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INTERNAL REVENUE SERVICE OPERATIONS AND FISCAL YEAR 2010 BUDGET PROPOSALS

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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INTERNAL REVENUE SERVICE OPERATIONS AND FISCAL YEAR 2010 BUDGET PROPOSALS

THURSDAY, JUNE 4, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:00 a.m., in Room 1100, Longworth House Office Building, Hon. John Lewis (Chairman of the Subcommittee) presiding.

[The advisory of the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

May 27, 2009

By (202) 225–5522

Lewis Announces a Hearing on Internal Revenue Service Operations and Fiscal Year 2010 Budget Proposals

House Ways and Means Oversight Subcommittee Chairman John Lewis (D–GA) today announced that the Subcommittee on Oversight will hold a hearing on Internal Revenue Service (IRS) operations, the fiscal year 2010 budget proposals, and the 2009 tax return filing season. **The hearing will take place on Thursday, June 4, 2009, at 10:00 a.m., in the main Committee hearing room, 1100 Longworth House Office Building.**

In view of the limited time available to hear witnesses, the Commissioner of the IRS, the Honorable Douglas Shulman, will be the only witness at the hearing. Any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

In 2008, the IRS collected $2.7 trillion in taxes and processed nearly 250 million tax returns, including 150 million individual income tax returns. Through May 1, 2009, the IRS collected $1.5 trillion in taxes and processed nearly 155.4 million returns, including 126.4 million individual returns. The Subcommittee will discuss the most recent tax return filing season with a focus on taxpayer service, the recovery rebate, and taxpayer privacy concerns.

The Subcommittee also will review IRS operations not related to the filing season. Specifically, the Subcommittee will look at examination rates, collection activities, and the tax gap. The Subcommittee will discuss the Making Work Pay credit and new withholding tables, and administration of other tax provisions in the American Recovery and Reinvestment Act of 2009 (Pub. L. 111–5).

As part of its consideration of IRS operations, the Subcommittee will discuss the Administration's fiscal year 2010 proposed budget for the IRS of $12.1 billion, an increase of 5.2 percent over the fiscal year 2009 level (excluding funding under Pub. L. 111–5). The Subcommittee will examine the Administration's revenue proposals and budget proposals with respect to taxpayer service, enforcement, operations support, and information technology.

In announcing the hearing, Chairman Lewis said, **"The recession has affected all aspects of our economy, including IRS operations. We must make sure that the IRS strikes the right balance between enforcement and taxpayer service in these difficult economic times. As we move forward toward 2010, the Congress must ensure that the IRS has the tools it needs to collect taxes in a manner that is fair for all Americans."**

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://democrats.waysandmeans.house.gov, select "Committee Hearings."* Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online in-

structions, complete all informational forms and click "submit" on the final page. ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Thursday, June 18, 2009.** Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and summiteers are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TDD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman LEWIS. Good morning. The hearing of the Subcommittee on Oversight and Investigation will come to order. Again, this year the subcommittee is holding an oversight review of the Internal Revenue Service. We intend to examine the operation of the agency, its budget and its service to taxpayers.

This is the first time the commissioner has been before the Subcommittee this Congress. We welcome you, Mr. Commissioner. This is also the first time many of the Members of this Subcommittee will have the opportunity to review the agency. We look forward to their participation.

Today's hearing is a chance for the IRS to assure this Subcommittee and the public that it is acting fairly—fair in how it treats taxpayers and fair in how it treats its employees. Overall, I think the agency has done a good job. However, there is always room for improvement.

I do not think it is fair that five million taxpayers received busy signals when they called this year for help and almost 18 million taxpayers hung up before getting through. If the agency needs additional resources to meet its customer service mission, we need to know that.

I am also concerned that low-income taxpayers are having their Social Security payments levied by the agency. And, it is a shame

that victims of identity theft do not have their cases resolved with more urgency.

Where this Subcommittee can help the agency improve, we will. Taxpayers wanting to settle their tax debts should not be required to make a downpayment with their offer. Small businesses should not be run out of business by tax shelter penalties aimed at big corporations. These issues require tax law changes that the Ranking Member and I support.

Finally, I want to be sure that the agency is being fair to its employees. Each year, the agency's employees collect about $2.7 trillion and process 250 million returns. As fewer paper returns are filed, the agency has started to consolidate. In these difficult times, I ask the agency to take every reasonable step to ensure that employees at these locations, such as Atlanta and Andover, are not without jobs.

I want to again thank the commissioner for being so helpful and so responsive and thank you for being here today, Mr. Commissioner.

And I am pleased to recognize the distinguished Ranking Member, Dr. Boustany, for his opening statement.

Dr. BOUSTANY. Thank you, Mr. Chairman. Thank you for yielding time to me.

Welcome, Commissioner. Good to see you again.

Mr. Chairman, I want to thank you for holding this hearing and for your leadership on a number of legislative initiatives on which we are both cooperating, including our offers in compromise legislation as well as some other projects that we have discussed.

As the new Ranking Member for this Subcommittee, I look forward to continuing to work with you to improve IRS tax administration to make the system work better for the American people.

We are conducting this important annual hearing to review the proposed budget for the IRS and the latest filing season. These last two filing seasons have clearly been different from previous years, as the IRS has faced the enactment of economic stimulus legislation that provides for many tax benefits to the American taxpayers. These provisions have created an unanticipated workload on top of the expected workload for the 2009 filing season, and I look forward to hearing about how the IRS has handled it and what long-term lessons the agency has learned from the experience.

The President's budget for Fiscal Year 2010 requests additional resources for IRS enforcement efforts. And while additional enforcement tools may be necessary, it is important to remember that the most effective way to close the tax gap would be to simplify the Tax Code, especially for small businesses and the self-employed. Most of the tax gap results from honest mistakes by taxpayers trying to make sense of complex tax laws rather than intentional wrongdoing. And in this time of economic hardship and restricted access to credit, small businesses across the country are hanging on by a thread. Overly aggressive tax enforcement activities that single out small businesses that have been trapped by the complexity of the Tax Code could be the difference between those businesses surviving and disappearing.

Also, as the IRS steps up enforcement efforts in the area of international tax evasion, I hope the Obama administration, Members

of Congress, the media and the American people will remember that there really is a bright line distinction between tax evasion on one hand, which is illegal, and legitimate international tax policies that improve the competitiveness of American businesses on the other hand.

Tax evasion is a Federal crime and individuals who break the law by hiding their income in offshore accounts should be aggressively pursued and punished to the fullest extent of the law but these efforts should not be confused with policies, such as the ability of U.S. businesses doing business overseas, to defer tax on foreign profits, a longstanding principle of sound tax policy that puts our businesses on a more even playingfield with foreign competitors.

My previous conversations, Commissioner, with you give me great confidence that you appreciate that distinction, and I am heartened by that, although as I read your testimony, there were a couple of areas that gave me some concern that I would like to pursue as we get into questioning. So I certainly look forward to your testimony today and to discussing these issues further.

Again, Mr. Chairman, thank you, and I yield back my time.

Chairman LEWIS. Thank you very much. Now, we will hear from our witnesses, the IRS commissioner Doug Shulman. I ask, Mr. Commissioner, that you limit your testimony to 5 minutes. Without objection, your entire statement will be included in the record. Welcome.

STATEMENT OF HON. DOUGLAS SHULMAN, COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. SHULMAN. Chairman Lewis, Ranking Member Boustany, Members of the subcommittee, I want to thank you for the opportunity to testify here today, and I want to thank this Subcommittee for all the support that it has given the agency.

I am very proud to be here today to talk to you about the dedicated work of the IRS employees around the country as they delivered a successful, yet difficult, filing season. I also want to talk to you about the President's 2010 budget request.

Among the highlights of this year's filing season was record e-filing, as well as an increase in the average value of a refund by 14 percent, which was good news for taxpayers in this difficult economic time.

Mr. Chairman, I also want to take this opportunity to announce today that by the end of the year I plan to deliver to the President and the Treasury Secretary a comprehensive set of recommendations on how to better leverage the tax return preparer community to increase taxpayer compliance and ensure high ethical standards of conduct for paid tax return preparers. Today, over 80 percent of taxpayers use either a tax return preparer or third party software to complete their returns. This is a transformational shift in tax administration.

The first part of the review that I plan to undertake will involve fact finding and receiving input from a large and diverse constituent community. I know that this has been an issue of great interest to the subcommittee. I look forward to hearing your thoughts on the matter and keeping you apprized as we have this dialog.

Paying taxes is one of the largest financial transactions that individual Americans have each year, and we need to make sure that the professionals who serve them are ethical and ensure that the right amount of tax is paid.

Let me turn to the economy. The IRS is acutely aware of the many financial problems facing individual Americans, businesses, and nonprofit organizations, and I am very committed to striking the right balance between collecting the revenue to fund the government and using all of the tools at our disposal to work with taxpayers who are in difficult financial circumstances.

The IRS this year continued to help boost the economy by executing the provisions, the tax provisions, of the American Recovery and Reinvestment Act. We acted in record time after Congress passed and the President signed legislation to boost working American's paychecks, and will continue to focus on outreach efforts to make sure that taxpayers get every credit, every deduction and every exclusion that they qualify for.

Mr. Chairman, in the past year, the IRS has demonstrated its ability to be agile and respond to quickly changing situations. The 2010 budget that was submitted by the President will help build the strategic foundation for us to continue moving forward.

My belief is that the IRS needs to excel at both service and enforcement to meet its mission. It is not an either/or proposition, and the budget helps us focus on both. It includes a robust portfolio of enforcement initiatives, including a focus on international enforcement that the President, the Treasury secretary and I unveiled on May 4, 2009. I have made international issues a top priority for my tenure, and we are going to have an unprecedented focus and investment in international issues.

The budget also allows us to continue to evolve and improve with service delivery, which is fundamental to collecting the right amount of taxes and funding the government.

Let me turn to the modernization of our core account payer database. We have consistently delivered on our commitments over the last several years. This year we have adopted a much more focused strategy that is going to allow us to complete the taxpayer database conversion on an accelerated timeframe, which is an essential element for our service and enforcement activities.

Finally, Mr. Chairman, let me just encourage the Committee's support for the legislative proposals in the President's budget and let me highlight three of them: First, there is a suite of proposals to curb international tax evasion, which are very important to the IRS. Second, a proposal to require tax return preparers who have a certain volume of tax return filings to file electronically; and, third, is the proposal that you and the Ranking Member have put forth in legislation, which is to eliminate the 20 percent downpayment to receive an offer and compromise. And offer and compromise is a very important tool for us to work with taxpayers who cannot meet their tax obligation.

These three provisions, the entire budget will be very helpful as we pursue our strategy of having a modern agency that continuously improves and excels at both service and enforcement.

Again, thank you for the opportunity to testify, and I am happy to answer any questions.

[The prepared statement of Mr. Shulman follows:]

Prepared Statment of the Hon. Douglas Shulman
Commissioner, Internal Revenue Service

Chairman Lewis, Ranking Member Boustany and Members of the Subcommittee on Oversight, thank you for this opportunity to testify on IRS' efforts to ensure a smooth and successful tax filing season. I would also like to provide you with an overview of our proposed FY 2010 budget request and what we hope to accomplish with these resources.

I am pleased that the 2009 filing season has proceeded as planned. And it is important to note this year has presented us significant challenges. The IRS is acutely aware of the many financial problems currently confronting individual taxpayers, businesses and non-profit organizations—from struggling to hold on to jobs and homes, making payrolls, securing lines of credit, meeting pension plan obligations and paying taxes. We were also a key component in the implementation of the American Recovery and Reinvestment Act (ARRA)——legislation enacted earlier this year to help the economy and taxpayers in these tough times.

Mr. Chairman, the IRS' mission consists of two important elements—service and enforcement. We need to provide world class service to the vast majority of taxpayers trying to pay their taxes and wrestle with a complex tax code. We need to carry out rigorous enforcement programs for those who do not meet their legal obligations to pay taxes. This proposition isn't an either/or choice. We need to do both. And we need to do both well.

However, it is inevitable that during an economic downturn, taxpayers may fall behind in paying their taxes. As IRS Commissioner, I am committed to striking the right balance between collecting the revenues needed to fund the government, and using all the tools available to us to work with taxpayers who find themselves in difficult financial situations.

Granted, this balance is a very fine line. On the one hand, we need to raise the funds to run the government. On the other hand, we also have to be tough on those who flout the law and won't pay what they owe. The American people who play by the rules every day expect us to vigorously enforce the tax law.

But we also want to provide tangible relief to taxpayers in distress while also helping to prevent others from straying across the line into non-compliance. In the end, we need to be flexible yet principled and to empower our employees to use their judgment when dealing with taxpayers.

THE 2009 FILING SEASON

Mr. Chairman, although the current filing season will not officially conclude until mid-summer, I am pleased that it has proceeded smoothly and with few problems. Those problems that occurred, such as math errors and refund issues associated with the Recovery Rebate Credit (RRC), were quickly identified and remedied.

The IRS and its volunteer partners have also responded with events such as Super Saturday both to help taxpayers identify and avail themselves of every credit, deduction or benefit for which they may be eligible—including those in ARRA—and to assist in return preparation. And by e-filing these taxpayers' returns, we can speed their refunds to them in a matter of days and help cushion the economic blow they may be experiencing.

As was discussed earlier this year in the Subcommittee's hearing on assisting distressed taxpayers, those in hardship situations may also be able to adjust payment for back taxes, avoid defaulting on payment agreements or possibly defer collection action.

Moreover, simplified processes, such as e-filing and self-serve applications on IRS.gov can improve compliance. For example, an electronically prepared and filed return has an error rate of less than one percent, compared to an error rate of approximately 20 percent for a paper prepared return. Taxpayers can also go to our web site and determine if they are eligible for the Earned Income Tax Credit or subject to the Alternative Minimum Tax using a calculator to determine the proper amount of withholding. The Sales Tax Deduction Calculator can even help taxpayers determine the amount of optional state and local sales tax they can claim on Schedule A of Form 1040.

General Filing Season Data

As of May 29th the IRS received almost 134 million total individual returns. And we have seen a continued growth in e-filing with a corresponding drop in paper re-

turns. Of the total returns filed to date, more than 68 percent were e-filed by individuals, as compared to 60 percent over the same time period last year. This amount is a major milestone and demonstrates the IRS' commitment to a robust electronic tax administration program.

The use of e-filing by taxpayers from their home computers continues to grow this filing season. More than 31.5 million people prepared their own e-file return in 2009, representing more than a 19 percent increase from the previous year. Overall, 87 percent of taxpayers now use computer software or a paid preparer. Tax preparers and the associated industry can help us increase compliance and strengthen the integrity of the tax system.

Through May 29, 2009, the IRS issued 104.4 million refunds for a total of $279.2 billion, as compared to 100 million returns for a total of $235 billion over the same time period in 2008. The Average Dollar Refund totaled $2,674, as compared to $2,347 for the same week last year, an increase of almost 14 percent. Over the same time period, the IRS directly deposited 70.9 million refunds to taxpayers, as compared to 64.7 million last year.

Working with media and its many stakeholders, the IRS publicized that taxpayers filing electronically with direct deposit can get their refunds in as few as 10 days. Based on the most current Refund Timeliness data, the average time to process arefund for a paper tax return is 6 to 8 weeks this year.

Getting this extra money into taxpayers' hands faster is particularly important as the economic recovery and rebuilding process begins. Taxpayers can use this infusion of cash to pay bills or buy needed items that can help stimulate retail sales and the overall economy.

Web Site Expansion and Usage

IRS.gov continues to exhibit great popularity with taxpayers. The number of visits to the web site in 2009 is on a par with last year as taxpayers consistently rely on the Internal Revenue Service's online resources to get answers to tax questions, the economic recovery legislation and to prepare and file tax returns accurately and on time.

This year, there have been almost 200 million taxpayer visits to the IRS web site. Perhaps reflecting the economic downturn, visits to the "Where's My Refund" electronic tracking tool are up more than 44 percent over the same period last year.

Some of the other electronic tools on IRS.gov include: The Recovery Rebate Credit Calculator, "How Much was My 2008 Stimulus Payment?", and the EITC Assistant where lower-income working taxpayers can determine if they are eligible for the refundable tax credit. IRS.gov/Español offers many of the same tax forms, publications and information in Spanish.

Taxpayers can also find the latest information about the ARRA, including details on extending health insurance for people who lost their jobs, and tax breaks for first-time homebuyers. In addition, the IRS has developed "What If" scenarios and the possible tax implications for people who may be facing financially difficult times.

When taxpayers visit the IRS.gov web site this filing season, they may also notice the new "rotating spotlight" feature on the homepage. The spotlights, which change every few seconds, give the taxpaying public direct access to more of the IRS web site's vast amount of content.

Also on the homepage, taxpayers can click on "1040 Central" to find help preparing and filing their tax returns. Like last year, this popular section of IRS.gov has a wide range of offerings that address taxpayer needs.

Finally, the IRS produced a number of podcasts this filing season that are available on IRS.gov. In addition to Tax Tips, Fact Sheets and News Releases, these short audio interviews cover a wide range of topics and are a way for the IRS to reach out to a new generation of taxpayers.

Toll-Free Telephone Performance

As of May 9th, the IRS had answered 20.3 million calls, a 3.6 percent increase over the 19.6 million calls during the same period last year. It also completed 23 million automated calls, a decrease of almost 10 percent from last year's 25 million.

As of May 9th, the IRS Customer Service Representative Level of Service (CSR LOS) dropped to 65.6 percent from 69.6 percent last year, a decrease of approximately 6 percent.

The drop in CSR LOS is partially due to the number of taxpayers calling to obtain their Prior Year Adjusted Gross Income (PYAGI), which is used to satisfy the signature requirements when e-filing a current year return. More taxpayers were also

calling regarding math errors and refund issues related to the RRC, and questions generated by the economic downturn and the ARRA.

It should also be noted the lower LOS is due in part to voluntary hang-ups. IRS added an "Estimated Wait Time" feature this year so taxpayers could choose whether to wait to speak to an assistor or hang up and call back at a less busy or more convenient time. These abandoned calls are still reflected in the LOS measure and also contributed to the drop in service level.

The IRS took aggressive actions to address the additional calls, including: identification and special processing for AGI and RRC calls; diversion of staff from other programs during peak demand periods; and redesign of the "Stimulus Hotline" to include information on both new legislation and the RRC.

Because of these and other actions, we have been able to answer 7.5 percent more calls than projected in our 2009 filing season plan, while achieving high productivity and quality. The Tax Law Customer Accuracy Rate for the 2009 filing season is 92.2 percent, as compared to 89.9 percent in 2008, and the Accounts Customer Accuracy Rate for this filing season is 95.1 percent as compared to 93.6 percent the previous year.

With the 2009 enacted budget, the IRS projects that it will answer a total of 35,213,718 calls. Although the current filing season CSR LOS is 65.6 percent we project we will achieve a 69 percent cumulative LOS for the year.

Taxpayer Outreach

Through a series of massive outreach efforts, the IRS wants to make sure that taxpayers are aware of every credit, deduction and exclusion for which they qualify, including several new benefits this year. One of these outreach events was aptly called "Super Saturday."

On Saturday, March 21st, the IRS and its community partners, such as the Volunteer Income Tax Assistance (VITA) and the AARP, opened their doors across the nation to help low-income people needing free tax preparation, a question answered or payment schedule arranged. Our message to taxpayers was that we are going the extra mile to help those of you in economic distress. These steps build on our efforts in every tax season to increase awareness of the EITC and encourage low income filers to claim their money.

By the end of the day, 252 IRS Taxpayer Assistance Centers had served approximately 11,000 taxpayers and 1,772 partner sites had prepared approximately 54,000 individual taxpayer returns and helped taxpayers learn if they were eligible for a number of important credits and benefits, such as the Earned Income Tax Credit (EITC) (see following section on assisting taxpayers).

As of April 11th, total Volunteer Return Preparation stood at 2,941,281—down 10 percent from last year's performance of 3,266,741, and Volunteer e-File increased by 5.4 percent compared to the same time last year.

American Recovery and Reinvestment Act (ARRA)

The Internal Revenue Service is proud of the role it has played in helping to implement, provide guidance and publicize many of the provisions of the ARRA that will assist both individuals and businesses in economic distress and get the Nation back on the road to economic recovery. The following summarizes the issues the IRS has addressed through recently issued guidance or increased outreach to the public.

Make Work Pay Credit: A mere four days after President Barack Obama signed ARRA into law, the Treasury Department and the IRS swung into action in record time, developing new withholding tables to ensure money would get into American's pockets through the Make Work Pay Credit. As Treasury Secretary Geithner observed, "Just days after the President signed this landmark legislation into law, we have the wheels turning to deliver much needed boosts to the paychecks of working Americans."

New Car Purchase: Under ARRA, taxpayers who buy a new passenger vehicle this year may be entitled to deduct state and local sales and excise taxes paid on the purchase next year on their 2009 tax returns. The IRS has been publicizing the deduction. For those thinking about buying a new car this year, this deduction may give them a little more drive to make their purchase this year.

Earned Income Tax Credit: One important benefit available to many taxpayers of low- to moderate-income is the EITC. The ARRA temporarily increases the EITC for working families with three or more children. The IRS put in place an aggressive outreach program designed to reach every taxpayer who qualifies for the EITC. These efforts included EITC Awareness Days in which the Commissioner and various Members of Congress participated. We also offered EITC assistance in more

than 170 Taxpayer Assistance Centers across the country on three Saturdays in 2009.

Net Operating Loss: On March 16, 2009, the IRS announced that small businesses with deductions exceeding their income in 2008 can use a new net operating loss (NOL) tax provision to get a refund of taxes paid in prior years. The new net operating loss provisions could throw a lifeline to struggling businesses, providing them with a quick infusion of cash. Moreover, the IRS wants to make it as easy as possible for small businesses to take advantage of these key tax benefits.

COBRA: ARRA provides for a 65 percent subsidy for continuation of health insurance premiums for up to nine months; reimbursement to employers would occur through reduced payroll taxes. For this to work, the IRS worked with employers and payroll processors to set up systems, develop new forms, train people, and start up a compliance program.

Build America Bonds: ARRA also included provisions to allow state and local governments to issue bonds to help finance public projects that will benefit the local communities in many ways, including job creation. The IRS issued the legal guidance that potential issuers need to issue these bonds. According to industry figures, $10.2 billion in Build America Bonds have been issued as June 1, 2009 for key state and local infrastructure needs, creating jobs and boosting the economy along the way.

Other Credits: The IRS publicized other ARRA credits, such as the residential energy efficient property credit that can provide a tax credit up-to-$1,500 for installing energy efficient windows and the American Opportunity Tax Credit that provides as much as $2,500 a year for the cost of a college education.

First-Time Homebuyer Credit: For qualifying homes purchased after December 31, 2008, and before December 1, 2009, the ARRA expanded this unique tax incentive as a fully-refundable credit of up to $8,000, which does not have to be repaid provided the home remains the main residence for 36 months after the purchase date. As first enacted in the Housing and Economic Recovery Act of 2008, this credit provided a repayable credit of up to $7,500 for qualified taxpayers who purchased homes after April 8, 2008 and on or before December 31, 2008 and acted much like a 15-year interest-free loan.

Other Benefits: The IRS also worked with the media to publicize that under ARRA, the first $2,400 of unemployment benefits is tax free for 2009.

Financially Distressed Taxpayers

As the economic downturn became more severe, the IRS leadership team created a strategy and action plan to help financially distressed taxpayers. The IRS worked with the media and a vast network of stakeholders, including tax professionals and preparers and business and industry groups and organizations, to raise taxpayer awareness about these important new options.

- **Offering Installment Agreements:** The IRS reminded employees of their ability to offer installment agreements at the end of an audit when taxpayers are having difficulty satisfying their obligations immediately, thereby enabling them to minimize interest and penalty charges.
- **Postponement of Collection Actions:** IRS employees were provided greater flexibility to suspend collection actions in certain hardship cases where taxpayers are unable to pay. This situation includes instances when the taxpayer has recently lost a job, is relying solely on Social Security or other assistance, or is facing devastating illness or significant medical bills. If an individual has recently encountered a certain type of financial problem, IRS assistors may be able to suspend collection without further documentation to minimize the tax burden on the taxpayer.
- **Added Flexibility for Missed Payments:** The IRS has flexibility in working with previously compliant individuals in existing Installment Agreements who have difficulty making payments because of financial hardship. The IRS may allow a skipped payment or a reduced monthly payment amount without automatically suspending the Installment Agreement.
- **Prevention of Offer in Compromise (OIC) Defaults:** Taxpayers who are unable to meet the payment terms of an accepted OIC will receive a letter from the IRS outlining options available to help themavoid default.
- **Expedited Levy Releases:** The IRS will speed the delivery of levy releases by easing requirements on taxpayers who request expedited levy releases for hardship reasons.
- **What If Scenarios:** The IRS recently added a special area on its web site focused on the financial downturn. Taxpayers with financial problems who discover they can't pay when they file their 2008 tax returns have options avail-

able to them. IRS.gov has a list of "What If?" scenarios that deal with payment and other financial problems. These scenarios, in question-and-answer format, provide needed information.

ENFORCEMENT

In today's economic environment, it is more important than ever that our fellow citizens feel confident that individuals and businesses are playing by the rules and paying the taxes that they owe. With so many individuals struggling to keep their jobs and homes and provide for the basic necessities of life, there is little tolerance for those who can pay their taxes, but don't.

Mr. Chairman, there is no "silver bullet" or one strategy that will alone solve the problems of the tax gap and tax avoidance—at home and abroad. As I have said on numerous occasions, we cannot audit our way to full compliance. Rather, an integrated approach is needed, made up of separate but complementary programs that will tighten the net around those not paying what they owe.

For example, we know that those taxpayers who have their taxes withheld and reported to the IRS through third parties are the most compliant. On the other end of the scale, those operating without third-party withholding information reporting and/or withholding are the least compliant.

We know that better information reporting can benefit the entire spectrum of taxpayers and boost compliance. In this regard, we have been given some new information reporting tools recently.

For example, last year, the Congress passed new legislation relating to businesses that accept credit and debit cards. Starting in January 2012, the bank will send an information report on credit and debit card sales to the business and to the IRS, at the end of the year.

Brokerage firms will also be required to file with the IRS annual information returns showing a customer's cost basis in securities transactions, which will go a long way to reducing misreported capital gains. We are taking steps to ensure that our systems are ready to process these additional returns in a productive and efficient manner.

As I testified in March before the Ways and Means Subcommittee on Select Revenue Measures, international issues are now a major strategic focus of the IRS.

While it is true that IRS agents and investigators will ultimately generate net enforcement revenues for the government, we view our international compliance strategy to date as more focused on protecting the approximately $2 trillion in revenue the IRS collects than the incremental enforcement revenue that we collect from these specific activities.

A key focus of our overall enforcement strategy is to shift resources so we can expand programs targeted at non-compliance among large corporations, U.S. businesses with international operations, high net-worth individuals, flow-through entities and partnerships.

Accordingly, the IRS has framed an aggressive, proactive yet balanced agenda to lead the agency into a new era of global tax administration in the 21st century. On May 4, 2009 President Obama put forth a set of far reaching international measures designed to rein in offshore tax evasion and close certain ambiguities in the tax code. These are discussed in detail later in my testimony under "Legislative Proposals."

The IRS is putting pressure on offshore financial institutions that help U.S. citizens conceal taxable income. We are also looking for ways to improve the information we receive from foreign banks and through access to wire transfers.

The IRS has increased the number of audits in this area over the last seven months and prioritized stepped-up hiring of international experts and investigators. With the enactment of the omnibus spending bill in March, the IRS began a hiring initiative to boost its ranks of revenue agents and officers.

Because this problem is global, it will require a closely coordinated strategy among nations dedicated to ending this abuse that deprives our country of precious resources and erodes confidence in the fairness of our tax administration system.

Enforcement Results

Enforcement revenue has risen from $33.8 billion in FY 2001 to $56.3 billion in FY 2008, an increase of 67 percent.

In FY 2008, both the levels of individual returns examined and coverage rates rose substantially. We conducted nearly 1.4 million examinations of individual tax returns in FY 2008, an 8 percent increase over FY 2006. This trend reflects a steady and sustained growth.

While the growth in examinations of individual returns is visible in all income categories, it is most apparent in examinations of individuals with incomes over $200,000. Audits of these individuals increased from 105,549 in FY 2007 to 130,751 during FY 2008, an increase of 24 percent. Their coverage rate has risen from 2.68 percent in FY 2007 to 2.94 percent in FY 2008.

Of note, coverage rates for three classes of large corporations with assets between $50 million and $250 million and higher all increased. Coverage rates for partnership returns stayed even as compared to FY 2007, while Subchapter S returns reflected a small .05 percent drop due largely to the increase in number of S-corporations. The coverage rate for tax-exempt organizations increased slightly.

IRS Criminal Investigation has also been vigorously addressing egregious tax evasion, money laundering, and other financial crimes that have a corrosive effect on our tax system. For example, the overall number of individuals charged in aninformation or indictment rose from 2,323 in FY 2007 to 2,547 in FY2008.

Over the same period of time, prosecution recommendations for employment tax evasion more than doubled. The incarceration ratein these investigations was 81 percent and the average sentence was 29 months.

In FY 2008, IRS-developed cases related to foreign and offshore issues also resulted in 61 criminal convictions, and the average term for those going to jail was 32 months. For the first four months of FY 2009, there were 20 convictions, and the average sentence was 84 months

The Administration's FY 2010 Budget Request Funds Key Priorities

The Administration's FY 2010 budget request for the IRS is a strategic and wise investment in the nation's tax system that will help the IRS stay on a path of continuous improvement in such critical areas as service, enforcement, technology, and human capital.

Total resources to support IRS activities for FY2010 are $12,440,801,000. This amount includes $12,126,000,000 from direct appropriations, an estimated $147,101,000 from reimbursable programs, and an estimated $167,700,000 from user fees. The direct appropriation is a $603,402,000 increase, or a 5.2 percent increase over the FY 2009 enacted level of $11,522,598,000. This amount excludes funding to implement the ARRA.

The IRS continues to achieve efficiency savings in its operations. Because of the increase in e-filing, the IRS has effectively revised base operations and continues to implement savings resulting from the consolidation of an additional two paper processing sites.

The IRS Strategic Plan 2009–2013 guides program and budget decisions and supports the Department of the Treasury Strategic Plan. The IRS Strategic Plan builds on past successes while being innovative and adapting to new situations, such as the increasing complexity of tax laws, changing business models, expanding use of electronic data and related security risks, accelerating growth in international tax activities, and growing human capital challenges. I am a firm believer that organizations always must be evolving, changing, and improving—and the Strategic Plan reflects that philosophy.

The IRS Strategic Plan has two overarching goals: (1) improve service to make voluntary compliance easier; and (2) enforce the law to ensure everyone meets their obligation to pay taxes. The IRS must excel at both service and enforcement to meet its mission; it is not an either-or proposition.

To improve service and make voluntary compliance easier, the FY 2010 President's Budget Request for IRS provides the necessary funding to implement the following key strategic priorities.

Enforcement Program

The FY 2010 President's Budget request is $5,504,000,000 in direct appropriations and an estimated $60,797,000 from reimbursable programs, plus an estimated $7,800,000 from user fees,[1] for a total operating level of $5,572,597,000. The direct appropriations level is an increase of 7.6percent from the FY2009 enacted level and includes $600,000,000 to support tax enforcement activities funded by an allocation adjustment.

The FY 2010 President's Budget request includes program increases of $332.2 million for investments in strong compliance programs, including a robust portfolio of international enforcement initiatives discussed under "Legislative Proposals."

[1] Note that user fees are available to supplement appropriations contingent on demand for user fee services and receipt of fees. These amounts are subject to change.

Increased resources for the IRS compliance programs yield direct measurable results through high return-on-investment activities. The new enforcement personnel funded in the FY2010 President's Budget are expected to generate $2.0 billion in additional annual enforcement revenue once the new hires reach full potential in FY 2012. This estimate does not account for the deterrent effect of IRS enforcement programs, which are conservatively estimated to be at least three times larger than the direct revenue impact.

The tax law is complex, and even sophisticated taxpayers make honest mistakes on their tax returns. Accordingly, helping taxpayers understand their obligations under the tax law is critical to improving compliance. To this end, the IRS remains committed to a balanced program of assisting taxpayers in both understanding the tax law and paying the proper amount of tax.

Taxpayer Service Program

The FY 2010 President's Budget request is $2,269,830,000 in direct appropriations, an estimated $39,000,000 from reimbursable programs, and an estimated $127,000,000 from user fees, for a total operating level of $2,435,830,000. The direct appropriations level is a reduction of 1.0 percent from the FY2009 enacted level, though it does not represent a program reduction due to non-recurrent activities and savings, such as one-time funding to carry out remaining work associated with the 2008 stimulus.

The President's budget request continues improvements to both the quality and efficiency of taxpayer service, using a variety of person-to-person, telephone, and web-based and self-serve methods to help taxpayers understand their tax obligations and pay what they owe. The IRS taxpayer service program is funded in the Taxpayer Services and Operations Support appropriations. It should be noted that service investments and strategy are guided by the Taxpayer Assistance Blueprint—a five year plan that outlines the steps the IRS should take to improve taxpayer service and the IRS strategic plan.

Providing quality taxpayer service is fundamental to keeping honest taxpayers in the tax system and compliant. It also helps them avoid making unintentional errors before returns are filed, which, in turn, reduces the need for follow-up correspondence from the IRS.

The IRS provides year-round assistance to millions of taxpayers, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, the IRS.gov web site, Taxpayer Assistance Centers (TACs), Volunteer Income Tax Assistance (VITA) sites, and Tax Counseling for the Elderly (TCE) sites.

For example, in the Small Business arena alone, in FY 2008, the IRS participated in over 2,600 meetings, symposiums, and seminars attended by over 162,000 small business owners and tax professionals. The IRS also holds national and local Small Business Forums which provide an open avenue of communication between IRS and trade and industry groups. We held 135 Small Business Forums and facilitated 410 Small Business Tax Workshops in FY 2008.

Business Systems Modernization (BSM)

The FY 2010 President's Budget request is $253,674,000 in direct appropriations. This amount is an increase of 10.3 percent from the FY2009 enacted level. This appropriation funds the planning and capital asset acquisition of information technology (IT) to continued modernization of the core taxpayer account database.

This effort is a critical underpinning of the next generation of IRS service and enforcement initiatives. The integration strategy includes a particular focus on enhanced account information technology security practices and robust accounting and financial management controls. This also funds the ongoing development of the Modernized e-File platform for filing tax returns electronically, as well as BSM labor (salaries and expense dollars) and related contract costs.

American Recovery and Reinvestment Act

As previously noted, the IRS is now implementing a number of ARRA tax provisions, including individual tax credits, such as the Making Work Pay credit; energy credits for certain appliances, education credits, and child credits; tax incentives for business; bond incentives; and a tax credit to provide discounted health benefits to certain workers who have lost their jobs. The IRS will be able to continue to implement and administer these critical tax programs within the levels contained in this Budget request.

Legislative Proposals

The FY 2010 President's Budget includes a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. These proposals will specifically target the tax gap and generate nearly $2 billion a year starting in 2012. The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, expand penalties, and make it easier for taxpayers to enter into offer-in-compromise agreements (OIC).

I also want to acknowledge that Chairman Lewis and Ranking Member Boustany have already introduced legislation to drop the requirement that a person who is requesting an offer in compromise—usually a person in a difficult financial situation who cannot meet their full tax bill—pay a 20 percent down payment to apply for the OIC. This legislation will increase access to OICs.

- *Modify Electronic Filing Requirements*—Electronic filing benefits taxpayers and promotes effective tax administration because it decreases processing errors, expedites processing and payment of refunds, and allows the IRS to efficiently maintain up-to-date records. This proposal would require electronic filing by paid tax return preparers as determined by a set threshold amount of taxpayers assisted. Volunteer preparers and direct filers would not be subject to this requirement.
- *Expand Information Reporting*—Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific information reporting proposals would:

  1. Require information reporting on payments to corporations;
  2. Require a certified taxpayer identification number (TIN) from contractors;
  3. Require increased information reporting on certain government payments; and
  4. Increase information return penalties.

- *Improve Compliance by Businesses*—Improving compliance by businesses of all sizes is as important. Specific proposals to improve compliance by businesses would:

  1. Require electronic filing by certain large organizations; and
  2. Implement standards clarifying when employee leasing companies can be held liable for their clients' federal employment taxes.

- *Strengthen Tax Administration*—The IRS has taken a number of steps under existing law to improve compliance. These efforts would be enhanced by specific tax administration proposals that would:

  1. Expand IRS access to information in the National Directory of New Hires for tax administration purposes;
  2. Make repeated willful failure to file a tax return a felony;
  3. Facilitate tax compliance with local jurisdictions;
  4. Extend statutes of limitations where state tax adjustments affect federal tax liability;
  5. Improve the investigative disclosure statute;
  6. Repeal the requirement of a partial payment with an application for an offer-in-compromise; and
  7. Allow assessment of criminal restitution as tax.

- *Expand Penalties*—Penalties play an important role in discouraging intentional non-compliance. Specific proposals to expand penalties would:

  1. Impose a penalty on failure to comply with electronic filing requirements; and
  2. Clarify that the bad check penalty applies to electronic checks and other forms of payment.

International Legislative Proposals

The President's international legislative proposals represent a balanced approach that would allow U.S. companies to continue to compete in the international marketplace, but would eliminate three major ambiguities, or gray areas, employed by U.S. multinational corporations to legally avoid U.S. tax.

The international initiatives include reforming business tax deferral rules so that—with the exception of research and experimentation expenses that have significant spillover benefits to the United States—companies cannot receive deductions on their U.S. tax returns supporting their offshore investments until they pay

taxes on their offshore profits. The Administration would also seek to prevent abuse of the foreign tax credit.

In addition, clamping down on overseas tax havens is an integral part of the Administration's plan. It would reform the so-called "check-the-box" rules to require certain foreign subsidiaries to be considered as separate corporations for U.S. tax purposes. These subsidiaries could no longer "disappear" from the tax system.

President Obama also unveiled his legislative proposals on financial institutions that enable and profit from international tax evasion. They will enhance information reporting, increase tax withholding, strengthen penalties, and shift the burden of proof to make it harder for foreign account-holders to evade U.S. taxes. They will also provide the enforcement tools needed to effectively deal with tax haven abuse.

The core of the Administration's proposals is a new approach to investors who use financial institutions that do not agree to be Qualified Intermediaries (QI).

I should note the OECD has also been studyingbest practices, data templates, outside auditor requirements, and other guidelines for building QI-type networks. We believe the enhanced QI system proposed by the President is a good starting point for a multilateral QI system.

Under the President's proposal, the assumption will be that non-QI institutions are facilitating tax evasion, and the burden of proof will be shifted to the institutions and their account-holders to prove they are not sheltering income from U.S. taxation. Let me highlight some of the key elements.

First, the Administration proposes to impose significant tax withholding on transactions involving non-Qualified Intermediaries. It would require U.S. financial institutions to withhold 20 percent to 30 percent of U.S. payments to individuals who use non-QIs. To get a refund for the amount withheld, investors must disclose their identities and demonstrate that they are obeying the law.

Second, the President's plan would create a legal presumption against users of non-Qualified Intermediaries. U.S. citizens who send money to one of these foreign banks that do not cooperate with us will have to provide convincing evidence to prove they are not breaking U.S. tax laws.

Moreover, these presumptions will make it easier for the IRS to demand information and pursue cases against international tax evaders. This shifting of legal presumptions is a key component of the anti-tax haven legislation recently introduced in Congress.

Third, the Administration's plan would give the Treasury Department authority to issue regulations requiring that a financial institution may be a QI only if all commonly-controlled financial institutions are also QIs. As a result, financial firms could not benefit from siphoning business from their legitimate QI operations to illegitimate non-QI affiliates.

Fourth, the Obama Administration proposes to improve the ability of the IRS to successfully prosecute international tax evasion. For example, it would double certain penalties when a taxpayer fails to make a required disclosure of foreign financial accounts.

Fifth, the plan would increase the reporting requirement on international investors and financial institutions, especially QIs. QIs would be required to report information on their U.S. customers to the same extent that U.S. financial intermediaries must.

This means U.S. customers at QIs would no longer be allowed to hide behind foreign entities. U.S. investors would be required to report transfers of money or property made to or from non-QI foreign financial institutions on their income tax returns.

Financial institutions would face enhanced information reporting requirements for transactions that establish a foreign business entity or transfer assets to and from foreign financial accounts on behalf of U.S. individuals.

Of particular note, the Administration's plan would also extend the current statute of limitations on international tax enforcement from three to six years after the taxpayer submits required information.

In addition, the President is giving the IRS resources to support the plan. The Administration's proposed FY 2010 budget for the IRS will allow us to make investments in the people, tools, and overall coverage in the international arena.

This investment would increase the IRS' ability to combat offshore tax avoidance and evasion, including transfer pricing and financial products and transactions such as purported securities loans.

IMPROVE TAX ADMINISTRATION AND OTHER MISCELLANEOUS PROPOSALS

The Administration has put forward additional proposals relating to IRS administrative reforms. These proposals would:

- Increase information reporting penalties;
- Improve the foreign trust reporting penalty;
- Apply the Federal Payment Levy Program to contractors before providing Collection Due Process;
- Impose a penalty on failure to comply with electronic filing requirements; and
- Clarify that vendor levy on "goods and services" would not exclude "property."

CONCLUSION

Mr. Chairman, thank you again for this opportunity to testify on the successful 2009 filing season and the President's FY 2010 Budget Request for the Internal Revenue Service.

The IRS has not only demonstrated continuous improvement in key areas such as e-filing but it has demonstrated its effectiveness by reacting quickly and in unusual situations, such as the economic downturn.

We also urge passage of the President's proposed FY 2010 budget for the IRS. It provides the IRS with the much needed resources to provide taxpayers with high quality customer service, and bolster IRS enforcement in critical areas, such as unlawful offshore tax evasion. It also makes wise investments for the next generation of technology and the IRS workforce.

We further urge this Subcommittee to support the enactment of the legislative proposals included in the Budget to improve compliance. Collectively, they will generate more than $10 billion over the next 10 years if enacted.

I look forward to working with you and the Subcommittee on this important budget request, and I will be happy to respond to any questions.

Chairman LEWIS. Mr. Commissioner, thank you so much for your testimony. We appreciate your testimony and your willing to come here this morning and testify. At this time, I will open the hearing for questions. I ask that each Member follow the 5 minute rule. If the witness will respond with short answers, all Members should have an opportunity to ask questions hopefully before the first vote. We should move this hearing with all deliberate speed. And some of you understand what I mean by using the phrase "all deliberate speed."

Mr. Commissioner, I am troubled by the fact that almost 23 million taxpayers were not able to reach the agency by telephone this year. Some received busy signals. Others hung up after waiting. Could you tell us why has the level of service dropped? What steps are you taking to allow more taxpayers to speak to the agency during the next filing season?

Mr. SHULMAN. Yes, it is a great question, it is one we are focused on. Any time a taxpayer calls the IRS and does not get right through, I am not happy. Let me give you a couple of statistics. In 2000, between January and May, we received 48 million calls—I'm sorry, in 2007. In 2008, we received 64 million calls during that time period. In 2009, we received 74 million calls during that time period.

That was a result of economic stimulus payments going out last year, cleaning those up this year, and reconciling accounts this year and then the American Recovery and Reinvestment Act coming in this year. And so the IRS has been called on to have an unprecedented amount of activities. The level of service dropped, it especially dropped during a couple of peak weeks, which is normal.

Like any big enterprise, we need to balance all of our resources and one of the things we are quite focused on while our phones get a lot of attention, we triage between phones and paper, so we don't want people waiting a long time if they have written us. We don't want people waiting a long time on the phones.

Our level of service was lower than we would like. We have done a couple of things. One is we are pushing more people to the web. Five million of those calls were people trying to find out their adjusted gross income. By next year, you will be able to find that out on the web. We have changed our telephone scripts to try to move and process people more quickly.

We also have added an estimated wait time to your call, so if you call, you will know how long it takes and you can hang up and call back at a less busy time. So some of those hang ups, while they show up in our level of service going down, aren't necessarily a bad thing because they move people to non-peak hours and people do not waste their time for 10 minutes before they figure out that they actually cannot wait any longer.

And so those are some of the things we are doing. We are going to keep closely monitoring those, and we are going to try to improve every year, albeit within resource constraints and try to make smart resource decisions.

Chairman LEWIS. Thank you. Mr. Commissioner, I understand that the agency has assessed millions of dollars of penalties on taxpayers for failing to disclose tax shelters. Ninety-four percent of these taxpayers are small businesses. Is this true?

Mr. SHULMAN. We have for listed transactions and reportable transactions, Congress passed a law that made a strict liability penalty if you do not report one of those transactions. The idea was to have some of the most egregious tax behavior have high penalties. We are quite well aware that there have been people caught up in this who the law was not intended for, and we are focused on this. Right now, we do not have discretion to waive those penalties, but I would like to work with Congress to try to make this reasonable so we have a little more discretion in these areas so if people, like small businesses you mentioned, get caught up unexpectedly, we have some leeway.

Chairman LEWIS. We understand that the agency has imposed over $1 million of penalties on some taxpayers. I would like to submit for the record real life examples provided by the Small Business Council. How can this be—can you lower the penalty? Do you have the capacity? Do you need us to change—will our piece of legislation help change that?

Mr. SHULMAN. No, this is strict liability, so generally the agency has quite a bit of discretion. We do not have much discretion here. And, as you said, there are people caught up in this that the law probably was not intended, so getting some more discretion would be something that I would be very interested in working with the Committee on.

Chairman LEWIS. Thank you very much, Mr. Commissioner. I yield to the Ranking Member for his questions.

Dr. BOUSTANY. Thank you, Mr. Chairman. Commissioner, everyone agrees that those who criminally evade U.S. tax obligations should be brought to justice and that greater enforcement resources

for the IRS certainly could make this happen. I do have some strong concerns, however, that the administration and the press tend to lump together the need to combat offshore tax evasion on one hand with raising taxes on foreign profits of fully compliant U.S. businesses on the other.

What we want really are U.S. corporations doing business overseas to be able to compete on a level playingfield with their foreign competitors. So for the sake of clarity, do you agree that the international tax enforcement funding we are discussing here today in the proposed budget should be kept distinct from proposed tax policy changes, such as restrictions on deferral and foreign tax credits, about which reasonable people can disagree?

As I read your testimony on page 9, I think it was the very top paragraph, you referenced the May 4th statement by President Obama, and you referenced closing certain ambiguities in the Tax Code, which is really a policy issue that Congress will have to take up. And then I go down to page 14, and the first three paragraphs under "International Legislative Proposals," and you reference a balanced approach that will allow U.S. companies to continue to compete in the international marketplace but yet I get to the second paragraph, and this is an assault on deferral, and in the third paragraph you talk about clamping down on overseas tax havens and then you get into the check the box provision. And so, again, do you agree that we ought to have a clear line of distinction between dealing with evasion and legitimate tax policy?

Mr. SHULMAN. Yes, let me tell you how I think about this. I think there are two distinct sets of issues that the IRS spends times on and worries about. One is very clear: U.S. taxpayers hiding assets overseas illegally, not paying taxes, for those people we have an aggressive agenda. We are going to find them, and we are going to prosecute them and pursue them and there are a lot of very public cases out there.

The second issue is with multi-national businesses, a very different and distinct issue. There is plenty of legitimate tax planning, and there are a lot of people trying to be competitive, trying to construct business transactions that also have a tax benefit, and people who stay within the lines of the law, we have no issue with.

I also think there are large corporations that use the complexities of global capital markets and the complexities of the Tax Code to push the envelope beyond what we think is legal, and we have disagreements sometimes about the law. And so that is where I end up focusing as the IRS commissioner.

There is also a set of—I'm sorry.

Dr. BOUSTANY. Yes, let me just say isn't it true that most large U.S. businesses with worldwide operations are under continual audit by the IRS and have agents trained to detect illegal activity year round—working year round doing auditing?

Mr. SHULMAN. Most of the largest corporations are under continual audit. One of the pieces in the current legislation—or in the President's budget is to give us money for offshore tax evasion but it is also to give us economists, lawyers, agents, who are well-trained to make sure we can continue to match off against corporations who are doing tax planning but occasionally pushing the bounds.

Dr. BOUSTANY. Thank you. I have another question on a different subject. Back in I think it was 2007, then assistant secretary for tax policy, Eric Solomon, sent a letter to then Ranking Member Jim McCrery, ranking member of the Full Committee, explaining his concerns with the ability of the IRS to administer tax credit bonds. And according to Mr. Solomon at that time a lack of uniform rules and the proliferation of special purpose tax credit bonds imposed tremendous administrative burdens on the IRS and Treasury. Clearly, the Emergency Economic Stabilization Act of 2008 and the Recovery Act of 2009 both contain significant expansions of these tax credit bonds. Do you share then Assistant Secretary Solomon's concerns about the difficulty in administering these bonds?

Mr. SHULMAN. I am not familiar with that specific letter, so I don't want to speak to his concerns. I would be happy to follow up with you. What I will tell you is there are some bond provisions in the Recovery Act that Congress passed, we are staffed up and ready to execute those. And so I am not aware of us having specific issues. I will tell you any time there is complexity in the Code, it puts a burden on the IRS. And when you get into lots of capital market flows and special deductions for special areas and incentives, it often causes administrative burden writ large, but I am not familiar with that specific issue.

Dr. BOUSTANY. Perhaps we can meet on that later and have someone from Treasury as well just to get clarification on where we were in 2007 and where we are today given the expansion of these various tax credit vehicles.

Mr. SHULMAN. Yes, I would be happy to.

Dr. BOUSTANY. Thank you. I yield back.

Chairman LEWIS. Now, I turn to Mr. Becerra for his questions?

Mr. BECERRA. Thank you, Mr. Chairman, and thank you for holding this hearing. Mr. Shulman, great to have you hear. Thank you for taking the time. I am very encouraged by your comments today and your announcement that you will be doing more to examine the whole issue of paid tax preparers. This is something I have been concerned about for quite some time. I will be re-introducing legislation soon that deals with the issue of paid tax preparers.

And I would like to see if I can ask a few questions. Understanding that you are now in the process of talking, collecting information and perhaps not having final answers, I would like to see if I can get from you some of your opinions on some of these issues but more importantly some of the facts that drove you to this decision and this announcement to move forward in examining the whole tax preparer community.

First, you mentioned that 80 percent of Americans use either a paid tax preparer or some third party software to try to file their tax returns. Mine understanding is that on top of that statistic, some 60 percent of Americans rely on paid tax preparers exclusively to do this. And so well over half of American taxpayers go to someone else and pay that individual or company to get their tax filings into the IRS and get them in accurately.

The concern I have, and the reason I have taken this issue on for quite some time, is that we find that in too many cases there are errors even in these filings by people who have paid tax pre-

parers to prepare the returns for them. And what we are finding is that we have all sorts of people who are being paid to do tax preparation, many are certified public accountants, many are attorneys with experience in tax law, many are individuals who worked in the field of tax policy and law for quite some time, whether through the IRS or otherwise, but there is no clear standard nationally that says what you have to do to prepare or to become a tax preparer. You could open a shop tomorrow without little trouble. In fact, you and I do not know how many tax preparers there are right now in America, is that correct?

Mr. SHULMAN. That's correct.

Mr. BECERRA. And so I know that there has been talk of requiring all tax preparers who are paid to register, so at least you can tell us the number of tax preparers that are out there and begin to track their work. But that seems to only deal with the problem once it has already occurred. If you are only going to register them, then you find out that some are not doing good work and Americans are now paying penalties to the IRS because they filed income tax returns improperly based on a paid tax preparer having prepared these tax returns for these American taxpayers.

And some of us believe, I am in this camp that believes that we have to do something to make sure there is a level of competency in these tax preparers so that when you pay good money to do your civic duty of paying your taxes, you do not have to find out that the IRS is going to come after you because you did it wrong. And it is very tough I suspect to go after that tax preparer afterwards to take care of your penalty, your fines, your late fees and all the rest. And so I am wondering if you can comment on this notion of going farther than just asking tax preparers, paid tax preparers, to register with the government through the IRS but also to ask for some level of competency of anyone who wishes to hold himself out as being a professional tax preparer?

Mr. SHULMAN. Yes, I think a couple of things. Clearly, with preparers and software providers being engaged with 80 percent of Americans plus, there are very few people who sit down like the old image that people have filling out the 1040 anymore, they need to be part of the overall tax administration system for two reasons. One is they are part of making sure we have compliance and collect the right amount of taxes. And, two is, as I mentioned, paying your taxes is one of these largest financial transactions that American citizens and American taxpayers have each year, and we need to make sure that people are ethical, they are well-trained, they are giving good service, both to make sure that we collect the right amount of money and that people are being treated fairly.

Mr. BECERRA. And so, Commissioner, how do you make sure that they are well-trained?

Mr. SHULMAN. Well, so what I have just announced is I will tell you exactly my thoughts on that by the end of this year, and I will submit it in writing to the Treasury Secretary and the President. I want to enter this with an open mind. I am a big believer in transparent and open dialog when the government gets involved in a big question like this that is going to affect a lot of people, and so we are going to hold some open meetings with preparers, with consumer advocates, with taxpayers, with any effective constitu-

ency. We are going to be looking forward to having discussions with Congress. And for me everything is on the table with this, everything from education, to services we provide, to strict enforcement we have, to all of the regulatory issues that you discussed.

Mr. BECERRA. Thank you, Mr. Commissioner. Thank you very much.

Chairman LEWIS. Now, I turn to Mr. Pascrell for his questions.

Mr. PASCRELL. Thank you, Mr. Chairman. Commissioner Shulman, welcome to the Committee. You did a fantastic job in the IRS in responding to the American Recovery and Reinvestment Act and all of the different programs here to stimulate the economy. I will ask you a question about that after. I want to get to this question, it is something that I have shared with the IRS a few times, and I want to—hopefully we can totally resolve it. The IRS is seeking to apply a Treasury regulation, which would re-define what normal retirement age means for purpose of examining pensions. Serious business.

This regulation will have significant adverse effects on public service employees, particularly cops and firefighters throughout the United States of America. I understand the new regulations, they stipulate that plans must specifically define normal retirement age so that it is not based on years of service and yet we know in public safety, that is how we do define retirement, based on years of service.

In October of last year, the IRS decided to delay the effective date of implementation until January 1, 2011. While the extension was good news, I think we want to resolve this once and for all. Typical public safety pension plans are designed around, I repeat, the years of service and not an arbitrary age due to the physical and mental strain of the job. The IRS regulation does not take into account the reasons for why this retirement system is established as it is. I would like to see governmental plans completely excluded from the normal retirement age regulation. Here is my question, would you be willing or able to provide a formal opinion stating that government pension plans are exempt from the normal retirement age?

Mr. SHULMAN. I am going to have to have conversations on this obviously with our attorneys on this and the Treasury Department but the sentiments you have around (a) pensions being important for public employees, firemen, policemen, people who have special stress on the job, I am very sympathetic to. I would ask you—I am not going to be able to make any commitments here, but I certainly will work with your office on it, look at it, and give you anything I can as far as commitments.

Mr. BECERRA. We are talking about a very different classification of workers, particularly when we talk about police and fire. You are talking about not only the stress of the job but you are talking about losing a lot of people that we need particularly at this time. And I would ask us to move as quickly as possible to get a final opinion on this. It affects every career firefighter and just about every police officer in the United States of America. I would ask for your indulgence on that.

The second question is I am glad to see in your testimony that you highlight the new car purchase deduction. We have sent so

much to the big three, we did not ask ourselves the question, some of us did on both sides of the aisle, what good is it if we provide dollars to keep them afloat and we do not sell any cars? Well, that is exactly what happened. And this is the result of a lot of the dealers having to shut down. It could have been avoidable. We had legislation to do that, as well as the Earned Income Tax Credit, which we have all been—many of us have been strong advocates of for a number of years.

You stated that, and I am quoting you, "Through a series of massive outreach efforts, the IRS wants to make sure that taxpayers are aware of every credit, deduction and exclusion for which they qualify, including several new benefits this year." You even used the word "publicize," and I do not know how you are publicizing what is happening in the automobile industry to get cars, to help the process of selling cars, I wish you would tell us that. What more can be done do you think to increase the awareness of both the EITC, for instance, as well as the new car purchase deduction, which is going to save people a lot of money?

Mr. SHULMAN. Yes, you mentioned we are very focused on the education and outreach component of our mission. We have got—I will not bore you with all the programs, but we run special events, we do events with Members of Congress. We do a lot of media, both in English and Spanish. We have a variety of mailings. We have a very large web presence. We have one of the most trafficked business non-individual web sites in the world. And with the Recovery Act, the President tasked every agency to be very aggressive about outreach. If my memory serves me correctly, the President actually announced the new car credit and he does well when it comes to media and getting attention and publicizing. We go all out to do that.

It also though, takes lots of partnerships, so we try to work through community groups, tax preparation groups, both low-income taxpayer clinics, a variety of folks to do publications. Media and outreach and publication is a science and also an art, and we try to home both of them. We spend a lot of time and resources trying to execute that part of our mission because, as I think the chairman and Ranking Member said, if we can get people to do it right in the first place, that is the best way to do tax administration.

Mr. BECERRA. Mr. Commissioner, in these thousands of dealers that are being forced to close, on the average there are 47, 48 employees at every one of these dealers. The level of income is between $48,000 and $55,000. You are talking about a lot of people. You are talking about a lot of people being put out to pasture, and I think whatever we can do to accelerate this. It is fine that the President made the statement, he has got the bully pulpit, but the fact is that the IRS must be a partner and the publicity must be something that gets down to the average person so that they know that this is real. And we should be working with the dealers to help them. We did such a great job, didn't we, of working with the big three, let's deal with the dealers and help those folks on Main Street.

Thank you.

Chairman LEWIS. Now, we turn to Mr. Linder for his questions.

Mr. LINDER. Thank you, Mr. Chairman. Mr. Commissioner, welcome, nice to have you here.

Mr. SHULMAN. Thank you.

Mr. LINDER. Increasing numbers, as you pointed out in the early part of your remarks, are going to professionals to prepare their tax returns and sending them in online. Do you have any idea what percentage of all taxpayers use itemized deductions and what percent do not take itemized deductions?

Mr. SHULMAN. I do not have that number off the top of my head, but I would be happy to get it.

Mr. LINDER. Do you have a ball park?

Mr. SHULMAN. Roughly a third.

Mr. LINDER. A third use itemized deductions?

Mr. SHULMAN. Yes.

Mr. LINDER. Yes? Those third that use itemized deductions pay about $350 billion a year to fill out their tax—to respond in writing to the IRS. Businesses and individuals spend another $100 billion a year calculating the tax implications of a business decision. If we are spending $450 billion a year just to deal with the IRS, is that productive time and money?

Mr. SHULMAN. If you are getting at is the Tax Code incredibly complex and difficult to deal with, I think it is incredibly complex and difficult to deal with, and my job would be a lot easier with a much more simple tax code.

Mr. LINDER. Do you have any tax task force in your agency looking at ways to fix that?

Mr. SHULMAN. The President has assigned the Economic Recovery Panel led by Paul Volcker to look at a variety of issues including burden and simplification, and we are engaged with that panel.

Mr. LINDER. Do you have any idea how large the underground economy is?

Mr. SHULMAN. I do not.

Mr. LINDER. Would you take any guesses?

Mr. SHULMAN. No.

Mr. LINDER. Would you believe $2 to $3 trillion?

Mr. SHULMAN. I will not hazard to guess.

Mr. LINDER. In the past, we gave unpaid claims of small amounts to private companies to collect and they raised some money. That has now been taken off the books. It is not legal for them to do that or for you to give them the claims. Who is filling in that role or are we just forfeiting the money?

Mr. SHULMAN. Yes, we have had what I think has been a successful honing and refining of our collection program. The way that we measure tax debt that is collectible, we have to keep debt on the books for 10 years, unlike private sector companies write off a lot of debt. But if you look at our inventory of potentially collectible debt was in 2003 about $7.3 billion, that has decreased in half over the last—since 2008.

Mr. LINDER. How can you say $7.3 billion when you tell us that the tax gap is $345 billion?

Mr. SHULMAN. Two different measures, potentially collectible inventory is agreed upon tax that we are out collecting. The tax gap is a measure of what is owed that is not paid, which includes

people who are not on the books, et cetera. So that is the amount of taxes owed minus the amount of taxes paid every year.

Mr. LINDER. So the question was is somebody now in your department pursuing those smaller claims that used to be pursued by private companies?

Mr. SHULMAN. Yes, yes.

Mr. LINDER. Thank you. Thank you, Mr. Chairman.

Chairman LEWIS. Thank you. Now, we recognize Mr. Etheridge for his questions.

Mr. ETHERIDGE. Thank you, Mr. Chairman. Mr. Commissioner, thank you for joining us today. Let me follow a line that has already been followed to an extent. If you would speak to the IRS' ability, you touched on it a little bit earlier, to deal with the growing complexity, number one, in the Tax Code. And, second, we have expanded tax credits for education, to provide benefits for homeowners, to give new credits for energy efficiency, among others, and they are meant to help people make the decision, number one, to go to college or buy a home or, as you just talked about, buy a car or improve the home to save energy, et cetera.

I guess the broader question, you testified about the outreach but are you reaching out through various groups out there? I would be interested in those comments because I think the time is running out on some of this.

Mr. SHULMAN. Yes.

Mr. ETHERIDGE. It is now June and December is going to be here real quick. I believe if I remember anything about the IRS, you have got to have that completed and paid for before you file your taxes. You cannot have it under contract and then work, and so I would be interested in your comments as we are reaching out because that time line really is not seven months now, it is probably more like four or five, depending on what you are going to do.

Mr. SHULMAN. Yes, we have been—for each of the different tax credits, we have a set of groups, there is a wide network of tax professionals, both preparers, the groups, umbrella groups for accountants, a variety of community groups who are our partners that generally we reach out to for people who to go to tax but then also for housing credit for instance. We have been working with specifically different groups that we usually do not work with to advertise those kinds of things.

Mr. ETHERIDGE. To get the information out.

Mr. SHULMAN. We have partnered with HUD for instance, who has their networks and their outreach program to all the different housing groups. They are working side by side with us to penetrate that market. We have partnered with education to do outreach there, and so we have tried to go through our traditional channels but also specific channels just to make sure people get all the information they need for the Recovery Act.

Mr. ETHERIDGE. To your knowledge, are all the rules and regulations in place or will they be in place shortly for these new bonds that are out there because I know there are a variety of zero interest bonds we put in the Recovery Act.

Mr. SHULMAN. Yes.

Mr. ETHERIDGE. And talked with some of the local governments, they are not real sure they have them in place where they can start issuing bonds.

Mr. SHULMAN. We have issued most of the guidance. We also have now gotten questions and are working on some very specific technical issues, but we have been very focused. I will tell you as an agency head, the Vice President was tasked with overseeing this. Everyone has deadlines around it. It is all very transparent, when we are putting out guidance for what. Most of all of our guidance is out. Anything that is not out is incredibly technical, more difficult guidance, and I am checking on it daily and putting pressure on our agency as is the Treasury Secretary for the things that have to come out of Treasury.

Mr. ETHERIDGE. Would it be possible for somebody from your department to be in touch with our office because we have got some specific ones I know the guidance is not there yet and they are in the process of trying to do some bonds that will help expand some stuff and this is a specific—these local bonds that deal with municipalities and counties and states.

Mr. SHULMAN. Absolutely.

Mr. ETHERIDGE. And economic development.

Mr. SHULMAN. We would be happy to work with your office immediately.

Mr. ETHERIDGE. Let me ask one other question in the time I have left because today our economy is increasingly global, and a lot of small businesses, who never thought they would be selling stuff offshore, are now selling stuff internationally, and many of them are doing quite well. When once they only worried about selling in state, there was not a problem for the tax system because they collected the tax they sold, et cetera. And as more businesses expand and become global, does the IRS have the manpower, I assume you have the expertise, to deal with these emerging businesses and give them the assistance they need in some of these complex areas because I think this is a great opportunity as the economy starts to recover in finding a level of ability to deal with that?

Mr. SHULMAN. I came from the capital markets regulation field before this, and now looking at the tax system, one of the issues we have in this country that everyone is wrestling with is how do you deal with sovereign laws and sovereign authorities in a global world and how do you deal when you cross borders. I would say this agency has done a good job trying to get ahead of the curve. We have got a long way to go, and it is going to be a multi-year effort.

You asked about if we have the resources and the competency. The people who are there are quite competent, they are going to need training because all of these techniques are emerging, and we are getting more resources in this year's budget and hopefully in next year's budget, the 2010 budget that was sent to the Hill. And so it is going to be an area that we are going to keep focused on and try to get in front of.

Mr. ETHERIDGE. Mr. Commissioner, is there any way we can be of help? I am sure the chairman would say to you let us know because I think this is an area where we are going to get growth,

and if we are really going to get out of this thing, we are going to need to help small business. Thank you, and I yield back, Mr. Chairman.

Mr. SHULMAN. Thank you.

Chairman LEWIS. Thank you very much. We now turn to Mr. Kind for his questions.

Mr. KIND. Great, thank you, Mr. Chairman, for holding this hearing. Mr. Commissioner, welcome back. It is always nice to hear from you. Let me just follow up quickly on what Mr. Linder had asked you previously about the Volcker Commission. That obviously has been tasked to meet this summer and fall and report back later. The IRS role, is there any role that the IRS going to be playing with the Volcker Commission or what?

Mr. SHULMAN. For the specific tax part that involves simplification, tax gap, enforcement, those kinds of pieces, yes, I have been invited to participate, we have staff engaged in that.

Mr. KIND. What stage are we in with that Commission? Has it had a formal meeting yet?

Mr. SHULMAN. I would rather not speak for the White House and the Volcker Commission. There was a formal public meeting in May of the whole group. I know the tax group has met but like I said I probably should not speak for the White House.

Mr. KIND. Has the IRS been involved in any meetings so far?

Mr. SHULMAN. Yes, I have attended the first meeting and am deeply involved as is the Treasury.

Mr. KIND. Let me ask you a question, my staff person in charge of IRS issues back home indicates to me just anecdotally that offers and compromise have diminished quite a bit recently. And in light of the current economic situation, is there a reason or is this an anomaly or what?

Mr. SHULMAN. They have been going down over the last several years. It is something I am quite concerned about. Two things that I think are in important. One is in the President's budget and in coming from the chairman and the Ranking Member and others Members of the Committee, there is a recommendation that we eliminate the 20 percent downpayment requirement, which I think will help boost that. We are also reviewing internally how we make sure we get the word out because I am very focused and everyone in our agency is very focused and understands we are a big service organization but we are also an enforcement organization.

Mr. KIND. Right.

Mr. SHULMAN. Not everyone in America understands the service component even though they file the return, and we want to make sure people know that if they reach out to us and they are having a hard time paying, we can work with them. And so we are doing an internal review and this legislative change I think would be important.

Mr. KIND. But what is the reason why there has been kind of a drop off in offers and compromise?

Mr. SHULMAN. We do not know, but I suspect one of the reasons is the law that went into place several years ago that required you to put a 20 percent down payment for your offer and compromise. And so this is usually people who do not have the money to pay their full tax debt. They may not have the full money to put

20 percent down when they do not even know if the debt is going to be compromised.

Mr. KIND. Right. I think later this year new tax gap estimates are supposed to be released, I think the last year we have available is the $345 billion in 2001, does that sound right? In 2009, we are supposed to get an update, is that right?

Mr. SHULMAN. So the tax gap, a couple of things. One is it is a very imprecise measure. The number is targeted to 2001 but a lot of that is extrapolated data from 1983, 1986, and so it is not based on real updated data. We have been giving some more money to actually update that research. We have given it in the past, we are giving it now. Our goal is to get to multi-year or to get to regular updates, recognizing that it is always going to be imperfect. We are shooting and right now working hard on S corp and C corp numbers, which are especially old, and we are hoping to get those out in the not too distant future.

Mr. KIND. I assume that your review of this is going to be able to identify what might be more achievable as far as going after some of the tax gap revenue that we are losing right now?

Mr. SHULMAN. Yes, I think a lot of focus on the tax gap, I am concerned about the tax gap. Some of these tax gap numbers though we know where there is no information reporting is where there is lower compliance, down in the 50 percent range. Where there is lots of information reported, like a W–2 and withholding, you are up in the 99 percent range. So it is somewhat imprecise because by definition the tax gap is money that is not coming in, so you do not know exactly where it is and what is the motivation. There are a whole bunch of proposals, this Committee was supportive of having credit card reporting and basis reporting. There are some proposals in the President's budget around having international focus, some reporting on businesses, and so I think we already have a whole bunch of strategies that are good to go after. And, yes, the research will help us target that.

Mr. KIND. Let me ask a quick question on the withholding tables on Making Work Pays. It is my understanding that for married couples, the credit is listed as 600 bucks but is not the maximum amount for a married couple $800, so am I missing something here in the withholding tables?

Mr. SHULMAN. Yes, the withholding tables are estimates and guides. If you are married, you might have one person working or two people working. You might be able to get $400 or $800 depending who is working in the household. And so by definition these things—the withholding table is not going to take into account every single taxpayer's situation. My understanding is the Treasury Department economists who put together the tables tried to come up with an average which would work for the most people, recognizing it is not going to work for everybody.

Mr. KIND. Is it creating confusion?

Mr. SHULMAN. Withholding tables every year are imprecise, and so the important thing is for people to look at their own situation, decide what their withholding should be. Some people like to under withhold and owe something at the end. Some people like to over withhold and get a big refund. And so the one piece that was creating a lot of confusion to this committee was good and brought

to our attention early was the withholding tables for people on pensions who were not working were taking too great of deductions and therefore were going to owe more at the end, and we have corrected that. And so where there is more confusion than normal, we will be agile and try to update those as we see problems.

Mr. KIND. Thank you, Mr. Commissioner. Thank you, Mr. Chairman.

Chairman LEWIS. Thank you. Now, we turn to Mr. Roskam for his questions.

Mr. ROSKAM. Thank you, Mr. Chairman. Thank you, Commissioner. Just two quick areas, one is could you give me a general sense, based on your conversation earlier with some of the other Members, about your view on the Free File Alliance and how that sort of—how that interplays with other plans? The President during his campaign talked, I think it was pretty explicitly, about getting official help on the side of taxpayers if he had income under $100,000.

I guess my question is do you view that Free File Alliance as a helpful tool right now? I guess the question is if you are having a hard time answering the phones and answering the mail, and you have got a complicated job admittedly, is that any time to be bringing in tax preparation in-house so to speak? Could you just give me your general sense of that?

Mr. SHULMAN. Yes, my general sense is this, I would like the Tax Code to be simpler first so people have to rely less on software and people, et cetera, and it was easier. Second is the American people have to pay taxes, and so as cheap and easy as it can be, that would be great philosophically is where I lean. I also think the Free File Alliance has been a very good partnership we have had over the years that has allowed low-income people to file their tax returns for free online.

It was developed at a time where the Internet had not been as developed and expectations of consumers broadly were probably not that they could get online and do something quick and for free. A lot of members of the Free File Alliance actually this year for the first time are allowing free electronic filing even when you purchase their software. And so I think this is a rapidly evolving area. I think any time you are talking about electronic filing, software preparation, the Internet, it changes every year, both the expectations of the American people change every year, as well as the abilities of both government and the private sector to deliver. And so it has been a good program.

I think all of our programs around electronic filing are going to evolve. This year you might have seen—last year, we had about 58 percent of individuals filed electronically. This year, to date, about 68 percent have, although people who have extensions usually come in paper because they are more complex returns but it is still clearly going to be above the 58 percent, so that keeps growing. So I think this is just going to be an ongoing conversation that we are going to have, and we as the government need to keep up with the times. That means we are going to be doing certain things, we are going to be doing certain things with the private sector and keep moving.

Mr. ROSKAM. I would just encourage a lot of private sector involvement. It seems like there has been a good history there, so that is I am sure in the stew as you are making your decisions.

Mr. SHULMAN. Absolutely.

Mr. ROSKAM. Just switching gears quickly, and this has to go with the administration's request for additional enforcement funding, really targeted toward small business entrepreneurs, can you speak to that? Folks in my area, if there is a legitimate—well, here we have the Secretary of the Treasury that came in and admitted that it was so complicated that he had a difficult time discerning a tax liability. Is this really where the emphasis should be going right now at a time when we are in real turmoil from an economic point of view, should we really be focusing in from a targeting point of view at small business and entrepreneurs? Could you give me your sense in terms of emphasis?

Mr. SHULMAN. Yes, my priority areas for coverage and compliance, which is not always the same as enforcement because sometimes you find issues and when we find issues, we try to work through with people hopefully, a lot of people make inadvertent mistakes, my priority areas are high net worth individuals, large corporations, international, and then some of the flow through entities, which are much more difficult for us. Those are areas where there has been—where we find bigger issues with tax sometimes. I do not think we have a specific coverage targets and increase around small business.

I can tell you I have been in conversations with the administration that small businesses are engines of growth in this country, that entrepreneurship is very important in this country. What I would say is where there is not a lot of information reporting is one area where we are focused on. Sometimes we get a 1099 from a bank and sometimes it is attached to a Schedule C, which is part of a return, and we are going to be able to increase our ability to do pure document matching, send out letters if there is a mismatch, make sure people have the—get information from us and pay the right amount of taxes, but I do not think we have a special target on small businesses.

Mr. ROSKAM. Thank you. I yield back.

Chairman LEWIS. Thank you. We now turn to Mr. Larson for his questions.

Mr. LARSON. Thank you, Mr. Chairman, and thank you as always for holding this very fine hearing. Thank you, Mr. Shulman, for being here and your service to the country. How many employees do we have in the IRS?

Mr. SHULMAN. We have about 93,000 FTEs, full time equivalents. We have a lot of seasonal people who come on during filing season and process returns and go off, but the working number is about 93,000.

Mr. LARSON. Has the IRS ever been specifically charged by the Congress to if the IRS was re-writing the Tax Code, how would it re-write it, have you ever received—just a curious question, it always comes into my mind, my guess is probably not?

Mr. SHULMAN. No, I think of it as the prerogative of the Ways and Means Committee and Finance Committee, so no.

Mr. LARSON. Wasn't that an intelligent answer? Let me ask you this as a follow-up. If you were charged by the Congress, who after all with the number of employees that you have and the vast experience of looking at a Tax Code that at best certainly some could describe as a Gordian Knot, would not a number of people who have been in that very noble public service have ideas about where they think changes could be made?

Mr. SHULMAN. Sure.

Mr. LARSON. And if you were charged, how long do you think a study like that would take?

Mr. SHULMAN. I cannot say. What I will tell you is we have a very good relationship and we are a bureau of the Department of Treasury. I have a very good relationship with the Treasury Secretary. The White House and the Treasury take the lead on tax issues. We were talking before of the Volcker panel is actually engaged in that as is the Treasury Department, and we certainly have a strong voice in this effort.

Mr. LARSON. We kind of consider ourselves representatives of the people as well, so we are interested in the sinew and the nuts and bolts and it would be interesting to see what our frontline people have to say about our tax system as well. But let me move rapidly on to do you have an opinion or has the IRS expressed an opinion on the issue that was discussed in this committee, et cetera, one point is we are looking at revenues on carried interest?

Mr. SHULMAN. The administration has sent its opinion via the President's budget and I am supportive of that.

Mr. LARSON. All right, let me try another area here for you.

Mr. SHULMAN. It is hard to draw me into too much tax policy.

Mr. LARSON. What is the IRS' feeling, 60 Minutes ran a special about what has been going on in terms of the dark market or the over-the-counter market with credit default swaps and derivatives, et cetera, should there be a separate tax treatment for those?

Mr. SHULMAN. Well, as you know, internationally there is actually a lot of different treatments of securities lending, equity link notes, swaps, derivatives. What I would say is there is inconsistent treatment in the code today. All of it has been put together for different reasons and around competitiveness, capital flows, a variety of things. Clearly, with what has happened in the financial markets, there is interest in this, but I will not opine on whether or not it should be different or not.

Mr. LARSON. Well, it is interesting because usually the feedback we get, "Oh, no, God, government has got to stay away from this because certainly if there was an effort in this area, they would move offshore." Well, it seems to me like this is a global economic crisis, and when reports account for anywhere from $40 to $60 trillion in trades that happen in an over-the-counter, unregulated area, that this might at least pique the interest of the IRS or the administration or anyone concerned about revenues and loss thereof and then appropriate regulatory steps that should be taken in this area. Do you have any opinion on that?

Mr. SHULMAN. My only opinion is I know that Treasury has put forward proposals around derivatives regulation. It is being debated in Congress and the Senate. Clearly, this is an area that has the attention of leaders in the country.

Mr. LARSON. With regard to the American Recovery and Reinvestment Act, taxpayers are eligible for Making Work Pay, some have become aware of the fact that they potentially are going to have to repay a portion of their credit, others have not. I understand you are going to be undertaking an outreach campaign to make sure on this issue. Could you elaborate what efforts are being made to make sure that people will not get sticker shock, so to speak, when they find out they have been the benefactor of Making Work Pay but now they may end up paying portions of that back?

Mr. SHULMAN. Yes, the biggest confusion this year was around pensioners who were using the tables but not working so they were not eligible for the Making Work Pay credit but their pension was being drawn down. We have changed that on the tables. We have worked directly with pension organizations. We have been working with organizations, such as the AARP, to do outreach to individuals to make sure they make any changes to their withholding as appropriate. And so we have got a pretty deep network through out tax exempt group into the pension community. So all the groups who can reach the actual pensions——

Mr. LARSON. Including Social Security?

Mr. SHULMAN. Exactly.

Mr. LARSON. Yes. Thank you very much. Thank you, Mr. Chairman.

Chairman LEWIS. Well, thank you. Mr. Commissioner, I want to yield to Mr. Boustany for an additional question.

Dr. BOUSTANY. Thank you, Mr. Chairman. Commissioner, I looked over the June 2009 GAO report on your budget estimates and requests, and there was conclusion that came out. I am going to read briefly a paragraph here from the report. It says, "By presenting ROI projections for the proposed enforcement initiatives in its budget request, the IRS is providing important information about estimated costs and potential revenues. Such information should be useful to Congress for budgeting and oversight. However, without actual ROI information, Congress, IRS management and the public will not know whether the approximately $900 million investment from Fiscal Year 2010 through Fiscal Year 2012 for enforcement initiatives actually realized the projected results."

GAO goes on to recommend that the commissioner take steps to develop a return on investments for IRS' enforcement programs using actual revenue and full cost data and compare that to the project. So could you comment on the steps that you are going to take in that regard?

Mr. SHULMAN. Well, let me comment in general. One is we do track ROI on an aggregate basis. When I came into the job, one observation I have is there is a very well-defined, and agreed upon between OMB and CBO, of what ROI is for our collection versus our exam, et cetera. I think one place all the ROI discussions miss the mark is investments in technology and service also help yield voluntary compliance.

It has often been said that a dollar put into enforcement has a three to one deterrent impact and education brings in the right amount, the preparer work that we are doing, and so I am actually quite focused on making sure that service, technology and enforcement are all seen as part of funding, helping make sure we fund

the government and get it right. And so those are the kinds of things that I am quite focused on making sure that we have the proper dialog about it and obviously the measurements on the back end.

Dr. BOUSTANY. Thank you. I yield back.

Chairman LEWIS. Mr. Commissioner, I want to just ask one last question. In my statement, I mention the fact that the agency is closing the Atlanta and Andover units that handle paper returns. Could you tell us how many employees will be affected?

Mr. SHULMAN. I can talk to you some about Atlanta, and these are all estimates because it would not happen until 2011. In Andover, we actually are in the process of it. And we try to give employees advance notice. We try to give them reassignment preferences. We try to allow people who want to retire early to swap with people who want to stay longer.

Our experience doing this in Brookhaven and Philadelphia and Memphis is very few people at the end of the day actually have to be rifted, that we go the extra mile and try to work with employees because I personally believe we have an obligation to people who have been with us a long time, that if we are trying—and we have an obligation to the American people to try to run efficient operations and as more electronic filing comes in, not waste money. But at the same time, we have personal obligations to people who have been dedicated to the government, to help find them another job.

And so in Atlanta, the number of permanent employees that could be affected, we have some people we brought on just for contracts and they knew exactly that this was a 1 year deal or a temporary deal, but the number of permanent could be up to 1,000. For those people, we are going to make sure we stretch and bend and find other work.

When we have opportunities to make new investment, we are going to try as long as it makes business sense to put it in the place where there are potential layoffs. So in Andover, for instance, we are committed to opening another AUR site, which is where we match information returns against actual tax returns.

And so I want to just tell you I believe we have an obligation to people to do everything we can to work with them. I have instructed my staff who runs the division that is going to have to work on the ramp down, that if there is any place to be flexible and creative, that is here. And we are going to have an eye toward, if there is more work to be done, trying to have it there so we can pick up other employees.

Chairman LEWIS. I appreciate your concern and your feeling along these lines. Have you had an opportunity or someone at the agency to talk with other Federal agencies, such as the Social Security Administration, about the possibility of looking at some of these individuals?

Mr. SHULMAN. We have not to date but we certainly will.

Chairman LEWIS. Thank you very much. I believe Mr. Becerra has a last question or two?

Mr. BECERRA. Yes, Mr. Chairman, if I may.

Chairman LEWIS. So I turn to you, sir.

Mr. BECERRA. Thank you, Mr. Chairman. Commissioner, before I leave the whole issue of tax preparers, can I get a sense, the door

is completely open to try to examine this issue of tax preparers, you are not limiting your scope of inquiry to one aspect of tax preparation, is it wide open?

Mr. SHULMAN. Yes, there is going to be a very open, transparent and I have no pre-conceived notions, and we are going to just try to open the door.

Mr. BECERRA. Great, good to hear. The tax gap, if the estimate for the 2001 tax gap is anywhere near accurate, and we have no way of knowing, but if it is in fact or it was in fact something in the order of $345 billion of uncollected owed taxes, over the last 8 years we could have collected enough money to not only cover this massive deficit that we see for 2009 but probably enough to cover most of the deficit from the last several years, so it adds up to quite a bit of money.

And I know that your agency is going to come up with a new estimate for the tax gap to update the numbers since the 2001 number is obviously very old. We thought we were going to receive something soon, if not already, on this tax gap number, and I am wondering if you can tell me when can this Committee expect to hear from you and your agency on the work you have done to estimate the size of the tax gap between what we should collect and what we actually collect?

Mr. SHULMAN. So a couple of things, one is, as I mentioned before to one of your colleagues, these are real estimates, 2001 happens to be the year that we looked at but a lot of these are extrapolated from eighties numbers. It is very hard to get your hand around it. Two is I think it is important that Members of Congress know that this is not just free money that can go and get grabbed to close the deficit. This is money that is going to take multi-year work.

The best way to go over the tax gap is going to be information reporting. We do not have a big tax gap with wage earners in this country, where we get their information, they file their return, if there is any problem, we just send them a letter, and we get it closed off and there is actually withholding at the source. And so there are a whole bunch of proposals that are in here.

Our goal is to have annual tax gap updates. We are trying to roll through the different segments. The ones that we are most focused on right now are S corporations and C corporations and those I hope to get out in the not-to-distant future.

Mr. BECERRA. And, Mr. Chairman, I will end with this last question or it is more of a comment. I want to pick up on something the commissioner just said. The issue of the tax gap really does not relate to salaried workers who get a paycheck week in/week out because that income is reported in a fairly aggressive and accurate way on a constant basis. You get your paycheck, taxes are deducted based on how many exemptions you claim and so forth. And so most wage earners do not do the type of tax evasion or innocent filing mistakes that would lead to this massive tax gap of several hundred billions of dollars.

As you said, it is the fact that we do not have information from others that should be paying taxes that causes us not to be able to collect enough from those who have earned an income and have not paid it.

The point that I am trying to make here is that most Americans who work for a living making a salary or a wage are not the folks who are trying to evade paying taxes or are making mistakes paying their taxes. It is folks who do not have the constant documentation required to pay the taxes that are leading to this problem. I will not say they are causing it because a lot of folks are innocently not filing correct information or inadequate information on what they should be paying.

But it is clearly the case that we need to have a better way of tracking those who do not have a regular paycheck within their scope of income generation so we can figure out how it is that we can get every American to pay his or her fair share of taxes, so that we can have every American who is dutifully paying their taxes, not pay more than necessary to make up for the gap created by those who are shirking their responsibility to pay their fair share. So I think it is important.

My dad worked all his life in road construction and in agriculture, picking crops, he always got paid through a check. He never got to take a deduction for his lunch or anything like that, but he always got taxed. And I think it is important that those who work day in and day out and get a paycheck know that they are not going to be made to pay higher taxes because there is somebody who is able to write off that two martini lunch, who is not documenting as well as he or she could and paying his or her fair share of taxes.

So I thank you, Commissioner, for your presence today and your testimony. Thank you, Mr. Chairman.

Chairman LEWIS. Without objection, I would like to submit a question for the record from Congressman Levin and Congressman Thompson.

[The information follows:]

Question from Congressman Levin

Question from Rep. Levin

I have recently received the attached letter from Shawnda Boyd, President of Boyd's A Nice Place to Stay, Inc., a non-profit organization in my district regarding the burden placed on small tax exempt organizations by the current $750 user fee imposed on exempt organizations with $10,000 in gross receipts.

1. **Does the Internal Revenue Service grant hardship waivers of this fee for small exempt organizations?**
2. **Do you think that in the current economic environment $750 could present an undue hardship to some exempt organizations?**
3. **If so, should the Internal Revenue Service consider a waiver in some circumstances?**
4. **Does the Internal Revenue Service have the authority to grant such waivers?**

1) Section 7528 of the Internal Revenue Code (Code) requires the IRS to establish user fees for letter rulings, opinion letters, determination letters, and other similar requests. This includes user fees for exempt organizations seeking recognition of tax exempt status. Under the statute, the user fees charged must (1) vary according to categories or subcategories established by the Secretary of the Treasury; (2) take into account the average time for, and difficulty of, complying with requests in each category and subcategory; and (3) be payable in advance. The statute also establishes a minimum average fee that we must charge for each fee-charging program. In the case of the determination letter program for the review of applications for tax-exemption, the minimum average fee must not be less than $275.

2) We list the schedule of fees in Revenue Procedure 2009-8, which we update annually (see 2009-1 Internal Revenue Bulletin at page 229). The fee for exemption application cases is currently $750. This amount is based on our cost of providing the service.

3) We appreciate the burden of the fee on small organizations. However, we believe that the current fee structure, including a significantly reduced fee for small organizations, strikes an appropriate balance between the statutory mandate to recover the cost of providing government services and the hardship this could create for small organizations

4) The statute allows us to provide for exemptions and reduced fees as determined appropriate. While we do not grant hardship waivers of the fee for small organizations, we do offer a reduced fee of $300 for organizations that have or expect to have annual gross receipts averaging not more than $10,000. A significant percentage of organizations (approximately one-third of all filers) take advantage of the lower fee. Because of the difficulty of fairly defining which

applicants would be entitled to a waiver, and the costs of evaluating and verifying applicant waiver requests, a fee waiver program could be costly and administratively impractical. In addition, as required by the statute, the costs of a fee waiver program would have to be reflected in the costs of the standard user fee for applications for tax-exemption.

Finally, we would like to note that we have developed a web-based tool (referred to as “Cyber Assistant”) that organizations will be able to use in the future to assist them in completing their Form 1023 exemption application. This tool is still in the testing phase, but because it should result in decreased processing costs by the Service, we plan to allow applications prepared with the product to be eligible for a significantly reduced user fee. We have not yet determined what this fee will be, but for planning purposes we have estimated it may be approximately $200. We anticipate that Cyber Assistant will be available early in 2010. Because the reduced fee will be available to all applicants, it will no longer be necessary to offer the reduced $300 fee currently available to small organizations.

Question from Congressman Mike Thompson

Question for the Record
Congressman Mike Thompson
June 4, 2009

1. **What prompted the Internal Revenue Service (IRS) to initiate a Compliance Initiative Project (CIP) on wineries employing LIFO inventory accounting methods in Napa and Sonoma Counties, California?**

   Through the normal course of examinations of taxpayers in the wine industry, several examinatons revealed the LIFO issue where a taxpayer was using only two items, bulk wine and cased goods, to define the wine inventory under the LIFO rules. The examinations concluded that the use of just two items to define numerous wine varietals, each with varying costs and at different stages of production, did not properly determine LIFO inventory values and thus did not clearly reflect income. As part of one these examinations, IRS lawyers advised the relevant IRS auditors on these issues. This advice was published at 2006 TNT 209-25.

   Based on the results of the examinations discussed above, LMSB management determined that further investigation was warranted to determine if this is an industry-wide issue. The IRS utilizes the Compliance Initiative Project (CIP) process to identify similarly situated taxpayers where a potential issue is being evaluated. Through the CIP, we are able to review taxpayer returns in the same industry with similar fact patterns to determine whether the issue is more widespread. If it is, then we are able to identify what actions need to be taken such as focused outreach to educate the taxpayers in this group, expanding the number of examinations, and/or legislative proposals to address the compliance gap. Because both the IRS agents familiar with the issue and a significant number of taxpayers using the LIFO method were located in this geographical area, we determined to analyze the issue further in this geographical area, and then assess whether we needed to expand the scope to other areas.

2. **Why is the CIP focused exclusively in Napa and Sonoma Counties when wine is a nationwide industry and there are wineries in all 50 states? If the rationale relates to the location of the IRS agents managing this particular CIP as your staff has indicated, why were other counties in the Bay Area not considered?**

   The scope of the original CIP request focused on wineries covering parts of six counties – Napa, Sonoma, Santa Cruz, San Joaquin, Solano and Alameda. As part of the initial screening of tax returns, a largest concentration of tax returns with the potential LIFO issue were identified in two counties - Napa and Sonoma. LMSB determined to start with these two counties and depending on the initial

results of the CIP project, the examinations could be expanded to other geographical regions.

3. **If IRS employees are concerned that a large number of wineries are not properly complying with LIFO-related tax regulations, which your staff has indicated is the case, why is the IRS not making efforts to a) educate the wine industry on how to properly comply with the regulations, and/or b) consider working with Congress to modify or clarify the regulations so wineries are better able to comply?**

   The IRS became aware of this issue during the regular course of examinations of taxpayers in the wine industry. The IRS held informal discussions with wine industry representatives and also provided guidance which was published at 2006 TNT 209-25. The CIP is intended to provide enough information to validate the compliance risk and the need for additional compliance strategies, including education, industry outreach and additional guidance beyond what was issued earlier. We are not far enough along in reviewing this issue to know the full extent of the compliance risk and the extent to which additional outreach would be appropriate or necessary. After we learn more from the CIP, regulatory changes and return reporting enhancements would also be considered as appropriate, depending on our assessment of compliance risk.

4. **Why is this coordinated audit of 28 wineries in Napa and Sonoma Counties, which is a small geographic area, considered the best method for increasing compliance among all wineries, considering that there are nearly 3,000 wineries across the nation?**

   CIPs are one of the many tools used by the IRS to address compliance risks and they provide an effective and efficient use of IRS examination resources when issues are identified. The CIP focused initially on this geographical area with the largest concentration of potential LIFO issues and the expertise of the IRS agents in this area. We will consider expanding to other areas as appropriate.

5. **More broadly, what criteria are used to determine when CIPs are necessary? What oversight is conducted within the IRS to determine the CIPs or any other audit-based research are justified and properly executed?**

   In general, a CIP is initiated when an area of non-compliance is discovered that is not being identified and addressed through traditional return selection criteria. There are a number of checks and balances built into the process to ensure that no single person or office commences any CIP.

   CIPs such as this LIFO inventory project must be reviewed and have the concurrence of the initiator's immediate manager, Senior Manager and Executive level Director of Field Operations. One of our LMSB Headquarter offices,

Planning, Quality, Analysis and Support provides oversight and regularly monitors all CIPs for compliance impact and quality of work.

Chairman LEWIS. Commissioner, I would like to thank you for being here today, for your testimony. We appreciate your views. You have been more than helpful.

Is there any other business to come before the Subcommittee? There being no further business, this hearing is adjourned. Thank you very much.

[Whereupon, at 11:20 a.m., the Subcommittee was adjourned.]

[Submissions for the Record follow:]

Statement of Alvin S. Brown

Chairman Lewis, Ranking Member Boustany, and Members of the Subcommittee on Oversight, I appreciate the opportunity to address Internal Revenue Service (IRS) operations now subject to its annual review. Mr. Chairman, I agree with your concern about IRS levies on Social Security income. The IRS often levies Social Security income without taking into account whether the taxpayer is left with money for food, housing, transportation and other necessary expenses. Under section 6343(a)(2)(D) of the IRS Code, the IRS is prohibited from any levy that creates an "economic hardship." [1] My testimony deals with the larger topic of counterproductive IRS tax lien and tax levy practices. In many cases, these liens and levies not only cause economic hardship to individual and business taxpayers, they even have the perverse effect of decreasing tax revenue and, correspondingly, increasing the Tax Gap.

I am a tax attorney with the law firm of Alvin Brown & Associates [2] and the founder of The IRS Forum, www.IRSForum.org,[3] a 501(c)(3) educational organization. I had a 27 year career in the Office of the IRS Chief Counsel. I have been representing taxpayers throughout the U.S. and abroad specializing in IRS controversies for more than a decade. With this experience within and outside of the IRS, I have valuable insight on current IRS practices that negatively impact both the collection of revenue and economic growth. My testimony reflects my personal experiences with the IRS representing taxpayers before the IRS. I will support the following statements:

- In many instances, IRS tax levies of salaries of taxpayers and gross income of businesses reduce the collection of tax revenue, destroy small businesses, cause the loss of jobs, and reduce tax compliance;
- In many instances, IRS tax liens also reduce tax revenue, destroy small businesses, cause the loss of jobs and reduce tax compliance.
- The Subcommittee's annual review of the IRS fiscal year budget proposal, with testimony from the IRS Commissioner, while important, does not assure effective IRS oversight because the Subcommittee does not have access to sufficient data to independently evaluate the operations and activities of the IRS. Greater transparency of IRS operations and activities is necessary for effective oversight of the IRS. There is ample available data that could provide transparency of IRS practices in its administration of the tax law, but it has not yet been compiled in an accessible database.
- The Subcommittee would be assisted in providing more effective IRS oversight if it could reference a data base of taxpayer complaints about IRS abuses of power, abuses of discretion, misapplication of law, and even misconduct. If the individual taxpayer complaints to Members of Congress were saved and combined, organized by issue, and uploaded into a permanent data base, the Subcommittee would have important data to provide needed IRS transparency and result in more effective IRS oversight. Such organized data are necessary to identify IRS positions and practices that have a negative impact on the economy and on the collection of tax revenue.
- The National Taxpayer Advocate does not effectively use its authority to issue Taxpayer Assistance Offers under section 7811(a) to impede IRS abuses of power and abuses of discretion.

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[1] Section 301.6342–1(b)(4)(i) of the Income Tax Regulations states the general rule that a levy creates an "economic hardship" if the levy, "in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses."

[2] 9667B Main Street, Fairfax, VA 22031 (703) 425–1400 ab@irstaxattorney.com.

[3] The IRS Forum offers an internet platform for taxpayers to voluntarily upload their IRS experiences by issue. The objective of the IRS Forum is to provide IRS "transparency" with a national data base of actual taxpayer interactions with the IRS. A perpetual data base of taxpayer experiences with the IRS will provide educational insight on IRS operational and administrative practices.

Counterproductive Tax Liens

Section 6321 of the Internal Revenue Code creates an unperfected (statutory) tax lien on taxpayers in cases where there is an unpaid tax debt. The IRS thereafter has the plenary discretion to file the Notice of Filing of Tax Lien (NFTL) in the public records. The NFTL is immediately picked up by the credit agencies in their credit reports. The tax lien will not be released until the tax debt is paid or otherwise discharged. The credit agencies keep a record of the tax lien on the taxpayer's credit report during the period that the tax debt remains unpaid and for seven years after the tax debt is released or discharged. The NFTL has severe negative economic consequences on individual and business taxpayers often initially and long after any tax obligation is resolved.

The IRS criteria for filing tax liens is found in the Internal Revenue Manual (IRM) 5.12.2.4.1 (05–20–2005). The IRM requires a filing of a NFTL if the unpaid balance of assessment (UBA) is $5,000 or more. Even where a taxpayer has offered to pay in full the UBA in an Installment Agreement (including interest and penalties), the IRS mandates the filing of an NFTL.

A mandatory NFTL, in effect, is in conflict with the intent of Congress to make the NFTL discretionary. IRM 5.12.2.4.1 requires the NFTL without taking into account whether or not the tax lien will cause an economic hardship or reduce taxable revenue. My personal experience with IRS Revenue Officers is that they will file a an NFTL even when they know it will cause irreparable economic harm to an individual or business taxpayer because they believe they are mandated to file the NFTL by the IRM despite the Congressional statute to the contrary.

The underlying tax policy for IRS tax liens is to protect the standing of the IRS as a creditor over other future creditors. That tax policy is not served where an individual taxpayer has limited assets, owns no real estate and has limited income that is only sufficient for reasonable and necessary living expenses. That tax policy is not served if the result of an NFTL is a large loss of current and future income for individual and business taxpayers.

An NFTL filed in the public records is devastating to individual taxpayers. We live at a time where there is immediate access to credit reports. Landlords will often not rent an apartment to a taxpayer with an NFTL. Increasingly, employers will not hire a taxpayer with an NFTL, and some employers will dismiss an existing employee with an NFTL. The reduction of taxable income caused by an unnecessary NFTL undercuts the ability of a taxpayer to pay his or her outstanding tax liability. For that reason, this IRS practice actually reduces revenue and expands the Tax Gap.

When an NFTL is filed on a business, current lenders often withdraw financing (e.g., account receivable factors), and the business will not be able to get credit for inventory and supplies. Business customers often terminate their business relationship immediately when they have notice that their supplier or service provider has an NFTL. The bad credit caused by an NFTL means that the business will lose the ability to borrow money to purchase inventory or borrow to invest in further business growth. An NFTL is one of the largest factors contributing to the demise of small businesses. When the business closes, there is a loss of business income, a loss of tax revenue and a loss of jobs.

In small-asset situations and in the case of pure service providers (e.g., consultants and other professionals), an NFTL has no effect or purpose other than to ruin the credit of the service business taxpayers. Insurance companies will not accept contracts from an insurance broker with an NFTL. Stock brokers will lose licenses as the result of an NFTL. The Department of Defense will not do business with an individual or a business with an NFTL and will also refuse to renew an existing contract. Without real estate or other large assets, the purpose for an NFTL, to give the IRS a security interest in assets, is not met. In these cases the NFTL causes a loss of employment, a loss of business income, creates economic hardship, and discourages tax compliance with a resulting negative impact on the Tax Gap. Taxpayers incurring economic hardship as the result of an NFTL may join the underground economy and not be tax compliant.

It is counterproductive to file tax liens on taxpayers who are willing to pay their tax debt in full, including interest and penalties in an Installment Agreement. In Installment Agreement cases, individuals and businesses are penalized with a mandatory NFTL even though they want to pay their outstanding tax debt in full because of the NFTL. A loss of business due to the NFTL diminishes the ability of a taxpayer to make the Installment Agreement payments.

If an NFTL is filed when an Offer in Compromise (OIC) for a business is under active consideration, the resulting loss of business income will correspondingly re-

duce the amount needed to pay the IRS to settle the outstanding business tax debt because business income is considered in the settlement calculations.

The economic damage caused by an unnecessary and economically counterproductive tax lien is inconsistent with the Mission Statement of the IRS to apply the tax law with "fairness" and with "integrity." It is senseless for the IRM to mandate an NFTL without measuring whether the economic damage or hardship caused by the NFTL outweighs the benefit of the NFTL. There is no current legislative threshold or "safe harbor" to prevent an economically counterproductive NFTL. My comment in this matter only applies to situations where the NFTL is not justified. Obviously, there are situations where the NFTL is needed to protect the creditor status of the U.S.

An NFTL can be appealed under section 6320 and section 6630 for a collection due process or equivalency hearing. The problem is that these statutes do not offer NFTL relief; they merely provide collection alternatives such as the filing of an OIC or an Installment Agreement. There is an anomaly that section 6320 and section 6330 provide an opportunity to appeal an NFTL but no opportunity to ask for a tax lien withdrawal even if the tax lien is causing an economic hardship and a loss of income. Collection due process appeals under section 6330 provide no relief even when an NFTL is causing an economic hardship. The discretion of the IRS to withdraw a tax lien under section 6323(j) is rare and unusual. Although the National Taxpayer Advocate (NTA) has been granted the authority to stop a "significant hardship" under section 7811, that authority is underused, rare, unusual and difficult to achieve on any tax lien issue.

Section 7811(a)[4] of the Code permits the NTA to stop a "hardship" with a Taxpayer Assistance Order (TAO) as the result of the manner in which the internal revenue laws are being administered by the IRS. Notwithstanding, a TAO is not used on tax lien issues under the authority of the "hardship" language of section 7811. Instead the NTA involvement with tax lien issues is considered, if at all, for tax lien withdrawal requests under section 6323(j)(1)(D) with the consent of personnel at the centralized IRS lien office. The NTA defers to the IRS centralized lien offices to resolve tax lien withdrawal matters. The IRS consent to a tax lien withdrawal is rare and unusual (e.g., situations where there has been an error or mistake in filing the NFTL). The NTA does not use its authority under section 7811 to consider tax lien "hardships" and make determinations independent of the IRS centralized lien office in requests for lien withdrawals. The function of the NTA as an ombudsman on tax lien matters is inert and inconsistent with Congressional intent under section 7811 to use a TAO when there is a "significant hardship" and irreparable injury to taxpayers. I cannot think of greater irreparable harm than the loss of businesses, jobs and taxable revenue resulting from an NFTL when the interest of the U.S. as a creditor is economically insubstantial in contrast to the economic damage caused to individual and business taxpayers as is the case, for example, in pure service businesses.

Counterproductive tax levies

The tax policy of section 6343(a)(2)(D) to prevent or stop a levy in the case of an "economic hardship" is explicit and unqualified. Congress prohibits[5] a tax levy if the levy denies a family, food, housing transportation, medicine, health insurance, child care, court ordered payments, and other reasonable and necessary living expenses. Families in an "economic hardship" situation cannot be tax compliant. If there is a choice between food and taxes, the election will always be to feed the family. On the other hand, if taxpayers have sufficient assets and income for their necessary expenses, they are able to seek gainful employment and contribute to the tax revenue base. Taxpayers frequently quit their job when a levy on wages causes an economic hardship. My testimony today is that in almost every IRS levy of income, the IRS Revenue Officer levy invariably creates a taxpayer "economic hardship" within the meaning of section 6343(a)(2)(D) for two reasons: (1) levies on income from employment and levies on accounts receivable are continuous; and (2) the IRS sends the employer Publication 1494[6] which lists the amount exempt from income under

[4] Under section 7811(a)(1)(A) the NTA has the authority to issue a Taxpayer Assistance Order if "the National Taxpayer Advocate determines the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary * * *." Section 7811(a)(3)(D) a "significant hardship" includes "irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted."

[5] Through section 301.6343–1(b)(4) of legislative regulations under 6343(a)(2)(D).

[6] Last published in 2007.

section 6634.[7] The amounts exempt from levy under section 6664 are minimal amounts unrelated to the amounts that cannot be levied under section 6343(a)(2)(D). When employers receive Publication 1494 from the IRS, the employers erroneously believe that the levy is for all amounts that exceed the section 6634 limitations because the IRS does not also give employers instructions that will create a prohibited "economic hardship" precluded by section 6343(a)(2)(D). For this reason IRS continuous levies of wages will generally create a taxpayer "economic hardship" in conflict with the intent of Congress under section 6343(a)(2)(D). In these circumstances taxpayers often elect to work in the underground economy and avoid future tax compliance. These dire consequences result when the IRS refuses to follow the unqualified legislative mandate of section 6343(a)(2)(D). The willful failure to comply with the "economic prohibition" of 6343(a)(2)(D) is an "unlawful" act.[8] That unlawful act is not prohibited by either IRS management or the NTA.

Almost all businesses will fail if the IRS files a continuous levy on accounts receivable. Gross income is needed for taxes, payroll, and other administrative and operating expenses. A levy on gross income will usually force a business to discharge all employees and cease operations leaving an unpaid tax debt. A levy can be appealed but the business will normally be irreparably damaged before the three to six months it takes to schedule a levy appeal.

Levies on bank accounts can also be economically counterproductive. Although the bank account levies are one-time only levies and capture only the amount in the account at the time of the levy, levies can be made on the same account repeatedly at the discretion of the IRS Revenue Officer. In the case of a business bank account, the levy often takes money deposited for payroll, taxes and other necessary business administrative and operational expenses. A bank account levy on a business bank account can put it out of business resulting in a loss of jobs and taxable income.

The NTA and the IRS have taken the position that a business cannot have an "economic hardship" within the meaning of section 6343(a)(2)(D). This position apparently came from TD 9007 that published the final OIC regulations on July 23, 2002. TD 9997 states that the economic hardship standard of section 301.6343–1 on the regulations "specifically applies only to individuals." The IRS position in TD 9007 is wrong because section 6343(a)(2)(D) does not distinguish between individual and business "economic hardship" and further because of § 301.6343–1(a) is expressly limited by the term *in general.* The "in general" preface does not exclude a business hardship. It is patently absurd for the IRS and the NTA to take a position that a business cannot have an economic hardship.

Levies can be appealed under section 6330 and that appeal, if made timely, will stop collection action. In the appeal, the Taxpayer can submit an OIC or an Installment Agreement as an alternative to the collection action. However, under section 6330(c)(2)(B), the underlying tax liability may not be raised as a basis for appeal unless the taxpayer did not receive a statutory notice of deficiency or did not otherwise have an opportunity to dispute the tax liability. The limitation to challenge the underlying liability in section 6330(c)(2)(B) is inconsistent with the fact that a taxpayer is always able to challenge the underlying tax liability in an OIC under the plain language of section 7122(a). Further, the IRS will permit "audit reconsideration." The advantage of raising a liability issue under section 6330 is that the discretion of the IRS is subject to judicial review for "abuse of discretion" whereas there is no judicial review for an OIC.

Taxpayers are often not represented or underrepresented when tax assessments are made. I have frequently found tax issues that should have been raised had there been competent representation. In the best interest of helping individual and business taxpayers who may have an erroneous tax assessment that results in an inappropriate tax levy, taxpayers should be allowed to raise substantive issues in a section 6330 appeal even if there has been prior consideration of the substantive issues. Although section 6330(c)(2)(A)(iii) allows an OIC to be submitted, the IRS will not permit an OIC based on "doubt as to liability." That limitation on IRS appeals of a tax levy is incorrect because the statute does not distinguish between the different types of OICs. Further, the language of section 6330(c)(2)(A)(iii) is not modified by the limitations of section 6330(c)(2)(B).

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[7] Section 6634 of the Code identifies property exempt from levy. The exclusion includes clothing, tools and other items including the minimum exclusion from income under section 6634(d). The small section 6634 exclusions from levy are unrelated to the "economic hardship" prohibition under 6343(a)(2)(D).

[8] Section 7214(a)(3) makes it an "unlawful act" when an IRS willfully fails to comply with a tax statute. Any unlawful act requires mandatory dismissal from the IRS and subject that employee to a fine of up to $10,000.

The NTA does not use its authority to issue a TAO in levy and tax lien hardship cases.[9] My office has literally filed hundreds of Forms 911, a request for a TAO, and no TAO has ever been issued in any of those cases even when the economic hardship caused by a levy is irreparable and clear "misconduct" within the meaning of 7214(a)(3). Instead the NTA attempts to orally persuade IRS Revenue Officers to stop levies that create an economic hardship. That advocacy style intervention does not always work when Revenue Officers and their managers refuse to release a levy even when they know the levy will close a business or cause an economic hardship to an individual. The refusal of the NTA to issue a TAO in "significant hardship" cases is in conflict with the legislative intent of Congress to use a TAO as a tool to intercede in those circumstances. The underutilized TAO has the obvious effect of reducing taxable revenue caused by closed businesses and lost jobs. In these instances the NTA does not stop clear IRS "misconduct."

The problems described above in tax lien and tax levy hardship cases, and the resulting loss of tax revenue, can be ameliorated in large part if the NTA consents to use a TAO as intended by Congress under section 7811. Every Form 911 should result in an expeditious TAO if a TAO is justified at the discretion of the NTA to conform with the intent of Congress to have the NTA use its power as ombudsman for taxpayers. The NTA condones IRS misconduct if it does nothing to stop IRS misconduct on "economic hardship" issues precluded by 6343(a)(2)(D).

The Need for IRS "Transparency" to Facilitate IRS Oversight

My testimony today highlights the need for improved IRS transparency and oversight on a daily basis rather than at the time of the annual oversight review by the Subcommittee of the IRS fiscal year budget. The economically counterproductive activities of the IRS that I have identified in this testimony would likely not occur if visible to Congress, the media and the public.

The Internal Revenue Code quite properly limits disclosure of its interaction with a taxpayer.[10] The privacy of a taxpayer is protected by law. For this reason nobody knows what actions the IRS takes except the IRS, the taxpayer, the taxpayer's representative, and in some cases the NTA. However, taxpayers can voluntarily reveal their IRS experiences with or without disclosing their identity.

"Transparency"—National Data Base—Voluntary Taxpayer Submissions

It is fair to say that every Member of Congress gets complaints about the IRS regularly. Constituents complain about IRS abuses of power, IRS misconduct, erroneous applications of law, and hardship. However, these data are not saved; becoming wasted data. The complaint traffic to the NTA is also wasted data. There is no national data base for IRS complaints. Obviously, the IRS will be hesitant to be overly aggressive on a tax matter or to engage in the counterproductive practices I have described if IRS actions were more transparent to the public, to the media, and to Congress.

The Subcommittee on Oversight will be able to execute its oversight function over the IRS more effectively if it has access to a national data base reflecting IRS interactions with taxpayers. Taxpayers throughout the U.S. voluntarily voice their IRS experiences constantly to all Members of Congress as well as to the members of this Subcommittee. That empirical data is available but it is neither organized nor saved. There is also no platform to upload that data to a combined data base. Such a national data base of taxpayer and constituent experiences, if collected, organized by issue and analyzed would give this Subcommittee and Congress the IRS transparency that is presently lacking.

The IRS Forum as a Vehicle to Provide IRS Transparency and Oversight

The IRS Forum has been approved by the IRS as a 501(c)(3) educational organization. The IRS Forum has a presence on the internet at www.irsforum.org to encourage the uploading of the experiences of taxpayers with the IRS. The sole purpose of this is to provide IRS transparency to facilitate oversight of the IRS.

The IRS Forum provides an internet portal for taxpayers to record and discuss their IRS experiences with other taxpayers who have suffered with the same or similar abusive experiences. Individual taxpayers will be able to facilitate positive changes in the IRS by joining with hundreds and thousands of other taxpayers with

[9] IRM 13.1.2.D (12–15–2007), requires a TAO in stalemate situations involving a "significant hardship."

[10] Section 6103.

similar experiences and similar issues into a unified national voice of sufficient magnitude to get the attention of the media, top management of the IRS, and the Congress for constructive changes in the law and the administration of the tax law. Taxpayers are thereby empowered.

At the IRS Forum, with a platform to upload experiences, taxpayers can fully discuss their IRS experiences along with the factual and legal issues considered by the IRS. This transparency will put the spotlight on IRS practices and encourage the IRS to treat taxpayers with integrity and fairness.

In particular, the IRS Forum data base has important potential benefits for Members of Congress:

- The IRS Forum will accumulate constituent data that would otherwise not be saved.
- To the extent that constituents vent their IRS complaints directly to the IRS Forum, that action will free up more Member and staff time for their legislative responsibilities.
- Actual case histories of IRS administrative and operational problems create "talking points" for tax simplification or tax reform.
- Constituent problems and complaints about the IRS have far greater impact when they join with a larger group with similar issues at the IRS Forum.
- Transparency of IRS operations enhances the ability of the Subcommittee on Oversight to identify IRS abuses of power, abuses of discretion, and misapplication of the law. For example, the tax lien and tax levy abuses discussed above would be identified from voluntary submissions of cases of these abuses by taxpayers to the national data base.
- When the data hits critical mass, it will get the attention of the media, the public and Congress for possible corrective legislation.
- When tax legislation is being considered, that data base in the IRS Forum could be searched for information and guidance.

In addition, the transparency of the accumulative data will be educational for all taxpayers and constituents.

The non-partisan IRS Forum is not a commercial venture. There are no membership fees, and the IRS Forum does not accept advertising. The IRS Forum functions only as a non-profit educational organization on IRS positions and administrative practices.

The Immediate Goal of the IRS Forum: to provide assistance to the Congress in conducting oversight of the IRS by accumulating and making publicly available data regarding IRS practices. To facilitate the accumulation of that data, the members of the Subcommittee on Oversight, other Members of the House Committee on Ways and Means, and other members of the House and Senate are encouraged to **refer constituent IRS complaint traffic to the IRS Forum. That cooperation would** help in building a permanent institutional data base of taxpayer experiences with the IRS to facilitate IRS transparency and oversight.

Summary

I thank the Chairman and this Committee for receiving this testimony. From my personal experiences in dealing with the IRS on behalf of clients, I have identified IRS administrative practices dealing with tax liens and tax levies that reduce the collection of tax revenue, increase the Tax Gap, create economic hardship for taxpayers, contribute to a loss of jobs, result in business failures, and conflict with sound tax policy. Correction of these counterproductive practices by the IRS will operate as a "revenue raiser" that will assist in reducing the Tax Gap and have a positive impact on the economy.

I believe it is important for the NTA to change its procedures to use a TAO for every significant economic hardship. I have also made some suggestions to improve the rights of taxpayers in collection due process appeals and also broaden the issues that can be petitioned to the Tax Court.

IRS oversight by the Subcommittee will be significantly enhanced with improved IRS transparency from a permanent national data base with information voluntarily uploaded by taxpayers to the IRS Forum. With guidance from the Subcommittee, I am willing to modify the IRS Forum in any way that would help serve the non-partisan oversight objectives of the Subcommittee and the constituents of all Members of Congress. It is also helpful to the U.S. public to have a platform to learn about tax issues. The simple idea of a permanent data base on the internet managed by the IRS Forum is an elegant way to improve IRS transparency and oversight and serve its educational purposes. The IRS Forum can meet all of its educational objectives if Members of Congress elect to inform constituents, complaining

about the IRS, that they can upload those experiences to the IRS Forum and gain the benefit of interacting with other taxpayers with similar issues and at the same time, help make the IRS transparent and also help make their experiences part of an important data base.

Given my long history of dealing with the IRS as a manager in the Office of the IRS Chief Counsel and also in representing taxpayers before the IRS, I would be pleased to make myself available to the Subcommittee and its staff on any of the issues discussed in this testimony, the IRS Forum, and on any other IRS matter including some suggestions for revenue raisers that can improve tax compliance.

Respectfully submitted,

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Colleen M. Kelley, Statement

Chairman Lewis, Ranking Member Boustany, and distinguished members of the Subcommittee, I would like to thank you for allowing me to provide comments on the Administration's FY 2010 budget request for the Internal Revenue Service(IRS). As President of the National Treasury Employees Union (NTEU), I have the honor of representing over 150,000 federal workers in 31 agencies, including the men and women at the IRS.

IRS FY 2010 Budget Request

Mr. Chairman, NTEU strongly supports the Administration's FY 2010 budget request of $12.1 billion for the IRS, a roughly $600 million increase over FY 2009 levels. We believe that the President's request will allow the IRS to continue providing taxpayers with top quality service and will assist efforts to enhance taxpayer compliance and close the tax gap.

We are particularly pleased the Administration's budget request would provide $5.5 billion for IRS tax enforcement, including additional resources made available through a program integrity allocation adjustment. According to the Administration, IRS enforcement efforts recoup $5 for every $1 dollar invested and the program integrity savings from increased investment for IRS enforcement efforts will be more than $13 billion between 2010–2014.

We are also pleased to see the recently passed budget resolution fully funds the President's budget request for the IRS and includes the President's request for additional resources for IRS tax-law enforcement.

I would also note that in previous years, NTEU has supported the budget recommendations proposed by the IRS Oversight Board which have generally called for additional resources above that requested by the Administration. For FY 2010, the Oversight Board has recommended $12.961 billion in funding for the IRS. While we have not seen the specific details of the Board's updated proposal, we would be inclined to support providing additional funding for the IRS above the Administration's request and look forward to reviewing the Board's final recommendation.

Major Challenges

Mr. Chairman, NTEU believes the President's request will allow the IRS to meet its customer service and enforcement challenges while also addressing some of the most immediate challenges it will face in the coming years, including the growing human capital crisis, increasing complexity of tax administration, and a burgeoning tax gap.

Human Capital Crisis

NTEU believes that IRS employees are the most valuable asset in effective tax administration. We are glad to see that the IRS Strategic Plan for 2009–2013 recognizes this fact and stresses the importance of investing in the workforce in order to achieve its service and enforcement goals. But as the IRS notes, they face several major challenges such as large numbers of retirements and competition with both the public and private sectors for critical talent. According to the IRS, more than half of IRS employees and managers are age 50 or older. The expected large scale retirements of thousands of Service personnel over the next several years will only further deplete the decimated IRS workforce that is down by more than 23,000 since 1995. According to a report by the IRS Oversight Board, an independent body

charged with providing IRS with long-term guidance and direction, roughly 4,000 IRS employees a year for the next four years are expected to retire, taking with them years of experience and valuable skills. The dramatic decline in staffing levels coupled with the pending retirement wave has caused the Oversight Board to identify human capital issues as one the most important strategic challenges facing the IRS.

In the face of an aging workforce and looming wave of retirements, Commissioner Shulman created the Workforce of Tomorrow task force to ensure that in five years the IRS has the leadership and workforce ready for the next 15 years and to help make the IRS the best place to work in government.

NTEU was happy to see that the President's budget request acknowledges the human capital crisis at the Service and provides for major increases in Service staffing, particularly in the area of enforcement. According to the Administration, the new enforcement personnel funded in the President's budget will generate $2.0 billion in additional annual enforcement revenue once the new hires reach full potential in FY 2012.

Increasing Complexity of Tax Administration

Under the President's budget request, the IRS will also be better equipped to handle the challenges associated with the increasingly complexity of tax administration. For example, one of the biggest challenges the IRS confronts each year is identifying new tax law and administrative changes as well as expiring tax provisions. According to the IRS, in 2007 alone, 41 tax provisions expired affecting a wide range of taxpayers.

During the 2009 Filing Season, the IRS was presented with additional challenges due to the enactment of two significant new tax laws, the "Housing and Economic Recovery Act of 2008," which includes a refundable homebuyer credit as well as an additional standard deduction for real property taxes, as well as the "Emergency Economic Stabilization Act of 2008," which included 116 different tax provisions.

In the future, the IRS will also be confronted with the challenges presented by the increasing globalization of individual taxpayers and businesses. As more and more U.S. taxpayers and businesses expand into global markets, it will be important that the IRS has the technical expertise to identify and understand the proliferation of complex international activities and the emerging global nature of tax administration.

Tax Gap

Recent and projected large federal budget deficits have generated congressional and executive branch interest in raising revenue by reducing the tax gap, that is, the difference between what taxpayers should have paid and what they actually paid on a timely basis. For tax year 2001, the IRS estimated a gross tax gap of $345 billion, equal to a noncompliance rate of 16.3 percent.

NTEU believes that efforts to close the tax gap must focus on improving compliance activities and enhancing taxpayer service. By improving document matching, examination, and collection activities, the IRS will be better able to prevent, detect, and remedy noncompliance. And providing taxpayers with assistance and clear and accurate information before they file their tax returns will help reduce unnecessary contacts afterwards, allowing IRS to focus enforcement resources on taxpayers who are intentionally evading their tax obligations.

In addition to generating additional revenue for the federal government, reducing the tax gap will help strengthen public trust in the fairness of the tax system which will positively impact voluntary compliance with tax laws.

That is why NTEU supports the President's request for an additional $332 million to help close the tax gap by strengthening compliance and allowing the IRS to better address the main components of the tax gap including, underreporting, non-filing and underpayment.

Enforcement

Mr. Chairman, as you know enforcement of the tax laws is an integral component of IRS' effort to enhance voluntary compliance and close the tax gap. IRS enforcement activities, such as examination and collection, target elements of the tax gap and are a high priority for the Service. In FY 2008, the IRS initiated additional information reporting requirements for large partnerships and foreign corporations, soft notices and self-correction to improve compliance.

These efforts helped the IRS bring in $56.4 billion in enforcement revenue in 2008, a 65 percent increase over FY 2002. The $56.4 billion in collections in 2008

represents a 5 to 1 return on investment for all IRS activities. In addition, the IRS showed consistent improvement in its enforcement results meeting or exceeding 78 percent (14 of 18) of its program targets.

Most impressively, the IRS continues to bring in record amounts of enforcement revenue despite severe cuts to enforcement staffing over the past 13 years. In particular, the number of revenue officers and revenue agents—two groups critical to closing the tax gap and thereby reducing the federal budget deficit—have shrunk by 33 and 20 percent respectively. Revenue officers went from 8,139 to 5,481 and revenue agents fell from 16,078 to 12,951. As noted previously, these drastic cuts have come at a time when the IRS workload has increased dramatically due to the increasing complexity of tax administration.

NTEU believes it is essential that the IRS continue to direct resources toward enforcement activities that have the greatest overall impact on compliance and can best aid the Service's efforts to close the tax gap. One such activity is the IRS Automated Underreporter (AUR) program which has evolved as an important Service compliance initiative using third-party information returns to identify income and deductions that were not reported on tax returns. NTEU believes the program is an effective way to detect taxpayer underreporting which accounts for roughly 82 percent of the gross tax gap.

In FY '08, increased AUR contact closures increased by almost 4 percent from the previous year and dollars collected through AUR and information return processing increased by 22 percent.

The Administration's budget request acknowledges the import role the AUR program can have in closing the tax gap by reducing the number of taxpayers who underreport their income and proposes an increase of $26.2 million and 300 FTE to increase coverage of the AUR document matching program. According to the Administration, this request will generate $386.5 million in additional revenue once new hires reach full potential in FY 2012 resulting in a return on investment (ROI) of 17 to 1.

Taxpayer Service

Mr. Chairman, NTEU strongly believes that providing quality customer service to the taxpayer is an important part of IRS efforts to help the taxpaying public understand their tax obligations while making it easier to participate in the tax system. Through many sources, the IRS provides year-round assistance to millions of taxpayers, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, the IRS.gov web site, Taxpayer Assistance Centers (TACs), Volunteer Income Tax Assistance (VITA) sites, and Tax Counseling for the Elderly (TCE) sites. These efforts have helped the IRS raise their standard of service to America's taxpayers and assisted in efforts to improve voluntary compliance. The IRS has continued to make great strides in recent years in the quality of the service it provides despite relatively flat budgets, that when adjusted for inflation, have provided the IRS with fewer resources over the past several years compared to FY2002.

But despite receiving fewer resources and continued reductions in the number of customer service representatives at the Service, the IRS was able to deliver a successful 2008 filing season. As you know, the 2008 filing season was particularly challenging due to late enactment of the AMT legislation and implementation of the Economic Stimulus Payment program. Despite these challenges, the IRS carried out another successful filing season during which IRS employees processed more than 155 million individual returns including returns filed solely to claim an economic stimulus payment, an increase of 11 percent over last year and issued 107.6 million refunds, totaling $369 billion; answered over 40.4 million calls, an increase of 21 percent due to a large increase in taxpayer inquiries about the economic stimulus checks; completed 52 million automated calls, an increase of over 123 percent; maintained account and tax law accuracy rates of over 90 percent and expanded return preparation at IRS Taxpayer Assistance Centers (TACs) preparing over 575,000 returns, a 42 percent increase over last year.

Mr. Chairman, while IRS employees were able to continue providing quality service to taxpayers in FY 2008, we do have concerns about the potential negative effect on IRS' ability to continue doing so should the "efficiency savings" assumed in the Administration's budget request not materialize. For FY 2010, the budget request identifies "efficiency savings" of more than $118 million at the cost of 1,504 FTE's. If, as sometimes been the case in previous years, IRS fails to realize all expected savings then the funds available for critical Service personnel, such as those working at the 401TACs located nationwide, would be further reduced.

As stated previously, NTEU strongly believes providing quality service to taxpayers is critical to ensuring taxpayers understand their tax obligations while making it easier for them to participate in the tax system. And in the current economic climate, we believe it is more important than ever that taxpayers be able to deal with the IRS directly to work through any financial difficulties they may encounter. IRS employees have a wide range of tools and information at their disposal, which allow them to work with taxpayers to address their financial hardships and to become compliant.

Above all else, the IRS employee's interest is in assisting struggling taxpayers to meet their tax obligations in a way that will not exacerbate their financial distress. When an IRS employee works with a taxpayer, the employee has access to all of the taxpayer's information and can answer questions and offer advice. For example, they can see whether a taxpayer has not filed a return and explain that the sooner the taxpayer makes arrangements to address filing and balance due issues the less penalty and interest they will owe. They can look at the taxpayer's records and answer questions about why they owe a balance and what they can do about it. They can also tell the taxpayer that they are not having enough taxes withheld by their employer and need to address that or that if an ex-spouse is claiming a child as a dependent they will not also be able to receive an exemption. If a simple mistake, like a math error, has occurred, they can fix it. They can provide an extension of the time period for payment. They can make a determination that the taxpayer meets the currently not collectible requirements or whether the taxpayer may be eligible for an Offer in Compromise, in which part of the balance due is forgone.

NTEU believes providing quality services to taxpayers is an important part of any overall strategy to improve compliance and that the President's request for taxpayer services will enable the IRS to deliver another successful filing season, improve the responsiveness and accuracy of taxpayer service, and support Service efforts to enhance taxpayer compliance.

Section 1203

Mr. Chairman, while meaningful funding for the IRS is important to operations, NTEU also believes that in order to maximize efficiencies at the IRS, Congress must act to modify Section 1203 of the IRS Restructuring and Reform Act of 1988 (RRA 98). Commonly known as the "Ten Deadly Sins," Section 1203 outlines ten infractions for which IRS employees must be fired, including the untimely filing of federal income taxes even when a refund is due. No other federal or congressional employee is subject to similar mandatory termination.

Without question, Section 1203 has had a negative impact on the morale of the IRS workforce and is impeding the ability of the IRS to perform its mission. According to numerous GAO reports, IRS employees greatly fear the threat of being fired under Section 1203. This in turn has had a chilling effect on the ability of IRS employees to do their jobs. In particular, employees specifically attribute the decrease in recommending a seizure of taxpayer's assets to Section 1203. Clearly, Section 1203 impedes IRS' enforcement mission and is unfair to the IRS employees who must work under the constant threat of losing their jobs.

NTEU believes mandatory termination for Section 1203 violations is unduly harsh and should not be the only disciplinary action available. We advocate amending RRA 98 to allow for appropriate penalties other than mandatory termination for Section 1203 violations and to allow for independent review of determinations.

To be clear, NTEU does not condone any violation of law or rules of conduct by its members at the IRS or in any other government agency. Violations of some rules clearly warrant termination of employment. However, one group of federal employees should not be singled out and required to be fired for offenses that do not subject other executive, judicial, or legislative branch employees to the same penalty.

Mr. Chairman, the large majority of IRS employees work hard, follow the rules and pay their taxes on time. It is patently unfair to hold those who are charged with enforcing the tax laws to a higher standard than those who write them. NTEU asks for your support for changes to Section 1203 of the IRS Reform and Restructuring Act, so that tax fairness applies to all Americans, even those who work at the IRS.

Conclusion

Mr. Chairman, thank you for the opportunity to provide NTEU's thoughts on the Administration's FY 2010 budget request for the IRS. We believe that by investing in the IRS workforce and demonstrably effective enforcement and taxpayer service programs, the Administration's request will ensure the IRS continues to meet its mission of providing America's taxpayers top quality service by helping them under-

stand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Mark R. Secrist, Statement

Chairman Lewis, Ranking Member Boustany and Members of the Subcommittee on Oversight, thank you for this opportunity to participate in these discussions concerning the efforts made by the IRS to assist economically distressed taxpayers. I am most fortunate to have been born in the United States, and I have grown to appreciate the tremendous blessing it is to be a citizen. I enlisted in the Army in 1973 during the Vietnam conflict. I received an appointment to the United States Military Academy at West Point. I received a commission as a 2nd Lieutenant in the Marine Corps and served as a C–130 tanker pilot. I am currently living in Winchester, Virginia with my wife and six children. I am also serving as a pilot for a major commercial airline. I consider it an honor and a duty to pay taxes for the operation of this country as I have always done, and I am pleased to read Commissioner Shulman's comments when he remarked:

> **"We need to ensure that we balance our responsibility to enforce the law with the economic realities facing many American citizens today. We want to go the extra mile to help taxpayers, especially those who've done the right thing in the past and are facing unusual hardships."**

Contrary to the statement of Commissioner Shulman, my testimony today is that the IRS has misapplied tax law and has even broken law as I will document to the Subcommittee. My testimony today will illustrate astonishing misapplication of the facts and the law that does not take into account the IRS Mission Statement to apply the tax law with "integrity" and "fairness."

This is a time that is very stressful for my family and me. I am facing a most unusual hardship caused by extraordinary misapplication of the law by the IRS arising out of the fact that I am a victim of an offshore Ponzi scheme. I am 54 years old, I have had a flawless record in paying my taxes and fulfilling my tax obligations to this wonderful country, but the "unthinkabl" has happened. I was financially destroyed by white-collar criminals, on the island of St. Kitts, who were running a complex and elaborate Ponzi scheme that hurt me and many other US citizens as well. In exchange for $300,000, sourced from refinancing my home, I was promised 20 percent interest. The $300,000 was embezzled. The problem has been exacerbated by an IRS examination which resulted in approximately $1.1 million in section 6677 penalties on the money that was embezzled. The IRS also assessed a 75 percent penalty for civil fraud for making contributions to two 501(c)(3) approved churches. I believe that the Subcommittee and Commissioner Schulman need to know the facts about IRS misconduct in this matter.

General Statement of the Issues for the Subcommittee.

I got caught up in an offshore Ponzi scheme operated by Administrative Services Limited (ASL) and its successor in interest (BMT). Each of these companies, and others, were Kittitan entities set up, beneficially owned, and controlled by two Americans, Bill Gagnon and his wife, Mary Estes. I sent them approximately $300,000 in exchange for a 20 percent return. ASL would not let me invest the $300,000 unless I agreed to pay them for two foreign non-grantor trusts formed by ASL under St. Kitts law. The money was embezzled. I was assessed the 35 percent penalty under section 6677 for not filing a Form 3520 to report an interest in a foreign "grantor trust."

In order to assess the 6677 penalty, the IRS "deemed" a non-grantor trust to be a grantor trust. The 6677 penalty was assessed even though the Department of Justice stated that the trusts formed by ASL were "sham" trusts. The penalty was assessed even though the High Court of St. Kitts has held that I was a victim of fraud and that ASL and others conducted a Ponzi scheme. The penalty was applied even though the "deemed" grantor trusts are void from their inception under the law of St. Kitts. The penalty was assessed even though there is court testimony from ASL insiders that my money never got into a foreign trust. The penalty was assessed even though I have demonstrated "reasonable cause" under section 6677(d) that included full due diligence, reliance on a CPA, reliance on a private ruling letter from IRS Puerto Rico, reliance on Kittitian Attorneys Inniss and Inniss, reliance on State Department Website commenting on the development of the Gagnon Resort, and reliance on two expert tax attorneys. The penalty was assessed because the IRS took

the view that a "sham trust" can be deemed to be a valid trust so that the IRS could assess the 6677 penalty for not reporting an interest in a foreign grantor trust. If that were not enough, I have been assessed tax on the 20 percent interest income that I did not receive even though the IRS knows that the money was embezzled. I was also hit with a 75 percent civil fraud penalty for making documented contributions to two 501(c)(3) churches located in the U.S. I also want the Subcommittee to know that this matter was brought to the attention of the National Taxpayer Advocate on the issue of whether the IRS can take the inconsistent position of deeming a sham trust to be a valid trust solely for the purpose of assessing the 6677 penalty. The National Taxpayer Advocate considered the issue but elected to defer to the IRS examiners even though the position of the IRS on taking inconsistent positions is unpublished.

My testimony will illustrate abusive IRS examination tactics, and a refusal to follow the law. For that reason there is very serious IRS misconduct that I can document under the facts and under the law.

I can document the following facts:

1. The High Court of St. Kitts determined that ASL and BMT conducted a Ponzi scheme and that I am a victim of fraud.
2. The Department of Justice determined that ASL was a fraudulent tax shelter and that the trusts were sham trusts.
3. Investor data held in respect of over 100 US citizens was demanded and received by IRS examiners in this matter (William Everett and Louis Pacho, Manager) in violation of the MLAT Treaty between the US and St. Kitts. This data was demanded of BMT Ltd, a St. Kitts company with no place of business in the US. The IRS has no jurisdiction over BMT Ltd, yet despite this, Mr. Everett of the IRS purported to issue a summons against BMT Ltd, at BMT's request. Failure to follow the law is a serious issue under section 7214(a)(3) of the Code.
4. The IRS Examiners returned the data on 3 government CDs, with all of the private data of investors including social security numbers and bank account numbers. This data was returned to be used by ASL and BMT's owners and officers in their defense of a class action law suit in St. Kitts in which I was a claimant. The data was made available to third parties. The investors, whose data this was, had not consented to it being sent by the IRS to the third party concerned, one Janet Conway, an unlicensed private investigator based in Blue Bell, Pennsylvania; who was retained by BMT at one time. I believe that disclosure is prohibited by section 6103 and 7213 of the Code.
5. I reported the IRS misconduct for Everett's disclosures, to TIGTA. Incredibly, TIGTA did not find IRS misconduct when the IRS examiners sent off tax return data with the potential for identify theft to third parties, contrary to section 6103 and section 7213 of the Code.
6. The 3 CDs with confidential data were sent to BMT's investigator, Janet Conway, to help in its defense against me and other claimants. Since ASL and BMT were ultimately found to be liable to the claimants, the IRS examiners at minimum provided assistance to their efforts to avoid that liability.
7. I have a letter from Martin Kenney & Co, an English law firm which acts for me in St. Kitts, that states that the foreign trusts were void from their inception under the law of St. Kitts. The IRS has treated the Ponzi trusts as valid trusts solely for the purpose of assessing the 35 percent 6677 penalty on the money that was embezzled.
8. There is court testimony by insiders filed in my St. Kitts action, that most of the investor income was embezzled by Mr. Gagnon and his successors, and that Gagnon controlled entities kept false records to record the fictional 20 percent investment return.
9. The IRS and the case law conclude that in the case of abusive tax shelters, "substance" prevails over "form." For that reason I got in touch with the National Taxpayer Advocate for assistance on the 6677 penalty. There is no precedent for treating a "sham trust" as a trust solely for the purpose of filing the 6677 35 percent penalty. I argued that if the IRS wanted to take an inconsistent position and disregard a sham trust and then take a conflicting view that it is a trust, they should publish that position first. Otherwise, the IRS cannot meet its Mission Statement to apply the tax law with "integrity" and "fairness." The NTA took no action because the IRS said that they wanted to take this inconsistent position even though the IRS has not published that inconsistent position. The NTA deferred to the IRS examiners.

10. The section 6677 penalty can be abated for "reasonable cause" under section 6677(d). I raised substantial reasons for "reasonable cause" but the IRS refused to discuss any of the reasons for "reasonable cause" including reliance on a tax attorney with 40 years IRS experience who advised me that Form 3520 does not have to be filed if the foreign trust is a sham trust.
11. The IRS in Puerto Rico apparently provided a "Private Ruling Lette" to ASL, dated 8–23–98, from District Director Guaynabo, that states (1) The ASL trust structures are code compliant valid structures, (2) They are not a tax avoidance or evasion trust, (3) They are Non-Grantor Trust which are not reportable on Forms 3520/3520A.—(PRL) 19981007, letter 729 (Rev.7–97)

Chronological Statement of the Facts.

1. *In 1999, I picked up a flyer and a card at church from a neighbor who had just heard Mr. Bill Gagnon speak. Gagnon and his wife were the owners of ASL, a St. Kitts company. My neighbor said that Bill Gagnon was a Christian Minister businessman who was involved with the building and the construction of a resort project on the island of St. Kitts that was nearing completion. I was told that the resort was 85 percent rented out most of the time to people from the UK and other parts of the world, and that it was generating income for those who could invest in the project. I flew down to St. Kitts in 1999 to meet Mr. Gagnon personally. He acted in a very professional manner as he persuaded me to be a better steward of my money by investing it wisely. He introduced me to his staff, gave me a tour of the resort he was promoting for investment, and provided me an opportunity to stay in a room at the resort. I chose not to accept his offer to stay at the resort. I wanted to have more time to speak with him to learn all I could during my short visit and accepted his offer to stay at his home. During my visit he told me he was an ordained minister and that he had previously served as a missionary in Africa for over twenty years. I heard him passionately speak of spiritual matters and watched him lovingly care for his quadriplegic wife, Mary Estes, all of which made me to believe he was sincerely a man of God and could be trusted. I also saw the completed buildings with people in them. I toured the individual rooms that were filled with fine teak wood furniture and beautiful dcor immaculately maintained. I saw the buildings that were under construction with workers present, and I saw the blueprints for the entire project including the pool and restaurant.*

   Special notices were given to me by Brad Woodard (the CFO of ASL) informing me that a staff of attorneys and legal professionals were on the job and currently involved in maintaining trust documents for other clients, thus keeping us in full compliance with the US tax law. Mr. Brad Woodard, was held out as an expert accountant and would regularly communicate his analysis of U.S. tax laws to me. Mr. Woodard assured me that Mr. Gagnon's organization was U.S. tax compliant. A letter, dated 14 January 1999, by the respected and prominent St. Kitts law firm of 'Innis and Innis' stated that: "the trust document structures were legal and compliant with US tax law and IRS rules and regulations. They are Non-Grantor status according to three US CPA's, therefore no legal and no annual IRS 3520 or 3520A forms need to be filed." Even the Federation of St. Kitts government said the trusts were legal and compliant with US tax law and IRS regulations in a letter dated 12 April 1999, by GA Dwyer Astaphan, Minister. I've shown good faith, reasonable cause and reliance on professional counsel as I'm ignorant of the complexities associated with this type of trust.

   ASL was a St. Kitts Corporation that Mr. Gagnon claimed had a 'start to finish' plan for a complete package with the staff to walk me through it. I decided to invest also because Mr. Gagnon promised a 20 percent return on my investment. So convinced was I of ASL's knowledge, professionalism and legitimacy that under its guidance and direction I took out two equity loans on my house and sent two large checks into the Paradise Beach Investment totaling approximately $300,000.
2. *In order for me to invest, Mr. Gagnon said that everyone desiring the 20 percent return must have ASL create a foreign trust structure that involved one domestic trust and two foreign trust documents. Mr. Gagnon and the staff explained to me that I was not the owner of the trust, only the administrator of the trust.*
3. *A few years later, in 2001, Mr. Gagnon died from a heart attack. Mr. Gagnon's wife, Mary Estes, then assumed control of the Gagnon organization. Mary was*

a quadriplegic M.S. sufferer. She died in 2003. Shortly before Mary Estes' death, Roland Thomas took control of the Gagnon organization, including the resort complex. Mr. Thomas kept control until sometime in 2007. As a result of four years of hard fought litigation in St. Kitts, I and my co-claimant established that a constructive trust was impressed upon the Resort which Gagnon had used our money to buy and develop. Mr. Thomas denied knowledge of me and others, under oath, as a person(s) who had invested in the resort. Thomas hoped to get rid of the investors in ASL, so he would be able to keep the resort property without any obligations to me and the other ASL investors whose money was embezzled.

4. *I began a class action lawsuit in St. Kitts in 2003 against ASL, BMT and others. At the time I commenced my action, Roland Thomas was CEO of BMT. Mr. Thomas is a British citizen who I believe currently resides in the Las Vegas area. (BMT is a St. Kitts company with no presence in the U.S.) I am one of the lead claimants against BMT and others for recovery of the assets of BMT.*
5. In 2004, Judge Baptiste (a St. Kitts Judge) ordered BMT and Mr. Thomas, (the CEO of BMT in 2004) to produce the personal and financial records it held of myself (and the records of 125 other US citizens who had invested also) that were located on the property. These records would have proven my case against ASL, BMT and others. Mr. Thomas did not obey Judge Baptiste's court order. However, Mr. Thomas went back into the courtroom, seven days later, and testified before Judge Baptiste that, ***"There were no records to be found."*** —A direct lie.
6. To get around the Baptiste Order, Thomas called the IRS and made contact with Agent Louis Pacho (group manager) and Agent William Everett who worked for Mr. Pacho. These two federal employees coordinated with Mr. Thomas by supplying him with an IRS summons. The IRS summons was signed by Mr. Everett and was directed to Mr. Thomas as CEO of BMT. Under the MLAT Treaty between the US and St. Kitts, data held in St. Kitts can only be requested by the IRS in a criminal matter. The Summons was a civil summons. Before the data left the island, according to sworn affidavit testimony of certain "whistle blower" employees, Mr. Thomas instructed the office manager to destroy all documents pertaining to the ASL investors and to "bleach" computer records. The Court of St. Kitts was denied critical evidence needed to support my claims. The data received by the IRS from BMT was data which it was not entitled to request or obtain. The IRS summons was in breach of (a) the Baptiste Disclosure Order; (b) the US—St. Kitts MLAT Treaty; and (c) the St. Kitts Confidential Relationships Act 1985.
7. Two years went by, and a number of "whistle-blowers" who worked for BMT, at that time, surfaced. Their combined testimony concerning the presence of the records on the property and what these records contained was enough to convince Judge Belle that Judge Baptiste was lied to by Mr. Thomas, and others acting for BMT in 2004.
8. In 2006, Judge Belle ordered BMT to produce these same records in three days, or its defenses would be completely struck out and BMT would be prevented from filing any other defense as well. Mr. Thomas was caught in a lie. Janet Conway (an unlicensed Pennsylvania private investigator hired by Mr. Thomas) and professional advisors working for BMT made an urgent plea to IRS Agent Everett for the data to be returned to them ASAP to comply with Judge Belle's order. The data was needed to satisfy the Order made by Belle J. in October, 2006. A letter written by Mr. Thomas to IRS Agent William Everett, dated, March 17, 2006, contains Mr. Thomas' urgent request for an inventory to be done on all of the data that was sent by him pursuant to the IRS summons. *Mr. Thomas tells Mr. Everett that he is being falsely accused of improprieties by myself and that the private/taxpayer data is absolutely needed for BMT to defend itself from these false accusations. Mr. Thomas accused the Claimants of fraud and communicated that charge to Mr. Everett. Mr. Everett proceeded to help the Defendants even though Mr. Everett and his manager were conducting IRS examinations on the investor-Claimants at that time.*
9. At this point, Agent Everett came to the rescue of BMT by quickly, and voluntarily providing all of the data requested by BMT on 3 government CD's printed from Atlanta, GA. However, the IRS agents did not send the data directly back to BMT. Agent Louis Pacho or his assistant sent the data to Janet Conway. She did not have authority from any of the individuals whose data was on the discs, to view the private taxpayer data. At that time, Janet Conway was operating her business unlawfully, as she did not have a private

investigator's license, which is required by the state of Pennsylvania. The IRS agents chose to deal with her anyway and provided her the private/taxpayer data on 3 government printed disks that were not encrypted. Over 630 pounds of US citizen's private data were on these disks. The Federal Trade Commission's protocol for data breach is currently being followed.

10. The data on the IRS CD's satisfied the demand of Judge Belle, and as a result, the lawsuit continued to rage on, burning-up more of my assets, totaling over 1 million dollars of additional attorney fees. Finally, the St. Kitts government seized the property. Based on current information, the St. Kitts government then quickly sold the property to the Marriott Hotel for an undisclosed amount. The Kenney Firm (my attorneys) is now engaged in an effort to obtain appropriate compensation from the Government of St Kitts. This effort is currently going on, and may last for years to come. If the IRS agent(s) did not take the private/sensitive data from BMT in 2004, and then give it back in 2006, I would have (1) won the lawsuit sooner and (2) I could have sold the Resort for top-dollar as I had a purchaser willing to buy it from me. I would have been able to pay my attorney fees and to completely recover financially from this.
11. On September 27, 2007, the High Court of St. Kitts along with the attorneys representing both the defendants and the claimants concluded that I, along with the others, was a victim of fraud. My money was in fact embezzled by Mr. Gagnon and others. The court determined this to be a Ponzi scheme as noted by Judge Belle, who presided over my case, and made the court order that concluded my lawsuit against the defendants.

Judge Belle wrote on September 27, 2007:

"The financial schemes marketed to the Claimants and operated by Bill Gagnon, and following his death by Mary Estes, were nothing more than a mechanism to cause the Claimants to unknowingly and unwillingly invest their money into an elaborate and fraudulent ponzi scheme that collapsed under its own weight."

12. *I have been charged by the IRS Civil Penalties for tax year(s) 1999, 2000, 2001, 2002, and 2003* ***totaling $1,174,934.50*** *for violations under IRC 6038, 6038A, 6677, and 6679.*

I was audited by IRS Agent Eugene Nelson (50–19235) on April 26, 2006, concerning my involvement with ASL. My case languished on his desk for almost 2 years after the audit until I received a letter from him dated, January 8, 2008. I was given 30 days to respond to the penalties he had determined that I owed. However, after looking closely at Mr. Nelson's work, my CPA and I noticed that he did not take into account that I amended my taxes in January of 2005. Mr. Nelson also has charged me with civil fraud as well, based on donations that I gave to (two) legitimate churches that are still currently recognized on government web sites as being 501(c)3 organizations. I was given misinformation by Mr. Gagnon to induce me to give money to the churches. Mr. Gagnon told me that I could receive a future economic benefit from doing so; however, no future benefit promised by Mr. Gagnon was received by me. My attorney wrote a protest letter to Mr. Nelson. Mr. Nelson provided no response to my attorney's protest letter. My case was mysteriously transferred to Mr. Everett. No reason was provided by Mr. Nelson for the transfer. My case has been with Mr. Everett now since February 2009 to the present. Mr. Nelson has accused me of civil fraud assessed under section 6663 of the Code and the negligence penalty under section 6662(a). I do not understand why it should take over three years to examine the tax return of a victim of a Ponzi scheme. I am just a W–2 employee.

I initially took a 100 percent charitable deduction for all of my cash contributions. When I consulted an expert tax attorney, he advised me to amend my tax returns because I was told by Mr. Gagnon that 90 percent of the charitable contribution would provide some kind of an economic benefit in the future. I now know, as will be discussed below, that I was given misinformation by Mr. Gagnon, or his agents, to induce me to give cash payments to the 501(c)(3) churches. I disallowed myself the 90 percent benefit in Jan. 2005.

To illustrate the extreme nature of the IRS examination, Nelson has charged me with having received interest income from the 20 percent Ponzi interest income even though I did not receive the income and there is now strong evidence that ASL kept "dummy" records to reflect interest income. This evidence comprises(a) the sworn testimony of Derrick Fraites, who worked for several years as the Office Manager within ASL and BMT under Bill Gagnon, Mary Estes, Robert Estes and Roland

Thomas; and (b) copies of those dummy records, which Mr. Fraites described and exhibited to his affidavit, sworn in the St. Kitts Action. It cannot get more bizarre to have ASL steal my money, and then be charged with taxable income from the money embezzled.

The cash contributions were made to 501(c)(3) churches. I have canceled checks for all of the charitable contributions. Mr. Nelson saw and reviewed all of the checks that were given to the churches. It is basic law that all taxpayers are entitled to charitable contributions when they donate money to 501(c)(3) churches.

I provided Mr. Nelson with communications that were received by the IRS. In these communications, I expressed my personal emotions about my reliance on the "ministry" of Bill Gagnon, a minister who took advantage of my Christian faith. These documents were in the possession of Mr. Nelson and show my good faith, reliance on a Christian Minister, and my "good faith" in placing investments with ASL.

This reliance is sufficient to justify "reasonable cause" under section 6664(c) of the Code for the penalties proposed by Mr. Nelson under section 6662. Obviously, if there is "reasonable cause" for a negligence penalty, it would be impossible to prove "willfulness" under section 6663.

A report from CPA Audry Pomerening, dated February 1, 2008, indicates that Mr Nelson disallowed the charitable deductions twice and gave no credit for the taxes paid to the charities.

Under new facts, I may have been wrongly told that the churches did not keep all of the money donated to them. More importantly, I had no obligation under law to monitor what a church does with donations and how they expend donations for religious purposes. The IRS is required to follow the law under the clear language of section 170. See section 7214(a)(3) of the Code.

There is no technical authority for Mr. Nelson to invent interest income on embezzled money, nor is there authority for a finding that if a taxpayer is embezzled, then the taxpayer should be charged with civil fraud for having his money embezzled.

In summary, Nelson has made audit adjustments and alleged civil fraud without any justification in fact or in law. During the examination conference, Mr. Nelson did not mention civil fraud in any way. No allegation of civil fraud should be made by Mr. Nelson merely because a taxpayer is a faithful Christian. Further, Mr. Nelson cannot make the case that bogus interest income that was based on a false set of books to cover up embezzlement is taxable income.

Department of Justice Determines Administrative Services, Ltd. used sham domestic and offshore trusts, in the case of Victor Carlysle Sullivan, Jr. 1/12/2007.

The Complaint filed by the Department of Justice states ASL operated a tax-fraud scheme. The ASL tax scheme involves the sale and use of sham business organizations and offshore trusts. Paragraph 16 of the complaint states: ***The reason that the customers fail to report their assets and the income filtered through these trusts*** [reference is to the failure to file Form 3520] ***is that the trusts are simply sham entities formed without any economic purpose.*** Paragraph 32 states: **The intent and effect of the ASL offshore tax scheme is to promote, aid, and abet federal income tax evasion.**

The IRS is required to follow the determination by the Department of Justice that the trusts created for Taxpayer in the present case by ASL are sham trusts. In addition, I consulted Carlyle Sullivan, a CPA to prepare my tax returns. I relied on Mr. Sullivan for my ASL investments. Reliance on a CPA is "reasonable cause" under the section 6664 regulations. Obviously, if negligence can be abated by reliance on a "professional" there is even a stronger reason why there is no civil fraud in my case.

Court Order from the St. Kitts and Nevis Circuit Court.

This Court Order is significant because it is a judicial determination of fraud and it was agreed to by the principal Defendants in the class action law suit I brought with others, in St. Kitts. BMT was the successor in interest to ASL and held all of the assets embezzled from the investors in St. Kitts, including myself.

Paragraph N. states: *It is now apparent that the various financial schemes marketed to the Claimants and operated by Bill Gagnon, and following his death, my Mary Estes, were nothing more than a mechanism to cause the Claimants to unknowingly and unwillingly invest their money into* ***an elaborate and fraudulent Ponzi scheme*** *which ultimately collapsed under its own weight. Under this scheme, investors were promised rates of return upwards of 20 percent per annum. However, there was never any genuine economic activity underlying the scheme which produced a rate of return.* ***Instead, the Investors' capital was simply misapplied***

and paid out as a form of "income" or "return;" used to fund the overhead of the Sherwood/Estes enterprise and the lifestyles of Mr. Gagnon and Ms. Estes; and used to acquire the title to the lands and build the Resort.

Paragraph O states that the Investors' capital ended up being remitted to bank accounts maintained by BMT ***while exclusively controlled by Bill Gagon and Mary Estes. Mr. Gagnon was the sole signatory for all of the accounts that he maintained for the claimants.***

By this Order, BMT agreed that there was fraud on the ASL investors (including Mr. Secrist). Judgment in default was entered against ASL.

Memorandum from Martin Kenney & Co., ("MKS") December 6, 2006 and December 13, 2006.

MKS specializes in fraud recovery. MKS was successful in having me and my co-claimant declared to be owners of the Angelus Resort, in place of BMT. Mr. Kenney is an expert in English law, from which the law of St. Kitts is derived. His opinion letter indicates that the foreign trusts located in St. Kitts, purchased by myself are void ab initio.. Mr. Kenney identifies a Ponzi scheme and other fraudulent activities and that all funds transferred to Administrative Services were not under the control of Mr. Secrist. *"The trust documents, fabricated by Mr. Gagnon were designed to create the illusion that the administrators had some control over their investment dollars, but this was not the case."* Mr. Kenney concludes that the trusts purchased by Mr. Secrist were "sham trusts."

Because the trusts were procured by Estes/Gagnon as a centerpiece to their grand scheme of fraud, we say they were not properly constituted from their inception.—Martin Kenney

Kenney has concluded that the foreign trusts never existed!

Affidavit of Derrick Fraites 5/24/2004 before the High Court of St. Kitts 5/24/2004.

Mr. Fraites was the office manager for ASL and he testified under oath that all of the money paid to ASL was embezzled and that ASL kept a false set of books. Mr. Fraites would make fictitious entries into the accounts so that I would see what I had invested. He testified that the entries *"were fictitious as the actual accounts were almost always empty. Mr. Gagnon would endorse all of the checks coming in for his own use."*

This further establishes the sham nature of all of the ASL operations. This document is important because it is court testimony made under penalties of perjury, that my money was embezzled and that ASL and other entities within the Gagnon organization maintained a dummy set of books.

IRS Summons Dated March 8, 2004.

The summons was sent to BMT Ltd, a St. Kitts Corporation by William Everett and his manager Louis R. Pacho. **There is no jurisdiction for the U.S. Summons on a St. Kitts corporation, therefore, all of the data received by the IRS and used in my examination is unlawful.** The IRS has been using data from an unlawful Summons, including the Secrist investment data. Mr. Nelson's willful use of unlawful data is a 7214(a)(3) violation.

Affidavit of Janet Conway, April 13, 2006 before the High Court of St. Kitts.

Ms. Conway referenced the fact that an IRS examiner (apparently Everett) advised her that ***the investigations had been completed and that appropriate documentation and recommendations had been sent to the Department of Justice in Washington DC.*** It appears that Ms Conway was referring to Mr. Everett. Apparently, the IRS was conducting a criminal examination in the guise of a civil examination because Mr. Everett made contact with the Department of Justice.

For the reasons set out above, it is reasonable for me and my attorney to ask that he be removed as my examiner.

Amended tax returns of Secrist for 1999, 2000, 2001, 2002, and 2003 with evidence of payment.

I was told by Mr. Gagnon that I could make contributions to the two churches and also get a personal benefit in some way. In my original tax returns I took charitable deductions for the full amount of cash paid to the churches. My amended returns, submitted in Jan. 2005, were made just in case the churches did not keep

all of the money I contributed to them. However, I have discovered zero data that the churches did not keep all of the money given by myself. In November 2004, I ordered my CPA to remove 90 percent of the cash contribution benefit that I received from the donations as I was informed by an expert tax attorney that I cannot take the full donation amount as the churches, as I was told, only kept 10 percent of my donation. I paid all of the back-taxes and the interest to the IRS for this 15 months before any contact with me at all was made by the IRS. I found the problem, I fixed the problem. It's not a crime to be temporarily deceived and fooled by people who misrepresented the law to me. My conduct negates any willful attempt to not pay my taxes as I have always paid.

TIGTA has failed to provide oversight.

I filed a misconduct complaint against Everett for unlawful disclosure of my tax return data in the 3 CDs sent to Janet Conway to be used by defendants in the class action lawsuit. TIGTA cleared Mr. Everett without seeing the CDs and without discussing the facts with me or my attorney. Obviously, there was a disclosure and the potential for identity theft. It is not clear to me why TIGTA cleared Everett when there appears to have been a clear disclosure violation under section 6103.

Summary and Conclusions.

My testimony is intended to make sure that the Subcommittee on Oversight is aware of the fact that in my case, the IRS did not comply with its Mission Statement to apply the tax law with integrity and fairness. I have also identified IRS documented misconduct for making social security numbers and other financial data available to people not entitled to have that data. I can document the fact that the IRS examiners did not comply with the U.S. MLAT Treaty. The IRS also refused to follow the law on trusts under the applicable law of St. Kitts. I have also identified the fact that in my case the Taxpayer Advocate did not exercise her independent judgment to act as ombudsman for me when the IRS deemed a sham trust to be a valid trust. In effect the IRS recognized a sham trust solely for the purpose of accusing me of not filing a Form 3520 for the fictitious foreign "deemed" grantor trust. This was despite the previous applicable finding in the *Carlysle* case. I have identified IRS examination that is so outrageous that it was necessary for them to use a fictional grantor trust just so they could find a way to assess a 35 percent penalty on the money embezzled by crooks in a fraudulent Ponzi scheme. I am a victim. The IRS chose to punish a victim with a new position for which there is no legal precedent. I am available to Members of the Subcommittee to show you all of my documentation and the outrageous positions taken by the IRS. This testimony is submitted in good faith and on the assumption that the Subcommittee is interested in an actual case like mine in addition to the platitudes of the IRS Commissioner and the National Taxpayer Advocate. What is important are actual case histories for true oversight of the IRS. I would encourage the Subcommittee to hold hearings on the subject of IRS misconduct and whether TIGTA is policing IRS misconduct. I would be pleased to be a witness at any Hearing on this topic. The extreme position taken in my case by the IRS is in contrast to the liberal policy taken by the IRS for Ponzi scheme victims in Rev. Rul. 2009–9 and Proc. 2009–20. Although the IRS has provided favorable guidance to the Madoff Ponzi victims by giving them tax relief and "safe harbor" benefits, the IRS has treated me with absurd determinations including assessment of interest income based on demonstrably dummy records.

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Michele Dyson, Statement

Chairman Lewis, Ranking Member Charles W. Boustany, Jr., and Members of the Subcommittee, I am honored to have the opportunity to present testimony that I hope will be considered by this distinguished Committee during the Internal Revenue Service (IRS) annual review to safeguard taxpayers against unfair IRS collections procedures. My testimony addresses the adverse financial hardship caused by premature IRS tax liens, tax levies, and Trust Fund Penalties against citizens and small business. In my case, the IRS misapplied tax payments, miscalculated penalty and interest and filed a tax lien. This pre-mature and capricious tax lien against

my company caused a domino effect which resulted in loss of our credit line, revenue, tax revenue to the Treasury, including the revenue lost from the employees who were let go. My company would be in an entirely different position today, if the IRS had corrected its records and applied the payments to the proper periods. Instead of an overpayment of over $114,000, the IRS misapplication of payments and miscalculations resulted in a liability of accruing penalties and interest of over $400,000.

I applaud the Ways and Means Oversight Subcommittee Chairman John Lewis and Ranking Member Charles W. Boustany, Jr. **introduction of the OIC Legislation that Eliminates Down Payment** H.R. 2343, the Tax Compromise Improvement Act of 2009 to help taxpayers enter into offer in compromise agreements with the IRS. Due to the broad discretion of the IRS, taxpayer offering to settle a tax liability to make either a partial payment with submission of an OIC application (e.g., a nonrefundable, 20-percent down payment) or to make proposed installment payments during the period of the OIC's pendency are often denied. If the OIC application is rejected, the taxpayer's down payment (or installment payments) is not refunded and with it any hopes of resolution denied as well. This vicious circle incarcerates taxpayers to pay money they do not have in addition to interest and penalties they cannot afford. The financial devastation caused by liens, levies, and IRS discretionary actions against taxpayer's causes economic hardship, loss of employment, and destruction of one's credit rating. Moreover, taxpayers cannot get a Government job or can lose their security clearances resulting in the same fate. The proposed changes in the OIC legislation must make it out of Committee to offer some relief. But more needs to be done to protect taxpayers and provide relief.

My story like many others was the realization of the American dream. In my case, I started a family owned business.

My great grandmother was a slave, my grandmother an elevator operator, and my mother a government worker. I built my business from the basement of my home in an industry where over 25 years ago, there were no women represented. Over the past 25 years, it grew into a multi-million dollar technology company that employed over 400 people, provided college scholarships, summer employment, and contributed time and money to a number of community charities to feed the homeless and others less fortunate. We paid taxes in excess of over $30 million and supported various community and educational programs.

In 2002, my company received a notice from the IRS for tax liabilities owed dating back to 1996 which had accrued over $400,000 in penalties and interest. We were assigned a Revenue Officer whom we met and presented documentation which showed that deposits/payments had been misapplied and the IRS calculations were incorrect. The IRS officer stated in fact, that it made no mistakes and she would not move payments.

Within 30 days, the Revenue Officer filed liens and levies against the company, eventually a Trust Fund Penalty against me; and our bank records summoned. We were told by the Revenue Officer—"it is easier for you to pay the tax and go to court and try and get it back." It was at that point, I knew that the IRS mission was not about assisting taxpayers—it was about collecting money.

Premature tax liens, levies and Trust Fund Penalties, and summons destroyed my business, bank credit, and my personal finances. My personal and company bank accounts were levied, revenues from invoices seized, and our credit line cancelled resulting in layoffs and an inability to pay creditors.

We hired an expert Forensics IRS Accountant who through the Freedom of Information received our IRS internal records. Using the IRS internal records of payments received and documented in their system, the accountant applied tax payments to the correct periods. The recalculation showed that once the payments had been applied correctly; the company had overpaid its taxes by over $114,000.00. **The IRS rejected the report.**

We contacted the Tax Advocates office asking for records dating back to 1996. It was through the Tax Advocates office, we received internal IRS reports which clearly showed that the IRS had applied tax deposits incorrectly dating back to 1996 resulting in miscalculation and misapplication of payments and penalty and interest calculations. **The IRS rejected the IRS report.**

Under the Freedom of Information, we were able to get the Revenue Officer's ICS Transcripts which documents IRS communication with the taxpayer and internal IRS employees. The ICS records documented that the IRS applied payments to the wrong period; the Revenue Officer interfered with the appeals process; and filed false statements. **The IRS rejected our complaint.**

We requested a new Revenue Officer. **The IRS rejected our request.**

We filed misconduct complaints. **The IRS rejected the complaint.**

We requested the removal of the liens, levies, and Trust Fund Penalties submitting numerous Offers in Compromise. The Revenue Officer stated the OIC was not processable and not in the best interest of the Government.The IRS rejected the OIC.

We filed an appeal. **The IRS rejected our appeal.**

Later under FOIA, we discovered that the IRS Revenue Officer had contacted the Appeals Officer who in conversation called me a criminal who they couldn't wait to take to court. My attorney was called a racist; during a meeting I was searched and interrogated by investigative officers with guns for over an hour due to a false statement by the Revenue Officer.

Finally, we submitted our complaint to tax court. The IRS attorney's reviewed the case, the documentation, and returned it to appeals for re-consideration.

Seven years later, the IRS still refuses to correct the error. Refuses to remove liens, levies, Trust Fund Penalties, accrued penalties and interest; and continues to reject any OIC stating that it is too complicated and not in the best interest of the Government. Due to the devastation of the IRS process to my business, we were no longer in a position to pay the outstanding liability which had accrued interest and penalty since 1996—although we were notified in 2002. The review of our finances by the IRS Appeals office states that the tax is uncollectable. Yet, the IRS continued to reject the OIC.

The abusive process and actions taken by the IRS were at the Revenue Officer's discretion. The Revenue Officer has an enormous amount of power to ruin a taxpayer's life and livelihood under the guise "it is not in the best interest of the Government" without cause or substantiation. A taxpayer with no knowledge of the IRS system is rendered helpless going up against a Goliath Government bureaucracy which lacks transparency and accountability to the taxpayer.

My testimony demonstrates how a correctable IRS payment misapplication escalated into an abuse of discretion resulting in IRS misconduct, premature liens, levies, and seizures that destroyed the lives, livelihood, and inappropriate tax collection of a taxpayer under the unsupportable cover that IRS actions were in "best interest of the Government".

I am here to ask Congress to ensure that this does not happen to another taxpayer. IRS delays, misconduct, and abuse should not destroy a taxpayer's livelihood; and create laws to make IRS actions transparent to Congress, to the American people, and to those IRS Government employees who are accountable.

IRS Delays

- IRC 6501 allows the IRS three years from the filling to assess tax. In my case, the IRS notified me six years later of a tax liability, filed tax liens, levies, and Trust Fund Penalties resulting in damage to my credit, loss of revenue, and company layoffs. Taxpayers should not be penalized for an unknown potential tax liability. Nor should they have to pay accrued tax on unknown amounts without the ability to verify or dispute the liability which allows escalate into an unpayable amount. There should be no limit to correcting a tax problem identified years later.
- The IRS response was that if the liability is incorrect, then they can go back and correct the records. Correcting a problem months or years later does not help a taxpayer, the damage is done—jobs are lost, credit is ruined, and a company goes under. In my case, the records were never corrected and revenue to stay afloat seized.
- Some tax periods that were lien/levied were beyond the 3 years statute of limitation. The date of assessment was 9/00. However, my company was not notified until 10/02. (I.R.C 650 (a)) Our first meeting with the IRS revenue officer was 10/31/02.

Disputed Liability

- Penalties and interest should not be applied to any tax liability until 90 days after the taxpayer has been notified and allowed time to dispute or verify the tax liability.
- According to IRS Act 3001(a) IRC 7491, the IRS must provide proof of its facts. IRS regulations allow tax payments to be moved to the period requested by the tax payer. In my case, the IRS never presented any facts disputing the misapplication of payments and refused to move payments to the correct period as requested as was documented in the Revenue Officer's internal ICS records.
- The IRS should not be able to seize refunds, bank accounts, properties on disputed liability.

Liens, Levies, Trust Fund, Seizures

- Liens, Levies, Trust Fund, and Seizures should not be placed on disputed liabilities until the IRS can provide documented proof that the amount is owed. This can be done by providing detailed reports that show the date of the liability, the date and amount of payment applied and any calculation of penalty and interest. The taxpayer has no knowledge of the IRS systems or available reports, so they do not know what information to request.
- The IRS should be required to provide a report that breaks down how each tax payment was applied, how the IRS calculated interest and penalty, and ensure that the application of payment is accurate. In cases where payments are misapplied, the IRS should run the best scenario for the taxpayer to reduce the tax liability and be able to show the tax payer ways they can get help.
- Through the Tax Advocates Office, I was able to receive a breakdown of a tax report that showed how the taxes were applied by date and amount. If it were not for that report, I never would have known that the IRS applied the taxes incorrectly. The reports received from the Revenue Officer only showed a listing of payments made and the tax liability due. It did not show how the tax was applied to a specific quarter. Our tax liability was twice a month. The IRS split the liability into four times a month which incorrectly increased the liability and penalty and interest without our knowledge.
- When the IRS files liens, levies, Trust Funds, or seizures, a taxpayer is assumed guilty. In today's credit ill world, credit is never repaired and the hardship caused collapses a company's revenue base.

Offers in Compromise

- H.R. 2343, the Tax Compromise Improvement Act of 2009 to help taxpayers enter into offer in compromise agreements with the IRS is a good change to the OIC regulations. However, the IRS has enormous discretion in how it applies the regulation and must be required to put in writing with supporting documentation stating the regulation that allows the rejection.
- In my case, the IRS refused to accept the OIC stating that "it was not processable" and that "it was not in the best interest of the Government." This is neither acceptable nor supportable. It is a flawed and false interpretation of the intent of the OIC regulation and should not be allowed as valid justification. The Tax Advocate should be allowed to reverse such action and work with the taxpayer to process the OIC.
- Unsupportable OIC rejections should be documented in a Revenue Officer's personnel file and reviewed as a part of their annual review as a part of IRS accountability to the taxpayer. Multiple infractions should be documented for disciplinary action.
- If tax records cannot be corrected in two years, then an OIC should be automatic where if not executed by the Revenue Officer, the Tax Advocate can grant.

IRS Officers/Employees Accountability

- IRS representatives are accountable to the American people. They must be able to support and document adverse actions against a taxpayer and show compliance with IRS regulation as well as intent of law to the taxpayer. General unsupportable statements must not be a basis to take adverse actions against a taxpayer. Laws must protect the tax payer against unfair tax collection and interpretation.
- In my case, the Revenue Officer stated:
  - The OIC is not process able
  - It is not in the Best Interest of the Government
  - That she stopped any chance of an appeal
- Complaints against an IRS employee should become a part of the employee's record and addressed as a part of their annual review. When numerous complaints of similar nature are repeatedly reported, the employee should go through a reprimand procedure to include dismissal. The names of agents with numerous complaints should be made available so that a taxpayer can request a different agent if necessary.
- In my case all requests were ignored, we:
  - Filed a misconduct complaint

- Requested the Revenue Officer be removed
- Requested supporting documentation of the regulation that allowed the discretionary OIC rejection

All requests were rejected.

Tax Advocate

The Tax Advocate must have the power to intervene and enforce regulations on the Tax payer's behalf:

- Stop IRS officers from taking adverse action where clearly there are disputes, misconduct, or abuse of discretion.
- Stop liens, levies, seizures when the tax payer can show cause.
- Request written regulatory support from the IRS Revenue Officer that upholds a discretionary decision.
- Investigate and replace a Revenue Officer if requested by the tax payer.
- File a quarterly report of complaints against IRS employees to the Secretary of the Treasury and to the Office of IRS Human Resource Director that is filed in each employee's folder.
- The tax Advocate should have the power to grant an OIC where abuse, improper discretion, or unreasonable delays in correcting tax records is demonstrated.

Transparency

After taxpayers spent billions of dollars on an IRS Enterprise System, accuracy of tax records are not transparent. Taxpayers have no idea of what information is available to them if not provided by the IRS Revenue Officer. Complaints are buried by bureaucracy forcing the taxpayer to get an attorney.

- The Congressional Oversight Committee needs to have visibility into the complaint process to identify problems and abuse of authority to safeguard taxpayers against unfair IRS collection actions and repeated offenders.
- Taxpayers must have a way to file confidential or open complaints that are not buried and rejected by IRS bureaucracy.
- Complaints should be tracked or categorized on IRS abuses of power, IRS misconduct, erroneous applications of law, abuse of discretion, and unnecessary hardship caused by IRS actions.
- Taxpayers should receive a complete report breakdown of the tax period in question showing the tax liability, payments, and penalty and interest calculations. This report should show the date and amount of payments applied so that the tax payer can verify or dispute the liability.
- The taxpayer should be provided a list of all reports available including information available under the Freedom of Information when they are notified of a liability.

Summary

In 2002, I owned a viable business that employed people who had been with the company over 10 years. Our company was a family owned business that supported its employees, their families, and its community. I have spent the last seven years in a process of malfeasance due to the abuse of IRS collection procedures and lack of transparency.

I know that I am not the only one. We as taxpayers must stand up for our rights when wronged.

If my records had been corrected in 2002, we would have had an overpayment of over $114,000 not a tax liability of over $400,000. Instead, every asset of the company and my personal assets are levied, lien, seized, or lost. OIC' were rejected based on the unsupportable discretion of the IRS Revenue Officer who hid behind one phrase "Not in the best interest of the Government." After numerous submissions of financials, supporting documentation, expert forensic reports, and IRS determination that the tax was uncollectable, there is still no relief and nothing more to take. There must be a time limit on the IRS to correct a tax payer's record and relief for the taxpayer against IRS abuse.

Today, there is no transparency against these abuses. IRS employees set a scenario of "us against them." Complaints get buried, questions go unanswered, and accountability is non-existent.

Today, I come to the House Subcommittee on Oversight on Internal Revenue Service Operations to ask for new laws that protect, safeguard, and require Internal Revenue Service (IRS) accountability against unfair IRS collection procedures to:

- Establish transparency for complaints
- Give the Tax Advocate power to intervene to approve an OIC, document, and demand IRS accountability
- Stop penalty and interest calculations and accrual until the taxpayer is notified and provided 90 days to verify the liability
- Stop liens, levies, seizures, and Trust Fund Penalties until the IRS can document that the liability exist and that they provide the taxpayer all available information to support their position
- Require an automatic OIC approval if taxpayer's records are not corrected in a timely manner and at a maximum two year period.

Somewhere along the line, there are IRS employees who forgot their mission to serve the public through fair, unbiased, and reasonable interpretation of the law—not distorted discretion rendering the intent of those laws lost in translation. The frustration of the taxpayer can only be documented when we speak out. It is why America exists today.

While it would be hard to point to any one event that singularly led to the American Revolution, there is no doubt that taxation without representation was a major factor. Americans should not fear their government—the tax system—nor be at the mercy of unfair IRS tax collection procedures. Unless we as Americans let Congress know the hardship created by this lack of accountability, safeguards, and transparency—we have no one to blame but ourselves.

Congress must enact laws that safeguard the taxpayers to protect our rights so that IRS employees do no harm through abusive enforcement and interpretation of the law. It is the voice of the people who expose any betrayal of that public trust.

The times we face are trying the very soul and spirit of every American. But opportunity will rise from chaos. But when opportunity is destroyed by distortion of the law—by those who hide behind the guise of their authority to harm the people they are entrusted to help, tax payers face their government in adversarial combat—a battle no one wins. Lives are destroyed—in some cases; those so overwhelmed and weakened by the fight take their own lives.

In my case, the IRS misapplied tax payments, miscalculated penalty and interest, and filed a capricious tax lien. This pre-mature and capricious tax lien against my company caused a domino effect which resulted in loss of our credit line, revenue, tax revenue to the Treasury, including the revenue lost from the employees who were let go. My company would be in an entirely different position today, if the IRS had corrected its records and applied the payments to the proper periods. Instead of an overpayment of $114,000, the IRS misapplication and miscalculation resulted in an accruing liability of penalties and interest of over $400,000.

Who sees? Who knows? I am here to share my story—so that this committee knows. Congress is the ultimate protector of the people with the power to enact laws to stop adverse financial hardship caused by premature IRS tax liens, tax levies, Trust Fund Penalties, and unfair IRS collection procedures.

If this administration wants transparency and fairness of Government, this Congress must demand it.

Respectfully Submitted,

Michele Dyson
President Computer Information Specialist
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Statement of the National Association of Professional Employer Organizations

Chairman Lewis, Ranking Member Boustany, and other members of the Subcommittee, thank you for providing the opportunity to comment on the Obama Administration's FY 2010 budget proposals.

The National Association of Professional Employer Organizations (NAPEO) supports the Administration's budget proposal that would clarify when employee leasing companies and professional employer organizations (PEOs) would be held liable for their clients' federal employment taxes.

NAPEO is the largest trade association for PEOs nationwide, with nearly 400 PEO members operating in all 50 states, representing approximately 90 percent of the revenues of the $64 billion industry. PEOs provide human resources services to their small business clients—paying wages and taxes and assuming responsibility for compliance with myriad state and federal laws, including employment taxes.

PEOs Help Small Businesses Comply with Federal Tax Laws

Small businesses face significant challenges in meeting many complex federal and state compliance responsibilities, and in the current economic climate, hiring and maintaining a full complement of staff proficient in the regulatory and record-keeping functions needed to fulfill these responsibilities can be cost prohibitive.

Although PEOs are sometimes labeled employee leasing companies, as a practical matter, PEOs do not lease employees. Rather, PEOs provide a solution to the burdens their small business clients face by assuming responsibility and liability for remitting federal employment taxes, maintaining employee records, handling employee complaints, providing information to workers, and providing many other essential human resource functions as well. In addition, PEOs provide workers a variety of benefits, including retirement (usually a 401(k) plan), health, dental, life insurance, and dependent care. PEOs also bring workers under the protection of federal laws applicable only to large employers, providing workers such benefits as COBRA health care continuation coverage—protections that would not otherwise have been available to those workers. The average client of a NAPEO member has 19 employees who are paid an average of $31,000. That small business cannot efficiently handle the many obligations placed on it by state and federal laws. The PEO lifts those cumbersome responsibilities from the shoulders of business owners allowing the small business to devote more time and energy to core business functions.

As small- and medium-sized businesses have increasingly sought out the services of PEOs over the past decade, the industry has expanded to meet this demand. At the state level, NAPEO has in many cases sought recognition for PEOs and supported regulation, such as licensing, to help make certain that the industry could grow in a manner that ensured quality services. Today the majority of states specifically regulate PEOs. At the federal level, however, PEOs have been confronted with a tax code that was written long before the development of our industry. Therefore, the current law governing who can collect employment taxes does not neatly fit PEOs, their customers, or their on-site workers.

The President's Budget and H.R. 2447 Will Improve Compliance and Fairness

The President's FY 2010 budget proposal would clarify the rights and responsibilities of companies like PEOs with respect to employment taxes due. Today, the determination of which party or parties are ultimately responsible for employment taxes is a complex factual determination based on a multi-factor common law test. In some cases, this leads to uncertainty as to which party is ultimately liable for unpaid federal employment taxes; uncertainty that is detrimental to tax compliance and unfair to small businesses.

The Obama Administration has stated that its budget proposal will facilitate the assessment, payment, and collection of employment taxes. NAPEO shares that view. We believe the Administration's proposal will substantially improve compliance with employment tax requirements, facilitate tax administration, reduce the number of returns the IRS has to process, and reduce errors in calculating and paying employment taxes.

As a general matter, the President's proposal would clarify that an entity that holds itself out as an employer (by filing employment tax returns using its own name and employer identification number) could not later attempt to escape liability by arguing that it was not actually a common law employer. In that instance, the entity that held itself out as the employer would, under the Administration's proposal, be held to be jointly and severally liable for federal employment taxes due on wages paid. The Administration would also provide that entities like PEOs that meet specified requirements would be solely liable for such taxes. That latter part of the Administration's proposal tracks the structure proposed by four members of this Committee in legislation introduced last month. Representatives Earl Pomeroy, Kevin Brady, Ron Kind, and Wally Herger introduced H.R. 2447 (the Small Business Efficiency Act), a bill that embodies the Administration's sole liability budget proposal and that is substantively comparable to legislation that twice passed the Senate in the last Congress. NAPEO applauds the introduction of H.R. 2447 and urges its prompt adoption.

The Administration's budget proposal and H.R. 2447 clear up ambiguities for PEOs and their small business clients. They would also provide important safeguards and guarantees to the federal government and workers in PEO arrangements. H.R. 2447 directs the Department of Treasury to create a certification program for PEOs to collect and remit federal employment taxes for their business clients. To become a certified PEO (CPEO), the CPEO must meet financial conditions

(including bonding and financial audit requirements), must satisfy reporting obligations, and must meet other ongoing standards set by the IRS. After meeting certification requirements, the CPEO assumes full and sole responsibility for employment taxes on wages that it pays. For this purpose, the bill is narrowly targeted, making clear that except for the payment of employment taxes as provided in the legislation, there is no inference regarding the determination of who is a common law employer under federal tax laws or who is an employer under other provisions of the law.

Mr. Chairman, thank you for the opportunity to speak to the importance of the Administration's budget proposal and H.R. 2447 for PEOs, their clients, and the federal government. This legislation will provide significant benefits to the all parties, in terms of efficiency, effective oversight, and revenue in trying financial times when every little bit helps.

National Association of Professional Organizations
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Milan Yager, Executive Vice President
Cheryl Gannon, Director, Federal Government Affairs

Patricia Read, Letter

June 17, 2009

The Honorable John Lewis
House Ways and Means Subcommittee on Oversight
343 Cannon House Office Building
United States House of Representatives
Washington, DC 20515

RE: Internal Revenue Service Operations and Fiscal Year 2010 Budget Proposals

Dear Chairman Lewis:

Thank you for the opportunity to submit this statement for the record of the June 4 hearing regarding the Internal Revenue Service Operations and Fiscal Year 2010 Budget Proposals.

Independent Sector, the national coalition of public charities, private foundations, and corporate giving programs, urges support for expanding IRS authority to require electronic filing of the Form 990. We also support a recommendation on streamlining the international grantmaking process that was recently issued by the Advisory Committee on Tax Exempt and Government Entities (ACT).

In his FY 2010 budget proposal, President Obama recommended allowing reduction of the current threshold (250 or more returns per calendar year) for mandatory electronic filing. Independent Sector strongly supports this proposal, as well as a similar proposal you incorporated in Section 9 of your bill, the Charity Enhancement Act of 2008 (H.R.7083), which passed the House of Representatives on September 27, 2008.

The Form 990 informational tax return filed by nonprofit organizations serves as the primary document for providing information about an organization's finances, governance, operations, and programs to federal regulators, state charity officials, and the public. Expanding electronic filing of this annual information return will enhance tax compliance and transparency, improve oversight and enforcement by the IRS, and provide more timely, accurate information to the public.

We also bring to the Subcommittee's attention a compliance recommendation offered in the June 10, 2009 report of the Advisory Committee on Tax Exempt and Government Entities (ACT). That recommendation calls on the IRS to permit grantmaking organizations to share and rely on determinations that foreign organizations are the equivalent of a U.S. public charity, and thus eligible to receive qualifying grants. This sharing of information through an Equivalency Determination Information Repository would both improve efficiency and enhance compliance with tax rules. We ask that the Subcommittee promote the adoption of this ACT recommendation.

Thank you for the opportunity to share these comments. We look forward to working with you on this and other legislation related to oversight of the nonprofit sector.

Sincerely,

Patricia Read
Senior Vice President, Public Policy and Government Affairs

Statement of Paul Cherecwich, Jr.

The Internal Revenue Service (IRS) Oversight Board thanks Chairman Lewis, Ranking Member Boustany, and members of the Subcommittee for the opportunity to present the Oversight Board's views on the Administration's FY2010 IRS budget request.

This statement presents the Board's recommendations for the IRS' FY2010 budget and why the Board believes this level of funding is needed to meet the needs of the country and of taxpayers. Created as part of the IRS Restructuring and Reform Act of 1998 (RRA 98), the Oversight Board's responsibilities include overseeing the IRS in its administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws. The Board is also responsible for ensuring that the IRS' organization and operations allow the agency to carry out its mission. To this end, the Board was given specific responsibilities for reviewing and approving annual budgets and strategic plans.

The Board has a responsibility to ensure that the IRS' budget and the related performance expectations contained in the performance budget support the recently published *IRS Strategic Plan 2009–2013*. In addition to this statement, the Board develops a formal report in which it explains in detail why it has recommended this budget for the IRS. Because of the late budget cycle caused by the change in Administrations, this report is still under development. The Board requests that this report be entered into the meeting record when it is sent to the Subcommittee later this month.

FY 2010 IRS Budget Recommendations

The IRS Oversight Board recommends an FY2010 IRS budget of $12.489 billion, an increase of $966 million over the enacted FY2009 amount of $11.523 billion. This recommendation is $363 million above the President's request of $12.126 billion.

Tables 1 and 2 at the end of this statement show more information on the Board's budget recommendations. Table 1 shows the program initiatives or increases the Board is recommending, and Table 2 shows the Board's recommended budget by account.

As the Board stated in its 2008 *Annual Report to Congress*, our tax administration system has two serious weaknesses, the $290 billion tax gap and the archaic nature of IRS information systems. As a result, the Board recommends that strengthening the system be a national priority. Addressing those weaknesses is critical and urgent. The Board is fully supportive of the Administration's boost in enforcement funding. However, the Board recommends greater funding in the areas of Business Systems Modernization (BSM) and Operations Support than the President's budget requests. While the Oversight Board and the Administration's budgets agree in many ways, the Board feels that these key additional investments are needed sooner—not later—to strengthen our tax administration system.

The effort required to correct the two weaknesses identified above is not to be taken lightly. Although the tax gap can never realistically be eliminated, it is equally as foolish to suggest that nothing can be done to reduce it. As the Board has opined on numerous occasions, there is not a single solution to reducing the tax gap. Rather, a comprehensive, multi-faceted, multi-year, approach is needed that provides for excellent taxpayer service combined with vigorous enforcement, along with a long-term investment in IRS information technology and infrastructure. It is generally recognized that the IRS "cannot audit its way out of the tax gap." Balance between immediate expansion of personnel combined with long term investments in information technology and infrastructure is needed.

The second weakness, modernizing the IRS' archaic information technology systems, is equally daunting—yet it must be done. As noted in the Board's 2008 *Annual Report to Congress*, the IRS' systems modernization program has been on the Government Accountability Office's (GAO's) high risk list since 1995. The GAO placed this program on its high risk list because it believed that the IRS relied on obsolete automated systems for key operational and financial management func-

tions. The Board believes that it is unacceptable for this program to remain on the high risk list for so long.

The Board believes strongly that the IRS' BSM program must be in a position to move forward in FY2010 and FY2011 so that program milestones scheduled for 2011 can be achieved. Because the President's budget provides little additional funding for the Customer Account Data Engine in FY2010, it puts the FY2011 milestones at great risk. In addition, the Board believes additional funding is needed to refresh and update the IRS' aging infrastructure. In total, of the $363 million difference in the two budgets, about $332 million is for investments in critical information technology and infrastructure.

The Board would also increase funding for several key initiatives to improve taxpayer service. These initiatives are all designed to help the IRS plan and implement better taxpayer service in the future.

Board Fully Supports Increased Enforcement Funding

The Board's recommendation for the enforcement account, which at $5.5 billion is close to half of the IRS total budget, is identical to the President's budgets. Both the President's and Oversight Board's budgets add $332 million for additional enforcement. This increase constitutes a 7.6 percent boost in enforcement funding, and includes additional funding to strengthen criminal investigations programs, increase examinations and collections, and support a variety of regulatory matters.

This increase in enforcement resources pays for itself; in some cases many times over—a consideration that should not be ignored in the budget process. In addition, it helps to reduce the tax gap, which deprives the nation, and hence its citizens, of $290 billion it is legally owed. The tax gap is an affront to honest taxpayers and efforts must be made to reduce it.

The President's request for enforcement funding includes a multi-year investment of $128 million, starting in FY2010, to deal more effectively with increasing international tax activities of individual and business taxpayers. The Board is pleased with this, as the effects of globalization on tax administration are significant and must be addressed.

The Board also strongly supports additional funding to improve compliance among "high-risk" taxpayer segments. Estimates shows that much of the tax gap is due to underreporting of income by businesses, mostly run by individuals. It is imperative that the IRS not only ensure that all individuals understand their tax obligations, but that they report their income and pay their taxes.

Taxpayer Service Increase Recommended

For the taxpayer service account, the Oversight Board's and President's budgets are within 0.2 percent of one another. The President's budget request for taxpayer service benefits from congressional action taken during consideration of the FY2009 budget. By adding additional funding to the IRS taxpayer service budget in FY2009, Congress raised the base amount for taxpayer service in FY2010, giving the IRS additional resources to serve taxpayers in an increasingly more complex economic environment.

The need for taxpayer service is especially acute during periods of economic hardship, as taxpayers may find themselves facing challenging financial situations. In addition, taxpayers need additional help to understand new tax provisions and programs designed to help them during difficult times. Every change in the tax code causes the tax administration system to become more complex, with more taxpayers in need of help to understand and meet their obligations. It is especially important during this recession that the IRS be able to follow through on its strategic goal to "make voluntary compliance easier."

Despite a higher funding base for taxpayer service, there are several areas where the Board recommends additional funding. In 2005, Congress asked the IRS, National Taxpayer Advocate, and the IRS Oversight Board to develop a five-year plan to improve taxpayer service. The result was the Taxpayer Assistance Blueprint (TAB), which was completed in April 2007. In the Board's opinion, the IRS needs additional resources to more fully carry out the TAB by expanding its on-line capabilities. Additional funding is also needed to optimize the use of Taxpayer Assistance Centers, also known as walk-in sites, which traditionally serve lower income taxpayers who depend more on walk-in services. Overall, the Board recommends an additional $31.6 million be appropriated for taxpayer service, all of which will be focused on improving taxpayer service in the future.

Strategic Funding Needed for Business Systems Modernization

The IRS' archaic computer systems are a serious challenge facing the IRS. The Board is dismayed by the long-term under-funding of the BSM program, forcing the IRS to stretch out its efforts at a painfully slow pace, to the detriment of taxpayers.

The Board is pleased that the IRS has revised its BSM approach to put more focus on completing the program, and considers it a critical foundation of service and enforcement in the future.

However, the Board questions whether the President's budget will allow for substantive progress in the coming years. The Board has opined in past years that the BSM account is fundamentally under-funded, and despite the additional $7.3 million added by Congress in FY2009 and the President's FY2010 requested increase of $22.6 million, the FY2010 request for BSM continues to be far too low. Progress will come slowly should that trend continue. The Customer Account Data Engine project, in particular, has funding needs that go far beyond what was requested in FY2010, and those needs will only grow in FY2011.

The Board's recommended BSM budget of $400 million is 58 percent higher than the President's BSM budget of $253.7 million. At $253.7 million, the President's BSM budget consumes 2.1 percent of the IRS total budget of $12.126 billion. This compares to the Board's recommendation of a $400 million BSM budget, which consumes 3.2 percent of its total $12.489 billion budget. Although the difference is quite small when viewed as a portion of the total budget, the vision presented by these two BSM budgets is quite different. The Board believes that funding decisions for the IRS must look beyond consideration of short term benefits and immediate return on investment. Serious consideration must also be given to the long term benefits to taxpayers and the tax administration system that will result from a modernized information technology system. These investments will result in fundamental changes to tax administration that will benefit both taxpayers and tax administrators alike.

The Board recommends that a total of $400 million be appropriated for the BSM program so that the pace of progress is increased, allowing the IRS to achieve key milestones in FY2011, such as the deployment of a daily Individual Master File capability and a Customer Account Data Engine relational database.

More Funding for Operations Support

Another important aspect of the IRS' performance is the state of its legacy infrastructure: the technology and tools used by IRS employees to do their work. IRS laptops, software, the telecommunications systems, and the buildings themselves are aging and must be updated and maintained. In addition, the IRS must protect its hardware and data infrastructure from threat, whether it comes from bad weather or cyber-attack.

The Administration's FY2010 budget calls for $108.1 million in program increases to address information technology security and material weaknesses and to strengthen the Electronic Fraud Detection System. The Board supports this funding, as both can help ensure the integrity of the tax system and maintain taxpayer confidence that its returns remain private and safe from security risks.

However, more needs to be done. The Board recommends a total of $292 million in infrastructure program initiatives, compared to the $108 million requested by the President's IRS budget. The Board recommends an additional $164 million in technology initiatives and a $20 million initiative related to workforce development. This funding is needed to refresh and maintain the IRS' infrastructure, strengthen its ability to protect the personal information of taxpayers, increase the productivity of its workforce by leveraging information technology, and upgrade its financial services accounting system that uses a software application product that is so old the vendor will no longer support the program in 2013.

In addition, workforce development cannot be ignored, especially during a period when the IRS is losing experienced employees to retirement and is hiring a significant number of new employees. Frontline supervision plays a key role in employee satisfaction, quality, and productivity, and the IRS lacks funding to properly train frontline managers in a timely fashion. Approximately $15 million of the workforce initiative is for frontline management training, with the remaining $5 million for succession planning and executive development.

Long-Term Investment Key to IRS Strength

Although the magnitude of the Board's budget recommendations for the IRS are not vastly different from the President's budget request in amount, they do focus more on the IRS' strategic goals and call for investments that are needed today for a stronger tax administration system in the future. The Oversight Board believes that its approach represents a meaningful long-term investment to benefit our nation in the decades to come.

Table 1.

IRS Oversight Board Recommended FY 2010 IRS Budget by Program Initiative

(dollars in thousands)

FY 2009 Enacted	**$11,522,598**
Changes to Base:	
Maintaining Current Levels	**$256,329**
Efficiencies/Savings	**($118,125)**
Reinvestment	**$2,331**
Subtotal Changes to Base	**$140,535**
Total FY 2010 Base—Current Services	**$11,663133**
Program Increases	
Taxpayer Service Initiatives	
TAB Technology Enhancements	$6,000
Optimize TAC Footprint	$17,880
Research and Analysis to Improve Taxpayer Service	$7,750
Subtotal, Taxpaper Service Initiatives	**$31,630**
Program Increases:	
Enforcement Initiatives	
Reduce the Tax Gap Attributable to International Activities	128,064
Improve Reporting Compliance of SB/SE Taxpayers	94,215
Expand Document Matching for Business Taxpayers	26,237
Address Nonfiling/Underpayment and Collection Coverage	83,644
Subtotal, Enforcement Initiatives	**$332,160**
Infrastructure Initiatives	
Address IT Security and Material Weakness	$90,000
Implement Return Review Program	$18,100
Refresh/Sustain Infrastructure	$75,000
Training and Certifying Project Managers	$5,000
Enhance Privacy, Information Protection and Data Security	$9,154
Technology Investments to Enhance Operations	$35,000
Upgrade Integrated Financial System (IFS)	$40,700
Leadership Training and Development	$20,000
Subtotal, Infrastructure Initiatives	**$292,954**
BSM Initiative	

IRS Oversight Board Recommended FY 2010 IRS Budget by Program Initiative—Continued

(dollars in thousands)

Fund BSM to Accelerate Taxpayer Benefits	$168,933
Subtotal, BSM	**$168,933**
Subtotal FY 2010 Program Initiatives	**$825,677**
Total FY 2010 Request	**$12,488,810**
FY 2010 President's Request for IRS	$12,126,000
Increase Over President's Request	**$362,810**

Table 2

Summary of Oversight Board Recommended IRS FY 2010 Budget by Account

(dollars in thousands)

	Taxpayer Service	Enforcement	Ops Support	BSM	HITCA	Total
FY 2009 Enacted Budget	$2,293,000	$5,117,267	$3,867,011	$229,914	$15,406	$11,522,598
Changes to Base:		$0				$0
Maintaining Current Levels Adjustment	$60,195	$133,815	$61,060	$1,153	$106	$256,329
Efficiencies/Savings	($90,918)	$0	($27,207)	$0	$0	($118,125)
Reinvestment	$2,025	$0	$306	$0	$0	$2,331
Subtotal Changes to Base	($28,698)	$133,815	$34,159	$1,153	$106	$140,535
Total FY 2010 Base—Current Services	$2,264,302	$5,251,082	$3,901,170	$231,067	$15,512	$11,663,133
Program Increases						
Taxpayer Service Initiatives						
TAB Technology Enhancements	$592		$5,408			$6,000
Optimize TAC Footprint	$4,238		$13,642			$17,880
Research and Analysis to Improve Service			$7,750			$7,750
Subtotal, Taxpayer Service Initiatives	$4,830		$26,800			$31,630
Enforcement Initiatives						0
Reduce the Tax Gap Attributable to InternationalActivities	$3,124	$104,113	$20,827			$128,064
Improve Reporting Compliance of SB/SE Taxpayers	$267	$75,114	$18,834			$94,215
Expand Document Matching for Business Taxpayers	$1,425	$17,955	$6,857			$26,237
Address Nonfiling/Underpayment and Collection Coverage	$712	$55,736	$27,196			$83,644
Subtotal, Enforcement Initiatives	$5,528	$252,918	$73,714	$0	$0	$332,160
Infrastructure Initiatives						
Address IT Security and Material Weakness			$90,000			$90,000
Implement Return Review Program (RRP)			$18,100			$18,100
Refresh/Sustain Infrastructure			$75,000			$75,000
Training and Certifying Project Managers			$5,000			$5,000
Enhance Privacy, Information Protection and Data Security			$9,154			$9,154
Technology Investments to Enhance Operations			$35,000			$35,000
Upgrade Integrated Financial System (IFS)			$40,700			$40,700
Leadership Training and Development			$20,000			$20,000
Subtotal, Infrastructure Initiatives	$0	$0	$292,954	$0	$0	$292,954

Summary of Oversight Board Recommended IRS FY 2010 Budget by Account—Continued
(dollars in thousands)

	Taxpayer Service	Enforcement	Ops Support	BSM	HITCA	Total
Business Systems Modernization Initiative						
Fund BSM to Accelerate Taxpayer Benefits				$168,933		$168,933
Subtotal, Business Systems Modernization	**$0**	**$0**	**$0**	**$168,933**	**$0**	**$168,933**
Subtotal FY 2010 Program Changes	**$10,358**	**$252,918**	**$393,468**	**$168,933**	**$0**	**$825,677**
Total FY 2010 Board Recommendation	**$2,274,660**	**$5,504,000**	**$4,294,638**	**$400,000**	**$15,512**	**$12,488,810**
FY2009 Enacted	**$2,293,000**	**$5,117,267**	**$3,867,011**	**$229,914**	**$15,406**	**$11,522,598**
FY2010 President's Request for IRS	**$2,269,830**	**$5,504,000**	**$4,082,984**	**$253,674**	**$15,512**	**$12,126,000**
Increase Over President's Request	**$4,830**	**$0**	**$211,654**	**$146,326**	**$0**	**$362,810**
Percent Increase Over President's Request	**0.2%**	**0.0%**	**5.2%**	**57.7%**	**0.0%**	**3.0%**

MATERIAL SUBMITTED FOR THE RECORD

Questions from Congressman Joseph Crowley

Congressman Joseph Crowley
Questions for the Record
June 4, 2009 hearing
House Ways and Means Subcommittee Oversight

Earned Income Tax Credit (EITC)

Q1. While I do appreciate the due diligence undertaken by the IRS to ensure that all recipients of the EITC are the justified beneficiaries, I have concerns about the hold up of at least 90,000 refund checks claiming EITC.

I have been told that, at the time of the hearing, the IRS has sent over 400,000 audit letters to taxpayers claiming the EITC this year. Of this number, about 130,000 are in the final 90 day notice of deficiency stage and the IRS reports that nearly 90,000 of these taxpayers have not responded to several letters from the IRS seeking additional information.

My concern is that you are holding up the tax refunds of taxpayers who are entitled to EITC. These are lower income taxpayers who may be intimidated by the IRS and they may not have understood the IRS letter, they may never have received the IRS letter, or they may have replied to the letter and the response has not been processed.

My concern is that during this tough economic time, the IRS is squeezing those who are most vulnerable – working families, likely with children.

Could you report on the number of total audit letters sent, the status of these letters now, and comment on the IRS' holding nearly 90,000 refund checks claiming EITC?

IRS Response:

A1. The IRS issued almost 418,000 initial audit letters to EITC taxpayers during the period October 2008 through May 2009. Few cases are closed because the IRS gives taxpayers a total of 195 days from the date of the initial audit letter to respond. If the taxpayer does not respond within this timeframe, the audit is closed and the EITC disallowed. Of the audits started, 45,500 of these audits have been completed. Of the audits that have been completed, 41,500 taxpayers contacted the IRS. The IRS is holding the EITC refund on 276,000 of the audits that are in open status and awaiting resolution. Of these, 90,000 are in 90 day status. The taxpayers in the remaining 96,500 cases in open status had already received their EITC refunds before they were selected for audit and notified.

The IRS is sensitive to taxpayers and the challenges they face during these hard economic times and has taken a number of steps to help financially distressed taxpayers maximize their refunds and speed payments while providing additional

help to people struggling to meet their tax obligations. To balance our responsibility to enforce the law with the economic realities facing many taxpayers, the IRS has shown flexibility in audit and collection processes, expanded education and outreach programs to promote new and existing credits and provided free tax preparation and filing assistance.

The IRS has a balanced approach to administering EITC, ensuring that taxpayers eligible for the credit receive it while minimizing EITC paid out in error. The EITC audit process is an important piece of the IRS's EITC compliance strategy to address the 23% to 28% of EITC paid in error annually. The strategy also includes a robust outreach and education component focused on both the taxpayer and the tax professional community.

The IRS has been successful in identifying taxpayers not likely eligible for the EITC for audit. The IRS is sensitive to the burden placed on low to moderate income taxpayers by the audit process so we use external data and sophisticated filters and models to select highly questionable EITC returns for audits. This selection tool is updated annually to improve its performance.

Historical data supports that the EITC audit selection process is very accurate, resulting in the EITC disallowed on over 90 percent of the audits, especially pre-refund audits, where we hold the refund until the audit is complete. Taxpayers in pre-refund audits who claimed EITC, and who are found not eligible for it, will not be placed in the difficult position of having to repay EITC received in error.

The IRS uses the current address the taxpayer has on file to send audit letters. If the letters are returned, the IRS conducts additional research to find a more current address. It should be noted that pre-refund audit letters are sent out immediately after a return is filed, using the very current address supplied by the taxpayer on the return.

During the audit process, taxpayers receive multiple opportunities to provide information to IRS to support their claims and exercise their right to disagree to IRS findings. At a minimum, taxpayers are sent two requests for information, with 30 day response intervals, before a statutory notice of deficiency (90 day letter) is issued. The IRS adds an additional 15 days to each due date to ensure replies are taken into consideration before the next action is taken. The second letter and deficiency notice allow the taxpayer to informally appeal and petition the Tax Court, respectively.

If a taxpayer responds with incomplete information during the process, the IRS will call and/or correspond back to try to resolve the issue. The IRS gives responses on pre-refund audits priority status to minimize the time the refund is withheld. After taxpayers respond and are found eligible for EITC, the IRS is able to release their refunds within four to six weeks.

The audit process for EITC taxpayers is designed to select only those most likely to have claimed EITC in error, but during this process, taxpayers are provided guidance and given time to respond with information to verify their claim. This entire process is designed to protect taxpayer rights. The IRS is committed to a robust examination strategy that balances resources across the tax gap. As part of that strategy, we will continue to seek opportunities to simplify and improve the audit process to reduce both taxpayer and IRS burden.

Transfer Pricing:

Q2. On Tuesday, June 2, 2009, you spoke at the OECD Conference here in Washington, where you discussed some actions being taken by the IRS to address international tax administration. Specifically, in your prepared remarks, you mentioned the importance of IRS enforcement, including the recent successful decision for the IRS in the Xilinx decision last month.

This leads me to a question to get a better understanding of the philosophy of the IRS with respect to transfer pricing and this recent court decision.

Both the OECD and US Treasury regulations dictate that all deductions and income in transfer pricing arrangements are allocated according to an "arm's length" standard --how unrelated companies would share those costs.

But the panel of judges ruling in favor of the IRS in the Xilinx decision held that the regulation limiting the IRS to an arm's length standard is in "irreconcilable" conflict with another regulation that gives the IRS authority to decide how R&D-type expenses should be allocated between corporate subsidiaries.

While this decision is considered a victory for the government, many tax practitioners worry that this decision gives the IRS too much discretion in allocating expenses among related entities and provides the IRS with new broad powers to adjust corporate tax returns.

Could you comment on how this court decision will guide the IRS in other transfer pricing cases, and the types of guidance you will provide to multi-national corporations to ensure rules are not arbitrary, as some fear.

A2. The opinion of the United States Court of Appeals for the Ninth Circuit in Xilinx, Inc. v. Commissioner was filed on May 27, 2009. Subsequently, the taxpayer filed with the Ninth Circuit a motion for an extension until August 12, 2009, to request rehearing of the case by the three-judge panel or *en banc*. Even if the taxpayer's pending request is denied, the opinion will not become "final" until the end of the time period for filing a petition for certiorari with the U.S. Supreme Court. Effectively, this case is still in active litigation and the period for appeals has not yet expired. We need to wait until all appeals are exhausted and the case becomes "final" before we can fully assess the impact of the case and whether further guidance is appropriate. However, it should be noted that subsequent regulations (in 2003 and 2009) specifically address the technical interpretation of the arm's length

standard in the context of a cost sharing arrangement, and require the foreign subsidiary to compensate its U.S. parent for its full portion of costs of developing intangibles, including employee stock option compensation. The Treasury Department and the Service remain committed to the arm's length standard.

Foreign Tax Credits:

Q3. Commissioner, in the remarks you gave at the OECD Conference here in Washington on June 2, 2009, you highlight that the volume of foreign tax credits claimed on tax returns by US businesses increased by 71% between 2000 and 2007. But that that volume of foreign tax credits claimed by individual Americans rose an eye-popping 133%. Can you explain the increase in both of these numbers -especially among individuals?

A3. The increase in foreign tax credit claims may result from several factors: (i) increased foreign investment and business activity by both individuals and corporations; (ii) increased use of structured transactions such as foreign tax credit generators, and (iii) statutory changes such as those relaxing the limitations on the foreign tax credit that took effect in 2003 and 2007, and the temporary repatriation incentive for 2004-05 included in the American Jobs Creation Act. For example, it is likely that a substantial portion of the recent increase in individual foreign tax credit claims resulted from increased investment by individual U.S. taxpayers in foreign equities paying dividends subject to foreign withholding tax, both directly and through mutual funds, as well as foreign income taxes on wages, and other foreign business and investment activity conducted through partnerships or disregarded entities.

Questions from Representative Dave Reichert

Questions from Rep. Dave Reichert, Member of Congress for Commissioner Douglas Shulman, International Revenue Service:

1) **I really want to see the IRS Free File program continue to grow and succeed. Does the IRS plan to renew the current Memorandum of Understanding with the Free File Alliance?**

   IRS Response: Since its inception in 2003, the IRS Free File Program has generated over 27 million free federal returns for America's taxpayers. The existing agreement between the IRS and the Free File Alliance expires October 31, 2009 and the IRS is currently in discussions with the Free File Alliance about the potential to extend the current agreement or enter into a new one.

2) **If so, for how many years does it plan to renew the Free File Alliance? Two years? Five years? Or even longer?**

   IRS Response: The term of the agreement, whether it be an extension of the existing one or a new one, is also included in the discussions with the Free File Alliance. The IRS believes the Free File program has provided, and will continue to provide, an effective way to deliver free tax preparation and filing for taxpayers.