

# Commissioner of Internal Revenue

## 1979 Annual Report

This year I'm pleased to report that a number of organizational changes have been implemented and appear to be accomplishing the intended goals. The changes were undertaken last year to implement recommendations made in a study conducted by senior IRS career executives.

The change most directly affecting taxpayers was the modification of our administrative appeals procedure by consolidating the former two levels of appeal into a single appeal structure at the regional level. This system is now fully in effect and is resulting in the more expeditious handling of controversies at less expense to both taxpayers and the IRS. We continue to hold appeals conferences at all locations where district conferences were formerly held with the result that taxpayers have conveniently available to them a regional appeals officer with full settlement authority.

We believe the change in settlement procedures of docketed Tax Court cases is working effectively to utilize our resources better and to provide a more orderly procedure for handling the increasing volume of docketed cases.

The streamlining of our smallest districts has been accomplished smoothly. We are realizing savings at no loss of service to taxpayers.

Separating functions involving service to the public from those involving compliance has increased our emphasis on taxpayer service as well as permitted better integration of our collection activities with related compliance functions.

Notwithstanding our increased emphasis on taxpayer problems, it seems clear that some of these will continue to "slip through the cracks." If this occurs in even a very small percentage of the huge number of matters we handle the number of such cases will be large. To address this problem we instituted our problem resolution program (PRP) on an experimental basis in 1977 to provide a separate function to handle persistent taxpayer problems — those not satisfactorily resolved through normal channels. PRP is now fully operational in all of our 58 districts and 10 service centers with problem resolution officers who have the ability and know-how to cut through red tape quickly on behalf of taxpayers. About 72,000 taxpayer problems were successfully resolved through this procedure in 1978 and a number of systems changes identified by this program have been made to improve IRS efficiency and responsiveness.

A sample followup with taxpayers whose problems were handled through PRP found a high degree of satisfaction, but I will not be satisfied as long as some taxpayer complaints and problems persist. Therefore, as the year ended we were planning to set up an ombudsman-like position in my immediate office to have broad authority over PRP and to serve as an advocate for taxpayers.

Our forms and instructions are a matter of continuing concern. The challenge of presenting and explaining a complex law in an understandable way is formidable and we devote substantial effort to this problem. In addition to our normal work in this area we have formed a high-level task force to consider longer-range possibilities. We have engaged a private firm to review all the individual tax return forms, schedules and instructions and to make recommendations for redesign and rewriting. This effort should be completed in the fall of 1980 when we will start evaluating and testing any recommended alternatives.

While it is important that we constantly look for ways of simplifying the burden of reporting, frequent changes should be avoided. There is great value in taxpayers' familiarity with our forms. I'm, therefore, pleased that the 1979 forms follow the 1978 forms except for a few changes required by new legislation.

There is no doubt that better taxpayer assistance, more sensitive responsiveness to taxpayer complaints and problems and simpler tax forms and instructions are of great importance in achieving a high level of voluntary compliance with our tax laws. But our enforcement efforts also are crucial. Any significant noncompliance is a matter of deep concern to the IRS, Congress and the taxpaying public. Beyond the tax revenues lost when income is not reported is the basic question of fairness to taxpayers who voluntarily obey the laws.

Since the mid-Sixties the IRS has regularly measured compliance on filed returns through its taxpayer compliance measurement program (TCMP). As an adjunct to our audit program, TCMP is an effective tool to measure the unreported income detectable by normal audit procedures and to develop the computer formulae used to identify returns for audit. It does not, however, measure the unreported income of those who fail to file returns nor certain types of income not readily detectable by normal audit procedures, such as income from illegal sources.

In 1978 I appointed a study group to prepare estimates of unreported income. The group's report, "Estimates of Income Unreported on Individual Income Tax Returns," was released in August 1979. This report, using data for the 1976 tax year, marks our first effort to measure unreported individual income.

The report estimates that individuals failed to report \$75 billion to \$100 billion in income from legal activities, with a resulting revenue loss of \$13 billion to \$17 billion. Unreported income from certain illegal sources — narcotics, illegal gambling and prostitution — was estimated to be between \$25 billion and \$35 billion, and cost the government approximately \$6 billion to \$9 billion in lost tax revenues.

To put these figures in context, in the same tax year individuals voluntarily reported nearly \$1.1 trillion in income and paid a total of \$142 billion in income taxes

The report lends considerable weight to conclusions drawn from past TCMP studies that voluntary reporting is highest when incomes are subject to tax withholding. Incomes subject to information reporting show a lower compliance level but still much higher than incomes subject to neither withholding nor information reporting.

In fairness to the millions of taxpayers who voluntarily file, report all their income and pay the tax due, we must strengthen current compliance efforts and, where called for, plan innovative actions to find and tax unreported income.

A Treasury legislative proposal, currently under consideration by Congress, to withhold taxes from certain independent contractors would be a major step in dealing with one area of low compliance.

Our program to match information documents filed by payers of wages, dividends, interest and certain other payments with income tax returns has become an increasingly important tool to identify cases of underreporting of income and nonfiling of returns. The number of documents matched has been increasing substantially and with the full implementation of the combined annual wage reporting system will reach 400 million or about 80 percent of the total filed.

Our document matching activity has been separate from our examination program and has not affected the selection of returns for audit or their actual audit. However, in the next filing season, a printout of the information documents processed will be associated with returns selected for the examination program so that the information will be available to tax return classifiers and to return examiners. Since these documents will also be used during TCMP audits, the accuracy of the results of that program should also be improved.

In last year's report I noted our increasing concern about the use of abusive tax shelters — those which take positions beyond a reasonable interpretation of the law — and our increased audit effort in this area. As a result of that effort we have, at various stages of the examination and appeals process, about 200,000 tax returns involving about \$4.5 billion of questionable deductions. This program requires a substantial commitment of resources but it is a commitment we will continue to make, and even increase if necessary. The great abuse we are finding in this area, if allowed to continue unchecked, could result in a serious decline in taxpayers' perception of the fairness and evenhandedness of our administration of the tax system and consequently in their voluntary compliance.

Many abusive tax shelters depend for their successful marketing on the participation of professional tax advisors. We intend to continue an exploration, begun this year, into the ethical and legal standards that should govern such participation.

Tax administration today calls for us to increase our abilities to serve the majority of taxpayers who comply with the law. A crucial aspect of this service is to enforce the law vigorously against the few who attempt to subvert it. We believe this year's report reflects that commitment.



Jerome Kurtz  
Commissioner of Internal Revenue