Case Study

Topic 1.3

ETHICS AND CORPORATE RESPONSIBILITY IN THE TAX ADMINISTRATIONS

Linda Stiff
Acting Commissioner
Internal Revenue Service
(United States of America)

Discussions with our international partners have never been more critical. Without question, one of the greatest challenges we face from a tax administration standpoint in the U.S. is the rapid pace at which our overall economy is becoming more global.

A growing percentage of the tax filings from large and mid-size business are from multinational companies that have a variety of subsidiaries and partnerships operating within an enterprise structure where the ultimate parent is as likely to be foreign as domestic.

In addition, a growing number of U.S. businesses acquire raw materials, inventory, financing, products, and services from foreign businesses.

These are natural outcomes of an increasingly global economy and businesses optimizing their global structures to maximize profits.

Nonetheless, the complexities of globalization and cross-border activity continue to challenge U.S. tax administration.

With multiple domestic and global tiered entities, it is often difficult to determine the full scope and resulting tax impact of a single transaction or series of transactions.

I am sure that many of the tax administrations represented here face similar problems in dealing with the increasing globalization of your taxpayers. I also think it is critical that we continue to share our experiences and work cooperatively in dealing with the issues presented by globalization.

To that end, I commend you on your topic for today's session – Strategies for the Development of a Tax Culture and I am pleased to offer some insight on one component of that topic – Ethics and Corporate Responsibility for Tax Administrations.

Strong ethical behavior is a core value of the IRS as it must be. This is reflected in our mission statement which says we are to:

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

It is also reflected in terms of the way we are structured relative to the rest of the Federal Government, in the way we, as an agency, interact with taxpayers, and in the strong personal commitment to strong ethical behavior of our employees.

Allow me to discuss each of those areas individually.

The IRS is somewhat unique relative to other Federal agencies within the U.S. government. Because it is part of the Department of Treasury, it is not classified purely as an "independent agency".

However, in reality it is perhaps the most independent of all U.S. Federal agencies.

For example, unlike most Federal agencies, the IRS is not filled with political appointees who serve at the pleasure of the sitting President.

There are only two political appointees in the entire agency – the Commissioner and the Chief Counsel. All other employees, including me, are career civil servants.

And, though the Commissioner is a political appointee, he or she is nominated for a fixed term, unlike other political appointees.

Specifically, the Commissioner serves a 5 year term – a length of time longer than a Presidential term – as a means of further insulating him or her from political influence.

Another factor supporting the agency's independence is that it does not take positions on policy matters. Our job is tax collection and administration – not tax policy.

We will comment on issues associated with how a particular change in the tax law might be implemented, but we take no position on the underlying tax policy issue itself.

This independence is critical to our relationship with taxpayers. If taxpayers question the independence of the Service on key issues they are less likely to comply voluntarily or to demonstrate strong corporate responsibility.

Strong ethical behavior is also reflected in the manner in which we interact with taxpayers.

The premise of that interaction is that most taxpayers are honest and are willing to pay their fair share. But given the complexity of our tax code, it is sometimes difficult for them to understand or even calculate what their fair share is.

That is why we have in place strong taxpayer service programs designed to assist taxpayers and tax practitioners in any way we can.

Some of the most exciting and innovative programs we are utilizing in terms of working with taxpayers are in the corporate arena. These programs are designed to improve compliance and encourage greater corporate responsibility.

We recognize that we have many things in common with taxpayers, especially our corporate taxpayers.

For example, the IRS wants to get it right in terms of tax administration. We want to ensure compliance with the tax laws.

Corporate taxpayers want to get it right in terms of complying with the tax laws.

Corporate taxpayers also need a level of certainty – so do we. And, we both want to achieve that certainty sooner rather than later.

We also both want to be more efficient. At the IRS, we want efficiency not only in tax administration but in how we manage our organization.

With that as a backdrop we began to look at ways we could work with corporations in the pre-filing environment.
Perhaps the hallmark of our efforts thus far is our Compliance Assurance Program – or CAP.
CAP is a pre-filing compliance assurance process that focuses on issue identification and resolution through real-time interaction between the taxpayer and IRS.

When we launched the CAP pilot program in 2005, we had 17 companies participating. Last year 34 taxpayers participated and for 2007 the number has risen to 73.

The results thus far appear positive. Our initial cases worked under CAP resulted in a reduction in time from filing to case closure from 52 months to just fewer than 6.

But, we know that no matter how hard we work at taxpayer service or corporate responsibility that some taxpayers will still be noncompliant. That is why we balance our strong taxpayer service program with an equally strong enforcement effort.

One of the most recent new tools we have added to our enforcement arsenal is our Whistleblower Office.

This office was established by Congress in 2006 to process tips received from individuals who spot tax problems in their workplace, while conducting day-to-day personal business and anywhere else they may be encountered.

A reward worth between 15 percent and 30 percent of the total proceeds the IRS collects could be awarded, if the IRS moves ahead based on the information provided.

This program involves the individual taxpayer in assisting our enforcement efforts and helps insure that everyone is subject to the same ethical standards.

We also recognize that an important element in promoting voluntary compliance is making sure that lawyers, accountants and other tax practitioners behave in an ethical manner.

That is why we have upgraded dramatically in recent years our Office of Professional Responsibility. This office has broad authority to regulate those who practice before IRS or the Department of the Treasury for incompetence or disreputable behavior.

Until 2002 this office was known as the Office of the Director of Practice. However, in the height of the tax shelter wars, we saw a real opportunity for the office to become a real enforcement tool in combating tax schemes by sanctioning the individuals who promote them.
The office was renamed and has undergone a three-fold increase in staffing in order to better combat ethical abuses by practitioners.
Now, let me spend a few minutes discussing the strong ethical standards that apply to all IRS employees.
The IRS employs approximately 100,000 people in locations spread across the country. But, before we hire any new employee they must first undergo a rigorous background check. Depending on the position this background check can be very extensive and could take weeks if not months.

Once hired, new employees – like existing ones – are subject to various restrictions on their behavior.

Some of these restrictions are imposed by statute.

In 1998 the U.S. Congress passed the IRS Reform and Restructuring Act. Included in section 1203 of that legislation is what IRS employees “fondly” call the 10 Deadly Sins.

They are called that because Congress required that any IRS employee who violated one of these provisions would be terminated. These are broad standards and include such things as:

- Willful failure to get the required signatures on documents authorizing the seizure of a taxpayer’s home, personal belongings on business assets;

- Providing false statements under oath with respect to a material matter involving a taxpayer;

- Any violation of a taxpayer or other IRS’ employee’s civil rights or other right guaranteed by the constitution;

- Falsifying or concealing mistakes made by any employee with respect to a matter involving a taxpayer or taxpayer representative;

- Conviction of assault or battery on any taxpayer, taxpayer representative or other IRS employee;

- Violations of the Internal Revenue Code, Treasury Regulations or IRS policies for the purpose of retaliating against or harassing a taxpayer, taxpayer representative or another IRS employee;

- Willful misuse of taxpayer information otherwise protected by IRS regulations;

- Willful failure to file a timely tax return unless such failure is due to reasonable cause and not willful neglect;

- Willful understatement of Federal tax liability, and;

- Threatening to audit a taxpayer for purposes of extracting personal gain or benefit.

In addition to abiding by these 10 requirements themselves, every IRS employee is required to report possible violations of Section 1203 promptly.

The same law that included the 10 Deadly Sins also included another key provision designed to protect taxpayers. Section of 1204(b) requires the IRS to ensure that managers do not evaluate employees using any record of tax enforcement results or base employee successes on meeting arbitrary production goals and quotas.

This provision is designed essentially to ensure that employees are not encouraged through the use of professional advancement, financial or other incentives to close cases or make assessments based on anything other then their best judgments of the case.

In addition to these statutory provisions, there is a series of overlapping regulatory requirements that ensure that IRS employees behave with only the highest ethical standards.

For example, by virtue of being a division of the Department of the Treasury, the IRS is subject to the Treasury Department's Employee Code of Conduct that is included in the Treasury Ethics Handbook.

The Treasury Ethics Handbook includes interpretive guidance on a variety of recurring ethics issues as well as the Standards of Ethical Conduct for Employees of the Executive Branch.

In addition to these restrictions, every IRS employee is subject to broad ethical standards that apply to all Federal employees. In fact the U.S. has an Office of Government Ethics that exercises leadership in the executive branch to prevent conflicts of interest on the part of Government employees, and to resolve those conflicts of interest that do occur.

The OGE also partners with executive branch agencies and departments – like the IRS – to foster high ethical standards for employees and to strengthen the public's confidence that the Government's business is conducted with impartiality and integrity.

So clearly, IRS employees are subject to a myriad of ethical requirements, the logical question is how such requirements are enforced.

The first step is to remind employees periodically of their ethical requirements. This is done in several ways.

First, employees must take ethics training at least once a year. This is generally done on-line at the employee’s convenience.

Second, IRS leadership issues periodic messages to all employees reminding them of their responsibilities under ethic laws.

For example, leadership may post a message on IRS.gov – the IRS website – that IRS employees must file all tax returns on a timely manner.

The third manner for enforcing ethic requirements is more formal. The U.S. has established a Treasury Inspector General for Tax Administration, which is commonly referred to by its acronym – TIGTA.

TIGTA’s primary responsibility is to provide independent oversight of IRS activities. It is also committed to the prevention and detection of fraud, waste, and abuse within the IRS and related entities.

A good example of what TIGTA does can be seen by referring back to something I discussed earlier – the prohibition that IRS managers not evaluate their employees using any record of tax enforcement results or base employee successes on meeting arbitrary production goals and quotas.

This is an area where TIGTA will periodically review our work to ensure we are in compliance with the law.

The latest review came in March of 2007 and it found that IRS' efforts to enforce the employee evaluation requirements under Section 1204 are generally effective and are helping to protect the rights of taxpayers.

There are also required financial disclosures by certain IRS officials. Currently there is a broad requirement for financial disclosure by the Ethics in Government Act that all senior officials – including those in the IRS – must complete.

In addition to this, the IRS also requires mid-level officials to complete a financial disclosure form if they participate in such areas as contracting, procurement, or the administration of grants or subsidies or other federal benefits.

As I conclude, let me reiterate something that I think we all know. Strong ethical behavior and corporate responsibility exists only in a ***culture*** that allows such behavior to flourish.

Likewise strong tax administration can only succeed in such a culture.

That is especially true when the tax collection system is based on voluntary compliance. In such a system, taxpayers must first understand how their fair share ***assessment*** was determined and that it is the same way that the fair share of their neighbors or corporate competitors is calculated.

They must also believe that everyone is ***paying*** their fair share and that the money is being used appropriately.

And they must believe that their confidential information is being protected.

These are difficult standards which can only be attained through an open, transparent system that promotes a culture of strong ethical behavior and corporate responsibility.

The IRS collects $2.2 trillion annually for the U.S. government. We have what is considered by most standards to be a very good voluntary compliance rate of 85 percent.

But, we know that though the voluntary compliance rate is comparatively high, the fact that 15 percent of our taxpayers do not pay all of their taxes on a timely basis could undermine our entire system.

That is why we are spending considerable effort looking at that 15 percent to determine what we might do from a taxpayer service or an enforcement perspective to reduce it as much as possible.

In the end, we know we can not collect every dollar owed. To do that would take enforcement actions so draconian as to be inconsistent with voluntary system that allows us to collect the $2.2 trillion that we do collect.

It would require us to fundamentally change the way we interact with taxpayers at all levels and it could undermine our culture of voluntary compliance and belief in the ethical behavior of most taxpayers.

Doing that might mean we would collect even less than we do now and spend more resources doing it.