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#3**IRS STRUCTURE: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply****RESPONSIBLE OFFICIALS**

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**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to give organizational units end-to-end responsibility for providing service to specific taxpayer population segments.<sup>2</sup> After RRA 98, the IRS created national operating divisions (ODs) named after four segments: Small Business/Self-Employed (SB/SE), Wage and Investment (W&I), Tax Exempt and Government Entities (TE/GE), and Large Business and International (LB&I).

However, taxpayers generally do not receive end-to-end service from a single OD. SB/SE, LB&I, and TE/GE allocate only about one percent, zero percent, and four percent, respectively, to service, whereas W&I allocates 82 percent to it.<sup>3</sup> For example, SB/SE's only service function is Communications and Stakeholder Outreach, which primarily focuses on providing information to stakeholders rather than taxpayers.<sup>4</sup> By contrast, W&I's only "enforcement" function is Return Integrity and Compliance Services

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998); JCT, General Explanation of RRA 98, JCS-6-98, 17 (1998).

3 IRS Chief Financial Officer (CFO) response to TAS information request (Oct. 12, 2016).

4 SB/SE has the following top-level organizations: Collection, Exam, and Operations Support (OS). OS includes: Technology Solutions, Communications and Stakeholder Outreach (CSO), Human Capital, Finance, Research and Strategy, Servicewide Operations, and Leadership Development. SB/SE, *Operating Unit Org Charts* (Nov. 16, 2016). According to SB/SE, its service appropriation is allocated to Stakeholder Liaison Field (SLF) employees. SB/SE response to TAS fact check (Nov. 22, 2016). SLF is a component of CSO, which focuses "on the needs of the taxpayers with the expectation that all information provided [to stakeholders] reaches the taxpayer." *Id.*

(RICS), which focuses on preventing improper refunds.<sup>5</sup> As a result, no single unit is responsible for either SB/SE or W&I taxpayers. These taxpayers receive most services from W&I, but SB/SE audits and collects delinquencies from them. The IRS's functional structure presents the following challenges:

- No unit below the Deputy Commissioner for Services and Enforcement (DCSE) has the authority to ensure functions collaborate.<sup>6</sup>
- Each function focuses on completing tasks quickly without sufficient regard for the downstream consequences to other functions or taxpayers.<sup>7</sup>
- IRS “enforcement” functions waste resources and create problems when they use enforcement tools before working with service functions to address the root causes of compliance problems using the most effective and least burdensome alternative treatment(s) (e.g., educating taxpayers, alerting them to apparent discrepancies and improving guidance, and improving forms, communications, and outreach).<sup>8</sup>

If the IRS has not tried alternatives before resorting to enforcement, then the enforcement may be unnecessary. The use of unnecessary coercion violates the *rights to quality service, to a fair and just tax system, to privacy*, and in some cases *to pay no more than the correct amount of tax*. Moreover, when the IRS violates taxpayer rights, it likely reduces voluntary compliance by eroding trust for the IRS and promoting the view that noncompliance is justified.<sup>9</sup> In addition, the IRS's service functions may waste resources if they do not use information from enforcement functions to identify the services taxpayers need to help them comply.

5 Internal Revenue Manual (IRM) 1.1.13.6 (Oct. 7, 2013); IRS, *Wage & Investment Division At-a-Glance* (May 6, 2016), <https://www.irs.gov/uac/wage-investment-division-at-a-glance>. According to W&I, its Identity Theft Victims Assistance organization is also funded from “enforcement” dollars. W&I response to TAS fact check (Nov. 21, 2016). When we use the term “enforcement” in quotes, we are referring to the IRS's overly-broad definition (e.g., any action by a so-called IRS “enforcement” function); when we use it without quotes, we are referring to its more natural meaning — the IRS's use of coercive power to compel action (e.g., assessment, summons, lien, levy, and the withholding of refunds). See THE OXFORD ENGLISH DICTIONARY, [http://www.oxforddictionaries.com/us/definition/american\\_english/enforcement](http://www.oxforddictionaries.com/us/definition/american_english/enforcement) (“The act of compelling ...”). For further discussion of this issue, see Nina E. Olson, *The Future of Tax Administration*, 2016 TNT 49-11 (Mar. 10, 2016) and Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

6 See, e.g., IRS, *IRS to Realign Compliance Operations* (Nov. 3, 2014), <https://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations> (“The goal of the realignment is to primarily focus SB/SE on post-filing compliance and W&I on pre-refund compliance.”).

7 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (Most Serious Problem: *IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*).

8 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 188-95 (Most Serious Problem: *Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*); National Taxpayer Advocate 2014 Annual Report to Congress 31-39 (Most Serious Problem: *The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).

9 See, e.g., Tom Tyler, *Legitimacy and Criminal Justice: The Benefits of Self-Regulation*, 7 OHIO ST. J. CRIM. L. 307-359 (2009); Erich Kirchler, *The Economic Psychology of Tax Behaviour* 203-205 (2007); Most Serious Problem: *The IRS Can Increase Voluntary Compliance Using Behavioral Science Insights, But Is Overly Focused on So-Called “Enforcement” Revenue and Productivity*, *supra*.

## ANALYSIS OF PROBLEM

### Before 1998, Local Managers Who Engaged the Community Had the Authority to Require Local Service and “Enforcement” Functions to Work Together

Before 1998, the IRS served every taxpayer at one of ten centralized IRS service centers and 33 local district offices.<sup>10</sup> Each district director assigned taxpayer education programs to the examination or collection functions within their districts.<sup>11</sup> This structure reportedly developed creative and technically-savvy managers accustomed to addressing local compliance problems using more than one function and communicating with and being accountable to the public.<sup>12</sup>

However, because district employees had to serve every type of taxpayer, they could not focus on a segment’s needs or maintain the technical expertise to address all of the issues that might arise.<sup>13</sup> Serving each taxpayer from both a district office and a service center also raised concerns about consistency and accountability.<sup>14</sup> In addition, competition on enforcement productivity measures (*i.e.*, records of tax enforcement results, or ROTERS) led to abuses that eroded public confidence.<sup>15</sup> Moreover, IRS “enforcement” functions focused on short-term processing efficiencies (*e.g.*, closures) rather than identifying the root causes of noncompliance.<sup>16</sup>

### The IRS Restructuring and Reform Act of 1998 (RRA 98) Required the IRS to Give Units End-To-End Responsibility for Serving Specific Taxpayer Segments, But the IRS Has Interpreted It Narrowly

RRA 98 contemplated that the IRS would improve service and accountability by assigning one employee to handle a taxpayer’s matter until it was closed,<sup>17</sup> including the employee’s name and telephone number

10 S. Rep. No. 105-174, at 9 (1998); Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1998*, JCS-6-98 16-17 (1998); IRS Pub. 3349, *Modernizing America’s Tax Agency* 1-10 (Apr. 2000), <https://www.irs.gov/pub/irs-utl/27877d00.pdf>.

11 IRM 22.30.1.1.2 (Jan. 1, 2002).

12 See Frank Wolpe, *A White Paper on Executive Action to Restore Trust in the Internal Revenue Service by Rebuilding Field Operations*, American Bar Association (ABA), Section of Taxation, News Quarterly 17 (2014), [http://www.tnorrislaw.com/pdf/FW\\_WhitePaper.pdf](http://www.tnorrislaw.com/pdf/FW_WhitePaper.pdf). Similarly, traditional police enforcement strategies are not as effective in reducing crime as working with community partners to address the underlying problems (called problem-oriented policing, or POP) at the local level. See, *e.g.*, David Weisburd *et al.*, *Is Problem-Oriented Policing Effective in Reducing Crime and Disorder? Findings From a Campbell Systematic Review*, 9 *CRIMINOLOGY & PUB. POL.* 139, 141, 162 (2010), [http://www.smartpolicinginitiative.com/sites/all/files/POP%20Weisburd\\_et\\_al.pdf](http://www.smartpolicinginitiative.com/sites/all/files/POP%20Weisburd_et_al.pdf).

13 See, *e.g.*, *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. 12, 14 (1998) (testimony of Charles Rossotti, Commissioner of Internal Revenue), <https://www.irs.gov/pub/irs-news/ir-98-3.pdf> (“The IRS organizational structure no longer enables its managers to be knowledgeable....Since each [new] unit will be fully responsible for serving a set of taxpayers with like needs, the management teams responsible for each of these units will be able to become knowledgeable about the needs and problems of their customers, and be held fully accountable for achieving specific goals in serving them.”).

14 See, *e.g.*, *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. 12 (1998) (testimony of Charles Rossotti, Commissioner of Internal Revenue). Although consistency issues can be minimized through transparent procedures, some problems may be inevitable, as even campuses can have inconsistent procedures. See, *e.g.*, National Taxpayer Advocate 2004 Annual Report to Congress 132-42 (Most Serious Problem: *Inconsistent Campus Procedures*).

15 See Douglas M. Browning *et al.*, *Special Review Panel Report for Charles O. Rossotti, Commissioner, IRS* (Aug. 1998). Similarly, among local police organizations an excessive focus on efficiency statistics including reported crime statistics and revenue from tickets, rather than on the means used, can lead to misreporting of crime, abuse of power, and a dysfunctional organizational culture. See, *e.g.*, Malcolm Sparrow, *HANDCUFFED, WHAT HOLDS POLICING BACK, AND THE KEYS TO REFORM* 20-22 (2016).

16 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 20 (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf>. (“Employees believe that [performance metrics] do not measure long-term quality performance accurately. Consequently, employees put an emphasis on short-term performance and meeting goals of efficiency ... One of the most significant efforts that the IRS must undertake is to redesign its internal measurement system to encourage behavior which makes it easy for taxpayers to interact with the IRS.”).

17 RRA 98, Pub. L. No. 105-206, § 3705(b), 112 Stat. 685, 777 (1998).

on any “manually generated correspondence,”<sup>18</sup> providing callers with the option to talk to an employee who could help,<sup>19</sup> and placing the addresses and telephone numbers for local offices in phone directories across the country.<sup>20</sup> RRA 98 also directed the IRS to: (1) establish “organizational units serving particular groups of taxpayers with similar needs;”<sup>21</sup> (2) “restate its mission to place a greater emphasis on serving the public and meeting taxpayers’ needs;”<sup>22</sup> and (3) adopt “balanced measures,” including customer and employee satisfaction, to counter “efficiency and productivity” metrics.<sup>23</sup> Legislators believed that increasing the IRS’s focus on customer service would improve voluntary compliance by promoting public confidence in the IRS.<sup>24</sup>

The IRS could have responded to RRA 98 by assigning units and individual IRS employees with more responsibility for providing end-to-end service to specific taxpayers or taxpayer segments, potentially increasing their communications with and accountability to taxpayers. However, the IRS has interpreted these directives narrowly.<sup>25</sup> Its interpretation has enabled it to shift more work from highly-trained field employees to lower-graded campus employees who have less authority and are assigned narrower issues and mechanical tasks.<sup>26</sup>

18 RRA 98, Pub. L. No. 105-206, § 3705(a), 112 Stat. 685, 777 (1998).

19 RRA 98, Pub. L. No. 105-206, § 3705(d), 112 Stat. 685, 777 (1998).

20 RRA 98, Pub. L. No. 105-206, § 3709, 112 Stat. 685, 779 (1998). At recent public forums, stakeholders reiterated their preference for personal service. See, e.g., Oral Statement of Jennifer MacMillan, Chair, Internal Revenue Service Advisory Committee (IRSAC), National Taxpayer Advocate Public Forum 93 (Feb. 23, 2016), <http://taxpayeradvocate.irs.gov/public-forums> (“[T]he number one issue that I think builds trust among taxpayers and practitioners with the IRS is to have a person that they can deal with either by phone or face-to-face. I think that is the most crucial thing required. And I don’t see that going away even with advances in the digital tools.”); Oral Statement of Robert Wall, Esq. Attorney, Member, Spilman Thomas & Battle, PLC, National Taxpayer Advocate Public Forum 59 (Apr. 4, 2016) (“The golden ticket, when dealing with the IRS, as everyone will back me up, is when you get a letter with someone’s name and phone number on it. And when that happens, I would say nine times out of ten you can get an answer within 15 minutes.”).

21 RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998). For further discussion of the restructuring, see, e.g., IRS Pub. 3349, *Modernizing America’s Tax Agency* (Apr. 2000).

22 RRA 98, Pub. L. No. 105-206, Title I, § 1002, 112 Stat. 685 (1998). See also National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 20 (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf> (“Reorganizing into specialized units focused on taxpayer needs, rather than IRS internal needs, should better serve the American public.”).

23 See RRA 98, Pub. L. No. 105-206, Title I, §§ 1204, 112 Stat. 722, 9508(a)(2) (1998); J. Comm. on Tax’n, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998* 47-50 (1998); T.D. 8830, 64 Fed. Reg. ¶ 42,834 (Aug. 6, 1999) (explaining “[t]he presence of measures that evaluate the quality of the work done by the unit, the satisfaction of customers served by the unit (including taxpayers), and the satisfaction of employees working in the unit will obviate the risk that managers place undue emphasis upon the quantity of work completed.”).

24 See, e.g., JCT, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 19 (1998) (“the Congress believed that most Americans are willing to pay their fair share of taxes, and that public confidence in the IRS is key to maintaining that willingness.”).

25 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 134-44 (Most Serious Problem: *The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*); National Taxpayer Advocate 2014 Annual Report to Congress 145-53 (Most Serious Problem: *The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*); National Taxpayer Advocate 2014 Annual Report to Congress 123-33 (Most Serious Problem: *Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*).

26 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 31-45.

## IRS Employees Need Sufficient Authority, Technical Expertise, and Communication With Taxpayers to Improve Service and Compliance

Stakeholders have recently complained that IRS employees sometimes do not have sufficient expertise,<sup>27</sup> or authority to resolve problems.<sup>28</sup> Stakeholders have also observed that employees need to communicate with taxpayers enough to understand the reason(s) for apparent discrepancies, and resolve cases correctly.<sup>29</sup>

Similarly, employees will not be able to identify appropriate alternative treatment(s) to address the root causes of noncompliance if they do not have enough personal communications with taxpayers. RRA 98 contemplated that these communications would occur. It provided that “front-line technical experts” with an understanding of taxpayer problems would report back to the tax writing committees with respect to the “administrability” of pending amendments to the tax code,<sup>30</sup> and that the IRS would report to Congress each year on the sources of complexity in tax administration and on ways to reduce it.<sup>31</sup>

It may be easier for the IRS to manage campus employees charged with narrow tasks. However, their geographic isolation, narrow knowledge base, and limited authority likely make it more difficult for them to understand and communicate with taxpayers and resolve their problems.<sup>32</sup> An organizational design textbook elaborates on some these concerns as follows:

[A] service firm[’s] ... greatest economies are achieved through disaggregation into small units that can be located close to customers. Stockbrokers, doctors’ clinics, consulting firms, and banks disperse their facilities into regional and local offices ... These employees need enough knowledge and awareness to handle customer problems rather than just enough to perform mechanical tasks. Employees need social and interpersonal skills as well as technical skills. Because of higher skills and structural dispersion, decision making often tends to be

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- 27 See, e.g., Oral Statement of Rollin Groseclose, CPA, Johnson, Price, Sprinkle, PA, National Taxpayer Advocate Public Forum 64-65 (Apr. 4, 2016) (“... we use practitioner priority ...and they can’t always find the answer, or they will give a recommendation and it doesn’t quite line up with the documentation we received. So they seem to have limited, either training in some instances, or access to information within the databases that the IRS has.”); Oral Statement of Audience Member, National Taxpayer Advocate Public Forum 47-48 (May 5, 2016) (“...you’re still dealing with fairly uneducated people on those lines. If it’s not on their checklist, and I can literally hear them going down the — okay, what are you talking about, okay, let me get my — I hear pages flipping or something or the computer system is slowing down. I cannot imagine how another taxpayer without some basis of knowledge would be able to get satisfaction or resolution to the question.”).
- 28 See, e.g., Coalition for Effective and Efficient Tax Administration, *CEETA Addresses Changes Under Way in LB&I Division*, 2016 TNT 140-13 (July 21, 2016) (“taxpayers typically want a single point of contact ... Under the new structure, the first point of convergence of the nine practice areas, i.e., so-called tie-breaking authority, is the Deputy Commissioner .... Taking issues all the way to the Deputy Commissioner level for resolution will be a long, frustrating process for both taxpayers and IRS personnel and will add to the potential for conflict in the examination process.”); Oral Statement of Elizabeth Atkinson, Esq., LeClairRyan, PC, National Taxpayer Advocate Public Forum 82-83 (May 13, 2016) (“... when I worked at the IRS, there were a lot of really good IRS employees who want to do the right thing for the taxpayer. Often, they are unable to do that because there is a gap in authority.”).
- 29 See, e.g., Oral Statement of Warren Hudak, EA, President, Hudak & Company, National Taxpayer Advocate Public Forum 24-25 (Apr. 8, 2016) (“Oftentimes, during the course of an audit, the taxpayer is — has taken a position on an issue that is perfectly fine, but because they don’t understand the language of the law, they don’t understand the language of regulations, they inaccurately communicate their point, their perspective, their position. And it isn’t because they’re taking an improper position, but because they don’t know how to communicate it properly.”).
- 30 RRA 98, Pub. L. No. 105-206, Title IV, § 4021, 112 Stat. 685, 785 (1998). The IRS does not facilitate such communications. See National Taxpayer Advocate 2014 Annual Report to Congress 108-11 (Most Serious Problem: *The IRS Has No Process to Ensure Front-line Technical Experts Discuss Legislation with the Tax-writing Committees as Requested by Congress*).
- 31 RRA 98, Pub. L. No. 105-206, Title IV, § 4022(a), 112 Stat. 785 (1998). The IRS no longer produces a complexity report. See National Taxpayer Advocate 2014 Annual Report to Congress 102-07 (Most Serious Problem: *The IRS Does Not Report on Tax Complexity As Required by Law*).
- 32 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 31-45 (Most Serious Problem: *The Lack of a Cross-Functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).

decentralized in service firms, and formalization tends to be low. Although some service organizations, such as many fast-food chains, have set rules and procedures for customer service, employees in service organizations typically have more freedom and discretion on the job ... The concept of separating complex tasks into a series of small jobs and exploiting economies of scale is a cornerstone of traditional manufacturing, but researchers have found that applying it to service organizations often does not work so well ...<sup>33</sup>

Moreover, between 1970 and 2014, financial institutions, whose business models the IRS initially emulated, were opening local branches at a rate nearly twice as fast as U.S. population growth.<sup>34</sup> Immediately after RRA 98, the IRS planned to address many of these issues by forming units responsible for narrower taxpayer segments, as shown for W&I in Figure 1.3.1.

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33 Richard Daft, *ORGANIZATION THEORY AND DESIGN* 270-71 (10th ed., 2010).

34 See Federal Deposit Insurance Corporation (FDIC), Press Release, *Branch Banking Remains Prevalent Despite the Growth of Online and Mobile Banking* (Feb. 19, 2015), <https://www.fdic.gov/news/news/press/2015/pr15018.html>. Similarly, problem- and community-oriented policing is deemed so effective that the Department of Justice (DOJ) Office of Community Oriented Policing Services (COPs) provides grants to facilitate its adoption. DOJ, *Congressional Justification, FY 2017 Performance Budget* (Feb. 9, 2016), <https://www.justice.gov/jmd/file/821491/download>.



FIGURE 1.3.1<sup>35</sup>

<b>W&amp;I TAXPAYER CHARACTERISTICS</b> <b>Examples of Special Needs of Individual Taxpayer Market Segments</b>			
SEGMENT	PROFILE	KEY NEEDS	PROPOSED STRATEGY TO ADDRESS NEEDS
Segment I	<ul style="list-style-type: none"> <li>Simple returns; low income (&lt;\$30K); low tax understanding; language assistance; urban; possible dependents; possible compliance issues</li> </ul>	<ul style="list-style-type: none"> <li>Face-to-face contact required; tax education; needs hand-holding; language assistance</li> </ul>	<ul style="list-style-type: none"> <li>Focus on education about taxes; reach through walk-in centers; bi-lingual assistance</li> </ul>
Segment II	<ul style="list-style-type: none"> <li>Simple returns; low to middle income; educated and computer proficient; understands taxes; prepare own returns; compliant</li> </ul>	<ul style="list-style-type: none"> <li>Need for accurate and fast access to IRS (through Internet); answers to specific questions</li> </ul>	<ul style="list-style-type: none"> <li>Aggressive marketing of e-commerce products; education on forms to file and taxation issues pertaining to them; greater access to electronic sites (e.g., through schools and universities)</li> </ul>
Segment III	<ul style="list-style-type: none"> <li>Middle income families; average return complexity; familiar with taxation; typically paper filers; prepare own returns; compliant</li> </ul>	<ul style="list-style-type: none"> <li>Reliable information on tax law changes, new forms and procedures; prompt and accurate response to queries</li> </ul>	<ul style="list-style-type: none"> <li>Provide information on tax laws through direct mail; marketing of e-commerce products—migrating them toward e-commerce; provide more accessibility through new channels</li> </ul>
Segment IV	<ul style="list-style-type: none"> <li>Complex returns, investment and schedules; high income; professionals and wealthy retirees; paid preparers; compliant</li> </ul>	<ul style="list-style-type: none"> <li>Customized assistance through preparers; need help with complex problems; easy access to tax information through preparers</li> </ul>	<ul style="list-style-type: none"> <li>No direct assistance required from IRS; focus on providing high-quality assistance to practitioners; leverage partnerships with practitioners to provide better service</li> </ul>
Segment V	<ul style="list-style-type: none"> <li>Divorced/separated individuals; simple/average complexity of returns; low/middle income; low understanding of taxation; possible compliance problems</li> </ul>	<ul style="list-style-type: none"> <li>Increased understanding of tax system; recognition of their circumstances—possible hardship assistance; accessibility to someone who will solve their problems; clear explanation of child support test</li> </ul>	<ul style="list-style-type: none"> <li>Basic tax education (e.g., seminars on return preparation); hardship programs; outreach through divorce courts, single parent associations</li> </ul>
Segment VI	<ul style="list-style-type: none"> <li>Balance due and non-filers; some understanding of taxes; possible fear of the tax system; low understanding of collection options; financial problems; withholding (W-4) problems; frequently ignoring notices, contact attempts; prepare own returns</li> </ul>	<ul style="list-style-type: none"> <li>Understanding of the collection process, options and implications; understanding of withholding; accessibility to tax help; reduction of penalties for honest mistakes</li> </ul>	<ul style="list-style-type: none"> <li>Aggressive marketing/clinics on collection options (installment agreements, offers in compromise and credit card settlement); information on reasonable cause incentives; providing specific help on the phone; quicker response to non-filing situations</li> </ul>
Segment VII	<ul style="list-style-type: none"> <li>Elderly/retired; low to middle income; Social Security/pension-based incomes; simple/middle complexity returns; prepare own returns; not computer literate; value face-to-face contact; easy to reach through retirement communities</li> </ul>	<ul style="list-style-type: none"> <li>Face-to-face assistance/education; information on Social Security/pension changes; desire to volunteer; increased awareness of investment tax law changes; assistance on return preparation</li> </ul>	<ul style="list-style-type: none"> <li>Increased coordination with AARP and other relevant stakeholders; seminars and assistance on filing through community organizations; reach through VITA and TCE; joint ventures with Social Security, investment firms, banks, etc.</li> </ul>

35 This table appears as Exhibit A in IRS Pub. 3349, *Modernizing America's Tax Agency* 22 (1999).

IRS units responsible for smaller segments could better understand these segments, and use this specialized knowledge to improve service and compliance.<sup>36</sup>

### No IRS Unit Has End-To-End Responsibility or Accountability

The IRS continues to move away from the end-to-end service concept. In 2014, SB/SE and W&I realigned operations.<sup>37</sup> The goal was to improve processing efficiencies and to ensure a single executive has “end-to-end accountability for Collection and a single executive has end-to-end accountability for Examination.”<sup>38</sup> However, as noted above, exploiting economies of scale is more suited to manufacturing than service industries. The IRS solicited comments about the realignment from employees,<sup>39</sup> but not from its customers or external stakeholders.

No unit was assigned end-to-end accountability for specific segments.<sup>40</sup> Because SB/SE took responsibility for most post-refund compliance work for individuals,<sup>41</sup> even the W&I Commissioner does not have end-to-end responsibility for compliance by most individual taxpayers. Similarly, SB/SE, LB&I, and TE/GE devote a small fraction of their resources to assist the taxpayers they are named after.<sup>42</sup> As shown in Figure 1.3.2, for fiscal year (FY) 2016 only about one percent, zero percent, and four percent of their respective budgets were devoted to service.<sup>43</sup> By contrast, 82 percent of W&I’s FY 2016 budget was devoted to service.<sup>44</sup>

36 See, e.g., IRS Pub. 3349, *Modernizing America’s Tax Agency* 34 (1999) (“since the taxpayers served [by each unit] are reasonably homogeneous in their needs, it will be possible and expected for the managers at all levels to be knowledgeable in the substantive problems and issues that arise in administering the tax law in their division.”); GAO, GAO/T-GGD-91-54 *Identifying Options for Organizational and Business Changes at IRS* (July 9, 1991), <http://www.gao.gov/assets/110/103988.pdf> (recommending the IRS consider: “assigning a single staff to perform both auditing of tax returns and collecting taxes due. Reinforcing accountability ... [and reorganize them] to focus on types of taxpayers with common noncompliance problems, thereby enhancing the expertise of the agency in dealing with industries with special or complex tax situations.”). The IRS briefly established units of examination and collection employees who would report to multi-functional managers. See IRS Pub. 3349, *Modernizing America’s Tax Agency* 1-15 (Apr. 2000).

37 Email from W&I and SB/SE Commissioners to all W&I Employees, *An Update on the Realignment Process* (July 17, 2014). The IRS did not document a business case for these changes. See, e.g., Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-IE-R005, *Several Changes Sought by the Internal Revenue Service Restructuring and Reform Act of 1998 Remain a Challenge* 6 (Mar. 28, 2016), <https://www.treasury.gov/tigta/iereports/2016reports/2016ier005fr.pdf>.

38 Email from W&I and SB/SE Commissioners to all W&I Employees, *An Update on the Realignment Process* (July 17, 2014); SB/SE, *General questions about the realignment* (Nov. 13, 2014). Even though the Examination and Collection functions are both lodged within SB/SE, they generally do not work together. See, e.g., TIGTA, Ref. No. 2016-30-070, *Examination Collectibility Procedures Need to Be Clarified and Applied Consistently* (Sept. 7, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630070fr.pdf>.

39 The IRS held 31 employee focus groups and town hall sessions at all ten campuses and considered more than 1,600 emails from employees before finalizing its realignment plans for SB/SE and W&I. Email from W&I and SB/SE Commissioners to all W&I Employees, *An Update on the Realignment Process* (July 17, 2014). The current IRS Commissioner is careful to consult employees before making organizational changes. See, e.g., *Prepared Remarks of Commissioner of Internal Revenue Service John Koskinen before the National Press Club*, IR-2014-42 (Apr. 2, 2014).

40 Taxpayers who claimed the Earned Income Tax Credit (EITC) or who had been the victim of identity theft would generally be assigned to specific units, however. Email from W&I and SB/SE Commissioners to all W&I Employees, *Organizational Realignment Announcement* (Oct. 8, 2014) (referencing the EITC).

41 IRS, *IRS to Realign Compliance Operations* (Nov. 3, 2014), <https://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations> (“this plan would move pre-filing compliance work to W&I and post-filing compliance work for individuals and small businesses to SB/SE”).

42 *Id.*

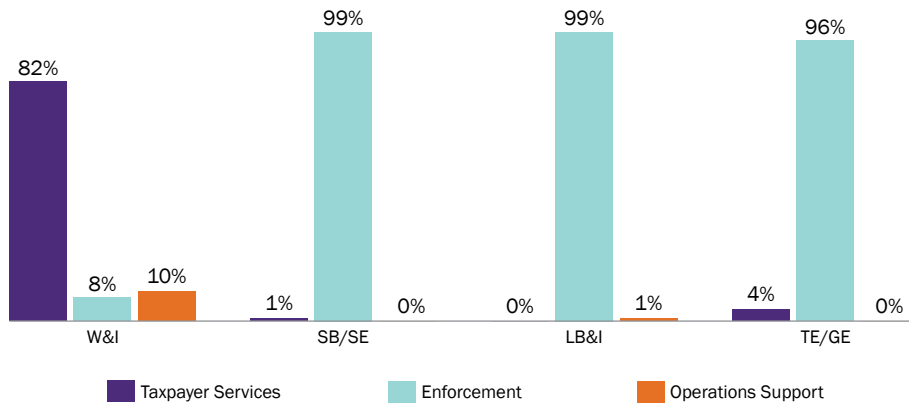
43 CFO response to TAS information request (Oct. 12, 2016).

44 *Id.*



FIGURE 1.3.2<sup>45</sup>

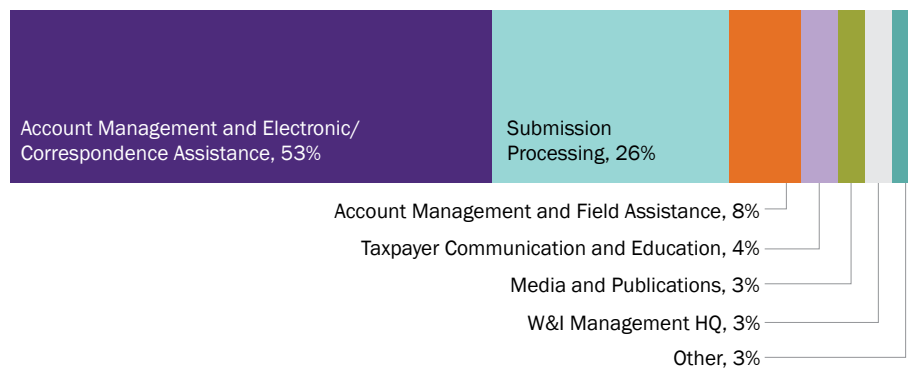
Budget Allocation by Operating Division for FY 2016



The vast majority of W&I’s service budget is allocated to agency-wide services such as processing correspondence and returns, answering calls, staffing assistance centers, and maintaining IRS-wide Internal Revenue Manuals (IRMs) and publications, as shown in Figure 1.3.3.

FIGURE 1.3.3<sup>46</sup>

W&I’s Service Budget for FY 2016



Even before the recent realignment, most of W&I’s budget was devoted to agency-wide services.<sup>47</sup> Thus, the IRS is even more organized around internal functions than it was before RRA 98. The National

45 CFO response to TAS information request (Oct. 12, 2016). These figures do not include user fees.

46 TAS analysis of W&I budget data (Oct. 13, 2016). These figures do not include user fees.

47 National Taxpayer Advocate 2010 Annual Report to Congress 49-70 (Most Serious Problem: *The Wage & Investment Division Is Tasked With Supporting Multiple Agency-Wide Operations, Impeding Its Ability to Serve Its Core Base of Individual Taxpayers Effectively*).

Taxpayer Advocate has recommended placing W&I's agency-wide back-office support functions into a separate organization so that W&I could focus on wage earners and investors.<sup>48</sup>

### In a Functional Organization, Each Function Needs to Be Accountable for Coordinating with Others

#### *The IRS's Functions Sometimes Focus on Narrow Productivity Measures Rather Than Broader Agency Goals*

To prevent errors, IRS "enforcement" functions need to identify the causes of noncompliance and communicate them to taxpayers, service functions, and other stakeholders so that the agency and its stakeholders can address them.<sup>49</sup> Instead, IRS "enforcement" functions generally focus on processing efficiency, perhaps because efficiency statistics are more readily available than information about root causes.<sup>50</sup> IRS examiners are no longer required to identify and record the reasons for misreporting, and the IRS no longer tracks the laws that trip up its own employees or reports on the sources of complexity.<sup>51</sup> LB&I has problems accurately tracking its audit adjustments by issue so that it knows where taxpayers are making the most significant errors.<sup>52</sup> Similarly, collection employees do not accurately record what actions prompt taxpayers to make payments.<sup>53</sup>

As another example, without doing any research that could help avoid burdening taxpayers unnecessarily, IRS "enforcement" functions allow computers to make inaccurate assessments or unnecessarily delay

48 See National Taxpayer Advocate 2010 Annual Report to Congress 49, 70 (Most Serious Problem: *The Wage & Investment Division Is Tasked With Supporting Multiple Agency-Wide Operations, Impeding Its Ability to Serve Its Core Base of Individual Taxpayers Effectively*).

49 See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS 20* (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf>. ("In a stovepipe operation, functional units such as taxpayer services, exam, collection, appeals, and counsel set and implement their own priorities and objectives, which often are disconnected from the other functions and the organization as a whole. This is why a taxpayer may receive a notice from the IRS, but when the taxpayer calls the toll-free number, the customer service representative is unable to help. ... The new IRS leadership team should establish performance measures that encourage functions within the IRS to cooperate. Additionally, the IRS should continue on the course begun in Compliance 2000, in which cross functional teams work together to solve problems. Finally, the Commission considered more far reaching reforms to break down functional stovepipes, including reorganizing the entire organization into four divisions ...").

50 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (Most Serious Problem: *IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*). For example, LB&I's "Key Stats" report contains 14 substantive worksheets. LB&I response to TAS information request (June 23, 2016). The first 12 contain detailed enforcement productivity statistics (e.g., closures, dollars per hour, yield, hours per return, cycle time, no change rates, etc.) broken out by type of taxpayer, income level and issue (i.e., activity code). *Id.* Only the last two worksheets are devoted to quality, and customer and employee satisfaction data are not broken out by activity code, and for the last few years have not been broken out by industry. *Id.* LB&I's lack of disaggregated satisfaction data is due to IRS-wide changes to its survey process.

51 See National Taxpayer Advocate 2013 Annual Report to Congress 102 n.5 (Most Serious Problem: *The IRS Does Not Report on Tax Complexity As Required by Law*) (describing how the IRS is required to identify the areas of the tax code where taxpayers and revenue agents make frequent errors, but the IRS no longer tracks tax law errors by code section); National Taxpayer Advocate 2007 Annual Report to Congress 35, 57 (Most Serious Problem: *The Cash Economy*) (recommending that when the IRS's national research program examinations identify an error on a return, the IRS should determine the reasons why the taxpayer made the error).

52 See TIGTA, Ref. No. 2016-30-089, *The Large Business and International Division's Strategic Shift to Issue-Focused Examinations Would Benefit From Reliable Information on Compliance Results* (Sept. 14, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630089fr.pdf>.

53 National Taxpayer Advocate 2014 Annual Report to Congress 221-26 (Most Serious Problem: *The IRS's Failure to Accurately Input Designated Payment Codes for All Payments Compromises Its Ability to Evaluate Which Actions Are Most Effective in Generating Payments*).

refunds.<sup>54</sup> These and similarly automated enforcement tools prompt communications to which the IRS cannot timely respond.<sup>55</sup> Automated IRS “enforcement” functions create these types of problems far too often.<sup>56</sup>

### *Procedural Requirements, Multi-Functional Compliance Projects, Teams, and Campaigns Could Help Ensure Functions Work Together*

Procedural safeguards could help mitigate problems caused by the IRS’s functional structure. For example, the IRS could require all “enforcement” functions to document the reasons for any noncompliance, communicate them to service functions, and implement alternative treatments before resorting to coercive ones.

The IRS could also establish more effective local and national multi-functional groups (*e.g.*, councils, program management offices, and cross-functional groups and initiatives). To be effective, these groups should have the responsibility and authority to identify compliance problems and implement alternative treatments to address them. The IRS has long known that multi-functional Compliance Initiative Projects (CIPs) could prevent noncompliance by identifying and delivering what a segment needs to comply.<sup>57</sup> In theory, an examination function could use CIP procedures to collaborate with other

54 See, *e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 114, 119-20 (Research Study: *Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*); National Taxpayer Advocate FY 2017 Objectives Report to Congress 80, 82 (Area of Focus: *IRS Implementation and Enforcement of Withholding on Certain Payments to Foreign Persons Is Burdensome, Error-Ridden, and Fails to Protect the Rights of Affected Taxpayers*) (discussing how the IRS improperly denied or delayed tens of thousands of refunds to international students because of transcription errors and poor IRS data quality, rather than first investigating the reason(s) for apparent mismatches).

55 See, *e.g.*, Oral Statement of Troy K. Lewis, Chair, Tax Executive Committee, AICPA, National Taxpayer Advocate Public Forum 72–73 (May 17, 2016) (“The income, which was reported to the IRS on a Form 1099-B, was properly reported on my client’s tax return, and the appropriate amount of income tax had actually been paid. There was no error on the return. However, due to requirements in its matching system, the IRS needed additional information to verify the income was indeed properly reported. The notice was a mere case of matching the third party information reported to the IRS with information reported on the return. However, it took me two letters and four months to resolve this notice. It was a highly inefficient experience and an example of where change is clearly needed.”).

56 See, *e.g.*, National Taxpayer Advocate 2015 Annual Report to Congress 188-95 (Most Serious Problem: *Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*); National Taxpayer Advocate 2015 Annual Report to Congress 112-22 (Most Serious Problem: *The IRS Files Most NFTLs Based on Arbitrary Dollar Thresholds Rather Than on a Thorough Analysis of a Taxpayer’s Financial Circumstances and the Impact on Future Compliance and Overall Revenue Collection*). TIGTA, *Actions Can Be Taken to Better Address Potential Noncompliance for Roth Individual Retirement Arrangement Conversions*, Ref. No. 2016-10-054 (Aug. 30, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201610054fr.pdf> (“Our review found that 97 (25 percent) of the 383 sampled cases had information that could have been researched on IRS systems that would have enabled AUR Program personnel to correctly conclude that minimal or no taxes were due on discrepancies resulting from Traditional IRAs being converted to Roth IRAs. In each of the 97 discrepancies, taxpayers received CP 2000 Notices. However, after correspondence with the taxpayer, little or no additional tax was assessed.”). As another example, the LB&I Commissioner had to ask W&I to stop its automated assessment of penalties for failure to file Forms 3520 and 3520-A due to concerns that these assessments were inaccurate. Memorandum from LB&I Commissioner to W&I Commissioner, *Direction to Close All Current Inventory Related to Forms 3520 & 3520A* (Mar. 20, 2013).

57 Multi-functional CIPs are similar to the Compliance 2000 projects endorsed by the IRS and its stakeholders in the late 1990s. See, *e.g.*, National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 23, 27 (June 25, 1997).

functions to implement alternative treatments,<sup>58</sup> but “enforcement” functions use them primarily to identify returns to examine.<sup>59</sup>

The IRS provided TAS a list of 114 teams and highlighted several that it believes address compliance problems using a multi-functional approach.<sup>60</sup> For example, multi-functional issue management teams (IMTs) seem promising because they can address compliance problems using CIPs, proposed legislation, settlement offers, or guidance to the field, provided they coordinate with the Servicewide Compliance Strategy (SCS) Executive Steering Committee (ESC).<sup>61</sup> However, IMTs focus on abusive transactions rather than common transactions or local compliance issues.<sup>62</sup> In most cases, the development of a service-wide strategy must also be approved by high level executives on the SCS ESC. Moreover, W&I is not on the SCS ESC, potentially making it less likely to consider alternative treatments.

### *The Right Operational Measures Could Help Ensure Functions Work Together*

Functional managers are naturally interested in whether their employees are following procedures and working efficiently.<sup>63</sup> It may be more natural for them to focus on productivity than on the effect of their employees on taxpayers’ views of the agency and voluntary compliance. For example, collection employees may seem to have little ability to influence voluntary compliance or a taxpayer’s view of the agency. To counter this without making radical changes, the IRS could measure factors that likely affect voluntary compliance (*e.g.*, multi-functional collaboration on alternative treatments) and public perception of the agency (*e.g.*, respect for taxpayer rights), as recommended by the National Taxpayer Advocate.<sup>64</sup> IRS employees should be able to affect taxpayer behavior and attitudes by measurable amounts if the taxpayer segment is small enough.

58 IRM 4.17.1.4 (Feb. 25, 2010); IRM 4.17.4.4.1 (Feb. 25, 2010); Form 13498, *Compliance Initiative Project Authorization - Part Two* (Apr. 2009).

59 There may have been a few multifunctional CIPs, but they are not the norm. IRS response to TAS information request (June 22, 2016) (“SBSE Exam is not aware of any non-enforcement function working Compliance Initiative Projects.”); SB/SE response to TAS information request (Oct. 22, 2016) (“SBSE is still not aware of any non-enforcement functions working Compliance Initiative Projects.”); SB/SE response to TAS fact check (Nov. 21, 2016) (“During a cursory review of CIPs for this fact check request response, SB found two examples of multi-Functional CIPs .... We also have [six] examples where our Communication and Stakeholder Outreach function (CSO) [formerly known as Communication, Liaison, and disclosure (CLD)] has worked with our Examination function on a CIP and signed off on the CIP”). Alternative treatments could be used in most CIPs. For example, the IRS could send soft notices and educational materials to all of the taxpayers with apparent discrepancies to give them an opportunity to self-correct so that an examination would not be necessary.

60 IRS response to TAS information request (July 13, 2016).

61 See IRM 4.32.1 (June 5, 2014). The SCS ECC reports to the Enforcement Committee, which is chaired by the DCSE. *Id.* LB&I’s new “campaigns” could also use alternative treatments to address compliance problems. However, without direct access to any significant resources for service, it is not clear how LB&I will ensure that alternative treatments are actually implemented.

62 IRM 4.32.1 (June 5, 2014); IRS response to TAS information request (July 13, 2016).

63 See National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (Most Serious Problem: *IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*).

64 In her 2013 Annual Report to Congress, the National Taxpayer Advocate proposed a “report card” of measures that “... provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance,” which she has updated in subsequent reports. See, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress xvii-xviii (Preface); National Taxpayer Advocate 2015 Annual Report to Congress xvii-xxiii (Taxpayer Rights Assessment: *IRS Performance Measures and Data Relating to Taxpayer Rights*).

The IRS could routinely estimate the effect of alternative treatments on “service revenues,” voluntary compliance, and the views of narrow taxpayer segments.<sup>65</sup> Some proxies for measuring the effect of alternative treatments on voluntary compliance are:

- On-time filing and payment rates;
- The percentage of returns with unexplained discrepancies (*e.g.*, mismatches and math errors);
- The IRS’s estimate (as measured by the Discriminant Index Function or other screens) of the amount of underreporting it would find if it audited the segment’s returns;
- Changes to income or deductions actually reported on subsequent returns as compared to appropriate benchmarks or control groups; and
- Satisfaction with and trust for the agency.<sup>66</sup>

Standard examinations (and compliance checks) could be used, in large part, to educate specific taxpayers and identify areas of noncompliance that need to be addressed more broadly and systemically through coordination with the IRS’s other functions, including through education and outreach.

## CONCLUSION

The IRS’s functional organization does not empower employees or business units to find creative ways to prevent noncompliance by collaborating with other functions or using alternative treatments, even if doing so would be more efficient and effective. However, one premise of the IRS’s Future State plan is “to provide [taxpayers] the services they need in the way that works for them.”<sup>67</sup> This presents an opportunity for the IRS to increase the links between functions and embrace the end-to-end service concept.

Luckily, some of the initial benefits of centralization — efficiency in processing calls and correspondence — can now be achieved by leveraging technology instead. Today, calls can be routed anywhere, 88.2 percent of the individual returns received during the 2016 filing season were filed electronically, and the IRS’s Future State plan is to establish more digital communication with taxpayers.<sup>68</sup> As a result, the IRS has more freedom to decentralize and empower highly skilled multi-functional groups of employees in local offices to better understand their customers where they work and live. The IRS should give them more autonomy, discretion, and incentives to cut across functional lines to identify systemic solutions and help customers, rather than asking them to be uncreative cogs in a centralized processing and enforcement machine.

65 See Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra*.

66 Voluntary compliance is correlated with trust for the IRS. See, *e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

67 IRS, *Future State Initiative* (Feb. 22, 2016), <https://www.irs.gov/uac/Newsroom/Future-State-Initiative>.

68 IRS, *Filing Season Statistics for Week Ending May 13, 2016* (May 19, 2016), <https://www.irs.gov/uac/newsroom/filing-season-statistics-for-week-ending-may-13-2016> (reporting individual filings received); Pub. 3415, *The Electronic Tax Administration Advisory Committee’s June 2016 Annual Report to Congress* 4 (June 2016) (Table 2) (discussing the future state plan and projecting 152,825,688 out of 195,931,400 returns would be e-filed for calendar year 2016), <https://www.irs.gov/pub/irs-pdf/p3415.pdf>. It could achieve consistency by increasing the transparency of its procedures by incorporating them into the IRM.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Remove service-wide functions from W&I by establishing a new unit that handles service wide functions (*e.g.*, submission processing, media and publications, etc.) so that W&I can focus on providing end-to-end service to W&I taxpayers, as previously recommended.<sup>69</sup>
2. Establish cross-functional units that have true end-to-end responsibility and accountability for voluntary compliance (*e.g.*, on-time filing and payment rates), satisfaction with, and trust for the agency by narrow taxpayer segments that they can affect, such as those shown in Figure 1.3.1.
3. Establish procedures that require the ODs to implement alternative treatments to address the root causes of noncompliance for a segment or issue (*e.g.*, using multi-functional CIPs, campaigns, or similar programs) before applying coercive treatments, except when it is clear that alternative treatments would be ineffective.

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<sup>69</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 49, 70 (Most Serious Problem: *The Wage & Investment Division Is Tasked With Supporting Multiple Agency-Wide Operations, Impeding Its Ability to Serve Its Core Base of Individual Taxpayers Effectively*).