

IRS Oversight Board
FY2005 Budget/Special Report
March 2004



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Introduction

The Internal Revenue Service (IRS) Oversight Board is required by 26 U.S.C. § 7802(d) to review and approve the budget request prepared by the IRS, submit such request to Treasury, and ensure that the approved budget supports the annual and long-range strategic plans of the IRS. The President is required to submit the Board's request, without revision, to Congress along with his own request.

Each year, the Board works closely with the IRS and Treasury as the IRS' budget is developed. In September 2003, the Board submitted its recommended FY2005 budget to Secretary of Treasury John Snow. On February 2, 2004, President George W. Bush presented his FY2005 Budget Request to Congress.

In this special report, the Board presents its recommended FY2005 IRS budget, compares it to the Administration request, and explains why the Board believes its recommended budget is needed to support the annual and long-range needs of the IRS.

Executive Summary

The IRS budget is more than dollars and cents. It represents the choices that we as a nation make about the future of our tax administration system and how we help over 100 million American taxpayers deal with an increasingly complex tax code while ensuring that everyone pays his or her fair share of taxes.

The Board believes that now is a critical time for our tax system to be strengthened, not merely maintained at current levels. Enforcement activities are still at unacceptable levels. Our nation's tax gap is estimated at \$311 billion,¹ leaving billions of dollars on the table simply because the IRS does not have the resources to do its job.²

The Board's own research shows that each year, more Americans believe it is acceptable to cheat on their taxes. At the same time, our already complex tax code continues to be a changing, tangled mystery to most honest taxpayers — and an asset to those intent on skirting the law. Every effort must be made to provide quality service to honest taxpayers who want to comply with the law.

In crafting its FY2005 budget for the IRS, the Board addressed these concerns head on by reinvesting in the IRS to produce tangible benefits and results for America's taxpayers and our nation. It is a sensible and pragmatic budget that reflects the real world in which the IRS must operate and be funded.

The Board recommends a 10 percent increase in funding from FY2004 to \$11.204 billion, with a significant increase of 3,315 full-time equivalents (FTEs) to boost enforcement efforts. If enacted, the Board's budget would increase our nation's revenue by approximately \$5 billion each year³ once the IRS has hired and trained additional enforcement personnel.

Under the Board's budget, the IRS would have the additional resources to:

- Close over an additional 1,000 cases involving high risk/high-income taxpayers and promoters who avoid paying income taxes by using offshore credit cards and abusive trusts and shelters.
- Boost audit rates by 42 percent from FY2004 to examine companies that use aggressive tax avoidance tactics, such as offshore transactions and flow-through entities.

IRS Oversight Board

- Contact an additional 200,000 taxpayers who fail to file or pay taxes due; a 40 percent boost from FY2004 and a 27 percent increase from the Administration's request. This alone will allow the IRS to collect \$84 million more in revenue owed than the Administration's request would allow.
- Sustain the one-on-one assistance that millions of Americans rely on at tax time. The Board's budget will ensure that the IRS will be able to maintain its improved service to taxpayers by answering eight out of ten phone calls.

By comparison, the Board believes the Administration's FY2005 budget cannot achieve its stated goal to add almost 2,000 personnel to bolster the IRS' enforcement efforts, and will threaten hard-earned improvements in customer service. This year's request will lead to a \$230 million shortfall in the IRS budget because it fails to budget adequately for the anticipated \$130 million of congressionally-mandated civilian pay raises, rent increases, and at least \$100 million of unfunded expenses.

In fact, FY2005 is the fourth year in a row in which the Administration has called for IRS staff increases, while not covering pay raises or required expenses.

As a result, the Administration's proposed increase in the IRS' FY2005 budget will erode before new employees can be hired, more taxpayer phone calls can be answered, or new audits of possible tax cheats can be conducted.

Impact of \$230 Million Budget Shortfall on Three Major IRS Functions

Function	Performance Measure	FY2005 performance goal	Revised goal after \$230M cut
Field Collection	# of tax delinquent account cases resolved	981,000	463,000
Toll-free Telephone Level of Service	Calls answered	32 million	17 million
Field Exam	Exams of individual taxpayers <\$100K AGI	118,840	73,000

Another important component of the Board's budget is its recommendation to provide the resources needed to focus and stabilize the IRS' computer modernization initiative. While this program has experienced significant and unacceptable delays and cost overruns, the Board firmly believes that the modernization plan cannot be allowed to fail. Over time, the existing systems will become impossible to maintain, and at that point, our nation's tax system would face a catastrophic disruption.

For that reason, the Board believes FY2005 BSM funding should be set at \$400 million, with only \$285 million put into the FY2005 spend plan. This recommendation sets the foundation for genuine progress on the program in FY2005, and allows the BSM fund to operate like a multi-year fund, as originally envisioned by Congress and as the Board has recommended each year since its inception.

By contrast, the Administration's request for \$285 million to fund the IRS' Business Systems Modernization initiative will adversely affect funding in future fiscal years and force the program to take longer and cost more than necessary. While the Administration's request is a meaningful investment for FY2005, the IRS must be able to plan into FY2006 and deliver tangible results for taxpayers sooner, not later.

The IRS Oversight Board acknowledges that the IRS's budget has increased in each year of President Bush's Administration, and that the increase is significant against other non-defense, non-homeland security discretionary funding. That commitment is commendable, and the Board recognizes and thanks Secretary Snow for his efforts, especially at a time when the nation must balance many important and competing priorities.

However, the Board was established to bring to bear its collective expertise and familiarity with private sector best practices on the IRS' problems. To the private-life Board members, investments in enforcement pay for themselves many times over, not only in revenue dollars but by reinforcing the belief that all taxpayers are paying their fair share. A strong business case can be made for providing the IRS with several hundred million dollars so it can collect billions in revenue. Federal revenues as a percentage of the economy have shrunk to 1950s levels. We face a \$500 billion deficit. The Board believes it imperative that we strengthen our tax collection system.

For that reason, the Board recommends that both Congress and the Administration reevaluate their methodology by including the revenue value to the country when estimating budget requests for the IRS. Indeed, considering the positive impact of additional resources provides a better framework for making informed decisions and will lead to a more effective IRS.

In conclusion, the Board calls for Congress to stay the course it set more than five years ago with the passage of the IRS Restructuring and Reform Act. The IRS has made progress in carrying out the spirit and letter of the Act; we must now give it the resources to finish the job.

IRS Oversight Board Recommendation

The IRS Oversight Board's proposed budget for the IRS takes into account the unfunded mandates and costs that have undercut previously promised gains. It provides realistic funding that will allow the IRS to achieve the goals outlined in the Administration's budget that otherwise cannot be attained.

The Board calls for a much needed funding boost, with a substantial staffing increase, so the IRS can reverse its declining enforcement levels, maintain its hard-earned customer service improvements, and reduce the risk of failure associated with its aging computer systems. Specifically, the Board calls for a 10 percent increase in funding from FY2004 to \$11.204 billion, with a significant increase of 3,315 FTEs from FY2004 to boost enforcement efforts (*for Program Summary, see Appendix 1*).

The IRS Oversight Board has consistently asked the IRS to strive for balance between customer service and enforcement. Balance means helping taxpayers understand their obligations in an increasingly complex tax system while at the same time identifying and pursuing those who flout the tax code. The Board recommends a budget that promotes balance by maintaining customer service funding at FY2004 levels, with a significant increase in resources to address declining enforcement. Shifting resources is not the answer; providing enough resources is.

How the Board Arrived at Its Budget

In its FY2005 budget recommendation, the Board anticipates a 3.5 percent pay raise for civilian employees, which achieves parity with the Administration's call for a 3.5 percent military pay raise. The Administration, by contrast, calls for a 1.5 percent civilian pay raise. The Board believes that the 1.5 percent civilian pay increase fails to recognize recent history.

For the past four years, Congress has insisted on parity for both military and civilian pay raises. For FY2005, it is likely that Congress will follow this approach and approve a civilian pay raise comparable to the military's 3.5 percent increase. If it does, the IRS will have to come up with the money that otherwise would be used to improve enforcement.

This historical record crosses over into another area. Each year, the IRS must absorb millions of unfunded costs, such as rent increases and postage, left uncovered by the Administration's budget request. In FY2002 and FY2003, unfunded costs emerged after the budgets were submitted to Congress. In FY2002, these non-pay costs, exclusive of

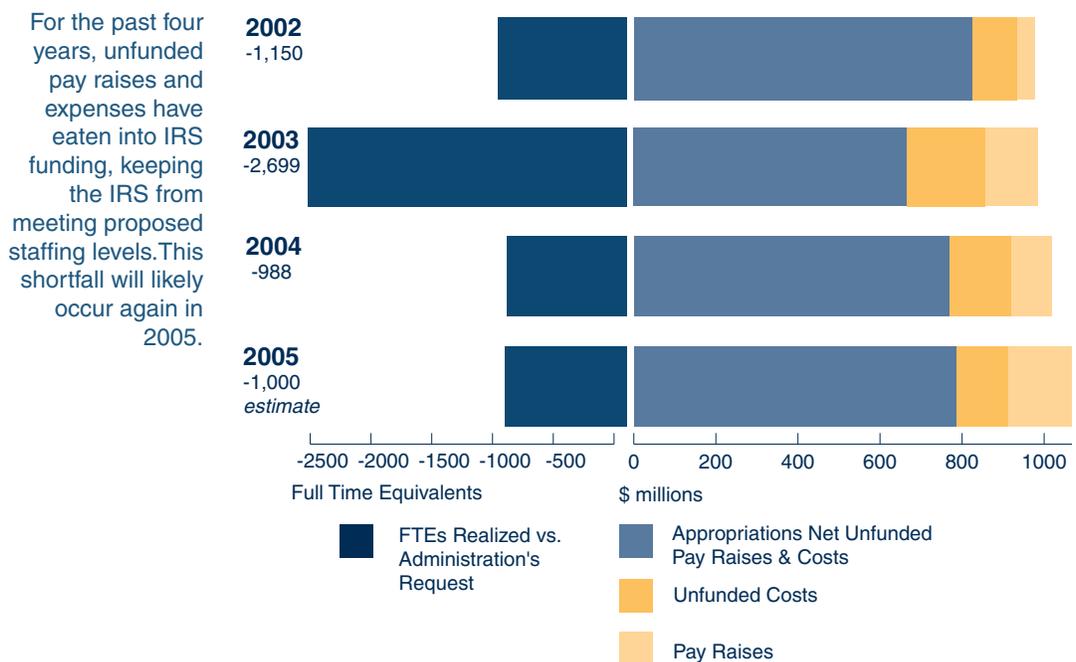
rental increases, were \$79 million. In FY2003, they were \$122 million. The Board estimates that in both FY2004 and FY2005, there will be at least \$100 million in unfunded expenses. The resulting shortfalls mean that the IRS is consistently unable to hire the personnel assumed in the Administration's request.

In its recent report, "Challenges Remain in Combating Abusive Tax Schemes," the General Accounting Office observed, "Despite receiving requested budget increases, staffing levels in key occupations were lower in 2002 than in 2001. These declines occurred for reasons such as unbudgeted expenses consuming budget increases and other operational workload increases."⁴

In addition to savings realized by shifting resources, the Administration requests an additional increase in IRS staff by 1,963 FTEs (see Appendix 3). Yet it is highly unlikely the IRS will be able to hire that number of personnel. Again, if past is prologue, Congress will pass a significantly larger civilian pay raise with no additional funds being appropriated to make up the difference and unfunded costs will be left uncovered (see Appendix 2). The result is that the IRS will not have the money to meet proposed staffing levels, continuing a very alarming course.

The Board wants to put an end to this trend by adding \$130 million to make up for the difference in the pay raise and rent shortfalls.

Budget Requests, Appropriations & Hiring Outcomes, 2002-2005



IRS Must Stay the Course on Customer Service

The vast majority of Americans want to file their returns and pay their fair share, yet our nation's tax code continues to become more complex. Resources must be available so the IRS can answer taxpayers' questions promptly and accurately, whether it is over the phone, through the IRS web site, by mail, or at walk-in centers.

Under the Board's proposed budget, customer service funding will remain at about the same level as FY2004; however, service should improve due to the deployment of self-service technology.

For taxpayers, that means eight out of ten phone calls will be answered. For tax practitioners calling the IRS toll-free hotline to resolve problems regarding clients' accounts, hold-time will remain at current levels.

The IRS call-routing systems as well as web-site applications that allow taxpayers to check the status of their tax refunds have already shown dramatic benefits in speeding service to taxpayers. New systems, such as e-Services, will soon be available, providing additional automated services to tax practitioners.

Clearly, service to taxpayers has improved in the past five years. Such improvements make it all the more imperative that we sustain them and not allow this positive trend to languish, or worse, decline. The agency must now stay the course.

Days of "Outmanned and Outgunned" IRS Must End

The IRS is doing a better job of identifying egregious noncompliance — now it needs the resources to fight back. In the past two years, the IRS sharpened its compliance focus to identify and pursue promoters and participants of abusive tax shelters and tax evasion schemes. For example, the agency is now targeting its resources on promoters of illegal tax schemes that are often marketed to high-income individuals, but are also finding their way to middle-market businesses.

Despite this focus, enforcement activities are still at an unacceptable level simply because the IRS does not have the resources needed to accomplish its mission. It continues to be outmanned and outgunned. In FY2003, the agency was able to pursue only 18 percent of known cases of abusive devices designed to hide income, leaving an estimated \$447 million uncollected.⁵

GAO warned: "The extent to which the caseload and resources will match each other in the future remains to be seen, given the uncertainty about the volume of additional work and the rate at which the IRS can close abusive scheme examinations."⁶ Again, a key problem surfaces: workload increases without a commensurate workforce increase to deal with it.

The IRS must prove to the public that it can and will identify and pursue those who show contempt for the tax code. The Board's proposed budget allows the IRS to begin to reverse this disturbing trend. It believes that its

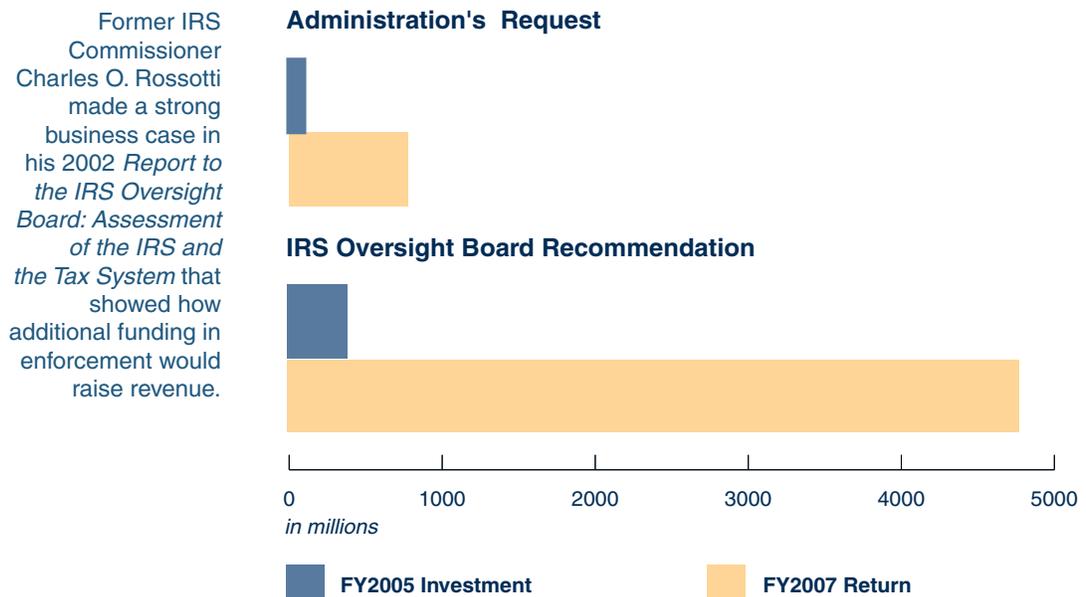
budget recommendation would provide the means to:

- Close over an additional 1,000 cases involving high risk/high-income taxpayers and promoters who avoid paying income taxes by using abusive trusts, shelters, and offshore credit cards.
- Boost audit rates by 42 percent from FY2004 to examine companies that use aggressive tax avoidance tactics, such as offshore transactions and flow-through entities.
- Contact over 200,000 more taxpayers who fail to file or pay taxes; a 40 percent boost from FY2004 and a 27 percent increase from the Administration's budget. This alone will allow the IRS to collect \$84 million more in revenue owed by wage-earners than the Administration's request would allow.
- Develop an effective means to identify individuals participating in illegal tax avoidance activities so that issues can be addressed through education, outreach, legislation, or improved form design.

The Board's recommendation would increase our nation's revenue by almost \$5 billion each year once the IRS has hired and trained additional enforcement personnel. The Board believes the additional revenue achieved makes a strong business case for the recommended additional

Return on Investment in Enforcement ³

After adjusting Administration's Request for \$230 million of known shortfalls and estimated unfunded expenses.



enforcement resources. Moreover, while this is a modest boost in closing our compliance gap, it will also send a message to those contemplating tax avoidance: the IRS' hands are no longer tied behind its back.

Modernization Critical to Tax Administration

In December 2003, the Oversight Board released an independent analysis of the IRS Business Systems Modernization (BSM) program. The Board called for nine specific recommendations for turning around the critical but troubled program that has experienced significant and unacceptable delays and cost overruns.

However, the Board still believes that the overall Modernization plan is sound and well-designed. Moreover, it is critical to the future of tax administration. As a nation, we must remain committed to the IRS' computer modernization program. The Board testified before the House Ways & Means Subcommittee on Oversight on Feb 12, 2004:

The IRS Oversight Board firmly believes that the IRS Modernization program cannot be allowed to fail. The IRS cannot continue to operate with the outmoded and inefficient systems and processes it uses today. Over time, the existing systems will become impossible to maintain and at that point, the ability to administer our country's tax system will be in grave danger. Such a risk to our nation is unacceptable. We remain convinced that the overall Modernization plan is sound and well-designed. The challenge is executing that plan. The IRS and the Prime must get it right this time.⁷

The Board's proposed budget provides the stable resources needed to focus and stabilize the steady stream of funding for the IRS' computer modernization initiative. Special controls are in place to ensure that no funding in this account is spent until the IRS has the capability to spend it effectively. If the IRS does not correct the weaknesses in the BSM program by FY2005, the Board advocates that the funds earmarked for modernization should not be spent. However, the Board does not believe the IRS should plan for failure. The agency must be poised to move forward with BSM once it has demonstrated that it has corrected the program's weaknesses. The funding level recommended by the Board sets the foundation for genuine progress for the program in FY2005.

The Board expects that the Customer Account Data Engine (CADE) Release 1 will occur in 2004. Over the next year, the IRS will test and build upon that system. The IRS should continue to strengthen its ability to manage the program and the Prime to deliver projects on budget and on time. By the end of FY2005 and early FY2006, the IRS should be able to proceed with the remaining releases of CADE as quickly as possible. This will minimize future risk and the long-term cost of modernization while providing a basis to deliver tangible results for taxpayers.

If the IRS' FY2005 BSM funding is reduced to \$285 million, as it is in the Administration's budget, future funding likely will be adversely affected. If

that happens, the projects will drag on, risk will increase, and ultimately, the program will cost taxpayers much more.

For that reason, the Board believes FY2005 BSM funding should be set at \$400 million, with only \$285 million put into the FY2005 spend plan. This will allow the IRS' Business Systems Modernization fund to operate like a multi-year fund, as originally envisioned by Congress and as the Board has recommended each year since its inception.

Further, as its archaic, tape-based computers begin to give way to modern business systems, the IRS must plan for a smooth transition. The Board's budget recognizes that need. As new systems are incorporated, the IRS must plan to operate both the old and new systems in parallel for some time. The IRS must also retain employees with critical skills while training existing and new employees to use new systems. This will allow the IRS to reduce the risk of a catastrophic disruption to the system.

In addition, the Board believes that the transition to modernization is a real cost that must be incurred. There are no short cuts to successful modernization — the IRS' budget must reflect the real cost of maintaining legacy systems while simultaneously supporting modernized systems. Accordingly, the Board recommends an additional \$25 million to cover these costs. The Administration's budget fails to acknowledge them.

The Administration's FY2005 Budget Request

The IRS Oversight Board acknowledges that the IRS's budget has increased in each year of President Bush's Administration, and that the increase is significant while compared to other non-defense, non-homeland security discretionary funding. That commitment is commendable, and the Board recognizes and thanks Secretary Snow for his efforts, especially at a time when the nation must balance many important and competing budget priorities.

The Board also believes that the Administration's FY2005 Budget Request takes notice of important issues by calling upon Congress to boost compliance and simplify the tax code to ease taxpayers' burdens. The Board has called for both since its inception. The Board has supported several of the Administration's specific legislative proposals, including allowing private firms to collect some unpaid taxes and extending the April 15th deadline for e-filers to April 30th.

Further, in last year's Annual Report, the Board called on the IRS to "make the most of its limited resources, and continue to find ways to operate efficiently and effectively." The Board believes the IRS is taking action to be more productive, and should be challenged to do more. The IRS should continue to find ways to reengineer its business processes so it can operate more efficiently.

Technology improvements, such as intelligent call-routing, Free File, and soon, e-Services, allowing tax practitioners to interact with the IRS securely over the internet, are making it easier for Americans to meet their tax obligations and the IRS to more efficiently and effectively meet their needs. Increases in e-filing will permit the IRS to close its Memphis tax return paper processing operation, allowing resources to be freed up to hire new enforcement personnel.

However, for all of these gains, the Administration's budget will lead to a \$230 million shortfall in the IRS budget because it fails to fund \$130 million of congressionally-mandated civilian pay raises, known rent increases, and at least \$100 million of unfunded expenses.

The Board and IRS Commissioner Mark Everson have consistently stated that customer service plus enforcement equal compliance. In setting its FY2005 budget, the Board called for funding that would allow the IRS to boost enforcement, sustain its improved level of customer service, while reducing the risk of failure associated with its aging computer system. These goals will not be met under the Administration's budget.

Budget Fails to Shrink Tax Gap

Unfortunately, this budget not only threatens to end the clear progress made in customer service, it also does little to shrink our nation's tax compliance gap. It does not back up its goals on enforcement with the necessary resources to do the job.

On any given year, the IRS does not have the resources to pursue at least \$30 billion worth of known taxes that are incorrectly reported or not paid. In 2001, our nation's tax gap — the total "inventory" of taxes that are known and not paid — was estimated at \$311 billion. Meanwhile, the IRS workload continues to increase while the workforce remains stagnant or declines. The number of tax returns has grown much faster than the IRS workforce; IRS workload grew 16 percent between 1992 and 2001, while its workforce declined 16 percent.⁸ This alarming trend shows no sign of abating.

Moreover, the number of returns of individuals earning more than \$100,000 has grown 342 percent over the past decade.⁹ These returns tend to be more complicated and require more time and resources to examine. Currently, the IRS examines approximately one out of 100 returns for individuals earning more than \$100,000. Under the Administration's budget, even by shifting of resources, it is unlikely the IRS will have the resources to examine appreciably more.

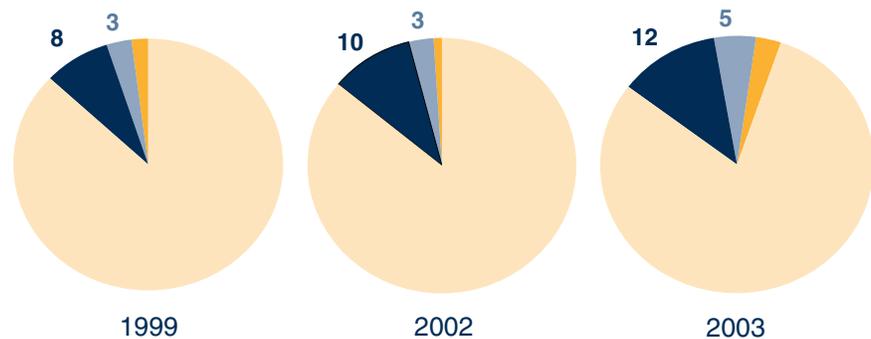
On a broader level, the IRS is unlikely to achieve its new enforcement strategy focusing on identifying and pursuing promoters of abusive tax shelters and tax evasion schemes if it does not have the resources to back it up. Since 1996, the number of revenue officers and agents has dropped dramatically from 22,751 to 16,761 — a 26 percent decrease.¹⁰ The IRS is operating with its hands tied behind its back, and promoters and buyers of abusive tax avoidance devices know it and attempt to take advantage of this vulnerability. Pulitzer Prize-winning *New York Times* reporter David Cay Johnston, in his book *Perfectly Legal*, comments:

The IRS budget has been restrained so severely that only one in five of the tax cheats it identifies is pursued to make him pay. The other four pay nothing. Tax law enforcement became so weak that businessmen were quoted on the front page of the The New York Times in the year 2000 boasting about how they neither paid taxes nor withheld them from their employees' paychecks. More than two years later, not one of them had been indicted or even forced through civil court action to pay up. Not only did more than 1,500 people, caught red-handed hiding money offshore when their banker turned over records of their crimes, escape prosecution, but most were not even asked to pay the taxes they had evaded.¹¹

These weaknesses and shortcomings could not come at a worst time. Public attitudes towards tax cheating show some alarming trends, particularly among young Americans. The Board's 2003 Survey on Taxpayer Attitudes found that support for total tax compliance diminished by four

points over the previous year to 81 percent. In other words, nearly one out of five Americans now believe that it is acceptable to cheat at least a little on their taxes. Almost one-third (30%) of young adults age 18-24 are among those most likely to feel that any amount of cheating is acceptable, an increase of six points since last year.¹² Yet ironically, “fear of being audited” has the greatest impact on these non-compliers at a time when actually being audited is near historic lows.¹³

Tax Cheating: Alarming Trends



How much, if any, do you think is an acceptable amount to cheat on your income taxes?

- Not at all
- A little here and there
- As much as possible
- Don't know/NA

The Board was established to bring to bear its collective expertise and familiarity with private sector best practices on the IRS' problems. To the private-life Board members, investments in enforcement pay for themselves many times over, not only in revenue dollars but by the deterrence value of reinforcing the belief that all taxpayers are paying their fair share. A strong business case can be made for providing the IRS with several hundred million dollars so it can collect billions in revenue. At a time when federal revenue as a percentage of the economy has shrunk to 1950s levels and we face a \$500 billion deficit, the Board believes it imperative that we strengthen our tax collection system.

For that reason, the Board recommends that both Congress and the Administration reevaluate their methodology by including the revenue value to the country when evaluating budget requests for the IRS. Indeed, considering the positive impact of additional resources provides a better framework for making informed decisions and will lead to a more effective IRS.

Customer Service Threatened

Shortfalls within the IRS' budget will put pressure on the progress made in improving customer service from the unacceptable levels of the mid-1990s. Quality IRS customer service is as critical to taxpayer compliance as is a vigorous enforcement program. The 2003 IRS Oversight Board Annual Survey on Taxpayer Attitudes found:

The most heavily relied upon source of tax information and advice are IRS representatives (83% see them as very/somewhat valuable), closely followed by IRS printed publications such as brochures (82%), and the IRS website (77%). The only non-IRS-provided information source that is rated as highly is a paid tax professional (83%).¹⁴

Improvements have been made. This past fiscal year, there was a dramatic boost in key areas of customer service, particularly over IRS' toll-free telephone lines. Telephone assistor level of service increased from 68 percent in FY2002 to 80 percent in FY2003.

The Board believes that this improvement is important for two reasons. First, more taxpayers are beginning to receive the help they need to comply with a complex and confusing tax code. Second, these key indicators prove that the long-term investments made in customer service are starting to pay off and provide their intended benefits.

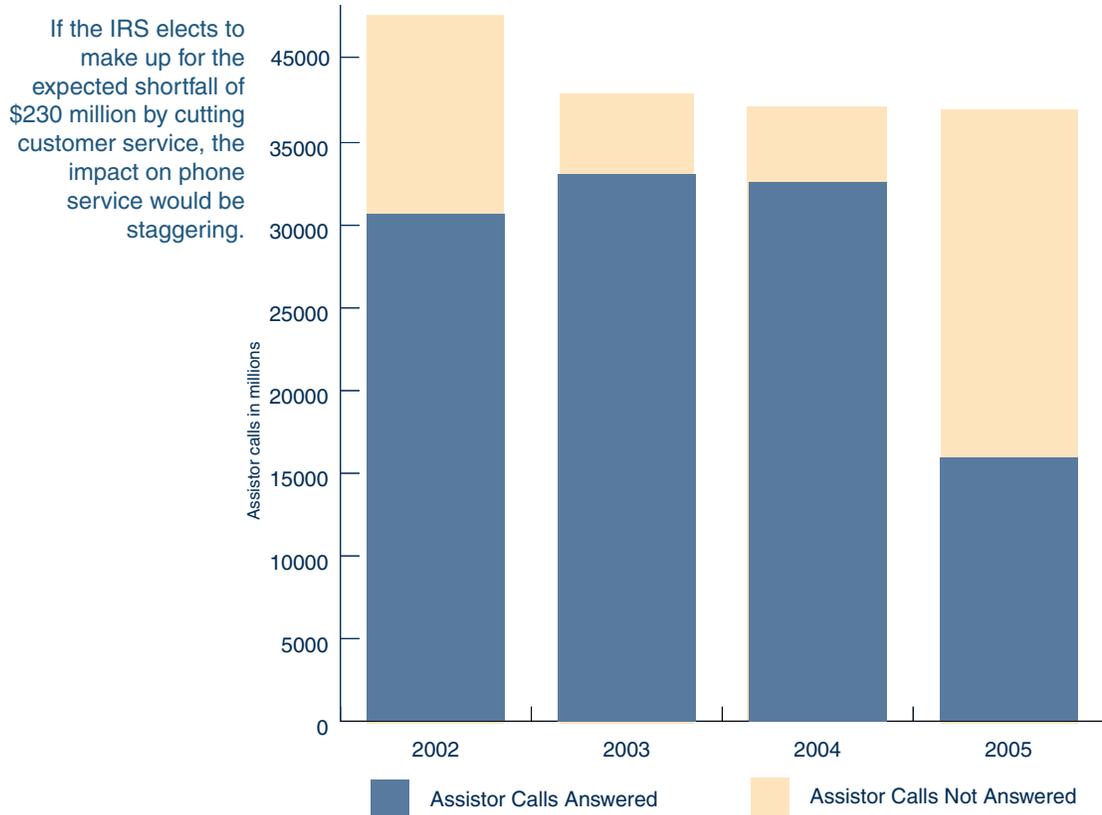
However, the job is far from over. Taxpayers deserve better. Level of service is still below that of the best financial services institutions — the best benchmark for measuring IRS progress. Last year, toll-free account quality fell by 10 percent to an unacceptable 67 percent and toll-free tax law quality fell by six percent to 80 percent. It is imperative that we sustain current levels of service and then improve upon them.

If the IRS elects to make up for the expected shortfall of \$230 million by cutting customer service to reach its enforcement goals, the impact on customer service would be staggering. A \$230 million reduction in customer service levels — which is possible under the Administration's budget — could leave 22 million phone calls unanswered. While self-service technology will continue to ease the need for live assistance, it will not address all the needs of all taxpayers. Reductions in phone service will penalize those who have no computer access, most notably the elderly, the poor, and those for whom English is a second language.

BSM Cuts Could Become Permanent and Impair Project

Modernizing the IRS' business systems is imperative. Over time, the existing systems will become impossible to maintain and at that point, the ability to administer our country's tax system will be in grave danger. Such a risk to our nation is unacceptable. While the IRS' Business Systems Modernization program reached a troublesome point last year, steps have been taken to review and refocus the program. However, dramatically reducing funding at this point will likely result in higher costs down the road. The Administration's request for \$285 million is a meaningful invest-

**Dramatic Drop on Phone Calls Answered:
One Scenario Under Administration's FY2005 Budget**



ment for FY2005, but the IRS must be able to plan into the next fiscal year so that it can make genuine progress and deliver tangible results for taxpayers. The Board fears that BSM budget reductions in FY2005 will have an adverse affect on future funding and ultimately impair the project before it is completed. The longer it takes to modernize our computer systems, the more expensive and risky it becomes.

Board Cites Complexity as Fundamental Flaw

The IRS Oversight Board is precluded by law from addressing tax policy issues, but it would be remiss not to address the cost of our nation's complex tax system; a cost ultimately borne by taxpayers and the IRS. The Administration's legislative proposals contained in its budget request only begin to address the problems caused by complexity. The approach so far to tax simplification fails to address a fundamental flaw in our tax system: its costly, confusing, and debilitating complexity. The Administration has, however, requested that Congress provide some relief in FY2005 on the Alternative Minimum Tax, but has not yet identified a long-term solution.¹⁵ In her annual report, IRS National Taxpayer Advocate Nina Olson recommended repeal of the AMT, saying:

The AMT is extremely and unnecessarily complex and results in inconsistent and unintended impact on taxpayers....[T]he AMT is bad policy, and its repeal would simplify the Internal Revenue Code, provide more uniform treatment for all taxpayers, and eliminate the oddity of dual tax systems. AMT repeal would also allow the IRS to realign compliance resources to facilitate more efficient overall administration of the tax code.¹⁶

The Board fully concurs with her assessment, and urges the Administration and Congress to consider accepting this recommendation in future legislation.

Conclusion

At Commissioner Everson's confirmation hearing last year, Senate Finance Committee Chairman Grassley stated: "[It] is clear that it unfortunately will take years to get the IRS to where it provides first-rate customer service as well as an appropriate enforcement presence that respects taxpayer rights."¹⁷ The Board agrees; much hard work lies ahead.

Both the Board and the Administration concur that our tax system must be strengthened. The Board believes its budget recommendation will allow the IRS to put muscle behind its enforcement efforts, particularly to identify and pursue abusive tax shelters and tax evasion schemes. The Board's recommendation will also allow the IRS to sustain and improve customer service, and proceed with its critical Business Systems Modernization program. By comparison, the Administration's budget will allow the IRS to stay even, at best.

Strengthening our tax administration system sends a strong and simple message to taxpayers: we are fair to everyone. Enforcement goals that are not backed with resources reinforce the growing sense that tax cheating is acceptable.

The Board calls upon Congress to invest in our tax system. That means providing the resources needed to identify and pursue those who show contempt for our tax code. It means giving taxpayers the ability to get help over the phone, at walk-in centers, and over the internet so they can understand and meet their tax obligations. It means supporting the development of much-needed modernized business systems until they are completed. It means boosting revenue at a critical time.

The IRS has made great strides since the passage of the IRS Restructuring and Reform Act of 1998. We must now give it the resources needed so it can do the job Congress and American's taxpayers expect.

Endnotes

¹ Nina Olson, *National Taxpayer Advocate's 2003 Annual Report to Congress*, (Washington, DC-December 31, 2003) p. 20-21. This is based on a July 2001 IRS Office of Research report.

² Charles O. Rossotti, Report to the IRS Oversight Board: Assessment of the IRS and the Tax System (Washington, DC: September 2002), p. 16.

³ These estimates are based upon the projected revenue anticipated by hiring and training full-time employees who would audit or collect owed taxes in known cases of taxpayers who did not file or pay, or who substantially underreported their taxes, as described in former IRS Commissioner Charles O. Rossotti's *Report to the IRS Oversight Board: Assessment of the IRS and the Tax System*, p. 16.

⁴ U.S. General Accounting Office, *Challenges Remain in Combating Abusive Tax Schemes*, GAO-04-50 (Washington, DC: November 19, 2003), p. 23.

⁵ Rossotti, p. 16.

⁶ GAO, p. 2.

⁷ Larry R. Levitan, IRS Oversight Board Testimony before House Ways and Means Oversight Subcommittee Hearing on IRS BSM Program, February 10, 2004.

⁸ Rossotti, p. 5.

⁹ Ibid.

¹⁰ Internal Revenue Service, *IRS Enforcement Activity FY2003* press release.

¹¹ David Cay Johnston, *Perfectly Legal*, Penguin Group, (New York: 2003), p. 43.

¹² Roper ASW, *2003 IRS Oversight Board Annual Survey on Taxpayer Attitudes*, September 2003, p.17.

¹³ p. 4.

¹⁴ p. 17.

¹⁵ Recent public remarks by Treasury Secretary Bodman noted that the President's budget extends through 2005 the temporary increase in the AMT exemption and the provision that allows certain personal credits to offset the AMT. These temporary provisions will keep the number of taxpayers affected by the AMT from rising significantly in the near-term. More importantly, they will allow the Treasury Department the time necessary to develop a comprehensive set of proposals to deal with the AMT in the long-term. Treasury Press Release JS-1250 contains the full statement of his remarks.

¹⁶ Olson, p. 16.

¹⁷ Chairman Charles Grassley, Opening Statement, Senate Finance Committee Hearing on Nomination of Mark Everson to be IRS Commissioner, March 18, 2003.

Appendix:

- 1: IRS Oversight Board FY2005 Budget Recommendation and Administration Request: Program Summary Comparison
- 2.: Unfunded IRS Costs, 2002-2003
- 3: Where the Additional Enforcement Resources are Applied under Board's Budget

**Appendix 1:
IRS Oversight Board FY2005 Budget Recommendation and
Administration Request: Program Summary Comparison**

Administration FY2005 Budget Request Program Summary
(dollars in millions)

Appropriation Title	FY2004 Enacted	FY2005 Request	\$ millions	Percent
Processing, Administration and Management	\$4,009	\$4,148	\$139	3.5%
Tax Law Enforcement	\$4,171	\$4,564	\$393	9.4%
Information Systems	\$1,582	\$1,642	\$60	3.8%
Business Systems Modernization	\$388	\$285	-\$103	-26.5%
Health Insurance Tax Credit Administration	\$35	\$35	\$0	0.0%
Appropriation	\$10,185	\$10,674	\$490	4.8%

IRS Oversight Board FY2005 Budget Request Program Summary
(dollars in millions)

Appropriation Title	FY2004 Enacted	FY2005 Request	\$ millions	Percent
Processing, Administration and Management	\$4,009	\$4,291	\$282	7.0%
Tax Law Enforcement	\$4,171	\$4,770	\$598	14.3%
Information Systems	\$1,582	\$1,708	\$126	38.0%
Business Systems Modernization	\$388	\$400	\$12	3.1%
Health Insurance Tax Credit Administration	\$35	\$35	\$0	0.3%
Appropriation	\$10185	\$11,204	\$1,019	10.0%

Appendix 2:
Unfunded IRS Costs, FY2002-2003
in millions, rounded

Detail	FY2002	FY2003
Labor Inflation		
Unfunded Pay Raise Increase (President's Request to Congressional Action)	\$42	\$128
	\$42	\$128
Non-Labor Inflation		
Rent Shortfall	\$32	\$54
Postage	\$16	\$53
Corporate & Electronic Contracts		\$23
Health Service Contract	\$3	\$2
Interpreter's Contract	\$0.5	\$0.3
Child Care Subsidy	\$1	
Increased Department of Labor EFAST Contract Processing Costs	\$2	
	\$55	\$132
Added Requirements		
Background Investigations		\$4
Increase Case Awards from 1.24% to 1.42%	\$8	\$16
Competitive Sourcing		\$8
Campus Security Response	\$15	
Congressional Mandates	\$5	
Guard Services	\$20	\$16
Public Transportation Subsidy	\$9	
	\$56	\$44
Total	\$153	\$304
Total less pay raise and rent	\$79	\$122

Appendix 3:

Where the Additional Enforcement Resources Are Applied

(in thousands rounded)

Enforcement Initiatives	Board Recommendation		Administration Request		Difference	
	Budget	FTE	Budget	FTE	Budget	FTE
SBSE-2 Curb Egregious Non-Compliance	159,264	1,408	90,161	874	\$69,103	534
SBSE-3 Select High-Risk Cases for Examination	5,500	0	0	0	\$5,500	0
SBSE-7 Savings through Consolidation - Case Processing	16,085	200	14,469	144	\$1,616	56
SBSE-8 Savings through Consolidation - Insolvency Processing	7,656	69	5,531	65	\$2,125	4
W&I-2 Increase Individual Taxpayer Compliance	46,406	521	15,469	175	\$30,937	346
W&I-9 Improve ITIN Application Process	15,484	50	0	0	\$15,484	50
W&I-10 Eliminate Erroneous EITC Payments	18,000	0	0	0	\$18,000	0
LMSB-1 Combat Corporate Abusive Tax Schemes	60,017	394	36,100	207	\$23,917	187
TEGE-1 Combat Diversion of Charitable Assets	3,914	44	3,914	44	\$0	0
TEGE-5 Stop Abusive Transactions in the TEGE Community	11,140	100	11,140	100	\$0	0
CI-1 Combat Financial Fraud in the Corporate Sector	25,600	98	25,600	98	\$0	0
CI-2 Dismantle International and Domestic Terrorist Financing	12,208	80	0	0	\$12,208	80
CI-3 Reinforce Core Mission Tax Enforcement Resources	34,086	130	34,086	130	\$0	0
CI-7 Forensic Electronic Evidence Acquisition and Analysis	3,104	4	3,104	4	\$0	0
CI-10 Leverage/Enhance Special Agent Productivity	2,500	28	2,500	28	\$0	0
APPEALS-1 Resolve Appeals	13,945	112	7,000	56	\$6,945	56
COUNSEL-1 Combat Abusive Tax Avoidance	10,852	75	5,426	38	\$5,426	37
NHQ-2 Deliver Strategic Compliance Data	2,712	2	0	0	\$2,712	2
FY2005 Enforcement Increases	448,472	3,315	254,500	1,963	\$193,972	1,352

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