

IRS Future State Public Forum

Statement of Pamela Olson

Washington, DC

February 23, 2016

Introduction

My compliments to Commissioner John Koskinen and National Taxpayer Advocate Nina Olson for holding a public forum on the future state of the IRS. In my experience, attitudes about our government are shaped by our day-to-day experiences with it, positive and negative, and affect the respect we have for its institutions. There is no agency of the federal government - save possibly the US Postal Service - with whom the people of this country have more interaction. And certainly there is none with which they have a more intimate interaction. That means that the IRS's interaction with taxpayers is not only important to the smooth functioning of our self-assessment tax system, it is important in shaping the view that our citizens have of their government and its institutions. In other words, the work the IRS has undertaken to look at the future of tax administration has implications that extend beyond the tax system.

Adapting to change and funding

The world is changing rapidly. Tax administrations must adapt to the change. The IRS's ability to manage the change is complicated by a shortage of funds and by the responsibilities it has been delegated that might be called non-mission critical because they do not relate directly to the collection of tax. The IRS's role in implementing the Affordable Care Act and FATCA are two recent examples, but the IRS has long been assigned responsibility in one way or another for the implementation of government policies as diverse as poverty alleviation, education, health care, retirement savings, corporate governance, the environment, energy conservation, state and local government operations, investment incentives, R&D, manufacturing, and export incentives.

When it comes to funding, the IRS's position is always delicate because, as late Commissioner Don Alexander used to observe, tax collectors have never been popular, going all the way back to biblical times. That said, I think it is safe to say that funding shortages are not limited to the IRS. Many of us in the business world have had to find ways to do more with less. Just keeping up requires that we operate more effectively and efficiently. Particularly in the tax function, our responsibilities seem to be continually expanding while the resources allotted to fulfilling the responsibilities are not expanding at the same rate. In other words, we feel your pain, and we understand the need to husband resources carefully.

Transparency and trust

As I see it, the IRS's future state initiative represents an essential effort to find more efficient and effective ways of interacting with taxpayers, an effort that is to be applauded. There are two items that I think are critically important to designing the IRS future state: (1) opening the design process to the public, and (2) building trust. Each will lead to and reinforce the other: the greater the transparency around the design, the greater the trust; the greater the trust, the greater the willingness to engage and participate in the process. There is much to be gained from an open and collaborative process that includes taxpayers and tax professionals in the design. Our needs and capabilities have to be taken into account and the best way to understand them is through open and frank discussion.

The future state vignettes the IRS has released are premised on tax administration rather than law enforcement, which is the right focus to bring to a future IRS. While the IRS has a number of non-tax collection responsibilities, even its core mission is best thought of as multifaceted. The facets include interpreting the law, advising taxpayers, collecting tax, and enforcing the law. The IRS's role as a law enforcement agency often seems to dominate, which is unfortunate because the most important part of what the IRS does revolves around helping citizens meet their tax obligations. The vast majority of taxpayers voluntarily comply with their tax obligations. They may need advice or assistance, but there is no need for enforcement actions to compel them to pay their tax or punish them for failing to do so. It may be obvious, but I think it is worth noting that the more resources the IRS focuses on upfront tax administration, the greater the likelihood of taxpayers correctly reporting their income, calculating their tax liability, and paying it without the need for costly after-filing interaction. In other words, dollars invested upfront are likely to reap substantial rewards on the back end.

While I'm going to focus the remainder of my comments on business taxpayers and the redesign of the large business division, I believe my comments have broader applicability to the IRS's future state. I am struck by the similarity of the issues of individual and business taxpayers. Both would benefit from an increase in transparency regarding how the IRS operates and makes decisions and currently find it difficult to have meaningful interactions with the IRS. In my experience, both want to understand what their tax obligations are and to have certainty as quickly as possible regarding the satisfaction of their tax liabilities.

The LB&I reorganization

When fully implemented, the redesign of the business audit process will fundamentally change for the better the way the Large Business & International (LB&I) division operates. The current business examination process is inefficient, relying on the capacity of agents to discover issues to audit, one return at a time, and often results in a misallocation of resources. Instead of 100 percent coverage of certain taxpayers on the basis of size, after the reorganization, LB&I plans to allocate examination resources on the basis of risks identified from review of returns and other data. One of my favorite Yogi Berra lines captures it: "You have to be careful if you don't know where you're going, because you might not get there." Rather than embarking on a journey in search of issues, the planned reorganization of LB&I represents a carefully considered decision to choose issues and plot a course to address those issues.

To succeed with the change, LB&I will have to develop a methodology for (1) identifying the issues that require examination and the returns on which they appear and (2) setting examination priorities that dedicate resources to the identified issues. This can be done, but it will require commitment and determination. In recent years, means have been developed to highlight the key issues on large business tax returns. There is coordinated disclosure by businesses and their advisors in addition to Schedules M and UTP. In addition, there is much greater transparency regarding businesses tax affairs. As a result, there are many sources of public information outside of the return such as audited financial statements and other public filings. There is also extensive press coverage of business tax matters, and there are academic, nongovernmental organization, and think tank studies. While there may appear to be risk in moving away from soup-to-nuts audits, the reality is that the risk to tax administration in sticking with the current process is far greater.

Those of us who deal with IRS examinations on a regular basis can easily tick off a number of issues with the current examination process and ways in which it could be improved. Setting aside the process for selecting returns and issues for examination, in the view of many taxpayers, IRS examinations have become increasingly inefficient. The issues observed in the examination process include:

- A lack of centralized management, accountability, and transparency.
- Inconsistencies and rigidity in the process employed to gather audit information from taxpayers.
- The use of litigation tactics that can turn what should be a cooperative effort into a contentious process.

These issues should be considered upfront in the reorganization with the goal of more efficient and effective audits for both the IRS and taxpayers.

In revamping the process, LB&I will have to consider or be aware of a number of factors, some of which are internal, that could impede success. The factors include a natural resistance to change, the independence with which revenue agents have historically been vested, training, attitudes toward risk-taking, and the role of a rewards system that aligns behavior with goals. Success will require a concerted effort to get over the distrust and suspicion that taxpayers and the IRS sometimes exhibit towards each other and a willingness to collaborate. I'd like to share a few thoughts on these points beginning with the latter.

Distrust and suspicion. The relationship between business and the IRS is often marked by distrust and suspicion. This is a two way street. With or without LB&I's reorganization, administration of the tax law could be improved with a conscious effort to be transparent, speak openly, understand opposing points of view, and work together to resolve issues. Part of this involves giving and taking criticism. Criticism can be difficult to take, especially when it doesn't appear to be offered constructively. But we can all do better if we learn to give and take constructive criticism.

Collaboration. The government benefits significantly from what it learns from external sources. Taxpayers and tax professionals benefit significantly from what we learn from the IRS. In the networked world in which we operate, a decision not to collaborate is a decision to fail. The crowdsourcing concept we hear so much about today is a good metaphor. My partner who leads our NY Metro practice tells of the difference between two new hires, one of whom has a network and the confidence to use it and the other of whom does not and is afraid to ask for help. Given the same assignment, when the project is due, the first turns in a product that has had the benefits of input from the network - a template, a precedent, a model, a spreadsheet, a shortcut, a similar experience - that results in a polished work product. It has, in effect, been crowdsourced. The second turns in a product that reflects what the new hire has been able to figure out alone. The first turns in a top quality work product. The second turns in a product that needs work. Fear, distrust, and suspicion are impediments to collaboration, but collaboration is essential to more effective and efficient tax administration.

Training. Those of us who work in the tax area have a constant need to upgrade our skills and knowledge. Laws are changed, regulations are written, interpretations evolve, and cases are decided. It's a challenge to stay up to date. The bottom line is business and the tax law are more complicated today than ever. Failing to understand either of them well makes it difficult to perform our job. In my view, the cuts in the IRS's training budget make it incumbent on the private sector to contribute to the IRS's training. Many organizations offer IRS employees programs at significantly reduced cost. An advantage of such programs is that the private sector and IRS employees train side-by-side.

Risk-taking. Success will require the willingness to take some risks, such as a different way of thinking about compliance. The unalterable reality is that we will never return to a world with sufficient resources to achieve tax compliance by auditing one return at a time. Implicit in the LB&I redesign is the recognition that an audit (or enforcement) may not be the best answer to many compliance issues. LB&I contemplates employing different mechanisms - under the rubric of "campaigns" - to improve compliance

with respect to the issues identified. While an issue could be audited, it could also be the subject of published guidance, proposals to change the law, or greater transparency. In my view, the return disclosure that has been added over the last couple of decades represents a significant way in which the IRS has positively affected compliance. Disclosure brought sunlight. Sunlight altered behavior. Altered behavior meant voluntary compliance and fewer issues to examine.

The essential ideas behind the reorganization will require considerable effort to rethink many of the programs and procedures currently in place. In the meantime, operational decisions are being made, some of which, at least at the surface, are hard to align with the logic of the reorganization. For example, what happens to the compliance assurance program (CAP) through which companies are examined on a real-time basis before their returns are filed? For now, we understand that CAP will remain in place; however, companies that had been working towards admission to CAP in 2016 have been advised that they will not be admitted. Companies that are part of CAP understandably want to preserve the program and the “certainty sooner” that it brings. For many companies, CAP has not meant a reduction in resources, though the process is much more efficient because it is current and focused on resolution of issues rather than raising issues as is the case with the normal audit process. I understand the same is true of the IRS’s resources. If the IRS intends to allocate resources more effectively, then I believe it must consider more radical steps. If CAP taxpayers represent the most compliant companies, why not move all of them into the post-CAP program (CAP maintenance) and replace them with the new applicants? Or if the new applicants have earned a place in CAP, perhaps they, too, should be moved directly to the post-CAP process.

Changing the rewards system. Taxpayers often believe they are held to a very high standard but they see limited consequences for the IRS’s failure to live up to similar expectations. The IRS should develop a system that rewards behaviors that foster a more effective and efficient tax system. The experience of the private sector, which is increasingly using methods that permit instant feedback, could be highly beneficial to the development of such a system.

Conclusion

There is considerable business taxpayer and tax professional interest in improving tax administration, including a coalition of trade associations supported by the corporate community that has devoted time and effort to considering the problems in tax administration and developing solutions. The current IRS quality examination program has its roots in the collaboration of TEI and the IRS years ago. Together we can build a better process, and today’s technology provides the platform for doing so.

Thank you for the opportunity to speak at the forum.