level people probably than any recent history of the agency.

I think getting that behind us was a very important step that needed to be taken to show that we seriously took the issues that were raised. However, I believe we are almost at the end of that road now, and when we get done, which will be very soon, we will issue an additional report, just like we did last fall, of the results of the actions we have taken.

Senator GRASSLEY. That statement that you just made to me is your answer to my question that you have taken those actions. So, hence, there is an environment that further retaliation against whistle-blowers will be punished or where taxpayers have been abused will be punished. Is that what you are saying?

Commissioner ROSSOTTI. That is absolutely true. I was just dealing with one set of it.

Beyond that, as I mentioned to the chairman, I have done quite a few other things to more broadly establish the policy that retaliation will not be tolerated. Now, of course, we also have the provisions of the Restructuring and Reform Act, which add further sanctions to those who might commit that kind of misconduct.

Senator GRASSLEY. Then, additionally, can you say by law that nobody be promoted or rewarded on the basis of quotas is being followed today?

Commissioner ROSSOTTI. I can say that. I think I can say that with high confidence. We have a whole process of certification in place now that is being reviewed. Everybody has to sign every quarter, every incident where somebody may have cited an enforce-

ment statistic and an evaluation is followed up on, and those have been virtually eliminated.

I have to stress that just eliminating those by itself is an essential thing to do, but if that was all we did, we would be back into this problem again. Until we put something in its place that is a more balanced system that makes more sense in terms of what we really want to measure, we would just have a void and therefore accomplish nothing.

The balanced measurement system that I mentioned is really designed to correct this problem.

Senator GRASSLEY. I have seen some real improvements in some areas, but there are other areas like offers to compromise that do not seem to be improving. Practitioners are saying that proposed rules for offers to compromise are not going to work.

Is there anything that you are doing to prove that these practitioners are wrong?

Commissioner ROSSOTTI. I believe that what the practitioners are responding to is some interim guidance that we put out earlier this year to expand and improve the way we process offers in compromise under the previous authority that we had, under the old law, not under the new law.

The new law that was passed last year provided some additional authority, significant broadening of authority to deal with offers in compromise. We have not yet completed the regulation that is necessary in order to proceed with that broadened authority. We hope to get that out within the next 30 to 45 days. It is really quite complicated. It is an issue that requires great care and drafting with counsel.

I believe that the practitioners that you are hearing from are responding and saying the guidance that we issued back in December and January does not go to the level of what was proposed by Congress. It does not because that was just an interim step. We have another major step that we have to take, which we will take as soon as we can get the regulation out.

Let me just say that we have also made some internal management changes to have specialists to process these offers to be sure that we work with the taxpayers.

Previously, a taxpayer would send in a complicated form. If it was not just right, the IRS would send it back. We have completely changed that process. Now, the IRS will accept the form unless it is completely unprocessable. We will work with the taxpayer, help them get this form right and see if we can get it right. However, this is not as far as we are going to go because we have not gotten the regulation out that is necessary to complete this process.

Senator GRASSLEY. Thank you, Mr. Chairman.

The CHAIRMAN. Just let me make a short comment. I do think it is very important that the IRS consider factors like equity, hardship, and public policy where compromise of an individual taxpayer income tax liability would promote effective tax administration. I would urge that to be high in your thinking.

Commissioner ROSSOTTI. Mr. Chairman, could I just say, those are exactly the parts of the law that we have not yet implemented because we have not gotten the regulation completed. That is not because we have not been working hard on it, but because it is

complicated. Those are whole new areas of authority that have never existed before, and it takes some time to work out the guidance for that, but we are working on it. We are getting close to getting that completed, and then we will be in a position to process those offers.

The CHAIRMAN. We will look forward to that.

Senator Kerrey?

Senator KERREY. Thank you, Mr. Chairman.

First of all, let me thank you, Mr. Rossotti, for making the point that the law giving you a 5-year term is an important part of creating the incentive for employees to adopt to what I find to be a very exciting plan that you have put together.

Your modernizing the tax agency's plan is a very good plan, in my judgment, and should enable you to make a considerable amount of progress, presuming that Congress provides the kind of support that you need, and I would like to get into that a bit, but having a 5-year term helps a great deal and the board.

The importance of having a staggered board confirmed by the Senate is that you need somebody who is independent of you who can come to us and say, "Congress, you are making our job difficult." You cannot do that. You cannot come to this committee, to the appropriators, to the Government Oversight Committee. Those are the three that you have to do in the Senate. There is also three over in the House, and from time to time, you get called up before Joint Tax. So you have committees that you have to appear before to rationalize your budget and your plan and explain. You spend a lot of time up on the Hill as opposed to out managing the agency. God knows, if you get one of us angry, that you relocated an office, I have got a taxpayer that said you are mistreating them—our prisons are full of people who did not do anything wrong. If I get angry at you, my most obvious course of action is to cut your budget. That is a fairly repetitive problem, it seems to me.

I think there is an urgency, Mr. Rossotti for us to get into as quickly as possible the details of your plan. I am very much concerned that as a consequence of the budget caps and the flat budgeting, you are going to be getting approximately what you got last year, and there is reason to believe that may get you through this particular year, but as I look at it, we have got a growing economy. You are going to be collecting more revenue than you collected last year, a more complex economy.

One out of seven people in Nebraska are self-employed. That is an extremely difficult kind of question that they come up with.

I read in the paper every day not just mergers and acquisitions, but corporations that instead of merging are forming very complicated associations.

As well, the chairman had an excellent hearing earlier on the problems that companies face that are doing international businesses.

So not only are you facing a rapidly increasing amount of volume, but the complexity of businesses is also a factor, as well as the complexity of the code. You are coming up with an exciting new plan that calls to revamp business practices for operating divisions, management roles with clear responsibility. You are pushing deci-

sion-making further out towards the taxpayer, flattening out the organizational structure, proposing new technology.

You have told me that you have got 1962 computers still cranking out paper with 600 gray-haired people that you hope do not leave because if they leave then you will not know how to operate the machines any longer.

So you have got a very exciting plan, it seems to me, Mr. Rossotti, but it seems to me that we have got to take a very hard look on the appropriations side of making certain that you get the resources that you need to train.

One other factor I did not mention is that, unlike the previous business that you operated, in this business, you have got revenue that surges in. It is not spread out equally over 12 months. I do not know what the percentage is of temporary help that you hire, but you have got a lot of temporary help that you bring in, all of whom have to be well trained because if they are not well trained they will make the kind of mistakes that both the chairman and Senator Grassley were talking about, either with respect to taxpayer's harassment or just not being able to get the job done, not being able to answer all of the various questions that taxpayers have when they are trying to fill out and comply with the Tax Code.

So am I correct in assuming that we need to pay especially close attention to the amount of money that you are going to be able to use to train your employees to all these new missions, all these new responsibilities, all the new complexities in the code book that we pass, as well as what the taxpayers themselves are creating as a result of different kind of business practices?

Commissioner ROSSOTTI. Senator Kerrey, I think you put your finger on the immediate future especially, but also going on one of the key things that we really have to pay the most attention to if we want to fulfill the mandate of the bill and deliver good service to taxpayers, which is in fact the training of the work force.

My proposal is that we not increase the size of the work force, despite the increase of the complexity of the economy and the size of the economy.

I believe that if we invest in the work force that we have and provide them the proper management and training and technology, I believe that we can fulfill the mandates of the bill.

Senator KERREY. Mr. Rossotti, you have got an \$8.1-billion budget. That is what you had last year. That is what you are going to have this year.

Commissioner ROSSOTTI. Yes.

Senator KERREY. My guess is you are going to have at least 10-percent more revenue and substantially more work. Let's presume that you can get by with that.

Of that 8.1, how much of that is personnel?

Commissioner ROSSOTTI. About 70 to 75 percent of the budget is just pay and benefits for the people.

Senator KERREY. Can you estimate for me? If you were a private-sector company, how much would you allocate for training, given all the requirements? If you cannot do it today, perhaps you could follow up.

Commissioner ROSSOTTI. I can get back to you.

Senator KERREY. It is one of the arguments that I intend to take to the floor of the Senate during both the authorizing and especially the appropriating process. I appreciate that we have got caps that are imposing limitations on what we can do. I think all of us need to be very much alert to the problems that is going to create in terms of being able to full implement the law itself.

Commissioner ROSSOTTI. I will try to get back to you with some bench marks, but just to indicate what we did in the budget, we have asked for a particular increase, \$17 million, just to bring us up to what we think is the regular ongoing level we need just to train people on these laws, and then another \$36 million for specifically making these transitions in the cultural changes.

Senator KERREY. If you would, as a follow-up, provide me at a later time, since my red light is on, whether or not you have had to take money away from compliance in order to be able to do training.

Commissioner ROSSOTTI. We will do that.

Senator KERREY. Thank you.

The CHAIRMAN. Senator Mack?

Senator MACK. Thank you, Mr. Chairman.

I mentioned my skepticism earlier. I still maintain that skepticism, but I, by the same token, do not want to allow this time to go by without recognizing the accomplishments that you have made.

My interests are to follow up on some of the cases that we heard about in the past and see what the status of those cases may be.

A chief in the Personnel Branch of the IRS Office of Chief Counsel, Yvonne DeJardins, testified that the Inspector General investigated and substantiated allegations of travel fraud, abuse of subordinate, sexual harassment, fraudulent performance appraisals, and orders to cover up illegal actions, all against IRS executives. Yet, in all cases, reports from the IG were sent to the Deputy Commissioner's desk, and no disciplinary action was taken.

Has the IRS now followed up on these IG reports?

Commissioner ROSSOTTI. I do not have at my finger tips those specific cases. So I will be glad to get back to you on the answers on any particular cases, but let me just say that we have got a whole new management team in place here, as you know, with a new set of players involved, and we have established just recently a new unit to specifically track all complaints and disciplinary actions, especially those against senior individuals, to make sure that none would fall through the cracks. So we have done a lot, I believe, to make sure that those kinds of falling-through-the-cracks kinds of issues or failure to follow up will not occur, but on the specific ones, I do not think I can give you the answers right off the top of my head. I will be glad to get back to you and give you those details.

Senator MACK. There is a note there.

Commissioner ROSSOTTI. The note has to do with the fact that the allegations, now that I remember, that were made by Ms. DeJardins, I believe was in the April hearings, and what we agreed was that all of the allegations that were made in those hearings would be investigated by the GAO Office of Special Investigations.

Senator MACK. What is the status of those investigations?

Commissioner ROSSOTTI. That, I do not know. I do not know. That is being done by—

Senator MACK. Does the fact that it has been turned over to the GAO mean it is totally out of your hands? There is no interest or concern to follow up?

Commissioner ROSSOTTI. Depending on what they find, if they come back and substantiate the allegations, we would have to act on them.

Senator MACK. All I am saying is I would appreciate it if you would instruct whoever is responsible for it to follow up to see what the status of that is.

Commissioner ROSSOTTI. Yes, okay. I just want to make clear—

Senator MACK. If I can, I think this goes to the matter of whether employees take seriously whether there are going to be changes.

Commissioner ROSSOTTI. Let me just try to explain. On the GAO, we did that specifically, I think in agreement with the chairman, to make sure that they would be followed up on by an independent agency that was not in any way, shape, or form dependent on me or anyone in the IRS.

Senator MACK. I do understand that.

Commissioner ROSSOTTI. Right.

Senator MACK. Again, it just seems to me there should not be a circumstance, though, that just says that that is now someone else's responsibility because what they do and how they do it will affect how people in the IRS react to whether there are going to be changed.

Commissioner ROSSOTTI. I agree. As soon as we get to whatever their findings are, it will be our responsibility to act upon them and ensure that if there is any substantiation that we will act. I assure you of that.

Senator MACK. Let me just again for the purpose of, I guess, emphasis point out my concern. Another case which happened to a constituent of mine by the name of Tommy Henderson, he blew the whistle on a renegade special agent with a number of problems. It apparently has turned out that the renegade was protected instead of punished by his supervisors, and the IRS employee with the courage to report the misconduct ended up being the target of retaliation.

Again, I am raising this because it seems to me that these specific cases that we raised at hearings, there ought to be a special sensitivity to that—

Commissioner ROSSOTTI. There is, yes.

Senator MACK [continuing]. With the IRS management. So I am not asking you to give me details on that. I am asking you to look at it again—

Commissioner ROSSOTTI. Yes, sir.

Senator MACK [continuing]. And let me know what the status is.

Commissioner ROSSOTTI. We will do that.

The CHAIRMAN. Could I just make a comment? I think the record ought to be clear that it was agreed that we would have the GAO make the study. That study was made at my request, and when the results are out, it will, of course, be available for the IRS. At that time, we expect the appropriate action to be taken.

Senator MACK. Can you tell me when you think that report will be out?

The CHAIRMAN. We have had no information on it.

Senator MACK. Let me just make the point. Again, I understand what we did, and it was a reasonable approach to the problem, but I do not know and apparently you do not know and apparently you do not know what the status of that GAO report is. It seems to me that some of us ought to be putting a little bit of pressure on getting that report out.

The CHAIRMAN. That has been done, and the GAO is well aware of it, but there are a number of cases. We will renew the request, along with your demand.

Senator MACK. The last area that I want to touch on is on one of the comments that I made in my opening statement. It had to do with Dennis Crawford, director of the National Operations in the Criminal Investigation Division, who recently stated in The Washington Post that the agency is now employing more armed search-and-seizure raids than before.

Commissioner ROSSOTTI. I do not know about that particular comment, but let me just say that the biggest thing that we have just done with respect to criminal investigation is we just finished about 7 months of a very detailed review by Judge Webster and his team. We just received that yesterday, as a matter of fact. I do not know whether you have gotten a copy. I hope we have given you a copy.

Just going back, I have made the commitment that we would review from top to bottom basically all aspects of the IRS, and the Criminal Investigation Division is a very specialized component. We needed some outside help to do that. That is why we got Judge Webster to look at it. His role was to look not so much at the individual cases that were raised, which were turned over to the GAO, but rather to look more systematically at what we should do with this component of the IRS. I think he did that mandate very, very well, very thoroughly. Essentially, they came up with a number of very important recommendations. The most fundamental is that, as they described it, there has been drift from the main mission of what should be the mission of this agency, this component of the agency, which is to focus on administration of the tax laws into some other kinds of law enforcement activities.

Their recommendation, and they have many specific ones, is that the main focus of CID should be what it is there for and that really it is placed as the only agency that can fulfill that role. In order to implement that, they have made a number of very important recommendations. One of them has to do with reorganizing it, getting new leadership, changing in some cases, not so much changing procedures, but seeing that certain procedures, for example, on search warrants that are on the books are more carefully documented and followed up before they go forward with those kinds of activities. So it is really a very comprehensive blueprint, I believe, of what needs to be done to ensure that CID is doing the mission that it is really there to do, which is to help in the administration of the tax laws.

We are going to proceed forward with that under the authority we have under the Restructuring and Reform Act. We have the au-

thority to proceed to do this reorganization and basically implement all of the things that are recommended in the report. So I think we can move rather quickly to do these things.

Senator MACK. I thank you for that.

I do have a copy of the report, and one of the specific recommendations was that the division cease making high-risk entries into taxpayers' premises, and it should seek instead to call on other law enforcement agencies.

Commissioner ROSSOTTI. Yes.

Senator MACK. Again, the quote or the statement by Dennis Crawford that more of these are taking place than before, the report comes out yesterday saying that in essence there ought to be fewer of them, and I am just raising that—

Commissioner ROSSOTTI. Sure.

Senator MACK [continuing]. That that is another concern that I have with respect to what is going on.

Commissioner ROSSOTTI. I can assure you that that recommendation, along with the others, will be implemented, and with the new structure that we put in place in the new leadership, we will ensure that those things are done.

Senator MACK. Thank you very much.

The CHAIRMAN. Senator Robb?

Senator ROBB. Thank you, Mr. Chairman.

Mr. Rossotti, when you were describing some of the progress that you are making in terms of the requirements for better training, et cetera, you pointed to the volumes just to your right, four very thick volumes, plus an additional volume sitting next to it, and although I know you meant for that to be reassuring, I found it just the opposite. Let me just suggest to you why. I am sure that there is a good answer, and it might relieve others who become a bit anxious.

When you said those four volumes related just to the telephone training or those who respond to telephone inquiries—I do not remember the precise nature—it occurred to me that if I were someone on the IRS staff or prospectively a new employee, I would look and that and I would think, "Wow, that is sort of intimidating." The sheer paper volume alone is more of a threat than that beaver in the Tidal Basin here last week, whatever the case may be, if we are putting out that much paper in a period of time when we are attempting to modernize.

I took a look here at the IRS modernization booklet that my friend, Senator Kerrey, made reference to, and I looked through it rather quickly and I found a couple of things about information technology that I was not able to find anything that gave me the confidence that we are going to try to make as much of that kind of information available on the computer screen of the operator and accessible as a resource bank rather than expecting someone to read and understand that many volumes with respect to the general questions that might come in.

Again, I suspect those are ways of responding to different types of questions that are raised. That is pure speculation on my part, but I just want to give you a chance to deal with my concern in this area because it seems to me that we ought to be moving as we are. We are encouraging filing electronically, and we ought to

be encouraging employees, notwithstanding your 1962 machinery technology, computers, whatever it is, and the people you have to keep on to keep those machines operating.

When I got to thinking about that, it occurred to me that we ought to be able to probably make that same file available to taxpayers so they could simply download it themselves and find the answers at least the IRS would purport to give to those kinds of questions, and then they could call for additional help. Tell me that that is all being done and that my fears are misplaced with respect to where the modernization effort and the simplification and the money-saving efforts that could be otherwise directed elsewhere are going.

Commissioner ROSSOTTI. I wish I could say that your fears are misplaced. They are not all misplaced.

Senator ROBB. Then, that is really scary. I thought that was a softball question.

Commissioner ROSSOTTI. Unfortunately, I have to say honestly what the reality is at the IRS. The reality is that many of the things that can be done with today's technology and should be done are not being done because of the limitations of the existing base of technology that we have installed, which is very fragmented, relatively poor quality in terms of systems, and very old.

With respect to the specific question of these four volumes, which is a reference manual—of course, it is not something that you read every day, but it is a reference manual—in the last year, we have made some progress in putting this where it should be, as you noted, online and through a computer screen with reference where the customer service reps, as they are called, can call these up on a computer screen.

As of a year ago, we had only a very few reps that had that capability to do that. Over the course of the last year, even with old technology, we have been able to give a significantly greater number of those people access, but not all of them.

Senator ROBB. Let me just stop you there, if I may, because I am, again, new to the official inquiry into the inner workings of the Internal Revenue Service.

Are we in a position where we simply do not have the dollars for capital investment to provide those who are on a phone with that kind of instant response, so that they have to, in effect, take one of those manuals and put somebody on hold and look up page whatever it is and give them at least the school solution, as we used to call it in the military 40 years ago?

Commissioner ROSSOTTI. We have—

Senator ROBB. I am becoming more anxious, rather than less.

Commissioner ROSSOTTI. I cannot be reassuring with respect to the base of technology that we have at the IRS. It is really very deficient in relation to what we need to have, and that is part of what our whole modernization program is, to replace this.

I do want to say we can make some progress. We have in the last year given most of the people who are on the telephones access online through their computer screens to these documents. We have been able to do that, but it is through a very, I will call it, jury-rigged kind of a process, and the process of updating it and main-

taining it is not a modern one that would be consistent with what you would have in a private-sector company.

We have also been able to put a lot of these things on our web site, which is one thing that is a successful short-term improvement that we have been able to make for taxpayers. In fact, that has been very successful. We had over 600 million hits to our web site so far this year, and for the very kind of thing that you are talking about, where taxpayers can come in and get the answers to this "school solution" to the questions.

The reason I do not think I am giving you the reassurance you would like to have is that all of this is essentially, you might say, held together with baling wire. We have a base of systems that was initially built in the 1960's, which is the foundation system that keeps all the taxpayer records. Over the course of 30 years, there have been about 130 or 140 other individual systems that have been added onto these things, not in a way that was subject to any real technology standards or any defined architecture.

So, when you put this together, you have a base of technology that is really not adequate to support the current work that the agency is being asked to do, which is why we have this plan that is going to take quite a few years to do, to basically re-architect this, replan it, and replace it.

Senator ROBB. With all due respect, and I know you are spending a lot of time on Y2K compliance and you have gone through two phases and whatever, that led me to believe that you were far more electronically advanced than it sounds to me like you are, and without having looked at the problem in detail, I would simply have to tell you that it seems to me that ought to be a much higher priority. If you are dealing with the kinds of records that it sounds to me like you are dealing with, getting those into some kind of a system where you can update them electronically and not have to go retrieve each file and go through all of these processes that are engaged, it is going to be a long time.

Commissioner ROSSOTTI. It is one of the major priorities. It is just that it is an enormous job and a very risky one.

In fact, one of the main things we have done is given an award to a prime contractor to work with us to implement what is called the technology blueprint to do exactly as you are saying, but the IRS is one of the biggest data-processing users in the world, and we have to continue to maintain the current operations and change the tax law every year, even while we are replacing these systems. So it has to be done very carefully in pieces, one step at a time.

Senator ROBB. My time has expired, and I thank you, Mr. Chairman.

May I just ask, anything you could give us or you can give me in writing, some sense of what you are attempting to do would be very much appreciated.

Commissioner ROSSOTTI. I would be glad to come over. In fact, I have got our Chief Information Officer right here. We would be glad to come over and give you a sense of this because there is a plan, but it is a big, big long-term job.

Senator ROBB. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Graham?

Senator GRAHAM. Thank you, Mr. Chairman, and thank you for holding this and the series of hearings that you are going to be on oversight of the IRS reform.

I would make a preliminary comment that what we have just heard in the last hour or so is not unique. There are many complex organizations which in recent years have gone through the kind of fundamental cultural change that we have now asked the IRS to undertake, and those organizations would include the United States Army, the telecommunications systems, the commercial aviation, the Post Office, just to mention a few.

I would suggest, Mr. Chairman, that it might be helpful if at some point in this series of hearings we would have a hearing in which we could invite witnesses from those major enterprises, such as the examples I have just given, who have experienced the same type of change that the IRS is going to be experiencing over the next decade to gain from their experience what are the trouble points, such as the kind of training questions that Senator Kerrey was asking and the information technology questions that Senator Robb was just raising, that we need to be aware of and what can we gain from the experience of other organizations that have already traveled this route that would help us in anticipating and responding to those issues for the IRS.

It would also, I think, help give us a sense of reality. This is not going to be an easy transition. One of the things that makes it particularly complicated and will be the subject of a couple of questions I am going to ask is we are demanding of the IRS very fundamental reform. At the same time, we want the ongoing day-to-day business of the agency to be conducted without interruption. Those are two difficult challenges to ask of an agency to implement concurrently. So that is my suggestion for the morning.

If I could turn to that question of how do you maintain a consistent level of service to the taxpayer customer while undergoing this change, in our office back in Tallahassee, we get about 50 IRS cases a week, that is, Floridians who have had some concerns and call us and ask for help.

I asked if we had seen any change in that number or the nature of those since the IRS reform process commenced, and the answer was essentially no, that the level of citizen requests for assistance and the character of those are about the same.

There does, however, seem to be some increase in the number of cases that relate to rather ministerial problems, such as the wrong identification number and the inability after several contacts by the taxpayer alone to get that rectified.

I wonder, and this is probably largely a budget question, if you are being aggressive enough in asking us for the resources that you need to continue to provide an acceptable level of service while you are making this massive investment in restructuring and in areas like retraining.

Commissioner ROSSOTTI. First, let me just say, you have put your finger on what is really the hardest management part of this whole thing, which is to make all of these changes. I mean, we are rebuilding the house while we are living in it, and, of course, as you know, other organizations have gone through that, but when

you are living in the house and you are changing it, it really is not very easy.

Many of the kinds of things you mentioned, ministerial acts, have to do with technology. We have a very error-prone process because of this technology. If a taxpayer calls up today with something that they got in the mail and it is not correct and they said this is just wrong and they call us up and they get somebody on the phone, even if the person is well trained, they do the best job that they can. They put it into a system which is not a user-friendly system. Even if they get it in right, it could take up to 16 days before that actually gets into this antiquated tape file system we have.

During that 16 days, many things could happen. There could be some other system that generates another notice to the taxpayer about the same problem, and then if the taxpayer calls up again, they could get a rep on the phone and that rep may or may not know for sure that the previous rep fixed the problem. It can just cascade and really cause a lot of frustration for everyone.

There is no immediate fix that we can make for those kinds of problems, short of replacing the technology.

What we are trying to do, of course, is to provide some better training for the employees so that they can recognize these kinds of issues and deal with them, but I have to tell you, oftentimes the employees are frustrated because they have got these computer systems that do not give them the information they want.

So this is the kind of thing where we can put some Band-Aids on the problem in the short term, which is what we are attempting to do, but in the long term, we have got to fix this technology and we have got to get the whole thing straightened out.

I think as far as the budget is concerned, the approach that we have taken is to say we think that we can—the most expensive resource we have is our work force, our people. That is 70 or 75 percent of the money.

If we were to try to go back to the old way of doing business and just do the same number of audits, do everything the same way, we would have to have an enormous increase in the work force to keep up with the economy, and I do not think that that is really practical from an economic standpoint or even necessary.

What I think we do need is the investment money to be able to make these technology changes, to make the organizational changes, and to have better training and better qualifications in the work force. I think if we can do that and we can sustain that over a period of years, we can solve this problem, but one of the things that makes it a long-term process is the fact that we do have to do, as you say, be very, very careful about making these things.

We are imposing a lot of change in this organization in a very short period of time. If you look at that set of red bullets there, any one of those projects, any one of those line items would be a major project by itself. So we cannot push this too far or we take the risk of undermining the ongoing day-to-day operations.

Tomorrow, we are finishing this filing season. So we have kept our fingers crossed, and I think we have gotten through it without any major glitches, but it is quite a risky period when you go

through one of these filing seasons, while making all of these changes.

Senator GRAHAM. Mr. Chairman, I see the red light is on. I had hoped to also ask some questions on a couple of areas in which I was particularly interested during the legislative phase of this IRS reform, offers in compromise and innocent spouse. I would like to ask if I could submit those questions in writing for subsequent response.

The CHAIRMAN. Without objection.

Senator GRAHAM. Thank you.

The CHAIRMAN. Senator Bryan?

Senator BRYAN. Thank you very much, Mr. Chairman, for holding this meeting, and thank you very much, Mr. Rossotti, for your continued public service. You have one of the most difficult jobs in all of the Federal Government. Yours is an agency that is unaccustomed to praise, but one area in which I have had some very positive response is the tele-filing system.

Can you give me some indication as to, A, are the number of tele-filings increasing and, B, is there anything that we need to do legislatively to facilitate the expansion of that?

Commissioner ROSSOTTI. It is interesting. The tele-file system is one that actually did win an award from a public agency for excellent service, and it has gone up quickly to about 5 million filers for the relatively simple forms.

Unfortunately, this season, we have had a little bit of a surprise on that matter in that we have actually, after several years of very rapid increases and great response, had a slight decline in the number of users, about a 5-percent decline, and we do not have the research yet to know why that is, but we think we have got a pretty good suspicion, which is that many of the users of the tele-file, as it is a simple form, tend to be people like students that have a very simple situation, but they still have to file a return.

With the benefits under the new tax law, there are more opportunities for students to claim things like student loan interest and certain credits, but they cannot do it with the simple form. So it drives them away from the simple form into the more complicated form.

We may still have gotten those users electronically, though, because we had an enormous increase in the number of people this year that were filing from their home PC's. It is possible that we do not yet have the data that some of the people who would have otherwise used the telephone may have used the home PC and filed, and there is also increased use through the Internet, in some cases through some of the providers.

I do not think there is anything bad to be drawn from the slight decline in tele-filing. I think we have just shifted some users who are computer literate and used to doing things electronically to some other means of filing.

Senator BRYAN. If there are things that we need to do to encourage that, we certainly want to respond to your request.

Let me address an issue of quotas which, as you know, all of the IRS reform measures have sought to address the issue of eliminating quotas as a basis for determining and evaluating employee performance.

Notwithstanding the earlier Congressional enactments as a prelude to the legislation that was adopted a couple of years ago, in my own State, we received a good bit of information that the quota system was alive and well. It is difficult to stamp that out.

One of the provisions in the reform or restructuring legislation is to specifically prohibit, as you know, the employee evaluations to be conducted on the basis of how much is collected in an audit or in revenue collection.

I guess my first question is, to the best of your knowledge, have we eliminated the culprit, and, secondly, what steps have been taken to make sure that that does not creep back in? In other words, what kind of alternative evaluation processes are you adopting or implementing as a part of eliminating this from creeping back into the system?

Commissioner ROSSOTTI. That is a very important question. As a matter of fact, that whole area has been one of probably the largest areas of focus that we have had since I have been in office, and exactly as you say, there are really two parts to it.

One is to ensure that we get rid of the use of enforcement revenues and quotas as a method of measuring employees or managers up and down the chain, and, of course, that relatively speaking is actually the easier part.

We have withdrawn all of those measurements, and there is actually a quarterly certification that is required of everybody up and down the line that is now taken very, very seriously. It is reviewed all the way up to the Deputy Commissioner. I think that we get those reports and we have gotten those out of the system.

I have looked back over the history, and I would be glad to send you a document which reviews this, Senator, but I have looked over the history, and as early as 1959, there were hearings by the Ways and Means Committee on this issue. You can go back over the 40-year history of trying to deal with this problem, and I think the root of the issue is that you can say do not use enforcement revenues and do not use quotas, but unless you put something in its place that allows you to manage the organization, you end up with a void, and you, one way or another, get back into the problem again.

So the thing that we have been working on very, very hard and have recently, within the last few months, completed is developing a new system of measurements which is right in the middle there. It is called Introduce New Balanced Measures.

This is a new system of what we call balanced measures. It does not use enforcement revenue as a part of this. Instead, it uses a three-part system which is what we call customer satisfaction, measuring the surveys from the taxpayers, business results which has a quality and quantity measure to it, but not enforcement revenues, and an employee point of view in there, those three balanced measures.

We have developed that system. We have lifted this from other leading organizations in the private sector, as well as other public agencies, and we are now in the process of rolling this out and training our managers and employees in this system.

We are not going to get it completely rolled out this year for the whole organization, but for major parts of it. And this is really a

very, very revolutionary change in not only measurement system, but really in the whole way that people work with each other because it requires not depending on numbers as much, but getting behind the numbers and looking at the quality of individual case actions in the work that is done.

I would say in January alone, we had over a thousand managers, and I personally participated in this for about 2 days, of training on this whole new way of working and this new way of system. We now are having throughout the whole country training sessions on rolling this out.

By the end of this fiscal year, we will have had for a major part of the organization at least the first round of implementation.

Again, this is something that is so new and so different that we expect it will take a number of years for it to be fully developed and fully implemented throughout the service.

Senator BRYAN. Thank you very much. My time is up. Like Senator Graham, I had some other questions. I want to just acknowledge that I appreciate working with you and trying to resolve the employee meals issue and maybe to address a question to you in writing in terms of what we might do to facilitate a resolution process, short of the confrontation that comes at the end, if there is no ability to sit down and try to work things out.

Commissioner ROSSOTTI. We are working on that problem, Senator.

Senator BRYAN. I appreciate that.

I thank you, and I thank the chair.

The CHAIRMAN. Thank you, Senator Bryan.

I have a couple of questions I want to propound, but then I would like, if it is satisfactory with you, for you to introduce your new team.

Commissioner ROSSOTTI. Yes, sir.

The CHAIRMAN. Let me go back, if I might, to the Webster criminal investigation report. Judge Webster's report did find what I deem to be very serious problems in the CID. He says that the CID has drifted from its tax enforcement mission, it lacks accountability and oversight, it does not follow its own search warrant policies, disciplinary action is irregular, and agents lack substantive tax law training.

Commissioner Rossotti, how do you evaluate those problems, and what do you propose to do?

Commissioner ROSSOTTI. As indicated in the letter that I sent back to Judge Webster, I feel that he did an outstanding job. He and his team did an outstanding job, really very thorough. They did 600 interviews. They looked at just about every document that exists with respect to CID.

The CHAIRMAN. They did not look at the specific cases we had.

Commissioner ROSSOTTI. No, in terms of looking back at any specific allegations, but they did look at many case files with the point of view of looking at how the work should be done.

I think the main conclusions—in fact, all of the conclusions are ones that I agree with very much and intend to proceed expeditiously to implementing.

I think the sort of fundamental conclusion is that the agency, as he said in his first sentence there, has drifted somewhat from its

mission of focussing on the administration as being a component in the administration of the tax laws. That is their main mission, and they are the only organization in the Federal Government that can do that.

He noted that part of that is, unlike other law enforcement agencies, we have a policy that says we should use the least-intrusive means, not just what is legally permitted, but least-intrusive means, and we need to make sure that that is indeed done.

So we are going to follow up with doing the things that he suggested, refocusing the mission, setting them up as a line-accountable organization. At this point, we agree that it is advisable to bring in the next head from outside the organization, someone with tax law experience.

The CHAIRMAN. I do think these are very, very serious problems.

One of the things that concerns me is that insofar as the policy on the least-intrusive method of enforcing tax collection, that there are basically no records. So, even though it is a good policy, we really have no idea how well that policy was adhered to. That bothers me.

A second thing that bothers me is that much of the grand jury information, where they investigated for tax fraud, that information was not made available to Judge Webster, and I think that was a serious problem.

I know that information is confidential, but it is available to you. They would not give it to him because he was not technically a member of the IRS, and I find that very bothersome because it means much of the information we needed to evaluate the CID just was not available.

I know that you are concerned about CID, and I just want to stress how serious I take these problems.

I also would like to ask you about the innocent spouse cases. I have been told that IRS employees in the field may not be resolving innocent spouse cases under the new law. This was a very important change, as you well know. So I guess my question to you is what is the IRS doing to train its employees and to ensure that innocent spouses are properly treated?

Commissioner ROSSOTTI. This is one of the particular provisions that I think is most important, the taxpayer rights area, and we have put a great deal of time and effort into coming up with the guidance and the regulations internally. However, it was complex, and we did not really complete especially the equitable relief portion until really earlier this year. So we have only really begun to process the cases under the full range of authority that is given under the law.

We have done some important things. We have centralized the initial processing in one location so that we have a better ability to train and control people, and then we have recruited some additional experts in other locations to work on some of these cases. Those are some of the steps that we have taken to make sure that we do a quality job on processing these cases.

However, particularly with respect to the equitable relief provision, which is a very new and different kind of provision, we know we are going to have to learn from experience on that. So what we intend to do, which it is too early to do this now, but later this year,

once we have gotten a sufficient volume of these cases processed, we are going to do a post-review. We are going to have a team of experts go and do a sample review of these cases just to see if we are doing them the right way and that they are being done in accord with what we think the intent of the Congress was on these provisions.

So I would certainly say that we have our work cut out for us to do a quality job on this because it is very important, but it is also a complex provision. By the end of this fiscal year or at least this calendar year, we will have a lot better information to report to you on how we are doing on administering that provision, and if there are problems that we have in administering it, we will certainly acknowledge those and do what we need to do to fix them.

The CHAIRMAN. Let me ask you one final question on the reorganization of the IRS into functional division. How will taxpayers and IRS employees be affected by the IRS transition away from a geographically based organization?

Commissioner ROSSOTTI. I think that from a taxpayer point of view, the most important thing is that we will have a set of people in both management and on the front line that are dedicated to trying to understand what the needs of those taxpayers are and meeting them.

For example, in very specifically meeting those needs, I will just give a few examples. In the case of the wage-and-investment taxpayer, which is 90 million taxpayers, but relatively in some cases only interacting with us once a year when they file a return, what we want to have the team focus on them for is good customer service, getting through on the phones, answering the questions quickly, and most of all getting their return out. If they do have a problem, having a network of offices around the country, where they can walk in and get a problem solved very quickly, much as we did on problem-solving day, that is what they need at that end.

To take another example at the other end, the large corporations, the middle and large corporations need an entirely different kind of set of services, and they need a team that is dedicated to working with them on things like getting guidance and regulations out quickly, making sure they are clear, getting the audits done when we do, do audits and resolving those issues as quickly as possible and working with those taxpayers on interpretation of the law. Things like international tax law issues, such as you had in your hearing, are very complex and require special focus.

So I think from the taxpayer's point of view, what we hope we will get, and I do not say this will be quickly, is we will get a set of people inside the IRS that are actually talking to these taxpayers and understanding the particular kinds of needs they have and being able to come up with solutions and relieve their burdens.

From the employee point of view, what we hope is that we are going to be able to focus their efforts so we will be able to make their training more effective and reduce the number of layers in management so they will be more closely connected with those and policy-making points of view.

I think there is another longer-term effort, which is going to facilitate the introduction of this new technology that we absolutely

need in order to basically provide our work force the tools that they need.

The CHAIRMAN. I think the hour is growing late, and I do have some other questions, but I would welcome your introducing the new team you have brought into the IRS.

Commissioner ROSSOTTI. Sure. We have got them right here. Do you want them to come up?

The CHAIRMAN. I will come down in a minute, but why don't you stay close to the microphone.

Commissioner ROSSOTTI. Let me just introduce the two Deputy Commissioners, and maybe you could just stand up. This is Bob Wenzel here. Bob is Deputy Commissioner for Operations. John LaFaver is one of my outside recruits. He is Deputy Commissioner for Modernization.

Val Oveson, over here, is the new National Taxpayer Advocate. I think you have met him.

John Dalrymple is the Chief Operations Officer, and over here, we have Paul Cosgrave who is the Chief Information Officer.

David Williams, as you know, is Chief of Communication and Liaison.

That is really the top-management team that right now is working with us to make this whole thing go forward.

The CHAIRMAN. I would just like to welcome them to their new responsibilities. I cannot emphasize how important I think it is. I think progress is being made, but as you and I agree, we have a long, long ways to go. Welcome and good luck.

Thank you very much, Mr. Commissioner.

Commissioner ROSSOTTI. Thank you.

The CHAIRMAN. The committee is in recess.

[Whereupon, at 12:05 p.m., the committee was adjourned.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF HON. ORRIN G. HATCH

I want to commend the Chairman for holding this hearing today. Last year we had the opportunity to pass what is perhaps the most far-reaching legislation of our careers in the Congress. Legislation that would reform the Agency that touches the lives of U.S. citizens more completely than any other institution. The IRS Restructuring and Reform Act of 1998 (IRRA) was about more than just changing the way one federal agency works, it was about reflecting American values and priorities—about just who the government is here to serve and what it is here to do.

I want to commend Commissioner Rossotti for the progress we have seen to date: we have seen the National Taxpayer Advocate's office reorganized and made more independent; we have seen increased customer service; and we have seen an increase in electronic filing. However, we still have a long way to go. We need to see more improvement in taxpayer rights and we need to see more IRS employees buy into the reform effort and change their attitude and the way they work with the taxpayer. I am also waiting to see the completion of several of the new regulations and procedures being worked on at the IRS to put into place the changes included in last year's reform bill.

The IRRA included two important elements to changing the culture at the IRS: creating responsible leadership and providing accountability for the Agency. The first was done through granting Commissioner Rossotti flexibility to carry out a fundamental reorganization of the Agency. I want to commend him on his progress to date on that important project.

The second step was just as important. The creation of an independent Oversight Board brought some much-needed accountability to the IRS. I wish I could say that we have seen some progress on this front as well, but I have to say that we have not. I am deeply disappointed that the Administration has not lived up to its responsibility by nominating the Members of this Board. They are over two months late in this task. This blatant disregard for the deadlines contained in the IRRA—which was signed by this President with much fanfare last year—sends a dangerous signal. If these nominations are not made in a timely fashion, we can only conclude that this Administration is not serious about real reform of the IRS.

I welcome the testimony of Commissioner Rossotti here today. I am eager to hear what the status of reform is and what further actions we can expect to see in the future. He has taken on a Herculean task of redefining and changing a culture that has been in place for far too long. I want to congratulate him on the significant strides he has made in completing that task and urge him to push forward. I look forward to working with him as he continues to progress toward full implementation of the IRRA.

PREPARED STATEMENT OF CHARLES O. ROSSOTTI

INTRODUCTION

In July of last year, Congress passed by a nearly unanimous vote the IRS Restructuring and Reform Act of 1998. This bill included many provisions to enhance taxpayer rights and to deal with specific aspects of the IRS. As important as these individual provisions are, the bill collectively said something even more important. It told the IRS that we must fundamentally change direction. We must not only col-

lect taxes, we must think about our job as serving the people who are paying the taxes, America's taxpayers.

The IRS is fundamentally changing, Mr. Chairman, and in the direction the Congress mandated. We are not only implementing the letter of the law that Congress prescribed in RRA '98, we are rethinking and redesigning our whole way of doing business.

In the year since I last appeared before this committee, I have become even more convinced that we can succeed in the mandate Congress gave us. I firmly believe that we can have a tax agency that does a far better job of serving the American public in the way it expects to be served. This means providing each taxpayer with the service he or she expects, the rights he or she deserves, and all taxpayers having the confidence that the tax law is fairly administered.

And while I believe we can succeed, we now know quite clearly the fundamental changes we must make in all parts of the Agency to succeed.

Some of these changes are intangible, such as the agency's mission, goals and principles. Many are quite tangible, such as how we measure performance, how we train people, how we organize to manage, and many detailed procedures and technology programs. Collectively, these changes affect the skills, attitudes, tools and processes which constitute the way taxpayers are served.

No one change will fulfill our mandate. There is no quick fix and there is no silver bullet. Nor is there a low risk plan, since such major and fundamental change necessarily carries with it the risk that plans and timetables may need to be altered and operational errors may occur along the way. We have made some already in implementing provisions of the RRA, for example.

What we need most of all, given the current situation at the IRS, is the sustained support of Congress and the public while we make these fundamental changes while we administer a huge and complex tax system. And I have been very, very pleased at the support we have received to date from all quarters. However, we will also need your understanding of the enormity of our challenge. One forecast I made at my confirmation hearing before this committee was that it would take the better part of a decade to reach our goals for the IRS. Having now been in office for 17 months, this is one forecast that I stand by. But I believe that the destination is worth the long and difficult journey we are now starting.

NEW MISSION AND GOALS

I believe that one of the most important mandates of the restructuring bill was for the IRS to rewrite its mission statement not only to change its focus, but to set a broader and higher standard of performance for the entire Agency. Thanks to the Congress and this Committee, our new mission statement is: "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. Rather than just collecting the "proper amount of revenue at the least cost," as had been our charge in the past, it is now 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 receive elsewhere. And 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 Federal Government 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 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 administers 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 sector best practices. We refer to this whole process of change as "modernization," because it involves building on the essential compo-

nents that made the IRS successful in the past while bringing them up to date in a way designed to achieve the new mission.

To carry out our new mission statement, we proposed three strategic goals to guide us. The first is to provide top quality service to each taxpayer, one at a time. The IRS has millions of interactions with taxpayers each year—from the very simple to the very complex. Whether it's providing a form, answering a question, or performing an audit, the taxpayer should receive top quality service based on that taxpayer's specific situation and needs. That also means that taxpayers should always be treated professionally and courteously and with full consideration of their rights. Our second strategic goal is service to all taxpayers collectively—seeing to it that the law is applied with integrity and fairness to all so that taxpayers who do not pay their taxes are not allowed to place a burden on those who do.

Our third strategic goal is to increase productivity by providing a quality work environment for our employees. Good service to taxpayers will be accomplished by providing employees at all levels with high quality technology tools, adequate training, effective management and active engagement in the goals of the organization.

Over the past year, we have worked hard to communicate the new mission statement and goals to our entire work force. Each employee now has a wallet-size copy of the new mission statement and our strategic goals are stressed in all of our communications vehicles, including training materials, town hall meetings, video conferences, broadcast voice messages, and our biweekly modernization newsletter, "New Directions" which all employees receive.

TAXPAYER RIGHTS AND SERVICE IMPROVEMENTS

This past year brought a dramatic expansion in taxpayer rights due primarily to RRA '98. From new rules ranging from protecting innocent spouses to offers in compromise to greater power for the National Taxpayer Advocate, taxpayers are finding an array of new options available to assist them.

Delivering on the new law and the hundreds of specific changes to both the tax code and our organization is an enormous task. We are in the process of: (1) implementing 157 near-term initiatives to improve service and treatment of taxpayers, of which 82 are mandated by RRA '98; (2) implementing 1,260 tax code changes from the Taxpayer Relief Act of 1997 and RRA '98, many of which require significant and complex interpretations to guide taxpayers and employees; and (3) providing essential training related to these many changes to nearly every one of our over 100,000 employees.

Let me highlight some of the progress to date in implementing RRA '98: a massive training effort is underway; two new forms are being developed (706C/706D on estate taxes); 153 forms have been revised; 39 publications have been revised; 30 items from Chief Counsel were published (14 regulations, 5 revenue procedures, and 11 notices/announcements); 66 guidance memoranda have been issued; and 1,300 implementing actions have been identified.

I want to particularly stress that increased training of our employees is essential for delivering on the mandates that Congress gave us and the service that the public expects. About 70 percent of IRS employees deal directly with taxpayers. And taxpayers have every right to expect that in every such encounter with an IRS employee, whether it's a phone call asking a question about how to fill out a return, or a meeting with a revenue agent in an audit, the IRS employee should understand the current tax law and have the skills to understand the facts and circumstances of that taxpayer.

A year ago, when I took office, it was abundantly clear that there was already a serious deficit in this area. Since then, Congress has given us the responsibility of implementing the 1260 changes to the Tax Code and a mandate to restructure the whole way we do business with taxpayers. And this will require extremely complex training for our employees. The money in our FY 2000 budget request, including that part included within modernization program, is essential and will only begin to rectify our training deficit.

There are three phases to our RRA '98 training, and even prior to enactment of RRA '98, we began to take action. In July of 1998, the IRS' Chief Operations Officer established a National Resource Center to coordinate policy and program questions so that consistent messages were sent to stakeholders. As of March 15, 1999, more than 1,100 inquiries have been submitted. Also in July, approximately 185 RRA '98 field coordinators in each IRS district, region and service center were identified and trained to be local points of contact for coordination and questions. I held my first RRA video conference on July 17, five days before the President signed the legislation into public law.

RRA '98 Phase I training took place from July 1998 to January 1999. Some of the actions we took included: (1) providing 60,000 front-line employees with basic implementation training on new statutory requirements and key procedures; (2) developing individual training plans for each IRS function; (3) implementing a course completion certification process; (4) establishing weekly conference calls with over 180 RRA '98 Coordinators and Education Branch Chiefs; and (5) posting information on School of Taxation Web Site and links to the National Resource Center.

We are now in the midst of RRA '98 Phase II training. Our overarching goal is to provide formal training with clear learning objectives, testing and evaluation. We are developing courses on: Due Process, Installment Agreements, Offers in Compromise, Seizures, Relief from Joint and Several Liability, Third Party Contact and Interest netting. The goals for RRA Phase III Technical Training for FY 2000 are to: (1) embed specific provisions of RRA '98 and the newly revised Internal Revenue Manual into the IRS day-to-day operations; (2) supplement Phase I and Phase II training as needed; (3) deliver Phase II of Customer Service Training; and (4) continue to evaluate, monitor and update training as necessary.

One of our critical training needs has been Section 1203 in which all 100,000 employees must be trained. The initial mandatory training that all employees have now received was certainly an important first step, but we must do more. Last week, all employees received with their pay stub a brochure written especially for them on Section 1203. It includes a plain language summary of all the provisions, how potential violations are reported, employee appeal rights and other important reminders. We are also encouraging our employees to take advantage of the IRS Labor and Employee Relations Resource Center that can help answer many of their Section 1203 questions.

We will then build on this information with better training and guidance. Beginning later this month, all employees will be provided detailed instruction on the procedures to be used in handling Section 1203 cases. This instruction, including a training video, will be based on a new Section 1203 Procedural Guide that is currently under development. It will emphasize good customer service and case management practices. In addition, we are ensuring that all training courses on RRA '98 consider the impact of Section 1203 on how employees carry out their duties and we will then begin the process of integrating Section 1203 into course material already in existence.

In addition to training, I would like to highlight some of the significant changes called for by RRA '98. In January, the IRS issued new versions of its form and publication for innocent spouse relief, each revised to incorporate the changes made by RRA '98. This is the latest of several steps we have taken in our ongoing effort to help innocent spouses. We hope that our materials will effectively explain the new law to taxpayers and assist them in taking full advantage of their rights. We also appreciate the comments we received on the draft form last fall and welcome suggestions on how we might further improve these items. In addition, the IRS plans to incorporate additional feedback from taxpayers and practitioners—as well as our own experience in processing these requests—and provide even better products.

In the area of due process, taxpayers now have the right to request a hearing before an impartial appeals officer within 30 days after a notice of lien has been filed or a notice of intent to levy has been sent. In addition, the IRS must provide the taxpayer with a written notification of this appeals right. If the taxpayer requests a hearing during this period, the proposed levy may not take place until after the appeals officer makes a finding. The taxpayer also has 30 days to challenge the appeals finding in U.S. Tax Court or U.S. District Court, during which period the IRS may not levy. During the appeals process the taxpayer can also request the IRS to consider establishing collection alternatives, such as an installment agreement, to pay off the tax bill. Under the new law, the IRS must consider all other payment possibilities before seizing the assets of a business.

With the publication in March 1999 of revised tax Form 656, and an array of internal changes, the IRS is also fundamentally changing the Offer in Compromise program to make it easier for taxpayers to apply for help and allow the IRS to be more flexible when considering taxpayer offers to settle tax bills. For taxpayers facing dire financial circumstances and unable to pay the entire tax bill, the Offer in Compromise program allows the IRS to negotiate a settlement. We expect to have the new OIC program in operation by the end of the year.

For taxpayers, the settlement offer must reflect the maximum amount they can pay after basic living expenses. The IRS may accept the taxpayer's offer under certain conditions prescribed by law. In the end, this helps all taxpayers. Instead of collecting nothing from people with an unpaid tax bill, we are able to collect something. We will also work with taxpayers facing severe hardship to help find a way to satisfy their tax obligations.

In addition, under the changes being made at the IRS, the Offer in Compromise program will feature more straightforward rules, increased flexibility by key agency employees and fewer rejections of compromise offers.

Even more changes will unfold in the weeks and months ahead. We want to work with taxpayers to make it simpler for them to apply for an Offer in Compromise. The process will be streamlined to make more and more people eligible. The program will feature new flexibility in evaluating taxpayer expenses. In the past, the program frequently relied on local and national standards for evaluating cost-of-living expenses—a key element in determining how much a taxpayer can afford to pay through the compromise offer. But the new guidelines allow IRS employees more freedom to assess an individual's particular financial hardship beyond the standard cost-of-living formulas. The move will help guarantee that a taxpayer can still afford basic living expenses while paying the tax bill.

Mr. Chairman, RRA '98 also directed the IRS to place a greater emphasis on serving the public and meeting taxpayer needs, and that new focus is reflected in not only our new mission, statement but new commitment to customer service. While providing service on a level with the best financial services institutions may take years, we have put some serious management muscle behind some near-term service improvements. It is service when and where our taxpayers need it.

Our toll-free telephone lines are now open 24 hours-a-day/7 days a week. This filing season, more than 250 of our offices across the nation offered Saturday service. We are making it easier for taxpayers to get forms and information whether it is from our website (www.irs.ustreas.gov), fax machine or CD-ROMs. We also have a vigorous electronic tax administration strategy and program that will help us get the paper out of filing and payments and refunds. In addition, we hope to be able to add even more services in the future as we bring new technology on-line, and just as importantly, be able to measure taxpayer satisfaction with our services.

BALANCED MEASURES OF PERFORMANCE

The techniques that an organization uses to measure its performance go to the heart of what it 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.

For many years too, 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 percent of which comes in voluntarily and 2 percent 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.

For these reasons, enforcement revenue was 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 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.

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.

In his testimony before the Senate Finance Committee in 1997, the then IRS 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.

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. 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. Last year, I 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 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. As a result of their report, disciplinary action was taken with respect to 14 executives and managers.

Sections 1201 and 1204 directly addresses the subject of the performance measures used by the IRS. Section 1201 directs the IRS, consistent with its current performance planning procedures, including those established under the Government Performance and Result Act, 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.

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. The difficult challenge that this history and these provisions pose is to create a system of measures for the IRS that appropriately reflects our mission and goals and which carries out the directive to have quantitative measures that do not use tax enforcement revenue statistics.

The Conference Report accompanying RRA 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."

It is therefore essential to establish appropriate quantitative performance measures for the IRS. This is not only required by the Government Performance and Results Act but 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 chart the 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.

After a year of analysis and planning, we have developed the beginnings of a balanced measurement system. Since the beginning of the year, we held major conferences in Atlanta and Washington to introduce in concrete terms the new system. At the IRS, for the first time, customer satisfaction, business results and employee satisfaction will carry the same weight. And business results will be determined by both quantity and quality.

Our new balanced measures will support all three of our three strategic goals: service to each taxpayer, service to all taxpayers and productivity through a quality work environment. Let me describe how they work at just one level—the operational level. This includes many of our customer service representatives, and the employees handling collections and examinations in the field—in other words, the people taxpayers deal with every day.

Taxpayer satisfaction with the particular service will be measured by surveying a sample of taxpayers who have transacted business with a particular IRS organizational component.

And we have found through our surveys that taxpayers generally do not distinguish between the professionalism and quality of the interaction and the tax result they receive.

Our business, or compliance, goal will be measured by a combination of case quality and neutral quantities such as number and mix of cases handled. We measure quality through a peer review that determines whether the appropriate issues were raised, and whether appropriate actions were taken in light of the case's circumstances.

Let me emphasize that enforcement revenues—the money coming in from audits and collections—are not used as an operational measure. Therefore, if an audit determines that the taxpayer's return was correct, this so-called "no change" audit would be measured as appropriate and high quality as far as the organization conducting the audit is concerned.

The productivity and work environment goal is measured by employee surveys of work environment. 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 top quality service to taxpayers.

Of course these new measures, or any measures for that matter, are not an end in themselves. They are an indicator of how the IRS as an organization is performing and how we as an organization can improve that performance on behalf of taxpayers.

This whole process also implies profound changes in the way IRS employees work with each other in the IRS and how they interact with taxpayers. All of our actions must be looked at as if we were standing in the taxpayer's shoes. Good quality work at the IRS will be the result of understanding the taxpayer's point of view and the law—not one or the other.

ORGANIZATION AND MANAGEMENT

Mr. Chairman, a little more than a year ago, I presented to the Congress our concept to modernize the IRS. A year ago, it was just that—a "concept." However, a year later we have achieved a number of milestones in our modernization "plan" that I want to share with you today.

This real progress is due in no small part to the Restructuring Act which gave us our marching orders and the tools to implement the practical changes needed to move the IRS in the direction of seeing our operations, and their impact from the taxpayer's point of view.

The need to change, and the general direction of change was clear. The hard part was how to do it. The first and most basic need was to set a clear direction and priorities. In the short term, we had to fix our massive Y2K problem as well as deliver some visible, immediate service improvements to taxpayers, such as the ones I described—keeping our phones and offices open at convenient times and making our notices easier to understand. We set those as priorities and put some serious energy and commitment behind them to make sure they happened in the near term.

For the longer term, one part of the overall change program we are undertaking is the proposed reorganization of the IRS. The Restructuring Act directed me as IRS Commissioner to restructure the IRS as an organization built around serving particular groups of taxpayers with similar needs.

I want to stress that the IRS restructuring is not just a rearrangement of organizational boxes. Rather it's designed to implement our new approach to tax administration, which is to work with taxpayer groups to understand taxpayer problems and taxpayer needs from their point of view—and then tailor and improve taxpayer programs to meet them.

Under our plan, the IRS will be based on four business units each charged with full end-to-end responsibility to serving a different group of taxpayers. The four units are: (1) Wage and Income, (2) Small Business and Self-Employed, (3) Large and Mid-size Business, and (4) Tax Exempt. We are currently recruiting the top leadership for these divisions and we will shortly begin implementing the detailed blueprint of exactly how each will operate.

Let me also note that the National Taxpayer Advocate Organization was the first office to go into the new reorganized structure. The Taxpayer Advocate organization will establish a functional structure around two main roles: casework, and advocacy and analysis. This will ensure that both roles receive the appropriate emphasis and provide clear responsibility for each. The casework will be managed by locally-based Taxpayer Advocates in the field and each service center.

To manage the enormous amount of changes, I put together last August my senior management team. The changes to our top management structure will ensure the highest level of management focus on IRS modernization and service to taxpayers while maintaining the necessary attention on operations. The personnel flexibilities you provided us, Mr. Chairman, as part RRA '98 contributed greatly to our ability to recruit the talented individuals we now have on board to lead and manage the IRS restructuring.

During this process, we also 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.

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. For 1999, we have six Executive Steering Committees: (1) Y2K/Filing Season; (2) Taxpayer Treatment and Service Improvement; (3) Organization Modernization; (4) Measures; (5) Business Process/Technology Modernization; and (6) Internal Management Processes.

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.

TECHNOLOGY

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 from the top on professional management of information technology resources. 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: 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 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.

The implications of this archaic technology are startling. Following are some of the more prominent:

- 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.
- 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.
- 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.
- Although the Master File system holds the IRS' authoritative financial record for every taxpayer, it does not conform to accepted accounting standards. 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.

RESOURCES

The problems that led up to the passage of the Restructuring Act can be solved but they will require fundamental change in order to modernize almost all aspects of the IRS. This process also carries with it considerable cost and risk. Our plans may need to be revised and operational problems may occur. However, there is no low risk plan for the massive job we must do at the IRS that I described at the beginning of my testimony.

We will complete the plan for our new organization structure this year and have already begun implementing parts of it. Much more implementation will occur in FY 2000. Using the authority granted by Congress, we also have put in place a new top management team and are actively recruiting to fill leadership positions in our new operating divisions.

Updating our business practices for dealing with taxpayers requires almost a complete replacement of IRS information technology systems, which are built on a 30 year-old fundamentally deficient foundation that cannot provide accurate up-to-date information about taxpayer accounts. And GAO has repeatedly reported IRS cannot provide reliable financial information to manage the Agency. On December 9, 1998, the IRS awarded a Prime Systems Integration Services Contract (PRIME) to Computer Sciences Corporation (CSC) and their partners. We are currently working with CSC to update our strategic systems plan and to implement near-term projects which will focus on improved phone service and electronic filing options. +987

Despite these many challenges, in preparing the budget request for FY 2000, we are well aware of funding constraints and have therefore requested the bare minimum. Without this funding, the entire reform and restructuring program demanded by Congress and the public could stall and the risks increase.

The FY 2000 resource request of \$8.105 billion will enable steady progress on the many changes needed to deliver on the reform and restructuring program and the Year 2000 Conversion. This request in total is essentially level with resources provided in FY 1999, which totaled \$8.105 billion including \$505 million from the Y2K emergency fund.

This is an unlikely combination—major changes requiring investment with a flat budget. This combination is only possible in FY 2000 for three reasons: first, because of the stringent fiscal constraints we are carrying out many of the changes by diverting resources from on-going programs such as compliance; second, the Congress advance funded our ITIA to a level that will sustain us through FY 2000; and third our current estimates of specifically identified and known year 2000 costs are less than the costs for FY 1999.

These three factors enable us to include in our budget request some absolutely 789+essential items for implementing the required changes. These include \$40 million for implementing the Restructuring Act's customer service and ETA initiatives, \$17 million to train our employees in the tax laws that Congress passed; and \$140 million for implementing the modernization plan called for in the Restructuring Act which will increase accountability for service to specific groups of taxpayers. The money for implementing the modernization plan will be used to reorganize and provide new skills for the IRS workforce.

Overall, this budget will continue the trend of the last six years in which the IRS workforce has been shrinking in relation to the size of the economy. In FY 2000, while the workload grows as a result of the growth in the economy and the additional demands of the Restructuring Act, the total workforce size will remain approximately constant. This trend will only be possible if we make the investments in organization, training and technology that are needed.

CONCLUSION

Mr. Chairman, I believe that the IRS is fundamentally changing in the direction mandated by the RRA. And it is change in virtually every aspect of the IRS—in mission, goals and principles, practices and procedures, management and organization, training, performance measures and technology. Through these changes, we can succeed in producing an IRS that better serves America's taxpayers—individually and collectively—but we must realize that there are no quick fixes, magic bullets or low risk plan. Yet, we are convinced it is worth the difficult journey, and with the continued support of the Congress and the American people, we are confident we can succeed. Thank you:

Internal Revenue Service (IRS) Response to questions submitted by Senator Bob Graham in connection with the Senate Finance Committee hearing regarding the restructuring and reform of the IRS (April 14, 1999).

OFFERS IN COMPROMISE (OIC)

1. *What is the acceptance rate for OIC?*
2. *Please compare acceptance rates for OIC by region and year-by-year.*

ACCEPTANCE RATES				
	FY 1999 *	FY 1998	FY 1997	FY 1996
National Total	63%	50%	46%	48%
Northeast	58%	45%	41%	46%
Southeast	55%	48%	45%	46%
Midstates	68%	54%	49%	48%
Western	65%	52%	48%	51%
A/C International	77%	53%	55%	52%

• *Data through March 1999*

1. *What is the difference in acceptance rates between initial decisions on OIC and Appeals?*

The national cumulative acceptance rate for FY 1999 (through March 1999) is 63%. The acceptance rate for Appeals for the same period is 55%. It should be noted that those Offers in Compromise accepted by Appeals might have been correctly rejected by Collection. For example, a taxpayer who does not provide the necessary documentation to Collection later provides this documentation to Appeals, thereby, allowing Appeals to accept the offer.

2. *What progress has IRS made in including all information on OIC in a single form? Presently such information is contained in Forms 656, 433A and 433B, and Publication 1854.*

We are making substantial progress in including all necessary Offers in Compromise information in one package. This new package should be available by January 2000 and will include Forms 656 (Offer in Compromise), 433A (Collection Information Statement for Individuals), and 433B (Collection Information for

Business). Currently, Forms 433A or 433B, as appropriate, are mailed to the taxpayer when a request is made for Form 656.

3. What is the time frame for implementing changes to the OIC program?

An action plan has been developed to implement changes to the OIC program. Complete implementation is expected by December 1999.

4. Does the Agency have enough resources to handle any increased acceptance rate for OIC?

The Agency will use its resources to ensure that all Offers in Compromise are handled in a timely manner. If necessary, resources will be redirected from other Collection activities to ensure Offers in Compromise are handled efficiently. The volume of Offers in Compromise received will drive the resource commitment the Agency will make.

5. How has the Agency simplified the OIC process?

The Agency has simplified the OIC process in several ways:

New, flexible IRS rules for processing taxpayer offers. Instead of the old, stringent application guidelines that often led to irremediate rejections, the IRS will now work with taxpayers to fine tune their compromise offers - a step that will lead to accepting more offers.

Less documentation. Taxpayers will be asked to provide fewer financial documents to qualify for smaller compromise offers.

New payment procedures. New deferred payment procedures provide more opportunities for compromise offers to be submitted by taxpayers who may have been excluded under the old guidelines. A short-term deferred payment option allows taxpayers up to two years to pay the compromise offer.

6. What assistance on the OIC process is available to taxpayers?

Specially trained IRS experts will be devoted to handling compromise offers. These new offer specialists will bring more consistency to the offer program and centralize offer processing.

Instead of automatically rejecting Offers in Compromise that are incorrectly prepared, incomplete, or incorrect, the offer will now be accepted for processing and the taxpayer will be allowed to perfect the offer during the initial processing period.

Each and every rejected compromise offer will be subjected to an administrative

review. These administrative reviews assess whether rejection is in the best interest of the taxpayer and the government.

Collection activity *will be withheld* during the processing of offers.

INNOCENT SPOUSE

1. Comment on the perception that while the law on innocent spouses was changed retroactively, there is a continued reluctance to settle outstanding cases.

All IRS employees who are examining innocent spouse claims have been instructed to address all relief sections (pre-and post-RRA 1998 provisions) that may be applicable and grant relief, if appropriate, under the provision most advantageous to the requesting taxpayer. In addition, examiners auditing a joint return are also instructed to advise taxpayers of innocent spouse relief provisions. However, guidance was needed on applying the equitable relief provision of RRA 98. Thus, all innocent spouse claims were held in suspense waiting for this guidance which was issued in December 1998. This 5-month delay in processing innocent spouse claims may have been perceived as a reluctance to settle outstanding cases.

2. What changes has IRS made administratively in innocent spouse cases?

Prior to enactment of RRA 1998, IRS made the following changes:

- The processing of innocent spouse claims was centralized in one service center.
 - A form to apply for innocent spouse relief (Form 8857) was developed. After comments from external stakeholders, this form was revised to make it easier to apply for this relief.
- All district examiners were instructed to advise taxpayers of availability of innocent spouse relief.
- When a claim of innocent spouse is raised during the collection of an unpaid tax liability, this claim will receive expedited processing.
- All cases involving an innocent spouse issue will be reviewed for quality and consistency.
 - Each region and district has an innocent spouse coordinator.

Post-RRA 1998, IRS took the following actions in addition to the above:

- Publications, forms and instructions were revised to include an explanation of, or reference to, the innocent spouse relief.
 - Employees were trained on innocent spouse provisions.
- District employees are required to advise taxpayers of the provisions during an audit.
- Cases that would have been disallowed under sec. 6015(b) or (c) were suspended until guidance on applying the equitable provisions under 6015 (f) were issued in order to give taxpayers every opportunity for relief.

- Internal Revenue Manual Procedures and guidance on innocent spouse relief will be issued shortly.

6. *Has the number of innocent spouse cases increased following reform legislation?*

Yes. In Fiscal Year 1999 (through the week ending April 17, 1999), we have received 14,166 innocent spouse claims.

7. *How are most innocent spouse cases brought to the attention of the IRS—through forms sent to the service centers, through the taxpayer advocate's office, or through local offices?*

Through forms sent to service centers.

8. *How are innocent spouse cases processed?*

Forms 8857 are processed in Cincinnati Service Center (CSC). CSC is responsible for establishing the claim on our computer system for tracking purposes. In addition, the claim is screened to ensure it contains all necessary information and the taxpayer is eligible to apply for relief, e.g., there was joint return filed; there is an unpaid liability, etc. When the claim is determined as ready to be processed, (taxpayer is eligible and has provided all necessary information), the case is assigned to an examiner. Most cases are being assigned to examiners in a district office. Taxpayers will be notified of the determination and, if the relief is denied, given an opportunity to appeal the determination.

9. *Is the law clear to IRS staff working on innocent spouse determinations?*

As with any new statute, IRS received legal guidance and clarification from Chief Counsel as a part of implementation of the provision. We have issued guidance and clarification on the provision to field employees and provided training to ensure its proper application. Experience will be needed in processing the cases to determine whether there are areas needing clarification.

