

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
STATEMENT PRESENTED TO**

**INTERNAL REVENUE SERVICE OVERSIGHT BOARD
PUBLIC MEETING**

**MEETING THE CUSTOMER SERVICE NEEDS OF TAXPAYERS AND THE
IMPORTANCE OF MEASURES**

February 8, 2006

The American Institute of Certified Public Accountants thanks the IRS Oversight Board for the opportunity to appear before you today. I am Tom Purcell, Chair of the AICPA's Tax Executive Committee; and Associate Professor of Accounting and Professor of Law at Creighton University, Omaha, Nebraska.

The AICPA is the national, professional organization of certified public accountants comprised of approximately 350,000 members. Our members advise clients on federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses. It is from this broad perspective that we offer our comments today.

Today's meeting addresses two critical topics affecting tax administration: (1) the customer service needs of taxpayers and (2) the importance and impact of measures.

The AICPA's Commitment to Serving the Public Interest

The AICPA strongly supports the goals set by the IRS Oversight Board for today's meeting. We appreciate the need for the IRS to provide the highest level of customer service at a reasonable cost to the public at large; and for the establishment of positive effective measures, which we view as crucial to implementing goals designed to improve the long-term effectiveness of the tax system.

We commend the IRS for the agency's far reaching and thoughtful Mission Statement which focuses on providing "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, which was revised in light of passage of the IRS Restructuring and Reform Act of 1998, places a greater emphasis on customer service (the topic of the first panel for today's meeting).

The Mission Statement of the AICPA Tax Section like that of the Service, places a major emphasis on promoting the interests of the public. According to our statement, "The Tax Section serves the public interest by assisting AICPA members to be the preeminent professional providers of tax services, and by advocating sound tax policy and effective tax administration."

Similarly, our current strategic plan states that “As representatives of CPAs in tax practice, the Tax Section best serves the public interest by assisting members to hone their professional skills, regulating unacceptable professional conduct, and—simultaneously—demonstrating our commitment to promoting and developing an efficient and effective system of taxation.”

I. MEETING THE CUSTOMER SERVICE NEEDS OF TAXPAYERS

Customer Service Demands a Vibrant IRS Budget

In his April 19, 2005 testimony before a House Appropriations Subcommittee¹, Commissioner Mark Everson defined service to “mean helping people understand their tax obligations and making it easier for them to participate in the tax system. “We strongly support this concept of customer service, and believe the best way of fulfilling this laudable objective is for Congress to ensure full funding for the IRS budget.

The AICPA is well aware of the Oversight Board’s active support for proper funding levels for the Service’s budget, and we urge the Board to continue such support as Congress and the Administration begin their deliberations on the fiscal year 2007 budget. By providing the Service with the proper resources to meet its needs, the agency will be empowered with the necessary funding to fulfill both its customer service and enforcement responsibilities.

Commissioner Everson recognizes that any increase in enforcement funding must be balanced with positive responses to the taxpaying public as customers. We encourage this type of balanced approach and stand ready to work with the Service to ensure that the needs of America’s taxpayers are fulfilled. As we have stated in the past, all taxpayers must have access to resources that enable them to fulfill their responsibilities, and budgetary funding must be provided to insure this access.

Many AICPA members are tax practitioners. As such, we have seen first-hand the problems caused by an IRS that is not responsive to taxpayers as customers. We have also witnessed the improvements initiated by Commissioner Everson, particularly with respect to enforcement. Reductions in IRS funding requests that focus on customer service will only undercut efforts to improve compliance, and the nation’s taxpayers will suffer as a direct result.

Pro Bono Tax Assistance and Customer Service

We support IRS efforts to partner with professional organizations in the area of pro bono tax assistance. We believe this provides the IRS with opportunities to leverage scarce resources and increase customer service at the same time.

Our members are active in their local communities through pro bono activities. They are involved in volunteering to serve at Volunteer Income Tax Assistance (VITA) and Tax

¹ Commissioner Mark W. Everson, Hearing on Internal Revenue Fiscal Year 2006 Budget Request, House Committee on Appropriations, Subcommittee on Transportation, Treasury, and Housing and Urban Development, the Judiciary, District of Columbia, April 19, 2005.

Counseling for the Elderly (TCE) sites, community and academic-based low-income tax clinics, and other non-profit organizations.

We view pro bono activities by CPAs and other practitioners as an important way for the Service to promote customer service. This is particularly true in light of the joint efforts of the IRS, AICPA, and several state CPA societies in response to the devastation caused by Hurricane Katrina and other natural disasters during Fall 2005. We joined forces with the Service in a program designed to utilize CPA volunteers at disaster relief sites in various states. In addition, the IRS has asked CPAs within our state societies to teach local tax practitioner courses and small business tax workshops that IRS staff may have otherwise taught in the past.

Form 1040 Instructions and Stakeholder Outreach

The IRS has generally done a very good job in recent years, of seeking the input of the AICPA and other stakeholders prior to the agency's announcement of a new program, initiative, or policy change. Examples of previous initiatives in which the Service did seek the input of the practitioner community with positive results include the National Research Program, and the development of the new Schedules K-1 and M-3.

However, there have been times when the Service has inadvertently not consulted with the practitioner community about a new initiative, only to later find itself as an agency in a difficult position. The most recent examples of what we believe were poor communications and collaboration efforts on the Service's part involve the inclusion of (1) tax return preparation cost estimates as part of the 2005 Form 1040 instructions and (2) the specific requirement in the 2005 Form 1040, Schedule D instructions for taxpayers to list all capital gains or loss transactions on Schedule D.

The AICPA has expressed its strong opposition to the preparer cost estimates and the Schedule D instructions matters in two letters and conversations with the IRS during the last two months.² IRS executives have assured us that they value the input of the practitioner community on important policy initiatives and programs; and we appreciate the Service's timely responses to the practitioner concerns regarding the agency's recent communications with respect to the preparer cost estimates and Schedule D. However, our members continue to express concern that even the recent clarifications by the IRS do not fully address the Schedule D issue and so we do not consider this issue resolved. While we continue to work with the IRS on satisfactory resolution of these issues, we believe the Service has lost credibility and generated unnecessary frustration with tax professionals over the communication of their positions on these policy issues.

² AICPA letter to Commissioner Everson (dated November 30, 2005) regarding the IRS's inclusion of tax preparation cost estimates in the 2005 Form 1040 instructions, found at URL: <http://tax.aicpa.org/Resources/Individual/AICPA+Urges+IRS+to+Reconsider+Including+Tax+Preparation+Cost+Estimates+in+the+2005+Form+1040+Instruc.htm>; and AICPA letter to Commissioner Everson (dated December 23, 2005) regarding the reporting of capital gains transactions on Form 1040, Schedule D, found at URL: <http://tax.aicpa.org/Resources/Individual/AICPA+Urges+IRS+to+Eliminate+Scedule+D+Reporting+Burden.htm>.

The Pre-Filing Phase and Taxpayer Education

In previous comments to the Oversight Board, the AICPA has stated that we strongly support the IRS's efforts to place a greater emphasis on the pre-filing phase within all four operating divisions. We believe this is one of the most critical areas for ensuring an effective customer service philosophy within the Service.

Excellent examples of the IRS's efforts in the pre-filing phase include the Stakeholder, Partnership, Education, and Communication Office (SPEC) in the Wage and Investment Division (W&I) and the Communications, Government Liaison & Disclosure Office (CGL&D) at the Small Business/Self-Employed Division (SB/SE), and their broad commitment to improving communications through websites, conferences, and newsletters. Another critical component is taxpayer education about recordkeeping responsibilities and major substantive areas of noncompliance.

In early 2005, the IRS implemented a plan for downsizing organizations like SPEC and the predecessor organization to CGL&D (what SB/SE previously called Taxpayer, Education, and Communication or TEC), with the reassignment of personal to the enforcement side of the agency. We have received some scattered reports that these structural changes within the agency are having a negative impact on customer service and enforcement. The AICPA and the stakeholder community will continue to monitor these changes and will share any further observations that may develop with the IRS Oversight Board with respect to these two very important customer service oriented offices within the agency.

Telephone Service

According to a November 2005 report of the U.S. Government Accountability Office, the IRS made a "strategic decision" to reduce taxpayer access to the agency's telephone service because the agency viewed this as a flexible area for absorbing a general budget reduction. For example, the IRS reduced the number of full time equivalent employees (FTEs) by one percent in 2005 as compared to 2004, representing the period of January 1 through July 15 for each year. Although this represented a budget reduction of \$5 million for the period, the IRS called its service reductions for taxpayer telephone service "acceptable reductions", thereby permitting the IRS to effectively manage its resources while maintaining high levels of service.³ Moreover, the Treasury Inspector General for Tax Administration has reported that while taxpayers generally received improved toll-free customer service during the 2005 filing season from the IRS, taxpayers did experience modest increases in (1) caller wait time and (2) caller decisions to disconnect before talking to an IRS customer service representative.⁴

While the IRS initially announced plans in December 2005 to reduce telephone helpline hours from 15 to 12 hours a day, the Service released a statement in the last few weeks that the agency

³United States Government Accountability Office Report on "Tax Administration: IRS Improved Some Filing Services, but Long-term Goals Would Help Manage Strategic Trade Offs," November 2005, pages 17-21.

⁴Treasury Inspector General for Tax Administration Report on "Taxpayers Continued to Experience Improved Access to Toll-Free Telephone Service During the 2005 Filing Season, Reference Number 2005-40-155, September 21, 2005.

will not be reducing helpline hours. In general, the AICPA has not received any significant reports from tax professionals over the last year regarding whether there has been an appreciative reduction in the overall quality of the IRS's telephone service. This is an area that we will keep a close eye on, and will report back to the IRS Oversight Board if our membership and taxpayers begin to experience significant declines.

One area of telephone service that tax professionals particularly support is the IRS's Practitioner Priority Service, commonly referred to by tax professionals as the "practitioner's hotline." The Practitioner Priority Service is staffed by IRS customer service representatives trained to handle taxpayer account related issues. We urge the IRS Oversight Board to support continued funding of this important customer service program.

IRS Website

We are well aware that the IRS has made (or is considering cuts) in a number of customer service areas because of the wide availability of lower cost, alternative distribution channels for dissemination of taxpayer assistance information, such as the IRS website – IRS.gov. According to the Service, IRS.gov received over 176 million "hits" and 1.2 billion pages were viewed by the public during fiscal 2005.

IRS.gov was first available to the public on the Internet in 1996, and has undergone several updates. The most recent redesign took place in November 2005, with improvements made to the site's search engine and the establishment of new navigation buttons for individuals, businesses, nonprofits, and tax professionals, etc. Many CPAs report the modifications to the Service's website are positive, including that the website's design is easier to navigate and the new search engine yields more meaningful results.

Taxpayer Assistance Centers

The Service's taxpayer assistance centers (TAC) have been a vital customer service function as outreach to taxpayers. These walk-in centers provide an excellent avenue to taxpayers and tax professionals for addressing taxpayer account issues, tax law questions, and in the preparation of low-income taxpayer returns. However, we recognize that the public demand for use and access to TACs throughout the country has begun to drop in recent years. According to the GAO, there were 385,000 taxpayer contacts at TACs in 2005, a ten percent decline from the year before; with a 22 percent drop in the contacts for return preparation over the same period.

While this drop in demand is attributable to attractive alternatives, like IRS.gov, the GAO states that "some [of this drop in demand] is attributable to IRS's attempt to direct taxpayers away from face-to-face assistance. For example, since 2003, IRS has required appointments for most taxpayers seeking return preparation at its sites."⁵

The AICPA recognizes that there may be legitimate budgetary needs that require closing TACs that are underutilized. The IRS objective of identifying less costly alternatives (in terms of meeting the services delivered to the public by TACs) is a laudatory objective. We believe,

⁵ United States Government Accountability Office Report , pages 23-24.

however, that the Service must have a clear understanding of whether and how these alternative taxpayer service vehicles are in fact serving the specific segments of the public that would be impacted by the closing particular walk-in centers. For example, large segments of the population still do not have access to the Internet, and so the alternative of online assistance, while generally available to the public, is not an option for this subset of the populace.

For tax professionals, the TACs are a very important avenue for resolving taxpayer accounts and collection matters, particularly when time is of the essence. For example, a taxpayer may confer with a tax professional about an IRS collection case involving a clear threat by the agency to take decisive action (such as foreclosure against the taxpayer's personal residence) within a period of days. The TAC provides the tax professional and the taxpayer with a forum to quickly resolve these types of cases in a face-to-face fashion with an IRS employee.

Increase in User Fees

The IRS announced a series of increases in user fees in December 2005, effective for 2006. These user fees are levied by the IRS to charge taxpayers for the privilege of receiving advance assurance from the IRS about the tax consequences of certain transactions. For example, under the new fee schedule, the IRS Chief Counsel has increased the fees (among others) for private letter rulings by \$2,500 to \$10,000 (with lower fees for taxpayers earning under \$1 million); requests for changes in accounting method by \$1,000 to \$2,500; corporate pre-filing agreements to a flat fee of \$50,000, and Advance Pricing Agreements to as much as \$50,000.

We understand that these increases generally reflect an attempt by the IRS to respond to an Office of Management and Budget directive for agencies to charge user fees reflecting the full cost of goods or services. However, we are concerned that these increases (many of which are dramatic increases over previous levels) will result in a substantial reduction in general taxpayer use of critical IRS programs. These programs for the most part encourage taxpayers to seek advance assurance from the IRS that the tax consequences of their proposed actions will be treated consistently by both the taxpayer and the IRS. Actions by the IRS that discourage use of programs, such as private letter ruling requests, could result in greater compliance costs for taxpayers and enforcement costs for the IRS. The AICPA does not support the possible use of fee increases as a management tool by the Service to control its workload burden.

Business Systems Modernization

The Oversight Board's 2005 Annual Report states that "the IRS' once-troubled BSM [Business Systems Modernization] program experienced better performance in FY 2004."⁶ This is clearly a more optimistic report by the Board when compared to prior years, particularly in comparison to press reports from recent years about long-standing delays in major projects like the customer account data engine (CADE), the system designed to replace the master file for taxpayer records.

The BSM goals are critical to the future successes of the Service. The program is designed to change the entire way the IRS conducts business with taxpayers and stakeholders, by: (1) implementing systems to improve IRS effectiveness in receiving, routing, and responding to

⁶ IRS Oversight Board, 2005 Annual Report, October 24, 2005.

millions of taxpayer telephone calls; ((2) establishing a modern, reliable data base; (3) implementing a nationwide email and voice-mail messaging system for Service employees; and (4) supplying Revenue Agents with software capable of accurately assessing a taxpayer's liability when faced with a complex tax matter or calculation.

We strongly support the IRS BSM effort and urge the Oversight Board and Congress to continue their support for appropriate funding for the modernization effort. BSM must remain a robustly funded feature of the Service's implementation of its strategic plan.

Modernized E-File

The AICPA recognizes the administrative efficiencies and budgetary savings the IRS's electronic tax administration program achieves for the agency, as well as the customer service benefits that accrue to taxpayers from an effective electronic filing (e-file) program. The administrative benefits of e-filing include faster tax processing, reduced cycle time, quicker identification of emerging audit trends, and the potential for more current resolution of taxpayer uncertainties.

We applaud the success the IRS had with the e-filing program during the 2005 filing season, and we will continue to work closely with the Service to meet its expectations of 135 million individual e-filed returns during 2006 filing season.

The IRS has done a commendable job of introducing programs – such as the Free File and the Volunteer Income Tax Assistance (VITA) programs – to help low income taxpayers (who often don't own computers) to file their own income tax returns. Another critical component of helping low income taxpayers is to consider funding for low income tax return preparation clinics, in a similar fashion to the funding low income tax (controversy) clinics receive under Internal Revenue Code section 7526. We believe funding for tax return preparation clinics would encourage e-filing and improve compliance by low income taxpayers generally.

We support the IRS's suite of web-based products for tax professionals and taxpayers called "e-services." Through e-services, practitioners and taxpayers have access to a suite of online products, including the Preparer Tax Identification Number (PTIN) Application; the Online e-file Application; Electronic Account Resolution (EAR); submission of Form 2848, Power of Attorney and Declaration of Representative; and the Service's Transcript Delivery System (TDS).

When the program was launched in 2004, e-services was made available to tax professionals who e-filed 100 or more individual returns. Last year, the IRS lowered this threshold by making the e-Services suite available to tax professionals who e-file 5 or more individual and business income tax returns. We believe this expansion of e-services to more practitioners should have the added benefit of making the IRS's interaction with tax professionals more efficient, thereby generating significant cost savings to the Service.

E-File for Large Corporations and Exempt Organizations

The AICPA is closely consulting with the IRS on implementation of the mandatory e-file program during the current 2006 filing season, a program that generally requires large corporations (total assets of \$50 million or more) and tax exempt organizations (total assets of \$100 million or more) to file returns electronically. As the 2006 filing season progresses, the IRS must remain mindful of the difficult experience that taxpayers and the agency had with the mandatory large partnership e-file program rolled-out several years ago. The AICPA has previously recommended that the IRS delay the start of the new mandatory e-file program for one year, and we continue to observe that it is not unreasonable for the Service to anticipate significant issues upon implementation of this new program for large corporations and exempt organizations.

Our members remain concerned about a number of implementation issues such as the potential for security breaches, the ability of the IRS's computer systems to handle peak load demands by taxpayers, and the adoption of reasonable approaches by the agency in terms of defining what constitutes a timely filed return and valid elections. Moreover, we have recommended that the IRS must maintain a posture of flexibility on granting hardship waivers to corporations and exempt organizations, as opposed to a policy that grants waivers only in exceptional cases.

Even though this is the first filing season for implementation of the mandatory corporate and exempt organization e-file program, we cannot over emphasize the need for the Service to also adopt a posture of flexibility on critical implementation decisions for next year's filing season. For purposes of the 2007 filing season, the e-file thresholds will drop even further, subjecting middle-sized market corporations and exempt organizations to the mandatory e-file program, taxpayers who routinely (1) don't employ tax professionals on the entity's payroll and (2) utilize the services of tax professionals working for large and smaller-sized accounting firms. We will continue to work with the IRS in resolving the implementation issues as e-filing is expanded.

National Taxpayer Advocate

From our perspective, the National Taxpayer Advocate is one of the best customer service oriented programs within the IRS. We find the two yearly reports issued by the National Taxpayer Advocate to be excellent compendiums of systemic problems and evolving trends within the tax administration and tax policy implementation arenas.⁷ Some of the major areas of focus within these reports include taxpayer rights proposals, the Service's Private Debt Collection (PDC) initiative, the Earned Income Tax Credit (EITC) program, Offers in Compromise (OIC) and other collection measures, and the cash economy. On the issue of Offers in Compromise, we have worked very closely with the National Taxpayer Advocate over the last several years in advocating for effective and efficient administration by the Service of the OIC program.

In addition to systemic advocacy, the Taxpayer Advocate's office performs a vital function of providing taxpayers with an independent channel for resolving individual tax problems. The

⁷ See "The National Taxpayer Advocate's Fiscal Year 2006 Objectives Report to Congress," June 30, 2005; and the "National Taxpayer Advocate, 2005 Annual Report to Congress," January 10, 2006.

Advocate assists taxpayers by reviewing requests for assistance with respect to enforcement related cases involving “significant hardship,” and where appropriate, helps craft solutions to relieve such hardship.

II. THE IMPORTANCE AND IMPACT OF MEASUREMENTS

The AICPA supports the IRS Oversight Board’s quest to focus attention on the implementation of clear measurements for tax administration; what we define as the establishment of goals designed to improve the long-term effectiveness of the tax system.

As suggested by the Oversight Board in its letter announcing today’s meeting, an excellent example of a beneficial tax administration measure is the Congressionally mandated goal that the IRS attain an 80 percent level for all returns to be electronically filed. This measure has led to dramatic increases in the number of e-filed returns and at the same time, has greatly contributed to increased efficiency in tax administration overall.

We endorse the need for goal setting for tax administration, and in this context, we are providing comments on (1) the IRS’s aging work force, (2) IRS employee training, and (3) the Service’s private debt collection initiative.

Addressing the IRS’s Aging Workforce

One of the most critical challenges facing the IRS today is how the agency will address the problem of an aging workforce. We believe the recruitment, development and retention of a quality workforce is essential for the IRS, and we commend the Service for its recruitment in recent years of senior executives from outside the agency. In our experience, effective leadership results when these new executives are partnered with internally developed executives who have critical institutional knowledge. We are also encouraged by the quality of the outside technical experts who were brought into the four operating divisions. We encourage continued recruiting from outside the Service.

The IRS is experiencing a higher than normal attrition rate among its mid-level and rank-and-file employees, primarily through retirements. These retirements are clearly having an impact on the Service’s ability to implement the reorganization⁸, including the ability to increase productivity among its employees overall. Replacing these retirees and the resulting loss of “institutional memory” is a major challenge for the IRS.

The AICPA stands ready to support the IRS in achieving its goals for staffing over the coming years. We have found there are a number of CPAs in mid-level positions and recent accounting graduates who are interested in government and public service.

⁸ Due in large part to passage of the IRS Restructuring and Reform Act of 1998, the IRS has changed its structure to include four operating divisions, organized around four major customer segments; specifically the Wage & Investment, the Small Business/Self-Employed, Large & Mid-Size Business, and Tax Exempt & Government Entities Divisions. This change in the IRS structure is commonly referred to as the “reorganization.”

In order to help facilitate the hiring of new agency employees, we recommend that the IRS study its current salary/grade level structure. The study should take into account the salaries for comparable employees in other federal agencies and in comparable private sector positions. Also, the IRS should continue its recruitment efforts on college campuses, and possibly introduce an advertising campaign regarding agency job openings.

We welcome the opportunity to help the IRS identify qualified CPAs for employment within the Service.

IRS Employee Training

The AICPA also believes that an important area for establishment of measures involves IRS employee training. Some of the most frustrating experiences realized by taxpayers and tax practitioners in dealing with the IRS occur because of a lack of training on the part of IRS employees. It is much easier to work out a solution that is fair to both the tax system and the taxpayer if the IRS personnel resolving the issue are knowledgeable and well-trained.

Congress must provide the requisite budgetary resources overall, and the IRS must consistently target appropriate levels of such resources, on employee training; including training needed to overcome any inertia of mid-level and rank-and-file personnel that works against the reorganization or new agency programs. The AICPA strongly supports such efforts.

We believe we can be of immense help to the Service with employee training. First, we suggest that the Service seek prior input from key stakeholders on the details and development of the program, including suggestions from the AICPA and other stakeholders regarding training materials for the new initiative. Second, we recommend that the Service utilize CPAs and other stakeholders in teaching parts of the training curriculum for IRS personnel. By including outside tax professionals in the training process, we believe IRS employees become more sensitized to the burdens that taxpayers face due to complicated tax laws and regulations.

We firmly believe private sector involvement in the training process helps IRS employees to conduct new programs effectively for the tax administration process, while minimizing intrusion and taxpayer burdens.

Private Debt Collection Efforts

The IRS is in the process of launching the agency's private debt collection program, an initiative authorized through the enactment of the American Jobs Creation Act of 2004. We appreciate how private collection agencies could help the IRS resolve a portion of its collection inventory, and that the program has the potential of enabling the Service to focus the energies of its employees on the more difficult or complex collections cases. The Service has announced that private debt collection agencies will be held to the "same standards of service and protection of taxpayer rights" as required of IRS employees.

We believe that this program is a critical test program for the Service, especially in terms of enabling the agency to leverage private sector involvement with a reallocation of vital resources

towards programs of critical needs. Nevertheless, because collections is a program area which has historically been an area of chronic taxpayer complaint and alleged taxpayer rights abuse, we strongly urge the IRS Oversight Board to closely monitor implementation of the private debt collection program; and work with the IRS on the establishment of positive and realistic performance measures for the private debt collection firms.