

FINANCIAL SERVICES AND GENERAL
GOVERNMENT APPROPRIATIONS FOR 2013

HEARINGS
BEFORE A
SUBCOMMITTEE OF THE
COMMITTEE ON APPROPRIATIONS
HOUSE OF REPRESENTATIVES
ONE HUNDRED TWELFTH CONGRESS
SECOND SESSION

SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
APPROPRIATIONS

JO ANN EMERSON, Missouri, *Chair*

RODNEY ALEXANDER, Louisiana
JO BONNER, Alabama
MARIO DIAZ-BALART, Florida
TOM GRAVES, Georgia
KEVIN YODER, Kansas
STEVE WOMACK, Arkansas

JOSÉ E. SERRANO, New York
BARBARA LEE, California
PETER J. VISCLOSKY, Indiana
ED PASTOR, Arizona

NOTE: Under Committee Rules, Mr. Rogers, as Chairman of the Full Committee, and Mr. Dicks, as Ranking
Minority Member of the Full Committee, are authorized to sit as Members of all Subcommittees.

JOHN MARTENS, WINNIE CHANG, KELLY HITCHCOCK, and ARIANA SARAR,
Subcommittee Staff

PART 6

	Page
Office of Treasury Inspector General and Office of Treasury Inspector General for Tax Administration [TIGTA]	1
Internal Revenue Service	79
Department of the Treasury [Secretary]	157



COMMITTEE ON APPROPRIATIONS

HAROLD ROGERS, Kentucky, *Chairman*

C. W. BILL YOUNG, Florida ¹	NORMAN D. DICKS, Washington
JERRY LEWIS, California ¹	MARCY KAPTUR, Ohio
FRANK R. WOLF, Virginia	PETER J. VISCLOSKEY, Indiana
JACK KINGSTON, Georgia	NITA M. LOWEY, New York
RODNEY P. FRELINGHUYSEN, New Jersey	JOSE E. SERRANO, New York
TOM LATHAM, Iowa	ROSA L. DeLAURO, Connecticut
ROBERT B. ADERHOLT, Alabama	JAMES P. MORAN, Virginia
JO ANN EMERSON, Missouri	JOHN W. OLVER, Massachusetts
KAY GRANGER, Texas	ED PASTOR, Arizona
MICHAEL K. SIMPSON, Idaho	DAVID E. PRICE, North Carolina
JOHN ABNEY CULBERSON, Texas	MAURICE D. HINCHEY, New York
ANDER CRENSHAW, Florida	LUCILLE ROYBAL-ALLARD, California
DENNY REHBERG, Montana	SAM FARR, California
JOHN R. CARTER, Texas	JESSE L. JACKSON, Jr., Illinois
RODNEY ALEXANDER, Louisiana	CHAKA FATTAH, Pennsylvania
KEN CALVERT, California	STEVEN R. ROTHMAN, New Jersey
JO BONNER, Alabama	SANFORD D. BISHOP, Jr., Georgia
STEVEN C. LATOURETTE, Ohio	BARBARA LEE, California
TOM COLE, Oklahoma	ADAM B. SCHIFF, California
JEFF FLAKE, Arizona	MICHAEL M. HONDA, California
MARIO DIAZ-BALART, Florida	BETTY McCOLLUM, Minnesota
CHARLES W. DENT, Pennsylvania	
STEVE AUSTRIA, Ohio	
CYNTHIA M. LUMMIS, Wyoming	
TOM GRAVES, Georgia	
KEVIN YODER, Kansas	
STEVE WOMACK, Arkansas	
ALAN NUNNELEE, Mississippi	

¹ Chairman Emeritus

WILLIAM B. INGLEE, *Clerk and Staff Director*

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2013

WEDNESDAY, MARCH 7, 2012.

OFFICE OF TREASURY INSPECTOR GENERAL AND OF- FICE OF TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

WITNESSES

ERIC M. THORSON, TREASURY INSPECTOR GENERAL

**J. RUSSELL GEORGE, TREASURY INSPECTOR GENERAL FOR TAX AD-
MINISTRATION**

Mrs. EMERSON. The hearing will come to order.

I would like to welcome my Subcommittee ranking member Joe Serrano and I would like to extend a special welcome to you all. Thank you very much for your patience in allowing us to change the hearing time. The thought of having you just sit there for an hour while we had to go vote is just not fair. So we really appreciate it very much.

This is the first time in a long time that the Treasury Inspector General has appeared before this subcommittee.

Welcome, Inspector General Thorson.

And this is a return appearance for the Treasury Inspector General for Tax Administration.

We are very pleased to see you again, Inspector General George.

Speaking of firsts, for the first time since 1947, the Federal Government's debt-to-GDP ratio will exceed 100 percent. That means that the Federal Government has mortgaged the value of all goods and services produced in the United States this year to pay for past and current Federal spending.

This uncontrolled appetite for spending has landed the United States in the same elite group as Greece, Italy, Portugal, and Spain. Unless we make measurable reductions in spending now, we will be forced, perhaps suddenly and unexpectedly, to adopt drastic austerity measures later. Look at England, look at Greece. The cradle of Western civilization is mired in protests over cuts to government spending.

The Appropriations Committee's jurisdiction is limited to the discretionary spending part of the debt equation. Over the last 2 years, this Subcommittee has reduced spending in its jurisdiction by 11 percent. I am committed to making further reductions. Deciding how and where to reduce spending is a Gordian knot, to say the least, but one that the Committee is determined to cut with deliberate study and review.

Inspector General Thorson oversees all Treasury Department programs and offices, with the exception of the IRS and TARP, and is requesting an appropriation of \$29 million and a staff of 172. The Subcommittee is pleased that conditions will allow the IG to conduct more audits and investigations and fewer material loss reviews. We are depending on your work to help make Treasury more efficient.

Inspector General George oversees the IRS, which is in its third year of implementing the healthcare act. Hard for me to believe, but I guess it is the third year—amazing. The Subcommittee is concerned that the sheer enormity and novelty of the changes required by the healthcare act introduces risks and uncertainties in the Department's largest and most visible agency. Your work on all aspects of the IRS has been critical to the IRS and this Subcommittee.

Once again, welcome. We appreciate your service, and we look forward to your testimony. But now I would like to recognize my good friend, Mr. Serrano, for any opening statements he would like to make.

Mr. SERRANO. Thank you, Madam Chair.

I would like to join Chairwoman Emerson in welcoming both Eric Thorson, the Inspector General for the Department of the Treasury, and Russell George, the Treasury Inspector General for Tax Administration, although you keep reminding me you are a Mets fan. At least you are keeping it in New York, which is okay.

Mrs. EMERSON. I know. But the Mets—did you all beat my Cardinals yesterday?

Mr. GEORGE. You know, I am not sure. I was preparing for this hearing.

Mrs. EMERSON. Yeah, I know. I think you did, sadly.

Mr. SERRANO. That is a great comeback line.

Both of you have important jobs in making sure that our government is working in an effective and efficient manner.

Inspector General Thorson, I understand that Dodd-Frank gave your office an important new responsibility as the Chair of the Council of Inspectors General on Financial Oversight. I am interested to learn more about your role in this new entity. Additionally, I see that you have requested an approximately \$1 million decrease for the Office of Inspector General for 2013. Hopefully, we will have a chance to discuss whether this funding level is sufficient for the office in the coming year.

Inspector General George, thank you for once again appearing before this Subcommittee. I think we all found your testimony last year to be very interesting, and I look forward to hearing your views on the current challenges facing the IRS. In particular, I am interested in learning more about the impact that last year's budget cuts had on the IRS and its efforts to close the tax gap. Moreover, I hope you will be able to give us your sense of the impact on the IRS of the mandatory budget cuts that would be imposed if sequestration occurs.

I thank you both for your service and look forward to your testimony.

Thank you.

Mrs. EMERSON. Thank you so much, Mr. Serrano.

I will now recognize Inspector General Thorson and then Inspector General George to give his statement. If you could keep your comments to 5 minutes or less, I would be grateful that will give us more time for questions. Thank you so much.

Mr. THORSON. Okay.

Chairwoman Emerson and Ranking Member Serrano and Members of the Committee, I thank you for the opportunity to appear before you this afternoon with my friend and colleague Russell George. I appreciate that the Subcommittee is looking to us to help identify savings and promote efficiency, a goal that we certainly share with the Committee.

I have served as the Treasury Inspector General since 2008. My office provides independent audit and investigative oversight of the Treasury, except for IRS and TARP, as you mentioned. I also Chair the Council of Inspectors General on Financial Oversight, or CIGFO. That council was established by the Dodd-Frank Act to, among other things, evaluate the effectiveness and internal operations of the Financial Stability Oversight Council, FSOC.

My office has three mission components: audit, investigations, and the Small Business Lending Fund program oversight, which is led by a Special Deputy Inspector General.

Our 2013 budget request is \$28.59 million. Although our request is \$1 million less than our funding last year, I believe this request provides for an adequate oversight presence consistent with our responsibilities under the IG Act.

I would offer two observations about Treasury as you consider ways to improve efficiencies and to save funds.

First, several bureaus within Treasury do not receive appropriated funds for their operations: the Office of Comptroller of the Currency, OCC; Bureau of Engraving and Printing, BEP; and the Mint. The relatively new Office of Financial Research, OFR, and the FSOC will soon be funded by assessments of large financial companies.

Second, Treasury's fiscal year 2013 budget request at the appropriated level, excluding IRS and the three IG offices, is about \$35 million less than last year. This budget request supports an expansive and critical level of responsibilities that is carried out by about 4,800 full-time equivalent employees.

Treasury, among many other things, leads the Nation's fight against terrorist financing and money laundering. They administer foreign sanction programs against countries such as Iran and North Korea. They manage trillions of dollars in Federal collections and payments and the public debt, collect alcohol and tobacco excise taxes of about \$24 billion, and provide domestic assistance through the Community Development Financial Institutions Fund, CDFI. They also promote national security and other U.S. interests through multilateral financial institutions such as the World Bank. This is an extremely diverse group of responsibilities done by relatively very few people.

Each year, I provide the Treasury Secretary with my office's perspective on the most serious management and performance challenges facing the Department. My October 2011 memorandum to the Secretary identified four such challenges.

The first was transforming financial regulation. Dodd-Frank established a number of new responsibilities for Treasury and the Secretary. It created FSOC, chaired by the Secretary, to identify risks to financial stability, respond to emerging threats to the financial system, and promote market discipline. FSOC continues to work to meet its responsibilities, including designating non-bank financial companies for consolidated supervision and recommending heightened standards for large, interconnected non-bank financial companies.

The second challenge that I reported on was managing Treasury's authorities to support and improve the economy. During the financial crisis, Congress provided Treasury with broad new authorities under several acts: Housing and Economic Recovery Act, Emergency Economic Stabilization Act, American Recovery and Reinvestment Act, and the Small Business Jobs Act. While certain of these authorities have expired, Treasury continues to manage a very significant outstanding investment portfolio.

The third challenge is combating money laundering and terrorist financing and enforcing the Bank Secrecy Act, BSA. Treasury's Office of Terrorism and Financial Intelligence has made good progress in closing vulnerabilities that allowed money launderers and terrorists to use the financial system to support their activities.

Nonetheless, significant challenges remain. One is ensuring continued cooperation and coordination of all the organizations involved in anti-money-laundering and combating terrorist financing efforts. Many of these entities also participate in efforts to ensure compliance with U.S. foreign sanction programs administered by Treasury's Office of Foreign Assets Control, OFAC. Neither FinCEN nor OFAC can ensure compliance with their programs without significant help from other Federal and State regulators. FinCEN must continue to work with regulators in examining agencies in order to ensure that financial institutions establish effective BSA compliance programs and file accurate and complete reports on large currency transactions and suspicious activities.

The fourth and last challenge is managing capital investments, particularly IT investments. Over the years, we have reported on a number of capital investment projects that have either failed or had serious problems. Therefore, this continues to be a major challenge for the Department and, as such, a concern for our office.

In concluding, I would like to highlight just a couple of our ongoing oversight work projects. We are reviewing the progress in standing up the OFR and plan to do the same at the new Federal Insurance Office. Because Treasury, through the Federal Financing Bank, funded the \$535 million loan to Solyndra guaranteed by Energy, we are reviewing Treasury's role with this loan transaction.

With the other financial IGs, we are assessing controls over sensitive and proprietary information at FSOC, OFR, and OCC. And our auditors have undertaken work in response to congressional requests related to last summer's debt-limit crisis and OCC's supervision of community banks.

Our Office of Investigations has embarked on several important initiatives related to bank failures, money service businesses, and the Check Forgery Insurance Fund. These initiatives have resulted

in numerous arrests, indictments, and recoveries, and serve as important deterrents.

In closing, I would like to express my appreciation to the Subcommittee for its strong support for our office over the years. We very much appreciate that. And I will be pleased to answer whatever questions you might have.

Mrs. EMERSON. Thanks very much, Mr. Thorson.

[The prepared statement follows:]

STATEMENT OF THE HONORABLE ERIC M. THORSON
INSPECTOR GENERAL
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT
U.S. HOUSE OF REPRESENTATIVES
March 7, 2012

Chairwoman Emerson, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to appear before you this afternoon with my friend and colleague, Treasury Inspector General for Tax Administration Russell George. I appreciate that the Subcommittee is looking to us to help identify savings and promote efficiency in the Treasury Department. With that in mind, I will give you an overview of Treasury's more significant programs and operations under our jurisdiction as well as our perspective on the most serious management and performance challenges facing it. I will also discuss some of our more recently completed and ongoing oversight work. Before discussing this work, however, I will first briefly tell you about my office and our budget request.

Treasury Office of Inspector General

I have served as the Treasury Inspector General since 2008. The office that I lead provides independent audit and investigative oversight of the Department's programs and operations and that of its bureaus, except for the Internal Revenue Service (IRS) and the Troubled Asset Relief Program (TARP). I also chair the Council of Inspectors General on Financial Oversight. That Council was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) to facilitate information sharing among the nine financial Inspector General (IG) members, provide a forum for discussion of IG member work as it relates to the broader financial sector, and evaluate the effectiveness and internal operations of the Financial Stability Oversight Council (FSOC) chaired by the Secretary of the Treasury.

My office is staffed with about 190 employees and has three mission components: the Office of Audit, the Office of Investigations, and the Office of Small Business Lending Fund (SBLF) Program Oversight. The Office of SBLF Program Oversight, under the leadership of a Special Deputy Inspector General, conducts, supervises, and coordinates audits and investigations of the SBLF, which has invested more than \$4 billion in community banks, as well as the \$1.5 billion State Small Business Credit Initiative (SSBCI).

Our fiscal year 2013 budget request is \$28.59 million, a decrease of \$1 million from our fiscal year 2012 appropriation. Our request recognizes the government-wide need to rein in spending but maintains what I believe is an adequate oversight presence consistent with our legislative mandates. It should be noted that our Office of SBLF Program Oversight is funded through the SBLF.

As I discuss our priorities and work, I would like to make two observations about Treasury that are important when contemplating ways in which improved efficiencies and/or cuts can save government funds. As the first observation, several bureaus within Treasury do not receive one penny of appropriated funds for their operations. Those bureaus include the Office of the Comptroller of the Currency (OCC), the Bureau of Engraving and Printing (BEP), and the U.S. Mint. Instead, OCC collects fees from the banks it regulates and these fees are used to fund OCC operations. BEP and the Mint are principally reimbursed by the Board of Governors of the Federal Reserve System (FRB) for the currency and coins they produce. It should also be noted that, beginning on July 21st of this year, the Office of Financial Research (OFR), created by Dodd-Frank to support FSOC, and FSOC itself, are to be funded by assessments of bank holding companies with total consolidated assets of \$50 billion or greater and nonbank financial companies supervised by FRB.

As the second observation, Treasury's fiscal year 2013 budget request, absent the IRS and those funds allocated for the three Inspectors General, is about \$35 million less than last year, but continues to support an expansive and critical level of responsibilities that are to be carried out by 4,800 full-time equivalent employees (at the Treasury appropriated level). Treasury's responsibilities include, among other things, waging the Nation's fight against terrorist financing and money laundering; administering foreign sanction programs; managing the trillions of dollars in federal collections and payments; maintaining government-wide financial accounting records; managing and accounting for the public debt; collecting annual tax revenues of \$24 billion on alcohol, tobacco, and other products; providing domestic assistance through the Community Development Financial Institutions Fund; as well as promoting national security and other U.S. interests through multilateral financial institutions.

Treasury's Management and Performance Challenges

In accordance with the Reports Consolidation Act of 2000, I annually provide the Treasury Secretary with my office's perspective on the most serious management and performance challenges facing the Department. My October 2011 memorandum to Secretary Geithner identified four management and performance challenges, which I will briefly describe and provide some updated information.

Transforming Financial Regulation

Dodd-Frank established a number of new responsibilities for Treasury and the Secretary. As mentioned earlier, it created the FSOC, chaired by the Secretary, whose mission is to identify risks to financial stability that could arise from the activities of large, interconnected financial companies; respond to any emerging threats to the financial system; and promote market discipline. As required, FSOC issued its first annual report in July 2011. The report contained recommendations to (1) heighten risk management and supervisory attention in specific areas, (2) make further reforms to address structural vulnerabilities in key markets, (3) take steps to address reform of the housing finance market, and (4) ensure interagency coordination on financial regulatory reform. FSOC still has work ahead to meet all of its responsibilities, including designating nonbank financial companies for consolidated supervision and recommending heightened standards for large interconnected nonbank financial companies.

Dodd-Frank also established two new offices within Treasury: OFR, mentioned earlier, and the Federal Insurance Office (FIO). OFR is to be the data collection, research, and analysis arm of FSOC. As an illustration of the significance of OFR to Treasury, the fiscal year 2013 budget request shows OFR's estimated expenses at \$138.22 million which, in just its third year of operation, is already greater than that of several Treasury bureaus, including the Financial Crimes Enforcement Network (FinCEN) whose 2013 budget request is \$102.41 million.

Other regulatory challenges still remain within the Department. Specifically, since September 2007, 118 Treasury-regulated financial institutions failed, with estimated losses to the Deposit Insurance Fund of about \$35 billion. We have completed 52 material loss reviews and 52 other reviews of these failures. Our work found that OCC and the former Office of Thrift Supervision (OTS) often identified unsafe and unsound practices at the failed institutions; however, the regulators were slow to force corrective action. Furthermore, the irresponsible lending practices of many institutions are now well-recognized. At the same time, many of the failed banks also engaged in other high-risk activities, including high asset concentrations in commercial real estate and overreliance on unpredictable wholesale funding to fuel growth. In certain cases, investment holdings in Fannie

Mae and Freddie Mac securities and complex collateral debt obligations were also contributing factors.

Managing Treasury's Authorities to Support and Improve the Economy

Congress provided Treasury with broad authorities to address the financial crisis under the Housing and Economic Recovery Act (HERA) and the Emergency Economic Stabilization Act (EESA) enacted in 2008, the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the Small Business Jobs Act of 2010. Certain authorities in HERA and EESA have now expired but challenges remain in managing Treasury's outstanding investments. To a large extent, Treasury's program administration under these acts has matured.

SBLF and SSBCI The Small Business Jobs Act of 2010 created a \$30 billion SBLF within Treasury and provided \$1.5 billion to be allocated by Treasury to eligible state programs through the SSBCI program. Both programs were slow to disburse funds to intended recipients, with Treasury approving the majority of SBLF and SSBCI applications during the last quarter of fiscal year 2011. In this regard, just over \$4 billion of SBLF investments were approved of the \$30 billion authorized. Now that Treasury has completed the approval process for these two programs, the challenge will be to exercise sufficient oversight to ensure that funds are used appropriately by participants, SBLF dividends owed Treasury are paid, and the programs achieve intended results. To date, our Office of SBLF Oversight has issued four reports finding weaknesses in early SBLF investment decisions, the process used to evaluate applicants, the cost estimate for the SBLF program, and Treasury's oversight and compliance framework for the SSBCI program. We are currently evaluating the accuracy of small business lending activity supporting initial SBLF dividend rates and the soundness of investment decisions that were made in the months preceding the SBLF disbursement deadline. We are also conducting audits of the use of SSBCI funds by several participating states.

Recovery Act Programs Treasury is responsible for overseeing an estimated \$150 billion of Recovery Act funding and tax relief. Treasury's oversight responsibilities include programs that provide payments for specified energy property in lieu of tax credits, payments to states for low-income housing projects in lieu of tax credits, grants and tax credits through the Community Development Financial Institutions Fund, economic recovery payments to social security beneficiaries and others, and payments to U.S. territories for distribution to their citizens.

It is estimated that Treasury's Recovery Act payments in lieu of tax credit programs, for specified energy property and to states for low-income housing projects, will cost more than \$20 billion over their lives. As of January 2012,

Treasury had awarded approximately \$16 billion under these programs. We conducted a number of audits to determine whether specified energy property payments were properly awarded. We have found some questionable claims totaling several million dollars. As such, our Office of Investigations has reviewed hundreds of suspected fraudulent applications related to the disbursement of Recovery Act funds under the Specified Energy Property 1603 Program. These reviews have resulted in the initiation of numerous federal criminal investigations which are ongoing and have ensured that millions of dollars have not been disbursed and/or lost to suspected fraud against the program. We are continuing our work in this area and will report on instances of program abuse as necessary.

Fannie Mae and Freddie Mac Under HERA, Treasury continues to address the distressed financial condition of Fannie Mae and Freddie Mac which are under the conservatorship of the Federal Housing Finance Agency. Among other things, in order to cover the continuing losses of the two entities and their ability to maintain a positive net worth, Treasury agreed to purchase senior preferred stock as necessary, and as of September 30, 2011, invested \$183 billion in the two entities. We are currently auditing the process for determining the investment amounts and ensuring compliance by the entities for terms governing Treasury's investments. Even with Treasury's assistance, the future of both entities remains in question and prolonged assistance may be required. Just last month, Fannie Mae posted a \$2.4 billion loss for the fourth quarter of fiscal year 2011. Additionally, the legislative process for housing finance reform is in an early stage and it is difficult to predict what lies ahead for winding down the Fannie Mae and Freddie Mac conservatorships and reforming housing finance in the long run.

TARP Treasury's challenge in this area has changed from standing-up and running TARP programs to winding them down and recovering its investments. To date, Treasury has reported positive returns from the sale of its investments in the banking industry and has begun reducing its investment in American International Group. In this regard, I want to note that TARP is under the jurisdictional oversight of a Special Inspector General, who has issued a number of reports on TARP.

Combating Money Laundering and Terrorist Financing and Enforcing the Bank Secrecy Act

Ensuring that criminals and terrorists cannot use our financial networks to sustain their operations and/or launch attacks against the U.S. continues to be a challenge. Treasury's Office of Terrorism and Financial Intelligence (TFI) is dedicated to disrupting the ability of terrorist organizations to fund their operations. Treasury carries out its responsibilities to enhance financial transparency through the Bank

Secrecy Act (BSA) and USA Patriot Act. FinCEN is the Treasury bureau responsible for administering BSA.

Over the past decade, TFI has made progress in closing the vulnerabilities that allowed money launderers and terrorists to use the financial system to support their activities. Nonetheless, significant challenges remain. One challenge is ensuring the continued cooperation and coordination of all the organizations involved in its anti-money laundering and combating terrorist financing efforts. Many of these entities also participate in efforts to ensure compliance with U.S. foreign sanction programs administered by Treasury's Office of Foreign Assets Control (OFAC). Neither FinCEN nor OFAC has the resources or capability to maintain compliance with their programs without significant help from other organizations. To this end, Treasury has entered into memoranda of understanding with many federal and state regulators in an attempt to build a consistent and effective process. While important to promote the cooperation and coordination needed, it should be noted that these instruments are nonbinding and carry no penalties for violations.

Last year, financial institutions filed approximately 15 million BSA reports, including over 1.3 million Suspicious Activity Reports. While the number of Suspicious Activity Reports has been increasing since 2001, FinCEN needs to continue its efforts to work with regulators and examining agencies to ensure that financial institutions establish effective BSA compliance programs and file accurate and complete BSA reports, as required. Furthermore, FinCEN still needs to complete work to issue anti-money laundering regulations as it determines appropriate for some non-bank financial institutions, such as vehicle dealers; pawnbrokers; travel agents; finance companies; real estate closing and settlement services; and financial services intermediaries, such as investment advisors.

BSA data was maintained by IRS with access to the database handled through an IRS system. FinCEN's \$120 million BSA Information Technology (IT) Modernization program, begun in 2008, is being built to ensure efficient management, safeguarding, and use of BSA information. We believe the program is needed. While a prior attempt by FinCEN, from 2004 to 2006, to develop a new BSA system ended in failure with over \$17 million wasted, indications from our audit work are that project management for BSA IT Modernization is much improved and FinCEN advised that historical BSA data was successfully migrated to FinCEN from IRS in December 2011 and January 2012. The program is now at the critical point of broad-based integration testing. It is also highly dependent on continued funding, a challenge for many programs today. We noted that the Conference Report to our fiscal year 2012 appropriations requires us to monitor the BSA IT Modernization program and we expect to issue our first report at the end of March 2012.

Managing Capital Investments

Managing large capital investments, particularly IT investments, is a difficult challenge for any organization, public or private. After several years of attempting to centrally manage large infrastructure investments at the Department level, Treasury announced that it will de-consolidate all infrastructure investments to the bureaus. This move is intended to improve efficiency and transparency, cost savings and avoidance, and overall governance. In prior years, we reported on a number of capital investment projects that either failed or had serious problems. This year, we continue to identify challenges with ongoing IT investments. For example, Treasury has reported that the \$147 million Treasury Enterprise Identity, Credential and Access Management system, which will implement requirements for a common identity standard, is \$40 million over planned costs. As part of OMB's Federal Data Center Consolidation Initiative, Treasury has been closing some of its data centers. During fiscal year 2011, Treasury closed 3 of its over 60 data centers and plans to close 12 more by 2015. Treasury's ability to successfully accomplish this is contingent on adapting shared infrastructure services. Furthermore, it remains to be seen whether Treasury's decision to de-consolidate all infrastructure investments will improve efficiency and transparency, cost savings and avoidance, and overall governance as intended.

As a final point, I would like to highlight that information security at Treasury is an area of increasing concern. We reported information security as a serious management and performance challenge for a number of years but removed the challenge in 2009 based on the significant strides Treasury made in improving and institutionalizing its information security controls. We believe that remains the case today. However, notwithstanding Treasury's strong security stance, cyber attacks against federal government systems by foreign governments and the hacker community are unrelenting and increasing. Treasury's information systems are critical to the Nation, and thus potential targets of those wishing to do grave harm. Accordingly, this is a very troubling situation that requires the highest level of continual attention to ensure that information security policies remain current and practices do not deteriorate.

Completed and Ongoing Oversight Work

With respect to our Office of Audit, I have already mentioned work related to failed banks, Treasury's non-IRS Recovery Act programs, Treasury's assistance to Fannie Mae and Freddie Mac, and FinCEN's BSA Modernization Program. I also discussed the work by our Office of SBLF Program Oversight. Some other examples of recently completed and in progress audit oversight are discussed below.

BEP We reported on the production failure at BEP that resulted in the production of 1.4 billion new NexGen \$100 Notes that were not accepted by FRB. Putting

these new notes into circulation has now been delayed for over a year and no new date has been established. Additionally, when we first started looking at this, we found that many of the printed and partially printed notes were not being stored in secured vaults; BEP did promptly take corrective action when we brought this deficiency to their attention. In another audit at BEP, our IT auditors, through social engineering, gained access to all 23 employee user accounts attempted and were able to enter a secured area without the proper badging. We also noted other security vulnerabilities with BEP systems.

OFR and FIO As important new offices within the Department, OFR and FIO have been identified for review by my office. In fact, we are currently reviewing the Department's progress in standing up OFR, and plan to review FIO going forward.

Solyndra Because Treasury funded the \$535 million loan to Solyndra guaranteed by the Department of Energy and was to be consulted before the loan guarantee was announced, we are reviewing the consultative activities that occurred.

Mortgage Foreclosures In response to the robo-signing and other problems with home mortgage foreclosures, we undertook two reviews at OCC. One review is looking at OCC's examination coverage of national bank foreclosure activities. The other review is looking at how OCC is monitoring compliance with the April 2011 formal enforcement actions against eight national bank mortgage servicers and two third-party servicer providers for unsafe and unsound practices related to residential mortgage loan servicing and foreclosure processing.

FSOC As a CIGFO working group project led by the Federal Deposit Insurance Corporation's Inspector General, Jon Rymer, we, in conjunction with the other financial IGs, are assessing controls over sensitive and proprietary information at FSOC and member federal agencies.

OTS Transfer of Functions As a Dodd-Frank requirement, we and the Inspectors General of the Federal Deposit Insurance Corporation and FRB are reporting every 6 months on the transfer of OTS functions, employees, funds, and property to OCC, Federal Deposit Insurance Corporation, and FRB. To date, we have issued two reports on this on-going work.

U.S. Gold Reserves We are observing the Mint's inventory of the U.S. custodial gold reserves held by the Federal Reserve Bank of New York.

Other Congressional Requests We have undertaken work in response to congressional requests related to last summer's debt limit crisis and OCC's supervision of community banks.

Over the last 18 months, our Office of Investigations has embarked on several important investigative initiatives to combat fraud against the Department. Our Bank Failure, Money Service Business, and Check Forgery Insurance Fund initiatives all target vulnerabilities that lie within our nation's financial infrastructures or allow for the improper payment of government funds. These initiatives have resulted in numerous arrests, indictments, and recoveries. They also serve as a deterrent to fraudulent activities aimed at Treasury.

In closing, I'd like to express my appreciation to the Subcommittee for its strong support of our office over the years. I would be pleased to answer any questions that you may have. Thank you.

**The Honorable Eric M. Thorson
Inspector General
The Department of the Treasury**

Eric Thorson was nominated to be Inspector General of the Department of the Treasury by the President in November 2007 and confirmed by the Senate on August 1, 2008. As Inspector General, Mr. Thorson conducts independent oversight of the Treasury, keeping the Secretary and Congress informed through independent audits and investigations. As the Treasury Inspector General, he serves on the Recovery, Accountability and Transparency Board responsible for the oversight of the \$700+ billion stimulus package and on the National Procurement Fraud Task Force chaired by the Department of Justice Criminal Division. He was also named by the recent Dodd-Frank Act to be the Chairman of the Council of Inspectors General for Financial Oversight.

Before joining the Treasury, Mr. Thorson served as the Inspector General of the U.S. Small Business Administration, where his office uncovered one of the largest government-backed loan fraud schemes in history.

In 1997 Mr. Thorson became the Chief Investigator for the Senate Finance Committee. Prior to this Mr. Thorson was the Chief Investigator for the Senate Permanent Subcommittee on Investigations. His investigations resulted in Senate hearings on such topics as "Russian Organized Crime Within the U.S." and Gulf War "friendly fire" deaths.

Mr. Thorson has also served in the Pentagon as the Deputy Assistant Secretary, and as Acting Assistant Secretary of the Air Force.

Mr. Thorson is a graduate of the United States Air Force Academy, and is a past president and chairman of the Academy's alumni association. He served as an Air Force pilot in Southeast Asia and is a recipient of the Distinguished Flying Cross.

Mrs. EMERSON. Mr. George.

Mr. GEORGE. Thank you.

Good afternoon, Chairwoman Emerson, Ranking Member Serrano, and members of the Subcommittee. Thank you for the opportunity to testify on the President's fiscal year 2013 budget request for the Treasury Inspector General for Tax Administration, enabling our oversight of the Nation's system of tax administration.

While administering the tax laws, the IRS faces a number of significant challenges. A most serious one is the tax gap, the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay in a tax year. Despite an estimated voluntary compliance rate of 83 percent and IRS enforcement efforts, in January of this year, the IRS estimated the gross tax gap to be \$450 billion.

Every year, more than one-half of all taxpayers pay someone else to prepare their Federal income tax returns. During the 2011 filing season, the IRS processed approximately 67 million individual Federal income tax returns prepared by paid tax-return preparers. The IRS announced proposed reforms to improve oversight of the return-preparer community. While it has begun implementing the new preparer requirements, it will take years for the IRS to implement the Return Preparer Program.

I am concerned about the amount of fraudulent refunds associated with identity theft and the fact that the IRS is not effectively providing assistance to victims of identity theft. I am also concerned that the IRS's processes are not adequate to communicate theft procedures to taxpayers.

Unscrupulous individuals submit tax returns with false income documents to the IRS for the sole purpose of receiving a fraudulent tax refund. In the 2011 processing year, the IRS reported that it had identified over 2 million tax returns with more than \$16 billion claimed in fraudulent tax refunds and prevented the issuance of more than \$14 billion of those refunds. The IRS also reported that almost half of these fraudulent returns, with more than \$6 billion in associated fraudulent tax refunds, involved identity theft.

The IRS administers numerous refundable tax credits. Two significant refundable credits are the Earned Income Tax Credit and the Additional Child Tax Credit. The American Recovery and Reinvestment Act of 2009 also authorized several temporary refundable credits, including the First-Time Homebuyer Credit and the American Opportunity Tax Credit.

Our reviews have shown the need for appropriate controls to be established before refundable credits are issued. The EITC remains the largest refundable credit based on the total claims paid, and it continues to be vulnerable to a high rate of noncompliance caused by taxpayer error or resulting from fraud. In fiscal year 2011, the IRS estimated that EITC improper payments equated to \$14 billion to \$17 billion.

The Additional Child Credit is the second-largest refundable credit available to individuals. The refunds processed seeking it in fiscal year 2010 totaled \$28 billion. TIGTA recently reported that the IRS paid \$4 billion in these credits to individuals who were not authorized to work in the United States.

We have found that IRS processes are not adequate to prevent individual taxpayer identification numbers from being assigned to individuals who submit questionable applications. Production goals discourage employees from identifying questionable applications. TIGTA is currently evaluating IRS employees' complaints that IRS management has been requiring employees to assign ITINs even when the applications appear to be fraudulent.

The Recovery Act amended the Hope Scholarship Credit to provide a refundable tax credit to offset the costs of higher education. We identified 2 million taxpayers who appear to have received \$3 billion in erroneous education credits. Subsequent analysis also identified that these college tax credits were claimed for approximately 14,000 students who were age 10 or under.

As demand for taxpayer services continues to increase, resources have decreased, thereby affecting the quality of customer service that the IRS is able to provide. The IRS has reduced the operating hours for its main toll-free help line by 3 hours each day. Each year, more taxpayers also seek assistance from one of the IRS's Taxpayer Assistance Centers. These centers plan to assist more than 6 million taxpayers in fiscal year 2012. However, as a result of the IRS's smaller operating budget, the centers will not be able to offer tax-return preparation assistance to as many taxpayers as they had hoped.

Lastly, the Affordable Care Act contains an extensive array of tax law changes that will present many challenges for the IRS in the coming years. The IRS estimates that at least 42 provisions will either add to or amend the Tax Code, and at least 8 will require the IRS to build new processes that do not exist within the current tax administration system.

Thank you, and I look forward to your questions.

[The prepared statement follows:]

**HEARING BEFORE THE
COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON FINANCIAL SERVICES AND
GENERAL GOVERNMENT
U.S. HOUSE OF REPRESENTATIVES**

**“Budget Hearing – Office of Treasury IG and Office of
Treasury IG for Tax Administration”**



**Testimony of
The Honorable J. Russell George
Treasury Inspector General for Tax Administration**

March 7, 2012

Washington, D.C.

TESTIMONY OF
 THE HONORABLE J. RUSSELL GEORGE
 TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
before the
 COMMITTEE ON APPROPRIATIONS
 SUBCOMMITTEE ON FINANCIAL SERVICES AND
 GENERAL GOVERNMENT
 U.S. HOUSE OF REPRESENTATIVES

“Budget Hearing – Office of Treasury IG and Office of Treasury IG for Tax
 Administration”

March 7, 2012

Chairwoman Emerson, Ranking Member Serrano, and Members of the Subcommittee, I thank you for the opportunity to testify on the President's Fiscal Year (FY)¹ 2013 budget request for the Treasury Inspector General for Tax Administration (TIGTA). My comments will focus on our analysis of the Internal Revenue Service's (IRS) FY 2013 budget request and the most significant issues currently facing the IRS, as well as on TIGTA's FY 2013 budget request.

TIGTA is mandated to provide independent audit, investigative, and inspection and evaluation services necessary to improve the quality and credibility of IRS operations, including the oversight of the IRS Chief Counsel and the IRS Oversight Board. TIGTA reviews IRS programs; makes recommendations to improve effectiveness and efficiency; and investigates allegations of fraud, waste, and abuse. Oversight activities are explicitly designed to identify high-risk systemic inefficiencies in IRS operations and to investigate exploited weaknesses in tax administration. TIGTA ensures that the American taxpayer can have confidence that the IRS collects over \$2 trillion in tax revenue in an effective and efficient manner without fraud and abuse.

OVERVIEW OF THE IRS'S FISCAL YEAR 2013 BUDGET REQUEST

The IRS is the largest component of the Department of the Treasury and has primary responsibility for administering the Federal tax system. The IRS's budget request supports the Department of the Treasury's goals to pursue comprehensive tax and fiscal reform and to increase voluntary tax compliance.² The IRS strives to enforce the tax laws fairly and efficiently while balancing service and education to promote voluntary compliance and reduce taxpayer burden. To achieve these goals, the

¹ A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.

² U.S. Department of the Treasury Strategic Plan, Fiscal Years 2012 – 2015.

proposed FY 2013 IRS budget requests appropriated resources of \$12.8 billion.³ The total appropriations amount is an increase of \$945 million, or approximately eight percent more than the FY 2012 enacted level of approximately \$11.8 billion. The budget request includes a net staffing increase of more than 4,500 full-time equivalents (FTE),⁴ to a total of 95,257 appropriated FTEs. However, the FY 2013 increase represents only approximately 700 additional employees over the FY 2011 enacted level because of the budget cuts the IRS sustained in FY 2012.

**IRS FY 2013 Budget Request Increase
Over FY 2012 Enacted Budget
(in Thousands)**

Appropriations Account	FY 2012 Enacted	FY 2013 Request	\$ Change	% Change
Taxpayer Services ⁵	\$2,239,703	\$2,253,133	\$13,430	0.60%
Enforcement	\$5,299,367	\$5,701,670	\$402,303	7.59%
Operations Support	\$3,947,416	\$4,476,200	\$528,784	13.40%
Business Systems Modernization	\$330,210	\$330,210	\$0	0%
Total Appropriated Resources	\$11,816,696	\$12,761,213	\$944,517	7.99%

The three primary appropriations accounts are Taxpayer Services, Enforcement, and Operations Support. The Taxpayer Services account provides funding for programs that focus on helping taxpayers understand and meet their tax obligations, while the Enforcement account supports the IRS's examination and collection efforts. The Operations Support account provides funding for functions that are essential to the overall operation of the IRS, such as infrastructure and information services. Finally, the Business Systems Modernization account provides funding for the development of a new taxpayer account database and investments in electronic filing.

³ The FY 2013 budget request also includes approximately \$135 million from reimbursable programs, \$218 million from user fees, and \$239 million in available multi-year/no-year funds for a total amount of \$13.4 billion in available resources.

⁴ A measure of labor hours in which one FTE is equal to eight hours multiplied by the number of compensable days in a particular fiscal year.

⁵ In FY 2012, administrative resources for the Health Coverage Tax Credit were moved to the Taxpayer Services appropriation under the Consolidated Appropriations Act 2012 (Public Law 112-74) and are no longer funded as a separate appropriation.

ANALYSIS OF THE FISCAL YEAR 2013 BUDGET REQUEST

Changes to the Base

The IRS is requesting approximately \$108 million to fund the proposed 2013 employee pay raises, inflation, and an increase in its Federal Employment Retirement System participation. Non-labor inflation adjustments include rent, postage, supplies, and equipment.

These increases are offset by a decrease of approximately \$71 million related to efficiency and cost savings. The three largest areas of savings include targeted program reductions such as reduced staffing in support and analysis functions (a \$59.7 million decrease), increased electronic filing (e-file) savings (an \$8.6 million decrease), and reduced travel (a \$2.6 million decrease).

In total, this resulted in a net increase of \$37.6 million but a reduction in 724 FTEs from the FY 2012 enacted level.

Program Increases

The FY 2013 budget request includes program increases of \$706.5 million. The largest component of this \$706.5 million increase is \$431.4 million related to implementing enforcement initiatives to focus activities designed to improve compliance. In addition, the IRS is requesting an increase of more than \$275 million for infrastructure initiatives related to the *Patient Protection and Affordable Care Act* (Affordable Care Act).⁶ In total, this resulted in an increase of 3,590 FTEs.

Program Changes

In FY 2012, the IRS's budget was reduced by a total of \$305 million. The FY 2013 budget includes a request of \$200.5 million and 1,680 FTEs to restore the FY 2012 budget cuts related to tax law enforcement.

Funding Related to Business System Modernization

The FY 2013 budget request includes \$330.2 million in the Business Systems Modernization appropriation to modernize IRS business systems. The budget includes a decrease of 110 FTEs that were needed to support the Business Systems Modernization program in FY 2013. Cost savings from this FTE reduction and other efficiency savings will offset the necessary costs to maintain current operating levels resulting in no change to the budget request for FY 2013.

⁶ Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of 18 U.S.C., 20 U.S.C., 21 U.S.C., 25 U.S.C., 26 U.S.C., 28 U.S.C., 29 U.S.C., 30 U.S.C., 31 U.S.C., 35 U.S.C., and 42 U.S.C.).

Included in the \$330.2 million budget request is \$148 million related to the continued development of the Customer Account Data Engine 2.⁷ In FY 2012, the IRS implemented the first phase of the Customer Account Data Engine 2 and transitioned from a weekly processing cycle to a daily processing cycle. In FY 2013, the IRS plans to focus its efforts on the second phase of the Customer Account Data Engine 2 initiative, which addresses risks associated with the continued use of antiquated technologies and programming languages when used in the current IRS environment.

SIGNIFICANT ISSUES FACING THE IRS

As the IRS administers the Nation's tax laws, it faces a number of significant challenges, including:

Tax Compliance

A serious challenge confronting the IRS is the Tax Gap, which is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a tax year (TY).⁸ Despite an estimated voluntary compliance rate of 83 percent and IRS enforcement efforts, a significant amount of income remains unreported and unpaid. In January 2012, the IRS estimated the gross Tax Gap for TY 2006 to be \$450 billion.

The IRS continues to need broader strategies and more research to determine what actions are most effective in addressing taxpayer noncompliance. The IRS's current strategy for reducing the Tax Gap is largely dependent on funding for additional compliance resources and legislative changes. Despite a 19 percent increase in enforcement staffing levels since FY 2006 and the IRS's more vigorous use of collection enforcement tools, FY 2010 enforcement results were mixed when compared to FY 2009 results. The number of delinquent accounts closed by full payment increased, as did the amount collected on delinquent accounts. However, the Collection function received more delinquent accounts than it closed, gross accounts receivable rose, and the number of tax delinquency investigation cases⁹ closed with the receipt of a delinquent tax return fell.¹⁰

⁷ The Customer Account Data Engine 2 system creates a modernized processing and data-centric infrastructure that will enable the IRS to improve the accuracy and speed of individual taxpayer account processing, enhance the customer experience through improved access to account information, and increase the effectiveness and efficiency of agency operations.

⁸ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

⁹ An unfiled tax return for a taxpayer. One tax delinquency investigation case exists for all tax periods.

¹⁰ TIGTA, Ref. No. 2011-30-071, *Trends in Compliance Activities Through Fiscal Year 2010* (July 2011).

One means the IRS employs to collect unpaid taxes is the notice stream.¹¹ The notice stream is the least costly of the IRS's approaches to collecting unpaid taxes. While the notice stream collects billions of dollars in delinquent taxes annually, reducing the time between notices could result in millions more being collected annually. During FY 2010, the IRS sent approximately 21.9 million balance-due notices to individuals to attempt to collect unpaid taxes. By a wide margin, the first notice (also known as the Master File notice) closed the most cases, collected the most money, and generated the highest number of taxpayer responses. Cases not resolved after the Master File notice continue in the notice stream, and those taxpayers receive various sequences of notices. The IRS allows 35 days between notices for the taxpayer to respond, but our analysis shows that the time between notices can be reduced. As these balance due modules progress within the notice stream, the probability of collection diminishes.

TIGTA recommended that the IRS consider reducing the time between each notice by seven days. TIGTA estimates that the notice stream could potentially collect an additional \$363 million each year. In addition, taxpayers could potentially save \$1.8 million each year in interest payments. The IRS agreed with TIGTA's recommendations and plans to take corrective actions. However, in its response, the IRS stated that 35 days between notices were necessary to process taxpayer inquiries and correspondence. Our report noted that the IRS has controls in place to prevent the next notice from being sent when taxpayers' correspondence is being processed.¹²

Return Preparers

Every year, more than one-half of all taxpayers pay someone else to prepare their Federal income tax returns. During the 2011 Filing Season,¹³ the IRS processed approximately 66.9 million individual Federal income tax returns prepared by paid tax return preparers.

A series of reports issued by TIGTA have made a strong case for regulating those who prepare Federal tax returns and led the IRS to launch its Return Preparer Review. In December 2009, the IRS announced a suite of proposed reforms to improve oversight of the return preparer community. While the IRS began implementing the new preparer requirements in FY 2011, TIGTA reported that it will take years for the IRS to implement the Return Preparer Program and to realize its impact.¹⁴ When the decision was made to register preparers, the IRS had not established all of the program requirements. The IRS also had not established the organizational structure of the

¹¹ A series of balance-due notices sent by the IRS to the taxpayer to prompt payment.

¹² TIGTA, Ref. No. 2011-30-112, *Reducing the Processing Time Between Balance Due Notices Could Increase Collections* (September 2011).

¹³ The period from January 1 through April 15 when most individual income tax returns are filed.

¹⁴ TIGTA, Ref. No. 2010-40-127, *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact* (September 2010).

program, determined how it will verify all preparers met the requirements, determined how it will enforce program requirements, or developed the system(s) and processes necessary to administer and oversee the program. It will not be until Calendar Year¹⁵ 2014 that all preparers will be subjected to all suitability and competency tests. In the meantime, IRS management stated they will develop and implement an enforcement strategy. Currently, the IRS does not have a sufficient management information system to gather data on preparers. Further, the IRS will need to ensure that taxpayers understand the new requirements and the importance of using only registered preparers to prepare their tax returns.

Of the 66.9 million individual Federal income tax returns prepared by paid tax return preparers and processed by the IRS in FY 2011, 90 percent were e-filed. In November 2009, Congress approved a Federal e-file mandate for tax return preparers. TIGTA's review of the IRS's implementation of the mandate found that for the first few years the IRS plans to use a "soft" approach to enforcement that emphasizes educating and collaborating with preparers in implementing e-file requirements. Additionally, the continued use of multiple preparer identification numbers makes it difficult to match all tax returns to the preparers. However, improvements are under way to ensure the effectiveness of controls and system validations over the preparer registration process.

TIGTA recommended several actions, including that the IRS monitor preparers' compliance with the e-file mandate and ensure that suitability tests match applicants to IRS information to identify preparers who are not allowed to prepare tax returns. IRS management agreed and stated that corrective actions to address the recommendations have been taken or are planned.

Globalization

The scope and complexity of the international financial system create significant enforcement challenges for the IRS. International business holdings and investment in the United States have grown from nearly \$188 billion in 1976 to over \$14.5 trillion in 2007, while U.S. business and investment worldwide grew from nearly \$368 billion to nearly \$15 trillion over the same period. The IRS continues to be challenged by a lack of information reporting on many cross-border transactions. In addition, the varying legal requirements imposed by different jurisdictions result in complex business structures that make it difficult to determine the full scope and effect of these cross-border transactions. Technological advances also provide opportunities for offshore investments that were once only possible for large corporations and wealthy individuals.

Over the past few years, the IRS has taken steps and made strategic internal realignments to better coordinate international tax compliance issues. It has developed

¹⁵ The 12-consecutive-month period ending on December 31.

a strategic plan specifically for international tax issues with two major goals: 1) enforce the law to ensure all taxpayers meet their obligation to pay U.S. taxes and 2) improve service to make voluntary compliance less burdensome. The IRS realigned its international efforts under its Large Business and International (LB&I) Division. Also, during FY 2012, the IRS will merge the Office of Chief Counsel's Advanced Pricing Agreement Program with the LB&I Division's Mutual Agreement Program to form the Advanced Pricing and Mutual Agreement Program. This combined program will be a component of the LB&I Division's Transfer Pricing Operations. The IRS expects that efforts like these will improve international tax compliance by allowing it to focus on high-risk issues and cases with greater consistency and efficiency.

The IRS also continues to work with the U.S. Department of Justice on tax evasion cases involving foreign countries with bank secrecy laws that prevent the United States from obtaining information on taxpayer transactions. In addition, both the 2009 and 2011 Offshore Voluntary Disclosure Initiatives have encouraged taxpayers with hidden offshore assets and income to come back into the tax system using the IRS's Voluntary Disclosure Program. According to the IRS, these initiatives have resulted in the collection of over \$4 billion. Due to the success of the first two initiatives, the IRS is currently offering a third chance for delinquent taxpayers to disclose their hidden offshore assets. These initiatives are beneficial because they offer a uniform penalty structure for taxpayers who voluntarily disclose their hidden offshore assets and income to the IRS and, in return, ensure that the taxpayers receive consistent tax and penalty treatment. The initiatives also provide the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all outstanding offshore tax issues related to the undisclosed foreign bank and financial accounts and assets. On the other hand, taxpayers with undisclosed foreign accounts and assets who do not submit a voluntary disclosure run the risk of detection by the IRS. If caught, these taxpayers face the imposition of substantial penalties, including the fraud and foreign information return penalties, as well as an increased risk of criminal prosecution.

Like the IRS, TIGTA is expanding its international program. TIGTA recently worked with the U.S. Department of State to post information on its public website regarding our mission of combating fraud in Federal tax administration. The State Department also provided guidance to more than 270 U.S. embassies and consulates around the world regarding linking their individual web pages to the Travel.State.Gov website. TIGTA also continues to build a foundation of inspections of IRS global activities that will help IRS management maximize the effectiveness of its international operations. TIGTA will also seek to establish working relationships with foreign revenue collection agencies and anti-fraud organizations that are engaged in oversight of their own revenue collection agencies.

Modernization

The IRS's Business Systems Modernization Program (Modernization Program) is a complex effort to modernize technology and related business processes. It involves integrating thousands of hardware and software components while replacing outdated technology and maintaining the current tax system. The IRS originally estimated that the Modernization Program would cost approximately \$8 billion. The Program is in its 15th year; however, performance issues, appropriation shortfalls, and significant changes in the program's scope have reduced funding to \$3.8 billion. Factors that characterize the IRS's complex information technology environment include widely varying inputs from taxpayers (from simple concise records to complex voluminous documents), seasonal processing with extreme variations in processing loads, transaction rates on the order of billions per year, and data storage measured in trillions of bytes. The Modernization Program is working toward providing improved benefits to taxpayers, including:

- Issuing refunds more quickly;
- Offering electronic filing capability with dramatically reduced processing error rates;
- Delivering web-based services for tax practitioners, taxpayers, and IRS employees; and
- Providing the IRS with faster and improved customer service capability.

In FY 2012, the IRS has delivered significant updates to its core tax processing system, transitioning to a daily processing cycle for individual returns. Also, IRS processing systems are accepting all Forms 1040, *U.S. Individual Income Tax Return*, electronically through an updated e-filing capability. This capability is designed to eventually feed into a single, consolidated taxpayer account database that will support the deployment of the next generation of taxpayer service and enforcement functions.

The Modernization Program has continued to help improve IRS operations and has demonstrated successes in improving business practices by implementing new information technology solutions. Management of project costs and schedules has shown improvement, but some areas continue to need attention. Since 1995, the IRS had identified and reported the Modernization Program as a material weakness. In June 2011, the IRS Commissioner certified that the previously identified internal and management control issues had been fully addressed and the Modernization Program no longer warranted being identified as a material weakness. While we support the IRS's decision, we believe the Program remains a risk for the IRS, and we suggest that it continue to stress improvements in its overall processes and performance.

Improper Payments and Fraudulent Claims

Erroneous and improper payments issued by the IRS generally involve improperly paid refunds, tax return filing fraud, or improper payments to vendors or contractors.

Identity Theft and Tax Refund Fraud

TIGTA is concerned not only about the amount of fraudulent refunds associated with identity theft, but also that the IRS is not effectively providing assistance to victims of identity theft. TIGTA is also concerned that IRS processes are not adequate to communicate identity theft procedures to taxpayers. Identity theft involving refund fraud victimizes innocent taxpayers by impeding their ability to file tax returns and receive tax refunds.

Unscrupulous individuals submit tax returns with false income documents to the IRS for the sole purpose of receiving a fraudulent tax refund. For Processing Year (PY)¹⁶ 2011, the IRS reported that it had identified over 2.1 million tax returns with more than \$16 billion claimed in fraudulent tax refunds and prevented the issuance of more than \$14 billion (87.5 percent) of the refunds. The IRS also reported that of the 2.1 million tax returns identified as fraudulent for PY 2011, 938,664 of these tax returns, with \$6.5 billion in associated fraudulent tax refunds, involved identity theft.

The fraudulent tax returns are identified through the IRS's Electronic Fraud Detection System (EFDS) as well as through the manual screening of paper tax returns. Individual tax returns are sent through the EFDS and are scored based on the characteristics of the tax return and other data. The higher the score, the greater the probability that the tax return is fraudulent. For those tax returns meeting a certain score, the tax return is sent to an IRS employee to be screened for fraud potential. For the 2012 Filing Season, the IRS has developed new filters to better identify identity theft before issuing fraudulent tax refunds.

However, the IRS does not know how many identity thieves are filing fraudulent tax returns or the amount of revenue being lost. TIGTA is completing an evaluation of the IRS's efforts to identify and prevent fraudulent tax returns resulting from identity theft.¹⁷ Using characteristics of IRS-confirmed fraudulent tax return filings involving identity theft, TIGTA analyzed tax returns filed during the 2011 Filing Season to identify additional tax returns that met the characteristics of these confirmed cases.

¹⁶ The calendar year in which the tax return or document is processed by the IRS.

¹⁷ TIGTA, Audit No. 201140044, *Efforts to Identify and Prevent Fraudulent Tax Returns Resulting From Identity Theft* (planned report issuance in May 2012).

As TIGTA previously reported, expanding and expediting access to wage and withholding information could significantly improve the IRS's ability to identify fraudulent tax refunds, as these individuals frequently submit false income documents. To date, the actions the IRS has taken have not resulted in any significant expansion or expediting of access to this information. Access to this information at the time tax returns are processed is an important tool the IRS could use to identify and thwart tax fraud and could prevent the issuance of billions of dollars in fraudulent tax refunds.

Of further concern is the length of time taxpayers must work with the IRS to resolve identity theft. The IRS has been unable to work identity theft cases timely, and it can take more than a year to resolve them. The IRS does not provide taxpayers with realistic time frames for how long it will take to resolve their cases. Communications between identity theft victims and the IRS are limited and confusing, and victims are asked multiple times to substantiate their identity. Taxpayers do not speak directly with the assistants who are working their identity theft cases. They are instructed to call assistants in the Identity Protection Specialized Unit to discuss the status of their case. However, these assistants do not work identity theft cases and have limited information about a taxpayer's identity theft case.

As a result of an assessment of its Identity Theft Program completed in October 2011, the IRS is currently planning improvements to the program. However, the improvements may not be sufficient to significantly reduce the burden identity theft has placed on tax administration and on taxpayers whose identities have been stolen.

IRS employees who work the majority of identity theft cases are also telephone assistants who are trained to communicate with taxpayers and to know the tax laws and related IRS operational procedures. The assistants are not examiners and are not trained to conduct examinations. However, identity theft cases, like examination cases, can be complex and present considerable challenges, requiring skills and tools beyond those of the assistants.

The IRS has dedicated 400 additional assistants to work identity theft cases, but because of limited resources and the high demand for telephone assistance, the IRS plans to continue to have assistants who work identity theft cases also work the telephones on Mondays (and any Tuesday following a Monday holiday). This presents a considerable challenge to overcoming the backlog of identity theft cases. Additionally, if controls the IRS plans to implement do not decrease identity theft incidences and identity thieves continue to prevent taxpayers from filing their tax returns, this inventory could remain significant.

Refundable Credits

The IRS administers numerous refundable tax credits.¹⁸ Two significant refundable credits are the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit (ACTC). The *American Recovery and Reinvestment Act of 2009* (Recovery Act)¹⁹ also authorized several temporary refundable credits, examples of which include the First-Time Homebuyer Credit (Homebuyer Credit) and the American Opportunity Tax Credit. TIGTA's reviews have shown the need for appropriate controls to be established before refundable credits are issued. This includes requiring documentation to substantiate claims, implementing filters timely to identify erroneous claims, and entering key information into IRS computers to allow its use to verify eligibility.²⁰

The EITC remains the largest refundable credit based on the total claims paid, and it continues to be vulnerable to a high rate of noncompliance, including incorrect or erroneous claims caused by taxpayer error or resulting from fraud. TIGTA continues to report that the IRS does not have effective processes to ensure that claimants qualify for these credits at the time tax returns are processed and prior to issuance of fraudulent tax refunds. As we reported in February 2011, the IRS has made little improvement in reducing EITC improper payments in the years since it was required to report estimates of these payments to Congress in Calendar Year 2002. The risk continues to remain high that no significant improvement will be made in reducing improper EITC payments. In FY 2011, the IRS estimates EITC improper payments equated to \$14 billion to \$17 billion.

TIGTA further reported that although Executive Order 13,520 requires the IRS to intensify its efforts to reduce EITC improper payments, reduction targets and strategies have not been established to reduce billions of dollars in improper payments made each year. For example, the Executive Order requires the IRS to provide TIGTA with its plans and supporting analysis for meeting those targets. The IRS's report to TIGTA did not include any quantifiable targets to reduce EITC improper payments. IRS management noted that it did not set reduction targets because it must balance enforcement efforts among different taxpayer income levels.

The ACTC is the second largest refundable credit available to individuals. ACTC refunds processed in FY 2010 totaled \$28.3 billion. TIGTA recently reported that the IRS paid \$4.2 billion in these credits in PY 2010 to individuals who were not authorized

¹⁸ A refundable tax credit is a tax credit that is treated as a payment and can be refunded to the taxpayer. Refundable credits can create a Federal tax refund that is larger than the amount a person actually paid in taxes during the year.

¹⁹ Pub. L. No. 111-5, 123 Stat. 115.

²⁰ TIGTA, Ref. No.2011-41-035, *Administration of the First-Time Homebuyer Credit Indicates a Need for Improved Controls Over Refundable Credits* (March 2011).

to work in the United States.²¹ Furthermore, the IRS does not effectively and efficiently work ACTC cases of those individuals filing with an Individual Taxpayer Identification Number (ITIN). An ITIN is available to individuals who are required to have a taxpayer identification number for tax purposes, but do not have and are not eligible to obtain an Social Security Number because they are not authorized to work in the United States. TIGTA has recommended that the IRS work with the Department of the Treasury to seek clarification in the law as to whether this and other refundable credits may be paid to individuals who are not authorized to work in the United States.

We have found that IRS processes are not adequate to prevent ITINs from being assigned to individuals who submit questionable applications. Production goals discourage employees from identifying questionable applications. Additionally, the IRS has eliminated processes that were successful in identifying questionable ITIN application schemes and replaced them with processes that are not adequate to verify applicants' identities. TIGTA is currently evaluating IRS employees' complaints that IRS management has been requiring employees to assign ITINs even when the applications appear to be fraudulent. TIGTA will report the full results of this audit later this year.

TIGTA also recently reviewed the IRS's processing of Adoption Credit claims.²² The Affordable Care Act increased the Adoption Credit from \$12,150 to \$13,170 and made the tax credit refundable. Recognizing the increased risk of erroneous claims, the IRS requires taxpayers to file via paper tax return, with each Adoption Credit claim being reviewed when the tax return is received and processed by the IRS.

Although the IRS requires taxpayers to attach documentation to their tax returns supporting Adoption Credit claims, it does not have math error authority²³ to deny the credits if documentation is not provided. As a result, tax returns without required documentation must be sent to the Examination function, increasing costs for the IRS and burden for the taxpayer. In October 2009, TIGTA recommended that the IRS work with the Department of the Treasury to seek legislation for math error authority for this credit.

As of December 23, 2011, the IRS received 101,627 tax returns with Adoption Credit claims. Of these claims, approximately 43 percent (43,295) had to be referred to the IRS's Examination function because of incomplete or missing required documentation in support of the Adoption Credit claim.

²¹ TIGTA, Ref. No. 2011-41-061, *Individuals Who Are Not Authorized to Work in the United States Were Paid \$4.2 Billion in Refundable Credits* (July 2011).

²² TIGTA, Ref. No. 2011-40-128, *The Passage of Late Legislation and Incorrect Computer Programming Delayed Refunds for Some Individuals During the 2011 Filing Season* (September 2011).

²³ A program whereby the IRS contacts taxpayers through the mail or by telephone when it identifies mathematical errors or mismatches of taxpayer information that would result in a tax change.

Recovery Act - Hope Scholarship Credit

The Recovery Act amended the Hope Scholarship Credit to provide a refundable tax credit called the American Opportunity Tax Credit to offset the costs of higher education. TIGTA identified 2.1 million taxpayers who appear to have received \$3.2 billion in erroneous education credits.²⁴ This includes 1.7 million taxpayers who received \$2.6 billion in education credits for students for whom there was no supporting documentation in IRS files establishing that they attended an educational institution. This is further indication that the IRS needs to have processes in place to verify eligibility for refundable credits at the time a tax return is processed.

The IRS did not agree with the amount of erroneous claims TIGTA identified. However, in subsequent communications IRS management informed TIGTA that they have found a high percentage of the claims we identified to indeed be erroneous. As of July 2011, IRS audit results showed that 72 percent of the claims reviewed were erroneous, and the IRS had proposed assessments totaling over \$2.2 million for 1,477 audited tax returns. IRS management noted that they expect the percentage of claims found to be erroneous to further increase and, as a result, have expanded the number of tax returns that they plan to review with this condition in FY 2012.

Furthermore, subsequent analysis TIGTA performed showed that the age distribution for those students for whom the credit was claimed was significantly different than the age distribution for college students when compared to Census data. For example, TIGTA's analysis identified that these college tax credits were claimed for 13,870 students who were age 10 or under.

Recovery Act - Homebuyer Credit

TIGTA previously estimated²⁵ that IRS control weaknesses allowed taxpayers who most likely did not qualify for the Homebuyer Credit to receive potentially erroneous refunds totaling more than \$513 million with no IRS scrutiny.

As of July 30, 2011, the IRS had processed more than 4.3 million claims for the Homebuyer Credit, totaling almost \$30.4 billion. Qualified taxpayers who purchased a home in 2008, 2009, or 2010 were able to take advantage of the Homebuyer Credit and claim up to an \$8,000 refundable credit on their tax return. The Homebuyer Credit may be an interest-free loan or a fully refundable credit, depending on when the taxpayer purchased his or her home. While the IRS completed 495,592 Homebuyer Credit examinations and disallowed credits totaling nearly \$1.6 billion, a large number of high-

²⁴ TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (September 2011).

²⁵ TIGTA, Ref. No. 2009-41-144, *The Internal Revenue Service Faces Significant Challenges in Verifying Eligibility for the First-Time Homebuyer Credit* (September 2009).

risk claims were not examined, and many of the examinations conducted were not productive. The IRS never ran some of the high-risk claims through the filters designed to select claims for examination. Its methods for determining the highest risk claims were flawed. Moreover, it continued to apply examination resources to large volumes of pre-refund audits of Homebuyer Credit claims, even after the establishment of other controls made these audits unproductive.

Based on TIGTA's recommendations, the IRS modified its case selection methodology, shifted examination resources to more productive cases, and agreed to ensure that all claims for the Homebuyer Credit are run against IRS automated examination filters, with the highest risk cases being selected for post-refund examinations. TIGTA estimates that these actions have or will result in funds put to better use of approximately \$115 million.

Contract and Other Payments

As of October 1, 2011, the IRS administered 976 procurements, including 783 contracts of varying types and 193 Blanket Purchase Agreements and Interagency Contracts and Agreements. These 976 active contracts have a reported systems life value of approximately \$49.6 billion. A number of past TIGTA investigations and audits have identified millions of dollars in questioned costs and several instances of contractor fraud. During FYs 2010 and 2011, court-ordered civil settlements directed \$156 million and \$113 million, respectively, to be paid back to the U.S. Treasury as a result of TIGTA's criminal investigative efforts. During these investigations, two recurring trends emerged: Contracting Officer's Technical Representatives were frequently overwhelmed by their workloads, and current business practices have not enhanced the IRS's ability to identify anomalies warranting additional review.

Taxpayer Service

As demand for taxpayer services continues to increase, resources have decreased, thereby affecting the quality of customer service that the IRS is able to provide. Despite other available options, most taxpayers continue to use the telephone as the primary method to make contact with the IRS. In addition, more taxpayers are calling the IRS's toll-free telephone lines each year. In August 2011, TIGTA reported an increase in call demand and limited resources continue to adversely affect the IRS's level of service²⁶ for its toll-free telephone lines. In the 2011 Filing Season, the IRS received approximately 80 million attempts to call the toll-free telephone lines. This is up from 54 million (48 percent) during the 2007 Filing Season, the last filing season with a level of service of more than 80 percent. Taxpayers waited an average of 10 minutes

²⁶ The primary measure of service to taxpayers. It is the relative success rate of taxpayers who call for live assistance on the IRS's toll-free telephone lines.

to speak to an assistor - a 137 percent increase since the 2007 Filing Season. Nevertheless, the IRS has reduced the operating hours for its main toll-free help line (800-829-1040) by three hours.

From the 2007 to the 2011 Filing Season, the IRS's ability to process taxpayer correspondence in a timely manner also declined. Assistors who answer the toll-free telephone lines also handle taxpayer correspondence (including processing amended returns and identity theft cases). During the filing season when call demand is usually at its highest, more resources are shifted to the telephones to answer calls, and correspondence inventory processing is placed on hold until call demand subsides. As call volumes have increased and assistors have been moved to answer telephone calls, paper correspondence inventories have substantially increased. The correspondence inventory rose from approximately 480,000 at the end of FY 2007 to more than 628,000 at the end of FY 2010, representing an increase of nearly 31 percent.

Each year, more taxpayers also seek assistance from one of the IRS's 401 walk-in offices, called Taxpayer Assistance Centers. These centers plan to assist more than 6.1 million taxpayers in FY 2012. However, as a result of the IRS's smaller operating budget, the centers will not be able to offer tax return preparation assistance to as many taxpayers. The IRS is also limiting tax return preparation to current tax returns and to two or three days a week. Taxpayers will not be allowed to make appointments. The IRS hopes that these efforts will help those taxpayers who need assistance the most, including those with tax law and accounts issues. The IRS also will not provide extended hours for the centers during the 2012 Filing Season. It had planned to extend hours of operation in approximately 47 centers during the week and on some Saturdays. However, hours were not extended due to budget cuts and continuing staffing shortages.

Affordable Care Act Administration

The Affordable Care Act contains an extensive array of tax law changes that will present many challenges for the IRS in the coming years. While the Department of Health and Human Services will take the lead role in developing the policy provisions of the Act, the IRS will administer the law's numerous tax provisions. The IRS estimates that at least 42 provisions will either add to or amend the tax code and at least eight will require the IRS to build new processes that do not exist within the current tax administration system.

The IRS received funding for implementing provisions of the Act from the Health Insurance Reform Implementation Fund, which is administered by the Department of Health and Human Services as provided for in the Act. The legislation provided \$1 billion in funding for implementation of the provisions. The funding was to be distributed

to the IRS and other participating agencies to implement the provisions with effective dates in Calendar Years 2010 and 2011. Up to \$350 million was made available to the IRS for implementation costs. The IRS requested and was provided more than \$20 million in FY 2010 and obligated more than \$168 million for FY 2011.

Small Business Health Care Tax Credit

Among the credits contained in this legislation was the Small Business Health Care Tax Credit, which was designed to encourage small employers to offer health-care insurance. In general, this credit is available only to small employers who pay at least one-half the cost of health insurance coverage for their employees. The IRS's efforts to implement this credit were mostly successful, but some improvements are needed.

Despite the IRS's efforts to inform 4.4 million taxpayers who could potentially qualify for the Small Business Health Care Tax Credit, the claims for the credit have been low. Through mid-October 2011, the IRS reported that only 309,000 taxpayers claimed the credit for a total amount of \$416 million, which is substantially lower than the Congressional Budget Office's estimate that taxpayers would claim up to \$2 billion of the credit for TY 2010. The time and effort required to claim the credit were among reasons given by industry groups and professional organizations for the low volume of claims.

Although the Small Business Health Care Tax Credit is specifically targeted to small employers, certain taxpayers may claim the credit even when they have not filed employment tax returns. This is the case when a company enters into a contractual relationship with a Professional Employer Organization that manages human resources. Form 8941, *Credit for Small Employer Health Insurance Premiums*, does not contain all of the data and calculations needed to verify each step of credit eligibility and calculation. Based on the information that was available, TIGTA found that both taxpayers and tax practitioners were making mistakes when completing Form 8941.²⁷

TIGTA made several recommendations. IRS management agreed and plans to take corrective actions.

Human Capital

Human capital is the Federal Government's most critical asset. At a time when agencies are preparing for increased retirements and taking on such challenges as health care reform, the recruitment and retention of employees plays a key role in maintaining a quality workforce. Like many Federal agencies, the IRS is faced with the major challenge of replacing existing talent caused by a large number of retirements

²⁷ TIGTA, Ref. No. 2011-40-103, *Affordable Care Act: Efforts to Implement the Small Business Health Care Tax Credit Were Mostly Successful, but Some Improvements Are Needed* (September 2011).

expected over the next several years. In five years, about one-third of the IRS's workforce of approximately 100,000 employees will be retirement eligible. In the leadership ranks, over two-thirds of IRS executives will be eligible for retirement in five years. Adding to this challenge, the IRS recently offered early retirement and buyouts to more than 2,200 employees.

The IRS's challenge of having the right people in the right place at the right time is made more difficult by many complex internal and external factors. The work performed by IRS employees continually requires greater expertise as tax laws become more complex, manual systems used to support tax administration become computer based, and attempts by taxpayers and tax practitioners to evade compliance with the tax laws become more sophisticated. The IRS must also compete with other Federal agencies and private industry for the same human resources, which becomes more complicated as younger generations of employees move between jobs more frequently than employees in the past. Further, budget constraints, legislative changes, and economic shifts can create unforeseen challenges for the IRS in addressing its long-term human capital issues.

While the IRS is improving its human capital management practices and has developed a comprehensive agency-wide recruitment strategy, there is still much work to be done. For example, TIGTA recently determined that the IRS was struggling to accomplish the basic tasks in acquisition workforce planning, including identifying its acquisition workforce, determining the number of acquisition workforce personnel it needs to accomplish its mission, and determining the skills that its employees have compared to the skills it requires.²⁸

TIGTA also found that while the IRS added 1,515 new revenue officers (ROs)²⁹ during a nine-month period, it still struggles to keep pace with attrition and workload. If the IRS does not have a sufficient number of qualified ROs to collect delinquent taxes, it could create an unfair burden on the majority of taxpayers, who fully pay their taxes on time. However, when estimating the staffing levels of ROs, the IRS does not determine the number needed to address the available workload. Instead, the IRS bases the RO staffing level primarily on a budgetary figure. The IRS believes that there is more than enough inventory to justify staffing increases. However, the IRS does not know when hiring additional ROs will no longer be needed.

²⁸ TIGTA, Ref. No. 2011-10-072, *Additional Actions and Data Are Needed to Further Analyze the Size and Skills of the Acquisition Workforce* (July 2011).

²⁹ Employees in the IRS's Collection Field Function who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses (formerly known as service centers) or the Automated Collection System.

The IRS's FY 2009 budget justification projected that the RO hiring initiative would allow 88,000 additional delinquent account closures, resulting in \$333.6 million in additional revenue for FY 2011. However, the IRS does not compare actual results to the original projections, as would be consistent with guidance from the Office of Management and Budget. As a result, it is unknown if the IRS realized all or part of the additional revenue, and the IRS lost an opportunity to collect information that could help improve future budgets. TIGTA recommended that the IRS establish rules for optimizing RO staffing levels and develop methods to track actual results with projected benefits in future budget justifications.

IRS management agreed to review workload and resource levels to improve future resource allocation and staffing decisions. IRS management also stated that they initiated efforts last year to determine the actual revenue collected from specific enforcement initiatives proposed in FY 2009. However, this information was not shared with TIGTA during the review. As a result, TIGTA did not assess whether those efforts addressed the recommendation.³⁰

TIGTA'S BUDGET REQUEST AND JUSTIFICATION

The President's FY 2013 \$153,834,000 budget request for TIGTA strikes a balance in addressing the critical needs of the Nation. The FY 2013 request represents an overall increase of 1.41 percent above the FY 2012 enacted budget and includes \$324,000 needed to support the Council of the Inspectors General on Integrity and Efficiency. However, TIGTA's budget request reduces existing programs by \$2,306,000 below the FY 2012 enacted level. These cuts reflect the tough choices that the Nation currently faces. TIGTA is reviewing all of its functions in an effort to reduce only those programs that will have the smallest impact on its critical mission.

The FY 2013 budget request includes an additional \$4,500,000 for 29 FTEs for oversight of the IRS's implementation of the Affordable Care Act tax provisions. This funding will support auditors, evaluators, and special agents specifically to provide oversight of Affordable Care Act issues. The oversight of the implementation of this law is a significant priority for TIGTA.

Going forward, FY 2013 will be an important year for the oversight of the Affordable Care Act. Several key provisions take effect in FY 2013 and FY 2014, and many provisions that previously became effective will require continued oversight to ensure that appropriate corrective actions are taken. TIGTA's oversight will require close coordination among its Audit, Investigations, and Inspections and Evaluations functions. Each program office brings unique skills and experience, but our overall

³⁰ TIGTA, Ref. No. 2011-30-039, *Challenges Remain to Balance Revenue Officer Staffing With Attrition and Workload Demands* (May 2011).

success depends greatly upon these offices' close collaboration. As such, TIGTA has developed a multi-year oversight strategy that includes audit, evaluations, and investigative resources to assess, and to proactively detect and deter efforts to impede, the IRS's implementation of the Act.

We at TIGTA take our mandate to provide independent oversight of the IRS seriously. I hope my discussion of the IRS budget request and some of the major challenges facing the IRS assists Congress in ensuring accountability over the IRS.

Chairwoman Emerson, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to share my views.

Biography of J. Russell George
Treasury Inspector General for Tax Administration

Following his nomination by President George W. Bush, the United States Senate confirmed J. Russell George in November 2004, as the Treasury Inspector General for Tax Administration. Prior to assuming this role, Mr. George served as the Inspector General of the Corporation for National and Community Service, having been nominated to that position by President Bush and confirmed by the Senate in 2002.

A native of New York City, where he attended public schools, including Brooklyn Technical High School, Mr. George received his Bachelor of Arts degree from Howard University in Washington, DC, and his Doctorate of Jurisprudence from Harvard University's School of Law in Cambridge, MA. After receiving his law degree, he returned to New York and served as a prosecutor in the Queens County District Attorney's Office.

Following his work as a prosecutor, Mr. George joined the Counsel's Office in the White House Office of Management and Budget where he was Assistant General Counsel. In that capacity, he provided legal guidance on issues concerning presidential and executive branch authority. He was next invited to join the White House Staff as the Associate Director for Policy in the Office of National Service. It was there that he implemented the legislation establishing the Commission for National and Community Service, the precursor to the Corporation for National and Community Service. He then returned to New York and practiced law at Kramer, Levin, Naftalis, Nessen, Kamin & Frankel.

In 1995, Mr. George returned to Washington and joined the staff of the Committee on Government Reform and Oversight and served as the Staff Director and Chief Counsel of the Government Management, Information and Technology subcommittee (later renamed the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations), chaired by Representative Stephen Horn. There he directed a staff that conducted over 200 hearings on legislative and oversight issues pertaining to Federal Government management practices, including procurement policies, the disposition of government-controlled information, the performance of chief financial officers and inspectors general, and the Government's use of technology. He continued in that position until his appointment by President Bush in 2002.

Mrs. EMERSON. Thank you both so very, very much.

I will go ahead and start the questions. And my first would go to you, Mr. George.

RELATIONSHIP BETWEEN IRS FUNDING AND TAX COLLECTION

Back in January, the National Taxpayer Advocate released her annual report to Congress and concluded, among other things, that the IRS is underfunded and can't adequately pursue unpaid tax liabilities. You obviously referred to this. And she goes on to say that IRS collects \$200 in revenue for every \$1 that it spends.

So, in order to close the estimated, as you said, the gross tax gap of \$450 billion, or let's just say the net tax gap of \$385 billion, the Advocate seems to be suggesting that the IRS could do so with an extra \$1.9 billion. Do you think that the IRS could close this tax gap if we gave it another close to \$2 billion?

Mr. GEORGE. That is a very difficult question because we have a voluntary compliance system in this country and we rely on people to be honest with the Internal Revenue Service as to the amount of income they receive, especially if it is not being reported by a third party. And as a result of that, if someone wants to cheat and if their information is not being reported from an outside source—that is, a third party—it is very easy for them to do so.

So, giving the IRS additional funds would help in the sense that, post-issuing refunds, they could do examinations of tax returns and try to determine whether or not the information reported by the taxpayer is accurate. But outside of that—or, actually, not—despite that, people could still hide—especially if they are operating in a cash basis only—income.

I believe I cited this figure the last time I was before you, but every opportunity that I have, I need to convey this information about the importance of third-party reporting. This information comes from the IRS itself. There is a high correlation between tax compliance and third-party information reporting and withholding. The IRS estimates individuals whose wages are subject to withholding report 99 percent of their wages for tax purposes. Self-employed individuals who operate non-farm businesses are estimated to report only 68 percent of their income for tax purposes. But the most striking figure is that self-employed individuals operating businesses on a cash basis report just 19 percent of their income.

So, just to conclude my answer, again, you could give the IRS 10 times the amount that they are requesting, but if people want to cheat the system, they have the ability do so.

Mrs. EMERSON. Yeah and, you know, we increased the budget for the IRS by about 20 percent between 2001 and 2006, and yet the tax gap remained more or less the same between the end of 2001 and the end of 2006. So, obviously, money isn't the very best—or, necessarily, the best thing to throw at it.

So, if you don't have voluntary reporting or if you don't do the withholdings and have a third party, I mean, what other factors affect revenue collections?

Mr. GEORGE. There are quite a few, but I would point immediately to the deterrent factor. And I hate to be this candid, but, putting the fear—

Mrs. EMERSON. We want you to be candid.

Mr. GEORGE. Putting the fear of the IRS into the mindset of people is an effective tool in encouraging compliance—that is, examinations by the Internal Revenue Service. And so that would suggest that providing additional resources to the IRS so that they could increase the number of examinations, i.e., audits, that they conduct on people would have an effect on compliance.

Mrs. EMERSON. In your professional opinion, do you think that it is possible to collect every dollar of the tax gap?

Mr. GEORGE. No.

Mrs. EMERSON. Well, that is——

Mr. GEORGE. I mean, it is because it is just so complicated. I believe my staff has shared with you the tax gap map.

Mrs. EMERSON. Yes.

Mr. GEORGE. And if you walk through that, I mean, it is estimated, again, that the underpayments—well, let's put it this way. Underreporting is the largest component of that. That is \$376 billion.

And so everyone, I am sure, has had a business say to you that they would give you a discounted rate if you pay cash as opposed to using a credit card or check.

Mrs. EMERSON. Right.

Mr. GEORGE. Now, the IRS has recently, as you know because Congress passed the law, has allowed for third-party reporting based on credit card transactions. That should help the IRS in addressing some of this. But, again, there are just still too many opportunities.

Mrs. EMERSON. Well, and it seems to me that the more difficult it is to detect any kind of fraud, for example, the more expensive it would be to try to collect it. And so there is, at some point, the law of diminishing returns sets in?

Mr. GEORGE. That is exactly right. And the challenge truly for us is, once the money is out the door, not only is it more difficult to collect, it is much more expensive to collect. So we have been prodding the IRS to address some of these issues before issuing refunds. And that relates both to refundable credits and in other areas of the Tax Code.

Mrs. EMERSON. And so would you surmise that if the Congress simplified the Tax Code, would it then be easier to close that tax gap? Or do you think there are just going to be people who are going to want to try to buck the system?

Mr. GEORGE. Allow me to preface my response by saying that, pursuant to Treasury Order 111-01, the Secretary of the Department of the Treasury has delegated tax policy questions to the Office of Tax Policy. And so I would have to defer to that office for a definitive response to your question.

Despite that statement, there is no question, if you make it easier for people to comply with their tax obligations, I believe they would be willing to do so.

Mrs. EMERSON. I mean, that sounds like common sense, anyway.

All right. Thank you. I am going to let Mr. Serrano ask some questions, and we will come back around again. Thank you.

Mr. GEORGE. Certainly. Thank you.

Mr. SERRANO. Thank you.

Let me just pick up on what the chairwoman was talking about. I am a little concerned about your response. It almost sounds as if you are saying it is very difficult to recover this, so let's not try. At least that is the sense I get.

And it may be that some people in this Congress are not interested in spending any more money, but rather cutting budgets. And so if people get the sense that you can't recover what is out there, you will never get—the agency will never get an increase of a dollar.

And so, what is wrong with trying to recover even if we know we are not going to recover everything?

Mr. GEORGE. Yes, if I gave that impression, that was in error, sir. I am not at all suggesting that the IRS not attempt to recover funds that were paid improperly.

I am just stating for the fact that it is much more expensive to do so once the money is out the door, has been spent. In some instances, again, the recipient if you do contact them and if you do identify and they acknowledge they owe it, they may not have the resources to repay the money because it has been spent.

Mr. SERRANO. You mean more expensive than what you would recover? In other words, you would spend \$1 going after them and—I thought it was just the opposite, that every agent that went out to recover money got \$7 for every dollar that we invested in those agents. That was the original argument we made for the last few years.

Mr. GEORGE. You know, I understand that the Commissioner or the IRS itself may have provided this committee and others with a return-on-investment figure. My office has not had an opportunity to review whether or not the numbers that they provided are accurate.

But the bottom line is, it is much cheaper for the IRS, if they suspect something improper in a tax return, to put it through some of the systems that they have internally within the IRS's computer programs before the refund is issued, as opposed to having to send an enforcement agent, a revenue agent, "officers" they are titled, to an individual's home, both to interview, work with that person or, in some instances, to receive threats from people who are just suspect of government officials, especially those from the IRS.

Mr. SERRANO. Well, just one last point on this. You have kind of, sort of created a small upheaval here over something we have been believing for a long time. So if there is a belief out there that we can't accomplish this the way we should, I think the IRS and the Inspector General should all get together and come to a conclusion, so that the Congress doesn't go around believing, as I have—do you know how many times I have been quoted in opening statements over the last few years saying that for every dollar we spend on an agent we get \$7 back? If that is not true, I need to know that.

And when we are in a climate of cutting taxes for the very wealthy and auditing the less wealthy, what message is it sending to people who have a lot of money that they could get away with not paying?

Mr. GEORGE. Very fair point, sir. And there is definitely a formula that the Internal Revenue Service can use, the amount of their budget devoted to, let's say, enforcement efforts versus the

amount that ultimately is returned or received from audits and other compliance initiatives on their part. They could do a computation, and they can come up with a figure.

And according to information that was just provided to me by staff, for the 2012 budget request the IRS claims that their return on investment is \$6.40 to \$1 and that it will generate—that figure would generate over a billion dollars a year.

Now, again, my office has not yet had an opportunity to analyze this figure to determine whether or not that is the case, that they actually received——

Mr. SERRANO. All right. So let me close this segment by just simply saying that that becomes very important for this committee. Because if we are going to continue to make the argument that we should invest, even during cost-cutting times, in the IRS and we should invest in going after tax cheats or people who made mistakes at all levels, then we need to know that.

Because there seems to be no end to the money we can spend on trying to figure out whether someone took a child tax credit or someone took a deduction for the Earned Income Tax Credit. My experience has been that we have plenty of money to do that. But now I am hearing something different about whether, in fact, we can recover big dollars.

And so I would hope and I would ask the Chairwoman to consider asking you folks just come back and let us know if I have been misleading people by saying that these things are good investments, to hire people to go out and get the money that is missing.

Mr. GEORGE. There is no question that if the IRS had additional staff they could do more work. But the fact that you have hundreds of millions of tax returns at stake here, unless they hired at an extraordinary rate, sir, they are going to have to pick and choose and make determinations that sometimes may not——

Mr. SERRANO. All right, but you are missing my point. And I don't want to beat this to death. My question is for you folks to get back to us, if the chairwoman would allow it——

Mrs. EMERSON. Absolutely.

Mr. SERRANO [continuing]. And tell us if it is a good investment to do what I am told we do. That is it. Not do they have more, do they have the ability. Is it a good investment to enforce, or should we just let people get away with it?

Mr. GEORGE. Very good, sir.

[The information follows:]

IRS Return on Investment

The Internal Revenue Service (IRS) annually measures “enforcement revenue,” which it calculates by reviewing the revenue collected by compliance programs across the organization each year. In the IRS Fiscal Year (FY) 2013 Budget Request to Congress, dated February 13, 2012, the IRS reported that its total enforcement revenue was \$55.2 billion in FY 2011, for a total IRS-wide return on investment (ROI) of \$4.6-to-\$1,¹ or a return of four dollars and sixty cents for every taxpayer dollar invested. In comparison, according to the IRS, the IRS-wide ROI for FY 2010 was \$4.7-to-\$1. The IRS has an overall ROI of nearly two hundred dollars to every dollar invested (\$200-to-\$1) when its FY 2011 enacted budget is compared to the \$2.415 trillion collected in FY 2011.

In a May 2011 audit,² TIGTA reviewed the IRS’s initiative of revenue officers hired during the period June 2009 through February 2010. The IRS’s FY 2009 budget justification projected that this hiring initiative would result in \$333.6 million in additional revenue in FY 2011.³ However, TIGTA found that the IRS does not track a comparison of actual results to the original projections in the years following the budget’s implementation. As a result, it is unknown if the IRS realized all or part of the additional projected revenue for this initiative. IRS management stated that they are working to develop a methodology to determine the actual revenue collected from specific enforcement initiatives that were requested in the IRS’s FY 2009 budget justification. Until IRS management implements this type of methodology, they will not know the actual additional revenue realized from requested enforcement initiatives.

¹ The ROI was calculated by comparing the \$55.2 billion in enforcement revenue generated to the IRS’s FY 2011 appropriated budget of \$12.1 billion.

² TIGTA, Ref. No. 2011-30-039, *Challenges Remain to Balance Revenue Officer Staffing With Attrition and Workload Demands* (May 6, 2011).

³ This FY 2009 budget initiative involved hiring additional Field Collection staff of 486 FTEs, which the IRS anticipated would resolve approximately 42,000 additional Tax Delinquency Accounts in FY 2009. Once new hires reached full potential in Fiscal Year 2011, the IRS anticipated that the additional staff would resolve an additional 88,000 delinquent tax accounts, generating approximately \$333.6 million in revenue.

MANAGEMENT CHALLENGES

Mr. SERRANO. Okay.

Could you both tell us—I know I have used up most of my time already, but—what are the main challenges facing various components of the Treasury that you oversee? What are the main challenges we should be looking at?

Mr. THORSON. You are on a roll.

Mr. GEORGE. As my dear friend has suggested, the Reports Consolidation Act of 2000 requires that we issue a memorandum to the Secretary of the Treasury on the top management challenges that we see confronting the agency that we oversee. And in October of last year, we issued our most recent memorandum to that effect.

Those challenges are: security for taxpayer data and employees; tax compliance initiatives; modernization efforts by the IRS to update their computer systems; implementing major tax law changes; fraudulent claims and improper payments; providing quality taxpayer service operations; human capital, which is a huge issue government-wide but especially for an organization such as the IRS that deals with such technical subjects; globalization; taxpayer protection and rights; and, finally, achieving program efficiencies and cost savings.

I can go into detail with each one, but I am now going to defer to my colleague so that he can lay out the top 10 for the Department overall.

Mr. SERRANO. Okay.

Mr. THORSON. I mentioned the challenges, that we had four major in our submission to the Secretary, the first being transforming the financial regulation, which really means trying to incorporate all of the things that FSOC and the Dodd-Frank bill, et cetera, all the responsibilities that were new, including designating non-bank financial companies now for supervision and standards.

The second one was the various authorities. And I won't go through the list of acts that were passed that gave Treasury broad new authorities, but certainly trying to implement those properly.

One of the big ones, identifying and trying to combat money laundering and terrorist financing and enforcing the Bank Secrecy Act. That one, obviously, is important to everybody. It involves a great deal more than just money; it really comes down to proper coordination among all the elements that are involved in that. And most people really aren't aware of all of the things that have to be done to get the agencies such as FinCEN, Financial Crimes Enforcement Network, and OFAC to be able to work and to ensure the compliance that is required there.

The last one I mentioned was capital investments, which is pretty much always a challenge for almost any of the agencies, specifically IT investments because they are so large. We have had problems in the past in reports that we have issued where projects have not gone well. Therefore, we do watch this carefully. And we do also make sure that the Department is paying a lot more attention to it.

I will add that I think the Department is very sensitive to our challenges and is very responsive to them. So it is a nice environment to work in to try and work through these.

EFFECT OF BUDGET CUTS

Mr. SERRANO. Okay.

Let me just ask you one more question in this round, because I know we have other Members who want to participate. Very briefly, you know that the Congress is in a budget-cutting mood. We are not going to get into how good or how bad that is. But assuming the IRS is not spared in this season of cutting, what do you see as the long-term ramifications, effects of those cuts?

Mr. GEORGE. Sir, it could have a very large impact on the IRS's ability to conduct its purpose. For example, a 6 percent cut would equate to about a \$700 million budget reduction in the IRS's operating budget. And that could result in a reduction in staffing of over 5,000, almost 5,500 employees, IRS employees.

And, now, it would be up to the IRS to determine how to allocate the impact of those reductions, whether it is less customer service, whether it is less enforcement or less efforts as it relates to updating its computer systems, the modernization efforts.

We have already announced—or reported, I should say, that the IRS hiring has not kept up with its attrition rate. And this relates to the human capital challenge that I referred to as one of the management challenges confronting the Internal Revenue Service.

All of this affects the tax gap, the ability of the IRS to collect past due moneys owed and not paid timely. And it could have—the bottom line is it really serves the opposite effect, because the IRS is the revenue-generating engine for the Federal Government. And if you reduce its resources or the ability for it to conduct its role, you are, in effect, doing a disservice to the American people.

Mr. THORSON. Your specific question regarded IRS. Are you talking about in general budget?

Mr. SERRANO. General, sure.

Mr. THORSON. You know, that really gets down to, I think—and I have given a lot of thought to this because I knew this would be asked. It really comes down to what makes your job very difficult. If you had to answer any of these questions like this, the one word would be “balance.” How much is the right amount for any overall budget? And once you have arrived at that, how do you divide that up? I mentioned, for instance, here terrorist financing, countering that and doing some of these other things. Or, for instance, even defense. How do you balance what is the right amount? How much debt do you incur to come up with this overall figure for a budget for the whole government?

As you look at Treasury, with all of its programs and all of its different responsibilities, it really is a very difficult thing to try and say, well, if we had more money over here, we could really do a lot more. And, mostly, you hear that from almost every IG office too. I like to think, for instance, our investigations office is a profit-making organization because we go out and we arrest people and we recover money. But the truth is, it isn't always money that is going to do it, and there is not an unlimited amount to be had.

And that is what, as I said, makes your job very difficult. Where do you draw that balance? For us as IGs, I think what we try and do is really assess how well the Department deals with whatever it is you agree on with them. That is what our challenge is, is to

look at that and try and decide, did they do this efficiently, did they do this right?

I mentioned in my statement, when you really come right down to it and you take out Mint and BEP and some of these other non-appropriated activities, you have about 4,800 people to run all of these different programs that Treasury does. I have been pretty impressed with what I have seen in the 4 years that I have been there, nearly 4 years. And that spans two administrations.

The balance, that whole thing that you deal with all the time, that is a very, very difficult question, clearly being discussed. I mean, you can open any newspaper on any day, and that is one of the issues you are going to see. And it is one that we deal with, as well. What is the right amount? How are they spending it?

You mentioned in your statement to me about, we had asked for a million dollars less this year as an IG office. That wasn't easy to do, but it was partly because we recognize what your responsibilities are, the Secretary's responsibilities, which is to cut the budget, to cut the deficit. We need to participate in that. So we did. We could always use more, sure. But I will never come here and say to you all, "I don't have enough resources to do that." You will never hear that from this office. We will deal with whatever is provided by the Congress, and we will do it as effectively as we know how.

But everything, all the things Russell talked about, that is all a balance. And that is, unfortunately, the job you guys have. We will certainly do our best to try and tell you how well it is being done with what you give them. But I think that is about the best answer I can give you on that.

Mr. SERRANO. Thank you.

Mrs. EMERSON. It is a conundrum. And, you know, I daresay that Members of Congress don't always know best. It has to be a partnership in trying to figure out.

Mr. THORSON. Right.

Mrs. EMERSON. Because you all live and breathe it up close and personal every single day. And, you know, generally speaking, you know, among some people, they have the attitude, well, you are working down in a government agency, and, you know, you just want to make sure you are going to be able to keep your job. I mean, so there has to be balance.

I mean, we are trying to make the best decisions we can. And so it also helps for us to get information from you all as to whether or not moneys are being efficiently spent, and within each department or each section of the department, for example. And, you know, perhaps we do need a little more here and a little less there. And so it is helpful for us to have your input there, because I don't want to presume that I know everything. Because I certainly don't, and I probably never will.

But, anyway, it is my pleasure to pass the microphone to Ms. Lee.

Ms. LEE. Thank you very much, Madam Chair.

Welcome. Thank you so much.

It is really very vital that independent agencies like the IRS, Treasury, SEC, SBA, FDIC, all of those under our jurisdiction, very important that they need to fulfill your missions, also, on behalf of

the American people. And for me, cutting budgets really diminishes your ability to be able to fulfill your mission. And so, yes, we have to have that balance, but I think there is a point of no return, you know, and a point where we do not need to go.

So thank you for your service during these very challenging times.

Let me ask you about Cuba enforcement and OFAC. The Treasury Office of Terrorism and Financial Intelligence does the incredibly vital work of cutting off funding for terrorist organizations and money laundering. Given the critical nature of this work, do you believe it is the best use of your time and money and human power at the Office of Foreign Assets Control to enforce the licensing of Americans traveling to Cuba?

And several years ago, Chairman Rangel and myself asked the GAO to conduct a study. We wanted to see how much money was being spent, how many employees were detailed to this mission. And could you kind of bring us up to date on that?

Secondly, let me just ask you with regard to Dodd-Frank requiring the Treasury Department to set up an Office of Minority and Women Inclusion, which is to be responsible for all agency matters relating to diversity and management employment and business activities. And so I want to know if the IG's office plays any kind of a role in the oversight of these efforts.

And, finally, I want to know if you are working with the administration and other agencies that have the expert knowledge, like the SBA, to ensure that you are adopting the best possible policies and practices to impact and maximize the work of the office.

Mr. THORSON. Okay.

Mr. GEORGE. That falls within the jurisdiction of my colleague.

OFFICE OF FOREIGN ASSETS CONTROL

Mr. THORSON. The first one, we are looking at OFAC's licensing and et cetera, and that is in progress. And that will be done in about 6 months, because this is a fairly recent effort.

But in addition to that, though, let me add, this is another case where, with TFI, Terrorism Finance Intelligence, OFAC and all that, this is another one where you could say, well, the more money you put in, the better you are going to do with it. And, again, you know, it is a balance.

FinCEN proposed, for instance, reducing its intelligence support to external agencies to save about a million dollars. Again, you know, you can always—the more that you increase—much like what Mr. George said, the more that you put into it, the more you will get out of it, but it is also—there is a limit to what you can do there.

You asked about the oversight, I believe, on the—

Ms. LEE. Well, let me just ask you with regard to OFAC, then, if your budget is cut, if you have choices to make in terms of, you know, investigating, cutting off funding for terrorist organizations, and money laundering by illegal drug cartels versus enforcing licensing of Americans who violate the licensing regulations, how would you make those decisions, with minimal resources?

Mr. THORSON. Okay. First, I guess fortunately, I don't make those decisions. It is much the comment that was made about, they

are there every day and they are in those offices. And we are also, obviously. But that balance has being worked out between those agencies and the Secretary and the Department. It is perfectly within our realm to come in and look at how they decided that, and it is certainly within our realm if you ask us to do work like that.

As far as the balance between the two, I am not really qualified to tell you that. It is off the top of my head because we haven't really looked at something like that. That same argument can really be applied to almost anything. Should we put money over here for this when TFI, you know, is being cut here? Those are all good questions, and they do get to the heart of what it is you do here.

And we want to help. I appreciate the fact that you even consider us a partner in this, because that is a great credit to us. We want to help that, but there are limits to what we can do. But, again, we are also very responsive to any requests that you make for us to look at any particular issue.

You asked a question regarding, I believe——

OFFICE OF MINORITY AND WOMEN INCLUSION

Ms. LEE. Oversight of the Office of Minority and Women Inclusion, in terms of your role in oversight of these diversity efforts. And what is an update? Do you have an update? Do you know what they are doing in terms of their efforts to create these offices?

Mr. THORSON. We are going to—the effectiveness of that office is in our annual plan, and we are planning to get to it and, actually, do exactly what you are talking about, is to go in and take a look at it. We have not done that as yet. And it is difficult for me, then, to make a comment about it. But that is in our annual audit plan.

Ms. LEE. So what is your time frame on that?

Mr. THORSON. Because it hasn't been started yet, that is kind of hard to say. But, I mean, we will certainly work with your office on discussing that and trying to figure out where to put it in the schedule, if you would like.

Ms. LEE. Yeah, I would like do that.

Mr. THORSON. Okay.

Ms. LEE. Okay. Thank you.

Thank you very much, Madam Chair.

Mrs. EMERSON. You had another question?

EARNED INCOME TAX CREDIT AND SEQUESTRATION

Ms. LEE. Well, in terms of the Earned Income Tax Credit——

Mr. GEORGE. Yes.

Ms. LEE [continuing]. Could you kind of let me know where that is in terms of sequestration, is that outside of sequestration?

Mrs. EMERSON. Yes.

Ms. LEE. It is?

Mr. GEORGE. Yes, well, let's put it this way. The only way that sequestration would affect that is that the IRS may have less resources to oversee how well that program or that credit is being implemented, which could mean less examinations of people who are alleged to have misused the program, to file for the claim who should not otherwise have filed for it.

But I don't otherwise see how sequestration would affect it directly. It would not. I am told it would not affect——

Ms. LEE. Okay. So any of the cuts, though, to IRS wouldn't affect efforts to maximize payments to families who need them the most. I mean, how would you investigate this——

Mr. GEORGE. Well——

Ms. LEE [continuing]. In terms of if, in fact, the EITC is working properly now with these budget cuts?

Mr. GEORGE. Well, see, that is slightly different. My comment initially referred to the ability of the IRS to investigate people who inappropriately applied for it. I do not, at this stage, believe that it would affect people's ability to apply for it and ultimately receive it.

Ms. LEE. Well, the thing, is we have—I think many Members of Congress have a great partnership with the IRS. It is one of the areas that I always say, because we do a lot of IRS casework, and, generally, the experience is not all that great, because we are advocates for constituents who have had problems with the IRS. But helping get the word out on EITC, helping to make sure we maximize, the returns, has been a really great, positive experience.

Now, what if these budget cuts affect that outreach operation? You know, if I called the IRS and said, okay, we are doing our EITC workshop today, you all may tell us, well, sorry, we can't send anyone because, you all cut our budget.

Mr. GEORGE. Actually, that is a very prescient comment, because what I should have noted is that a sequestration would have a direct effect on customer service offered by the IRS, which goes exactly——

Ms. LEE. Which is outreach, which helps maximize, the information that people get to know that they are eligible, which ultimately could be a problem.

Mr. GEORGE. Now, they would probably respond that a lot of the information is on the Web site and is available——

Ms. LEE. A lot of people don't have computers yet. The digital divide is real.

Mr. GEORGE. I agree. I agree completely. I do.

Ms. LEE. Okay. So then we have to figure out a way—if this impacts EITC outreach and customer service and information, you know, we have to figure out a way to keep doing the work without paying for it, right?

Mr. GEORGE. And it is——

Ms. LEE. Volunteers.

Mr. GEORGE [continuing]. Throughout the tax system. Yes.

Ms. LEE. Okay, Madam Chair, we have to have a volunteer corps for——

Mrs. EMERSON. You know, my staff actually does a lot of that, too.

Ms. LEE. Well, we do, too. But the IRS has to come out to make it real.

Mrs. EMERSON. Unless they just give us their papers.

Ms. LEE. Nobody believes that.

But thank you very much. I appreciate that.

Mr. GEORGE. Actually, Madam Chair, if I may, though, they do. The VITA program is an effort by the IRS to do just that, to get volunteers.

Ms. LEE. Thanks.

Mrs. EMERSON. We do that a lot in our senior nutrition centers, because I have a, you know, fairly low-income district myself, but very rural and so different, but same sorts of access issues. So, anyway, we should have a longer discussion about that.

Mr. Diaz-Balart.

Mr. DIAZ-BALART. Madam Chairwoman, thank you very much.

And let me thank you, gentlemen, obviously, first, for being here. But, you know, Mr. Thorson, you are saying, you know, how, I guess, thrilled you were that we listened to you. And let me tell you, it is the other way around. I mean, you know, you really provide—all of you provide an invaluable service to the taxpayers, to the American people, and, I will tell you also, the Congress. And if anything, we should be more aggressive in making sure that we implement what you recommend, not only the agencies but, frankly, those of us, as well, who are on this side of the dais.

So again, thank you for your service, and you do provide an invaluable service.

I was going to ask you I think something about OFAC, but I think you already answered that, and I am not going to get involved in the issue as to whether Cuba being one of the only four states that are the states that sponsor terrorism, being one who has a number of spies convicted of espionage, of murdering, of killing American citizens, of shooting down American airplanes in international airspace, of harboring terrorists and U.S. fugitives, or even currently holding an American hostage. Getting into the policy of whether that is something that we should do or not is obviously not in your realm, as you mention, it is a policy issue. I would tell you that it is good policy, but that is not for debate here today.

IDENTITY THEFT

What is my question, however, is one that, Mr. George, I believe you had talked about a little while ago, and that is about the identity theft issue. Years ago, I was a victim of identity theft. Yes. And I will tell you, I was one of the lucky ones, Madam Chairwoman. I wasn't hit as hard as others because by luck I was able to detect it relatively early.

I will tell you, however, that it is just really problematic, and it takes you months if not years to get over and to solve and to make sure that you are—and that is if you are lucky like me, that didn't get—even the people that applied for credit cards, they weren't able to totally succeed there and they didn't get a driver's license with my name on it and that kind of thing which happens to people. But it is obviously a lot more frustrating if it happens through a Federal agency, and you mentioned that.

Now, a couple years ago, Ryan Canfield of my staff and I spoke to a victim of identity theft through the IRS thing that you had already talked about, but she had been victimized once, came forward, it happened, and then the next year it happened again. And so I had that conversation here with your help, Madam Chairwoman, with Commissioner Shulman, and I asked him to come up with a detailed plan to prevent further fraud issues from taking place and to help the taxpayer who had already fallen victim as well.

The question is this: What actions have been taken by the IRS to fix that problem? And it is really, really during mostly—the issue that we dealt with was the E-file program. So what have they done, what else can be done? Are you satisfied that enough has taken place? I know you can never stop everything 100 percent, but where are they in that process?

Mr. GEORGE. Very much behind the curve, Congressman.

Mr. DIAZ-BALART. Really. Still.

Mr. GEORGE. Still. It can take more than a year to resolve an identity theft case. Communications between the victim and the IRS are limited and confusing. Taxpayers do not speak directly with the assistants who are working their cases and they are instructed to call a specific unit to ask about the status of their case. However, the person they will speak to is not the person who is actually working the case, so there is miscommunication. And most troubling is that many IRS employees who are handling identity theft cases are not trained to do so, and in fact, given the reduced resources that the IRS currently has, some of them are taken away from their casework and put on the help line to answer taxpayer questions about the 1040 or the Schedule A, what have you.

In the processing year of 2011, the IRS reported that it had detected 938,664 tax returns with fraudulent tax refunds, and as I quoted earlier in my opening statement, totaling about \$6.5 billion, which are directly involved with identity theft. The IRS does not know how many identity thieves are filing fraudulent tax returns and they don't even know beyond that estimate precisely how much is being lost through that effort.

We had an ongoing analysis in tax year 2010 looking at the 2011 filing season and we found that tax fraud from identity theft is much larger than what the IRS is reporting and preventing, unfortunately. So we are still conducting work in this area and will be issuing a report in more detail later in the year.

Mr. DIAZ-BALART. And, Mr. George, isn't that kind of a double whammy? Because you have the normal law-abiding citizen who wants to do the right thing and pay their taxes, and all of a sudden somebody else takes that person's identity, right, in essence gets a tax return for that person, has that money. That person gets hit because all of a sudden they didn't get the money they were due, number one, and number two, then obviously the taxpayer gets hit as well because we are sending out money to people who shouldn't get it, we are not sending it to people who should get it, and it is at least a double, double whammy. So it is expensive.

Now, that person who is the decent person, not the one who is committing the fraud, who then submits I guess a regular tax form, what happens to them? Do they get their tax return while this is in the process, or do they also then get kind of stuck in this process as well and have to wait? I mean, what is that process like?

Mr. GEORGE. You know, it is very, very involved, but the bottom line, and, again, I don't know whether you saw it, but recently a senior IRS official suggested that taxpayers file early so that in effect they could beat potential tax fraud.

Mr. DIAZ-BALART. I am not laughing because it is funny. I am laughing because it is kind of nuts. It tells you how bad the problem is.

Mr. GEORGE. Exactly. And the bottom line is that in this instance, the example you just cited, if the innocent party, the true taxpayer, fails to submit the tax return prior to the criminal—

Mr. DIAZ-BALART. The fraudulent one, right.

Mr. GEORGE [continuing]. That person will have to wait until the matter is resolved before receiving it.

Mr. DIAZ-BALART. And that could take—

Mr. GEORGE. That could take years. It could.

Mr. THORSON. Sir, I am not going to go into it a whole lot because it is ongoing, but the things you are discussing and describing is even more widespread than just IRS. There is a very aggressive task force that the special agents in my office are involved in, and I think at some point we will be able to maybe brief you a little bit about what that is about. But it is an excellent effort that is going on. And you are right, it is a big problem.

Mr. DIAZ-BALART. I would actually be interested in getting briefed on that, because it was as we heard, I guess it was yesterday, Madam Chairman, that Miami and south Florida, we were having a conversation about identity theft in general, and what did we hear, is it the worst in the country, or among the worst in the country, right?

Mrs. EMERSON. Yes, we had the Federal Trade Commission. Whether it is identity fraud or trade, you name it.

Mr. DIAZ-BALART. So we have a huge issue in south Florida, and, as you know, it is not a wealthy community, unfortunately.

Mr. GEORGE. I was just going to add, Mr. Diaz-Balart, adding insult to injury is that these cases are not handled specially. So, if someone is having an irregular or another tax problem and yet you have a victim of identity theft, they are added to the queue, and as you can imagine when dealing with hundreds of millions of tax returns, it takes a while before the IRS is able to resolve the issue.

Mr. DIAZ-BALART. Sure. And we find those all the time and deal with that with constituents that have that issue all the time. You said you are going to be putting together a report on that issue?

Mr. GEORGE. Yes, we are.

Mr. DIAZ-BALART. Do you foresee that you will have specific recommendations that might be helpful?

Mr. GEORGE. We generally—I can't anticipate, but normally we do have recommendations.

Mr. DIAZ-BALART. I would love to see that when it is out if we can get a copy of that.

Mr. GEORGE. Yes. I have just been told we will definitely have recommendations on how to improve the system.

Mr. DIAZ-BALART. Thank, you, Madam Chairman.

Mrs. EMERSON. May I ask just as a follow-up, and I might have missed this, when do you think that report will be out?

Mr. GEORGE. May.

Mrs. EMERSON. This May. A couple months from now. Wow, that will be wonderful. I think all of us would enjoy seeing that.

Mr. GEORGE. We will certainly share it.

Mrs. EMERSON. I am not sure we will enjoy seeing it, but we would appreciate you getting us the information.

Mr. DIAZ-BALART. Thank you, Madam Chairwoman.

Mrs. EMERSON. Is that all?

IMPROPER PAYMENTS

Mr. DIAZ-BALART. Yes, thank you. On kind of a separate issue, let me see, hold on a second, I have a couple notes here on a totally separate issue. I guess the report, there was a report estimating that 2.1 million taxpayers may have received over \$3 billion in erroneous education tax credits.

Mr. GEORGE. Yes.

Mr. DIAZ-BALART. That is, I guess, from the part of the stimulus program called the American Opportunity Tax Credit. Inspector General George, I guess you were quoted in the report saying that based on the results of our review the IRS does not have effective processes to identify taxpayers who claim erroneous education credits and if not addressed this could result in up to \$12.8 billion, with a B, in potential and erroneous refunds over 4 years.

Have you been able to get some recommendations on that to prevent this—you know, I mean, that is a pretty big number.

Mr. GEORGE. It is. And there is a common theme throughout the refundable credit realm that affects this particular credit also, and that is not having adequate documentation from taxpayers or, if they do receive documentation, not checking it. And it seems again like common sense that prior to issuing a check to somebody you would confirm that they are eligible for the money that you are sending them.

Mr. DIAZ-BALART. Well, we are going back to your original statement about that it is a lot more expensive to try to recover it after the money is out than before it goes out.

Mr. GEORGE. Exactly. Exactly. And, again, that applies throughout the system of tax administration.

Mr. DIAZ-BALART. Well, again, going back to Ranking Member Serrano's point and your point about balance, it would be interesting to find out, you know, whether when Mr. Serrano says has he been misstating the truth, well, he has been saying what we have always gotten, the information gotten. It would be very interesting to find out. And I guess you know that number will differ from different parts of the IRS, and so it would be interesting to see if when you get a chance to look at those, you know, because we have to make decisions on funding, and a lot of times if it is not for you all, we don't get all the facts.

So thank you. Thank you very much.

Mr. GEORGE. Thank you.

Mr. DIAZ-BALART. Thank you, Madam Chairwoman.

Mrs. EMERSON. Thank you, Mr. Diaz-Balart.

OFFICE OF FINANCIAL RESEARCH

Mr. Thorson, I want to talk a little bit about the Office of Financial Research that was created by Dodd-Frank to support FSOC. So now we know that in July the OFR will be a fee-funded agency, and I always get a little bit nervous when agencies are totally fee-funded. But I would like to know how the study is coming along that you all are doing with regard to how the OFR was set up and are you also looking at how they prepare their budget and if they are making cost-effective decisions. Just kind of give us an update, if you would, please.

Mr. THORSON. The OFR report on the stand-up activities which is in issue should be towards the end of April, so it is coming up pretty quick. We are obviously, going back to my role as the CIGFO Chairman, we are watching really all of what FSOC is doing, and certainly they are going through this whole rule-making phase of trying to establish what parameters they are going to be able to have and assessing all of this, trying to analyze and deal with all of the data which is going to take place, which is obviously why OFR was created. It is a very important piece to the Department, and it obviously is for us as well.

We are not looking at how they prepare their budget per se, because that is generally not our role. There are justifications and preparations, et cetera. But it is how they spend it. And one of the things that we have noticed is that about half their budget is contracting services, and that very much is something we would look at.

Mrs. EMERSON. What kind of contracting services?

Mr. THORSON. We don't know. I mean, that is part of it. Just contractual services is in their budget, and for 2013 it is about half of the budget. So we are going to spend a great deal of time on trying to assess that and how well that contracting has done, because that is a very clear element for our audit people to be able to look at and see. So since that amounts to nearly half of the budget for 2013, I think that will be a very helpful piece of information for you all to be able to look at.

Mrs. EMERSON. Yes, because usually agencies and/or departments have a professional—I mean someone with contracting experience doing the contracting, and one would hope that the person who is executing the contracts has the experience to do so.

Mr. THORSON. Right. And we hope that that is the case. But certainly with that size, with that percentage of the budget, then we need to be watching that and making sure. And that is a good way for us to be able to pretty much assess, too, about how this place is going to run, how is this office going to be set up and run. If half of it is in contracting, which is a little unusual, then we think this is a good way for us to approach it initially and to watch how they are going to begin to operate this office.

Mrs. EMERSON. Well, you know our Committee does depend on you to report back on gross mismanagement, waste of funds and the abuse of authority, and we appreciate that. It is kind of tough with a brand new agency, and we are not real sure what it is going to look like when it is finally stood up in totality.

Mr. THORSON. Right. And a lot of what we choose to look at in regard to this is with a little bit of an eye on what is helpful to you all. Your Committee has been very open, very communicative with us, which we appreciate, and it helps us to know some of the things that might help you all in doing the work you are doing as well.

Mrs. EMERSON. And you can be certain that we will provide that information for you, because it is important. And while I don't presume to know the number of employees that need to be doing X, Y and Z, it would be helpful to know that or to hope that this agency can run with a very small staff, because it does have one specific mission. At least I am under that impression.

INFORMATION TECHNOLOGY INVESTMENTS

Let me ask both of you, and since you are already on a roll, Mr. Thorson, we will let you answer this. One of the things that I feel very strongly about is if we are going to invest in IT, we need to just do it and get it done. And I would rather spend a little more money on it, too, because I believe that it can make an agency or department much more efficient. So I tend to want to get it done so the departments and agencies aren't operating with all these silos that don't talk to one another.

It is one of the reasons why the SEC managed to miss the whole Bernie Madoff scandal, because of the different silos and not being able to—and if people can't access one part of the database for security reasons or what have you, then they miss the whole thing, and that is exactly or part of what happened.

So can you comment first, Mr. Thorson, on the current status of the projects, the FinCEN particularly? I know that it is in this early stage, but we have suffered with failed first starts, and, quite frankly, I am not sure that I know of any agency or department in the government who has nailed it on the first time with upgrading or doing new IT projects. But certainly if you could just fill us in on this, I would be very, very grateful.

Mr. THORSON. Okay. As you all know pretty well, the prior attempt by FinCEN from 2004 to 2006 to develop a new BSA modernization system, et cetera, didn't work out real well, and there was about \$17 million that—wasted is such a harsh word, but that is about what it was.

Mrs. EMERSON. It went down the rat hole. Can you explain to me, tell me why didn't it work or was it the—

Mr. THORSON. Well, the one thing that is important to us now, what we are looking at, is that is still being worked on. So what we are doing now is to watch the project management, which is much improved, the oversight that has been provided by you all, by us and has worked out pretty well. They successfully migrated to FinCEN from IRS some historical BSA data. That was done in December of 2011 and January of 2012. That was an important milestone that we were watching. So it is now at a pretty critical point in broad-based integration testing.

So this is a big part of one of the projects we are working on, is to see how the improvements have been made, are they making any of the same mistakes, et cetera, and identifying the milestones that are going to tell us that things are pretty much on track. So far there is very much improvement. It is doing all right. But we continue to watch it and that is one of the major things that our audit group is looking at.

Mrs. EMERSON. Can you remind us what the date, their goal to be completely finished, what date that is?

Mr. THORSON. Which what is?

Mrs. EMERSON. The date of when they want to complete this project. Remind us of that.

Mr. THORSON. 2014.

Mrs. EMERSON. And heaven knows how technology will change in the next couple of years.

Mr. THORSON. Yes.

Mrs. EMERSON. We are always a little bit behind, unfortunately, it seems.

Mr. THORSON. Right. It does. But the first report, we will issue a first report on this by the end of this month.

Mrs. EMERSON. Excellent.

Mr. THORSON. This isn't a one-time deal and in 2014 we will get back to you. This will be an ongoing thing and we will try to keep you apprised as to how this is working. And we do the same thing, of course, with the Department, because if this starts to come unraveled again, we want to make a lot of noise about it. It is a lot of money.

Mrs. EMERSON. Well, it is a lot of money, and we really appreciate it and look forward to getting a report.

So, Mr. George, how do you think CADE-2 is doing?

Mr. GEORGE. They are making progress. As you know, this has been a longstanding effort on the part of the Internal Revenue Service. They originally estimated that it would take about 15 years. They are entering the 15th year in this effort. The good news, they originally estimated it would cost about \$8 billion and it has been only just about half of that. Now, they have had to downgrade some of the, you know, special features—

Mrs. EMERSON. Bells and whistles.

Mr. GEORGE. Exactly. When speaking to my staff about this entire effort, I related the fact that I had a dispute with a store about something I had purchased and I called American Express. Right on the spot they were able to identify the purchase, they were able to issue me a temporary credit, and they were able to send me—and I got a letter just the other day confirming all of this in the course of 3 or 4 days. So I said to my people, you know, if American Express can do this, why can't the IRS do this? So, of course, I was told, although I am not sure about this, that American Express has fewer customers than the IRS interacts with. I am not sure that is true.

But the bottom line is after all of this effort, you know, once completed, it will allow for quicker refunds to taxpayers, it will allow for those who are working at the IRS to be able to quickly access information on taxpayers accounts, it will allow for daily updates of taxpayer information, as opposed to the current, it is not a week, but it is more than one day. So they are making progress. They are.

But as you just noted, and, again, I note the IRS doesn't like me mentioning the tax system modernization effort that occurred 15 years ago where they expended \$2 to \$3 billion on a system that didn't work and literally in effect tossed it away and started the business modernization effort, in the past this modernization effort was considered a very high risk, and I forget the technical term we use in the audit community, high risk project. But anyway, the Commissioner recently certified that they had made enough progress in this new effort, and we agree with them, that they removed it from this high risk list.

So the bottom line is I am optimistic that we will be able to hopefully very soon report to you that the IRS has completed this, again with fewer bells and whistles, but nonetheless completed it under budget.

Mrs. EMERSON. Under budget.

Mr. GEORGE. Under budget.

Mrs. EMERSON. It is all relative, isn't it? You don't have to comment. I was being snarky. Well, you know, actually Winnie and I went down to the Memphis Service Center because it is not very far from where I live in Missouri and visited and to watch the old system, and it is very easy to understand why it takes a week to do anything or why letters pass in the mail. We sat in and watched one of the operators, assistants there and she had to go through about 15 screens based on the questions and everything else. And I know that this CADE-2 will simplify that process, so that once something is migrated into the system it makes it a whole lot easier.

But it is still something that we have to be very careful of, because our money is finite and we have to be careful. But certainly efficiency and productivity is very important, and heaven knows that our government IT systems are really back in the dark ages as compared to the private sector, just for example.

I have got another question I am going to want to ask, but go ahead. I will defer to you now, Joe, and then I will come back and ask my other question.

Mr. SERRANO. No problem. To both of you, throughout your testimonies you note matters about which your offices have issued recommendations to Treasury. Some of these recommendations have been implemented, some have not.

AGENCY RELATIONSHIPS WITH THE INSPECTOR GENERAL

Tough question: How would you describe your relationship with the Department? Do you feel that this is a productive relationship?

Mr. THORSON. I would say our relationship, especially on recommendations and that kind of thing, is excellent. They are responsive to us. They listen. As far as an IG-Department relationship goes, in my opinion it is really outstanding. They care about what we say. They know we are not out to get them, that we are trying to help and contribute to what they are doing. We may do it through critical statements, but the net result is the same. We want to help, and I think they recognize that. So I am overall very pleased with that relationship.

Mr. GEORGE. Mr. Serrano, I would like to associate my response with his comments, because we actually have a 94 percent implementation rate of our recommendations by the IRS and we are extraordinarily proud of that. We have a very good working relationship, both at the executive level, meaning the Commissioner and his senior people, as well as people subordinate to them. So it has been a very productive relationship.

Mr. SERRANO. I would love to hear where that 6 percent is.

Mr. GEORGE. We can supply that if you would like.

Mr. SERRANO. Well, I am sure the chairwoman may want to know that.

Mrs. EMERSON. Yes, I would.

[The information follows:]

TIGTA Audit Recommendations

The 94 percent represents the percentage of recommendations that the IRS reports as fully implemented. The percentage of recommendations that the IRS rejects is only a portion of the remaining 6 percent. Further details follow.

The Treasury Inspector General for Tax Administration (TIGTA) uses the Treasury's Joint Audit Management Enterprise System (JAMES) to track the progress of the Internal Revenue Service (IRS) implementing TIGTA audit recommendations within five years of the date they were issued. TIGTA uses the JAMES data to calculate the percentage of recommendations by dividing the total number of recommendations the IRS actually implements by the total number of recommendations contained in TIGTA audit reports issued during a Fiscal Year (FY). For the most current percentage calculation, TIGTA uses FY 2008 data as its baseline. Doing so gives the IRS an opportunity to realistically complete action on audit recommendations, most of which take several years to accomplish.

Turning to FY 2008, TIGTA issued 178 total reports. Eighty-three of these reports contained recommendations for a total of 285 recommendations. Of these, 267 recommendations (94%) have been fully implemented. The remaining eighteen recommendations (6%) include:

- One open recommendation;
- Fifteen rejected recommendations;
- One canceled recommendation; and
- One superseded recommendation.

An open recommendation occurs when the IRS has agreed with an audit finding and with the recommended corrective action as prescribed by TIGTA; however, the IRS has yet to fully implement all of the corrective actions. A rejected recommendation is one wherein the IRS does not agree with a specific audit finding, *i.e.*, that a particular problem exists. A cancelled recommendation is one that is no longer an option to address an audit recommendation. It usually occurs when an IRS activity stops or is replaced by some other functionality that makes the whole reporting issue moot. A superseded recommendation refers to an open recommendation that has been replaced by a newer, more current recommendation, which is noted in a subsequent audit report.

Information pertaining to the one open recommendation and fifteen rejected recommendations follow.

TIGTA Audit Recommendations

Fiscal Year 2008 Open Audit Recommendation

Report Title	Report Number	Summary of Audit Recommendation
The Withholding Compliance Program Is Improving Taxpayer Compliance; However, Additional Enforcement Actions Are Needed	2008-40-167	Create a single data entry point for Withholding Compliance Program cases, and provide lock-in letter issuance authority to other IRS functions.

Fiscal Year 2008 Rejected Recommendations

Report Title	Report Number	Summary of Audit Recommendation
Efforts to Update Aging Computer Hardware Are Underway, But Program Improvements Are Needed to Minimize Risks	2008-20-002	Permanently allocate funds to maintain and replenish computer hardware.
The Processing of Carry-Back Loss Claims Needs to Be Improved to Ensure Taxpayers Receive Accurate Refunds	2008-40-062	Modify the taxpayer instructions for Form 1045 and Form 1040X as it pertains to carry-back losses.
The Processing of Carry-Back Loss Claims Needs to Be Improved to Ensure Taxpayers Receive Accurate Refunds	2008-40-062	Modify the procedures for verifying the accuracy of carry-back refund claims and Forms 6251.
The Taxpayer Advocate Service Needs to Improve Its Processing of Economic Burden Cases	2008-10-088	Update Internal Revenue Manual Part 13, and when working cases, update the Taxpayer Advocate Management Information System (TAMIS) as the cases progress.
Installment Agreement User Fees Were Not Properly Calculated Or Always Collected	2008-40-113	Reinforce the importance of complying with the IRS' internal procedures requiring direct taxpayer contact, and consider modifying the payment coupon and programming.

TIGTA Audit Recommendations

Installment Agreement User Fees Were Not Properly Calculated Or Always Collected	2008-40-113	Develop a control/report pertaining to the reversal of duplicate user fees.
A Self-Assistance Option Would Reduce Burden And Costs Associated with Resolving Rejected Electronic Tax Returns	2008-40-128	Develop a business case on the feasibility of providing information to customers in the acknowledgement file.
While Progress Has Been Made, Limits on the Number of Examinations Reduces the Effectiveness of the Earned Income Tax Credit Recertification Program	2008-40-131	Ensure information on the Form 8862 is correct and consistent with information on the tax return prior to recertifying taxpayers.
Increased Call Volume Associated with Economic Stimulus Payments Reduced Toll-Free Access for the 2008 Filing Season	2008-40-168	Ensure callers have the option of returning to the main menu when the IRS uses a recorded message.
The Internal Revenue Service Needs to Evaluate Tolerance Levels to Ensure Program Objectives Are Met	2008-30-158	Actions are needed to make better use of resources when corresponding with taxpayers for missing forms and schedules.
Accuracy of Volunteer Tax Returns Continues to Improve, But Better Controls Are Needed to Ensure Consistent Application of Procedures And Processes	2008-40-177	Ensure that site visits include a review of Refund Anticipation Loans.
An Estimated \$1.6 Billion in Fraudulent Refunds Was Issued During the 2006 And 2007 Filing Seasons	2008-10-172	Develop an approach to achieve the legislative change exempting the IRS from having to issue statutory notices of deficiency on fraudulent returns.

TIGTA Audit Recommendations

An Estimated \$1.6 Billion in Fraudulent Refunds Was Issued During the 2006 And 2007 Filing Seasons	2008-10-172	Coordinate a review of identified returns during Processing Year 2006, and pursue recovery or offset as appropriate.
An Estimated \$1.6 Billion in Fraudulent Refunds Was Issued During the 2006 And 2007 Filing Seasons	2008-10-172	Implement procedures to ensure that suspicious tax returns are identified, and ensure resources are available to verify the accuracy of these returns.
The 2008 Filing Season Was Generally Successful Despite the Challenges of Late And Unexpected Tax Legislation	2008-40-183	Ensure that the computer systems are programmed to identify taxpayer returns claiming IRA deductions for taxpayers age 70½ and older.

Mr. SERRANO. I am giving you a lot of reports as I go along.

Mrs. EMERSON. I know. And I always get worried that we impose an awful lot of paperwork on our partners here, but, on the other hand, it does help us as we are trying to get our budget numbers figured out at the end of the day. Don't you agree?

Mr. SERRANO. I do.

Mr. GEORGE. And just to clarify, I just want to make sure, there are within that 6 percent a percentage where they say we don't agree with you, and then there are others where it is just taking them a while to implement the recommendation, too. So I wanted to make sure—

Mrs. EMERSON. Do you have deadlines on that? I am just curious.

Mr. GEORGE. No, we don't implement deadlines or set deadlines for them, but we say to them, and this is a perfect example, when it pertained to one of the refundable credits, the First-Time Homebuyer Credit, during the course of our audit of that when we were finding all of these instances of people seeking the credit who were not entitled to it, we made a recommendation to the IRS that they solicit from those seeking that credit proof of homeownership. And the IRS during the course of our review, before we issued the final report, implemented that recommendation and they were able to stop erroneous refunds from going out.

So, again, it is a symbiotic relationship. Because we have to rely on—I have a very limited staff. The IRS is just under 100,000 people and I have just over 800 people. So if the IRS wanted to hide things, and I am not suggesting that they are, and this applies to any governmental agency, they could easily do so.

So we have good working relationships where in some of our most high profile cases it was the Commissioner who brought the matter to our attention and allowed us to conduct an independent review, and obviously it wasn't good news for them, but it ultimately benefited the American people.

Excuse me, Mr. Serrano.

Mr. SERRANO. That is okay. I was going to—I can't help myself when I am going to say you are not going to get much sympathy about 800 employees when the average member of Congress has nine employees in their district and nine in their Washington office, and we are running the country, right?

Mr. GEORGE. You are.

IRS AUDITS

Mr. SERRANO. We are always at a slight disadvantage. But let me ask you a question. For a while, in addition to my quoting one for seven, which now I don't know if I should ever do it again, you know, there was also a report that at one time 44 percent of all audits were being conducted on 17 percent of the taxpayers with a great emphasis on the EITC program. And it gave the sense that if you were a big tax cheat, you would get away with it, that is the sense, but if you had claimed the EITC you could be in for an audit even if you had done nothing wrong.

Do you have any information on that? That one we weren't misled on. That one there was plenty of proof. Has that changed? Do we know what is going on with that? Or is this still a target? And let me say that it is not just the IRS. You will get certain Members

of Congress who, given a choice to discuss millionaires or EITC folks, will spend their 5-minute questioning period on how many cheats there are in the EITC program and not anywhere else. So what can you tell us about that?

Mr. GEORGE. May I beg your indulgence for one moment?

I have been informed by my staff that we do not have specific information on that exact question that you posed, sir, but our understanding is that the IRS is increasing the number of corporate audits. But I don't have percentages that I can provide to you at this time.

Mr. SERRANO. And I want to be clear. I am not suggesting we go after these folks and not after those folks. Go after everybody that the IRS needs to go after. But when you hear a report that 44 percent of the audits are being conducted on 17 percent of the taxpayers and that there was a great emphasis on people who had claimed the EITC program or the whole issue of how many people were claiming it that perhaps were not documented folks, as some people call them, the illegal aliens in this country, that just seemed to me to be more of a political statement at that time than an actual IRS, you know, go find the money statement. So, again, I hate to burden you guys more, but if there is anything you could tell us about that in the future, I would truly appreciate it.

IRS TAXPAYER SERVICE

As we approach yet another tax season, I am particularly concerned about the impact of the cuts made to the IRS budget last year in terms of taxpayer services. One of the most distressing items in your testimony, Mr. George, is the Taxpayers Assistance Centers will operate on reduced hours. This, of course, means that the people who might need this assistance the most won't be able to get to a center to ask questions. What is the impact of this decision, in your opinion?

Mr. GEORGE. You know, it is not only reduced hours, sir, it includes the fact that they no longer will accept reservations, appointments in effect. In the past, the IRS would allow a taxpayer to call and to make, in effect, an appointment to have their taxes worked on. Not only have they stopped that, they are now actually directing a lot of taxpayers who in the past would go to a tax center, a Taxpayer Assistance Center, to have assistance with completing their 1040 or whatever form they file, they are telling them no, no, no, you need to go to a VITA center or AARP or another tax assistance organization or entity.

We are also finding that the IRS is receiving more telephone calls to their help line than they can answer, and as of February 18th, they had received about—rather, about 46 million taxpayers have attempted to call the various toll-free telephone lines, and this compares to 32 million last year, and the IRS has only been able to answer about 5 million of these calls.

There is something that we refer to, and it is in my testimony, called the level of service for telephone. The toll-free telephone line this filing season is approximately 64 percent, and the level of service measures the relative success rate of taxpayers who call these toll-free numbers seeking assistance from these customer service representatives. The level of service this time last year was about

74 percent, meaning that the average speed that a taxpayer got an answer for a question was about 10 minutes. So all of this is getting worse. The average speed now is about 16 minutes, almost 17 minutes before a taxpayer gets an answer to a question.

So the bottom line is the IRS is reducing customer service. They received a slightly, you know, not slightly, they received a budget cut. They made choices that, again, during your questioning of the Commissioner I think would be a valid question as to why they chose to reduce the hours of service, the number of people being assisted at tax versus enforcement efforts.

Mr. SERRANO. Thank you.

Mrs. EMERSON. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Actually, I have no further questions, Madam Chairwoman. I just think one of the percentages that we should—by the way, I have to say I think Mr. Serrano has had some I think very interesting requests and some observations. But I think a new statistic is I think 50 percent of all the reports they have to write are your recommendations.

Mr. SERRANO. And you would be interested to know that I asked for a bilingual copy.

Mr. DIAZ-BALART. But again, I do want to thank Mr. Serrano for coming up with I think some very interesting questions.

I do want to end where I started though, if that is all right with you, Madam Chairwoman. I just want to thank you gentlemen for your service. I think you must have one of the most thankless jobs because, you know, you are not exactly the most popular with maybe most, but I will tell you that you do an invaluable service for the American people. And I don't know what we would do without having your input, your service. Again, thank you very much.

Mr. GEORGE. Thank you, sir.

INFORMATION TECHNOLOGY EXPERTS

Mrs. EMERSON. Thanks, Mr. Diaz-Balart.

I have two questions, one of which is a yes or no. Do you all have on each of your staffs experts in IT?

Mr. GEORGE. Yes.

Mr. THORSON. Yes.

Mrs. EMERSON. Okay.

Mr. GEORGE. Actually, the gentleman seated in the front row here, Alan Duncan, who actually came from IRS—no, the private sector, but is very well versed in IRS systems. We are very lucky to have him.

Mrs. EMERSON. Hi, Alan. I think that that would be an awfully good field to be in, so they are lucky to have you. I bet you could make more money in the private sector.

AFFORDABLE CARE ACT IMPLEMENTATION

Anyway, I do want to ask you about the health care law and the implementation of it, Mr. George. You all are requesting \$4.5 million of increase for oversight of the implementation of the Health Care Act. The IRS has already spent \$236 million, which was transferred from the Department of Health and Human Services, and they are requesting \$360 million this year from our subcommittee for implementation.

So what I want to know or would like to ask is for you to comment on the results of the quarter billion dollars that they have already spent on health care implementation and do you have any concerns about future implementation activities?

Mr. GEORGE. Yes. Thank you, Madam Chairwoman. The health care implementation effort is one of the IRS's top priorities. They have thus far hired approximately 700 people, or at least they are in the process of hiring about 700 people. As of May of last year they had hired 495 new employees. They plan to hire 87 new employees—they had planned to hire 87 new employees by the end of 2011, September of 2011. They have to—

Mrs. EMERSON. If you would tell me what these employees are supposed to do?

Mr. GEORGE. Well, keep in mind that some aspects of the health law are in effect. The small business credit is in effect and there are a few others. But most of these that I am describing are in the modernization information technology services organization.

Mrs. EMERSON. The data processing piece.

Mr. GEORGE. Exactly, known as MITS. And what they literally have to design are about eight new computer processes to implement the health care law, and as I indicated in my opening statement, there are about 40 provisions of the law that amend the Internal Revenue Code.

Now, keep in mind it is estimated by the Joint Committee on Taxation that almost half a trillion dollars in new revenue will be funneled into the IRS as a result of—I mean in effect new taxes, about half a trillion in new taxes will be handled by the Internal Revenue Service once this law is fully up and running, and this is expected between fiscal year 2010 to 2019.

Mrs. EMERSON. Do you have any idea how much it is going to cost the IRS to fully implement the Health Care Act, because I think it has provisions that go into effect as late as either 2018 or 2019. Because I know for example the State of Missouri in 2019 is going to run a Medicaid shortfall because they have to start taking over something that we used to do on the Federal level.

Mr. GEORGE. You know, that will be part of our review. The IRS currently is unable to provide a figure to address your question. But, again, I am sure in subsequent reviews we will come up with some estimates.

Mrs. EMERSON. And what I would appreciate, I understand they are tasked with doing this, and certainly with the small business tax credit and all of that. But I do recall having the discussion with the Commissioner that, you know, they were having to set up an interface for, you know, with HHS and an interface with the small businesses and an interface with the State exchanges, but there aren't any State exchanges except in Massachusetts, I believe. So I don't know how you set something up if those other things don't exist, which is hopefully something that you will be looking at in your report.

Mr. GEORGE. We will. But it is the practice of the IRS, because, as you well know, they have to anticipate things, and especially in the tax arena, because sometimes Congress delays making changes to the Tax Code and they just have to be able to implement it. So

they anticipate things even if they don't ultimately come to fruition.

Mrs. EMERSON. Right. And I appreciate that very much. I think, Mr. Serrano, do you have any more questions?

Mr. SERRANO. I have a few for the record.

Mrs. EMERSON. I have a few for the record. Mario, do you have any for the record?

Mr. DIAZ-BALART. No, Madam Chairman.

Mrs. EMERSON. We will submit them for the record, and hopefully you will be able to get back to us within 30 days.

Mr. GEORGE. We will do our level best, ma'am.

Mrs. EMERSON. None of mine require extensive research. Thank you all so very, very much for coming in, and once again I do apologize for having to delay the hearing, but we are grateful that you all were able to accommodate us.

[The information follows:]

Financial Services and General Government Subcommittee
Hearing on the Treasury – Inspector General and Treasury – Inspector General for
Tax Administration (TIGTA) FY 2013 Budget

Questions for:

Eric Thorson, Treasury Inspector General

Questions for the Record Submitted by Chairwoman JoAnn Emerson

DODD-FRANK REGULATIONS

Treasury is among many different agencies responsible for writing hundreds of rules to implement Dodd-Frank reforms. Federal financial agencies conduct regulatory analysis in a variety of ways and often lack formal policies for interagency coordination. The Financial Stability Oversight Council, or FSOC, seems like a natural organization to facilitate coordination, but GAO concluded that FSOC “has played a limited role in doing so beyond its own rulemaking.”

Mrs. Emerson: Is interagency coordination an opportunity to improve the effectiveness of financial regulations and to prevent introducing instability in US financial markets?

Mr. Thorson: Yes, I believe interagency coordination is critical. While coordination does go on, as GAO noted, there is generally not a formal process for these efforts. In June 2011, I informed Congress that Treasury’s Office of the Comptroller of the Currency (OCC) had processes in place to ensure that required economic analyses are performed consistently and with rigor in connection with its rulemaking authority. However, we noted that there was no formal process in place that provided for coordination on economic analyses between OCC and the other federal banking agencies.

Mrs. Emerson: Even if the FSOC is meeting, or on target to meet, its statutory deadlines, is FSOC demonstrating leadership in accordance with and inherent to its mission?

Mr. Thorson: Yes, I believe that FSOC is demonstrating the leadership that could be reasonably expected at this stage of its existence. It must be recognized that FSOC is very much a work in progress and it is the first time that such a framework has been put in place to coordinate the government’s efforts to identify and remediate threats to our financial system. It is notable that they have been able to complete rule making on difficult subjects such as identifying systemically important nonbank financial companies for supervision by the Federal Reserve and systemically important financial market utilities.

MERGING FINANCIAL MANAGEMENT SERVICE WITH BUREAU OF PUBLIC DEBT

The Department proposes merging the Financial Management Service (FMS) with the Bureau of Public Debt (BPD) in 2013. The FMS accounts and disburses all Federal funding and computes

the balances of Federal accounts. The BPD sells US debt and makes principal and interest payments.

Mrs. Emerson: Would it be advisable to combine these two bureaus without a detailed transition plan explaining, for example, how current responsibilities will be divided or shared, how customers will be affected, or how the management structure and staffing needs will change?

Mr. Thorson: Yes, we believe a detailed transition plan is essential. As a matter of fact, the Department has had a very recent experience with the transfer of Office of Thrift Supervision (OTS) functions to OCC, the Federal Deposit Insurance Corporation, and the Federal Reserve Board. In this case, the impacted agencies were required, by Congress, to develop and submit a comprehensive plan. Congress also required my office and the other affected Inspector General offices to assess the plan and periodically report on its implementation.

Questions for the Record Submitted by Ranking Member Jose Serrano**MATERIAL LOSS REVIEWS**

Mr. Serrano: Mr. Thorson, I know your office has had its hands full with the material loss reviews of failed banking institutions over the last several years. What can you tell us about what your office has learned from these reviews, and how can we ensure that this wave of bank failures does not happen again?

Mr. Thorson: Although many factors contributed to the turmoil in the financial markets, our work found that OCC and OTS often identified problems early, but did not force timely correction of unsafe and unsound practices by numerous failed institutions under their respective supervision. The irresponsible lending practices of many institutions are now well-recognized. I am referring to products such as Option Adjustable Rate Mortgages and to practices where banks did not even require the borrower to prove their income. At the same time, many of the failed banks also engaged in other high-risk activities, including high asset concentrations in commercial real estate and overreliance on unpredictable wholesale funding to fund growth. The sad thing is that these were lessons that we should have learned from the Savings & Loan crisis less than 20 years ago. Preventing such a wave of bank failures going forward is shared responsibility of both industry and their regulators.

DE-CONSOLIDATION OF INFRASTRUCTURE INVESTMENTS

Mr. Serrano: Mr. Thorson, you also state in your testimony that Treasury has decided to de-consolidate all infrastructure investments to its bureaus, which is exactly the opposite of what most agencies are doing. In fact, there is a great push within the Administration to consolidate these functions to reduce duplication and overlap and achieve efficiencies of scale. Are you concerned about this decision?

Mr. Thorson: Yes, such a decision does seem to be contrary to current trends. However, before we draw a conclusion, we will need to examine Treasury's rationale. In this regard, we intend to include a project in our fiscal year 2013 work plan to look at the Department's capital planning and investment control program.

Questions for the Record Submitted by Congresswoman Barbara Lee

FOREIGN ASSETS CONTROL

Ms. Lee: Please transmit to the Subcommittee your report on the Office of Foreign Assets control and their Cuba related enforcement efforts as soon as it is completed.

Mr. Thorson: We would be pleased to provide the Subcommittee with our report when it is issued. We do want to note that the objective of this review is to evaluate the licensing programs administered by the Office of Foreign Assets Control (OFAC) and whether licenses were appropriately granted. We focused our review on specific licenses which are based on applications from individuals or businesses. Among OFAC's licensing activities we are reviewing include its processing of license applications for exports of agricultural products, medicine and medical devices to Iran and Sudan pursuant to the Trade Sanctions Reform and Export Enhancement Act of 2000; license applications pertaining to travel and activities involving Cuba; and applications to release fund transfers blocked by U.S. financial institutions.

NEW OFFICE OF MINORITY AND WOMEN INCLUSION

Dodd Frank required the Treasury Department to set up an Office of Minority and Women Inclusion (OMWI) to "be responsible for all agency matters relating to diversity in management, employment and business activities."

Ms. Lee: Can you provide the Subcommittee an update on the Department's efforts at creating their office of Minority and Women Inclusion?

Mr. Thorson: Both the Treasury Departmental Offices and the Office of the Comptroller of the Currency have created an Office of Minority and Women Inclusion. While we have not yet conducted audit work related to those Offices, we recognize their important responsibilities under the Dodd-Frank Act and accordingly are including them in our planned audit work for fiscal year 2013. The timing and scope of that work has yet to be determined.

Ms. Lee: Please continue to update the Subcommittee on the progress and impact of the work of the OMWI office.

Mr. Thorson: Yes, we would be pleased to keep the Subcommittee updated.

Financial Services and General Government Subcommittee
Hearing on the Treasury – Inspector General and Treasury – Inspector General for
Tax Administration (TIGTA) FY 2013 Budget

Questions for:

J. Russell George, Treasury Inspector General for Tax Administration

Questions for the Record Submitted by Chairwoman Jo Ann Emerson

IRS MODERNIZATION

Question: The IRS is in the process of some significant transitions, most notably to the Modernized e-File system and to CADE 2. How have the Modernized e-File system and CADE 2, the two pillars of the IRS's modernization effort, performed so far this filing season?

Taxpayers who e-filed their tax returns early in the 2012 Filing Season have experienced delays in receiving their tax refund. The IRS experienced problems with its filters established to identify fraud and with the program used by Modernized e-File (MeF) to create output files using the accepted e-file tax return data that other IRS systems need to continue with the processing of the tax return. Filters established to identify fraud were initially identifying taxpayers as having indicators of possible fraud, which resulted in the tax return being held for additional screening. However, the IRS identified that these filters were incorrectly identifying some taxpayers. IRS officials have informed us that they corrected these filters, which has eliminated this problem.

Modernized e-File

A MeF programming problem resulted in the creation of incomplete and/or duplicate output files using the accepted e-file data. This resulted in delays in sending the output files to downstream processing systems. The IRS noted that the programming problem delayed the processing of approximately 7.8 million tax returns. These tax returns were processed through MeF February 2, 2012 through February 11, 2012. The IRS indicated that all of these delayed accepted tax returns were sent to other downstream systems for processing by February 18. However, MeF programming problems resulted in the IRS issuing an alert on February 10 to transmitters, encouraging them to once again use the Legacy e-file system rather than MeF. The alert noted that they discovered some issues with MeF data interfaces with downstream processing systems. IRS also indicated in the alert that it believes the issue is resolved. The alert encouraged transmitters to continue to use Legacy until further notice. As of March 7, the IRS is still allowing transmitters to use either Legacy or MeF.

The MeF programming problem has also resulted in accepted tax return information not always being timely available for use in its customer service operations and Internet tools, including "Where's My Refund?" The IRS has informed us that this problem has been addressed and that processes have been established to account for all tax returns accepted via MeF when the processing problem existed. IRS officials noted that they are developing an end-to-end balancing process to track MeF-accepted tax returns from acceptance to the posting of the

tax return on the Individual Master File. We plan to continue our evaluation of the IRS's implementation of the MeF system, and we will issue a separate audit report on the results. Based on the problems so far, we have concerns with the IRS's plans to retire its Legacy system at the end of this year.

Customer Account Data Engine 2

The IRS is moving forward with its Customer Account Data Engine 2 (CADE 2) implementation, which is a new way of posting taxpayer data to the Individual Master File and maintaining individual tax account data. For this filing season, the IRS changed from its decades-old method of posting data once a week to a method that allows them to post data to the Individual Master File daily. The ability to post information to the Individual Master File daily will enable the IRS to provide faster refunds to taxpayers and to provide more accurate and timely data to customer service employees. In addition, the IRS has initialized the database that will be the central repository for all individual tax accounts.

Prior to this filing season, the IRS went through an extensive process to identify those tax account transactions that could be processed on a daily basis. This undertaking took more than two years for a team of IRS personnel to analyze the various account transactions to identify those that could be processed daily. The accuracy of this undertaking is essential because certain account transactions require additional IRS screening during the return processing stage. These types of transactions do not qualify for daily processing and, once tax returns associated with that account transaction are identified, the processing timeframe is extended. For example, tax returns identified as having fraud potential are not processed daily. Extending the processing timeframe prevents the issuance of a potentially fraudulent tax refund by providing time for an IRS employee to review the tax return.

The CADE 2 relational database has been initialized and is being tested and evaluated during the current filing season. When implemented, the database is designed to be the central source of individual tax data and will be a platform for more meaningful business intelligence and enhanced compliance. The IRS plans to begin using the CADE 2 database in the second or third quarter of 2012 for Corporate Files On Line (CFOL) and providing data to select downstream systems.

We are evaluating the IRS's implementation of daily tax processing and its testing and implementation of the CADE 2 database. After our review and analysis, we will issue separate audit reports on the results

REFUNDABLE TAX CREDITS

Question: From a tax administration perspective, what is the merit behind requiring additional documentation for refundable credits? With the complexity of the tax code already placing a heavy burden on the taxpayer, won't requiring more documentation for refundable credits increase that burden? Would the documentation requirement prohibit taxpayers from filing electronically? Lastly, which credits are the most concern regarding improper payments?

Refundable credits are more prone to attract fraud because they are not only a tax offset; they result in a payment of Government funds. Once paid, the money is very difficult to recover. The following refundable credits are of concern because of the dollar amounts paid, in most instances without verification of eligibility:

- Earned Income Tax Credit (EITC)
- Additional Child Tax Credit (ACTC)
- American Opportunity Tax Credit

Requiring documentation to substantiate refundable credits would be commensurate with Federal benefits. For example, individuals who receive food stamps are required to provide the following:

- Identification such as a driver's license, state ID, birth certificate or alien card;
- Proof of income;
- Proof of amounts spent on child care;
- Rent receipts or proof of mortgage payments;
- Records of utility costs; and
- Medical bills for certain household members.

For the EITC, the maximum credit is substantial. It was \$5,751 for Tax Year 2011. The total ACTC can be even higher, depending on the number of children claimed. Taxpayers are only asked to provide the documentation that the IRS needs to verify the credit claim if their tax return is audited. However, the IRS does not have the resources to audit most improper refundable credit claims. Requiring documentation when the tax return is filed would discourage improper claims and enable the IRS to verify many claims without contacting the taxpayer. With the implementation of the IRS Modernized e-File for individual income tax returns, taxpayers can provide this documentation as an attachment to their tax return and still file electronically.

Questions for the Record Submitted by Ranking Member Jose Serrano

RETURN PREPARER PROGRAM

Question: Mr. George, I understand from your testimony that you are a proponent of further oversight over tax return preparers, but that you have some concerns over how the IRS has begun implementing their Return Preparer Program. I think this is an especially important program that the IRS has launched, and I have also supported their efforts. Could you outline the steps the IRS needs to take to make sure this program is as effective as possible?

The new preparer requirements will take several years to implement, and it will not be until Calendar Year 2014 that all preparers will be subjected to all suitability and competency tests. When the decision was made to register preparers, the IRS had not established all of the program requirements nor had it established the organizational structure needed to administer and oversee the new Program.

The IRS needs to take the following steps to ensure the Return Preparer Program is effective:

- Obtain direct access to the Return Preparer Program registration system. Currently, the IRS does not have direct access and neither does TIGTA. Therefore, independent testing cannot be completed to ensure that records are complete and accurate.
- Establish controls to ensure that Preparer Tax Identification Number (PTIN) applicants meet all requirements by verifying: (1) professional credentials for attorneys, Certified Public Accountants, and Enrolled Agents; (2) that all U.S. based preparers are U.S. citizens or legal aliens; and (3) that all applicants are compliant with their Federal tax compliance checks.
- Ensure that suitability tests of PTIN applicants include matching PTIN applicants to IRS information to identify preparers who are not allowed to prepare tax returns, including conducting background checks when applicable.
- Periodically match preparers with PTINs to available databases to ensure they are allowed to prepare tax returns and they are not deceased.
- Develop and implement a process to identify a tax return submitted with a PTIN that is being used by someone other than the authorized preparer.

Questions for the Record Submitted by Congresswoman Barabara Lee

IMPACT OF BUDGET CUTS

Question: How will cuts to the IRS or a possible sequestration and even greater reductions impact the services and enforcement efforts of the IRS?

In October 2011, the IRS Commissioner sent a letter to Congressional budget committees containing the IRS's perspective on proposed budget cuts to the IRS. Specifically, the IRS Commissioner stated that the proposed budget cuts contemplated by the Congress at that time would result in noticeable degradation of both service and enforcement and would have a serious detrimental impact on voluntary compliance for years to come. According to the Commissioner, cuts to the IRS budget at the contemplated levels would mean that front-line IRS staffing levels must be substantially reduced, leading to a measurable decrease of approximately \$4 billion in revenue annually, or seven times the contemplated reduction in the IRS's budget. The IRS estimated that IRS examinations of individuals and businesses, and collection actions taken to recover known unpaid taxes, would be down 5 to 8 percent. The Commissioner noted that budget cuts would also impact the IRS's customer service organization.

As a result of budget constraints for FY 2012, the IRS expected to be able to serve fewer taxpayers at its Taxpayer Assistance Centers and answer fewer taxpayer telephone calls during the 2012 Filing Season. The IRS anticipated it would have increased wait times, earlier cutoffs of assistance to avoid end-of-day overtime, and frequent unexpected closures of small Taxpayer Assistance Centers due to unscheduled employee absences. These centers planned to assist more than 6.1 million taxpayers in FY 2012. However, tax return preparation assistance would only be provided on a limited number of days per week and only on a first-come, first-served basis.

The IRS was also planning on providing only a 61 percent Level of Service on its toll-free lines. As of March 24, 2012, IRS assistors had answered 9.8 million calls and achieved a 68 percent Level of Service and a 950 second (16 minutes) Average Speed of Answer.

Regarding investments in new IRS enforcement staffing, in his March 22, 2012 testimony before the House Ways and Means Subcommittee on Oversight, the IRS Commissioner detailed the impact of the proposed budget increases on IRS enforcement. Specifically, he stated that the FY 2013 Budget Request includes \$403 million in new IRS enforcement activities, which, by FY 2015, are expected to raise \$1.48 billion in revenue annually at full performance, once new hires are fully trained and develop broader experience. The return on investment (ROI) for these activities is 4.3-to-1. According to the IRS Commissioner's testimony, the ROI is even greater when factoring in the deterrence value of these investments and other IRS enforcement programs, which is conservatively estimated to be at least three times the direct revenue impact. Further, the Commissioner stated that the enforcement budget also includes \$200 million in additional examination and collection programs that will generate more than \$1.1 billion in additional annual enforcement revenue by FY 2015. Of this \$200 million, approximately \$127 million restores cuts to the IRS examination program from FY 2011. The IRS estimates that these investments will restore annual enforcement revenue of \$661.7 million, an ROI of \$6.3-to-\$1 once the new hires, 912 FTEs, reach full potential in FY 2015. The remaining \$73 million restores cuts to the IRS collection program from FY 2011, resulting in additional annual enforcement revenue of \$486.9 million -- an ROI of \$7.6-to-\$1 -- once the new hires, 768 FTEs, reach their full collection potential in FY 2015.

Question: There was some discussion about just what the return for the taxpayer dollar is when it is invested in enforcement and service efforts at the IRS. Given that the current budget of the IRS is approximately \$12 billion and the return on that investment is \$2.5 trillion in gross receipts and the tax gap is already \$450 billion annually, what would be the impact on Federal revenue of additional cuts to the IRS budget?

The Internal Revenue Service (IRS) annually measures "enforcement revenue" that is calculated from compliance programs across the organization. In the Internal Revenue Service Fiscal Year 2013 Budget Request to Congress, dated February 13, 2012, the IRS reported that enforcement revenue was \$55.2 billion in Fiscal Year 2011 for a total IRS-wide return on investment (ROI) of \$4.6-to-\$1.¹ In comparison, for Fiscal Year 2010, the IRS-wide ROI was \$4.7-to-\$1.

In a May 2011 audit,² TIGTA reviewed the IRS's initiative relating to revenue officers hired during the period June 2009 through February 2010. The IRS's Fiscal Year 2009 budget justification projected that this hiring initiative would result in \$333.6 million of additional revenue in Fiscal Year 2011.³ However, TIGTA found that the IRS does not track a comparison

¹ \$55.2 billion in enforcement revenue compared to the IRS's Fiscal Year 2011 appropriated budget of \$12.1 billion.

² TIGTA, Ref. No. 2011-30-039, *Challenges Remain to Balance Revenue Officer Staffing With Attrition and Workload Demands* (May 6, 2011).

³ This Fiscal Year 2009 budget initiative involved hiring additional Field Collection staff of 486 FTEs, which the IRS anticipated would resolve approximately 42,000 additional Tax Delinquency Accounts in Fiscal Year 2009. Once new hires reach full potential in Fiscal Year 2011, the IRS anticipated that the additional staff would resolve an additional 88,000 delinquent tax accounts, generating approximately \$333.6 million in revenue.

of actual results to the original projections in the years following the budget's implementation. As a result, it is unknown if the IRS realized all or part of the additional projected revenue for this initiative. IRS management stated that they are working to develop a methodology to determine actual revenue collected from specific enforcement initiatives recommended in Fiscal Year 2009. Until IRS management implements this type of methodology, they will not know the actual additional revenue realized from requested enforcement initiatives.

The IRS has an overall ROI of nearly \$200-to-\$1 when its Fiscal Year 2011 enacted budget is compared to the \$2.415 trillion collected in Fiscal Year 2011.

Question: Is there any risk that critical services and mission critical work at the IRS would be impacted and would cuts to the IRS enforcement efforts actually increase the deficit?

TIGTA has not conducted audit work specifically on this question. However, as noted above, in October 2011, the IRS Commissioner sent a letter to congressional budget committees containing the IRS's perspective on proposed budget cuts to the IRS. Specifically, the IRS Commissioner stated that the proposed budget cuts contemplated by the Congress at that time would result in noticeable degradation of both service and enforcement and would have a serious detrimental impact on voluntary compliance for years to come. According to the Commissioner, cuts to the IRS budget at the contemplated levels would mean that front-line IRS staffing levels must be substantially reduced, leading to a measurable decrease of approximately \$4 billion in revenue annually, or seven times the contemplated reduction in the IRS's budget, which would result in a direct increase to the nation's deficit. The IRS estimated that IRS examinations of individuals and businesses, and collection actions taken to recover known unpaid taxes would be down 5 to 8 percent. The Commissioner noted that budget cuts would also impact the IRS's customer service organization.

As a result of budget constraints for FY 2012, the IRS expected to be able to serve fewer taxpayers at its Taxpayer Assistance Centers and answer fewer taxpayer telephone calls during the 2012 Filing Season. The IRS anticipated it would have increased wait times, earlier cutoffs of assistance to avoid end-of-day overtime, and frequent unexpected closures of small Taxpayer Assistance Centers due to unscheduled employee absences. These centers planned to assist more than 6.1 million taxpayers in FY 2012. However, tax return preparation assistance would only be provided on a limited number of days per week and only on a first-come, first-served basis. The IRS was also planning on providing only a 61 percent Level of Service on its toll-free lines. As of March 24, 2012, IRS assistants had answered 9.8 million calls and achieved a 68 percent Level of Service and a 950 second (16 minutes) Average Speed of Answer.

EITC AND CHILD TAX CREDIT

The Earned Income Tax Credit (EITC) is one of the most effective anti-poverty efforts that we have and the Child Tax Credit protects millions of children from poverty as well.

These credits are needed by more American families, now more than ever.

Question: How will deep cuts to the IRS effect efforts to maximize the proper payment of credits to the families who need them most?

Deep cuts to the IRS could negatively impact the IRS's ability to ensure that eligible taxpayers receive the EITC by reducing the resources needed to help taxpayers prepare their tax returns and comply with their tax obligations. As a result of current budget constraints, the IRS expected to be able to serve fewer taxpayers at its Taxpayer Assistance Centers, and answer fewer taxpayer telephone calls in the 2012 Filing Season. The IRS anticipated it would have increased wait times, earlier cutoffs of assistance to avoid end-of-day overtime, and frequent unexpected closures of small Taxpayer Assistance Centers due to unscheduled employee absences. Tax return preparation was provided on a limited number of days per week and only on a first come, first served basis.

Even though more taxpayers are calling the IRS's toll-free telephone lines every year, the IRS is answering fewer calls. A reduction in funding for toll-free telephone and correspondence services resulted in a Level of Service goal of 61 percent for Fiscal Year 2012, compared to 70 percent the IRS achieved in Fiscal Year 2011. The last year the IRS provided a Level of Service over 80 percent was Fiscal Year 2007.

Reducing resources available to conduct EITC education and outreach would also impact taxpayers eligible to receive the EITC. The IRS has a number of education and outreach programs designed to increase EITC participation, including:

- Partnering to conduct outreach with more than 300 coalitions, which represent hundreds of nonprofit organizations, financial institutions, and government agencies. These coalitions conduct their own local EITC outreach through direct mail and media efforts.
- Holding an annual National EITC Awareness Day to create national awareness of the EITC and educate the diverse EITC population. Actions include public appearances by members of Congress and key IRS executives to discuss the benefits of the EITC and focused assistance at IRS Taxpayer Assistance Centers.
- Improving information and tools available on the IRS web site (IRS.gov) to provide assistance to taxpayers, tax preparers, and the IRS EITC partners. For example, the IRS has updated the EITC Assistant, the EITC Electronic Toolkit for Tax Preparers, and the Electronic Toolkit for EITC Partners and has launched EITC Marketing Express.
- Providing key EITC Program information during annual Nationwide Tax Forums. Presentations are made to tax preparers nationwide.
- Sending computer-generated notices proactively to taxpayers who file tax returns and appear to be eligible for the EITC but did not claim the Credit.

Question: What does the IRS need to do and what other agencies do they need to coordinate with to intercept the large number of improper payments going out to tax payers before they are paid?

The IRS must move beyond traditional compliance methods to significantly increase the number of improper EITC payments it is able to identify and intercept before they are paid.

The IRS has math error authority to systemically adjust some tax credit claims with an invalid SSN. However, it must conduct an audit to address the majority of erroneous claims. The number of questionable claims the IRS can audit is limited to available resources and by the need for the IRS to provide a balanced enforcement program among all taxpayer income levels.

For example, the IRS currently uses information obtained from the Social Security Administration and the Department of Health and Human Services to validate EITC tax credit claims. The IRS uses these data to ensure claimants and children have a valid Social Security Number and a qualifying relationship for the purposes of claiming the tax credit. Currently, if the tax return is audited, the IRS asks taxpayers to provide documents such as a third-party affidavit or school records to support the taxpayer's claim that the child lived with the taxpayer for the required period of time.

Nonetheless, the IRS does not have the resources to audit most improper EITC claims. To expand the number of improper claims it is able to address, the IRS would need the authority to adjust claims without an examination when these claims have a high likelihood of being improper, based on available third-party data and the use of probability filters. This would still allow taxpayers to provide documentation to support the claims if they believe the claims are valid.

WEDNESDAY, MARCH 21, 2012.

INTERNAL REVENUE SERVICE

WITNESS

DOUGLAS H. SHULMAN, COMMISSIONER

Mrs. EMERSON. The hearing will come to order. I would like to welcome our subcommittee members and our witness, Commissioner Douglas Shulman of the Internal Revenue Service to this important hearing on the largest agency funded in a Financial Services and General Government bill. The IRS assists taxpayers and businesses who are voluntarily complying with their tax obligations, and investigates those who are not. Thank you, Commissioner Shulman, for your hard work, and that of all IRS employees. I want to take a moment to thank Floyd Williams, Director of the Office of Legislative Affairs, for the tremendous work that he has done over the many years that he has been at the IRS. Is it 35?

Mr. WILLIAMS. Sixteen in the present job.

Mrs. EMERSON. Okay. Thank you so much. You have been wonderful to work with. I know we are going to enjoy working with Cathy, your replacement, but we do appreciate your good hard work and that of all the IRS employees.

As my colleagues have heard me say before, two regrettable events are expected to happen this year. The Federal Government's debt to GDP ratio will exceed 100 percent, and its debt ceiling will be reached. This committee is determined to chart a course different from Greece, Italy, Portugal, and Spain, and we have already reduced spending within our jurisdiction by 11 percent over the past two years.

Even though the IRS's \$12 billion budget consumes about half of the funds in this subcommittee's jurisdiction, the IRS budget cuts were limited to 2.7 percent over the past two years in recognition of the IRS's necessary service. Protecting the IRS from double-digit cuts, however, means that other agencies in this subcommittee's jurisdiction sustained disproportionately higher cuts. This practice cannot continue indefinitely and the IRS may have to bear a greater proportion of future reductions.

The IRS is also responsible for another \$100 billion in spending outside of this Subcommittee's jurisdiction in the form of refundable tax credits and payments in lieu of tax credits. This category of spending will grow to \$160 billion by 2022 after the refundable health insurance premium tax credit goes into effect.

Once again, welcome Commissioner Shulman, and I look forward to your testimony which I hope will inform and guide our Subcommittee. I am interested in hearing how the IRS is reducing the administrative burden of tax compliance for individuals and businesses, preventing and detecting fraud, and realizing opportunities

for efficiencies. With that, I yield to my good friend Mr. Serrano for any opening statements he would like to make.

Mr. SERRANO. Thank you so much. Let me join you in paying tribute to Mr. Williams also for his style, his assistance, and being a true gentleman, and living proof that the tax man does not have to be a bad guy. We thank you for your service. Thirty-five years?

Mr. WILLIAMS. Close to.

Mr. SERRANO. That is a long time. That is a long time, and so congratulations, and thank you. I would like to join in welcoming once again Commissioner Shulman before the Subcommittee.

The IRS may be the one Federal Agency that most American people have contact with. In some cases, it may be the only contact people have with the Federal Government, whether it is in filing taxes, receiving refunds, or resolving a tax problem. In this sense, IRS employees are at the front lines of making sure that our government is responsive and fair to the people we represent.

Moreover, the IRS brings in the vast majority of our government's revenue by enforcing our tax laws, and by ensuring that tax cheats do not get away with breaking the law. Given these important roles, I was extremely disappointed with the final fiscal year 2012 funding levels for the IRS. The funding cuts for the IRS in fiscal 2012 resulted in a significant drop in IRS enforcement personnel. Because of the cuts you now have 5,000 fewer employees. As a result, I have no doubt that there is likely to be billions of dollars in lost revenue, and I look forward to discussing this with you further.

Your 2013 budget request has had to fill these budgetary gaps. I believe that you have done a good job in balancing the need to restore funds to critical areas, with the understanding that the IRS must become more streamlined in everything that it does.

A couple weeks ago we had a hearing with the Treasury Inspector General for Tax Administration. At that hearing, I was disturbed to hear comments that seemed to support the idea that we should not increase IRS funding because we could never collect the full tax gap. To me, such an attitude sends a bad message: that we do not actually want to catch the people who are cheating the U.S. Government. While it may be difficult to completely eliminate the tax gap, that does not mean that we should stop trying, nor does it mean that we should not give the IRS enough resources to give it their best effort.

To me, the equation is simple. When you cut IRS for short-term political gain, you do long-term damage by increasing our deficit. Last year's cuts will clearly result in a loss of revenue, and I hope we will not be put in the same position again this year. Unfortunately, given the recently released Republican budget, I fear that it will be so. Thank you, Madam Chairman, and welcome again Commissioner.

Mrs. EMERSON. Thank you, and with that, we would love to hear from you, Commissioner Shulman, if you can keep your remarks to five minutes or less, then we can ask you more questions.

Mr. SHULMAN. Thank you, Chairwoman Emerson, and Ranking Member Serrano, and Members of the Committee for having me here today. I want to discuss the President's 2013 Fiscal Year budget request, which would provide a needed increase over the fis-

cal year 2012 enacted levels for the IRS. A significant portion of the increase requested would restore congressional reductions in IRS funding that were made over the past two years.

Before I go further, I also want to tell you that I appreciate the support of the Committee. I recognize that while our budget was cut, and we are going to advocate for more in our budget, we recognize others were cut more, and we appreciate the consideration.

It is obviously incumbent on all of us in government to be as efficient as possible, and for the IRS, to me, that means cutting aggressively where we think we should, while continuing to invest to improve service and compliance for the nation.

From Fiscal Year 2009 to Fiscal Year 2013, we will have achieved nearly a billion dollars of cuts in our core operation. Many of those cuts were not forced on us, but we came forward and said these are pieces of the operation where we are going to drive efficiency; we are going to employ Six Sigma principles, et cetera.

I think these cuts we have made over the years show a commitment, from us, to be efficient in the money we spend. At the same time, I think it is worth noting that for every dollar we spend, \$200 ends up coming in to the Treasury. With this in mind, we are looking to continue to invest strategically to bring money into the Treasury.

Last year we brought in \$55 billion in through direct enforcement, going out and getting money from folks. We blocked another \$14 billion of fraudulent refunds. We detected these and they never went out the door. \$2.4 trillion came into the Treasury overall; so we obviously protect the top line of the government.

We have also made tangible progress in a variety of strategic areas which are crucial to the functioning of the United States tax system for the long term. Let me give you just a couple examples.

For the first time in the history of our tax system, the IRS has moved from weekly batch cycle processing to daily processing of tax returns through CADE 2. A couple of years ago, I laid out a plan for CADE 2, this Committee funded it, and we now have delivered. CADE 2 delivers on the promise of modernization going back two decades at the IRS, and we are very proud of this accomplishment.

Last year, also, our American Customer Satisfaction Index score, which is the broad index that takes a sample of tax payers and said, "Did you interact with the IRS, and how happy are you with the interaction?" was at its highest level ever: 73 on an index of 100.

Our Return Preparer Program is now up and running. To date, more than 840,000 tax return preparers have registered with us. This program will help ensure a basic level of competency for return preparers, while enabling us to focus on unscrupulous ones. We have also made significant progress in our battle against offshore tax evasion.

To date we have collected more than \$4.4 billion through just one of our offshore programs, the Offshore Voluntary Disclosure program. We are getting tax payers back in the system. Of course, we have also made significant and balanced progress in our customer service and enforcement areas. Of significance, e-filing continues to grow, which translates into cost savings for the government; it

costs us 17 cents to process an e-filed return but, it costs us \$3.66 to file a paper return.

Before I take questions, let me conclude my opening statement with one concern that I have for the agency moving forward. The IRS is tremendously dependent on information technology and highly specialized human capital. In this type of large organization, long-term strategic focus is critically important because if you fall behind, you lose momentum, and it is hard to gain that momentum back.

The funding uncertainty caused by multiple Continuing Resolutions, and the threat of government shutdowns, as well as the ultimate funding cut that the IRS took in the middle of 2011, required significant management and leadership attention from me, my deputies, and people throughout the organization, that otherwise would have been applied to running the day-to-day operation of the IRS. No leader of a large organization can precisely quantify the type of risk this uncertainty causes, but it is undoubtedly there.

Now, let me be clear, this is not a complaint, nor is it a comment on the ultimate result of last year's budget cycle. Indeed, with sufficient lead time and planning, the IRS has shown that it can achieve the targets and responsibilities that Congress gives it. It cannot, however, continue to deliver on so many fronts without time to plan and adapt, and it cannot simply absorb workloads that are increasing at a rate greater than even the most aggressive efficiency initiatives could absorb.

I am not naïve to the broader budget discussion, but I think as leader of this agency, I have a responsibility to say there is risk in the system with this kind of uncertainty. The Administration's Fiscal Year 2013 request for the IRS funds critical priorities that will allow the IRS to continue to help taxpayers navigate and comply with the nation's tax code.

Again, let me thank you for the opportunity to testify, and to discuss the budget for next year, and just say again, I really appreciate this Committee, Madam Chairwoman, Mr. Serrano, and all the Members of the Committee. Your thoughtful engagement with us over multiple years around the challenges of making sure the nation's tax system runs smoothly.

[The prepared statement and biography of Douglas A. Shulman follow:]

**WRITTEN TESTIMONY OF
DOUGLAS H. SHULMAN
COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
HOUSE APPROPRIATIONS COMMITTEE
SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT
ON FY 2013 IRS BUDGET
MARCH 21, 2012**

INTRODUCTION & SUMMARY

Chairwoman Emerson, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to appear today to discuss the President's FY 2013 Budget Request for the Internal Revenue Service.

While the economy is starting to regain strength, we still face numerous challenges, such as finding the right balance between fiscal discipline and investing in programs that produce a high rate of return, and are important to the future of our nation and the American people.

It is incumbent upon all of us in government to be as efficient as possible and spend taxpayer dollars wisely. For the IRS, that means finding savings where we can, and continuing to invest in strategic priorities that allow us to improve service and voluntary compliance.

Indeed, the IRS consistently achieves a high return on investment for its activities while running a fiscally disciplined operation. Over the last two years, the IRS has identified over \$166.3 million in efficiency savings and other program reductions. At the same time, the agency collected nearly \$200 in government revenues for every dollar spent on the IRS budget.

Against this backdrop, it is clear that the IRS is vital both to the functioning of government and keeping our nation and economy strong. In FY 2011, the IRS collected \$2.415 trillion in taxes, representing 92 percent of federal government receipts. The IRS processed more than 144.7 million individual returns during the 2011 filing season and issued almost 110 million refunds totaling \$345 billion that traditionally help boost consumer spending.

The IRS is proud of its record over the past few years as we have made tangible progress on a number of strategic initiatives while carrying out our core duties, such as delivering a smooth filing season in 2011 – despite the late passage of legislation. The following are some of the more prominent programs and initiatives, including those within our core programs that demonstrate how targeted investments can deliver real value to taxpayers and our nation.

Return Preparer Program

The Return Preparer Program is one of the most important initiatives the IRS has undertaken in recent memory that leverages preparers' expertise and their commitment to achieve our shared goals of quality service and the integrity of the tax system.

Boiled down to its essence, the program will ensure a basic level of competency for return preparers while enabling us to focus on finding unscrupulous preparers. First, we had to identify all preparers and have them register.

Since September 2010, almost 840,000 individuals have registered and obtained a Preparer Tax Identification Number, or PTIN, and are now in our tax professional database. And we are learning some interesting facts about not only the size, but the nature of the tax preparer community. For example, over 60 percent of PTIN holders are not attorneys, CPAs, or enrolled agents. Prior to the advent of the program, these individuals were not required to demonstrate competency, hold a PTIN or maintain a minimum level of continuing education.

Once PTIN registration was in place, we began the next phase of the program aimed at ensuring a minimal level of competency for all return preparers.

In November 2011, we launched a new competency test for certain tax return preparers who prepare Form 1040 returns but who are not attorneys, CPAs, or enrolled agents, or supervised by one of them in a firm. These individuals also have a new requirement to complete 15 hours of continuing education each year from IRS approved providers.

Let me add, too, that from the beginning, we planned to exempt CPAs, attorneys, and enrolled agents from the testing and continuing education requirements as they already have more stringent testing and education requirements.

As we've set up the registration, testing and continuing education components of our return preparer initiative, it is also important that we focus on finding unscrupulous preparers who damage the good name of honest return preparers and undermine the overall tax system; therefore, we have a comprehensive strategy to focus on preparer enforcement and compliance.

Our compliance efforts will be focused on places of highest risk – where the vast majority of preparers who play by the rules should want us to focus.

We will also continue to conduct undercover shopping visits to return preparers suspected of engaging in fraud, and we will continue to work closely with the Department of Justice to pursue civil or criminal action against unscrupulous return preparers.

CADE2 Launch

In January 2012, the IRS -- for the first time since the beginning of automated processing of tax returns five decades ago -- began processing tax returns daily instead of weekly. The new system, known as CADE2, is a major milestone for the tax system and the IRS.

CADE2 addresses a myriad of issues that have historically created challenges in the tax system. It will provide more up-to-date information at the fingertips of our customer account representatives, speed account issue resolution, allow for faster refunds, and provide a platform for more real-time analytics and compliance. It will also eliminate structural technology problems that could lead to time-lag problems, such as when notices are sent to taxpayers. For example, it will correct one of the biggest problems we have when a taxpayer calls about a payment he or she made, but our representative cannot tell whether it has been posted or not.

CADE2 also supports sophisticated, next-generation compliance systems which will improve overall compliance through enhanced workload selection and by enabling advanced decision analytics. The completion of the CADE2 core taxpayer account database creates a foundation for our ongoing modernization efforts and significant opportunity and innovation lies beyond it.

Budget Trends

Over the last several years, the IRS budget requests have reflected strategic investments in the IRS that reduce the deficit, along with substantial efficiency and other targeted reductions that reflect our commitment to effective stewardship of the resources that we are given.

From FY 2009 through the FY 2013 proposed Budget, the IRS will have achieved nearly \$1 billion in budget savings and efficiencies. These savings and efficiencies reflect an across-the-board commitment to finding better and more efficient ways to administer the tax system. They come from a variety of sources, including reductions in outside contracts, training and non-case-related travel.

However, even with these efficiencies, the IRS would not have been able to meet the budget enacted for FY 2012 without substantially reducing headcount. The IRS had already instituted an agency-wide hiring freeze and has only been replacing attrition on an exception basis. Attrition savings were not sufficient to meet the 2012 levels, however, so the IRS resorted to voluntary incentives designed to accelerate retirements of those who were retirement-eligible, or close to eligible. As of March 5, 2012, these incentives -- known as Voluntary Separation Incentive Payments (VSIPs) -- were given to approximately 1,000 workers. As a result of these measures, the IRS has approximately 5,000 fewer staff on the payroll this filing season compared to last year. Of the 5,000, approximately 3,000 were associated with enforcement activities, with the balance of the reduction principally coming from taxpayer service functions.

Offshore Tax Evasion

Our approach to offshore tax evasion focuses on cleaning up the abuses of the past and then mining and leveraging that data to mount a greater attack on present and future abuse.

A good example of our offshore successes is the IRS's work relating to a major Swiss bank, where for the first time in history, a bank secrecy jurisdiction turned over thousands of names and account numbers. The bank also agreed to pay hundreds of millions of dollars in fines, penalties, interest and restitution as part of a deferred prosecution agreement with the U.S. government.

However, our offshore work has never been about one bank or one country. The IRS has produced results and will continue to produce positive outcomes through other elements of our offshore program, such as our game-changing voluntary disclosure programs.

In January 2012, we reopened the Offshore Voluntary Disclosure Program (OVDP) to help people hiding offshore accounts get current with their taxes; since the end of 2011, we have collected more than \$4.4 billion from the two previous OVD programs conducted in 2009 and 2011. That number will grow as the IRS processes the 2011 cases.

My decision to reopen the Offshore Voluntary Disclosure Program was a result of continued strong interest from taxpayers and tax practitioners after the closure of the previous programs. People still wanted to come in and get right with their government. This new program makes good sense for taxpayers still hiding assets overseas and for the nation's tax system. This is the best chance to get these taxpayers back into the system and back into compliance, so they properly report and pay their taxes for years to come.

Large Business Issue Resolution

We have been in the process of transforming our relationship with our large corporate taxpayers. We need to work smarter. We need to be more efficient. We need to create innovative strategies for issue resolution that are less time and resource intensive for both the IRS and these taxpayers.

We now have a suite of programs at the IRS that are designed to provide greater certainty, consistency and efficiency going forward for both large taxpayers and the IRS. They may have different names and functions but all are focused on resolving issues.

First is the Compliance Assurance Program, or CAP, which we made permanent earlier this year. Any corporation that meets the program's requirements and wants the benefits of open, cooperative, and transparent interactions can now apply. The number of corporate taxpayers in the program has already grown from 17 in the 2005 tax year – when the pilot began – to 160 taxpayers in the 2011 tax year. In recent months, I have been talking with CAP taxpayers, and the feedback I have received is that the paradigm of greater transparency and certainty is a welcome change in our tax system.

We have another important tool in our toolkit that can help us cut through the fog of uncertainty. The Industry Issue Resolution Program – or IIR – can help the IRS and corporate taxpayers reach administrable, commonsense solutions for uncertain tax areas. For example, by using IIR, we resolved some long-standing controversies that had plagued the telecommunications, transmission and distribution industries for years. We see IIR as a very useful tool for issue resolution and continue to work on a number of new issues.

Fast Track Settlement is an additional issue resolution tool we are encouraging our agents to use. Instead of finishing an audit and then going to Appeals, Fast Track allows a taxpayer to settle an issue with an Appeals officer during the audit process. We have witnessed an uptick in participation, which is promising, and are committed to expanding our ability to resolve issues more quickly with taxpayers who want to do so. The latest data is promising, and shows that 83 percent of the cases accepted into Fast Track resulted in a resolution.

Our Uncertain Tax Position initiative gets to the heart of information we need, while respecting a taxpayer's internal analysis and deliberations. The program's goal is to have a transparent discussion with corporations to resolve issues much quicker, and be more efficient in targeting taxpayers and issues with the highest risk of non-compliance. And here are the latest statistics on Schedule UTP. As of January 1, 2012:

- Approximately 1,900 taxpayers have filed Schedule UTP
- Approximately 4,000 issues have been disclosed
- The top three Code sections are Section 41, research tax credits; Section 482, allocation of income including transfer pricing; and Section 162, trade and business expenses
- 19 percent of all issues disclosed are transfer pricing issues.

Lastly, I am the Chair of the global body of tax authorities called the FTA. We have been very focused on governments moving from information sharing to real, coordinated action. To that end, the U.S. recently led an effort to develop a protocol for joint audits, where two or more countries conduct a single audit of a taxpayer.

We thought that the benefits for both governments and taxpayers of a joint audit could be substantial. It could reduce taxpayer burden – especially for large multinational corporations that must face audits in multiple jurisdictions on the same set of transactions. It could provide these taxpayers with a timesaving and less resource-intensive way to address the tax consequences of a transaction on a bilateral or even multilateral basis. And just as important to a swift resolution of issues, the joint audit could provide certainty for the taxpayer today and in the future.

At the same time we were developing a protocol for joint audits through the FTA, I asked our IRS team to find opportunities to start some joint audits immediately.

We started several joint audits, and let me describe one. This year, we conducted a joint audit with another country of one of our CAP taxpayers involving a transfer pricing issue. We resolved the issue bilaterally, and we also were able to provide the taxpayer with a bilateral Advance Pricing Agreement to cover future years. And we did this all in six months.

This result hits on many of the elements of our future vision for a well-functioning tax system in a global environment:

- **Transparency:** We started with a CAP taxpayer, who had already agreed that in exchange for opening their books to us, we would provide certainty before a return is filed.
- **Real Time:** We resolved a complex issue in six months, in this case moving the competent authority process into the audit – this represents a huge contrast between a normal competent authority process which typically takes place long after the tax year or years in dispute.
- **Certainty:** We resolved the issue for the current year, but just as importantly, through an Advance Pricing Agreement, agreed on a transfer pricing methodology for future years. This creates an environment in which the business does not have potential adjustments and planning uncertainty hanging over its head, and we know the issue is being dealt with correctly.
- **Coordinated action between two governments:** Unlike past practices, where each government might have negotiated hard after an audit adjustment was proposed by one of them, in this case, the two governments worked together cooperatively to reach a mutually-acceptable principled resolution.

The results of this joint audit were a win for the taxpayer and a win for us.

We at the IRS have dedicated ourselves to creating innovative new paths that will help both businesses and the IRS resolve issues and achieve our shared goals of certainty, consistency and efficiency. I think we can all agree that these are goals that, if achieved, would benefit the entire tax system.

IRS Customer Service

The IRS continues to provide taxpayers with quality customer service and different service channels and products. We recognize that we must never stop innovating to meet the service needs of an increasingly diverse taxpayer base and must serve taxpayers when and where they need it.

Our broad portfolio of customer service channels runs the gamut, from traditional walk-in sites for those who need to see an IRS representative face-to-face, to toll-free automated and assistor telephone service, to web-based applications and social media. All make it easier for taxpayers to file and pay their taxes.

One of our most far reaching innovations – and one of the most successful modernization programs in all of government – is e-filing. For the 2011 calendar year, the IRS processed

more than 112.2 million individual tax returns electronically, setting a new record. Individual returns electronically filed increased to 77.2 percent, up 13.6 percentage points from 2010. Business returns filed electronically jumped to 33.9 percent, up from 26.6 percent in 2010 and home-computer filing increased to 39.8 million returns, 14.2 percent more than 2010.

IRS.gov has become the favorite source of information for millions of taxpayers. For the 2011 filing season, there were almost 323 million web page visits to IRS.gov – a five percent increase over the same time period last year. Use of the “Where’s My Refund” electronic tracking tool continued to post double-digit yearly gains. And in FY 2011, the IRS received a Compuware Gomez “Best of the Web” award, which recognized IRS.gov as one of the best websites in government for performance and quality and first in consistency.

The IRS is increasingly communicating with taxpayers who may not get their information from traditional sources, such as newspapers and broadcast and cable news. By employing social and new media, such as YouTube, Twitter and even iTunes, we are able to reach these taxpayers with important service and compliance messages. For example, during the week of February 10-17, 2012, our YouTube Video “When Will I Get My Refund?” had more than 254,000 views. Our “tweet” and subsequent “re-tweets” on the “Dirty Dozen” tax schemes reached almost 28,000 people.

Last year, the IRS also unveiled IRS2Go, its first smartphone application that lets taxpayers check on the status of their tax refund and obtain helpful tax information. This new smartphone app reflects our commitment to modernizing the agency and engaging taxpayers where and when they want.

However, we have not forgotten the content of our communications and we launched a major plan to overhaul our notices with a focus on clarity. Our efforts were recognized last May when the Center for Plain Language honored the IRS with the ClearMark Grand Prize Award, citing two of our revised notices for the best clear language of all the documents they reviewed.

We received another sign of the progress the IRS is making. Every year, an independent survey is conducted by the American Customer Satisfaction Index. For 2011, the survey of taxpayers showed satisfaction with our services reaching 73 on a scale of 100 among all individual tax filers. That score is a three-point jump from a year earlier and our highest score since the survey began in 1994. Satisfaction among people who filed electronically came in even higher at 78. This is a tremendous step in the right direction and one that we will build upon in the future.

Enforcement

Turning to enforcement, the IRS continues to run robust compliance programs. We continue to have appropriate and balanced audit coverage rates across taxpayers and to innovate in our collection programs. As previously noted, through our Offshore

Voluntary Disclosure Programs we have collected more than \$4.4 billion from those hiding money overseas and that number will grow as the IRS processes the 2011 cases.

In FY 2011, IRS compliance activities returned \$55.2 billion to the Treasury as a result of our examination and collection programs, translating to a direct return on investment of nearly \$5-to-\$1 for the entire IRS budget. While the direct revenues brought in by IRS activities are important, the indirect effects are far more substantial and important. A strong and fair enforcement program serves to support over \$2 trillion that is paid voluntarily and on a timely basis every year. In addition, IRS enforcement revenues do not include billions of dollars in attempted refund fraud that is stopped by IRS up-front fraud detection programs.

In short, despite a quickly evolving taxpayer base and unprecedented demands on IRS resources, the IRS continues to deliver for the American people.

People

The IRS' workforce is our greatest asset. Three years ago, I embarked on a campaign to make the IRS the best place to work in the federal government. This past November, the Partnership for Public Service released the results of the 2011 Best Places to Work in Federal Government survey. The IRS ranking improved yet again, moving over a two-year period from a ranking of 127 to a ranking of 65 out of the 240 participating agencies. And, we are now ranked third out of 15 large agencies (those with over 20,000 employees) in the employee engagement index from the survey.

In addition, our own employee engagement index – which measures the degree of employees' motivation, commitment and involvement in the mission of the organization – and the job satisfaction index both remained stable compared with last year. In other words, we saw no erosion of the substantial gains we had made over the past few years.

This is especially heartening to me because we have faced more than the usual number of challenges this year, from late tax law changes, to six short-term continuing resolutions during filing season, to weeks of speculation of a possible government shutdown, and ultimately a decreased budget.

The fact that our survey results showed that our employees remain engaged, motivated and committed, regardless of the external environment, is a testament to the professionalism and deep commitment to service woven into the culture of the IRS.

Real-Time Tax System

Last April, I began discussing a potential new structure that would fundamentally change the way taxpayers and tax practitioners prepare and file individual returns and that leverages technological innovations.

We initially came to call this vision the “real-time” tax system because it would deal in real time. We want to move away from the after-the-fact, or “look-back” model where audits may take place years after a return is filed, and taxpayers had to hunt for, or recreate records and documentation – to a new model where we reduce burden.

Under the vision of a real-time tax system, the IRS could embed more information return data into its pre-screening filters, and could provide the opportunity for taxpayers to fix the return before we accept it – if it contains data that does not match our records.

Under this vision – which I’ve described as a long-term destination, rather than a short-term project or initiative – taxpayers and the IRS would have more confidence that returns are accurate. Many problems could be dealt with up-front, while records are available, and many taxpayers have access to the tax professional who may have prepared their return. We could shift resources to spend more money on getting it right in the first place, and focus back-end auditing resources on more complex issues. There are huge compliance and service benefits associated with such a system, not to mention burden reduction for taxpayers.

The IRS has held two public meeting to get feedback on our initial work on real-time. Both of these meetings were very helpful to us and reinforced our belief that this is a vision worth pursuing.

THE ADMINISTRATION’S FY 2013 BUDGET REQUEST FUNDS KEY PRIORITIES

The Administration’s Fiscal Year 2013 Budget request for the Internal Revenue Service is approximately \$12.8 billion, a \$944.5 million increase (8%) over the FY 2012 enacted level but a \$639.3 million increase (5.3%) from the level enacted for FY 2011. A significant portion of the increase from FY 2012 represents the Administration’s request to restore lost resources resulting from reductions in IRS funding made over the past two years. Additional increases are requested through a program integrity cap adjustment to fund new activities that will enhance tax administration and build capabilities to meet today’s and tomorrow’s challenges. The overall request is designed to provide the resources necessary to administer and enforce the current tax code, implement recent changes to the Internal Revenue Code, conduct a robust and sophisticated enforcement program, and serve the American taxpayer in a timely manner.

To collect the revenues required to fund the policies passed by Congress and meet long-term obligations to the American people, the IRS FY 2013 funding request reflects a continued commitment to improving tax compliance through the balance of quality taxpayer service with fair enforcement of the tax laws. It also supports the Administration’s strategic goal of managing the government’s finances in a fiscally responsible manner, as well as Treasury’s priority goal of improving voluntary compliance.

As noted in the introduction to my testimony, the IRS consistently achieves a high return on investment for its activities while running a fiscally disciplined operation. In FY 2013, the IRS expects to identify nearly \$71 million in cost savings from increased use of electronic return filing, reductions in non-case related travel and streamlining operations.

Enforcement Program

The FY 2013 Budget includes \$403 million in new IRS enforcement activities, with over \$340 million of these new activities supporting investments directly boost revenue collection. Once these resources reach full performance in FY 2015 – as new hires get fully trained and gain experience – they are expected to raise \$1.48 billion in revenue annually. The average return on investment for these activities is over \$4-to-\$1. The return on investment is even greater when factoring in the deterrence value of these investments and other IRS enforcement programs, which is conservatively estimated to be at least three times the direct revenue impact.

The enforcement budget also includes about \$200 million in incremental examination and collection programs that will generate more than \$1.1 billion in additional annual enforcement revenue by FY 2015. Investments such as these in IRS enforcement programs are especially important to further the IRS' mission of improving tax compliance.

Specific areas where the proposed FY 2013 funding will enable the IRS to continue to strengthen enforcement efforts and reduce the tax gap include:

- Improving international compliance by individual and business taxpayers. In FY 2013, the IRS will continue to address offshore tax evasion by individuals through such efforts as increased examinations and the special offshore voluntary disclosure program. To ensure business entity compliance, the IRS will provide additional international technical specialists to increase coverage of complex international transactions;
- Protecting revenue by expanding efforts to identify fraud and prevent issuance of questionable refunds, including tax-related identity theft. The increase in funding will help support efforts to reduce erroneous refund payments, including non-compliant and fraudulent claims by prisoners and claims for the Earned Income Tax Credit (EITC) by ineligible taxpayers;
- Implementing tax law changes that make available the use of new information reporting requirements to help address the underreporting tax gap; and
- Enhancing IRS oversight of complex financial situations, including transfer pricing and uncertain tax positions.

Return Preparer Initiative

The FY 2013 Budget request includes \$35 million to strengthen return preparer compliance. It bears repeating that this initiative is one of the most important that the IRS has undertaken in recent years, the foundation of which is mandatory registration for all paid tax return preparers. In addition, the IRS is developing requirements to establish mandatory competency testing and continuing education for preparers to ensure that taxpayers are hiring preparers who have a minimum level of competency and adhere to professional standards. This initiative is core to the IRS' tax gap strategy and will increase government revenue, and support high-priority, preparer-related enforcement activities.

Implementation of Tax Law Changes

The request provides \$128 million to support IRS efforts to implement programs that are designed to ensure compliance with a number of recent changes to the tax laws, and to help taxpayers understand them. Recent tax law changes include the reporting provisions related to merchant payment cards and third party reimbursements (included in the Housing and Economic Recovery Act of 2008), basis reporting on securities sales (included in the Emergency Economic Stabilization Act of 2008), and the non-exchange related tax law changes included in the Affordable Care Act (ACA).

Infrastructure Requirements

The FY 2013 Budget also requests funding for the IRS to continue the development of new information technology systems, and substantial modification and enhancement of existing systems necessary to implement the new premium assistance tax credit and other tax law provisions related to the insurance exchanges created in the Affordable Care Act.

Taxpayer Service Program

The FY 2013 request includes funding for the IRS to continue delivering services using a variety of in-person, telephone and web-based channels to help taxpayers understand their tax obligations, correctly file their returns and pay taxes due in a timely manner.

The IRS is committed to expanding the use of electronic transactions, including increasing the e-file rate and expanding taxpayer service options available over the Internet. In 2011, there were more than 322 million visits to IRS.gov, and more than 78 million taxpayers checked their refund status by accessing Where's My Refund? in English or in Spanish on our website.

Business Systems Modernization

In FY 2013 the IRS will continue the modernization of its IT systems. It will strategically invest in state-of-the-art capabilities, such as online taxpayer services, and focus on the

second phase of the CADE2, to ensure the long-term viability of IRS tax processing systems and enable the next generation of enforcement and service capabilities.

In 2012, the IRS delivered the most significant update to its core tax processing system in decades. As noted, through the deployment of the first phase of CADE2, the IRS transitioned to a daily processing cycle from a weekly batch cycle. Also for the first time, IRS processing systems began accepting all 1040 forms electronically through a modernized e-filing capability.

EXPLANATION OF BUDGET ACTIVITIES

Taxpayer Services

The FY 2013 President's Budget request is \$2,253,133,000 in direct appropriations, an estimated \$24,050,000 from reimbursable programs, and an estimated \$142,742,000 from user fees, for a total operating level of \$2,419,925,000. This appropriation funds the following budget activities.

Pre-filing Taxpayer Assistance & Education (\$625,931,000 from direct appropriations, \$1,151,000 from reimbursable resources).

This budget activity funds services to assist with tax return preparation, including tax law interpretation, publication, production, and advocate services. In addition, funding for these programs continues to emphasize taxpayer education, outreach, increased volunteer support time and locations, and enhancing pre-filing taxpayer support through electronic media.

Filing & Account Services (\$1,627,202,000 from direct appropriations, \$22,899,000 from reimbursable resources, and an estimated \$142,742,000 from user fees).

This budget activity funds programs that provide filing and account services to taxpayers, process paper and electronically-submitted tax returns, issue refunds, and maintain taxpayer accounts. The IRS continues to make progress in decreasing paper returns and increasing the use of electronic filing and payment methods. This budget activity also provides operating resources to administer the advance payment feature of the Trade Act of 2002 (Public Law 107-210) health insurance tax credit program, which assists dislocated workers with their health insurance premiums.

Enforcement

The FY 2013 President's Budget request is \$5,701,670,000 in direct appropriations and an estimated \$73,604,000 from reimbursable programs, and an estimated \$17,750,000 from user fees, for a total operating level of \$5,793,024,000. The total direct appropriations level includes an additional appropriation for tax enforcement and compliance activities funded through a program integrity cap adjustment totaling \$691,028,000, of which \$276,964,000 will be funded from the Enforcement account. This appropriation funds the following budget activities.

Investigation (\$688,296,000 from direct appropriations, and an estimated \$61,633,000 from reimbursable resources).

This budget activity funds the criminal investigations programs that uncover criminal violations of the internal revenue tax laws and other financial crimes, enforce criminal statutes relating to these violations, and recommend prosecution as warranted. These programs identify and document the movement of both legal and illegal sources of income to identify and document cases of suspected intent to defraud. It provides resources for international investigations involving U.S. citizens residing abroad, non-resident aliens and expatriates and includes investigation and prosecution of tax and money-laundering violations associated with narcotics organizations.

Exam & Collections (\$4,846,749,000 from direct appropriations, and an estimated \$11,307,000 from reimbursable resources).

This budget activity funds programs that enforce the tax laws and increase compliance through examination and collection programs that ensure proper payment and tax reporting. It includes programs such as specialty program examinations (employment tax, excise tax and estate and gift exams), and international collections and examinations. The budget activity also supports appeals and litigation activities associated with exam and collection.

Regulatory (\$166,625,000 from direct appropriations, an estimated \$664,000 from reimbursable resources, and an estimated \$17,750,000 from user fees).

This budget activity funds the development and printing of published IRS guidance materials; interpretation of tax laws; internal advice to the IRS on general non-tax legal issues such as procurement, personnel, and labor relations; enforcement of regulatory rules, laws, and approved business practices; and support of taxpayers in the areas of pre-filing agreements, determination letters, and advance pricing agreements. The Return Preparer initiative is funded within this activity in addition to the Office of Professional Responsibility which is responsible for identifying, communicating, and enforcing the Treasury Circular 230 standards of competence, integrity, and conduct of professionals representing taxpayers before the IRS.

Operations Support

The FY 2013 President's Budget request is \$4,476,200,000 in direct appropriations, an estimated \$37,564,000 from reimbursable programs, and an estimated \$57,958,000 from user fees, for a total operating level of \$4,571,722,000. The direct appropriations level includes an additional appropriation for tax enforcement and compliance activities funded through a program integrity cap adjustment totaling \$691,028,000, of which \$414,064,000 will be funded from the Operations Support account. This appropriation funds the following budget activities.

Infrastructure (\$987,730,000 from direct appropriations, an estimated \$889,000 from reimbursable resources, and an estimated \$21,867,000 from user fees).

This budget activity funds administrative services related to space and housing, rent and space alterations, building services, maintenance, guard services, and non-IT equipment.

Shared Services & Support (\$1,348,363,000 from direct appropriations, an estimated \$20,207,000 from reimbursable resources, and an estimated \$11,700,000 from user fees). This budget activity funds policy management, IRS-wide support for research, strategic planning, communications and liaison, finance, human resources, and equity, diversity and inclusion programs. It also funds printing and postage, business systems planning, security, corporate training, legal services, procurement, and specific employee benefits programs.

Information Services (\$2,140,107,000 from direct appropriations, an estimated \$16,468,000 from reimbursable resources, and an estimated \$24,391,000 from user fees). This budget activity funds staffing, equipment, and related costs to manage, maintain and operate the information systems critical to the support of tax administration programs. This includes the design and operation of security controls and disaster recovery planning. This budget activity funds the development and maintenance of the millions of lines of programming code that support all aspects and phases of tax processing and the operation and administration of the mainframes, servers, personal computers, networks, and a variety of management information systems.

Business Systems Modernization

The FY 2013 President's Budget request is \$330,210,000 in direct appropriations. This appropriation funds the following budget activity.

Business Systems Modernization (\$330,210,000 from direct appropriations). This budget activity funds the planning and capital asset acquisition of information technology to continue the modernization of IT systems, including labor and related contractual costs. In FY 2013, the IRS will strategically invest in state-of-the-art capabilities, such as online taxpayer services and focus on the second phase of the core taxpayer account database, CADE2, Transition State 2, to ensure the long-term viability of IRS tax processing systems.

LEGISLATIVE PROPOSALS

The President's FY 2013 Budget request includes a number of legislative proposals intended to improve tax compliance with minimal taxpayer burden. These proposals will target the tax gap and generate more than \$12 billion over the next ten years. The IRS estimates the implementation cost for the proposals to be \$80.2 million over three years, including the initial startup, processing and compliance operational costs.

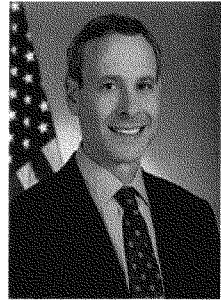
The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties. The Budget also proposes to amend the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA), as amended by the Budget Control Act (BCA) of 2011, to allow adjustments to the nine-year (FYs 2013-2021) discretionary caps to permit program integrity cap adjustments in support of additional IRS investments.

CONCLUSION

In conclusion, let me thank the subcommittee again for this opportunity to discuss the IRS Budget Request for FY 2013. Through its balanced and targeted investments in key enforcement, service and business modernization programs and initiatives, this budget will ensure that the IRS will continue its vital role in keeping our nation and economy healthy and strong.

Commissioner of Internal Revenue Douglas H. Shulman

Douglas H. Shulman is the 47th Commissioner of Internal Revenue. As Commissioner, he presides over the nation's tax system, which collects approximately \$2.4 trillion in tax revenue that funds most government operations and public services. Shulman manages an agency of about 100,000 employees and a budget of more than \$12 billion. The agency touches every facet of American society, including individual taxpayers, the tax-exempt sector, small businesses and large corporations.



As Commissioner, Shulman has emphasized the necessity of maintaining a balance between taxpayer service and tax enforcement. His goals for the IRS are improving service to make voluntary compliance easier for taxpayers while at the same time enforcing the law to make sure everyone meets their obligation to pay the taxes they owe.

During Commissioner Shulman's tenure, the IRS played a major role in the economic recovery efforts by delivering about \$300 billion — or 40% of the money of the American Recovery and Reinvestment Act — through the tax system as well as by designing IRS programs to assist individuals and businesses struggling through difficult economic times. In the face of increasing globalization of tax administration, Shulman has stepped up IRS activity on a variety of international tax issues, including offshore tax evasion. He has served as the Chair of the Organisation for Economic Co-operation and Development's Forum on Tax Administration since 2009. He has also led an effort to reshape the relationship with corporate taxpayers, by focusing on issue resolution, certainty and transparency. Also under Shulman's direction, the IRS launched the Return Preparer Initiative to ensure high standards of ethics and service across the tax preparation industry.

During his tenure, Commissioner Shulman has focused on employee engagement and performance. Under his leadership, the Agency has jumped from 8th to 3rd out of the 14 largest agencies in the federal government-wide Best Places to Work in Government survey. Also during his tenure, the IRS embarked on and is scheduled to finish a major modernization of IRS's core technology account database which will achieve the goal IRS set in 1988 to process all tax returns on a daily cycle, rather than weekly batch cycle, which leads to significant improvement in customer service and compliance activities. Other major initiatives launched during his tenure include expanded use of data analytics to enhance service and compliance, and shifting the agency to resolve taxpayer issues at the earliest possible time.

Commissioner Shulman came to the IRS from the Financial Industry Regulatory Authority (FINRA), the private-sector regulator of all securities firms doing business in the United States, where he served as Vice Chairman. He served in the same role at the National Association of Securities Dealers (NASD) before its 2007 consolidation with New York Stock Exchange Member Regulation, which resulted in the formation of FINRA. After joining NASD in 2000, Commissioner Shulman

played an integral role in restructuring the company, led the negotiations of the sale of the NASDAQ stock market and American Stock Exchange, oversaw the launch of industry-wide bond market transparency and modernized NASD's technology operations.

Earlier in his career, Commissioner Shulman helped to co-found Teach for America, was involved with several start-up organizations, was a vice president of a private investment firm and served as Senior Policy Advisor and then Chief of Staff of the National Commission on Restructuring the Internal Revenue Service.

Commissioner Shulman holds a B.A. from Williams College, an M.P.A. from Harvard University's John F. Kennedy School of Government and a J.D. from Georgetown University Law Center.

Page Last Reviewed or Updated: February 14, 2012

Mrs. EMERSON. Thank you so much, Commissioner Shulman. You are doing a good job in spite of the challenges that less funding presents to you.

TAX CODE SIMPLIFICATION

Let me just ask you a real quick question about this, in January the National Taxpayer Advocate released her annual report to Congress, concluding, among other things, that the IRS is both underfunded and overworked. I think, and many others think that perhaps you all are overworked because we have far too complicated tax system. If we had a less complicated tax code, perhaps we would have better voluntary compliance, maybe it would be easier for enforcement, and perhaps you would need fewer auditors. I am curious to know whether you think that there is a relationship between tax code complexity and compliance.

Mr. SHULMAN. I think the complexity of the tax code and simplifying the tax code is the single most important thing that we could do long term to help citizens navigate the code which would mean better customer service, better, easier, smoother interactions with the government. The tax code currently creates places where people who want to game the system can find nooks and crannies to game the system, and it creates more complexity in following the trail, so I think it creates non-compliance of two kinds. One is inadvertent non-compliance through mistakes, but it also creates opportunities for those who want to push the envelope to do so.

DISCRETIONARY CAP ADJUSTMENT

Mrs. EMERSON. Hopefully at some point in time we could move to a much simpler tax code that would make life easier for everyone, I think. The President's budget proposed \$691 million cap adjustment for the IRS. In order for the cap adjustment to work, the 2013 discretionary spending limit in the Budget Control Act would also have to be increased by \$691 million. By requesting the cap adjustment, the Administration has made \$691 million of the IRS's budget request dependent on the actions of the Budget Committee. So is it safe to assume that the IRS wants the \$691 million increase even if the Budget Committee does not amend the BCA?

Mr. SHULMAN. Obviously, here in the Appropriations Committee we are talking about the appropriations side. The President's Budget reflects revenue as well as spending, and I think the President's Budget reflects the notion that if you invest in the IRS, that is good for controlling the deficit. There are pieces of the Budget that are not, obviously, in the Appropriations Committee's control. We think this proposal is prudent, and I am very supportive of this proposal. I want to make clear, because I think there has been some confusion as this moved forward, the idea is that Congress would give discretionary cap adjustments for revenue-raising activities, but it would not generate revenue-raising activities.

Mrs. EMERSON. No, I understand that, but in order for us to be able to accommodate that \$691 million, within our own allocation then we are going to have to cut funding from somewhere else, and that is a whole big chunk of money to be cutting from all the other agencies.

Mr. SHULMAN. Well hopefully the timing works out. Maybe we can all work together with the other players who need to be involved in this.

Mrs. EMERSON. But seriously, if the Administration is not willing to accommodate that \$691 million in its own top line, how are we supposed to do that? I mean, I am just curious.

Mr. SHULMAN. My view is the Administration put forward a budget request, which is not just spending of appropriated funds, but it is also a plan to produce revenue, and spending that would accommodate that.

Mrs. EMERSON. Well, I mean, it is pretty clear for me to see that I do not know where I can find \$691 million to cut across every other agency, especially when you all have the biggest budget. I am just being realistic about it. Have you actually met with Chairman Ryan of the budget committee at all to talk about this, I am curious.

Mr. SHULMAN. I have had conversations with him.

Mrs. EMERSON. You have? How were they?

Mr. SHULMAN. They were very good.

Mrs. EMERSON. Were they?

Mr. SHULMAN. They were very good. I mean, they were not in the context of this. I would point out this was a proposal that was first put forward by President Bush in Fiscal Year 2006 and enacted in 2006, 2008, and 2009, so it has broad bipartisan support over the years. My understanding is it was not in the budget proposal put out yesterday, but I have had very positive conversations. Again, hopefully, as everything sorts out during the year then this will get worked out.

Mrs. EMERSON. I do not think our Subcommittee liked it back then either.

Mr. SHULMAN. I was not here back then.

Mrs. EMERSON. But anyway, it is a challenge. We have got so many people here; let me hold my next round of questions so that everybody else can get something in because I know there are a lot of hearings going on. Mr. Serrano.

EFFECT OF IRS BUDGET CUTS

Mr. SERRANO. Thank you so much. Mr. Shulman, as you painfully are aware, the fiscal year 2012 appropriations for IRS were cut back. What do you believe are going to be the impacts of those cuts and do you have a sense of how much revenue will go uncollected as a result of these budget cuts? And let me tell you something, we are discussing cuts all the time, so Congress now needs cuts to the point where some people would like to see a budget of zero. You try to say to folks, all right, I know it is easier to just cut across the board, but when you do that, then you can make certain mistakes, if you are out to get money that is sitting out there that is owed to the Federal Government, to cut the ability to collect that money could be a serious problem which would just add to the deficit. So it seems that we are making the cuts to save money, and then not collecting that money. What can you tell us about those cuts, and what effect will it have on collections?

Mr. SHULMAN. Well I am obviously biased because I run this agency, but I really do think, objectively, we are the agency that

produces money to fund the government. We are the one agency that has a very substantial return on investment, so I think we should be treated differently, and I think the President's Budget request reflects that. When we were faced with severe budget cuts, we took a number of actions. One is, as I said before, over the last several years, and going into 2013, we will have made almost \$1 billion in cuts to our operations.

First, we try to trim in places that do not affect tax payers, either from a revenue and a compliance side, or a service side and so we did a first round of buy outs in support functions. Long term you cannot just keep chipping away at support, although we have been doing it. Our Human Capital Office, our Finance Office, some of the back office technology, and on and on. We tried to have non-taxpayer focused cuts. We also cut contracts, limited attrition hiring, et cetera, but the cuts were of the magnitude, especially with inflation, we had to absorb them as well. We do have 5,000 less people on our rolls today than we had a year ago today. About 3,000 of those are in enforcement, so it is people who do examinations, do collection. I do not have the figures on the exact revenue effect, but I think there are two ways to think about it.

One is short term, when we make a collection call, do a visit, or send out letters—because we only send out letters if we have people who can answer follow-up phone calls—we are just going to do less activity, so less direct money will come in. I think there is also a point where the American people start to see the IRS budget being cut, and they see newspaper articles about compliance rates, and people start wondering, “hey, am I really going to get caught?” and what is the risk calculus? Most people are still going to pay their taxes because they are honest, hard-working Americans who want to pay their taxes, but we all know there are some people who will play the audit lottery, and we do not want to see rates go down and continual drumming down because that starts to really dig into voluntary compliance. That starts to dig, not into the \$55 billion that we collect every year, but the \$2.4 trillion base.

There is also the service element. We want to provide good customer service, and we want, when people call, to answer the phones. When they write us a letter, we want to get back to them so people do not throw up their hands and say, “if they will not even help me get this right, why am I going to file?” So we are going to do the best we can with the budget you give us, and ultimately we respect Congress's prerogative to give us the budget it sees fit in the broader context of the Federal Government, but the cuts we made are clearly going to have those revenue and service impacts.

Mr. SERRANO. Well in that answer you touched not only on the question I asked you, but on my second and my third questions as well. So rather than just ask you a second or third question, let me have you elaborate on it, and that is, you basically said that there comes a point, and that was one of my questions, at what point do we say okay, this is a little too far; and you say it will not be either you or I, or the Chairwoman, or the Congress, it is that the American people will begin to say something is going on here if the service is reduced to the point where somebody is getting away with something. You are right, most Americans will do the right thing,

but they will begin to question if others are doing the same. Then my second question, which you also touched on, and I want you to elaborate even more, is in the service area. You know, people call up, people get assistance, you want to wait your usual 15 minutes at the IRS telephone line, but you do not want to wait for an hour and a half. So at what point does that become a breaking point, if you will.

Mr. SHULMAN. I would posit your question about when do you get to a tipping point where it really starts degrading voluntary compliance; none of us want to be anywhere close to that line because if you are serious about deficit reduction, you can have a debate about whether you want to raise taxes, cut taxes, leave taxes the same, but you certainly want, whatever the tax rate is, for people to be paying because that is built into the whole deficit discussion. So I think everybody needs to be very careful about pushing up against that line. I cannot tell you exactly where that line is, but, again, no matter what we are given we are going to work very hard to make sure we serve the nation's tax payers well, and make sure the tax system is run well. I would posit you do not want to be pushing up against that tipping point.

I have been very focused on customer service since coming here, and I think the image of the IRS is often that we have what I call a ubiquitous brand. When people hear IRS, they think something. The reality is, the vast majority of Americans file a return, get a \$3,000 refund, and do not interact with us again. It is actually pretty nice experience. There is only a 1 percent audit coverage rates overall, and so most people are not experiencing what the brand necessarily says.

I also believe that it is important to the tax system, and I am chairman of a group of my counterparts globally, to have good customer service. Treating this like a big financial service institution that needs to have seamless interaction with the nation's citizens is a big deal for us, and so I think it is quite important that we try to put forward balanced budgets that fund service and enforcement. I think we are just going to have to keep investing.

Mr. SERRANO. Thank you, Madam Chair.

Mrs. EMERSON. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Madam Chairwoman. Good to see you sir. Let me first start by thanking you and your staff for being exceedingly accessible, in particular in south Florida. We are number one in identity theft, and Madam Chairwoman, you actually met with me on this issue, so again, thank you very much for being extremely helpful.

NONRESIDENT ALIEN INTEREST INCOME RULE

I am talking about a different issue that has me really concerned, and I think it has the potential to cripple the south Florida economy, to put thousands of people out of work, and frankly, even jeopardize people's lives. That is the proposed regulation that would require U.S. banks to record the deposit interest paid to non-resident aliens. When I say devastating, it is devastating to New York, it is devastating, in particular, to Texas, New York, California where there are a lot of non-resident deposits.

Now, there is clearly very good reason, first, for someone in Mexico or in Venezuela, just if I could name a couple, to keep their hard-earned money in the United States. U.S. financial institutions, I mean, we do not have to talk about the kidnappings, the corruption, for example, in those two countries. Again, they are rampant, and it is a serious concern that this regulation would do a couple things. I mean, look, if you are Mexican, and you are concerned about your safety, and you have the money outside the country in the United States, and all of a sudden, people in Mexico are going to hear how much you are getting. In essence, how much money you had in a U.S. bank, you are going to move that money elsewhere. This is not rocket science; this is not a static issue that money is going to stay there if you are risking their lives. There is about \$1 trillion in those deposits in U.S. banks. \$1 trillion, imagine the impact that would have; so a couple issues that I have.

By the way, something you may know is that the supposed goal of this regulation is to go after U.S. tax evaders. Now, I do not know how much money, how many Americans have bank accounts in Venezuela right now; I am looking at the issue in Venezuela. They are closing down banks, they are taking over banks, they are arresting people, and in Mexico. Do you know if that rule is still moving forward because it would be devastating, again, when you see the impact of the incredible flight of capital from the United States to other countries and, I would say, frankly, jeopardizing jobs?

Mr. SHULMAN. Let me just respond to a couple things, just give you context. As you know, we have made substantial efforts in our global effort to crack down on offshore tax evasion. There is a law that Congress passed that is going to go into effect starting next year, that is going to require all foreign financial institutions to share information with the United States or have withholding on payments coming out of the United States. We have had a lot of discussion about reciprocity and where there is the possibility for reciprocity. This regulation lays the groundwork for some reciprocity, but I want to be clear about a couple of things because I think there has been some misunderstanding. The regulation does not say we will get information and share it. It just says we will get information. When we get information, we will, A, only share it with people with whom we have treaties or tax exchange information agreements, and B that is the universe of people we would consider.

Mr. DIAZ-BALART. Venezuela and Mexico?

Mr. SHULMAN. Anyone we have a treaty with, but let me go to the second step. So the analysis does not end there. The second analysis is what is this information going to be used for? Is it going to be used for tax purposes? Is it going to be safeguarded? Do we think citizens are going to be put in danger by us sending this information, and is there reciprocity? I think some of the notion of sharing this with regimes like Venezuela is overstated. All we have said is we collected this information. Frankly, for us as a nation, to be serious about cracking down on offshore tax evasion and having regular trading partners like the U.K., like France, like Germany collect and give us information, we need to say that we will be prepared, under certain circumstances, to share some other in-

formation. So, one, we do not have intention of jeopardizing lives; we are very careful about that.

Second, if I could address the U.S. bank issue. I think that there was some similar concern when we did other information sharing agreements in the past, and it was not flights of capital. I know Treasury, who has done most of the analysis, I do not have it, has shared with you some information about flight of capital, and do not think it is as severe as some people have stated.

Mr. DIAZ-BALART. Commissioner, the reality is the northern hemisphere is two countries. In our hemisphere, there are two countries, so let me pose it this way, if I may. Do you not agree that Venezuela is a place where people can be threatened? I mean, I can share with you the New York Times article about how people who vote in Venezuela are persecuted rather substantially, and the government goes after them, gets the name for those people, and goes after them. The New York Times, they are not exactly a right-wing organization. Then in Mexico, one of the most violent places as far as kidnapping, so those are the two countries we are dealing with in this hemisphere.

Mr. SHULMAN. Yes.

Mr. DIAZ-BALART. So this is not theory. Now, for example, George Mason University did a study about capital flight and they said it would be substantial. But more specifically, the issue that I have is logic, forget about our government. There is a ton of money of American money in Venezuelan banks right now trying to avoid paying taxes in the United States?

Mr. SHULMAN. No, what I was going to say is I do not think we need to have this argument because I think if your main concern is Venezuela, it is not going to be a concern, and if it is those two we ought to have a offline conversation. I am not prepared to make broad international policy on the fly at a committee hearing, but I think if those are the two issues, you know, those are things that we can talk about. This is about a much broader set of issues around global collaboration around tax evasion.

Mr. DIAZ-BALART. And I understand that, commissioner. Madame Chairwoman, again, this commissioner has been exceedingly successful in the work, so why do we not do that, and why do we not get together and see if we can kind of iron out things, because there are a couple things that just defy common sense. You are dealing with Venezuela and Mexico, these are the specific different issues, but they are based on the same results; that is the very worst. So why do we not get together on that?

Mr. SHULMAN. Especially the appropriate folks in Treasury as well.

Mr. DIAZ-BALART. Of course. Thank you.

Mrs. EMERSON. Mr. Graves.

TAX-EXEMPT ORGANIZATIONS

Mr. GRAVES. Madam Chair, Commissioner. There has been a great deal of press in terms of the likelihood of your agency structure and form and funding of 501(c)(4) in terms of welfare organizations. This media attention specifically focused on our assets, examination of what are (c)(4) groups, who also engage in political activity, should be denied a release of their taxes. Two reasons I

think that your activities are of so much interest to the press, and to everyone out there, certainly to us in Congress, first because of the timing of the inquiries, which make it appear a little bit linked to other actions, and second, is the focus, since the examinations seem to be centered on groups that are considered Tea Party groups, or those that openly oppose the Administration's policies. Can you help put any of those concerns to rest today that these groups are specifically being targeted because of their political activities or their opposition to the Administration's policies?

Mr. SHULMAN. It is a good question. I am glad you asked it because I think there has been lots of information flying around in the press, and I think it is important that people put it in perspective. First, is for taxpayers to operate as a 501(c)(4) organization, they need to be primarily engaged in promoting the common good or general welfare. They are allowed to be involved in political campaign activity, but it cannot be the primary activity. Second, in order to be a (c)(4) organization, you do not need to apply to the IRS. You can hold yourself out as a 501(c)(4).

You then file your 990 at the end of the year, and if we see something that either has to do with political activity or something else, we have the option to do an examination, and there is not a high chance of an examination; we run samples. Third, when we decide to do an examination, we pride ourselves on being a non-political, non-partisan agency. We are given these complex rules that have things like political activity written into the tax code that does not allow you to do certain things or else you jeopardize your tax exemption. We have set up very clear safeguards, for determining exams. Our Chief Counsel and I are the only Presidential Appointees, and I have a five-year term, so that it goes past Presidential election cycles.

There is a committee of three career employees in our tax-exempt organization, not even based in Washington, who look at any political referrals or any allegations of political activity. Those three rotate, but they make decisions about farming out examinations to the field, so there are many safeguards built in. This work has nothing to do with election cycles and politics. And so that is, generally, what happens. But the important thing about what has been in the press in the last few weeks is not all of these organizations are being examined. They voluntarily came in and said, "I would like to apply for 501(c)(4) status, so I would like to engage the IRS in what my activities are," and when you apply, you send in an application. We ask sets of questions. These people had a choice to not engage the IRS, to be 501(c)(4)s, hold themselves up as such, file a 990 after a year plus of operation, and then there would have been a much less of a chance that we would have discussions with them. So this notion that we are targeting anyone, I think, is off because these people are going through an application process that they voluntarily decided to do. It is not required under the law.

Mr. GRAVES. Has the IRS recently changed its policies with respect to these organization's applications?

Mr. SHULMAN. No. No, when you apply as a 501(c)(3) or a 501(c)(4) you send in information. If we need more information, we do a back-and-forth with you. I think there have been press reports

about the questions we ask. We also send out information that say, "If you think you can provide us information in other ways, please let's have a conversation." I think we are quite reasonable around those things.

Mr. GRAVES. The questions you ask today are the same questions you asked two, three years ago?

Mr. SHULMAN. It is facts and circumstances, and up to the examiner what they think they need to ask to get the information to determine what the activities of this organization are.

Mr. GRAVES. So back to the original question. So you did not deny that are increasing in exams or looking into these organizations, in fact you said engaging in political activities is not the primary focus, but you can come good after determining that does increase the opportunity for examination, so sounds to me like you confirmed the fact that the groups identified that the primary focus here is not the common good, but it is of a political nature.

Mr. SHULMAN. No, I think you have got that wrong. I was reciting the tax law and what are the standards we use when we look at 501(c)(4) organizations. We have been clear in our exam plan that we will look at these groups. When we see 501(c)(4)s not using their status right, we will look at it. That is our job, it is written into the tax code, and when people apply, we will make sure we try to do our best to understand what is happening.

Mr. GRAVES. What is your intention when somebody is not using it correctly?

Mr. SHULMAN. People file a 990, we get referrals from organizations about what is happening, and our examiners have a variety of ways it comes to their attention. A lot of it is on the application. They say, "Here are my activities," and we will go out and do examinations.

Mrs. EMERSON. Mr. Womack.

PREVENTING IMPROPER PAYMENTS

Mr. WOMACK. Thank you Madam Chair, and thank you, Commissioner. It is great to see you again. I appreciate how you have articulated your responses to a variety of questions today. I want to talk a little bit about documentation. As you know, the IG for tax administration has issued a number of reports regarding some issues that you have had with administering tax credits and deductions. As an example, the IRS did not require third party documentation with residential energy credits, and according to the IG, 262 prisoners and 100 individuals under the age of 18 claimed the credit.

The same problem occurred with the American opportunity tax credit. According to the IG, 2.1 million taxpayers erroneously received over \$3 billion in payments for the education tax credit. For the qualified motor vehicle deduction, the IG identified \$151 million in excessive deductions. So if you just look at the three I just mentioned, there seems to be somewhat of a trend here. The IRS failed to require documentation which could have prevented these erroneous payments, and as a result, the federal government is doling out what amounts to billions of dollars to people that do not qualify. Why is something so simple, that is, the requirement of basic documentation, so difficult?

Mr. SHULMAN. It is a good question, and I think the broader question about refund fraud is obviously one that we take very seriously. Let me just say, last year we stopped \$14 billion of fraudulent refunds from ever going out the door. Some of these were prisoners, some of these were identity theft, some of these were lack of documentation, a variety of issues. If we say we want documentation for any of those credits that you just named, unless we have math error authority, we cannot just deny the credit. We can say, send us the documentation, and we have to actually enter into a full-fledged engagement with the taxpayer, often an exam, to see what is happening. So at its simplest, it is a problem of limited resources. We have a responsibility to make sure we get out refunds quickly to the vast majority of people who are counting on their refund when they file. We ask for documentation where we think it is appropriate, and where we think there is potential fraud.

In recent years, we have asked Congress to give us more math error authority because that is the real game. If Congress says we have math error authority, which includes not having documentation for one of those credits, we can just deny it. We do not have to have a whole team of people corresponding with taxpayers, going back and forth in limited budget environments where we are down 5,000 people this year. And so the simple answer to your question, the question of why can we not do something simple: Each of these takes resources to happen, and so we have to triage, and decide where it is most important to put our resources.

With that said, though, we have significantly ramped up our efforts on cracking down on some of the examples you gave, like prisoners committing refund fraud. I have been engaged with governors during the last year. We have much better lists. We have the list of prisoners; we can crack down on that kind of thing. So we are on the case with that, but there are some limitations to what we can do.

Mr. WOMACK. My follow up question, along that same line, though, is what can this Congress do to assist you? You have talked about math error authority. Is there anything else? It is frustrating. We are discussing budget numbers today. The gentlelady from Missouri is painstakingly going through these budgets. We are down to very minute amounts that we are trying to find savings and trying to best account for the outlays of our Federal tax dollars. So when you see the numbers that I have already discussed, and there are others, we are not talking about chump change. We are not talking about rounding errors. We are talking about significant amounts of money, and so I am curious as to if there is anything else that this Congress can do that can further allow us to provide the right documentation to ensure that the people who are receiving these refunds, or credits, are indeed qualified. Is there anything else that this Congress can do?

Mr. SHULMAN. So one is budget requests, a specific initiative for just that issue. \$88 million is for an initiative that is called Implement Revenue Protection Strategy. That is literally helping us make sure we have technology to filter these problem refunds out and have more people working just these kind cases, so we will not have those kinds of numbers going out. Second, is some legislation around prisoners and the kind of information we can share.

One of the problems with prisoners is they are already in jail. And so one thing you can do to them is take away privileges in prison. Wardens want to put them in isolation, those kinds of things. But our authority to share prisoner fraud information back to states has expired, and so Congress is working on that. And then third, in our budget proposal we have some math error authority proposals. One is a very simple one that is along the lines that was pointed out in the energy credits, which is give us math error authority to adjust the credit if, over a couple of years, you have exceeded your lifetime limits of credits. Right now, we do not have that as math error authority. We have to go into an examination process to have a dialogue with you and the burden is on us, and so passing those would be important.

Mr. WOMACK. Well, it would seem to me that, based on the numbers we are talking about, and I know the initial knee-jerk reaction of government is "Oh, we will throw a little bit more money at the problem," but with the kind of numbers we are talking about, even if it did require outlays for certain types of programming or software that could help us identify this, it might be a very wise investment on our part.

Mrs. EMERSON. Yeah, go ahead, and I am not disagreeing with you as far as that some of this might have to be done by the authorizers.

Mr. WOMACK. Yes, correct, and I am speaking specifically for the Congress, in general, but I know how difficult it has been on you, Mrs. Emerson, to deal with what you are dealing with, and our work is never done. We are down to very, very small amounts that we are trying to fix. I want to talk about the additional child tax credit for just a moment. In September, a report was issued indicating that over \$4 billion was paid out to illegal immigrants on the additional child tax credit. The IG recommended that the IRS work with the Department of Treasury to seek clarification on whether refundable credits may be paid to individuals who are not authorized to work in the United States, and that the IRS require individuals filing with individual tax identification numbers claiming the ACTC to provide specific, verifiable documentation. My understanding is your agency has agreed to work with Treasury to clarify whether the credits should be paid to those not authorized to work in the U.S. So have these discussions taken place? Where are we in this process?

Mr. SHULMAN. Thanks for the question. So there are certain tax credits that Congress has explicitly said you need a Social Security number to claim like the Earned Income Tax Credit, and there are certain tax credits, like the one you mentioned, that Congress has not said that. And so our best reading of the law—I know some people disagree with this policy. We really do not have a view on the policy as much as we just try to implement the law as it is written on the books—is that while that was an interesting statistic pointed out, it did not necessarily point out anything we did wrong. Those were eligible taxpayers, and so, we had discussions. We are very open to having dialogue with Congress, and ultimately, this is up to Congress to decide what they want to do. But these were, in our view, eligible taxpayers.

Mr. WOMACK. But did the IRS disagree with the IG's recommendation on additional documentation?

[CLERK'S NOTE.—Interruption noted here of the Reporter's Microphone.]

Mr. SHULMAN. Okay, that is good to know. There is a new procedure here at the Appropriations Committee.

Mr. WOMACK. For the record, that person is not associated with my question.

Mr. SHULMAN. We looked at that report very carefully. I do not want to give you the wrong answer, so we can come back to you on exactly what steps we have taken.

[CLERK'S NOTE.—Subsequent to the hearing, the Chairman provided the following redacted memo in response to the TIGTA report:]

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

WAGE AND INVESTMENT DIVISION

June 16, 2011

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr. /s/ Richard Byrd, Jr.
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report - Individuals Who Are Not Authorized to Work in the
United States Were Paid \$4.2 Billion in Refundable Credits (Audit # 200940031)

We have reviewed the subject draft report and welcome the opportunity to provide comments. The report accurately describes recent legislative amendments that have contributed to the increase in both the number and amount of claims for the Child Tax Credit (CTC) and its refundable component, the Additional Child Tax Credit (ACTC). Working within the framework of the law, we have established processes and controls to administer the provisions of the Internal Revenue Code (the Code) and are constantly assessing, evaluating, and modifying those processes to ensure they remain effective. It is important to recognize that unlike many other tax benefits, the law does not require the taxpayer or eligible child to have a social security number in order to receive the CTC or the ACTC. The IRS is administering the law accordingly. Legislative changes would be required to deny many of the claims discussed in the report.

The IRS agrees that the requirement for taxpayers to provide supporting documentation to verify eligibility for certain tax benefits could present a deterrent to some individuals who make improper claims. However, as indicated in the report, the IRS does not have the legal authority to deny credits during processing when documentation is not provided. Also, in addition to the obvious resource limitations associated with such a requirement, in the case of the CTC and the ACTC, *****2(f)*****. In most cases, eligibility can *****2(f)*****.

The Accounts Management Taxpayer Assurance Program (AMTAP), which is responsible for reviewing refund claims arising from questionable wages and/or with holdings reported on Form W-2, *Wage and Tax Statement*, does not have the legal authority to deny questionable ACTC claims that may also be present on the returns it reviews. Instead, such claims must be referred to the Examination function for verification under the deficiency procedures. *****2(f)*****.

The IRS recognizes the prominent role identity theft has assumed as one of the fastest growing crimes in the U.S. and the impact it has on the lives of its victims and has taken a number of steps recently to improve taxpayer service related to this issue. With regard to tax administration, identity theft can manifest itself as a refund-related crime where a perpetrator fraudulently uses the identity of another to claim a refund to which they are not entitled or as an employment-related crime where the identity of another individual is used to obtain employment. In either case, the victim is generally not aware that their identity has been compromised until they have contact with the IRS. We are currently conducting a study to determine the feasibility of expanding the use of account indicators. Indicators are placed on taxpayer accounts when those taxpayers have been identified as victims of identity theft. These indicators streamline the assistance process and help mitigate future account problems. They are also responsible for the generation of notices to the taxpayers, informing them that their Social Security Number and/or other identifying information appears to have been compromised and providing guidance in steps they can take to protect themselves.

With respect to the duplicate refund claims addressed in the report, we have taken actions to recover these refunds.

Mr. WOMACK. And Madam Chair, I yield back.

Mrs. EMERSON. You are welcome to, seeing the look on your face.
Mr. Yoder.

TAX-EXEMPT ORGANIZATIONS

Mr. YODER. Thank you, Madam Chair. Commissioner, I appreciate you being here today. I just stepped in from another Committee hearing, but I did want to follow up on some questions that I know Mr. Graves was asking earlier about credit organizations, and if you might just enlighten me, I know there has been some concern from some groups that the IRS has unfairly targeted political groups in their efforts, too. Certainly, there is a broad range of powers that the IRS can use to investigate with less paperwork, and things that can be somewhat subjective in its implementation. So you might just discuss that a little bit, and particularly, does the IRS use one examination regime for organizations deemed to engage in political activities and does not, versus the same approach?

Mr. SHULMAN. I will not repeat for the Committee, but I walked through the basic framework that we use in our Tax Exempt and Government Entities group to look at 501(c)(4) organizations. The main issue, I think, at stake is that 501(c)(4) organizations are allowed to engage in political and campaign activity, but it cannot be their primary purpose or primary activity. Anything that involves political activity, and it is really for all sorts of sensitive cases, if it has been referred by a Member of Congress, it gets the same treatment, because we want to insulate our people from any political influence on the IRS. That is very much built into the core of our non-partisan, non-political approach at the agency.

And so I will get in to the examination process in just a second, but I think a lot of the reporting has not been on the examination process. We have a committee of three people who looks at any referrals or any allegations of misconduct in the political sphere and determines if there is enough evidence that the allegations are correct. If so, it gets sent out to an individual examiner for further review. These three people are career professionals very much removed. I never talk about a case. No one would ever bring me any of these kinds of cases. I am very much removed from all of Washington politics and activity.

So, that is the process for deciding examinations that have any sort of political allegations, which is not the same as an exam in a government pension plan or something else in a risk-based kind of approach. 501(c)(4)s can hold themselves, out as such, and do not need to apply for an exemption, but then file their 990 and folks would look at it and see, is there a need for an examination. And as you know, from our examination statistics, the chance of examination is much lower. A bunch of organizations decided to apply for (c)(4) designation, and in the application process, that is what has gotten some of the back and forth, and it has gotten a lot of attention recently. And that is the normal back and forth of an application process.

Mr. YODER. Well, to the extent that there would be concern, whether it is justified or not, concerned that political organizations of certain angles are being unfairly targeted. How do you ensure

that in the process of auditing and examination and all of that, you ensure that is done in a fashion that does not look at one organization or another based upon their political perspective? Do you build in safeguards?

Mr. SHULMAN. I mean the built-in safeguards is, A, the culture and tone at the top. People know it will not be tolerated. This all started back when President Nixon tried to use the IRS for his own political gains, and there are laws in this country around people reaching into the IRS. If certain people call me or anyone else at the IRS about a specific case, we actually need to report this to Congress and to Inspector Generals. And so there are laws built into it.

The next safeguard is there are only two political appointees in the IRS. It is unlike any agency. And I happen to be one that has a five-year term, which overlaps Presidents, keeps it insulated from politics. It is my job to make sure that we run a non-political organization. And then we have the safeguards built into this process that no one person can decide to examine an organization based on political activity. You have also got your peers watching, and you cannot just get a case, go off in a corner and run with your own agenda. I think there are a lot of safeguards built in.

TAX CODE SIMPLIFICATION

Mr. YODER. Okay, I appreciate that. And then I believe the Chairwoman asked about the simplification of the tax code, and I just wanted to engage you a little bit on dialogue about how we get to that point. I hear both political parties talking about simplification of the tax code. I think most Americans think the tax code is too complicated and that they have to hire a lawyer and an accountant just to be able to fill out their basic income taxes. Also that small business are tangled up in a myriad of rules and regulations coming out of Washington, and certainly tax code frustrations are always on the top of their list of things that make it difficult for them. We are all focused on a pro-growth tax code; policies in this Federal Government that support job creation.

What steps can we start taking now to work within the existing code? And then, second of all, is the IRS taking any, and do they take any, positions on these issues in terms of where they have an opinion or not? And my assumption is no. But you might speak to that.

And then there are obviously lots of plans out there, from a straight flat tax to a fair tax. And so I think your department will be highly involved in much of what goes on in this Capitol over the next coming months as we try to sort through this.

Mr. SHULMAN. I think there is broad bipartisan consensus that the tax code is too complex. One of my favorite statistics is it is four times as long as "War and Peace." I think simplification would be helpful from a compliance *and* a service standpoint. I am not prepared to give you my dissertation on all the places you should simplify it. I think the President has talked about it being way too complex, as have the Chairmen of the Ways and Means and Finance Committees. I think there is good movement and agreement for the need to engage in serious simplification discussions. I think

I will leave it to the Congress to figure out exactly how it will get together and where it will put it in its set of priorities.

Mr. YODER. Well, I appreciate that and I think certainly in both political parties there is concern about some corporations that end up paying no taxes and then large percentages of Americans that do not end up paying any income taxes. And think there is just a general sense of frustration amongst Americans that the code maybe does not work for everybody the right way. And so we are very excited and interested in engaging with you and really in a bipartisan approach to figuring out a way to make this a pro-growth code, simplify it for Americans, make it more efficient and useful, and I look forward to engaging with you and others on that process. Thank you, Madam Chair.

AFFORDABLE CARE ACT IMPLEMENTATION

Mrs. EMERSON. Thank you so much. All right, let's talk about my favorite subject. For 2013, the IRS is requesting \$360 million and 859 full-time equivalent employees for health care implementation. But before we dig into the 2013 numbers, can you tell me, and the Subcommittee, how much funding the Department of Health and Human Services provided to the IRS in fiscal years 2010 and 2011.

Mr. SHULMAN. Sure, \$20 million in 2010, and \$168 million in 2011.

Mrs. EMERSON. So, what are the IRS's total health care implementation needs for fiscal year 2012?

Mr. SHULMAN. For 2012 the total is \$332 million.

Mrs. EMERSON. Okay, and those from HHS again, correct?

Mr. SHULMAN. I mean those are, ongoing discussions, but we would get it from the funding in the authorizing legislation, the Affordable Care Act.

Mrs. EMERSON. Okay, but last year, though, I think you told us that you were going to need \$450 million from HHS. No, you were going to need \$450 million, but yet there was nothing said, and perhaps because I did not ask the question properly that none of funds would come from HHS. So tell me what happened.

Mr. SHULMAN. I am sorry?

Mrs. EMERSON. So last year you told the Subcommittee that IRS needed \$450 million for fiscal year 2012, and that none of the funds would come from HHS. So, what changed?

Mr. SHULMAN. I am sorry, I did not remember saying that none of the funds would come from the authorizing legislation but we assumed in FY12 getting \$450 million in appropriated funds. I think I have got the gist of your question, but if I did not get it right, obviously, let me know. I mean, I think what changed is the Committee and the Congress did not fund the IRS's request for funding to implement the Affordable Care Act. We got the sense that there was not a lot of appetite in certain quarters of Congress to ever fund the Affordable Care Act.

Obviously it is something I disagree with. We have had a conversation about whether you like the policy or not, when laws are passed, we need to implement them. And so we have just been trying to modulate our spending and we have been trying to execute so we can get there, but, we are being as realistic as we can about where the sources of funding will come from, and just trying to

maximize our output and be responsible in the way we manage this.

And so we wanted this to come from Appropriations. We would like it to because we think that is the right place. One side of Congress gives us a responsibility and the other side gives us the appropriate money to do it. And so that appropriation is what we requested last year and, obviously, that is what we are requesting in 2013.

Mrs. EMERSON. So, and then question, the \$450 million versus the \$332 million?

Mr. SHULMAN. That is just us trying to stretch as much as we can because while we would like you to fund it this year, you have not done so yet.

Mrs. EMERSON. Right.

Mr. SHULMAN. And so we are trying to do the best we can under limited, difficult circumstances.

Mrs. EMERSON. Okay, so then let's get back to the request for the \$360 million for 2013. Tell me how much of that \$360 million is related to implementing the individual mandate? Can you break it down that way?

Mr. SHULMAN. Yes, the individual coverage requirement is 8.2 million in our budget request. So \$8.2 million of the \$360 million would be for implementing the individual coverage requirement. Generally the activities around that would be building the matching system that allows us to check when insurance companies report and say are you covered or not against what is sent on the tax return. And as you know, in the individual coverage requirement, if you have to pay that penalty for lack of coverage, and you do not pay it, we cannot use our normal enforcement authorities. Normally, way down the line, after having lots of dialogue with you, we have the ability to put a lien or a levy on you. We cannot do that for this provision. Our systems are hardwired to do that, so a lot of this work is the planning and the design and technology to figure out how to cut off those systems and make sure we follow the requirements of the law.

Mrs. EMERSON. Who knows what the Supreme Court is going to do? I have no clue, and I am not sure anybody does, with regard to the individual mandate and whether or not they will decide it is severable. But if they decide its severable and if, in fact, the individual mandate does not stand, will you need the \$360 million minus the \$8.2 million?

Mr. SHULMAN. Correct.

Mrs. EMERSON. Okay. Why do you not just go over, if you do not mind, for us, and certainly for my colleagues, exactly how you plan to use, with the exception of the individual mandate piece, unless we have some time for that, but tell us how you plan to use that \$360 million.

Mr. SHULMAN. Sure. Thanks for the question because it is important. You really can break it down into two pieces of work. One is the work around us building the systems that we need to interface with the 50 state exchanges. Because when you go to sign up at an exchange, one of the major questions is, "what is your income?" If you have a certain level of income, you qualify for Medicaid. If you have income up to 400 percent of the poverty level, but do not

qualify for Medicaid, then you are eligible for Federal tax credits, and that is where we come in. The Affordable Care Act has a definition that it links your eligibility to the entire household income. So it is about household income. So, the vast majority of this money, \$331 million out of the \$360 million, is in the Operations Support account, which is technology. And the vast majority of that is linked to this credit. Because this is the year, 2013 is the year we need to be building to get ready for 2014, when the exchanges are live. They actually are going to go live near the end of 2013 for open enrollment for coverage in 2014.

And so that is going to be spent building the database that extracts data out of our core database and moves it into a standalone database, because we want to have firewalls so that there is no overlap of our core account databases. With this system, it rejiggers the data so that we make sure it's household income; it builds real-time interfaces with the 50 state exchanges, or however many state exchanges there are, and the federal exchange. And then we set up the system for the reconciliation of issues for when there is a change of circumstance, et cetera. So that is really just the big technology build, 92 of the percent of the money is in Op Support, it is technology.

Then there is much less money that is around the IRS responsibility, its tax responsibility, around the Affordable Care Act. I like to remind people, it is not health policy, but it is around moving the money, which is tax credits and collecting some taxes. There is a set of pay-fors or taxes that are part of the Affordable Care Act. There is a fee on branded pharmaceutical drugs, a medical device tax, a fee on health insurers for certain amounts of net premiums. There is a new responsibility for oversight of tax-exempt hospitals and looking at their community benefits. There is the adoption credit. There is the small-business credit. So the rest of the money is just the normal money that we would need to spend any time there is a tax legislative change of any magnitude. That is for doing outreach and education, changing our forms, changing our systems to make sure that it accommodates these forms and this data, setting up filters around compliance, having a modicum of compliance coverage around these new taxes so we have ways to do checks on it. Those are really the two buckets, the vast majority being IT staff, IT people, IT expenses to interface with the state exchanges.

Mrs. EMERSON. So do you think once the IT is set up, do you still need to have all of these people?

Mr. SHULMAN. These are mostly technology people. This year we have, from the funds that were transferred out of the original authorization, we have about 800 people on staff working on all of this technology. The budget request would add 60. I cannot tell you exactly, but I mean these are big systems we are running that have architecture, design, operation, security. I cannot tell you what our future state is, or how many we would need in the future.

Mrs. EMERSON. Okay. And the 274 full-time equivalent employees that will be doing enforcement for this, tell me what those enforcement folks will be doing, specifically.

Mr. SHULMAN. Sure.

Mrs. EMERSON. We are still just beginning the process of having all this set up.

Mr. SHULMAN. Yes. Well, those are extra folks for making sure we have some coverage of the excise tax on tanning, on branded pharmaceuticals. That we have people who can analyze the data that comes in and make sure we interact with taxpayers based on the amount they owe, medical device the PCORTF fee and the high income taxes are part of this. So it is traditional enforcement personnel for new tax responsibilities.

Mrs. EMERSON. I am curious now that I asked that question. I am curious: How do the branded pharmaceutical companies, the medical device folks, the tanning salons, do they actually get a bill? I mean, how do they know they are supposed to pay? I mean, I know they, but you know what I am saying. Do they automatically send you the percentage or the money that they owe due, or whatever formula has been set up?

Mr. SHULMAN. Let me just give you two examples.

Mrs. EMERSON. Yeah.

Mr. SHULMAN. The branded pharmaceutical fee is actually a set fee based on market shares sold to the Federal Government, and so the way the statute works is the CMS, Veterans Affairs, and DOD, who do the vast, bulk purchases of branded pharmaceuticals, send us certain data. This is the design of this statute.

We look at the \$2.8 billion in fees, which it was last year, divide that and look at market share based on the brands. We actually sent out to the branded pharmaceutical manufacturers an estimate, gave them three months to engage with us to see where the different estimates were, and then we sorted it out and sent the final bills. We did an estimate in June and sent final bills last October. And so this is up and running.

So this is happening. So that is one extreme where we do a lot of the calculations, because it is based on market share and the government has the market share data. The other extreme is indoor tanning salons, where there is a 10 percent excise tax on those activities. And so we did an outreach campaign to them. We did a big campaign with preparers to let them know about it. That is like any excise tax. We do not calculate it. They have a form; they fill it out and they send it to us. When there are new taxes, again, despite the perception of our brand, we try to really engage communities and not just impose it because a lot of people are just learning about it. And so where we saw either mistakes or we knew there were places that would not be aware of the new requirement, we would correspond with them and say "We think you might have had a filing requirement. Please correspond with us." We do not go out hard-core, and so those are two extremes.

Mrs. EMERSON. Okay. I appreciate that. Thank you so much. Mr. Serrano.

Mr. SERRANO. Thank you so much.

CHILD TAX CREDITS

Let me just take a few minutes, Madam Chair, to make a statement and clarify something. First of all, on the additional child tax credit, current law allows the additional tax credit to be claimed by all individuals who file taxes, regardless of whether they use their

Social Security number or a Taxpayer ID. And I am speaking to the fact that the comment was made that illegal aliens were getting these credits. Eligibility regarding this tax credit concentrates on the eligibility of the child, not the parent. Children must be U.S. citizens, U.S. nationals, or U.S. resident aliens. This means that on a 1040 form, someone filing with an Taxpayer ID number, must provide their dependent child's Social Security number to prove their eligibility for this tax credit.

The whole point here being that this benefit does not go to the parent; it goes to the child. Secondly, to their credit in a very somewhat funny way, the IRS has not gotten involved in who is here in this country and why they are here. They want them to pay taxes. They collect from anyone, regardless of what situation they are in, and so these people are who's filing. What their status is not an issue. How they got into the country, it is not an issue. It is the fact that they pay taxes, they are filing, and they are claiming this credit, and it should not be portrayed as undocumented or illegal people are getting these.

NONRESIDENT ALIEN INTEREST INCOME RULE

Secondly, while you did refer to the government of Venezuela as a regime, you were answering the Florida member of Congress, and that sells well in South Florida. I think we have to be careful in what we do with information, because we have information that we share with other countries, but they have information that they share with us, and notwithstanding the rhetoric from Washington, and some parts of Florida about President Chavez, and the rhetoric from Caracas about our interference or our behavior, we do share information. That is not top secret information having to do with drugs, and human trafficking, and other issues.

And so if we are going to get into the business of not sharing information with them, then we have to be careful that we do not get into a situation where they stop sharing information with us.

And lastly, if one of the big issues in this Subcommittee has been getting people who have money stashed somewhere else, and then I think we can understand why some people may want to know about people from those countries who have money stashed over here. And so that is something we have to be, again, very careful how we handle it. And my comment about calling it a regime is not a personal comment; our country does that when we have elections, and we do not like the result of the election, we call them a regime, and that is what we do.

SEQUESTRATION

Let me ask you something now on sequestration. That looms over everybody's head here, and it has become a big issue and a big fear, and anyway, what can you tell us? I think as Congress moves to that possibility, we need to know what the impact will be on different agencies. So what can you tell us about that?

Mr. SHULMAN. My understanding is the law does not break it down by agency. We do not have exactly what would happen to the IRS, but know only of cuts of the magnitude being talked about across the board. I have told you that I think the IRS is very unique in government because we have a positive return on invest-

ment. Sequestration was part of a broad budget deal that looked at deficit reduction, and if you care about deficit reduction you do not give the IRS a big cut. I would refer you to the letter that I sent you all last fall, which explains how cuts would lead to significant lost direct revenue. Issues would arise around voluntary compliance and people believing that the system is fair and they should pay. Then there would be decreases in service. And so I think, obviously, it is not a result that we are hoping for, and if it does happen that it is not applied across the board.

Again, I would point out that the President in his 2013 budget recognized the difference between the IRS and other agencies, and asked for a significant increase for the IRS for that very reason that it is important to the functioning of this government, and in the context of deficit reduction. Investments here pay off in the long term.

Mr. SERRANO. Let me ask you a question. I have been around here long enough to remember right before 2000, the big issue with every agency, the question we ask at every hearing was, "What is going to happen, you know, at midnight December 31?" Remember, it was this fear that the world was going to fall apart, and I think nothing happened, actually. One computer went down somewhere. Y2K, which was the big deal. The T-shirts, the whole thing, it was a big business.

But there must be people, quietly, although you do not have to give me details, discussing at agencies, "Okay, what happens if sequestration comes?" Are you suggesting that if it comes, you will deal with it, or there are people already trying to figure out how it may impact a particular agency? Or you do not have the resources to spend time on that?

Mr. SHULMAN. Well, it is not the resources, but I said this in my opening statement. I mean, take my Chief Technology Officer. Every time there was almost a government shutdown, for a week, he was huddled, trying to figure out what is essential, what isn't essential, what are we going to shut down, what are we not going to shut down. That is not where you want him. I mean, you want him working on CADE, and you want him working on our core systems that run our filing season.

And so I will tell you, over the last year—and I am not a politician, but as someone who leads and runs an agency and tries to do it well, and do a serious job for the American people—the amount of time we spend on different scenarios is a drain. We have to maximize our time. Right now, we are not spending lots of time on sequestration because we have spent a lot of time. I mean, we will see where these things fall out, and I repeat, we would like to see our full budget funded, and that is our request.

TAXPAYER INFORMATION SECURITY

Mr. SERRANO. Let me ask you a question on an issue that I know is a bipartisan issue, and that is taxpayer information security. What are we doing to further improve the security of the taxpayer's personal information? I mean, this is always something in this country, especially, with the Internet and all the abilities for information to go out there. What are we doing to make sure that we take all the safeguards for no further information going out?

Mr. SHULMAN. When I think about information security, I have to think about it from several perspectives. One, perimeter security: Can anyone get in? Two is internal security: Are there any problems or vulnerabilities inside our system? And then you need to think about it from the network, and the hardware, and the software, internal and external threats. I, literally, my first month, called everyone in and said, "What are we doing about taxpayer security and data, because the worst thing that could happen to the confidence of the tax system would be a major data breach." We have not had major data breaches at the IRS, knock on wood. It is very hard; you need to stay ahead of it, and threats continue to escalate. One of the criticisms when I first came in was we were building new systems and we did not have enough money, and one of the things we were potentially short-cutting was security. So we said, "No, security goes to the top of the list. We will have less functionality and more security, if that is what we need to do." That is what we did.

We have GAO and TIGTA who have been very helpful identifying vulnerabilities and weaknesses over the year, and it is very dynamic. We have knocked down most of the identified security issues, but now you are always going to see new ones. There is a recent report that talked about servers inside a secure data center that has both physical, perimeter, virus, all sorts of monitoring security around the whole perimeter, but also servers talking to each other, and should we have encryption between those two servers? So those are the kinds of questions we are knocking down, which is frankly where you want to be. That means you have taken down all of the obvious, easy threats, and that you are just focusing granularly. And so I think we have a very good record on it, on not having major issues. I think if the government is serious about it you are always going to see continued recommendations for improvements because technology is continuing to advance.

INFORMATION TECHNOLOGY CLOUD SOLUTIONS

Mr. SERRANO. To show you the bipartisan nature of the Subcommittee, the Chairwoman handed me a follow-up question, which we spent on a lot of time on yesterday at another hearing, right? And when I asked a question like this I am tempted to look at the audience to see if there is anyone under 20, or under 25, in the crowd, because they probably know the answer better than the rest of us, no disrespect to you, but it is about the Cloud. In December 2010, OMB issued a Cloud-first directive, which, among other things, requires Federal agencies to move one service to a Cloud solution by December 2011, and to migrate two more services by June 2012. How much progress has the IRS made towards these goals? Do you have any security concerns about using Cloud technology for IRS activities? And Jo Ann and I brag about how modern we are. We have iPads, we have BlackBerrys, and we have email. The Cloud is still a little confusing to me. The whole idea of something going out there, and I do not mind, as I said yesterday, my Frank Sinatra collection being out there. Everyone should share it. But other information, I am not sure about. So how secure do you feel with the Cloud, as we say in my other language, la nube?

Mr. SHULMAN. I am smiling because last month I was on the phone with my mother, and she said, "Doug, I am thinking of moving to the Cloud." And I said, "What does that mean, Mom?" And she said, "I do not know, but I am thinking of moving to the Cloud."

Mr. SERRANO. You thought it was a town in Florida, or something, right?

Mr. SHULMAN. So, the Cloud is basically a way of talking about not storing things on your own hardware but having shared hardware, right? And a lot of the big technology companies would like to sell their Cloud, which is their data systems, but you could also have much more localized Clouds. And if you talk to our technology team—and we obviously take this seriously because this is about efficiency and modernization of government—we have things on common servers across IRS, and there are always questions of economies of scale, right? Any organization I have been in, it is a question: Is it organization-wide, is it by division, is it by department, is it individuals? Who has control of what? I think the answer is to progress. As far as I know, OMB is happy where our technology is, and that is reflected in their continued support of our investments.

Mr. SERRANO. Will tax returns be on a Cloud, eventually?

Mr. SHULMAN. Well, we have internal considerations, because we take security of tax data so seriously; we have a whole different set of considerations. There is section 6103; it breaks the law if you share information. And so we are going to use modern technology, and we are going to get economies of scales where we can, but we are also not going to compromise taxpayer data.

Mr. SERRANO. Okay. Thank you.

Mrs. EMERSON. Especially having been to the Memphis Service Center and seeing the big server room, if you will, it would obviate the need to have that room there anymore. But not everything has to be on the Cloud, I suppose.

Mr. SHULMAN. But that is an internal Cloud, right?

Mrs. EMERSON. I guess you can look at it either way. Mr. Yoder.

EFFECT OF IRS BUDGET CUTS

Mr. YODER. Thank you, Madam Chair. If we can come back out of the Clouds here and get Mr. Serrano back out of the Clouds. Just as we were listening to this dialogue, I wanted to ask you a little bit about the concept of, and I certainly understand your argument that investing money into the IRS is a net benefit in terms of the revenue that comes back to the Federal Government, but essentially that is the essence of your point, that as spending cuts happen to the IRS, there are less agents to go out and find folks that are not paying their taxes and therefore less revenue comes in, and so it is a sort of penny-wise, pound-foolish argument. Is that sort of the essence of your point?

Mr. SHULMAN. It is the essence, although there are lots of things we do that are not agents going out and doing exams. And so, it is investing in technology so we have better fraud detection; it is investing in customer service representatives so when people call and ask questions, we can respond; or when we sent you a letter, we can untangle the issue, and stop the bad returns, and make

sure the good ones go out. And the essence is the overall investment in the IRS leads to a positive return on investment.

Mr. YODER. Right. And so, with that, I think you make a good point in that not all of the money and not all the resources the IRS spends relates to bringing additional revenue into the Federal Government. And so as we make reductions and as we are all aware of the deficit crisis the country is facing, and some of the very heartbreaking things that we have to reduce to cut spending on this Subcommittee and other Subcommittees across the Appropriations Committee, that affect the lives of people and whether they have housing, and food, and the ability to realize the American dream, that may not be the things that you are cutting. Your agency may not be as critical as some of these other things we have to cut, and so I think the IRS has to be part of that equation as we make reductions.

I know you have had to make some, but I guess I want to be sure we are clear, as we make those reductions, it does not have to come from those agents that are going out and auditing, and examining, and bringing revenue into the Federal Government. And you sort of made that point before I kind of asked the question here; the inference here would be is that we make reductions that were not allowing the resources necessarily for the IRS to go and bring in revenue, and so it is short-sighted, and I just think there are other ways to get to that point.

Look at the IRS as a small business or something that you would try to run as any other manager in this country. Many of those folks are hanging on by the skin of their teeth, they have not taken salaries, they have fired people, they have huge health care mandates coming on them, they have new regulations coming on them, and so they have found ways to utilize technology and to become more efficient because of necessity.

And for some reason, in Washington, the necessities of the constriction of the economy are not really reflected in our spending. We continue to spend. In fact, I have people come up all the time and say, "Look across Washington, there are cranes everywhere, Washington is recession-proof. They continue to grow and grow and grow and grow and grow." And we have got to find ways to look at our agencies and look at the departments in a different way. And it cannot always be about investment and spending because there is a net return.

The theory out there is, if we would triple the amount of Federal spending, somehow it would be all this investment, because most groups that come into my office say, "Look, you spend a dollar with us, you get \$4 back." And the IRS has a similar thought. And so I guess I want to encourage you, then also ask you, what percentage of your budget is spent on investigation and auditing, and those things that actually bring in dollars? Not just all the other things. And I know the argument would be, "Hey, everything is part of the effort," but what things specifically go into that?

What impact does new responsibilities that the Congress gives you, such as the Health Care Act, that has all these new requirements, what impact does that have, and is that a greater impact on your ability to bring in revenue, and to find new dollars from those who are not paying their taxes properly? Because that also

is going to be a drain on your resources. And, for example, the 1099 form requirement, if that would have been implemented, those types of things seem very cumbersome, and would require a lot of agent time just to facilitate.

And so when we were talking about the 1099 requirement with small businesses, there was a frustration that small businesses were going to have to, now, respond; that takes time from them. IRS is going to have to hire folks to implement, and that we are going to have to hire folks to examine and prosecute those who do not respond. I mean, that is just a lot of money on paperwork. We cannot be a country that is a paperwork society, here.

And then, third of all, what are you doing specifically? I am sure you have talked about these things, but how do you try to, as we make reductions, rank and prioritize to ensure that it is being spent in a way that gets the best benefit for the American citizens? And then, regarding the Cloud conversation, what are we doing in terms of eliminating paperwork? I know that is certainly on your to-do list, and you have probably spoken to that, but what is the future in terms of cutting costs? In Kansas, our State Department revenue does not send out books, and most of it is done online now, and all those sorts of things.

Mr. SHULMAN. You covered a lot of ground, so let me try to briefly respond the best I can. First, I understand there is a broad discussion and lots of people like to say, "Oh, government does not want to tighten its belt the way private sector does." I have spent most of my career in the private sector. I have run small businesses, I have run big businesses, and I am quite proud that, by the time we roll into 2013, we will have cut almost \$1 billion out of core operations from the IRS while investing in the future. And that is the way we look at it.

But everybody knows when times are tough, you try to tighten your belt some places, but you do not cut the sales department that brings in the revenue because that is just going to make times tougher. We are the revenue generator, and so while I understand you might take issue with that position, I stand by that position that we have been extremely prudent with taxpayer money.

I was driving efficiency savings at this agency before Congress was threatening government shutdowns around budgets, et cetera. This is something we thought was a core responsibility, and so we did that. And the kinds of things we did was stopped sending out 1040 packets two years ago. Not everybody loved that, but we said, "Okay, people can get it online, they can get it at their post office, they get it at the IRS office, but we just need to make a set of tough choices."

I think on revenue production and our services versus other agencies I tried to articulate for this Committee in a letter I sent to Chairwoman Emerson and Mr. Serrano, that I get the argument that other people in the government have to answer phones. But we have this very serious oversight and enforcement authority and a lot of our customer service, things that are actually labeled customer service, like answering phone calls, are actually responding to enforcement activities.

And so the example I gave is, a small businessman has a lien. He cannot refinance, to hire a few people or to expand. We need

to answer that phone call if they say they want to work out a payment plan with us and remove the lien. And I would argue even our services is less discretionary.

So it is laid out in the budget, the things that will score through discussions with CBO, for deficit reduction. So it is very clear which are direct revenue-producing initiatives, but I still will not give up on the notion that you need the whole investment. Technology is as important as agents to get the money in because we have got to run the systems.

And then, finally, it all depends on the new responsibility. We implement the law that is written. We do not write the rules and the laws. It is why I recognize that our request for \$360 million for the Affordable Care Act was not going to be welcomed by everyone in Congress. But from where I sit, there is a discussion about, do you like the policy or not, and people have views on that. If this is on the books, and in 2014 people in your districts are going to be expecting tax credits, we have got to be given the funding to try to implement it.

And each thing that Congress passes, some costs more than others, but what we are trying to do is, in the most fiscally responsible way we can, implement the law in a way that is respectful to the American taxpayer.

Mr. YODER. What percentage would you say you are spending on investigation and audit?

Mr. SHULMAN. In the 2013 request, which is \$12.7 billion, \$5.7 billion is in Enforcement and \$4.4 billion is in Operations Support. And so, in Operations Support, some of it is for big technology, but some of it is, for you need a desktops, and networks, and Internet services for people. So you would have to get a combination of this. So we can get you the percentage; I do not have the exact breakdown. But the vast majority of the request is for enforcement-type, compliance-type activities.

Mr. YODER. Thank you, sir, I appreciate it. Thank you, Madam Chair.

[The information follows:]

IRS SPENDING ON AUDITS AND INVESTIGATIONS

The IRS's FY 2013 budget allocates 25.1% of the resources requested to audits and investigations.

INFORMATION TECHNOLOGY

Mrs. EMERSON. Let me ask you a couple of questions. Number one: Tell me, or tell us, how have the Modernized e-File system and CADE2 been performing so far this filing season?

Mr. SHULMAN. Sure.

Mrs. EMERSON. Any delays you all might have had?

Mr. SHULMAN. We put two big pieces of technology into play that this committee has funded over the years, the most important one being CADE2. CADE2 is a big success, it is working flawlessly, able to post and process on a daily basis, which I talked about before. The second is Modernized e-File. We have been running, for the last couple of years, both our legacy e-File and our Modernized e-File. Our modernized e-File is not just a modern platform for e-Filing, but it also gives taxpayers quicker responses, which people

like. And that functionality was working fine, the actual core of the Modernized e-File.

You mentioned delays, so let me just talk about that. There has been some press around filing season, what is happening. We always say you get your refund in 10 to 21 days if you electronically file and do direct deposit, and we have been hitting those historical norms. Average refund time this year is the same as it was last year. A large number of taxpayers are getting their refund faster this year than they got it last year, and we have a small number who had delays this year. And let me talk about the smaller number, what happened.

We basically had three things happening this filing season which accounted for some delays of taxpayer refunds. One is, we put in a whole new set of fraud filters to combat refund fraud. In the first two weeks of filing season, we actually found there had been a coding error in one of them and it was catching more returns than it should have. That got fixed, but it could have delayed a taxpayer up to a week. That week delay would still be in the 10- to 21-day window. If you show up at a preparer and they say you are going to get your tax return on Wednesday and you get it on Friday, you are going to call, especially early filers, who oftentimes need the money.

Second is in the interface between our e-File system and our downstream systems, we had done a lot of testing, and in the first couple weeks some of our technology people said, "We are not sure exactly that everything is working well. Out of an abundance of caution, let's put in a two-day delay so we can do some manual reviews with this new big system." So we implemented that.

So a two-day review, depending where you hit in the processing cycle, if it is coming up on a weekend, could be more than a two-day delay. And then some of those, a very small subset, actually, if when we were doing manual reviews, we thought we saw something, we could hold those for a week or two extra. And so you that was some of the noise in the system. Those were two types of delays I view as normal filing season issues that are going to come up, especially when you are deploying new systems and you are working out the kinks.

The third thing is we put in a lot of new fraud filters, and we turned up some of the tolerances. Partially, we did this after conversation here because we have seen a spike in identity theft, and so we put in new filters. So we are holding more returns than we have held in the past at this point in filing season. We have a very good hit rate of actual fraudulent returns we hold, but some taxpayers who have not been fraudulent are going to get caught up in that. That was on purpose, not holding up the taxpayers who are not fraudulent, but turning up the filters, and that is part of it as well.

But I go back to, say, 10 days ago, the last numbers I have: 59 million refunds went out. Fifty-nine million refunds had gone out at the same time last year. Refunds are going out the same speed as last year, on average, with a lot more taxpayers getting it faster and a small number getting it a little slower.

Mrs. EMERSON. Okay, that is good. So the \$330 million, or however much the President's budget request was, \$330 million flat-funded from last year, tell me what that is for BSM.

Mr. SHULMAN. BSM.

Mrs. EMERSON. Tell me what the next phase is. Will we be done?

Mr. SHULMAN. I would argue we would never be done with modernizing IRS's technology. The statistic where I come from, running stock markets and financial services, you do about 20 percent capital investment every year in technology because that is the whole game when you are moving the kind of money we are moving. That would mean I would come in and ask for a \$2–2.5 billion dollar modernization budget, so I am trying to work under the constraints of this Committee and of Congress. And so we asked for an increase, but it is still, I would argue, underfunded, in the long run, for an institution of this magnitude with the kind of responsibilities we have, for what we to do for technology.

With that said, this will take CADE2 to daily processing. We will flip it into a database, but some of it is going to be on old technology. So this is basically getting us on a platform that we can run the tax system on for the next 10, 15, 20 years, because we are still depending on some old technology where there are not a lot of coders out there who can do a lot of it, et cetera. So we got the functionality, did not get the platform.

Second is funding to do some investment in the downstream systems that take advantage of this new technology, so: customer service, the Web connection so we can have more self-service options, and better compliance data analytics. We've gotten the basic functionality; it is getting the platform solidified and then having a lot of the benefits flow from it.

Mrs. EMERSON. All right. And as you well know, I am not at all averse to making those investments, because the sooner we do it, the better it is all around. And it is actually less expensive to do it faster than spreading it out because by the time you finish something there is all this new technology, if you do not fund it properly.

Mr. SHULMAN. And for the record, you have been, as Chairman of this Committee, incredibly supportive of our technology investment and, just as important to our team, really interested in it and visited us a couple of times.

Mrs. EMERSON. No, it is. It is fascinating, pretty fascinating.

Mr. SHULMAN. We appreciate all the support.

OFFSHORE TAX EVASION

Mrs. EMERSON. So one other question I have and then we will see if Joe or Kevin have another one. Talk to me a little bit about how you are addressing tax evasion from transfer pricing.

Mr. SHULMAN. Sure. We get a lot of attention around our offshore tax evasion initiatives, but we have had a lot of attention also on business, making sure we engage with businesses and their cross-border transactions, and that we do a good job. And my view of doing a good job is understanding the business transaction that people are trying to accomplish, not overreaching and questioning things that are legal, and not pretending like the law is something that we wish it was, but applying the law. It's also catching places

where people are pushing the envelope and hurting the FISC and not complying with the law.

What we have done in the international area with business is we have really tried to shift the mindset of our agents, our economists, and others to say, "Your job is not to take individual transactions and compare it against the Code and nitpick it. Your job is to step way back and say, is there an issue overall and understanding this business transaction." I think that leads to fewer burdens for taxpayers and a better overall compliance approach. So we have been taking lots of people through training.

Even as we are cutting personnel and not allowing attrition hiring, we are ramping up staffing in our Large Business and International area, because a lot of issues have shifted to International. And then we have done a couple things. One, we have this Advance Pricing Agreement, where you can come in and get agreement on your transfer pricing methodology before you file, and you can get it for multiple years around certain kinds of transactions. We have actually moved that operation and combined it with our Competent Authority operation, which is the one who goes out and debates with other governments about where the person should pay tax. We were finding in the past some inefficiencies in transfer pricing, in which you get an APA but then it would get negotiated away with another country. And so we put those two together.

We also brought in two experts. One is Deputy Commissioner of International, Mike Danilack, who is a renowned expert in international tax issues, and he hired someone named Sam Maruca from Covington & Burling, who helped a lot of these organizations set up a lot of their arrangements. He is running the transfer pricing practice. And that group is building a set of expertise that is available to everyone. Again, the theory of the case is do not overreach and look at the wrong issues, and make sure you are engaged and looking at the right issues, because there is just a lot of money around transfer pricing. It is tough. A lot of times people are trying to get it right. Actually, a lot of times businesses are agnostic about where the cost is and they just want to get it right, and they are caught in these long issues with us and foreign governments, and so we have also stepped up our engagement with foreign governments.

Mrs. EMERSON. So do you anticipate, not necessarily this year, but in the near future that we may be able to grab a lot more revenue?

Mr. SHULMAN. I think a lot of it is just trying to get compliance right in the first instance. And that is very hard to measure, and, frankly, you might not want to measure it because once we have companies working with us cooperatively through issues before they happen, if we start advertising that brings in an extra \$3 billion, the boards might not be wanting to be so cooperative. But I think long run it is going to mean better compliance with the tax system.

But the heart of it is, a lot of the large business issues are international issues. The most serious one is transfer pricing. That is where we are shifting our large business operation, to make sure we are on top of those issues.

Mrs. EMERSON. Okay. Thank you so much. Mr. Serrano.

AUDITS

Mr. SERRANO. I just have two quick questions. I am told that you can more clearly see scams and potential fraud with your new systems, and I am hopeful that this will mean that your audits are better targeted. As you know, I have been concerned in the past that 44 percent of the audits at one time the IRS conducts, were on 17 percent of the taxpayers, disproportionately the taxpayers claiming the EITC deduction. Are the technology improvements that you have made going to enable you to make better decisions about where the IRS should do the audits?

Mr. SHULMAN. I think broadly, yes. We also are heavily involved in data analytics, and so we are analyzing data on a regular basis. We are seeing where we think there is fraud. We are then going out and testing the data we get with taxpayers to see where it is, and I think we are continually evolving. Our goal is to engage with taxpayers where there is noncompliance and not engage with taxpayers where there is compliance, and I think we are getting better at that every year.

Mr. SERRANO. And that 44 percent to 17 percent, that has changed, you think, somewhat?

Mr. SHULMAN. I guess I am not familiar with those numbers.

Mr. SERRANO. Well, the feeling was at one time, a few years ago, that there was more concentration on getting the EITC filers, or the people claiming the EITC, the earned income tax credit, than there was getting some other folks.

Mr. SHULMAN. We have tried to run a balanced program. And the statistics, I think, are most telling. If you make less than \$200,000, was a 1 percent audit coverage rate last year. If you make more than \$200,000, there was a 3.9 percent chance of getting audited. If you make more than \$1 million, there was a 12.5 percent chance of getting audited. And so we try to run a balanced program that looks where there is money and there is opportunity for evasion, but also has respectable coverage in all aspects. And it is a little higher than 1 percent in the EITC because it is a big refundable credit where we have seen fraud in the past. And with the EITC what we try to do is maximize participation and outreach; increase participation of those who deserve it, but also minimize the payments that go out that should not be going out.

RETURN ON INVESTMENT

Mr. SERRANO. Okay. And my last question is one where you might have to provide us with a chart or something, the committee, so that we can be clear on this. Your agency is one in which we talk about return on investment, and for good reason. I am confused as to which number are the right ones to use. Your testimony says that every dollar spent on enforcement returns \$4 as treasury. Your testimony also states that the IRS brings in \$200 for every dollar spent. So which one is it?

Mr. SHULMAN. So you can look at this in a number of ways. Let me explain each one that you have seen. Two hundred to one is from the \$12 billion IRS budget collecting \$2.4 trillion of revenue. It is the conversation that I had with Mr. Yoder about how I really think it is, especially when thinking about funding. The biggest

thing we do, and the most important thing we do, is that voluntary compliance and protect the \$2.4 trillion. And so that is just pure math: whatever our budget is, divided into however much comes in. And we need to run a fair and balanced program to make that happen.

Mr. SERRANO. How much you cost to run versus how much comes in?

Mr. SHULMAN. Yes. The 4 to 1 that I think you are referring to, and that is going to change with each budget we submit, that is taking, literally, initiative by initiative that we have proposed, looking at the 10-year historical averages of what those kinds of either examiners, or collection personnel, or analysts, based on grade levels, exactly how much they cost; what each has brought in traditionally to the FISC; what do those activities bring in based on our TERC figures which is an internal system that looks at real dollars coming in. So that is, literally, if you invest in this, history would tell us you get \$4 for those new investments, but it does not count all the money that is coming in from the base investment and everywhere else.

I think our staff has been in discussions with both Preparation staff and GAO around this whole issue, and I feel very comfortable with our numbers. But we are happy to engage you as much as you like on it.

Mr. SERRANO. Well, the last thing I can tell you, to close out, is that as Cardinal and Yankee fans, the Chairwoman and I are hoping that those baseball players have to pay more taxes this year because they would have been in the playoffs and World Series and made more. And so take that with you as you go back. Thank you.

Mrs. EMERSON. Does anyone have a debate about whether they deserve all the money that they get?

Mr. SERRANO. Oh, yeah. That is another issue for another day.

Mrs. EMERSON. I know, it is another issue. Anyway, Commissioner Shulman, thank you so much. Thanks to all of your colleagues who work so hard at the IRS. We appreciate what you do. And I look forward to talking with you on an ongoing basis as this budget process moves forward.

Mr. SHULMAN. Thanks so much.

Mrs. EMERSON. And once again, we will miss you, Floyd, but lots of luck to you.

[The information follows:]

Financial Services and General Government Subcommittee
Hearing on the Internal Revenue Service FY 2013 Budget

Questions for the Record Submitted by Chairwoman Jo Ann Emerson

BUDGET INCREASE

IRS's budget requests increases close to \$1 billion and over 5 thousand new employees.

Question. Before making this request to Congress, did the IRS conduct an analysis of anticipated workload, the size of workforce needed to process that workload, and the difference between the size and skillset of the IRS's current and future workforce? If so, please provide this analysis.

Response: Over the past few years of flat and declining budgets, the size of the IRS workforce has decreased significantly. Currently, the IRS has 5,000 fewer staff on its rolls than it did just last spring. The requested increase would restore these staffing losses in an environment where the overall workload of the IRS has clearly grown.

Before requesting an aggregate increase in resources, the IRS thoroughly reviews its operations looking for efficiencies and savings to fund increased responsibilities. As a result of that process, the IRS has included \$70.9 million in efficiency savings and other program reductions in the FY 2013 budget request, which when added to all savings realized from 2009 through our FY 2013 request will result in approximately \$1 billion in savings.

The President's Budget request for the IRS reflects a need to invest in personnel for specific areas and while reducing in areas where the agency seeks efficiencies. For example, the IRS has dramatically reduced its staffing devoted to processing paper tax returns as a result of the fundamental shift that has been achieved toward e-filed tax returns, while at the same time increasing staffing devoted to other activities such as combating refund fraud and identity theft.

TAXPAYER SERVICES

The Financial Services and General Government bill provides a single appropriation for the IRS's Taxpayer Services account. This account funds two types of activities: Pre-filing Taxpayer Assistance and Education, and Filing and Account Services.

Question. How does IRS decide to divide the account between the two activities?

Response: The IRS generally reviews its budget activities in light of taxpayer needs – in-person and telephone service, tax forms and publications, assistance with tax return preparation through partner organizations, and ultimately processing of tax returns. Once program level decisions are made, the associated funding needed for those activities is divided between the budget-level activities.

Question. After the IRS decides on an amount for Pre-filing Taxpayer Assistance and Education, how does the IRS decide to divide that amount among the different types of assistance?

Response As discussed above, these decisions are made around where taxpayer needs are greatest across the various service channels.

Question. Why does the IRS budget request a smaller increase for Taxpayer Services, than for Enforcement and Operations Support?

Response: The Budget reflects the priorities of the Administration, makes hard choices where necessary and includes resources for the IRS to achieve its Strategic Plan goals and objectives. The goals and objectives for Taxpayer Services are:

To improve service and make voluntary compliance easier, the IRS must:

- Incorporate taxpayer perspectives to improve all service interactions;
- Expedite and improve issue resolution across all interactions with taxpayers, making it easier to navigate the IRS;
- Provide taxpayers with targeted, timely guidance and outreach; and
- Strengthen partnerships with tax practitioners, tax preparers, and other third parties to ensure effective tax administration.

The Taxpayer Services President's Budget request for FY 2013 is \$2.3 billion in direct appropriations and 30,570 FTE. Ongoing investments in technology (funded in the Operations Support account) have resulted in substantial improvements in taxpayer service productivity, thereby enabling the IRS to more cost-effectively process returns and deliver services to taxpayers. The availability of internet and automated phone features have helped provide more options for taxpayers seeking assistance from the IRS. For example, in FY 2011, the IRS:

- Provided 100 Facilitated Self-Assistance (FSA) kiosks at 37 Taxpayer Assistance Centers (TAC). FSA kiosks are self-serve computer terminals connected to the internet that allow taxpayers to access the IRS tax-related services found on IRS.gov. More than 41,500 taxpayers used this service.
- Posted Volunteer Income Tax Assistance site locations on IRS.gov, which in prior years was only available via the IRS toll-free number. There were almost 168,000 hits to the listing on IRS.gov.
- Increased the number of Limited English Proficiency (LEP) products, translating key notices into the top five LEP languages and delivering an enhanced multilingual web site that offers an array of tax information.
- Broadened awareness of accessible tax products that serve and support hearing and visually impaired taxpayers, through partnership with the Library of Congress.

CLOSING THE TAX GAP

Question. In the absence of new powers or authority, how much funding and personnel would the IRS need to close the tax gap completely? And then how much of a burden would be placed on taxpayers from this increased enforcement?

Response: Consistent investments in a balanced mix of IRS initiatives would address the areas of highest tax compliance risk and serve to reduce the tax gap. While it would be implausible under the current tax code for the IRS to close the tax gap completely, even with expanded powers, judicious actions do improve voluntary compliance by (1) helping taxpayers comply voluntarily by providing helpful services; (2) expanding third-party information reporting (which helps taxpayers who want to comply, and makes economic transactions more transparent); and (3) simplifying the tax law (aiding those who want to comply).

OFFICE SPACE

The IRS pays almost \$700 million a year in rent to GSA. After salaries, rent is the IRS's single largest expense.

Question. How many leases does the IRS have with GSA?

Response: The IRS occupies space in 658 GSA-controlled buildings.

Question. How is IRS reducing its footprint, while remaining accessible to taxpayers?

Response: The IRS is focused on reducing its overall real estate footprint, and generally focusing on locations where employees can commute to a reasonable alternative location or make other arrangements. We are in the midst of working with NTEU to develop a revamped telework policy that will state that all employees working Frequent Telework (80 hours or more per month) will be required to share workstations. This policy would also include a recommendation for smaller workstations and manager offices.

Question. Does GSA ever offer advice on how to make the most efficient use of space or help IRS with plans to reduce space costs?

Response: In general, the IRS is in the best position to know its own space inventory and where space efficiencies can be realized. The IRS continues to work with GSA otherwise on its space reduction efforts, and work toward releasing unused space as quickly as possible.

Question. How extensively does IRS use telecommuting and which occupations at IRS are best suited for telecommuting?

Response: Approximately 36 percent of all IRS employees have approved telework agreements. These agreements allow IRS employees, with managerial approval, to telework on a normal workday and during unexpected office closures or emergencies. On average, over 20 percent of

IRS employees voluntarily telework each bi-weekly pay period. Two types of telework arrangements are available to employees with an approved telework agreement and managerial approval. These arrangements allow both full-time telework (must report to the IRS office two times per pay period) and ad-hoc, recurring or non-recurring telework up to 80 hours per month.

Telework is available to IRS employees in eligible occupations who meet certain eligibility requirements and whose duties can be effectively accomplished at an alternate worksite. Occupations include, but are not limited to, certain revenue agents, revenue officers, computer audit specialists, Estate and Gift Tax attorneys, research analyst, engineers, economist, appraisers and some secretarial and clerical staff. To participate in telework, an eligible employee must be performing successfully, able to effectively perform his or her job duties outside of the traditional office/team setting and independent of co-workers, support staff and/or his or her supervisor without adverse impact on the IRS mission, productivity and customer service.

Questions for the Record Submitted by Ranking Member José Serrano

VOLUNTARY DISCLOSURE PROGRAM

Question. Your testimony highlights the success of the Offshore Voluntary Disclosure Program, through which \$4.4 billion was collected between 2009 and 2011. What is the IRS's evaluation of the performance of the Offshore Voluntary Disclosure Program, and what are the lessons learned? In addition to resources, what else does the IRS need to ensure the success of the international tax enforcement initiative?

- 1) What is the IRS's evaluation of the performance of the Offshore Voluntary Disclosure Program, and what are the lessons learned?

Response: The success of the 2009 Offshore Voluntary Disclosure Program (OVDP) led the IRS to implement a second initiative in 2011 and a third initiative in 2012. Taxpayers with issues related to offshore accounts and unreported income continue to respond to our coordinated, sustained, and visible efforts in this area.

Based on the 2009 OVDP experience, we streamlined the process for submission of amended returns and related documents under the subsequent initiatives. For example, we developed a list of specific items individuals must submit with their application, to include: amended or delinquent tax returns, consents to extend the statute of limitations on assessment of tax and foreign bank and financial account reporting penalties, and bank statements for foreign accounts. This streamlined process has reduced substantially the time it takes to evaluate the voluntary disclosure. In addition, taxpayers are now required to calculate their offshore penalty and pay the tax, interest, and, if applicable, the failure to file and failure to pay penalties when they apply. Cases are not forwarded from our submission processing site to our field agents until the taxpayer has submitted all required documents and payment. Based on a field examination process we developed during the 2009 initiative, we continue to utilize centralized groups of agents throughout the United States to evaluate all voluntary submissions and we provide these agents with coordinated technical support.

Based on feedback from the legal and accounting community during the 2009 program, we modified our published guidance on the later initiatives, and the IRS's Criminal Investigation Division streamlined its "preclearance" process for preliminarily accepting a taxpayer into its Voluntary Disclosure Practice. Also, we continually respond to public comments and inquiries by maintaining a dedicated Frequently Asked Questions list on our public website.

Last, and importantly, information gathered through our voluntary initiatives has provided the IRS with substantial data that will help shape future enforcement efforts as we continue to focus on the offshore compliance problem.

- 2) In addition to resources, what else does the IRS need to ensure the success of the international tax enforcement initiative?

Response: Our offshore compliance effort, including both our voluntary initiatives and our direct enforcement action, has demanded tremendous resources. International enforcement initiatives such as the OVDP involve highly complex tax situations that require specialized skills that are in high demand across industries.

Beyond that, successful implementation of the new Foreign Account Tax Compliance Act (FATCA) regime, enacted as part of the HIRE Act in 2010, is critical to establishing a long-term solution to the offshore compliance challenge. FATCA calls for implementation of a comprehensive, worldwide system of information reporting and requires that we interact with foreign governments and foreign financial institutions across the globe in ways in which we have not in the past. Ensuring that FATCA is implemented effectively will require the dedication of substantial personnel and the development of major IT systems.

Finally, our offshore initiatives have brought to new light the complexity of our laws governing U.S. individual taxpayers living abroad. We need to focus on education, outreach, and customer service for U.S. taxpayers living overseas, so they can better understand and comply with their obligations.

BUSINESS SYSTEMS MODERNIZATION

Question. What are some of the other benefits of CADE 2, besides daily processing? What is your staff now able to do analysis on that they could not do before?

Response: The other benefits of CADE 2, in addition to daily processing, include:

- A single relational database containing trusted taxpayer data under a standard data model. This advancement sets the stage for modernizing the computer code used for tax return processing from the antiquated Assembly Language Code used for sequential (flat file) processing to a modern computer language, like Java.
- The addition of taxpayer history fields to address crucial components of the longstanding financial material weakness.

- The relational database allows the IRS to use modernized software and reporting tools to directly access data. The legacy flat file mainframe structure stored accounts sequentially requiring use of antiquated software languages to sort through millions of records to get the required information.
- The relational database allows the IRS to ensure, up front, that each taxpayer record contains data with consistent formats for dates, numbers, and characters, to ensure the data will load properly. The sequential flat file system the IRS used up to now did not have the ability to catch these types of errors.

The organization of the data we receive and, ultimately, the knowledge and intelligence we extract from it can show us the areas of greatest non-compliance, thereby contributing to more efficient and effective service and compliance programs.

EFFICIENCY SAVINGS

Question. Commissioner Shulman, your testimony states that this year's request includes \$166.3 million in efficiency savings, which brings your total efficiency savings from fiscal year 2009 forward to nearly \$1 billion. Please tell us some of the steps you have taken to streamline your agency and realize these savings?

Response: The IRS aims to consistently achieve a high return on investment for its activities while running a fiscally disciplined operation. The agency collects nearly \$200 in government revenues for every dollar spent on the IRS budget. The IRS has identified over \$70.9 million in efficiency savings and other program reductions in this year's request.

The IRS has used a variety of approaches to identify such savings, including:

- e-File savings resulting from reduced staffing in submission processing due to fewer paper returns filed
- Program efficiencies from enhanced technology and support structure improvements, streamlined and centralized work processes, enhanced workload selection techniques, and improved case selection tools
- Reduced supply and contractual service costs in information technology programs
- Expanded use of less expensive service delivery models (online tools and virtual tax assistance sites)
- Reduced procurement and contracting costs resulting from improved acquisition and acquisition-related program practices in project support, web learning, equipment, marketing, technical support contracts
- Reduce automated data processing, telecom and management consulting contracts
- Reduced travel, training, and administrative expenses through leveraging technology such as web conferencing for training and travel opportunities
- Reduced agency-wide printing of selected internal manuals, training materials, and other items
- Targeted attrition through hiring freezes in FY 2011

- Eliminated Selective Mailing of Forms and Publications and the automatic mailing of business tax products
- Reduced costs for rent resulting from space optimization efforts

RETURN ON INVESTMENT

Question. Commissioner Shulman, your agency is one in which we talk about return on investment, and for good reason. I, however, am confused as to which numbers are the right ones to use. Your testimony says that every dollar spent on enforcement returns \$4 to the Treasury. Your testimony also states that the IRS brings in \$200 for every \$1 spent. Can you provide, for our clarity, a chart that details the return on investment for the various functions of the IRS?

Response: For our new enforcement investments proposed in the FY 2013 Budget, we calculate a return on investment of \$4.3 to \$1. We are very conservative in our calculations for return on investment. This revenue is based on the results of the actual collections from cases. We calculate a 10 year rolling average based on the specific types of activities we have requested funding for.

Another way to look at returns on investment in the IRS can be done by dividing the annual enforcement revenue by the annual budget. For example, in FY 2011, the IRS enforcement revenue was \$55.2 billion and the FY 2011 Budget was \$12.1 billion. As noted below, this results in an IRS-wide enforcement ROI of over \$4.5 to \$1.

Internal Revenue Service				
Return on Investments - Enforcement Program				
ROI =	IRS Enforcement Program Revenue	\$55,229,000,000	=	\$4.5
	Total FY 2011 IRS Budget	\$12,146,123,000		

The ROI of \$200 to \$1 is based on the annual total revenue collected divided by the annual budget. For example, in FY 2011, the IRS collected \$2.415 trillion in taxes (gross receipts before tax refunds), 92 percent of federal government receipts. This amount is the total that taxpayers paid voluntarily, as well as what the IRS collected from its enforcement programs. As noted in the calculation below, this results in an ROI on total receipts of \$200 to \$1.

Internal Revenue Service				
Return on Investments - Tax Receipts				
ROI =	IRS Collected in taxes	\$2,415,000,000,000	=	~200
	Total FY 2011 IRS Budget	\$12,146,123,000		

IMPLEMENTATION OF HEALTH INSURANCE TAX CREDIT

In its ongoing implementation of relevant sections of the Patient Protection and Affordable Care Act, the IRS has proposed rules (REG-131491-10 Health Insurance Tax Credit; Notice of Proposed Rulemaking) on eligibility for subsidized Exchange coverage which would limit access to the Health Insurance Premium Tax Credit. Specifically, in your proposed rule, the definition of “minimum essential coverage” under section 1.36B-2(c)(3)(v) only considers the premium cost of self-only coverage when defining affordability for families. The cost of family coverage is far higher in nearly all cases, and by defining affordability for family coverage based on an individual, Treasury is unnecessarily limiting access to this credit, and essentially excluding many families from subsidized Exchange coverage.

Question. What is the reasoning behind this proposed definition? Does IRS have an estimate of the number of people who will be excluded from this credit as a result of this proposed definition? Is IRS in the process of considering an alternative interpretation of “affordability” based on the costs of family-based coverage?

Response: As noted, Treasury and the IRS have proposed regulations on the premium tax credit. The preamble to the proposed regulations describes the provisions, including the provision with respect to the affordability of employer-sponsored coverage and how that is determined not only for employees but also for their spouses and dependents. Treasury and the IRS have received numerous comments on the proposed regulations, including comments on this particular provision, and are considering all of them as they develop final regulations.

Questions for the Record Submitted by Congressman Kevin Yoder

501(c)(4)’s

Question. Commissioner Shulman: Has the IRS recently changed its policy with respect to the process for examining an organization’s application for 501(c)(4) tax exempt status? If so, what was the basis for changing procedures?

Response: We assume this question is referring to the initial application determination process for tax-exemption under section 501(c)(4) rather than the examination (i.e. audit) process. The standards for issuing a favorable determination letter or ruling on exempt status, including section 501(c)(4), are set out in Rev. Proc. 2012-9, 2012-2 I.R.B 261 (updated annually). These standards have been in place for many years. The process used to evaluate applications against those standards is described below.

The law allows a section 501(c)(4) organization to either apply to the IRS for recognition for tax-exempt status or to hold itself out to the public as tax-exempt rather than apply. All applications for tax-exempt status, including applications for status under section 501(c)(4), are filed with a centralized IRS Submission Processing Center, which enters the applications into the EP/EO Determination System and processes the attached user fees. The application is then sent to the

Exempt Organizations (“EO”) Determinations office in Cincinnati, Ohio for initial technical screening.

This technical screening is conducted by experienced revenue agents who review the applications and, based on that review, separate the applications into the following four categories:

- Applications that can be approved immediately based on the completeness of the application and the information submitted;
- Applications that need only minor additional required information in the file in order to approve the application;
- Applications that do not contain the information needed to be considered substantially complete; and
- Applications that require further development by an agent in order to determine whether the application meets the requirements for tax-exempt status.

Organizations whose applications fall into the fourth category are sent letters informing them that more development of their application is needed, and that they will be contacted once their application has been assigned to a revenue agent. The applications are sent to unassigned inventory, where they are held until a revenue agent with the appropriate level of experience for the issues involved in the matter is available to further develop the case.

Once the case is assigned, the revenue agent notifies the organization and reviews the application. Based upon established precedent and the facts and circumstances set forth in the application, the revenue agent requests additional information and documentation to complete the file pertaining to the exempt status application materials (the so-called “administrative record”) and makes a determination. Where an application for exemption presents issues that require further development to complete the administrative record, the revenue agent engages in a back and forth dialogue with the organization in order to obtain the needed information. This back and forth dialogue helps applicants better understand the requirements for exemption and what is needed to meet them, and it helps the IRS obtain all the information relevant to the determination.

Tools are available to promote consistent handling of full development cases. For example, in situations where there are a number of cases involving similar issues (such as credit counseling organizations, down payment assistance organizations, organizations that were automatically revoked and are seeking retroactive reinstatement, and most recently, advocacy organizations), the IRS will assign cases to designated employees to promote consistency. Additionally, in these cases, EO Technical (an office of specialists in Exempt Organizations), in consultation with the IRS Office of Chief Counsel, may develop educational materials to assist the revenue agents in issue spotting and crafting questions to develop cases consistently.

It is important to develop a complete administrative record for the application. The administrative record must be complete so that it either supports exemption or denial. If the application is approved, not only is the administrative record made publicly available (with certain limited exceptions), but organizations that act as described in the administrative record have reliance on the

IRS determination. If the application is denied, the organization may seek review from the Office of Appeals. The Appeals Office, which is independent of Exempt Organizations, reviews the complete administrative record and makes its own independent determination of whether the organization meets the requirements for tax-exempt status. It is to the organization's benefit to have all of its materials in the file in the event EO Determinations denies exemption and the organization seeks Appeals review. If, based on the information in the administrative record, the Appeals Office decides the organization meets the requirements for tax-exempt status, the application will be approved. If the Appeals Office agrees that the application should be denied, and the organization owes taxes, it may choose to challenge its non-exempt status by paying the tax owed and seeking a refund in federal court.

In those cases where the application raises issues for which there is no established published precedent or for which non-uniformity may exist, EO Determinations refers the application to EO Technical. In EO Technical, the applications are reviewed by tax law specialists whose job is to interpret and provide guidance on the law and who work closely with IRS Chief Counsel attorneys on the issues.

Similar to the process in EO Determinations, EO Technical tax law specialists develop cases based on the facts and circumstances of the issues in the specific application. EO Technical staff engages in a back and forth dialogue with the organization in order to obtain the information needed to complete the administrative record. If, upon review of all of the information submitted, it appears that an organization does not meet the requirements for tax-exempt status, a proposed denial explaining the reasons the organization does not meet the requirements is issued. The organization is then entitled to a "conference of right" where it may provide additional information. Following the conference of right, a final determination is issued. If the application is approved, the administrative record is made publicly available, and if the organization acts as described in the application filed, it has reliance on the IRS determination. If the application is denied, the applicant may challenge its non-exempt status by paying any tax owed as a taxable entity and seeking a refund in federal court.

Question. Who authorized this change?

Response: Please see response to the question above.

Question. Did the IRS have any communications with officials at the White House, political appointees of any part of the Administration, or Members of Congress or their staffs that prompted these changes?

Response: There have been no communications with the White House, political appointees or Members of Congress or their staffs that prompted any change to the application determination process for section 501(c)(4) organizations.

Question. Does the IRS use one examination regime for organizations deemed to engage in political activities and those that are not?

Response: We assume this question is referring to the initial application determination process for tax-exemption under section 501(c)(4) rather than the examination process. The process

discussed in response to question 1 applies to all organizations that apply for tax exemption under section 501(c)(4).

Question. What types of documentation are you now requiring organizations provide as part of the application review process?

Response: In order for the IRS to make a proper determination of an organization's exempt status, the Form 1024 instructs the applicant to report, among other things, all of its activities – past, present, and planned. The Form and instructions tell the organization that it must provide a detailed description of each individual activity, including the purpose of the activity and how it furthers the organization's exempt purpose, when the activity is initiated, and where and by whom the activity will be conducted. If the Form 1024 questions are answered with sufficient detail to make a determination, the applicant will not be asked additional questions. If, however, the applicant has not fully answered the questions, the detail provided is insufficient to make a determination or issues are raised by the application, then the IRS contacts the organization and solicits the information needed to provide complete responses to the Form 1024.

The range of organizations eligible for tax-exempt status under section 501(c)(4), the requirements they must meet, and the diversity of the facts and circumstances presented by the applications, require individualized consideration, and each development letter will vary depending on the facts and circumstances of the application.

Question. Does the IRS balance its examination process to ensure equitable treatment among organizations across the political spectrum?

Response: The IRS has a long tradition of being a nonpartisan nonpolitical agency. The IRS administers the nation's tax laws in a fair and impartial manner without regard to particular political views.

Question. How does the IRS target organizations for additional examination?

Response: We assume this question is referring to the initial application determination process for tax-exemption under section 501(c)(4) rather than the examination process. The following response relates to how the IRS decides that an organization's application for tax exemption requires further development. If you would like information on how organizations are selected for examination, we would be happy to provide that information as well.

The IRS will request additional information from an organization if the questions on the Form 1024 are not fully answered, the detail provided is insufficient to make a determination, or issues are raised by an application.

Where an application for exemption presents issues that require further development to complete the record, the IRS engages in a back and forth dialogue with the organization in order to obtain the needed information. This back and forth dialogue helps applicants better understand the requirements for exemption and what is needed to meet them, and it helps the IRS obtain all the information relevant to the determination.

The general procedures for requesting additional information to develop an application are included in the Internal Revenue Manual (IRM) section 7.20.2.

Question. On March 14, twelve US Senators wrote to you about IRS inquiries of organizations in Kentucky, Ohio, Tennessee, and Texas. Are you in receipt of that letter?

Response: The IRS has responded or is in the process of responding to a number of Congressional inquiries on this issue.

Question. In it, the Senators note that “it is imperative that organizations applying for tax-exempt status are able to rely on a consistent and foreseeable review structure from the IRS.” Is it your view that the IRS’s process for reviewing organizations’ 501(c)(4) status applications is today “consistent and foreseeable?”

Response: Please see response to questions above. All information gathered during the application process is evaluated based upon the requirements of the tax code and regulations.

Question. Given the importance to your agency’s credibility of addressing quickly the concern that the IRS examination process is being used for blatantly political purposes, when do you expect to respond to the Senators’ letter?

Response: Please see response to questions above.

Question. I want to ask in open session one question which was put to the IRS in the Senators’ March 14th letter: Will you provide this Subcommittee with copies of all IRS inquiries sent to and responses received from Priorities USA?

Response: Section 6104(a) of the Code permits public disclosure of an application for recognition of tax exempt status and supporting materials after the organization has been recognized as exempt. The application files of any organizations that have received recognition of tax exempt status are publically available. The Office of Legislative Affairs can assist in obtaining particular files. As noted above, however, the law does not require that section 501(c)(4) organizations obtain recognition of tax-exempt status from the IRS.

Question. Will you provide this Subcommittee with copies of all inquiries sent to organizations with or applying for 501(c)(4) status since January 1, 2012?

Response: Section 6103 of the Internal Revenue Code prohibits the disclosure of information about specific taxpayers unless the disclosure is authorized by some provision in the Internal Revenue Code. Section 6104(a) of the Code permits public disclosure of an application for recognition of tax exempt status and supporting materials only after the organization has been recognized as exempt. Under section 6110 of the Code, if the IRS ultimately denies the application for recognition of tax-exempt status, the denial letter and background information are subject to public inspection, with certain identifying and other information redacted.

The law does not allow the IRS to disclose information identifying organizations that may have received IRS requests for additional information until their applications have been approved. The files of any organizations that have received recognition for tax exempt status are available for your review. In addition, the redacted files of organizations for which exemption was denied are also available.

Question. On February 16, 2012, you received a letter from seven Democratic Senators urging you to do two things:

- 1) Re-evaluate the IRS' longstanding test used to determine the extent to which 501(c)(4) organizations may engage in political campaigns on behalf of or in opposition to candidates for public office.
- 2) "Investigate" wholly unsubstantiated "allegations" that "some political organizations" may be violating the current primary activity test.

Subsequent to you receiving this letter, Congress started to receive reports that an array of small, local 501(c)(4) organizations that openly and forcefully opposed the policies of President Obama—especially his healthcare law—operating in political battleground states, such as Ohio, started receiving very unusual and onerous requests for information from the IRS. As noted in a letter you recently received from members of the Senate finance committee, these requests sought unusual data on an incredibly short timeline.

Commissioner Shulman, either prior to or after February 16, 2012, did you, any member of your staff, any employee of the IRS, or any other person acting on your behalf or on behalf of the IRS, have any communications --orally or written in any form (including electronic communications), with any Senator, Senate staff person, or any official, officer, employee or agent of the Democratic National Committee, the Democratic Congressional Campaign Committee, or the Democratic Senatorial Campaign Committee about investigating 501(c)(4) entities.? If so, please provide the name of the parties to each such communication, the date of such communications, and the content of such communications.

Response: The IRS routinely receives examination referrals from a variety of sources including the public, media, Members of Congress or their staff. The IRS has a long standing process for handling referrals so that they receive an impartial independent review.

Question. Commissioner Shulman, either prior to or after February 16, 2012, did you, any member of your staff, any employee of the IRS, or any other person acting on your behalf or on behalf of the IRS, have any communications --orally or written in any form (including electronic communications), with President Obama, any appointee, official, employee, agent or other person acting on behalf of the White House, the Treasury Department, or the Obama Presidential Campaign, including Advisors to President Obama's campaign, or organizations affiliated with President Obama's campaign, such as officers, employees, donors or agents of "Super PACs" supportive of the President's re-election about investigating 501(C)(4) entities? If so, please provide the name of the parties engaged in such communication, the date of such communications and the content of such communication.

Response: There have been no such communications.

Question. Will you take all possible steps and issue any directives necessary to ensure that no records, recordings, emails, communications, records, files or correspondence in any form whatsoever related IRS inquiries, communications with or investigations of 501(c)(4) entities are preserved, including exempting them from any recurring document destruction or other electronic communications policies that may in the ordinary course result in their destructions, alteration or loss?

Response: The IRS has a standard document retention policy that would apply in this case.

Question. Commissioner Schulman, as you know, historically, not just 501(c)(4) entities, but also 501(c)(5)(labor organizations) and (c)(6)(trade associations) have been permitted to engage in campaigns for public office so long as such intervention does not constitute the organization's primary activity. As evidenced by the letter of February 14, 2012, Congress is aware of many burdensome and unusual requests with deadlines as short as two weeks to 501(c)(4) entities that have opposed the President and his policies.

Please provide to us any correspondence since January 1, 2011 requesting similarly detailed information on similarly short deadlines from 501(c)(4) or (c)(5) entities with history of supporting the President and or his policies that are of similar size and sophistication to the entities that have received the letter referenced in the Senate Finance Committee letter of February 14, 2012.

Response: As discussed, the IRS does not classify organizations based on the specific political views of the organization. Internal Revenue Manual section 7.20.2.7.1 outlines the standard response time (21 days) for applicants to submit additional information.

As noted above, section 6103 of the Internal Revenue Code prohibits the disclosure of information about specific taxpayers unless the disclosure is authorized by some provision in the Internal Revenue Code. Section 6104(a) of the Code permits public disclosure of an application for recognition of tax exempt status and supporting materials only after the organization has been recognized as exempt. Under section 6110 of the Code, if the IRS ultimately denies the application for recognition of tax-exempt status, the denial letter and background information are subject to public inspection, with certain identifying and other information redacted.

The law does not allow the IRS to disclose information identifying organizations that may have received IRS requests for additional information until their applications have been approved. The files of any organizations that have received recognition for tax exempt status are available for your review. In addition, the redacted files of organizations for which exemption was denied are also available.

Question. Will you also provide to this Committee a complete list of all 501(c)(4) or (c)(5) entities that have received inquiries from the IRS concerning their tax exempt status or factors bearing on their tax exempt status or requesting information about the identity of their donors since December 15, 2011, as well as copies of all such requests.

Response: Please see response to prior questions.

Question. Commissioner Schulman, if it should ever dawn on the Inspector General tasked with overseeing your agency that the matters about which I have been asking you warrant scrutiny to reassure the public that the IRS is not once again being subordinated to partisan political purposes, will you cooperate with reservation and direct every appointee, officials, employee and contractor of your agency to do so as well?

Response: The IRS is dedicated to administering the nation's tax laws in a fair and impartial manner. There are both statutory and policy safeguards in place to ensure this, and it is something we take very seriously. The IRS fully cooperates with any Inspector General inquiry.

Questions for the Record Submitted by Congressman Mario Diaz-Balart

IRS PROPOSED REGULATION ON BANKS REPORTING OF INTEREST PAID TO NON-RESIDENT ALIENS

Question. Is this regulation still going to be finalized and if so when will it be finalized?

Response: The IRS issued final regulations for reporting deposit interest paid to nonresident aliens in Treasury Decision 9584, which it filed with the Federal Register and made public on April 17, 2012. The regulations are effective for interest paid on or after January 1, 2013.

Question. What countries will the information collected be shared with?

Response: The United States will only share information with countries with which it has entered into an agreement to exchange tax information. The countries with which the United States currently has such an agreement in effect are listed in section 3 of Revenue Procedure 2012-24, released on April 17, 2012.

When an information exchange agreement is in effect, the IRS will evaluate specific requests to share deposit interest information on a case-by-case basis, taking into account the appropriateness of the request under the terms of the agreement and the requesting jurisdiction's compliance with the agreement's requirement to keep exchanged information confidential and to use the information only for purposes of administering and enforcing its tax laws.

In appropriate circumstances, the IRS may agree to exchange deposit interest information on an automatic basis with a country. A determination to enter into an automatic exchange relationship, however, will be made only after further assessment of a country's confidentiality laws and practices and the extent to which the country is willing and able to reciprocate. Section 4 of Revenue Procedure 2012-24 identifies Canada as the only jurisdiction that the IRS and Treasury Department have determined to be an appropriate automatic exchange partner with respect to deposit interest, but the revenue procedure will be updated as additional countries are identified.

Question. The law states that the U.S. can only exchange tax information with countries we have tax treaties or exchanges with. Why does the IRS plan on collecting this information from banks on all non-resident aliens and not just the non-resident aliens of countries we have tax treaties or exchanges with?

Response: The final regulations require banks to report only deposit interest paid to residents of a country with which the United States has agreed, through treaty or other exchange agreement, to exchange tax information. To relieve any burdens on banks to collect a limited scope of information, banks are permitted to report all interest paid to nonresident aliens.

Question. You stated in your testimony that if my main concern is this information being shared with Venezuela "it is not going to be a concern." Since we do have a tax treaty with Venezuela, what assurances can you give me that this information will not be exchanged with the Chavez regime?

Response: While we do have a tax treaty with Venezuela, we do not have an active treaty-based relationship with Venezuela between our respective competent authorities. Thus, we are not engaged currently in information exchange with Venezuela of any kind, nor are we engaged in any government-to-government communication either on general treaty matters or on the resolution of disputes in the context of specific cases. Therefore, we are simply not in a position to evaluate whether or not Venezuela is in conformity with international standards on tax information use and confidentiality. This situation precludes our sharing information with Venezuela.

Question. Has a cost benefit analysis been done on the proposed regulation and if so, what were the findings?

Response: During the course of finalizing these regulations, it was determined that the regulations are not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment, which generally includes a formal cost-benefit analysis, was not required.

Questions for the Record Submitted by Congressman Steve Womack

REAL ESTATE INVESTMENT TRUSTS

Recently, the markets have taken notice of the successful shift across the timber industry to Real Estate Investment Trusts (REITs), and there is an increased interest among other sectors to attempt similar restructuring efforts for tax purposes. In fact, a number of technology and information services companies are considering converting into REITs. There is concern that some companies considering such a conversion may not be traditional REIT candidates, because they derive most of their income from active, service-oriented operations as opposed to passive, income-producing real estate.

Question. Where do you see this trend going and what impact will it have on tax revenues?

Response: We have no analysis to suggest any trends on this issue.

Question. Is the REIT corporate structure a good fit for service-oriented businesses?

Response: Any corporation that meets the REIT qualification requirements set forth in section 856 of the Code is permitted to elect on its tax return to be treated as a REIT for federal income tax purposes. The primary substantive qualification requirements are that REITs must invest predominantly in real estate and real estate related assets (such as mortgages) that 95 percent of their gross income each year be derived from certain passive sources, and that 75 percent of their gross income each year be real-estate related (for example, rents from real property). The Code contains specific provisions that enable timber companies to qualify as REITs. In the absence of comparable provisions, a service-oriented business is exceedingly unlikely to qualify.

Question. Does the IRS have the statutory authority to approve REIT conversions that change the tax treatment of these service-oriented businesses?

Response: The IRS does not have the authority to approve or deny a corporation's conversion to a REIT. A corporation effects such a conversion by electing on its tax return to be treated as a REIT. If a corporation makes this election, but does not satisfy the REIT qualification requirements, it is not taxed as a REIT.

Question. Do you believe that the increased interest from the technology and information services sector to convert into REITs – and the possibility of the IRS approving these conversions – will undermine Congress's efforts on corporate tax reform?

Response: The IRS does not have the authority to approve or deny a corporation's conversion to a REIT. We have no basis on which to form an opinion on whether the increased interest in such conversions from the technology and information services sector undermines Congress' efforts on corporate tax reform.

Question. What factors does the IRS consider in private letter rulings for companies – particularly those companies in the technology and information services industry – converting into REITs?

Response: We do not issue private letter rulings regarding a company's conversion into a REIT. We do, however, issue private letter rulings regarding whether a specific asset or specific income source is sufficiently related to investments in real estate to satisfy the qualification requirements set forth in section 856(c) of the Code. Our role in that regard is limited to determining whether the specific asset or income source fits within the specific listed qualifying items in section 856(c), as those items have been interpreted.

Question. Does the IRS evaluate the impact of potential REIT conversions on job creation and the economy when making a private letter ruling?

Response: We do not issue private letter rulings regarding a company's conversion into a REIT. The IRS does issue private letter rulings with respect to whether specific assets or income

sources meet the qualification requirements for a REIT. The impact on job creation and the economy are not among the factors to be taken into account under section 856(c) of the Code.

Question. What is the IRS's guidance regarding potential REIT candidates that own only a small percent of their properties and lease the remainder?

Response: Section 856(c)(4)(A) of the Code requires that at the close of each quarter of the taxable year at least 75 percent of the value of a REIT's total assets is represented by real estate assets, cash and cash items, and Government securities. Section 856(c)(5) defines "real estate assets" as including an "interest in real property," which in turn is defined to include, among other types of interests, leaseholds of land or improvements thereon.

Question. What is the IRS's guidance regarding potential REIT candidates that lease a majority of real estate from already established REITs?

Response: Section 856(c)(4)(A) of the Code requires that at the close of each quarter of the taxable year at least 75 percent of the value of a REIT's total assets is represented by real estate assets, cash and cash items, and Government securities. Section 856(c)(5) defines "real estate assets" to include an "interest in real property," which in turn is defined to include, among other types of interests, leaseholds of land or improvements thereon. For REIT qualification purposes, whether the owner of property that is subject to such leasehold is itself also a REIT is immaterial.

Questions for the Record Submitted by Congresswoman Barbara Lee

DIVERSITY AT THE IRS

Dodd Frank required the Treasury Department to set up an Office of Minority and Women Inclusion (OMWI) to "be responsible for all agency matters relating to diversity in management, employment and business activities."

Question: Can you provide the Subcommittee with an update on the how the IRS is working with the Treasury OMWI office in their efforts at creating their office of Minority and Women Inclusion?

Response: Section 342 of the Dodd-Frank Act required the establishment of an Office of Minority and Women Inclusion (OMWI) in two Treasury components, the Office of the Comptroller of the Currency and the Departmental Offices. These OMWI offices do not have direct responsibilities related to other parts of Treasury. The IRS' Equity, Diversity and Inclusion Office has been closely working with the Department on a number of initiatives designed to promote diversity, including serving as a member of the working group (which included the OMWI for Departmental Offices) to develop the Treasury's Diversity and Inclusion Strategic Plan. The IRS worked closely with the Department to perform an in-depth assessment of the Workforce Analytics system used to monitor the diversity of the workforce. Most recently, the IRS partnered with Treasury to develop the Department's Diversity and Inclusion Strategic Plan as called for by Executive Order 13583, Establishing a Coordinated Government-Wide Initiative

to Promote Diversity and Inclusion in the Federal Workforce. Treasury's collaboratively developed Strategic Plan sets forth the Department's diversity vision, mission and strategic priorities as well as corresponding goals.

Question: Please provide an annual breakdown of the diversity of the staff at the IRS, by pay grade and executive category and continue to update the subcommittee on the diversity plans, outreach and other efforts the IRS is making to strengthen the diversity of the IRS employees, procurement processes and contractors.

Response: The table included below, *IRS Workforce Diversity*, provides an annual snapshot of the IRS permanent workforce stratified by pay-grade, race/ethnicity and gender, as well as the participation rates for persons with disabilities. IRS leadership approved and established the IRS equity, diversity and inclusion corporate priorities and a five-year strategic plan. In accordance with Executive Order 13548, the IRS has also developed a roadmap plan to continue increasing employment, retention, and advancement of individuals with disabilities over the next several years. The IRS has undertaken a variety of outreach and education initiatives designed to increase awareness and understanding of tax compliance as well as to recruit the talented men and women needed to accomplish our mission. Using both traditional and new media outlets, the IRS vigorously markets itself as an "Employer of Choice" to minority serving institutions, employee organizations, professional associations and other groups focused on women, minorities, persons with disabilities, and veterans. As a result of our robust recruitment programs at every level of the organization and outreach to numerous diverse professional organizations, a recent Treasury Inspector General for Tax Administration (TIGTA) audit of the IRS senior executive service ranks found that IRS diversity demographics compared favorably with other federal agencies.

The IRS has made great strides in our procurement processes and contractors. In FY 2011, for the first time in history, the IRS met all of its socio-economic acquisition goals (see table below, *IRS Procurement Socio-Economic 2011 Goals & Accomplishments*), which also enabled the Treasury Department to meet all socio-economic goals--the only cabinet level Department to do so. We will continue to strengthen our diversity through our outreach through the HUBZone Council, HUBZone firms, and the use of Federal Business Opportunities (FedBizOps).

GS/GM, SES and Related Grade	TOTAL EMPLOYEES		Hispanic or Latino		Non-Hispanic or Latino												[56-64] Disability	Targeted Disability				
					White						Black or African American		Asian		Native Hawaiian or Other Pacific Islander				American Indian or Alaska Native		Two or More Races	
					male	female	male	female	male	female	male	female	male	female	male	female			male	female	male	female
	All	male	female	male	female	male	female	male	female	male	female	male	female	male	female	male			female			
GS-01	#	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
	%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
GS-02	#	73	28	47	7	0	10	16	5	16	1	1	0	1	0	2	0	1	1	12		
	%	100.0%	38.32%	64.38%	9.59%	10.99%	17.81%	21.92%	6.89%	24.69%	1.37%	1.37%	0.00%	1.37%	0.00%	2.74%	0.00%	1.87%	42.47%	16.44%		
GS-03	#	2657	645	2011	121	455	587	1601	96	485	25	45	2	4	5	15	9	15	337	81		
	%	100.0%	24.31%	75.69%	4.55%	17.12%	14.57%	37.67%	3.61%	17.12%	0.94%	2.48%	0.08%	0.19%	0.23%	0.69%	0.34%	0.63%	12.68%	3.05%		
GS-04	#	9063	2079	6984	320	1381	1330	3605	313	1603	80	250	2	15	33	80	11	50	1180	302		
	%	100.0%	22.94%	77.06%	3.54%	15.34%	14.66%	39.78%	3.48%	17.69%	0.89%	2.76%	0.02%	0.17%	0.35%	0.88%	0.12%	0.55%	13.11%	3.33%		
GS-05	#	8182	2180	6002	290	777	1343	2687	411	1833	110	222	4	9	10	44	12	40	1062	265		
	%	100.0%	26.61%	73.39%	3.54%	9.48%	16.39%	37.66%	5.02%	22.38%	1.34%	2.71%	0.05%	0.11%	0.12%	0.54%	0.15%	0.49%	12.96%	3.11%		
GS-06	#	6237	1755	4482	210	539	1170	2471	252	1219	92	190	3	12	6	48	10	33	859	139		
	%	100.0%	28.14%	71.86%	3.37%	8.64%	18.76%	39.62%	4.03%	19.54%	1.45%	2.57%	0.05%	0.19%	0.13%	0.77%	0.16%	0.55%	11.03%	2.27%		
GS-07	#	12335	3028	9306	353	1233	1991	4282	526	2865	121	214	1	11	20	75	17	39	1318	268		
	%	100.0%	24.58%	75.41%	2.89%	10.00%	16.14%	34.77%	4.28%	23.19%	0.95%	1.73%	0.01%	0.09%	0.16%	0.61%	0.14%	0.32%	10.65%	2.26%		
GS-08	#	10189	2876	7313	369	865	1054	3425	504	2774	105	191	4	5	15	65	15	27	1190	238		
	%	100.0%	28.23%	71.77%	3.62%	8.49%	10.39%	33.61%	4.95%	27.23%	1.03%	1.86%	0.04%	0.05%	0.14%	0.56%	0.15%	0.25%	11.74%	2.32%		
GS-09	#	8185	2646	5540	301	699	1721	2680	415	1914	164	193	9	10	11	45	15	28	753	137		
	%	100.0%	32.32%	67.68%	3.66%	8.43%	21.15%	32.49%	5.07%	23.38%	2.00%	2.16%	0.11%	0.12%	0.13%	0.56%	0.18%	0.34%	9.20%	1.67%		
GS-10	#	581	144	436	14	61	102	407	26	218	4	10	0	2	0	5	0	1	54	10		
	%	100.0%	17.16%	82.84%	1.65%	7.29%	11.99%	47.83%	2.00%	38.62%	0.47%	1.98%	0.00%	0.24%	0.00%	0.89%	0.00%	0.12%	7.52%	1.93%		
GS-11	#	8965	3831	5134	311	678	1991	2951	500	1925	190	298	5	10	14	36	20	28	739	136		
	%	100.0%	33.81%	66.19%	3.47%	7.59%	22.21%	32.92%	5.58%	21.47%	2.12%	3.30%	0.06%	0.11%	0.16%	0.40%	0.22%	0.42%	8.24%	1.41%		
GS-12	#	7981	3144	4837	249	428	2128	2872	526	1514	205	278	5	9	21	35	14	20	653	113		
	%	100.0%	39.39%	60.61%	3.12%	5.12%	26.68%	35.99%	6.59%	19.57%	2.51%	3.48%	0.06%	0.11%	0.25%	0.44%	0.18%	0.25%	8.19%	1.42%		
GS-13	#	15387	7542	7845	482	538	5504	4575	842	1914	588	715	15	15	53	66	37	22	993	160		
	%	100.0%	49.02%	50.98%	3.15%	3.50%	35.91%	29.73%	5.47%	12.40%	3.85%	4.65%	0.10%	0.10%	0.34%	0.40%	0.24%	0.14%	6.45%	1.04%		
GS-14	#	7535	3736	3799	214	206	2798	2238	457	1068	260	242	3	4	34	31	20	18	465	72		
	%	100.0%	49.58%	50.42%	2.84%	2.73%	36.67%	29.69%	6.07%	14.17%	3.45%	3.21%	0.04%	0.05%	0.32%	0.41%	0.27%	0.24%	6.09%	0.95%		
GS-15	#	2385	1151	1154	66	52	840	715	162	321	67	57	4	0	5	5	2	4	140	18		
	%	100.0%	48.59%	50.67%	2.95%	2.28%	35.44%	30.02%	7.33%	13.85%	2.91%	2.47%	0.17%	0.00%	0.21%	0.22%	0.69%	0.17%	6.07%	0.39%		
Senior Level Position	#	231	120	111	8	5	81	82	22	20	7	4	1	6	1	0	0	0	11	1		
	%	100.0%	51.96%	48.03%	3.45%	2.16%	35.06%	35.50%	9.52%	8.69%	3.03%	1.73%	0.43%	0.00%	0.43%	0.00%	0.00%	0.00%	4.76%	0.43%		
Executive (EX)	#	1	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0		
	%	100.0%	100.00%	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%		
Total GS Permanent Workforce	#	100188	34103	66085	3337	7889	23294	34573	5067	19651	2015	2993	89	107	214	844	182	333	9535	1994		
	%	100.0%	34.04%	65.96%	3.33%	7.88%	23.22%	34.51%	5.06%	19.61%	2.01%	2.96%	0.09%	0.11%	0.21%	0.84%	0.18%	0.33%	9.62%	1.99%		
Total Permanent Workforce	#	100840	34103	66085	3338	7889	23294	34582	5081	19832	2016	2993	89	107	215	844	182	333	9542	1994		
	%	100.0%	34.07%	65.93%	3.33%	7.88%	23.24%	34.56%	5.07%	19.62%	2.01%	2.96%	0.09%	0.11%	0.21%	0.84%	0.18%	0.33%	9.62%	1.99%		
SOURCE	MC-15 Table AA-1																			MC-15 Table B4-1		

SOURCE:

MD-715 Table A4-1

MD-715 Table B4-1

IRS Procurement Socio-Economic 2011 Goals & Accomplishments

Category*	\$ Awarded	Goal	Accomplished
Small Business	\$564,396,399	28.50%	31.68%
8(a)	\$180,829,771	2.50%	10.15%
Small Disadvantaged	\$207,940,383	5.00%	11.67%
Woman-Owned	\$243,232,515	5.00%	13.65%
Historically Underutilized Business Zones (HUBZones)	\$72,699,576	3.00%	4.08%
Service Disabled, Veteran-Owned Small Business (SDVOSB)	\$61,062,939	3.00%	3.43%
Veteran-Owned	\$129,118,009	No Goal	7.25%

*Awards can be counted in more than one category

POSSIBLE IMPACT OF BUDGET CUTS TO THE IRS

Question: How will cuts to the IRS or a possible sequestration and even greater reductions impact the services and enforcement efforts of the IRS?

Response: The Congressional Budget Office (CBO) has estimated that a sequester would result in a 7.8% reduction from non-exempt discretionary accounts in FY2013. Cuts of this magnitude would greatly impair the IRS's ability to administer the law. More than 70 percent of the IRS budget supports labor costs, and hence a reduction along the lines of the sequester could only be achieved by through significant reductions in staffing. This would have an especially dramatic effect on both the service and enforcement programs. Cuts in taxpayer services staff would degrade the IRS' taxpayer outreach efforts and its ability to respond to taxpayer inquiries in a timely manner. The large reduction to enforcement programs under sequestration would result in billions of dollars of lost enforcement revenue, far in excess of IRS budgetary savings. This reduction would further increase the federal deficit.

Question: There was some discussion about just what the return for the taxpayer dollar is when it is invested in enforcement and service efforts at the IRS. Given that the current budget of the IRS is approximately \$12 billion and the return on that investment is \$2.4 trillion in gross receipts and the tax gap is already \$450 billion annually, what would be the impact on federal revenue of additional cuts to the IRS budget?

Response: In the last five years, the IRS has achieved almost \$1 billion in savings and efficiencies across the organization without significantly impairing front-line enforcement programs. However, it would be difficult for IRS to achieve further reductions without negatively affecting front-line taxpayer facing and enforcement programs.

Any further reductions to the IRS budget such as those anticipated under sequestration could not be accomplished without considerable staff reductions to all appropriations accounts through furloughs and/or reductions in force. These staff reductions would affect the ability of the IRS to carry out its core mission, and would result in reductions to core enforcement programs such as the automated underreporter program, field collection, individual audits, large and small corporate exams, Bank Secrecy Act and specialty activities, and money laundering activities,

resulting in a loss of billions of dollars in enforcement revenue annually. Reductions would also further degrade taxpayer outreach, telephone levels of service and other services such as toll-free requests for transcripts, refund inquiries, and tax law assistance, which could reduce voluntary compliance and revenues even further.

Question: Is there any risk that critical services and mission critical work at the IRS would be impacted and would cuts to the IRS enforcement efforts actually increase the deficit?

Response: Yes, reductions of the magnitude implied by sequestration would result in considerable staff reductions. This would cost billions of dollars in enforcement revenue; undermine the IRS's ability to protect revenue from identity theft; and increase the issuance of erroneous refund payments.

BUDGET CUT IMPACT ON IRS EFFORTS ON EITC AND CHILD TAX CREDIT

The Earned Income Tax Credit is one of the most effective anti-poverty efforts that we have and the Child Tax Credit protects millions of children from poverty as well.

These credits are needed by more American families now, more than ever.

Question. How will deep cuts to the IRS effect efforts to maximize the proper payment of credits to the families who need them most?

Response: We take our responsibility to deliver EITC and CTC to eligible families very seriously.

Budget cuts would lead to a noticeable decline in customer service to the taxpayers who are confronted with the complex tax laws associated with these credits and need help from the IRS. Thirty-six percent of EITC taxpayers and thirty-five percent of CTC taxpayers prepare and file their own returns. We do provide many channels to share information on these credits, including IRS.gov which provides a link to our EITC Assistant, an electronic tool to determine if they qualify for the credit.

Question. What does the IRS need to do and what other agencies do they need to coordinate with to intercept the large number of improper payments going out to tax payers before they are paid instead of having to clawback funds after they are paid out?

Response: The causes of EITC and CTC errors are many and arise from the highly complex nature of family living arrangements, as well as complexity in tax law, the ever shifting EITC-eligible population, and the refundable nature of the credit which increases the scope of unintentional errors, as well as abuse by taxpayers and preparers.

About sixty-five percent of taxpayers who claim EITC also claim the CTC. Generally the same child is at issue for all child related tax benefits claimed on a return. Therefore, when we determine a child does not meet EITC eligibility requirements, the child will generally not meet

the requirements for other tax benefits either. We disallow all appropriate child-related credits and deductions concurrently.

The IRS works with other government agencies and third parties to use available information to identify questionable returns. However, the IRS receives much of this information after returns are already processed and refunds issued. The IRS must balance getting refunds to eligible taxpayers as quickly as possible, while ensuring that appropriate and prudent controls and filters are in place to minimize errors and prevent fraud. The IRS continues to look for new sources of data which may be used to verify eligibility of a child for EITC, CTC and other child-related benefits and identify noncompliance.

The IRS currently uses information from the Social Security Administration to verify Social Security Numbers (SSNs). The IRS immediately rejects electronic returns and halts the issuance of refunds when the SSNs cannot be verified. We also use SSA data to verify relationship between the taxpayers and children and Department of Health & Human Services (HHS) Federal Case Registry to help verify the residency requirement for our EITC examinations, 60 percent of which are conducted before we issue an EITC refund.

The IRS systemically requests wage information from HHS's National Directory of New Hires database, verifies employment and then manually validates earned income for potentially fraudulent EITC returns. This database, provided by HHS, contains quarterly wage information on all wage earners, not just new hires, and under law can be used to administer EITC. The President's Budget for FY2013 proposes expanding access to this database by amending the Social Security Act, giving the IRS more capabilities to match data, verify taxpayer claims during return processing, prepare substitute returns for non-compliant taxpayers, and identify levy sources. Data obtained by the IRS from the NDNH would be protected by existing taxpayer privacy law, including civil and criminal sanctions.

The IRS also uses information on prisoners, secured from the state departments of correction and the Federal Bureau of Prisons to stop fraudulent prisoner claims; however the authority to exchange data expired at the end of 2011. The President's Budget for FY2013 seeks to reinstate the data-sharing provision, with changes to increase the provision's efficiency and effectiveness.

In FY 2011, we closed over 1 million EITC underreporter cases protecting over \$1.3 billion. The IRS has begun exploring the issues surrounding earlier receipt of third-party data to allow us to perform matching earlier in the process.

As noted above, the IRS conducts examinations of questionable returns, selecting them based on business rules and using available third party data. For FY 2011 we conducted almost 484,000 EITC examinations, with 60 percent before the refund was issued, protecting over \$2 billion. CTC was also adjusted in these examinations.

Returns are processed through our Electronic Fraud Detection System which is designed to identify schemes and suspicious patterns. For returns identified as questionable, the refunds are frozen and are reviewed by a team of employees before refunds are released. The IRS has

secured advance wage information from some large employers, which is used to screen questionable claims during processing as part of our Questionable Refund Program.

The IRS is taking other actions to reduce EITC improper payment rates. For EITC, paid preparers have specific due diligence requirements under Internal Revenue Code section 6695(g). These actions include the following:

1. New Return Preparer Initiative – Under this new program, paid tax return preparers are now required to register with the IRS and complete certain continuing education and testing requirements. We have the ability remove or suspend problematic preparers from the ability to prepare returns. Testing and enforcement strategies will include a focus on EITC issues. Because 62 percent of EITC returns are prepared by paid preparers, we expect this new initiative to have a positive impact on EITC returns.
2. Due Diligence Checklist – Beginning this filing season for tax year 2011 EITC returns, paid tax returns preparers are required to include the existing preparer due diligence checklist with the filed return. This change will help ensure that preparers are taking appropriate due diligence steps in the preparation of returns. Under prior rules, tax return preparers were only required to retain a copy of the checklist for their records. Failure to satisfy this requirement will result in a penalty on the preparer next filing season and noncompliant preparers will be warned this year.
3. Increase in EITC Due Diligence Penalty – Congress enacted an increased penalty from \$100 to \$500, beginning with tax year 2011 returns, for preparers who fail to exercise due diligence.
4. EITC-Specific Preparer Strategy – The IRS continues to refine and evaluate our focus on activities associated with a variety of EITC paid preparer treatments, based on risk-based selections, including due diligence audits, visits by revenue and criminal investigation agents, streamlined injunctions, and educational and compliance notices to first-time and experienced preparers to influence the accuracy of EITC returns filed. This year we tested an effort to address noncompliant EITC preparers real-time as they filed EITC returns.
5. Strategy for Multiple Use of Children for EITC (and other child-related benefits) – The IRS updated its strategy to address situations where multiple taxpayers claim the same child for EITC and other child-related benefits. In addition to conducting additional research to better focus our efforts, the IRS is taking stronger measures to address duplicate claims in a pre-refund audit environment.

Questions for the Record Submitted by Congressman Ed Pastor

REIT TRENDS

Question. Recently, the markets have taken notice of the successful shift across the timber industry to Real Estate Investment Trusts (REITs) and there is an increased interest among other

sectors to attempt similar restructuring efforts for tax purposes. In fact, a number of high-profile technology and information services companies have just announced their intentions to convert into REITs. Where do you see this trend going and what impact will it have on tax revenues?

Response: We have no analysis to suggest any trends on this issue.

JOB GROWTH

Question. As you know, REITs must distribute 90 percent of their taxable income to shareholders each year. While this pass-through model makes sense for bona fide REITs (since maintaining and managing their properties requires little retained earnings), I am concerned that innovative technology and information services companies would be required to make dramatic cuts in capital expenditures, long-term investments and human capital in order to comply with the 90 percent pass-through requirement. Additionally, these companies would no longer be able to retain and reinvest their earnings to grow their businesses and create – or possibly maintain – jobs. So at a time when America needs to be creating jobs, this part of the tax code may be creating an incentive to cut jobs. Does the IRS evaluate the impact of potential REIT conversions on job creation and the economy when making a private letter ruling, particularly those PLRs concerning technology and information services companies?

Response: We do not issue private letter rulings regarding a company's conversion into a REIT. We do, however, issue private letter rulings regarding whether a specific asset or specific income source is sufficiently related to investments in real estate to satisfy the qualification requirements set forth in section 856(c) of the Code. Our role in that regard is limited to determining whether the specific asset or income source fits within the specific listed qualifying items in section 856(c), as those items have been interpreted.

TAX BASE/CORPORATE TAX REFORM

Question. Recently, a number of technology and information services companies have announced their intentions to convert into REITs in order to receive favorable tax treatment by the IRS. These companies are not traditional REIT candidates, as most of their income derives from active, service-oriented operations as opposed to passive, income-producing real estate. REITs serve a legitimate purpose, but I am concerned that these service-oriented companies may be using the REIT structure in a way that falls outside of congressional intent. Is the REIT tax designation a good fit for service-oriented businesses? Does the IRS have the statutory authority to approve REIT conversions that so dramatically change the tax treatment of these service-oriented businesses?

Response: The IRS does not have the authority to approve or deny a corporation's conversion to a REIT. A corporation effects such a conversion by electing on its tax return to be treated as a REIT.

Question. I am concerned that the recent increased interest from the technology and information services sector to convert into REITs – and the possibility of the IRS approving these conversions – will undermine Congress's efforts on corporate tax reform. We've already seen

significant tax base erosion from the timber sector's recent REIT conversion: for instance, one company (Weyerhaeuser Company) saved \$1.064 billion in 2010 from income tax adjustments due to its REIT conversion. In addition, some have estimated that another company (Iron Mountain) would save \$148 million annually if it were to convert to a REIT. As Congress is looking to lower the corporate tax rate, it seems curious for the IRS to exempt these large, service-oriented companies from paying taxes. Would the IRS consider suspending private letter rulings on non-traditional REIT conversions until Congress addresses corporate tax reform?

Response: We do not have the authority to approve or deny REIT conversions, and do not issue, and have not issued, private letter rulings on these conversions.

REAL ESTATE OWNERSHIP

Question. Some of these technology and information services companies lease most of their real estate and, in many cases, lease real estate from already established REITs. What is the IRS's guidance regarding potential REIT candidates that lease a majority of real estate from already established REITs?

Response: Section 856(c)(4)(A) of the Code requires that at the close of each quarter of the taxable year at least 75 percent of the value of a REIT's total assets is represented by real estate assets, cash and cash items, and Government securities. Section 856(c)(5) defines "real estate assets" to include an "interest in real property," which in turn is defined to include, among other types of interests, leaseholds of land or improvements thereon. For REIT qualification purposes, whether the owner of property that is subject to such leasehold is itself also a REIT is immaterial.

WEDNESDAY, MARCH 28, 2012.

DEPARTMENT OF THE TREASURY

WITNESS

HON. TIMOTHY F. GEITHNER, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Mrs. EMERSON. Welcome, everyone. The hearing will come to order.

I am pleased to welcome members of the Subcommittee and our witness, Secretary Timothy Geithner from the Department of Treasury. Thank you so much for being here today.

For the first year since 1947, our debt will be larger than the size of the entire U.S. economy as measured by the gross domestic product. Discretionary spending as a percentage of GDP is projected to fall to its lowest levels since Dwight Eisenhower was President, but mandatory spending and net interest as a percentage of GDP is projected to rise to its highest level in recorded history.

Even if Congress were to adopt the Administration's budget, using the Administration's economic assumptions, both revenue and spending as a percentage of GDP are projected to exceed and remain above their historical average. How is the Federal Government ever going to convince Standard & Poor's that the U.S. has control over its debt and is deserving of the AAA rating that it enjoyed prior to this Administration? How can working people ever get ahead if the Federal Government keeps taxing and spending their income above historical levels?

The Appropriations Committee's jurisdiction is limited to the discretionary spending part of the debt equation. Over the past 2 years, this Subcommittee has reduced spending in its jurisdiction by 11 percent, and I am committed to making further reductions. Despite the need for restraint, the Department is requesting an increase in excess of \$1 billion. An increase of this magnitude is unattainable under the discretionary spending level being considered on the House floor today. Nonetheless, we want to work with you to make sure the Department has the resources it needs and ask the Department to be candid with this Committee about its priorities.

Based on an interview that you gave in January, Mr. Secretary, I understand this could be your last appearance before this Subcommittee, regardless of the outcome of the Presidential election, and I just want you to know how much we appreciate your service and wish you success in your next endeavor.

Once again, welcome, Secretary Geithner. I look forward to your testimony, and with that I yield to Mr. Serrano for any opening statements he would like to make.

Mr. SERRANO. Thank you, Chairwoman Emerson.

Secretary Geithner, I am happy to welcome you back before the subcommittee. The Department of the Treasury continues to play an important role in our ongoing economic recovery. From ensuring access to capital for small businesses and community development financial institutions to oversight of our financial system, to taxpayer assistance, the areas under your jurisdiction provide tangible benefits to everyday Americans.

Your budget request this year recommends a mix of reductions and increases. For most of your management and financial accounts, you recommend an overall budget decrease. We will hopefully get a chance to discuss whether there is sufficient funding for you to perform the traditional functions that the American people expect of you, and as discussed at our hearing on the Internal Revenue Service that this Subcommittee held last week, you have proposed an increase in funding to the IRS in order to fill the gap created by the funding cuts contained in the final fiscal year 2012 appropriations bill. Given the vital role that the IRS plays in collecting the revenue that our government uses to operate, I believe that these are necessary investments.

One program that I have always been particularly interested in is the Community Development Financial Institutions Fund. The CDFI Fund is an extremely important resource for underserved communities and helps promote the economic development of communities like mine in the Bronx, New York. Although your appropriations request is level with fiscal year 2012, I understand that the fund will this year begin to administer a new program, the Bond Guarantee Program, which will help increase CDFI lending and provide an important source of stable long-term capital. I hope to learn a little bit more about what the CDFI Fund still needs to do to get this program up and running and what you believe this program will accomplish. I look forward to discussing how the Treasury Department can remain responsive to the needs of everyday Americans while continuing to play a key role in overseeing our Nation's finances.

We welcome you again, and I want to join our Chairwoman in thanking you for your service to this country and to wish you luck, and I guess you are going to be owning the Yankees or something, so I will be keeping close tabs on that. Thank you. They are not up for sale. Thank you.

Mrs. EMERSON. I would now like to recognize Mr. Rogers for his statement.

Mr. ROGERS. Thank you, Madam Chairwoman, for yielding. That is a hard act to follow, my friend Mr. Serrano.

Mr. Secretary, it is good to see you, and thank you for being here. Welcome. And again, I would like to add my best wishes to you as you leave for greener pastures out there.

By now it is no news to anybody that we are in an unsustainable fiscal situation, the Federal Government annually heaping trillion-dollar deficits atop a debt pile now over \$15 trillion. A recent Gallup poll showed that more than 9 in 10 Americans are at least, quote, "somewhat concerned," quote, about foreign holdings of U.S. debt, 3 in 4 saying they were very concerned. You now only need to look at the seemingly perpetual debt crisis now occurring in Europe, as we have discussed, to recognize that our debt problem has

to be addressed now while we are still masters of our own fate rather than be punted to a future generation, which will find itself at the mercy of foreign creditors, particularly China.

The House has heeded the calls of Americans to rein in Federal spending. Last year the Appropriations Committee worked to restore transparency, austerity, and tough oversight to the appropriations process, and we have succeeded in reducing discretionary spending by some \$95 billion since fiscal year 2010. Those type of sustained cuts have not occurred since World War II. By contrast, had we gone along with the President's previous request, CBO forecasts that we would have spent an additional \$191 billion, which we don't have.

This Committee, therefore, is the tip of the spear in this effort to end overspending here in D.C., but we only have the capacity to address discretionary spending, and as you know, even wholly eliminating both nondefense and defense discretionary spending will not pull the budget out of the red. We would still be in the red at the end of the year.

As more baby boomers hit retirement age, mandatory spending, if allowed to go unchecked, will consume everything in the Federal budget except for interest payments. The debt incurred from this automatic spending run amok will threaten everything we hold dear, national security; our economy; our infrastructure; the health, well-being, and prosperity of future generations of Americans. Nevertheless, when my Republican colleagues offer politically difficult spending cuts and entitlement reform proposals, the Administration vilifies them.

For example, I think few would agree that Members of Congress, working to avoid a fiscal catastrophe, are, as Press Secretary Jake Carney is on the record as saying, aggressively and deliberately ignorant of the world economy. Those types of insults harm the prospects of compromise, and these comments themselves seem to ignore our budgetary reality, the crisis in Europe, and the will of the American people.

For its part, I fear that the President's budget request for fiscal year 2013 does not provide a meaningful framework for the negotiating spending priorities. The Administration argues that this budget would reduce deficits by a collective \$4 trillion between 2013 and 2022. In fact, the Congressional Budget Office found that this budget would add \$3.5 trillion in cumulative deficits over baseline projections. As a result, the CBO estimates this proposal would add \$8.7 trillion to the debt over the next decade.

These huge deficits demonstrate that the budget's purported savings and spending reductions are largely illusory, composed of budgeting gimmicks designed to conceal the diversion of funds toward pet programs and ever-greater and more expensive regulation. Congress and the President must seek greater cooperation to prioritize key programs, cull unnecessary spending, and increase efficiency to protect taxpayers.

Your own department's budget request is an 8.4 percent increase over fiscal 2012. That includes an 8 percent boost for the IRS to \$945 million, \$360 million of which is for facilitating tax enforcement of controversial healthcare reform provisions. This increase represents an expansion in real dollar terms of tax and health bu-

reaucracies to which the House has been starkly opposed. Given your unique role as Secretary of the department overseeing the disbursement of funds, I hope that you will be able to—explain the Treasury request as well as the Administration's holistic views regarding the entire Federal budget.

Good to see you, Mr. Secretary.

Mrs. EMERSON. Thank you so much, Chairman Rogers.

I would now like to recognize you, Secretary Geithner. If you could try to keep your remarks to 5 minutes or less, that will give us more time for questions, and we have got lots here to ask questions. Thank you so much.

Secretary GEITHNER. Madam Chair, and Ranking Member Serrano and Chairman Rogers, nice to see you, and, Members of the Committee, thanks for giving me a chance to come before you today to talk about the President's budget and these broader challenges facing the country.

Let me just start with a few remarks on the broader economic context in which you make these choices. Our economy, as you know, is gradually getting stronger. Over the last 2½ years the economy is growing about an average annual rate of 2½ percent. Businesses have added almost 4 million jobs now.

While the economy is gaining strength, though, we still face very significant economic challenges. Unemployment is still very high, the housing market remains weak, the overall effects of the financial crisis are still dampening growth, and, of course, we face a dangerous and uncertain world. The harm caused by the crisis came on top of a deep set of preexisting economic challenges, including a long period with very little growth in the median income, diminished hopes for economic mobility, a dramatic erosion in our fiscal position, and many other challenges.

As you know, the President has laid out a broad strategy to address these challenges, which entails a carefully designed set of investments and reforms combined with steps to reduce our projected deficits to a more sustainable level. As you have both said, and as the President recognizes, our fiscal deficits are unsustainable, and let me just talk a minute about what separates us on these basic questions.

I think we all agree we need to bring them down over time. Where we disagree is how fast we can afford to cut our deficits, how quickly we can afford to cut them. If we cut too fast, we risk damaging growth. We agree we have to cut spending, but we disagree on where we can afford to cut spending and what priorities should shape spending going forward.

As you know, we think there is a very strong economic case for preserving some room to make investments in education, infrastructure, and innovation, things like that. We disagree on how to make Medicare and Social Security sustainable over the long run. We disagree, I think, on what level of support, and how strong a safety net to preserve for low-income Americans. We disagree not on the need and desirability of tax reform, but on who should bear most of the burden in tax reform.

What separates us is not how we treat the vast majority of Americans, because I think both parties want to extend the middle-class Bush tax cuts. But what we believe is—we do not see a way

to solve our fiscal problems without asking the top 2 percent of Americans to pay a modestly higher share of their income in taxes. The reason why we believe that is because if you do not do that, then you have to raise someone else's taxes, or you have to cut very deeply in spending priorities that both parties share, for example in defense and other things like that. So it is just that basic reality that we do not have unlimited resources that leads us to that basic conclusion. I would be happy to talk about that in more detail.

Treasury, of course, plays a very important role in helping shape and implement the President's policies, driving financial reform, encouraging lending to small business, working to reform the tax system, helping repair the damage caused by the financial crisis, et cetera. I will be happy to talk about how we are doing on those fronts when we have a chance.

Now, our budget, as you both—as you all recognize, proposes a modest overall increase, but all of that increase is in the IRS. We think it is very important as part of the strategy to bring our long-term fiscal deficits down that we are making investments in the enforcement capacity of the IRS. As you know, every dollar we spend in enforcement at IRS raises \$4 in revenues, so we think that is a conservative and a responsible way to try to make sure that we are bringing a balanced push to deficit reduction. The rest of the Treasury budget we cut by finding savings still consistent with the priorities faced in the country.

As you know, in Treasury, unlike, I think, almost every other Cabinet agency, the vast bulk of our spending is for salaries—of the men and women at Treasury. The rest is really IT. A very modest portion of this budget is for specific programs.

In our budget we lay out a series of new proposals designed to demonstrate—we are finding ways to use our resources more efficiently. We have identified a set of reforms, program reductions, and other measures that would produce savings of about \$286 million in fiscal year 2013 and very substantial additional cost reductions in the years ahead. And among those proposals, of course—let me just list them quickly—are to combine the Bureau of Public Debt and the Financial Management Service, a very strong, compelling, pragmatic reason for doing that. We are looking at ways to extend what we call our paperless initiative to move the Federal Government to an entirely electronic payment system, encourage more e-filing for the IRS, et cetera. A range of other proposals are included in the request.

As I said, we think it is absolutely essential to make sure the IRS has the resources to not just provide better customer service to taxpayers, but to make sure we are investing in enforcement actions so that we are lessening the burden on the rest of the budget.

We request \$220 million for the CDFI Fund, which plays a very important role in supporting communities, urban and rural, poor, underserved communities across the country, and would like to work closely with you, Madam Chair, on how best to make sure we are addressing focusing those resources in areas where there is persistent poverty, very important to us. And I know you share that objective.

I just want to highlight too, the fact that the Treasury, as you know, plays a very important role in the broader national security

community's efforts to address the challenges posed by Iran, by Syria, by North Korea and by terrorists around the world. The Office of Terrorism and Financial Intelligence is doing a remarkably good job at bringing very substantial financial pressure on Iran. And I would be happy to talk to you more about the challenges ahead in that area.

In conclusion, let me just point out the Treasury, as you know, has a very talented and dedicated group of public servants. I began my career in public life as a civil servant in the Treasury. Their work affects the lives of all Americans. They played a very critical role in helping pull our economy out of crisis and laying a foundation for economic growth. They help protect America's economic interests and our national security interests, and they have worked very hard to make Treasury a more efficient, leaner provider of critical services to the American people.

And I just want to end by saying that I appreciate very much the support of this Committee over the past several years in a very challenging fiscal environment in helping us make sure we maintain a level of resources that allows us to do the things that you, the Congress, ask us to do. I look forward to answering your questions.

Mrs. EMERSON. Thanks very much, Secretary Geithner.
[The prepared statement follows:]

Secretary Timothy F. Geithner
FY 2013 Treasury Budget Testimony
House Committee on Appropriations Subcommittee on
Financial Services and General Government Wednesday,
March 28, 2012

Chairwoman Emerson, Ranking Member Serrano, members of the Subcommittee, thank you for giving me the opportunity to speak about the Treasury Budget.

I. Introduction

Let me start with the broader challenges facing the national economy.

Our economy is gradually getting stronger. Over the last two and a half years, the economy has grown at an average annual rate of 2.5 percent. Businesses have added nearly 4 million jobs over the last two years, including 429,000 manufacturing jobs.

While the economy is regaining strength, we still face significant economic challenges. Unemployment is still far too high, the housing market remains weak, and the overall effects of the financial crisis remain an obstacle to growth. The strength of our recovery will depend in part on events beyond our shores, as we saw last year when U.S. growth was buffeted by headwinds from Europe.

The harm caused by the crisis came on top of a set of deep, preexisting economic challenges, including a long period of stagnation in the median wage, diminished confidence in the ability of children to exceed the economic achievements of their parents, a substantial ongoing shift in the risk and cost of health care and retirement security away from employers and onto workers, poverty rates much higher than in any economy with comparable wealth, and the dramatic erosion in our fiscal position between 2001 and 2008.

The President has laid out a strategy to address these challenges. His strategy entails a carefully designed set of investments and reforms to improve opportunity for middle-class Americans and strengthen our capacity to grow by improving access to education and job training, promoting innovation in our manufacturing sector, and investing in infrastructure.

These critical investments are combined with a balanced plan for restoring fiscal sustainability. The President's Budget reduces projected deficits by a total of more than \$4 trillion over the next 10 years by adding more than \$3 trillion in deficit reduction to the approximately \$1 trillion in savings already enacted through the discretionary caps included in the Budget Control Act (BCA). These savings are sufficient to stabilize our debt as a share of the economy by 2015 and begin placing our debt on a downward path as a share of Gross Domestic Product.

Treasury plays a vital role in helping to shape and implement the President's economic policies, driving reform of the financial system, encouraging lending to small businesses, working to

reform the tax system, promoting economic prosperity, and monitoring risk in the financial system.

Treasury is working hard with the Department of Housing and Urban Development (HUD) and with the Federal Housing Finance Agency (FHFA) to repair the housing market. We have active programs to modify mortgages for distressed homeowners so that people can stay in their homes, help states in the hardest hit areas provide both loan principal reduction and payment forbearance for the unemployed, transition vacant homes to the rental market and make it easier for homeowners who are underwater to refinance their loans.

As the President has made clear, more can be done to help, and we urge Congress to consider the President's plan to help homeowners refinance their mortgages to take advantage of lower rates.

Treasury is also working with other agencies, in particular the Department of Education, on a range of ways to help make college more affordable, such as the President's proposal to make permanent the American Opportunity Tax Credit. The Administration is also moving forward with its "Pay As You Earn" proposal to help reduce debt burdens, and the President has called on Congress to stop the interest rate on Stafford loans from doubling in July.

In addition to our core policy functions, Congress has given Treasury a very broad mission, with responsibilities that touch many aspects of the lives of Americans.

Treasury is responsible for raising the resources necessary to fund critical government functions, from national defense to protecting national parks. The Department disbursed over \$2.4 trillion in Social Security benefits, veteran's pensions, and other benefit payments to more than 100 million Americans last year. Treasury delivered tax credits to drive investment in clean energy production and to help families finance college education. We design and enforce the financial sanctions necessary to prevent the spread of nuclear weapons and the financing of terrorism. Our Internal Revenue Service collected the \$2.4 trillion in taxes necessary to fund core government operations. We run the factories that produce every American dollar and coin.

Treasury's FY 2013 Budget proposal supports the President's strategy through key priorities that will strengthen economic growth and make the government more efficient while delivering essential services at lower costs to the taxpayer. The proposal also reflects Treasury's contributions to protect our national security interests and prevent illicit use of the financial system.

Unlike most federal agencies, Treasury's annually appropriated budget is about people more than programs. Salaries and operating costs make up 96 percent of our budget, and most of the rest of our budget is for investments in technology they require to function.

II. Improving Efficiency, Reducing Taxpayer Costs, and Reforming Government

The Treasury Budget request reflects our commitment to deliver core services more efficiently and at the lowest cost to the taxpayer. Our request includes efficiencies, program reductions, and

other measures that will produce savings of \$286 million in FY 2013 and additional cost reductions in the years ahead.

Key proposals include the consolidation of the Bureau of the Public Debt and the Financial Management Service. This consolidation will save \$36 million over five years, starting with FY 2014, through management, administrative, and support service efficiencies.

As you know, these bureaus provide the financial infrastructure for the federal government. Both bureaus have successful track records working together on joint initiatives, including a recent Information Technology consolidation, which is projected to save \$129 million over five years. I am confident that they will build on this success by consolidating and improving the delivery of their core services.

The Budget also proposes legislation to provide Treasury with the ability to change the composition of coins to utilize more cost-effective materials. Currently, the costs of making the penny and the nickel are more than twice the face value of each of those coins. In addition to this proposal, Treasury is implementing measures to improve the efficiency of coin and currency production, including improved manufacturing practices and administrative cost reductions, which will save more than \$75 million in FY 2013.

These savings build on a number of steps that the Department has taken during the last three years to improve efficiency and reduce taxpayer costs.

Last December, we announced that we were suspending the production of Presidential dollar coins for circulation. At that time, there were 1.4 billion surplus dollar coins sitting unused in Federal Reserve vaults. These surplus coins will now be drawn down over time. Taking this simple step will save taxpayers \$50 million per year in production and storage costs.

We are also continuing to achieve results in our ongoing paperless initiative, which will yield over \$500 million in savings over five years. These efforts not only improve our internal management but provide modernized services to meet the public demand for more electronic services. In response, we have changed the way we provide services and are achieving savings while providing taxpayers the services they deserve.

To give you an example of this, six years ago, just over half of individual taxpayers filed their returns online. We have worked proactively to increase electronic filing, and today, 77 percent of taxpayers choose to file online. In 2013, it is our goal to get 80 percent of taxpayers to file online, achieving an additional \$8.1 million in savings on top of the \$63.9 million we have saved since 2009.

The FY 2013 Budget for Treasury's operating bureaus is 2.7 percent below FY 2012 and 6.8 percent below our FY 2010 enacted budget, excluding the Internal Revenue Service (IRS). The request for the IRS includes investments in enforcement activities that will contribute significantly to improving voluntary compliance with the tax code and closing the tax gap. For each additional dollar we propose to spend on compliance activities we bring in more than four

dollars in additional revenue. The enforcement investments in our request will bring in an additional \$1.5 billion in annual revenue once fully implemented.

III. Economic Growth and Job Creation

We are also supporting small business growth through our Small Business Lending Fund (SBLF) and State Small Business Credit Initiative (SSBCI). Last year, we provided more than \$4 billion to 332 community banks through the SBLF. Participating institutions estimate that they will increase their small business lending by \$9 billion within two years of receiving the investments. By the end of this fiscal year, we will have provided approximately \$1.5 billion to state programs that support small business lending and investment through SSBCI. States expect these investments to spur at least \$15 billion in new small business financing.

Our \$221 million request for the Community Development Financial Institutions Fund (CDFI Fund) is focused on key community development priorities designed to improve services in underserved communities, including access to healthy food and financial services. Of the total request, up to \$25 million is for the Administration's Healthy Food Financing Initiative, which will support increased availability of affordable, healthy food alternatives in these communities.

The CDFI Fund's core program for financial and technical assistance provides monetary awards to CDFIs, which in turn provide loans, investments, financial services, and technical assistance to underserved populations and low-income communities. In 2010, CDFIs were awarded \$105 million in grants under the CDFI program, which should contribute to \$589 million in community development activity and the creation or preservation of approximately 10,000 jobs.

IV. Protect our National Security Interests and Prevent Illicit Use of the Financial System

Finally, Treasury's financial intelligence and enforcement activities play a significant role in protecting our financial system from threats to our national security. Our funding request for the Office of Terrorism and Financial Intelligence is maintained at \$100 million and reflects our continued efforts to combat rogue nations, terrorist facilitators, money laundering, and other threats to our financial systems and our Nation's security.

The work that this office conducts is far reaching and of critical importance to national security. The sanctions the Administration imposed on Libya were a critical factor in removing the Gadhafi regime, and they continue to add pressure to the regimes in Iran, Syria, and North Korea.

V. Conclusion

Treasury benefits from a talented and dedicated group of public servants. Their work affects the lives of all Americans. They have played a critical role in pulling our economy out of crisis and setting the Nation on a path to recovery.

Our Treasury team helps to protect America's economic interests and national security – so seniors can get their Social Security benefits, families can borrow money to buy a home or send a child to college, and businesses can grow and create jobs. They have worked hard to continue to make Treasury a leaner, more efficient organization that effectively delivers essential services to the American people.

I appreciate the support of this Committee over the past several years in helping to make sure we have the resources to carry out these important responsibilities.

The Secretary



Tim Geithner

Secretary of the Treasury

On January 26, 2009, Timothy F. Geithner was sworn in as the 75th Secretary of the United States Department of the Treasury in a ceremony attended by President Barack H. Obama, and Vice President Joseph R. Biden Jr.

Before his nomination to the Treasury, Secretary Geithner served as the ninth president and chief executive officer of the Federal Reserve Bank of New York, where he began on November 17, 2003. In that capacity, he served as the vice chairman and a permanent member of the Federal Open Market Committee, the group responsible for formulating the nation's monetary policy.

Secretary Geithner first joined the Department of Treasury in 1988 and worked in three administrations for five Secretaries of the Treasury in a variety of positions. He served as Under Secretary of the Treasury for International Affairs from 1999 to 2001 under Secretaries Robert Rubin and Lawrence Summers.

He was director of the Policy Development and Review Department at the International Monetary Fund from 2001 until 2003. Earlier in his career, Secretary Geithner worked for Kissinger Associates, Inc.

Secretary Geithner graduated from Dartmouth College with a bachelor's degree in government and Asian studies in 1983 and from the Johns Hopkins School of Advanced International Studies with a master's in International Economics and East Asian Studies in 1985. He has studied Japanese and Chinese and has lived in East Africa, India, Thailand, China, and Japan.

He and his wife, Carole Sonnenfeld Geithner, have two children.

TAX CODE SIMPLIFICATION

Mrs. EMERSON. Back in January, the National Taxpayer Advocate released her annual report to the Congress, and concluded, among other things, that the IRS is underfunded and overworked, and I think many of my colleagues would agree that those concerns could be solved by simplifying the Tax Code. The IRS would need to answer fewer questions, number one. They would have to do less policing and, therefore, need fewer resources. And last week IRS Commissioner Shulman told the Committee the single most important thing that could be done to improve taxpayer service and increase tax compliance would be Tax Code simplification. Would you agree with that?

Secretary GEITHNER. I do, but I would note, as you know, that IRS is responsible for administering the tax laws written by the Congress. So we have an obligation to the American people to make sure we are doing as much as we can to enforce those laws and to help people comply with those laws. But, of course, I agree with you, and the President agrees that we should work together toward a more simple tax system both on the business side and the individual side, and we hope we have a chance to do that.

Mrs. EMERSON. And I appreciate that.

Do you think that the complexity of the Tax Code affects productivity and innovation of American businesses?

Secretary GEITHNER. I think most economists would say that a broad tax reform process that lowers rates and broadens the base would lead to more efficient economic outcomes, on the business side in particular. As you know, we live with a system with a very high statutory rate, 35 percent, about to become the highest in the world, but really what is remarkable about our system is that companies in different industries pay very, very different effective tax rates, which is very unfair and very inefficient. What it means is that the companies with the best tax engineers or tax lobbyists are able to compete on the strength of those talents rather than primarily on the strength of the quality of products they sell, and that means that the economy as a whole does more poorly than it should than if we let the market allocate those investment resources.

So, absolutely, there is a good economic case for tax reform, and we hope we have the chance to work with both parties to achieve that in the coming months and years.

Mrs. EMERSON. So I assume, then, that your answer to the next question would be a yes, but I will ask it anyway, if you believe that a Tax Code that is easy to understand and, therefore, easy to comply with increases voluntary compliance and then would therefore decrease the costs to the IRS?

Secretary GEITHNER. I think so. It is worth noting, as, of course, you know, that the major source of complexity in the Tax Code is the complications associated with qualifying for the special benefits Congress puts in the Tax Code for individuals and for corporations. That is the overwhelming source of complexity. But if you move to a simpler system with lower rates and a broader base, with a fairer allocation of burden, and that encourages investment here and does other important things, then you would be reducing complexity,

and it might be easier for people to comply with their obligations of being a citizen.

Just one final point. We have really the best system of tax collection in the world, where we have withholding. The major source of the tax gap in the United States is where we do not have withholding, and that primarily is for businesses that do not have to withhold, on their income, and that is where most of the complexity in compliance is.

Mrs. EMERSON. Thank you.

GOVERNMENT-SPONSORED ENTERPRISE REFORM

Switching gears here just very briefly. The administration's plan to reform Fannie and Freddie so far consists of a paper from February 2011 which laid out a number of well-worn options for reform, and I hear complaints all the time, I am sure my colleagues do as well, that these GSA—GSE mortgage giants have already cost taxpayers about \$170 billion and continue to make draws on the Treasury. So when do you believe, Secretary Geithner, that Treasury and the Administration will provide a specific plan and timeline for mortgage and GSE reform, because I do not sense any urgency here?

Secretary GEITHNER. Good question. Thank you for asking it.

First let me just point out that the losses on those institutions today are now virtually entirely the legacy of the choices made in the years of the financial boom, and since Congress passed reforms over the GSEs in the fall of 2008, which they did before the TARP and before financial reform, those institutions have been managed much more conservatively, with much tighter underwriting standards. Most economists that look at the GSEs believe that the GSEs are now charging closer to an appropriate premium for the mortgage they guarantee, and that is why the forward-looking estimates of losses going forward on the things they are doing today are much lower.

You are right to say that it is very important that we work to find a bipartisan consensus with Congress on how to wind them down, bring the private capital back into this market, and ultimately replace the GSEs with something that is going to work better for the country in the future. We have been consulting very widely, both in the Congress with the Authorizing Committees, but also with the real estate community, with the housing community, and with the financial community. We are exploring a whole range of options, and we are hoping to be in a position relatively soon to engage with Congress more substantively to narrow that range of choices.

As we have been consulting, I am encouraged to see that there have been some proposals made, on the House side in particular, on a bipartisan basis for reform that look quite promising. So I think we are in slightly better shape than your question implied, but you are right to point out we have a lot of work to do in this area.

Mrs. EMERSON. So you do suspect, though, that you will have, if not a specific plan, at least a set of choices?

Secretary GEITHNER. As you said, we laid out more than a year ago a set of broad options, and we have been consulting in detail,

and there has been a lot of work in Congress, too, on which of those options make the most sense and how you should design them. And so I think we are getting closer to being able to work with Congress on something that might result in legislation.

Mrs. EMERSON. Okay, thank you.

Mr. Serrano.

EFFECT OF IRS FUNDING CUTS

Mr. SERRANO. Thank you, Madam Chair.

Secretary Geithner, before we move to your fiscal year 2013 request, I would like to revisit 2012 with you for a second. Though I know Chairwoman Emerson and her staff did their best to avoid layoffs and furloughs, and her staff did their best to work within what was allotted to us, the cuts were very serious to the IRS, and the IRS took the bulk of the cuts for the 2012 bill. Now, I want you to speak about what long-term effects you think that these cuts will have, reminding folks that this may be—and I know that everybody has a favorite cut or a cut they hate in the budget, but I think these cuts to the IRS are the ones that make really the least sense because the IRS collects dollars that go into the Treasury. I do not know of another agency that brings those kinds of dollars into the Treasury, so when you cut the workforce there, when you cut their ability to collect those dollars, you are getting into a deeper hole than before. So can you tell us how you see that working out?

Secretary GEITHNER. Well, of course, as you know, we agree with you very much. What it just means is that it is hard to get your phone answered if you are trying to pay your taxes. If you plan to evade your taxes, it is easier to because it is harder for the IRS to provide the customer service staff need, and it is harder for them to make sure they maintain an adequate enforcement capacity to make sure that, again, Americans are meeting their obligations as citizens.

Every dollar, and—independent estimates validate this very conservative estimate—every dollar the IRS puts into enforcement yields roughly \$4 in revenue. So at a time when we face unsustainable deficits, and the Congress has asked the IRS to take on a whole set of new responsibilities and administering a whole set of complicated benefits in the Tax Code, it is very important to make sure they have the resources they need to do their job.

I know we are making it harder for this committee because we propose as a way to accommodate this increase a program integrity cap adjustment, which, of course, Congress has done many, many times in the past. But I know that is not something you can control in this committee, and we know it is a special challenge for you to deal with but we think there is a good case for doing it.

Mr. SERRANO. I would like to revisit something interesting you said last week, and I do not want to put you here on the spot about something you said last week somewhere else before the Authorizers in a hearing. In regard to IRS cuts you said, quote, in my former life I was a tax attorney, and I was always happy to see the IRS cut because my clients had less concern, and that was fine by me.

Secretary GEITHNER. That was not me, that was a Member of Congress who said that in a hearing questioning me.

Mr. SERRANO. Really?

Secretary GEITHNER. Yeah. But it was not me. I can assure you I was not a tax attorney. That is okay.

Mr. SERRANO. I apologize that I am blaming you for what a Member of Congress said, which we do most of the time anyway. So I really was not out of bounds here.

Well, let us forget about that. Do you agree with this Member of Congress that people out there find a way to get around—

Secretary GEITHNER. As you know, I have been testifying a lot. I cannot remember the precise comment, but I will go back and look at it.

EFFECT OF DISCRETIONARY SPENDING CUTS

Mr. SERRANO. Okay. The proposed budget resolution of \$1.028 trillion, beyond the fact that this is a breach of a hard-fought agreement last year in the Budget Control Act, what will the impact be on our economy if we cut back so severely on discretionary spending? And, you know, this brings up this whole argument of when is it spending, when is it investment, and I really think that it has to be looked at closely. Give us your thoughts on that.

Secretary GEITHNER. Well, as I tried to say in my opening remarks, I think it is important to point out that we have very different strategies for addressing our fiscal position, and what separates these strategies are the following: We propose to cut the deficits quite dramatically over the next 5 years, but we do not try to do it all in 3 years because the economy healing from a crisis would be very damaged if we tried to cut deficits too quickly. That is one important difference.

Second is that although we cut spending quite substantially over the next 10 years, we do so in ways that are very different from what is in that resolution. We are very careful to make sure that we are using savings to make sure we can preserve room for investments in education, in infrastructure, and in innovation, and a very important second difference, is that we live within the caps that we negotiated last year.

Third important difference is that we have very different approaches for how we strengthen Medicare over the long run. You understand that debate.

Another important difference is that we are preserving a basic safety net for the least fortunate Americans. The resolution you referred to cuts very, very deeply in Medicaid and in food stamps and a whole range of other programs that are very important to the least fortunate. It is important to remember that we have very high rates of poverty in the United States, that was true even before the crisis, and 40 percent of American children are born to families eligible for Medicaid. So these cuts would be very, very severe.

And, of course, finally, what separates us is that we do not see how we solve this problem without a modest amount of additional revenue through tax reform on the most fortunate Americans, and we propose roughly 1 percent of GDP, about \$1.5 trillion, over 10 years in additional tax reforms on the top 2 percent of Americans.

It would raise their effective tax rates modestly, return them to a level that was more familiar in the second half of the 1990s. The reason we do that is because if we do not do that, then we have to find ways to cut defense or cut Medicare by very substantial amounts, and we do not think that makes sense for the country.

Mr. SERRANO. Well, I know we have a lot of other Members who want to ask questions, so thank you so much.

Mrs. EMERSON. Thank you, Mr. Serrano.

Mr. Rogers.

ENTITLEMENT SPENDING

Mr. ROGERS. Mandatory spending, entitlements. As you know, 63½ percent of the Federal budget is now mandatory spending; with entitlements about 13 percent of GDP. If every discretionary account were zeroed out entirely, including defense, Border Patrol, Park Service, agriculture, whatever; if we zeroed out the entire government, we would still be in the red due to entitlements, and yet the Administration in their budget proposal ignores that basic fact and proposes no reform or cuts in entitlement or mandatory spending. We are being eaten alive by it, and it is going to get worse as time passes. About 10 years from now, they tell me that it will consume 70 percent of the budget. Why does the President not address mandatory entitlement spending in this budget request?

Secretary GEITHNER. You are, of course, very right to point out that in many ways our budget is a very, very large insurance company and a large pension fund attached to an army, and the rest of the budget is very, very small. And you cannot balance the budget by reducing to zero that portion we call discretionary spending, which is about 12 percent of the budget. You cannot do that. The long-term sustainability problem we face is overwhelmingly the result of the fact that we have millions and millions more Americans retiring, becoming eligible for Medicare and for Social Security in the coming decades, and that will force some fundamentally tough choices on us as a country.

Now, in the President's Budget, we have laid out and identified I think it is roughly—\$350 billion in cuts to health mandatory programs over the next 10 years along with a range of very substantial additional cuts in other mandatory programs, farm subsidies, things like that, civil service retirement, and we combine those, and this is what separates us, with a modest amount of additional revenues.

Now, we have a \$4 trillion problem over the next 10 years we have to solve, meaning to get our deficits down to a level where the debt stops growing as a share of the economy, we have to find \$4 trillion in cuts in deficits. We agreed on a trillion dollars together last summer; we have to find another trillion over that period of time. We propose to do half of that remaining gap on the spending side, half of that remaining gap on the revenue side, but we do have a very substantial portion of those spending savings to come from changes to health mandatory and other mandatory.

We propose, as you know, to live within the caps we agreed, we are prepared to stick with that basic deal, and what that means is the savings we have to look for on the spending side for the next

10 years have to come from other parts of the budget, and you are right to point that out.

I do not believe, though, that it is correct to conclude—you were not implying this, but I do not believe that we have to cut nearly as deeply as the resolution that the House is considering in Medicare and Medicaid and food stamps to move us to a sustainable position. I do not think it is necessary. I do not think it is desirable. I do not think it is good economic policy, recognizing, of course, that we are going to have to bring those commitments down to a more sustainable level.

UNITED STATES DEBT OWNED BY CHINA

Mr. ROGERS. We are borrowing 42 cents on every dollar we spend, and depending on the accounting method, the national debt now is over \$15 trillion. On February 29th, your Department released numbers showing that in the year dated to June 30 of 2011, China's holding of U.S. securities expanded by \$100 billion to \$1.7 trillion, more than a tenth of our national debt. What are the risks of a single country holding so much of our debt and our time and attention?

Secretary GEITHNER. Well, like many countries, about roughly half of treasuries that are held by the public are held outside the United States. That is typical of many mature developed countries. And it is important to recognize that the amount we are borrowing from the rest of the world as a share of our economy has fallen roughly in half over the last 5 years or so, so our current account balance, which measures how much we are borrowing from the rest of the world, has fallen very sharply, which is good for the future.

You asked something very important, Mr. Chairman, at the beginning, which is we need to act on the deficits while we are still the masters of our own fate. And we are still the masters of our own fate, and although this is an important, urgent problem, we have some time to get this right and have some time to do it sensibly. It is important to recognize that our fiscal challenges, although daunting and considerable, are much more manageable for us and much less consequential than is true of what faces almost every other major economy. We have the ability to manage this problem by asking the American people to make some difficult, but manageable adjustments, and the sooner we do it, the better, because they have more time to make the changes necessary to adjust to that.

Mr. ROGERS. Well, I am not sure that we are still masters of our own fate. I mean, we have some real differences with China over illegal trade practices, human rights violations, foreign policy, the defense of Taiwan, and questions of all sorts. I wonder, you know, if push came to shove on some of these issues, whether or not the fact that they hold so much of our debt would influence us policywise to cede some territory, to cede some points. Am I completely out in left field on that?

Secretary GEITHNER. I understand that concern, but I do not share it, and I do not believe that gives China or any other country any leverage over the United States. And I think we are absolutely still the masters of our own fate, and the biggest risk to the United States is not—and I think you agree with me on this—the biggest

risk to the United States is not what other countries choose to do; the biggest risk to the United States is that Washington fails to find the ability to do things together to solve problems, including on this long-term challenge of fiscal sustainability.

And so you are right to say we cannot put this off indefinitely. It is important we do it, but how we do it is as important as the fact that we do it.

Mr. ROGERS. Madam Chairman, I have one brief question, if I may.

Mrs. EMERSON. Yes.

CHINESE CURRENCY VALUATION

Mr. ROGERS. And it deals with what we were just talking about. Some studies estimate the renminbi, the Chinese currency, is undervalued by 25 to 40 percent. American manufacturers are laying off people, and the jobs are going to China because we simply cannot compete with that kind of a disparity. And yet in your most recent semiannual report on foreign exchange, for a sixth time your Department passed up the opportunity to designate China a currency manipulator, which would allow the Commerce Department to implement countervailing duties. We really have a weapon here, but, despite broad consensus that China is a currency manipulator, we are refusing to designate it as such. Could this be a result of our fear of their extending further credit to us?

Secretary GEITHNER. That plays no role in our judgment. But let me just start by saying I very much share your concern, and it is important to us that China continue to allow their exchange rate to rise against the dollar. Just for perspective, the Chinese currency in real terms, adjusting for inflation, is up about 14 percent against the dollar in the last 20 months or so, and it is up about 40 percent against the dollar over the last 5 years, but we agree, as your question implied, that they have some ways to go. We would like them to push further in that context, and we are working very hard on that.

It is worth noting that U.S. exports to China are growing very rapidly, much more rapidly than our exports to the rest of the world. We have created almost half a million jobs in manufacturing since job growth started to resume after the crisis, and we are seeing a very promising shift in the relative competitive position of our two economies.

You can see this in the number of companies that announced they are actually starting to move some production back from China, and other countries to the United States because they see costs growing in China much more rapidly than in the United States. So you are seeing people start to reassess in recognition of the fact that the competitive playing field is shifting a bit in our favor, and reassess the merits of investing in building something in the United States.

That is very promising. We want to make sure we are encouraging that trend. That is why, Madam Chair, your emphasis on tax reform is important, because to do that effectively, not just to make sure China is moving its currency higher and reducing the subsidies it provides its domestic industries, we have to do things to

make it more compelling for people to invest in the United States, and tax reform is an important part of that.

Mr. ROGERS. So you are saying you are not shy about imposing countervailing duties because we owe so much to China?

Secretary GEITHNER. We have been more aggressive than any previous Administration in using the protections of our trade law to go after unfair trading practices in China, and if you look at the Administration's record on 301 cases in successful WTO challenges as well as in the use of our antidumping and countervailing duty laws, you can see we have been very aggressive, and we will continue to do so.

Mr. ROGERS. Thank you, Madam Chairman.

Mrs. EMERSON. Mr. Womack.

Mr. WOMACK. Thank you, Madam Chair.

And, Mr. Secretary, thank you very much for your service to our country. And I join the chorus of well-wishers in wishing you God-speed and thanking you for your service to our great Nation. And on a personal note, let me just say how grateful I am that you, during this last year, made a visit to my district, and it was great to have you down there to see the great things happening in Arkansas's Third District.

NORMALIZATION OF INTEREST RATES

One thing that keeps me up at night is the prospect of what I term normalization of interest rates, because in our work on appropriations, we see firsthand the impact of the net interest on the debt. And we talked a little bit about interest rate normalization last year in our hearing.

Give me some assurance or give me your thoughts about the prospect of what could happen. Of all the great work that we have done, and our Chairman, Mr. Rogers, has articulated that we have done a very good job of cutting spending and doing what the people asked us to do, but that could all be wiped away with just a modest increase in what we have to pay on this enormous debt. Your thoughts.

Secretary GEITHNER. You are absolutely right, and it is one reason why it is so important that we figure out how to reach a bipartisan agreement on how to take the next step to bring those fiscal deficits down to Earth. The necessary test of sustainability is to bring the deficits down to the level below 3 percent of GDP, and if we do that, that will make sure the debt burden stops growing as a share of the economy and starts to come down. And if we do that, we are at much less risk that confidence in the United States will erode over time, and we face a higher increase in interest rates, larger interest rates than would otherwise be justified by a growing economy.

Now, I want to point out—and that is why, Mr. Chairman, I said I am confident we are still the masters of our own fate—if you look at how investors judge the fiscal credibility of the United States, they still have a lot of confidence that Congress will ultimately figure out a way to reach agreement on these kind of things. The markets judge us every day on that front, and you can look in what is called the CDS spread, for example, the United States relative to other countries, where you look at expected inflation over the

long run in the United States versus other countries. There is a lot of confidence among investors around the world and the United States that Washington will ultimately do early enough what it has done in the past, which is to find a way to bring these things down.

But you are making a very important point, and that is one of the most compelling reasons why it is important that we not put this stuff off indefinitely.

ENTITLEMENT SPENDING

Mr. WOMACK. We have already discussed in this forum early on the impact of the mandatory side of the equation when it concerns Federal outlays, and there are some fundamental disagreements as to what our side believes should be done, particularly on the social safety net discussion. And you have already indicated that it is incredibly important that Congress be able to work some kind of a compromise out to be able to go after where the true drivers of the deficits and the debt actually are. There is a bipartisan proposal that is on the table, and I refer to Ryan-Wyden. So what is wrong with our approach? What is wrong with this approach?

Secretary GEITHNER. Well, again, there is lots that separate us; how fast we cut deficits, where we cut spending, where we make sure we are investing more things that matter for future growth, how we protect the safety net, how to make Medicare and Medicaid more sustainable, how do we design tax reform in a way that is fair, and those are very fundamental disagreements. They are not unbridgeable, but they are very large disagreements now, and that is why the country is having such an important debate about the future.

I would say in the area of Medicare, which you were focusing on, the big difference we face is a difference about what is the level of benefit we guarantee to our seniors as they retire? How fast do we let that grow to accommodate rising health care costs, and do we guarantee it? Do we guarantee that minimum benefit, or do we shift much more of the risk to them? And big, big disagreements, but the most fundamental is that the proposal that many people in this body support now would shift substantially more of the risk to those seniors over time than we think is necessary for the country. So although we agree with you, we have to reduce the rate of growth in those costs over time, we do not agree on either the depth of the changes you propose to make or in the amount of risk that those proposals would shift to seniors.

Mr. WOMACK. Well, our side truly believes that those that have built their lives around these programs should be protected, but our side also believes—and I know the minority side in the House maybe gives some lip service to it, that they believe also that program must be sustainable going forward.

We all agree that there needs to be a program for future generations. The question is whether or not the path that it is on today without substantive changes is actually going to be around for future generations. We want to preserve it for those that are at or near retirement now, but we also want to see a program in the future that is sustainable, and I just do not think we are on that path.

Secretary GEITHNER. Well, again, I agree with you that our deficits are unsustainable, and those commitments are unsustainable, but I think it is important to recognize that that is not the dominant economic challenge facing the country. And as we address that challenge, we have to make sure we are preserving some capacity to address the many other challenges we face, and we do have some time to get that right. That is not something we have to solve in the next 3 weeks, in the next 3 months. We have some time to get that right. We do not have a lot of time, and the sooner we do it, the better, because people have some time to adjust.

I guess the only thing I would encourage you to do is do not view—not you personally, but Americans should not view the economic challenges facing the country solely through the prism of how we make Medicare more sustainable, because we have to worry about how we are going to be competing with countries like China. We have to be worried about how to make sure our education outcomes are better for Americans. We have to make sure we are improving incentives for investing in the United States, and we have to make sure that we are doing other things that bring those deficits down to a sustainable level.

So that is the point I would make. Although we disagree on Medicare, we disagree on these other areas, too, and we are going to have to find some common ground.

DEBT LIMIT

Mr. WOMACK. One final question, and then I will yield back, Madam Chair, and that is debt ceiling increase. When are we looking at the next request for a debt ceiling increase?

Secretary GEITHNER. On the current estimates—as you know, these are very uncertain, they change over time, and we update the Congress very regularly on these—we do not expect to hit the debt limit until quite late in the year. We update the Congress, I think, every month on these projections, and they will change over time, depending on how the economy performs.

And, you know, let me just point out that we cannot put the country through what we put the country through last July and August with the threat of default for the first time in our Nation's history hanging over the United States for a long period of time. That did more damage to consumer confidence and business confidence than almost what was caused by the crisis in the United States.

So we have got to make sure that we find a way to solve this problem so Congress is not put in the rather awkward position of having to vote against things you already authorized. Again, you know, we cannot borrow a penny beyond what you have authorized us to borrow in the judgments made by the Appropriations Committee and other committees in that context. So as you consider how to deal with this, try to do it in a way that does not leave the country facing that enormous damage caused by the specter of default hanging over the country.

Mr. WOMACK. Thank you.

Secretary GEITHNER. Thank you.

Mrs. EMERSON. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Madam Chairwoman.

Mr. Secretary, good to see you again.

Secretary GEITHNER. Good to see you.

Mr. DIAZ-BALART. It is like déjà vu all over again, right?

I will tell you that as you part, I will also miss our exchanges, and thank you for your service.

A couple of issues. I just want to first comment on something the Chairman, Chairman Rogers, was talking about, whether the debt could hurt, impede our ability to act. I will quote the Secretary of State Hillary Clinton, September 2010, when she said, quote, "Rising debt levels pose a national security threat in two ways. It undermines our capacity to act in our own interest, and it does constrain us where constraint may be undesirable, and it also sends a message of weakness internationally."

I think, Mr. Chairman, I think it goes to the point that you were making.

You mentioned, Mr. Secretary, how we differ or what separates us is—among the things that separates us is how fast the deficit should be cut. I will tell you, however, that it seems on that issue the President separates himself from himself. I will quote him as well, including in the State of the Union in 2009 where he mentioned that he would cut the deficit in half in his first term. He has yet to propose a budget that does that and keeps his word. So, again, that separates the President from the President, not only from Congress.

NONRESIDENT ALIEN INTEREST INCOME RULE

Now, the issue that I want to bring up to you today, sir, maybe, Madam Chairwoman, he just needs a little bit more space after the elections to finally do that, but what I wanted to talk to you about today, Mr. Secretary, is a letter that some of us wrote to you, and it is a rule that the IRS is supposedly putting together that would require all U.S. financial institutions to report all interest payments made to nonresident aliens.

This proposed rule, in my opinion, would have a devastating effect on the economy of a number of States, including the one that I represent, and I think it would potentially put people's lives at risk, you know, Mexicans and Venezuelans who all of a sudden their bank accounts would and how much they have in the United States would be known by the Governments of Venezuela or the—you know, we know the issues in Mexico. So do you know if this rule is still being finalized and, if so, when it will be finalized?

Secretary GEITHNER. Yes. We expect to come out with it soon, and we think you are going to find it reassuring in the sense it is not the kind of risk you are concerned about. I have heard from a number of Members of Congress about those concerns and talked to many of you. I will be happy to talk to you in more detail about it.

And maybe just for the rest of the group it is worth pointing out that we cannot share and will not share information with countries we do not have tax agreements with or tax information-sharing agreements with, and where countries do not have adequate safeguards in place to protect the confidentiality of those exchanges, and because of that I am much less concerned about the concerns

you raise that this rule would be damaging to banks in your State or elsewhere.

Mr. DIAZ-BALART. Mr. Secretary, my understanding, however, is that two of the countries you do have that arrangement with are Venezuela and Mexico, and obviously Venezuela, that is—in this hemisphere, I understand, it is Canada—obviously Canada does not concern us, but my understanding is those two as well.

Secretary GEITHNER. Well, actually I think this I can talk to you in more detail about, but I actually think we are going to be able to reassure you significantly that we have enough safeguards in place that would reduce that risk.

Mr. DIAZ-BALART. Well, Mr. Secretary, you know, I appreciate that. You have always been very accessible to me, by the way. I will tell you, however, not you, but after last year when we had a similar discussion, we talked about getting together, your office contacted ours, we had a meeting scheduled. Right before the meeting they canceled, and I have not been able to reschedule that. So I would like to get back with you, if you could.

Secretary GEITHNER. I will fix that.

Mr. DIAZ-BALART. Thank you very much. I look forward to that.

Secretary GEITHNER. One thing, you began with this point. The President has proposed to cut the deficit in half as a share of the economy over that time frame, which is the right relevant metric, because what judges whether that burden is sustainable is how large the debt is relative to the share of the economy as a whole. And, again, we all agree that you have to cut the deficits fast enough so you bring them down to the point where the debt stops growing as a share of the economy, and that is something we are very committed to, but, of course, we cannot do it without the Congress.

Mr. DIAZ-BALART. Thank you.

I guess, Madam Chairwoman, it is, quoting another President, depending on what your definition of “is” is.

Thank you. I yield back.

Mrs. EMERSON. Thank you, Mr. Diaz-Balart.

Mr. Bonner.

Mr. BONNER. Thank you, Madam Chair and Mr. Secretary.

I would note that we have got some students who are visiting with us today. Some just left. It looks like we have got some who might be in high school and some in college. I might not be a good judge of their age. But when you pull your dollar bills out, there are a lot of people you could come watch present testimony to Congress, Secretary of Defense, Secretary of State, a lot of other officials in government. There is only one that has actually got his signature on your dollar bill, and that is the Secretary of the Treasury. So we are glad to have Secretary Geithner with us today, and we welcome these students from all over the country.

SENATE BUDGET RESOLUTION

There has been a lot of talk about the debt as well as the budget, so I am going to try to focus my two questions on that. The Administration has been critical, even today, of the House Republican budget that we are going to be voting on this week, and, correct me if I am wrong, I have not heard a word of criticism that our

friends on the other side of the Capitol, the United States Senate, has failed to produce a budget for more than 3 years.

You know, if you go back and look at history, we built the Pentagon in 16 months during World War II. I think budgets are important, I think most Americans believe they are important, whether it is the family budget or a small business's budget. Does the Administration have an opinion about the fact that while the Administration is required to produce a budget—and the President's budget last year was voted down 97 to nothing in the United States Senate, as I recall. Our budget will come up for a vote, and there will be alternative budgets. Does the Administration have a position that the United States Senate cannot seem to come up with a budget, Mr. Secretary?

Secretary GEITHNER. Congressman, that is a good question. I have been asked this before many times, but it is really a question for the Senate and the budget process. I think it is worth pointing out that even without a budget resolution, Congress is not constrained from passing laws that limit spending or change tax policy or address the entitlement problem. So nothing stands in the way of the Congress, the House or the Senate, even in the absence of a resolution, from moving forward with, for example, the agreement we reached last year to cut discretionary spending, defense, nondefense, and does not stand in the way of tax changes that will be good for investment or entitlement reforms that would make it more sustainable.

Mr. BONNER. It does not stand in the way, but perhaps if you have got any contacts over in the Senate or the President or the Vice President, both the President and Vice President were members of the Senate at one time, maybe they could pick up the phone and see if they would like to work with us on that. Because you are right, we do not have to have a budget, but it certainly would help the process going forward.

Secretary GEITHNER. Congressman, as you know, we have been working on it. You know, we did spend a lot of time last summer negotiating with the leadership in the House and the Senate on a set of long-term fiscal reforms. The supercommittee spent a lot of time, too, and we did reach agreement on a trillion dollars in savings over 10 years. That is not enough; we have got to go beyond that. We have been doing some good foundation laying about how to build on that, and, you know, we are having a great debate which we have to resolve about the remaining choices.

DEBT PROJECTIONS

Mr. BONNER. Chairman Rogers started the discussion about the debt, and I guess I will ask the question, but then before you answer it, we will kind of give a little bit more filler. How much debt is too much debt?

But before you answer that, CBS News, which conservatives do not often quote, I must add, last week came out with a story: The national debt has now increased more during President Obama's 3 years and 2 months in office than it did during the 8 years of the George W. Bush Presidency. The debt rose \$4.8 trillion during the two terms of the Bush Presidency and has now gone up \$4.9 trillion since President Obama took office. It goes on to say that the

national debt now exceeds 100 percent of our Nation's GDP, which is the total value of goods and services. And while the President, it says, has been quick to blame his predecessor, and clearly this Administration inherited a whole set of problems—every Administration inherits problems except President Washington's, and he did not have anyone he could blame—but while there are challenges, the President's own budget, as I read, would forecast a \$25 trillion debt in 2022 if we just—we will get a chance to vote on the President's budget tomorrow. If we pass it, is \$25 trillion, is that a good path to be on or the \$15 trillion that we are dealing with right now?

Secretary GEITHNER. Well, let us do a little bit about the past and a little bit about the future. The President's policies account for—and this is a CBO number, not ours—roughly 12 percent of the projected increase in debt over the next 12 years. The balance is the responsibility of, or the result of, the choices made by previous Congresses that predated this President, choices about how to finance two wars, and how to finance a bunch of tax cuts, and how to finance a pretty substantial expansion of Medicare. And they are the result of the costs of the crisis, which, of course, the President inherited.

The President's policies contributed—and they were absolutely necessary—a very small part of that increase in the projected debt burden, and his share of responsibility for that is very, very small relative to the dramatic erosion in the fiscal position of the United States that happened between 2001 and 2009.

Now, looking forward, we agree with you, and I will say it over and over again, I am the Secretary of the Treasury, our deficits are unsustainable. They have to come down over time.

If we do not act, the debt burden will rise to a level that will hurt the American economy, hurt our security interest, hurt our ability to do things that matter for the country as a whole, not least because of the risk of higher interest rates. So it is very important we move to address them, but we have to do it in a way that does not hurt the economy in the near term and undermine our capacity to meet our national security interests, meet our commitments to our seniors, make sure we are investing in things that matter going forward. And that is what separates us today.

Now, from an economic side, again, the critical test, the financial test is you have to get the deficits down to below 3 percent of GDP over the next roughly 4 to 5 years. And if we do that, that will stabilize our debt burden as a share of the economy somewhere in the 70s appropriately measured, meaning somewhere between 70 and 80 percent. And that is a manageable debt burden over time.

Now, of course, that won't solve our Nation's problems forever, because if you look out over the next two or three decades, four decades, you still see healthcare costs and Social Security benefits rising to an unsustainable level, so we will have to do more beyond that. But if we do take that one step, which is a totally achievable step, to find another \$3 trillion in savings over the next 10 years on top of the Budget Control Act, then we will stabilize the debt at a manageable level for this country and will be much more likely to grow over time.

Mr. BONNER. Did any of those come about as a result of cuts, or will they only come about as a result of tax increases?

Secretary GEITHNER. Thank you for asking that. I am very grateful you asked that question.

We need about \$4 trillion in deficit reduction over 10 years. We agreed on \$1 trillion last summer. We have to stick with that. That means we have \$3 trillion more we have to find. And we propose to do that roughly half in revenues and roughly half on the spending side. And our spending reductions rely, as the Chairman implied, mostly on mandatory programs. Our tax measures only apply to the top 2 percent of Americans.

Now, if you look at the total \$4 trillion, there is roughly \$2.50 of spending cuts for every dollar in revenues we propose. And it is only 1 percent of GDP in revenues. That is a totally manageable burden to ask the American people to bear as we try to restore our country to a sustainable fiscal position.

Mr. BONNER. Thank you.

Mrs. EMERSON. Mr. Graves.

Mr. GRAVES. Thank you, Madam Chair.

Quickly, before my question, I know you were reflecting on the past, and you were talking about the Congress and the problems that the President inherited from the previous Congress—we will certainly want to remind everyone that the President was part of that previous Congress—and the problems that he inherited being in the Senate; is that not correct?

Secretary GEITHNER. I was referring to the Congress that ended in 2008. Because, again, it is worth going through this. The huge drivers of the increase in debt are—I mean, to be fair, they are really about three things. Over the long run they are about Medicare, Medicaid, Social Security and millions of retirees.

Mr. GRAVES. And the President wasn't part of that Congress that ended in 2008?

Secretary GEITHNER. I see your point. That is a good point. He was a Senator for 2 years, you are right.

Mr. GRAVES. So he had an opportunity to be part of the solution?

Secretary GEITHNER. That is true. But the biggest erosion in that fiscal position came as a result of the choices made well before that. As you know, they are about how to finance the Bush tax cuts, Medicare Part D, and the two wars. Those were the most expensive choices we made fiscally, and that is what turned a bunch of surpluses into deficits.

Mr. GRAVES. Thank you.

But you talked a little bit about the budget and what we agree and what we disagree on, and there seemed to be a lot of disagreements. The one thing we do agree on, though, is—according to your statement, is about the deficit reduction. And that gets to the budget discussion that we are going to be having later today and tomorrow.

And a lot of people say, well, what is the importance of a budget? The Senate hasn't passed one in 3 years, and the House has one, the President has one. And when I try to reflect, and maybe you can confirm this, it is really a vision; it is a vision for where you see our Nation going and where it will be in the future.

And when you compare the two, I would say the Republican budget that you will see passed is a vision of opportunity and prosperity; it is less government, less taxes, and moving towards a better future and a balanced budget. Then you compare that with the President's budget, and the facts are out there. It is more government, it is more taxes, and my understanding is it never balances in the future.

But you sit here and you talk about deficit reduction, the importance of that, and it is the President's plan or his proposal, but yet it doesn't do that. It does, in fact, 4 consecutive years now \$1 trillion deficits and no balanced budget in perpetuity.

How do you share that to the American people that that is the right vision for moving forward is debt and dependency.

Secretary GEITHNER. Well, you are right that deficits are a reflection of values and priorities, and our priorities are very different than those embraced by many of your side. You are absolutely right, a big contrast between us on that basic front.

But let me describe the context a little differently. I think Madam Chair said at the beginning that under the President's budget discretionary spending, defense/nondefense, would fall as a share of the economy, the appropriate measure, to the lowest level since Eisenhower was President. So we are reducing, not increasing, those very important responsibilities of government.

The only thing that increases in our deficit are the costs of meeting our commitments to millions of retiring seniors. And we propose to reduce the rate of growth in those costs, but we are sustaining that commitment.

BALANCED BUDGET PROJECTIONS

Mr. GRAVES. And what year would that balance?

Secretary GEITHNER. You are absolutely right. I think your resolution balances in about four decades.

Mr. GRAVES. Your resolution?

Secretary GEITHNER. Yours. In about three and a half decades.

Mr. GRAVES. No.

Secretary GEITHNER. Now, none of us know what is going to happen the next 5 years and certainly not beyond that, and that may happen.

Mr. GRAVES. But when does the President's budget?

Secretary GEITHNER. And you are right, the President doesn't go that far.

Mr. GRAVES. It doesn't balance.

Secretary GEITHNER. No. Well, what ours does, and I said this before, we only budget for 10 years in the United States. We don't go beyond that. Ten years is a long time. The world is a very uncertain future. But for the next 10 years, we meet the critical test of bringing the deficit down to the level where the debt stops growing as a share of the economy. Now, your deficit is not balanced within 10 years. Your budget is not balanced in 10 years. It balances in about 40 years or 30 years.

We are not proposing to try to solve the next century's problems in these next 10 years. We are proposing to solve the next 10 years' problems. Ideally we can reach agreement in the next 18 months or so. As you know, the Congress faces a pretty strong incentive

to agree at the end of this year because we have the expiry of all these tax cuts and the sequester, so we hope this is a moment that will focus attention.

Mr. GRAVES. So we agree that budgets are a vision, they are a reflection of priorities, and you disagreed that the President's budget has no vision for balancing in the future, but the Republican budget does have a vision for balancing in the future?

Secretary GEITHNER. No, I would not say that, because first of all, I have no idea what would happen beyond the 10-year window. Within the 10-year window, what separates us really, is how fast and how quickly you cut the deficit—and we believe you do it imprudently in a way that will weaken the economy—and how deep you cut into the safety net and into entitlements, and of course taxes. And we are just being honest about it. We do not see how you solve this without roughly 1 percent of GDP in revenues.

Mr. GRAVES. Even with tax increases that you propose, your budget doesn't balance.

Secretary GEITHNER. But yours doesn't over 10 years either.

Mr. GRAVES. At any point. I did not say 10 years. I said yours doesn't balance in perpetuity, in forever, infinity, it doesn't balance even with the tax increases and all the proposals that you have. But at least we are willing to put both proposals forward that show a path towards a balanced budget, that show a path towards reducing the deficit and reducing our debt. And that is something that, while we may disagree on a lot of things, that is certainly a big void and a big divide.

And then my last question, Madam Chair, is who will be proposing the President's budget in the House?

Secretary GEITHNER. I cannot answer that question, but I know your colleagues can.

Mr. GRAVES. Is there a Democrat proposing the President's budget?

Secretary GEITHNER. A good question, but it is really not a question for me. But let me just respond to one thing.

Mr. GRAVES. Then you know the answer.

Secretary GEITHNER. No, actually I do not know the answer to that question. I really do not.

Mr. GRAVES. The President would have somebody to propose his budget in the House.

Secretary GEITHNER. But you are right to say that we disagree, and you are right to say that your proposal reflects a fundamentally different set of priorities for the country, and the country is going to have to choose in that kind of case. I totally agree with you. I wouldn't choose your path. I just wouldn't do it, because I think it will make the economy weaker over time, not stronger.

I want to just emphasize again it is not, I think, realistic to view the Nation's challenges solely through the prism of how we figure out how to make Medicare, Medicaid more sustainable over time. We have a vast, complicated set of other challenges, and they cannot be addressed thoughtfully, sensibly through an agenda that suggests that all we need to do is cut our way to growth or reduce government in that broader context.

I don't know how you think about education, or investment, or innovation or competitive challenges if you think that the Nation's

challenges are only about the next century of commitments on Medicare and Social Security.

Mrs. EMERSON. Thank you very much.

Mr. SERRANO. Madam Chair.

Mrs. EMERSON. Mr. Serrano.

Mr. SERRANO. Is there any way that I can make a quick statement?

Mrs. EMERSON. Sure. Go ahead.

Mr. SERRANO. I think we have to be honest with ourselves here. I think as we look closer and closer to November, these hearings and these debates are going to turn more and more and more into "defeat President Barack Obama." And I think the fact of life is that we just need to very quickly or very importantly look at a little bit of history here.

I have been here 22 years, and I remember President Clinton leaving a surplus. And I remember the next 8 years that surplus being squandered away by going to look for weapons of mass destruction in a country that obviously did not have weapons of mass destruction. The only weapons of mass destruction we had were the rates of poverty in this country and lack of education for some folks.

Secondly, it seems to me that there is a House of Representatives led by one party, the Republican Party. I don't like to talk this way, but I am just getting a little tired of hearing it. And we have a Senate with rules that allow the Republican Party to gum up the works and not allow anything to happen. Meanwhile, under that system, some people say that only President Obama has caused all these problems.

Well, ask the auto industry if they think he has been a bad President. Ask the people who thought we might go into a depression if they thought he has been a bad President.

The fact of life is that he inherited a problem. No one wants to hear about that. No one wants to talk about the past. We only want to talk about the future. But we have got to know where we have been in order to know where we are and where we are going.

The fact of life is that we squandered for 8 years all possibility. Last but not least, during those 8 years we were also highly disliked throughout the world. That has been regained. Our respect throughout the world has been regained. That may or may not be important to some; it is very important to me.

So I know I am over here by myself, and I know that I have a reputation for being a gentleman about these things, but there reaches a point where you just have to say, as we say in the other language, "Basta ya, enough." You know, get used to the fact that he is President. He is going to be President for the rest of this year, and chances are he is going to be President for another 4 years. And his economy and his plans will work if we believe that they should work. If we believe that his defeat is the only thing that matters to us, then nothing will work for this country.

Mr. GRAVES. Will the gentleman yield?

Mr. SERRANO. I will yield.

Mr. GRAVES. And I agree with you that we need to have a plan. And you ended with that. Who on your side will be shepherding the President's budget through the House this week?

Mr. SERRANO. Well, interestingly enough, this may come as a shock to you, but we are not in charge of any of the committees that handle the budgets. We are in the minority party. We will be speaking for those changes. We will be speaking for reaching out to you in a bipartisan fashion, as we have on many occasions on many issues, in the hope that we can get our economy going and continuing to grow as it has been growing slowly, but growing nevertheless. It is not a matter who will present, who will not be presenting.

Mr. GRAVES. Well, Mr. Van Hollen has a budget, the Congressional Black Caucus has a budget, progressives have a budget. Who will be presenting the President's budget?

Mr. SERRANO. We are Democrats, that is what we do. But we have budgets, and we will discuss—

Mr. GRAVES [continuing]. The President's budget.

Mr. SERRANO. We have budgets. What we don't have is a desire to do everything based on getting rid of a President in the White House. That is not what we are doing.

Mr. GRAVES. Thank you.

Mrs. EMERSON. Okay. Mr. Alexander.

JUDGMENT FUND

Mr. ALEXANDER. Thank you, Madam Chairman.

A few moments ago Mr. Bonner said that poor George Washington did not have anybody to blame his problems on, but it looks like we are doing a pretty good job blaming at least some of our problems on him.

Mr. Secretary, in 2012, the House Financial Services Appropriations language included a directive that would require the Treasury Department to provide a report on an annual basis 180 days after enactment of a law that would tell us what payments were made through the judgment fund and provide that information to Congress and also make it available to the public. Can you give us any idea of what the status of that report is?

Secretary GEITHNER. Can I just ask you which specific report is this? Is this the—

Mr. ALEXANDER. It was in—

Secretary GEITHNER. That was in the forfeiture fund? It is not that. You are shaking your head.

So can I respond to you in writing?

Mr. ALEXANDER. Sure.

Secretary GEITHNER. Obviously we will give it to you as soon as we can. And I am sure we are on it.

Mr. ALEXANDER. This is the U.S.C. 1304 report.

Mrs. EMERSON. That is all?

Okay. Mr. Yoder.

Mr. YODER. Thank you, Madam Chair.

I appreciate, Mr. Secretary, you being here today. And comments from my colleagues aside, I do think it is an important dialogue we have about this President's policies. And I certainly know you are well adept at answering and responding to those, and this is part of the exchange that goes on on some very critical issues that are facing our country.

DEBT AND SPENDING

It is no secret that no one in this room is excited about a \$16 trillion debt, unemployment 8 percent and higher. The President can't be happy with the status of the economy. And so I think it is natural that we are going to have a very good back-and-forth as we try to determine what the proper course is. And we know that there are multiple approaches, and there are frustrations that many in the House have with the administration's approach. And so this is an opportunity to ask questions about that approach and have a dialogue, and it is not an opportunity, I believe, for electioneering or election politicians. These are serious, serious issues that millions and millions of Americans are very concerned about in each one of our districts, that talk to us at town hall meetings about them, that have big concerns about the President's policies, and this is our opportunity to be voices for our district to ask you questions about how the President intends to proceed in this term or if there is another term, because these are critical issues.

And to that end, in listening to your testimony, I want to kind of continue along some of the questions that my colleague Mr. Graves was asking, particularly related to the President's approach related to debt and spending. The position that you are taking, sir, is that the President's approach is a very serious one, that it is aggressive. And I note that the President commissioned the Simpson-Bowles Commission last year. I know that there are much more aggressive proposals that the President could be putting on the table in terms of revenue and spending that would have a quicker resolution at some of these issues.

And I know the position is, well, first of all, we inherited this problem; second of all, that it can't be fixed overnight, and we need another term to do it. And I think, frankly, Americans are losing patience because they don't see the vision that the President believes he may have. This Congress doesn't see it; many of the American people don't see it. And when we see the Simpson-Bowles Commission and then the report go right on the shelf, I can tell you people ask all the time, why didn't the President embrace that Commission, why doesn't he take a bolder stand? And there is a cynicism that has grown that believes the President is merely focused on election.

So if we want to talk about election politics and where people are, that is where the cynicism is about electioneering. And so to that end, will the President take bold leadership beyond the marginal positions he has taken this year on the debt, or is the President—are we focused on November, and we are going to see some bold leadership in January if the President gets reelected?

Secretary GEITHNER. Well, the President has laid out, as I said, \$3 trillion in other deficit savings proposals over 10 years, about half in revenues, about half in spending. They are very detailed. I know that your side doesn't agree with them, doesn't embrace them. But they, if embraced by the Congress, would reduce our deficit to a sustainable level, stop the debt from growing as a share of the economy, start to bring it down, and it would do that in a way that still preserves room for us to be investing in education, infrastructure, national defense, things like that.

So we have contrasting visions about what makes sense for the country. I understand you don't like his vision. I think you know we are not going to support your vision. But ultimately we are going to have to make some choices, and at the end of the year, of course, we face this collision of expiring tax increases and a sequester that I hope will provide a strong incentive for Congress to——

REVENUE

Mr. YODER. Well, let us talk about the tax issues. The President's position this year has been, I believe, one that has been very divisive in our country in which the attempt has been to encourage Americans to focus on taxes that affect one another as opposed to the entire whole. And it is this whole debate—and really many call it class warfare—it is the politics of division that many believe is for personal gain, political gain, I might say.

And so as we go down that road, do you believe the efforts to divide Americans amongst groups, as the President has done on tax policy, and to try to target only 1 percent of the population, which—let me ask two questions here. One, do you believe that it has been good for the economic debate in this country? And two, do you believe that type of tax targeting will be enough revenue to solve the debt crisis that the country is facing?

Secretary GEITHNER. Well, maybe I should start this way. You began by extolling the virtues of Simpson-Bowles, I believe. And it is important to point out that in Simpson-Bowles, and like every other bipartisan proposal for fiscal reform, they include a very substantial amount of revenue increases. They propose \$2 trillion in revenue increases; we propose \$1.5 trillion. Some of them were modest revenue increases.

Our proposals are very similar in broad design as theirs, and if we were able to find support on the Republican side for that kind of a balanced plan, we would be much closer to a resolution. And, of course, I believe, and I very strongly believe, that the President's proposals of a more balanced approach with investments and national tax reform that raises revenues is better economic policy and better fiscal policy and will be better for the country if embraced.

Mr. YODER. How much revenue does letting the Bush tax cuts expire for the upper 1 percent bring in a year?

Secretary GEITHNER. Well, let me just say it is about \$1 trillion over 10 years. So if you extend those tax cuts——

Mr. YODER. What would it bring in in 2013, for example?

Secretary GEITHNER. Well, again, after 10 years you would roughly divide it by 10, so a little less than \$100 billion.

Mr. YODER. What is the annual deficit projection for next year?

Secretary GEITHNER. The deficit will be roughly, I don't know, 6 percent of GDP next year, maybe a little higher.

Mr. YODER. Sir, the number. I know we are mixing apples and oranges in your approach here.

Secretary GEITHNER. Is your question: can you do it just with revenues?

Mr. YODER. Well, my question is how much does letting the Bush tax cuts expire in the 1 percent, how much does it bring in next year?

Secretary GEITHNER. Well, as I said, it is roughly \$1 trillion over 10 years, which means roughly \$100 billion each year.

Mr. YODER. Okay. So \$100 billion next year?

Secretary GEITHNER. Right.

Mr. YODER. And the second question is, then, what is the deficit projection next year in terms of dollars?

Secretary GEITHNER. Well, I will look in my paper and find it, but as a share of the economy, it is somewhere between 6 and 7 percent of GDP. But another way to think about this is—

Mr. YODER. Sir, is it possible that you could give us an estimate of what the deficit estimate is for the next fiscal year?

Secretary GEITHNER. Of course. It is in the public record, but I am happy to look it up while I am answering the other questions. I am happy to do that.

Mr. YODER. Okay.

Secretary GEITHNER. But is your point that you cannot do it just with revenues? Because if that is your point, we agree with you.

Mr. YODER. No. My question is what percent of that is? Is it \$1.5 trillion, and we are talking \$100 billion? What is the difference?

Secretary GEITHNER. Well, again, I think this is the simplest way to think about it. We have roughly \$3 trillion we have to go over 10 years. We propose to do about roughly half of that in taxes. A big chunk of that comes through by letting the Bush tax cuts for the top 2 percent expire, as Congress intended. That is about \$1 trillion.

Mr. YODER. It is a big chunk of the national deficit.

Secretary GEITHNER. No. Well, again, it is a—

Mr. YODER. See, the problem, sir, is the challenge is in terms of the—

Mrs. EMERSON. Mr. Yoder, your time is way expired, so finish your sentence and then—

Mr. YODER. That is fine. I can yield back.

Mrs. EMERSON. Thanks.

IRS FUNDING

It is my turn again. I want to go back to this whole IRS question, if you don't mind, Mr. Secretary. Obviously, our allocation has been reduced by 11 percent over the past 2 years. In recognition of the critical service the IRS presents, we have reduced their funding by 2.7 percent over the past 2 years. As a result of that, the other accounts that we control have had disproportionately higher cuts.

I understand we are doing the best that we can; however, I am disappointed about budget. I don't like budget gimmicks, and I am disappointed that the administration would have proposed the \$691 million discretionary cap adjustment for the IRS rather than finding the funds for the IRS within its own top line. I mean, how do you reasonably expect our subcommittee to believe that tax administration is a priority, given the fact that you all were, in fact, proposing to use a budget gimmick in order to give the IRS the extra money it needed?

Secretary GEITHNER. Again, an important question. I know we put you in a difficult position. What we are proposing is something Congress has done many times in the past, in 2006, in 2009, under Republican administration and Democratic administration, and

that is to recognize that where we make investments in things that raise revenue, Congress should account for those because they are prudent investments.

IRS is the best example of that, because \$1 in the enforcement budget yields \$4 in revenues. So what we are proposing to do is for Congress to consider, like they have in the past, to adjust those caps to accommodate these investments. We think that it will fundamentally make the job of the Congress easier over time, not harder over time, because you will lessen the burden of other cuts in other parts of the budget, including in your committees.

Mrs. EMERSON. But you well know that Congress doesn't always do this?

Secretary GEITHNER. But it should.

Mrs. EMERSON. Well, I guess that is where we might disagree. But since neither the House nor the Senate Budget Committee has taken any step toward increasing the discretionary spending limit in the Budget Control Act, what is your all's legislative strategy for amending the BCA if need be?

Secretary GEITHNER. Well, we are going to work with your relevant colleagues in the Congress to try to encourage them to do that.

And again, just to come back to one thing you said, in the proposal we laid out, we accommodate and make up for where we make investments. This is different from other investments because, again, it is investments that raise revenue by any measure, and if proposed, Democrats agree on that context.

So, we recognize, Madam Chair, that we put you in a difficult position, that you can't determine the outcome in this context, and it puts more pressure on you. So we are going to work with your colleagues to see if we can convince them to make the adjustment necessary for this. We are doing it not because we think it is easy, but because we think it is part of a prudent and responsible way to get our arms around our fiscal problem.

IRAN SANCTIONS

Mrs. EMERSON. Well, given the fact that we are dealing with smaller numbers each and every day, I am not feeling optimistic on your behalf.

Let me switch over to Iran, because I really do want to thank you for the response to my letter about the Society for Worldwide Interbank Financial Telecommunications, or SWIFT. And I do appreciate, and I know others do, too, the efforts by your staff and that of the European Union to persuade SWIFT to terminate services for certain Iranian institutes. But I am concerned that Iran is not going to be deterred and simply will find a way to conduct the same types of transactions in the shadows, if you will. So could SWIFT's decision have the unintended consequence of generating more work for the Office of Terrorism and Financial Intelligence?

Secretary GEITHNER. I think that, of course, the burden they face is very large, and this challenge of making sure these sanctions have as much force as they need to is a never-ending challenge. You have to be relentless about it. Because, as you say, where you stop at over time, people try to find a way around it, so you have to keep expanding the net.

So, yes, they are under a tremendous burden, but they are doing exceptional things with limited resources. And we believe that the resources we propose in this budget are adequate to meet that challenge.

Mrs. EMERSON. But you do think they are well-prepared to detect any kind of underground activities and the like?

Secretary GEITHNER. Well, again, we have remarkably effective tools, really a model for the world, in how to marshal the resources of the United States Government, intelligence and other resources to try to make sure we can track down and stop this stuff from eroding the sanctions. And we feel we have asked for a reasonable amount of resources to support that objective and appreciate the committee's support for that in the past.

Mrs. EMERSON. And those folks do a very good job, and sometimes we are not in total agreement, too, on the financing of it, because I think this is absolutely critical for lots of reasons, not the least of which is our national security.

Just to inform colleagues, I am at 5 minutes. I am going to be very strict now on the 5-minute rule because I have got probably 18 rounds of questions, and I am sure everyone else does, too.

So, Mr. Serrano.

Mr. SERRANO. Thank you. I will be brief also.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

Let us turn to a subject where things are going very well. Even in these tough economic times, the CDFI funding produces incredible leveraging. In fiscal year 2011, CDFI grantees produced \$13 in private funding for every \$1 invested into the program. Mr. Secretary, what is the value of this leveraging in terms of job creation and economic development in underserved communities?

Secretary GEITHNER. Well, it is very powerful. What happens, those communities in general have a hard time attracting investment because people view them as more risky in that context. Those risks are dramatically intensified in a financial crisis like we have been through. This program has an exemplary record over time with a lot of, bipartisan support, which helps attract more investment to areas where we see concentrated poverty. And the markets need a little bit of encouragement in that context. A very good record. And I am very grateful for not just your personal support, but the committee's support for the CDFI program over time.

Mr. SERRANO. Could you very briefly tell us about the bond guarantee program through CDFI and how that will help?

Secretary GEITHNER. This is a modest innovation and expansion of the arsenal of tools that we use. As you know, in the CDFI program we have a range of different instruments—grants and loans. And like the Congress has embraced in lots of other areas, SBA as an example, we think there is a good use for guarantees, too, in this context. So I would view it as just a sensible, modest expansion of the tools we have to support this basic objective, which is try to make sure we are attracting investment into communities where Americans are still suffering a lot from the damage caused by the crisis there is a very good economic case for doing this.

Mr. SERRANO. Madam Chair, I know you have many more questions from other Members, and I want to be understanding of that. Let me just make one comment in closing this round.

I can't help but I heard the phrase "class warfare." I think it is important to note that some people consider class warfare for our President to say to those who are millionaires, pay a little bit more to make things a little easier for the rest of us and to make a better future for yourself, because a strong country and a strong economy helps people who have a lot of money. But it is never considered class warfare by those folks when you say, reduce the taxes of the millionaires and cut food stamps, Medicaid, school lunch programs, childcare benefits in order to pay for those cuts. That is not allowed to be called class warfare.

Well, I don't know if it is class warfare or welfare for the rich or what it is, but I think it is not improper. I am not a millionaire, but I tell you what, if I was a millionaire, and I would gladly pay more taxes if I was a millionaire. I am not wishing I was a millionaire, but if I was, I would pay more in taxes.

So I don't understand why telling folks who have more give a little bit more so we can have a stronger country is class warfare, and telling people on food stamps you will get less this year is not class warfare.

Thank you, Mr. Secretary.

Mrs. EMERSON. Thank you very much, Mr. Serrano.

And I just want to comment back to the Secretary, based on your comments about the CDFI, that I am grateful that you are willing to work with the Committee, or the Subcommittee rather, on persistent poverty counties, because language we had put into previous bills had been removed by the administration, and there is no language in the 2013 budget request. But it is absolutely critical that our persistent poverty counties do get the recognition they deserve with regard to this program.

Ms. Lee.

Ms. LEE. Thank you very much.

I apologize for being late, Mr. Secretary. I was across the hall at another hearing. But I understand that you have decided that maybe this may be your last hearing before this subcommittee.

Secretary GEITHNER. It is like attending your own funeral.

Ms. LEE. Well, first of all, let me just thank you so much for your leadership and for your real commitment in restoring sound regulation and helping to revitalize and stabilize our markets. And I am confident that what you have done will really fully finally implement our vital recovery so that our entire economy, Wall Street, as well as the 99 percent can recover. And so thank you for your service.

HOUSING

Also I just wanted to mention a couple of things as it relates to the foreclosure crisis. Of course, you know it has hit all of our communities. California has been severely hit. And you know about the efforts to try to get Fannie Mae and Freddie Mac to do more. They own a lot of these mortgages, and yet they don't seem to want to do the write-downs. These are some of the hardest-hit mortgages

in the country, I think 70 percent, and the Acting Director Mr. DeMarco just will not do that for whatever reason.

I want to get your sense of why that is the case, and what, if we could do that, that would mean. And I am one of the few who are calling for a real moratorium on foreclosures, and I want to get your take on that.

CUBAN SANCTIONS

Finally, with regard to Cuba, as you know, Treasury did not see fit to do the thorough risk-based assessment as was recommended through GAO as it relates to the work that OFAC is doing on Cuba as it relates to travel licensing. General McCaffrey in the past stated for the record that Cuba posed no strategic threat to the United States. I don't think Americans traveling to Cuba pose any real risk to the United States either; many of us don't.

So I just want to find out from you how many OFAC staff are assigned to enforcing the Cuba sanctions, how many OFAC staff are stationed at the Miami airport or any other airports with direct charters to Cuba, what percentage of flights and passengers returning from Cuba face a secondary screening or interviews by OFAC officials, and how many enforcement actions for Cuba-related sanctions were taken by OFAC last year given that in the past it didn't pose a strategic national threat to the United States. I am trying to get a handle on how much money, how many taxpayer dollars are being used to enforce some actions that don't pose a strategic threat, yet there are other terrorist-related activities that could possibly use some of these resources that pose real national security threats.

Secretary GEITHNER. Thank you for those questions. I will respond in writing to the details on Cuba. Let me just begin with that, though. Of course, Congress sets the laws in this area. We have to enforce those laws. So we have to make sure we have resources in OFAC devoted to enforcing those laws. But your question really reflects concern that those resources are coming at the expense of our ability to make sure we are meeting not just the broader obligations Congress gives us in enforcement, but those that pose a major national security risk to the United States, like Iran.

Let me just reassure you that I am very confident that the resources we have to put into enforcing the laws with respect to Cuba are not coming at the expense of our ability to make sure that we are protecting Americans from the threat posed by Iran, or terrorists, or other threats to national security. But I will respond in detail on those questions.

HOUSING

On housing let me just say the following: The FHFA is doing a lot in this area. They are doing a lot to modify mortgages. They are doing a lot to help Americans refinance even if they are underwater. But you are right to point out that they have been very hesitant so far to provide principal reduction in those cases where many of us, including the Treasury, believe that it makes sense for the taxpayer, it makes sense for the housing market overall. So we are working very closely with them to try to make the case, to ex-

plain to them where does it make sense for them as conservator, where is it good for the taxpayer, where does it make sense for the homeowner. And they are cooperating with us, working closely with us, and I hope they will have some more clarity on this in the coming weeks.

Ms. LEE. Let me just say clarity is one thing, but doing it is another.

Secretary GEITHNER. I mean clarity about action.

Ms. LEE. In terms of principal write-down.

Secretary GEITHNER. Well, again, we are encouraging them to look at it again because we think there is a good economic case, a good financial case for doing it in some cases.

Ms. LEE. And what about a moratorium on foreclosures until we figure this out? Because in the meantime folks have lost all of their wealth that they have accumulated all their lives. They have nothing left. The American dream is gone for so many, especially for people of color, where home ownership and one's equity is the only pathway to send their kids to college or start a small business.

Secretary GEITHNER. Well, again, what we need to do is make sure we are reaching as many Americans as possible and help them stay in their homes. We want to make sure when they cannot stay in their homes they are able to transition to more affordable housing options. We want to make sure that where they cannot meet those obligations, and where they face the threat of foreclosure, that the process has full integrity, and that they are protected from abuse in that process.

As you know, we have done a range of things, but we have got a long way to go still to heal all the damage caused by this crisis. And we want to do as much as we can to help protect the innocent victims of this crisis. You are right to continue to draw attention to the fact that there is still a lot of damage and a lot of pain out there, and we have got some distance to go.

Mrs. EMERSON. Mr. Womack.

Mr. WOMACK. Thank you, Madam Chair.

REVENUE AND SPENDING

I have just got one more question. I was going to finish the math on the gentleman from Kansas' math equation. Just a few minutes ago you said the expiration of the tax cuts was about \$1 trillion over 10 years. That is \$100 billion in 1 year. And then you followed up by saying that the deficit next year, you are going to look it up, but you said 6 percent of the economy; the economy roughly \$15 trillion, so 6 percent of that, if my math is correct, would be about \$900 billion. So we are talking about \$100 billion in tax increases versus a—you could even round up to \$1 trillion, but \$900 billion in deficit. That is still quite a gap. And as I said in my earlier testimony or in my earlier round of questions, that normalization of interest rates could wipe out that tax increase automatically and push this thing way back up over \$1 trillion in deficit.

So my question, Mr. Secretary, is why do we have this insatiable desire to want to continue to chase the issues facing our country with more tax increases when it is obvious we have serious spending problems?

Secretary GEITHNER. Well, you are right that we have unsustainable commitments on the spending side, and those have to be part of any solution. As we said, in our judgment, the right solution requires about \$2.50 of spending cuts for every dollar of revenue increases.

But let me just say why we think this is necessary. Again, we need about \$1.5 trillion in revenues over 10 years, less than Simpson-Bowles suggested. That is about 1 percent of GDP. If you don't do that, you have to figure out can you find another 1 percent of GDP, another \$1.5 trillion in cuts in the spending side without sacrificing other priorities that matter a lot to Americans. Fundamentally you have to look to find that in Medicare, Social Security, low-income programs, or defense, because the rest of the budget is not enough to absorb that. So our judgment is that you cannot really do it in a way that makes sense economically or fairly without that modest increase in revenues.

Now, we may disagree also about if you are going to do revenues, how to do it. But again, fundamentally our view is we can credibly protect 98 percent of Americans from asking them to bear a larger burden on the tax side. We can protect them from that, and we should protect them from that. Effective tax rates for the country as a whole and certainly on the richest 2 percent in records are at historic lows. They are the lowest they have been in a very long period of time. We think the economy can handle the modest increase in effective tax rates that would come with the President's proposals. And again, if you don't do that, then you have to find another trillion-and-a-half dollars in spending cuts on the things that are drivers of the deficits, and that is going to have to be, because that is where the money is, Medicare, Social Security, low-income programs like food stamps or in defense.

Mr. WOMACK. You mentioned that the tax rates are at historic lows, but would you not agree that spending as a percentage of the economy at historic highs?

Secretary GEITHNER. Well, only really again, and Madam Chair and Chairman Rogers said this at the beginning, spending is rising as a share of the economy only in, really, Medicare, Medicaid and Social Security. The only material increases in spending, not just over the next decade, but in the coming decades, as a share of the economy, are in those areas. These increases are driven by the fact that 15 million Americans become eligible for those programs over the next 15 years. And as you know, healthcare costs are growing more rapidly because there is so much technology available.

So when people say the government is too big and growing, what they mean is that those benefits are growing too rapidly. And that is something where we have to figure out a way to bring some gravity to the rate of growth in that context, and we disagree about how deep we can go.

But the rest of government, we all think about government from education to defense, is declining as a share of the economy and projected to fall, as the Madam Chair said at the beginning of her testimony, to the lowest level since Eisenhower over the next decade as a share of GDP. So when you talk about government in these areas, to be fair to people, it is about what do we do about those benefits. And I know that we have got big divisions between

us and your side about how deep to cut those benefits and how much risk to shift to retirees. That is not our only difference, but that is one difference.

Now, again, we are not proposing to solve this problem solely through tax increases. And our tax increases are very modest. They are very modest relative to Simpson-Bowles, they are modest relative to what this country has done in past fiscal crises in this context. But we don't see how you solve the problem without doing something on the revenue side.

Mr. WOMACK. Thank you, Mr. Secretary. Best wishes.

Mrs. EMERSON. Thank you.

Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Madam Chairwoman.

Mr. Secretary, I was pleased to hear about the enforcement against terrorist states. Obviously I don't have to remind this Committee that Cuba is the only one of four nations that is a state sponsor of terrorism; that there are many people who are in prison here who have been convicted of espionage, among other things, and that they are now holding an American hostage since December of 2009. You are aware of that, and you answer that rather firmly.

NONRESIDENT ALIEN INTEREST INCOME RULE

Going back to the proposed IRS rule, if I may, do you know if there has been a cost-benefit analysis done? I am not quite sure if there has.

Secretary GEITHNER. Good question. We look very carefully at the benefits of this relative to the costs, and we are very confident we can design this in a way that has very, very, very limited costs relative to the broader benefit.

Mr. DIAZ-BALART. And, Mr. Secretary, I would like to see that, number one.

Number two, also you mention the fact that you want to make sure that that information will not get in the hands of—the wrong hands. Any idea how you and the IRS intend to do that?

Secretary GEITHNER. Well, again—

Mr. DIAZ-BALART. In the case of Venezuela, Mr. Secretary, the entire government is a risky proposition. In the case of Mexico, it is a different situation, obviously, because of whatever you want to call it, the drug lords, et cetera.

Secretary GEITHNER. Again, we are aware of this concern, and we share that concern. And we have a set of safeguards in law Congress puts on us, but also some safeguards we are going to propose in this rule which we think will be responsive to that. We are happy to brief you on that in more detail.

Mr. DIAZ-BALART. And, Mr. Secretary, lastly on that, and, again, thank you for your offer to get together, the IRS Commissioner also said the same thing. I would really, however, ask of you before that rule if you can meet with us before the rule is finalized so we can work on it together. Thank you. That would be great.

And lastly, I wasn't going to do that, but I will miss you coming in front of this committee and other committees, because, frankly, I think you do a great job standing up and representing the viewpoint of the President.

Another person who I think is very passionate, obviously is a person who I have great affection for, is Mr. Serrano. I wasn't going to mention this, when he talked about the standing of the United States is at a great position. I would just like to quote a couple of newspapers, so don't quote me for it, how our allies see, for example, the reset with Russia. The largest Czech newspaper, I can't pronounce it, declared on its front page: No radar? Russia won. The Polish newspaper, quote: Betrayal: The U.S. Sold Us to Russia and Stabbed Us in the Back. The Romanian newspaper—I am not going to quote the name, I can't—quote: America's Betrayal of Europe for the Siren Call of Russia. Lech Walesa, my God, an institution, actually said something that to me that was profound and painful to have to hear when he said the United States cannot be trusted. By the way, all this was before the last gaffe with the open microphone. And we have seen the Polish newspaper that said basically, Are they trading Poland? So the facts don't bear it out.

Mr. SERRANO. Will the gentleman yield for a second?

Mr. DIAZ-BALART. Of course, to my dear friend.

Mr. SERRANO. One quick question. Do you honestly believe, and I am looking at you, that our world standing now is worse than it was during 8 years after we invaded Iraq, where just about every country in the world thought that we were totally whacked out?

Mr. DIAZ-BALART. And I thank my friend for the question. I honestly believe that our world standing now is as bad as it has been since the years of Jimmy Carter.

I yield back. Thank you.

Mrs. EMERSON. Mr. Bonner.

Mr. BONNER. Madam Chair, I am going to try to get four questions in, so I will not give a lot of opinion on this, just I would like your opinion.

REVENUE AND SPENDING

First of all, you said, and I think you are right, over the years Congress has been involved in providing special benefits in the Tax Code. We agree on that. And if I can get the questions in and then give you a chance to answer, do you have an opinion, since we have had a debate, but not recently, about the benefits, pros and cons of a flat tax versus a fair tax? That is the first question.

Number two, I think I am right that you were involved with Secretary Rubin when he was at the Clinton administration. And during the Clinton years, the administration and Congress at the time worked to get welfare reform. Since you have referenced and we have talked about the growth in the mandatory side of spending, do you believe it is time to have a conversation about welfare reform, too, since we have not had that conversation in 15 years or so?

Number three, you talk about if just a modest increase in revenue. Am I wrong? I was of the opinion we were not talking really about a tax on millionaires and billionaires, but it actually would go to include small businesses making over \$250,000, which, if that is correct, that is not a millionaire. In many small businesses, five out of six, I understand it, would be impacted by that.

And my last question is when you and others have talked about the Republican budget and the draconian cuts to Medicare, did I miss something, or is the healthcare bill that is being debated across the street in the Supreme Court, did it not include \$500 billion in cuts to Medicare and related programs?

Thank you, Mr. Secretary.

Secretary GEITHNER. Let me try and do this quickly. I would not support a flat tax. It would probably require a longer conversation to explore. I do think there is a good case to look at any proposals on the corporate side on how to lower rates and broaden the base to clean up a lot of the muck in the tax system to make it more simple, more fair. And certainly on the individual side, starting from scratch today, you would not create our current system. But a flat tax has all sorts of other challenges, and a lot of them have to do with fairness and how regressive they are.

On welfare reform, as I said, I think that on the—

Mr. BONNER. What about a national sales tax, fair tax?

Secretary GEITHNER. Oh, I would not. I didn't know what the reference was to, but, no, I would not support that.

On other fiscal reform, you used the word "welfare reform." As you know, we proposed very substantial changes in what is called other mandatory programs, nonhealth mandatory programs, farm subsidies, civil service retirement, other benefits for government employees, and even reforms in low-income programs. We spend a lot of time actually even with Republicans trying to find common ground in this area, and we found quite a lot of common ground last summer, and I think that will be the basis for what we do going forward. But happy to talk in more detail.

On the revenue side, you are right that under the President's proposals, the tax reforms that he proposed would affect only the top 2 percent of Americans. That means individuals making more than \$250,000. And that is true it would affect some small businesses, but it would only affect roughly 3 percent of small businesses. And even that definition includes—because of the way Congress defines these things, a lot of people you wouldn't consider small businesses, because it would cover every individual in a law firm as an individual small business if they make more than \$250,000. So very modest impact both in incidence and magnitude.

Finally—I can't read my handwriting. Can you tell me—

Mr. BONNER. Well, it was about the comment that our budget makes draconian cuts in Medicare. Am I wrong, did the healthcare bill being debated in the Supreme Court not include \$500 billion in cuts to Medicare?

Secretary GEITHNER. You are right. CBO, who is the referee for us on these things for Congress, says that over the first decade of the Affordable Care Act it saves roughly \$100 billion net in Medicare and another \$1 trillion over the next decade, and that is because of the mix of reforms in savings and other measures in the proposal. But the Affordable Care Act, if left in place by Congress and the courts, would substantially reduce our long-term fiscal deficits.

Mr. BONNER. Thank you.

Mrs. EMERSON. Mr. Graves.

Mr. GRAVES. Thank you, Madam Chair.

Mr. Secretary, to Mr. Serrano's point a minute ago, he likes to reflect back on Afghanistan and Iraq and blame it on the previous administration, when my recollection, and, again, I wasn't here then, but that was a very strong bipartisan vote of entering into the conflict there with a resolution that was Republicans and Democrats. But, you know, I know memory fades over time at who all was supportive of something in the past.

DEBT LIMIT

You talked about the debt limit increase earlier. The question was brought up. And you cast a very broad timeframe. You said later this year. And there seems to be another big event later this year, too, and I am curious how those are going to collide. And when do you expect or when do you expect the President to formally request raising the debt limit?

And the reason I ask you is because you brought up the point that we cannot afford to as a Nation come to that point, that brink again. So as the Secretary of the Treasury, when do you anticipate giving us advance notice of that request and a hard line? Because I remember last time it moved, and it moved, and it moved over time. But when do you expect us to see that request?

Secretary GEITHNER. Well, remember, when it moves, it is because we have a large economy, \$15 trillion economy, I don't know how many million payments we make a month in this context, and those change over time as the economy changes. But we give the Congress a regular estimate of those changes. And as I said, on current estimates it will be very late in the year, very late in the year. Now, that may change.

Mr. GRAVES. So this year you anticipate, this year?

Secretary GEITHNER. Yes. We do anticipate this year. Now, Congress, as you know, has legislated a series of provisions that allow us to give you more time to act. We have traditionally employed those. We are transparent with Congress on how we deploy them, and that might buy us a little bit of time. But I think our own view is Congress is going to act on this before the end of the year.

Mr. GRAVES. Before the election?

Secretary GEITHNER. No, not before the election, not on current estimates, but before the end of the year.

Mr. GRAVES. So you anticipate your office or the President's office requesting this 60 days ahead of the anticipated date to give Congress the time to work with this?

Secretary GEITHNER. The law you guys passed requires us to notify Congress when we come within, I think, \$100 billion of the limit, I am not sure. But it is not a date, it is a number test, and of course we will meet that test.

Mr. GRAVES. Okay. Great. Well, thank you. And we are working hard to find you somebody to introduce the President's budget today on the floor, so maybe it will get fully debated. Thank you.

Mrs. EMERSON. Mr. Yoder.

Mr. YODER. Thank you, Madam Chair.

Mr. Secretary, I noted earlier in your comments we were discussing the debt ceiling, and you brought up your fears that later this fall we might create instability with the specter of default. Certainly notwithstanding the President's previous comments in

2006 when he said the fact we are here today to debate raising America's debt limit is a sign of leadership failure, and he went on to say, Americans deserve better that way, therefore he intends to oppose the effort to increase the debt limit. So certainly it is a reasonable position, at least by the President, to oppose debt limit increases. And yet we have a looming specter of default when that occurs. The administration was very clear that if the debt ceiling wasn't increased, that we may default on some of our obligations.

I guess in a true dialogue about how we resolve that situation, again given the fact that the President previously opposed it when he was in the Senate, 52-48 vote, it barely got increased over his objection, noting that those types of objections still exist amongst both parties for the same reasons, are there things we can do structurally to avoid that problem?

And I note there is legislation that actually states that the first dollars into the Treasury would go to pay the debt. By everyone's estimates the amount of money that comes in every day into the Treasury is enough to pay the debt and interest payments and then some and other obligations, or is it enough to fund all of the obligations that may be outlaid by the Federal Government? And so rather, since we are both very concerned about the specter of default, and we know how important this is, rather than leave that as a gambling issue again and allow the Administration, whichever Administration it may be in the future, to say, hey, if you don't raise it, we are going to default, that creates a lot of that uncertainty. And so I would love nothing more than an arm-in-arm partnership between the Congress and the President to say no matter what happens during this debate, we will not default, we want to assure all of our investors, and I would love your role to be as an assuring role. And I guess I am concerned that some of the Administration's rhetoric actually heated that up and caused much of the instability that the Administration now criticizes.

Secretary GEITHNER. You know, we are fortunate, you are unfortunate, but as a country we spent four decades, five decades dealing with this kind of question because Congress uniquely has imposed on itself this requirement to vote around the debt limit after already authorizing and limiting how much we can borrow. And Republican administrations and Democrats have dealt with this over time, and they have found ways to deal with this without putting the Nation at peril.

And my basic advice to you, you don't have to take it, is don't play politics with this again because it will be terribly damaging to the country. There is no feasible option to allow the country of the United States to manage when the Congress puts us in default on a substantial number of obligations for a long period of time or meaningful period of time, even for a minute. That is a completely unacceptable way to run the country, and there is no responsible person in public life, I believe, who could advocate that we try to run the United States of America for a period of time where we are in default, or behind, or not meeting the obligations Congress placed for us. So don't play politics with this. It will be very damaging to the country.

Mr. YODER. Mr. Secretary, and knowing we have limited time, I would ask the same thing of the Administration, to please not play

politics with the specter of default and to go around the country, go around the world suggesting that if the debt ceiling is not increased, we would not be able to pay our debt and interest payments, because, Mr. Secretary, you know as well as the Administration knows that there is plenty of money that comes in every day to pay our debt and interest payments, and it would be very useful, I think, for both sides to take that revolver off the table so that we can discuss how do we move forward with the debt, as the President himself previously stated he did not support raising the debt ceiling.

So having the Administration argue against its own playing politics is very obviously comical, but at the end of the day we have to have the Administration as well as a partner in this. I am saying I think, as Congress, we ought to work with the Administration to do that, and I would love to see the Administration, rather than lambaste Congress for playing politics, to also join in an effort to take that issue off of the table.

Secretary GEITHNER. I would draw your attention to the many statements made by Republican Presidents and my Republican predecessors about exactly this question, and I would challenge you to find in any of their judgments about this any justification for an approach that would have us effectively try to run the country in a period where we are leaving in doubt the Nation's commitment and will to meet its obligations over time. You will find no support for that, and I would discourage you from testing the process again.

Mr. YODER. Sure.

If I just may conclude, Mr. Secretary, I would also discourage the Administration from continuing to go around the country and the world threatening those who invest in our country and lend us that money, and telling them that we cannot pay that debt when they know that is inaccurate.

And I yield back, Madam Chair.

Secretary GEITHNER. Let me try the more affirmative answer in this case. I want to say that I very much welcome the clear commitments made by the Republican leadership in the House and Senate last year to make sure that they told the world that they would never allow the United States to be in default on its obligations, and I respect them for that, honor them for that, and I hope they reassure people again, that again we will not put the country through what we put the country through last summer.

Mrs. EMERSON. And it needs to be a team effort.

Mr. YODER. Thank you, Madam Chair.

Mrs. EMERSON. So thank you very much.

And it does need to be a team effort, and we need to work together.

DUPLICATIVE PROGRAMS

However, I am going to switch gears, and I think that we may have found a way to save a little money, and perhaps, Mr. Secretary, you can help me on this. Within your Office of Domestic Finance, you have the Office of Financial Education and Financial Access and the Office of Consumer Protection, at least according to your website. These offices actually sound pretty duplicative of the Consumer Financial Protection Bureau. So, as a part of the admin-

istration's review to identify ineffective, duplicative or outdated programs, did you all consider closing either one of those offices or moving them over to CFPB?

Secretary GEITHNER. We did, and you are right that we need to take a careful look at programs where you have parts of the government doing similar things in this case, and we have taken a careful look at it. It is a very modest amount of resources, and we think there is a good case for any Treasury Department, helping to improve the quality of financial education across the country.

I would be happy to give you more information on why we think our efforts are complementary to theirs and justify the very modest amount of resources we are proposing.

Mrs. EMERSON. And I understand that. But, on the other hand, you know, a million here, a million there, and maybe we are actually saving money. And so I need you to tell this Subcommittee how the work of that office—I mean, you have outlined it to some extent—is different from the consumer education and protection programs that we have, obviously, or will have at the CFPB, the Federal Trade Commission, the Office of Comptroller of the Currency, the FDIC or the Federal Reserve. How is it different?

Secretary GEITHNER. Excellent question. I have asked that question a lot myself, and, as you know, I spent some time at the Fed, so I know a little bit about their programs. They are quite good programs, so I will be happy to give you more detail on that.

Mrs. EMERSON. Yeah, I appreciate it, because if it is something that we can just shift and do away with, it might be more efficient, and certainly it then frees up money for other things, not the least of which is, you know, helping to pay down the deficit.

Secretary GEITHNER. Madam Chair, could I just point out again that as I said in my opening remarks, we do identify efficiencies, reforms, and consolidations that are very dramatic in terms of savings, \$234 million in just this budget and much larger over the 10-year window.

Mrs. EMERSON. Well, and I am grateful for that, and that is very important, but if your office could get us some more detail, because we have asked for it, and we have not gotten any details from them on this.

FEDERAL INSURANCE OFFICE

Let me ask you about the Federal Insurance Office established by Dodd-Frank. Obviously, the goal of that office was to strengthen U.S. influence in international insurance forums, but there are only a couple people there. So I want to know what your highest priorities are for FIO and its international mission this year.

Secretary GEITHNER. We have got an excellent head of this office, and he has been working very carefully to build up an office that did not exist before and to recruit talented people. And you are right that he is moving carefully in the sense that he is being careful and prudent with the taxpayers' money. He has got an important mission, and he is doing a very good job. I think it is good for the country that we have at the Federal level some accountability and knowledge over the broader insurance thing, not least because, as you pointed out, we have to deal with countries around the world on this question, and we need the Federal Government to be

able to represent the interests of the United States in those discussions.

Mrs. EMERSON. Can you tell me what assignments and objectives that you all have established or specified for the FIO?

Secretary GEITHNER. Well, they are the ones established in the law, but it sounds to me like you would like a little more detail on what we are doing, which I would be happy to provide.

Mrs. EMERSON. Yes, please. And if we could get that within 30 days, I would be very grateful. And we have some other questions that we will follow up and I will submit for the record, but it is just a matter of knowing and bringing some clarity to the issue, particularly when those offices get funded.

BUFFETT RULE

Mrs. EMERSON. One more quick question. Back to the President's budget, he is proposing that the Buffett rule, in essence, should replace the alternative minimum tax, and at a hearing before the Senate Finance Committee last month, you testified that you were broadly comfortable with the approach Senator Whitehouse had laid out in his bill, S. 2059. The Joint Committee on Taxation has since estimated that S. 2059 would generate about \$47 billion in revenue over 10 years, but repeal of the AMT is estimated to result in revenue losses in the neighborhood of \$800 to \$900 billion over 10 years, so there is a huge difference in magnitude. Are you comfortable with that?

Secretary GEITHNER. Actually there is another, more recent score of that proposal which I think says it would raise \$161 billion over 10 years. But you are right that you are not going to achieve the necessary outcome in terms of revenues for tax reforms simply through that approach to the Buffett rule in that context, and you have to look at a whole range of other tax reforms in order to achieve a level of revenues necessary to help run the country in that context.

Mrs. EMERSON. Okay. Well, let me—

Secretary GEITHNER. But your math is right in the sense that even with the higher score of 161-, by itself it doesn't offset the cost of eliminating the AMT.

Mrs. EMERSON. Thank you so much.

Ms. Lee.

Ms. LEE. Thank you very much, Madam Chairman.

Sorry the gentleman from Georgia isn't still here, but I just wanted, for the record, to say this. I was here during the horrific events of 9/11, and, yes, there was a bipartisan vote, a strong bipartisan vote, on 9/14. I was the only one who voted against it because I knew that resolution was a resolution which would authorize war without end. However, with all due respect to both my Republican and Democratic colleagues, they thought that resolution was about al Qaeda.

Fast forward, another resolution came to the floor. I was on Foreign Affairs. The entire debate, the entire focus changed to Iraq. That authorization was passed on a bipartisan basis with bogus information as it relates to weapons of mass destruction. So I don't believe that many Members really realized that going into Afghani-

stan would then shift gears and go into Iraq based on this information.

I just wanted the gentleman from Georgia to know that because some of us were here, and I remember very clearly my conversations and debates with Members.

SMALL BUSINESSES, MINORITIES, AND WOMEN

Having said that, let me just ask you a couple questions now about Treasury. First of all, I am very pleased that you have made sure the small business subcontracting goals are included in overall prime contracting goals. Very important. I would like to know if you could report back to the Subcommittee—I am trying to get as much done since this is your last time here—a list of all the contracts where the contractors failed to meet their small business goals for any and all included, where they were included, and any performance bonuses withheld or liquidated damages that were levied against these primes, if there were any.

Secondly, I would like an update on how the Office of Minority and Women Inclusion is working, and how has that work impacted your Department? Have we seen any increase in minority and women—minorities and women in your Department?

And then, thirdly, the status of the companies that were bailed out by the TARP program and how executive compensation for these companies have been handled this year.

Secretary GEITHNER. I would be happy to respond to those things. Let me just say briefly that we have done exceptionally well on hitting pretty ambitious targets for small business contracting and a range of other targets in that context that I know you care deeply about. I think we have the best record of any executive branch agency except for the SBA in that context.

We also have been very successful in recruiting and promoting a very talented group of senior women at the Treasury, and I think if you look at Treasury today, the principal parts of the Department that report to me, the vast majority of them now are run by women, very talented women. So I am very proud of our record. I will give you details on both those questions.

POVERTY

Ms. LEE. Another question I have in terms of income security programs, like unemployment insurance, how do these impact the economy, especially during recessions? In terms of significantly reducing the rate of poverty in America, how do we address that, from your perspective, because poverty rates are increasing. I founded and cochair the Out of Poverty Caucus, and we are looking at some really terrible numbers, which did not just begin under the Obama Administration but are the result of some very terrible economic policies of the previous administration, and I want to know what Treasury can do specifically to target and to reduce long-term unemployment and reduce the rates of poverty in America.

Secretary GEITHNER. Well, you are right to point that out. I remind people every day that the United States has alarmingly high rates of poverty. No country as wealthy as ours lives with these rates of poverty, and this was true even before the crisis and the damage caused by the recession.

I said before you came in that I don't know how many Americans understand that 40 percent of American children are born to families under Medicaid. Really remarkable statistics. And again, that was before the crisis in this context, and the crisis caused, of course, a huge amount of pain and damage to the innocent.

I think our judgment is that the most important things for us to do and keep focusing on are to get the economy growing more rapidly, bring unemployment down, get more people back to work, make sure that people have access to affordable training opportunities and education so they can have the skills they need to get jobs in this economy, and make sure we are protecting the parts of the safety net which the most vulnerable Americans depend upon. Those are critically important things, and you are right to emphasize it, because when we think about these challenges on the fiscal side, how we reduce deficits, we have got to make sure we are protecting and preserving those basic commitments.

Ms. LEE. I hear the gavel.

Mrs. EMERSON. I am trying to be good.

Ms. LEE. Thank you very much, Madam Chairwoman.

Mrs. EMERSON. I know the Secretary has actually got to leave at some point here, just so we can quickly get another question in.

Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Madam Chairman. I will be very brief.

NONRESIDENT ALIEN INTEREST INCOME RULE

My able staff just reminded me, because you nodded yes about hoping that the rule doesn't—the NRA rule does not take place until after we are able to meet. I just wanted to——

Secretary GEITHNER. The deposit rule. Yeah, I will have my colleagues come and talk to you or your staff.

Mr. DIAZ-BALART. I just wanted to remind that we are in the district for 2 weeks, so my staff just told us that as soon as we get back after that is a meeting, so if you could——

Secretary GEITHNER. Or maybe we could do it by phone.

Mr. DIAZ-BALART. We could maybe do that. But I would just ask you, if you could, just see if that rule could be held back until we meet. I just want to remind you that it is 2 weeks, it is going to be another 2 weeks at least. That is the issue.

Secretary GEITHNER. I don't know where we are on timing, but, again, I will make every effort we can to make sure you understand where we are going to come out before it comes out, okay?

Mr. DIAZ-BALART. Thank you, sir.

[CLERK'S NOTE.—Member insert for the record follows:]



Frank Keating
President and CEO
202-663-5111
fkeating@aba.com

March 28, 2012

The Honorable Mario Diaz-Balart
Vice-Chairman
House Appropriations Financial Services Subcommittee
U.S. House of Representatives
436 Cannon House Office Building
Washington, D.C. 20515

Dear Congressman Diaz-Balart:

On behalf of the members of the American Bankers Association (ABA), I am writing to draw your attention to a matter of serious concern relating to proposed regulations from the Internal Revenue Service (IRS) (proposed REG-146097-09) for reporting on nonresident aliens (NRA). The NRA proposed regulations, issued by the IRS in January 2011, requires that U.S. bank deposit interest paid to any nonresident alien individual must be reported annually to the IRS. Similar regulations were proposed by the Clinton Administration in January 2001 and subsequently withdrawn. In August 2002, narrower NRA regulations that require reporting only on interest payments to an NRA individual that is a resident of Canada were proposed and have been in effect since.¹

We strongly oppose these expanded NRA proposed regulations and request that you urge the Secretary of Treasury (as part of the oversight of the IRS) to leave the rule as it currently stands. The regulations would have a negative impact on the U.S. economy, including the risk of flight of foreign capital at a time when such capital is very much needed. For instance, the implementation of the proposed rule would result in NRA depositors withdrawing their deposits and closing their U.S. accounts rather than being subject to a rule requiring that details pertaining to their personal accounts and investments be reported to the IRS and shared with their home governments.² For many banks, the resulting hit to the banks' deposit business will significantly reduce funds available for lending and investment purposes. This reduction in deposits will further weaken the economy by making it difficult for community banks to provide much needed services to their communities as well as to retain many of their employees or hire new ones.

Moreover, this proposal adds additional burdens to financial institutions that are currently in the process of implementing and complying with three new tax reporting rules – section 6050W, cost basis reporting, and the Foreign Account Tax Compliance Act. These costly information reporting regimes are not used by the banks themselves; instead, these are required *for the sole* benefit of the IRS. In some cases, it is difficult to understand how the IRS will even use these new reporting rules.

¹ The withdrawn 2001 regulations required expanded reporting but only with respect to NRAs that are residents of countries with which the U.S. had a tax treaty. The proposed regulations encompass all nonresident aliens – regardless of country of residence.

² There are legitimate reasons why NRAs place money in U.S. banks – for example: concerns and fears about crime/security in their home country; lack of trust in their governments or the privacy of financial institutions in their home country; and their view of the U.S. as a reliable place to deposit their money.

March 28, 2012
Page 2

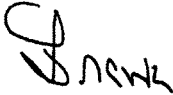
The NRA proposed regulations have no statutory basis, and there is no evidence that the IRS has conducted any cost-benefit analysis regarding this proposal. There is no indication whatsoever that it is Congress' intent to tax NRA deposit interest income or require reporting of such income. A proper cost-benefit study would show that the costs of compliance for many community banks significantly outweigh any illusory benefits that the IRS believes it will derive, because these banks will be forced to incur significant costs to implement a monitoring and reporting system – solely for the benefit of the IRS – that will not collect any new taxes for the U.S. Instead, the proposed regulations will further damage the very institutions that will be providing the information, as well as the U. S. economy.

Foreign deposits are important to U.S. financial institutions and any rule that might undermine the competitiveness of U.S banks with respect to foreign deposits should be seriously scrutinized by Congress, especially where there is no statutory basis for such a rule, as in this case. We believe that the Service should devote its resources to rules that actually help promote the U.S. tax laws, rather than focusing on regulations that, in fact, disregard the intent of Congress and hinder the efforts to revive the U.S. economy.

We recommend that you request that the Secretary cover this issue during the budget hearing scheduled for March 28, 2012. Further, we urge you to closely scrutinize this IRS initiative and ensure that the NRA proposed regulations are withdrawn.

Please feel free to contact me if you have any questions or would like to discuss this issue further.

Sincerely,

A handwritten signature in dark ink, appearing to read "F. Keating", with a stylized flourish at the end.

Frank Keating

Cc: Members of the Appropriations Financial Services Subcommittee

Mr. DIAZ-BALART. Thank you, Madam Chair.

Mrs. EMERSON. And it really is nice to do a face-to-face meeting as opposed to the telephone, I just find, because body language tells you everything.

BUSINESS AND TRADE REORGANIZATION

Quick question here on the President's government reorganization with regard to business and trade, and he mentioned that, and then there has been follow-up. He mentioned it in the State of the Union. There has been follow-up.

I am all for streamlining government and putting those agencies and/or departments together that have the same type of mission. The Community Development Financial Institutions program is specifically included among those agencies for consolidation, but the Department's Office of Trade Finance and Investment Negotiations and the Office of International Trade are not, even though the Trade Rep gets put into the consolidation. So I am curious why these two Treasury offices are overlooked. Do they have less effect on business and trade than CDFI?

Secretary GEITHNER. A good question, and, you know, Congress will have to reflect on where to draw those lines and what is the most efficient reconfiguration of those spaces. But, as you know, there is a whole range of credit-type programs across the U.S. Government, across lots of agencies, and the President's judgment was it makes sense to try to put those in one place, and they might be more efficiently deployed if they are in one place. I know there will be a lot of discussion about that, but I think they drew the line sensibly.

Mrs. EMERSON. How much advice or analysis did you all at Treasury provide to the White House about the reorganization before it was announced?

Secretary GEITHNER. Well, I was involved in the broad examination of the case to put in one place clear accountability for export promotion, investment promotion, those things, but we were not the detailed architects or the architects of the details.

Mrs. EMERSON. Okay. Now, I mean, you just said Congress obviously is going to have to sort of push around the puzzle pieces, if you will, but I am still a little concerned about how Congress can evaluate this reorganization proposal without any information about what the new organization is going to look like.

Secretary GEITHNER. Yeah, fair point.

Mrs. EMERSON. So I need your help on this.

Secretary GEITHNER. Right.

Mrs. EMERSON. All right. Thank you very much.

Ms. Lee.

Ms. LEE. CEO compensation. I want to go back to that. You are going to get me the information—

Secretary GEITHNER. Yeah, absolutely.

Ms. LEE [continuing]. On TARP?

EXECUTIVE COMPENSATION

Secretary GEITHNER. Yeah, absolutely. You know, we have a law we have to comply with, we have a detailed set of regulations that limited executive compensation for people who were recipients of

extraordinary assistance in the program, and I am happy to provide details on how those requirements have been enforced.

Ms. LEE. Okay. Well, I have legislation. I want to get your take on this concept. CEO compensation, I believe what my legislation requires is that any CEO making 25 percent more than the lowest-wage worker—of course, it is fine, you can pay them whatever, but they don't get the tax deduction—excuse me, 25 times more, which is a lot of money. That is a huge tax hit on the Treasury, and I am wondering how we can really begin to bring this under control and be sure that the taxpayers aren't subsidizing these huge compensation rates, and that is what is exact, that is what is taking place now.

Secretary GEITHNER. Well, I think that is one of the reasons why it is so important Congress take a look at the effective tax rates on the richest Americans. And I think, you know, they are extraordinarily low levels in history now, and our view is they need to go up a bit as part of asking the broader American people to make the sacrifices necessary to bring our deficits down.

And I agree with you that in many parts of the economy compensation got a bit unmoored from gravity. I think it is in the interests of the shareholders of those companies that they restore some gravity to those levels. But it is a good example and a good reason why when Congress debates the future of our deficits, they took a look at tax reform that would bring about a modest increase in the effective tax rates on the richest Americans.

Ms. LEE. And there was another proposal, I am just reviewing this, that I have been working on, and I would just like to get your take on it, but it is changing the corporate income tax rates so that instead of being fixed at 35 percent, it becomes a variable for each and every corporation based on the ratio between the CEO's compensation and the salary of—whatever the reasonable salary is of the worker of that corporation.

Secretary GEITHNER. Well, again, I would be happy to take a look at any proposal. I am not familiar with that. But in general, you know, Congress has a lot of history in taking a look at these kind of things, and not to be unfair, but Congress generally has not done a good job where they have tried to determine what is the appropriate level of compensation a publicly held company should provide its senior management.

I say that not to discourage you, because I deeply agree that in the financial sector and other parts of the economy things were defying gravity, and a big case for those companies to find some way to restore gravity to those.

Ms. LEE. But, Mr. Secretary, I am not talking about Congress regulating or controlling the amount. I am talking about tax deductions, and I am talking about the average taxpayer subsidizing these huge bonuses and CEO compensation. That is the issue, not regulating or determining what a CEO should or should not make.

Secretary GEITHNER. I have complete sympathy for that, complete support for that. And, again, one of the most important things that the financial reforms passed under Dodd-Frank did was to make sure that the financial industry bears the cost of the mistakes they make. That is very important. The large firms in particular bear the costs of any mistakes they make in the future so

the taxpayer is not protecting them from those mistakes. I am very sympathetic to that.

Ms. LEE. I am going to send you a letter, another follow-up, between now and when you unfortunately leave laying out both of these proposals, and I would love to get your response to them, because we cannot allow this to continue to take place in our country where taxpayers are subsidizing these huge bonuses and CEO compensation.

Thank you.

Mrs. EMERSON. Thanks, Ms. Lee.

Secretary Geithner, will you just explain in a little bit more detail what you mean about these financial firms should bear the burden? What specifically do you mean by that?

Secretary GEITHNER. Well, I just meant the simple premise that when financial institutions make mistakes and lose the capacity to operate on their own without government support, and the government is forced to step in and protect the economy from those mistakes, then the industry should pay the costs of that rescue, and that is a simple principle that lies at the heart of financial reform. It is true for deposit insurance, and it should be true generally where the government provides support in this context.

Now, what Dodd-Frank did was cement that basic principle and make it very clear and unequivocal, and there is no flexibility in it. I think that is a very welcome thing, because, again, you don't want these institutions operating with the expectation that taxpayers are going to come in in the future and protect them from their mistakes.

Mrs. EMERSON. I think that that is correct, that the American taxpayer has no interest whatsoever in coming back.

Secretary GEITHNER. I have been exposed to that view, and I agree.

Mrs. EMERSON. Ever again.

But, anyway, thank you so much. Thanks for all of the information that your staff will get back to us within—we have a new rule—30 days. I appreciate that. And best of luck to you in any future endeavors. We are grateful that you are here. Thank you.

Secretary GEITHNER. Thank you.

[The information follows:]

Questions for the Record Submitted by Chairwoman Jo Ann Emerson**OFFICE OF FINANCIAL RESEARCH**

The Office of Financial Research (OFR) was created by Dodd-Frank to support the Financial Stability Oversight Council (FSOC). Starting in July, OFR and the FSOC will become fee-funded agencies. There are no limits to the amount of fees that can be charged to fund the operations of these agencies.

- 1. Are the OFR's and FSOC's expenses clearly separate and distinct from the other Treasury offices' expenses, such as Domestic Finance or Economic Policy that perform work closely related to OFR's?**

Yes, expenses for OFR and FSOC are separate and distinct from funds appropriated to Departmental Offices. Funds appropriated to Departmental Offices are tracked in the financial system with cost centers that are specific and unique to each office. The Departmental Offices have controls in place as part of their accounting system that prevent funds from other organizations or appropriations from being spent inappropriately.

- 2. How does the Department know whether or not OFR's fees are being used to subsidize the expenses of other Treasury offices?**

OFR has its own Treasury account. Thus OFR expenditures follow the standard procedures established by Treasury's Office of Financial Management under the Assistant Secretary for Management. These procedures are designed, in part, to ensure that different funding streams are not inappropriately comingled. OFR's spending also is included in the Departmental Office's general financial audit. Furthermore, OFR has developed additional controls including project review and decision-making protocols to link spending with the achievement of the OFR's mission and pursuant to approval by OFR management. Furthermore, OFR is subject to periodic audits from both the Office of the Inspector General and the Government Accountability Office.

- 3. How does the Department determine an appropriate level of OFR and FSOC spending?**

The OFR budget was developed using standard Treasury budget formulation guidelines. The funding level was determined based on careful consideration of OFR's strategic goals and priorities for FY 2012 and FY 2013, and subsequent analysis of the human resource, business systems, and infrastructure costs that would be needed to meet those priorities in an effective and cost efficient manner. The FSOC budget was also developed using standard Treasury budget formulation guidelines. Prior to its finalization, the FSOC budget must be approved by a majority vote of FSOC members.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS (CDFI) – HEALTHY FOOD FINANCING INITIATIVE

The budget requests \$25 million for the CDFI Fund’s Healthy Food Financing Initiative, which is multi-agency initiative run by Treasury, United States Department of Agriculture (USDA), and Health and Human Services (HHS). When this program was announced in 2010 (News Release, February 19, 2010), its objective was to eliminate food deserts across the country within seven years.

4. How will the Administration attain this goal if none of the agencies share a common performance measure or use common definition of a food desert?

The Healthy Food Financing Initiative was launched by this Administration, and is a partnership between the U.S. Departments of Agriculture, Health and Human Services, and Treasury have joined together in an effort to increase access to healthy, affordable food in “food deserts.” All three agencies define food deserts as low-income communities that lack access to healthy food options.

The CDFI Fund expanded upon this definition by allowing CDFIs to use local or state definitions, if available. This allows the CDFI Fund to be more flexible in serving underserved communities. The primary Healthy Food Financing Initiative performance measurement the CDFI Fund uses is the number of retail food outlets created and maintained in low-income areas that have been identified through detailed census tract analysis as having limited access to healthy food retail options.

The CDFI Fund is: (i) providing training to CDFIs to establish or expand their healthy food financing programs, (ii) providing competitive awards to CDFIs to directly support healthy food investments, and (iii) encouraging investments in healthy food projects through the New Market Tax Credit (NMTC) Program.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS – BANK ON USA

The budget requests \$20 million to start a new CDFI program, Bank On USA, to encourage the “unbanked” – which are households that do not use bank services – to open bank accounts.

5. Why do banks require government assistance or subsidies to attract new customers?

The Bank On USA Program will research and develop approaches to expand access to financial services for un- and under-banked low- and moderate-income consumers who have not been well served by the market. We propose to conduct research and test pilot demonstrations to identify strategies and policies to expand and enable consumers’ access to safe and affordable financial products. Through the research and pilot testing, we will identify the range of factors that impede consumers’ abilities to access financial products and services. We also will identify the major factors that affect financial institutions’ ability to serve consumers, and we will identify

policy and programmatic strategies, such as community-based initiatives, to support the availability of financial products and services that meet underbanked consumers' needs in a way that is sustainable. We do not expect that subsidies to banks will be a primary use of funds.

6. Is Bank on USA redundant of existing State and local government programs?

In 2005, San Francisco launched "Bank On San Francisco." Financial institutions throughout the city agreed to offer products with features such as no minimum balance, waiver of first overdraft, acceptance of alternative forms of identification. Since then, Bank On USA efforts have emerged in both small and large communities and states across the country. In late 2011, the Treasury Department released "Banking On Opportunity: A Scan of the Evolving Field of Bank On Initiatives," describing these efforts. While much has been done through these state and local initiatives to foster new collaborations to support unbanked consumers, there is little documentation and data about the long-term effectiveness of these programs. Assessing successful models, based on a fuller understanding of un- and underbanked consumers' needs and the economics of offering sustainable products and services that meet those needs, is critical to an effective Bank On USA. Once we have this understanding, we believe Bank On USA will be able to support and enhance current state and local efforts, along with other effective approaches so that they can move from helping tens of thousands of people to helping millions of hard-working Americans build more secure financial futures.

7. Will the CDFI commit to work with the CFPB on all new products and services that are a result of Bank on USA?

The CDFI Fund, in coordination with the Office of Financial Education, Financial Access, and Consumer Protection will work closely with the CFPB to ensure products offered under Bank On USA meet the highest standards of consumer protection. We will also coordinate with the CFPB on outreach as appropriate.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS AND SMALL BUSINESS LENDING FUND

The Small Business Lending Fund was established in 2010 to provide \$30 billion to community banks to lend to small business owners. Of approximately 7,000 community banks nationwide, less than 1,000 applied and of those only 332 community banks and organizations were approved for these funds. Consequently, only \$4 billion of the \$30 billion was disbursed. For me, this program seems like a missed opportunity, but hopefully we can still learn from the experience.

8. As a result of administering the SBLF, what did the Treasury Department learn about the kind of assistance community banks need or don't need when providing funding to small businesses, particularly in rural areas?

Through the Small Business Lending Fund (SBLF), Treasury invested over \$4 billion in funding to more than 330 community banks and community development loan funds (CDLFs), including those in rural areas. Community banks and CDLFs specialize in small business relationship lending.

The SBLF was designed to provide capital to those qualified community banks and CDLFs that are well positioned to increase their small business lending. Treasury engaged directly with these institutions – including those institutions in rural communities – to build nationwide awareness about the SBLF program. During the application period, Treasury hosted or participated in more than 50 industry events, teleconferences, and webinars. In addition, Treasury initiated more than 4,600 outreach calls to potentially qualified institutions, including calls to 60 percent of the potentially qualified banks and 100 percent of the potentially qualified CDLFs.

As of December 31, 2011, participants have increased their small business lending by \$4.8 billion over a \$36.0 billion baseline and by \$1.3 billion over the prior quarter. 84 percent of participants report having increased their small business lending over baseline levels. A substantial majority of SBLF participants – more than 68 percent – have increased their small business lending by 10 percent or more.

9. Can the Treasury Department apply those experiences or lessons to its administration of the CDFI program?

Through the SBLF, Treasury provided \$104 million in funding to 51 CDLFs. CDLFs are non-profit loan funds that are certified by Treasury as CDFIs. They play a critical role in many distressed communities across the country, including those that lack access to mainstream financial services.

Treasury purchased equity-equivalent securities from each participating CDLF. For the first eight years, the dividend rate on the equity-equivalent securities is two percent. After the eighth year, the rate increases to nine percent if the CDLF has not already repaid the SBLF funding. The lending increases achieved to date by these institutions suggest that equity-equivalent securities may offer a useful approach for spurring small business lending by CDLFs.

The CDFI Fund promotes the use of equity-equivalent investment as a vehicle for increasing lending to distressed communities. For example, the CDFI Fund's Bank Enterprise Award Program gives depository institutions credit for increasing purchases of equity-equivalent investment from CDFIs in determining award amounts.

CDLF and CDFI Fund staffs have had initial discussion on ways to work together to monitor and evaluate the impact of CDLF investment which will support CDFI Fund's ongoing efforts to build the capacity and measure the use and benefits of CDFI awards and allocations.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS – ELIGIBILITY

10. Does the Treasury Department assist eligible financial institutions like community banks to become certified as a CDFI, especially in rural areas?

The CDFI Fund encourages all eligible financial institutions to become CDFIs to help our low-income communities in both metropolitan and nonmetropolitan areas. The CDFI Fund provides educational events across the country to explain the certification process and the advantages of becoming a CDFI.

For example, in May 2012, the CDFI Fund co-hosted, along with the Federal Deposit Insurance Corporation, Neighborworks, and the Housing Assistance Council, an educational forum in Kansas City, KS focusing on providing support to rural communities across Kansas. Nearly 100 local and regional banks, credit unions, nonprofit organizations, government agencies, and other organizations were present. Discussion topics ranged from the role of CDFIs within a wider community development system to the availability of resources to support state and local economic revitalization projects. Representatives from organizations supporting small business development, affordable housing, and consumer financial services, shared their experiences and challenges serving the Kansas City area, but also provided examples of ways to partner with CDFIs to build local capacity and expand the provision of products and services to low and moderate income communities.

A resource room at the forum provided attendees an opportunity to have one-on-one discussions with federal and state agencies about how to access funding and technical assistance to support CDFI strategies.

11. Does the Treasury Department consult with other agencies, such as the Small Business Administration, to improve administration of the CDFI program?

The CDFI Fund has a strong history of working with other agencies, including the Small Business Administration (SBA), to improve services and administration of the CDFI Fund. A few examples include workshops on “Economic Developments in Indian Country,” co-sponsored by the Federal Reserve Bank of San Francisco, the Department of Commerce, and the Department of the Interior’s Office of Indian Energy and Economic Development, the SBA, and USDA Rural Development, as well as the educational forum in Kansas referenced in Question 10, above. The CDFI Fund also is part of the following interagency initiatives and working groups:

- SBA’s Community Advantage Program: CDFI loan funds are eligible to apply to originate SBA 7(a) loans up to \$250,000;
- HUD’s Colonias Initiative and Growth Zones Initiative with HUD;
- The Healthy Food Financing Initiative: HHS and the USDA;
- Neighborhood Revitalization Initiative: Office of Urban Affairs, HUD, Education, Justice, and HHS;

- Appalachian Regional Development Initiative: Appalachian Regional Commission, USDA, Commerce, Education, Energy, HHS, HUD, Interior, Justice, Labor, Transportation, Veterans Affairs, Environmental Protection Agency, and SBA; and
- Strong Cities, Strong Communities: White House-led initiative, which includes participation from 13 federal agencies.

ALCOHOL TOBACCO TAX AND TRADE BUREAU

12. Is the Department contemplating closing the Alcohol Tobacco Tax and Trade Bureau and reassigning its responsibilities to other Treasury and non-Treasury agencies?

The President's Budget does not include any proposal to transfer TTB's functions. Furthermore, the Department has not altered TTB's reporting and decision-making structure and would consult with Congress before taking any such action.

MERGER OF FINANCIAL MANAGEMENT SERVICE AND BUREAU OF PUBLIC DEBT

The Department proposes merging the Financial Management Service (FMS) with the Bureau of Public Debt (BPD) in 2013. The FMS accounts and disburses all federal funding and computes the daily balance of federal government accounts. The BPD sells US debt and makes payments of principal and interest.

13. Are the core missions of these agencies so interrelated that they can be merged naturally and easily?

Yes, both bureaus have a shared mission of providing the financial infrastructure for the federal Government and report to the Secretary of the Treasury through the Fiscal Assistant Secretary. Both bureaus have a history of working together on large-scale mission-critical initiatives such as data center consolidation and sharing of human resource services. We have identified additional opportunities for collaboration such as the Do Not Pay (GOVerify) and the Electronic Invoicing initiatives. We believe that the consolidation of the two bureaus is a logical and natural advancement and will make a stronger joint entity than they would be remaining as two single entities. In addition, starting in FY 2014, the consolidation will save the federal government \$36 million over five years.

PREPAID CARD PILOT PROGRAM

In 2011, Treasury conducted pilot program for low income taxpayers to receive federal tax refunds in the form of prepaid cards.

14. When will the report about the pilot program be completed?

We expect to complete and release the report in the summer of 2012.

Questions for the Record Submitted by Ranking Member Serrano

SEQUESTRATION

15. In January, absent Congressional action, sequestration takes effect. I understand you cannot tell us the exact impact of sequestration, per se, but you can tell us the overall impact of cutting your budget by approximately 9%.

Cuts of this magnitude would greatly impair the Department's ability to fulfill its mission. Labor costs make up most of our discretionary spending. For example, more than 70 percent of the IRS budget supports labor costs, and hence a reduction of that magnitude could only be achieved by through significant reductions in staffing. This would have an especially dramatic effect on both the service and enforcement programs. Cuts in taxpayer services staff would degrade the IRS' taxpayer outreach efforts and its ability to respond to taxpayer inquiries in a timely manner. The large reduction to enforcement programs would result in billions of dollars of lost enforcement revenue, far in excess of IRS budgetary savings. This would further increase the federal deficit.

Additionally, funding for the Treasury Department supports the disbursements of many benefits, government-wide accounting activities, tracking and reporting on terrorist financing, and key economic, tax, and financial analysis functions. While the IRS is the largest portion of our budget, cuts to our other programs will have similar negative results. Cuts of this magnitude may reduce the personnel available for sound and timely analysis of economic and financial policy issues below necessary levels, and result in significantly limited staffing levels the important programs and services we deliver.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

16. Please explain how the subsidy rate for the Community Development Financial Institutions (CDFI) Bond Guarantee program was calculated.

The implementing regulations for the program are currently under development. The Bond Guarantee Program will be operated as a loan-by-loan program, where the subsidy cost for each bond facility will be calculated separately, and finalized up front at the point of obligation. For each transaction, there will be estimated cashflows reflecting all available information that would affect the cost to Government, including the terms of the contract, risks, and other characteristics of the bond that would affect the cashflows to and from the Government. It is currently anticipated that the program will operate as a "zero-subsidy" program, where premiums charged to the borrowers and the statutory risk-share provision will fully cover anticipated losses on the bonds.

EFFICIENCY SAVINGS

17. As Secretary of the Treasury, you have a particular responsibility to lead by example in terms of finding cost efficiencies and streamlining programs. Explain some of the ways that the Treasury Department is moving toward efficiency and, as you say, getting more “mission for the money.”

The FY 2013 President’s Budget reflects Treasury’s imperative to achieve our mission while also finding new, more efficient ways of carrying out the business of government. The FY 2013 Budget request for Treasury’s operating bureaus is 2.7 percent below the FY 2012 enacted level, and 6.8 percent below the FY 2010 enacted, excluding the Internal Revenue Service (IRS). Since 2010, Treasury has identified more than \$900 million in savings and implemented innovative new ways of doing business that reduce administrative and overhead costs, eliminate redundancies, and deliver more “mission for the money.” The FY 2013 Budget identifies \$286 million in efficiency savings and program reductions. Listed below are some examples of the ways Treasury is achieving savings and increasing efficiency:

- Expand the use of electronic transactions in conducting the business of government, saving an estimated \$500 million over five years from FY 2011 to FY 2015, including: electronic payroll savings bonds, electronic benefit payments, and electronic tax collection;
- Consolidate the Bureau of the Public Debt (BPD) and the Financial Management Service (FMS), saving \$36 million over five years, starting in FY 2014, and enabling Treasury to leverage the expertise of the two bureaus to better address the financial management needs of the federal government;
- Suspend the production of the \$1 coin, reducing costs by \$50 million annually;
- Improve debt-collection capabilities through legislative proposals and administrative improvements that will generate over \$2 billion in additional debt collection over the next ten years, a substantial portion of which is returned to states;
- Consolidate FMS and BPD data centers, achieving \$128 million total net cumulative savings from FY 2012 through FY 2016;
- Increase e-filing with the IRS, saving \$72.5 million (cumulative from FY 2009 to FY 2013);
- Replace the Alcohol and Tobacco Tax and Trade Bureau’s paper-intensive manual permit application process with a new electronic filing system, saving \$8.6 million over 10 years;
- Eliminate IT legacy systems at the Financial Crimes Enforcement Network, saving over \$3 million in FY 2013; and
- Achieve 21.4 percent reduction in energy intensity, a 9.4 percent increase in renewable energy, 20 percent reduction in potable water intensity in FY 2011, and maintain Gold LEED Certification for the Main Treasury building.

Please see the FY 2013 President’s Budget for a complete list of Treasury savings and efficiencies.

HOME AFFORDABLE MODIFICATION PROGRAM

The Home Affordable Modification Program (HAMP), your signature program for foreclosure mitigation, has produced far fewer mortgage modifications than anticipated or hoped. In fact, the House has voted to defund the program on several occasions, claiming that it is better to give up on solving the foreclosure crisis than to try to fix the program.

18. How have you reformed the HAMP program? How can you make it more useful for homeowners who are struggling?

The Making Home Affordable (MHA) program, which includes, among other programs, the Home Affordable Modification Program (HAMP), has been successful in helping over a million families avoid foreclosure and in transforming the mortgage servicing industry.

When President Obama took office in January 2009, millions of American families could not make their monthly mortgage payments and were unable to sell, refinance, or find meaningful modification assistance due to a housing price bubble that had been building for nearly a decade. As house prices started to collapse, homeowners' adjustable rate mortgages also started to reset their interest rates upward, significantly increasing many homeowners' monthly payments. The Administration took immediate steps to help these homeowners through MHA and its first lien modification program, HAMP.

To date, over one million families have received permanent HAMP modifications. We continue to help tens of thousands of families each month. These homeowners have saved an estimated \$12.2 billion in monthly mortgage payments with a median savings of approximately \$535 per month – a one-third reduction from the median payment before modification. Under HAMP, a standard mortgage modification typically involves reducing the interest rate and extending the term to lower the debt-to-income ratio to 31 percent. Modifying to this fixed debt to income ratio has led to a more affordable and sustainable first lien modification.

Before Treasury launched HAMP, the mortgage industry was ill equipped to respond to the foreclosure crisis. Their operations were focused on collecting payments on performing loans, and they did not have the systems, procedures, or people to modify mortgages, or otherwise help large numbers of delinquent borrowers. Borrowers had little meaningful assistance available and, in fact, before HAMP, borrowers who received private modifications saw a reduction in their monthly mortgage payment only 36 percent of the time.

HAMP set a new standard for assisting homeowners struggling to make their payments, and required servicers to establish modification programs at a time when proper assistance had been unavailable. Under the agreements servicers made with Treasury, they are required to consider borrowers found ineligible for HAMP for all other options, including proprietary modifications, following Treasury established protocols that provide strong consumer protections and a robust compliance process. By contrast to private modifications, almost 100 percent of HAMP loan modifications have led to payment reductions and HAMP standards have helped increase the proportion of private modifications that reduce monthly payments to 83 percent in April 2012 according to HOPENow. The standards set by HAMP as to how to achieve sustainable

modifications, as well as standards for consumer protection, have transformed the industry and helped to trigger an additional 2.9 million modifications that have occurred since the program was launched in March 2009. As a result, there have been more than twice as many public and proprietary modifications performed as there have been foreclosures completed.

Since launching HAMP, Treasury has made a number of changes to enhance the effectiveness of the program and provide additional alternatives to foreclosure. These changes include:

Verified Income: When HAMP was launched in March 2009, servicers were able to offer HAMP trial modifications to borrowers based only on the borrower's statements about their income and eligibility. Many of those "stated income" trial modifications far exceeded the anticipated three month trial period and many ultimately failed because the servicer was unable to collect the documentation necessary to verify the borrower's income.

Program rules were changed in June 2010 and servicers were required to offer a HAMP trial only to borrowers based on verified income documentation. Since this change to HAMP, the average length of time nationwide between the start of a HAMP trial and conversion to a permanent modification has been reduced to 3.5 months, a statistic that is published monthly in the MHA Program Performance Report. Additionally, 86 percent of all trials started since June 2010 have successfully converted to permanent HAMP modifications.

Principal Reduction Alternative: Treasury enhanced HAMP with the Principal Reduction Alternative Program (HAMP PRA), which provides incentives to participating servicers and investors to reduce the principal for underwater mortgages when the borrower has a hardship and doing so produces a better economic result for the lender. Empirical research has shown that mortgage default is caused by a combination of unaffordable monthly payments and high levels of negative equity. Adding HAMP PRA to the menu of available modifications allows negative equity to be addressed as well as monthly payments, thereby increasing the borrowers' likelihood of continuing to pay the manageable monthly mortgage payment amount and further increasing the likelihood that the borrower will remain current on the loan. Through April 2012, nearly 60,000 permanent HAMP modifications have included principal reduction.

Unemployment Forbearance: Treasury created the Unemployment Program (UP) to provide a minimum of 12 months of forbearance to enable unemployed homeowners to look for a new job without fear of foreclosure. Through March 2012, over 22,000 UP forbearance plans have been started.

Second Lien Modification Program: Treasury created the Second Lien Modification Program (2MP) to provide modifications or extinguishments on eligible second liens where the first lien was modified under HAMP on the same property. Through April 2012, over 80,000 2MP modifications have been started.

Short Sale / Deed in Lieu: Treasury created the Home Affordable Foreclosure Alternatives (HAFA) program to provide transition alternatives to foreclosure in the form of a short sale or deed-in-lieu of foreclosure. Through April 2012, nearly 45,000 HAFA agreements have been completed.

In January 2012, Treasury announced additional changes to HAMP.

Extend the deadline for the program. Tens of thousands of new borrowers enter into the program each month. In order to help more families at a time when many across the nation still need relief, the Making Home Affordable Program deadline will be extended for an additional year through December 31, 2013.

Expand eligibility requirements to reduce additional foreclosures and help stabilize neighborhoods. Eligibility will be expanded for HAMP to provide modifications for homeowners with reduced incomes or higher levels of secondary debts. Under current eligibility requirements, if a borrower's first-lien mortgage debt-to-income ratio is below 31 percent, they are ineligible for a HAMP modification. Yet many homeowners who have an affordable first mortgage payment – below the 31 percent threshold – still struggle beneath the weight of other debt such as second liens and medical bills. Therefore, Treasury expanded the program to those who struggle with this secondary debt by offering an alternative evaluation opportunity with more flexible debt-to-income criteria. In addition, Treasury expanded eligibility to include certain rental properties. This will provide relief to both renters and those who rent their homes, while further stabilizing communities from the blight of vacant and foreclosed properties.

Increased PRA incentives: Treasury tripled investor incentives in order to encourage more investors to use principal reduction as part of HAMP modifications. In an effort to expand the use of principal reduction where appropriate, Treasury has also offered to pay principal reduction incentives for modification of Fannie Mae and Freddie Mac (the GSEs) loans if the GSEs forgive principal in conjunction with a HAMP modification. The Federal Housing Financial Agency (FHFA), the conservator of the GSEs, is currently considering whether to allow the GSEs to provide principal reduction in connection with HAMP modifications.

Treasury developed standards for HAMP so that responsible homeowners who meet the eligibility criteria are properly evaluated and offered meaningful modifications, or where appropriate, other alternatives to foreclosure. This includes requiring servicers to increase staffing, establish single point of contacts, and improve customer service through its extensive compliance program. Treasury provides detailed public reporting on what mortgage servicers are performing, including through its quarterly Servicer Assessments for the largest servicers participating in MHA.

In addition to changes to HAMP and other MHA programs, in 2010 Treasury launched the Housing Finance Agency Innovation Fund for the Hardest Hit Markets (HHF). This program provides up to \$7.6 billion in funding to state housing finance agencies in the nation's hardest hit markets to design innovative, locally targeted foreclosure prevention programs tailored to their

local needs. States are experimenting with a number of different programs to help homeowners, including principal reduction, reinstatement, short sale/transition assistance, modification assistance, loan purchase, and mortgage payment programs. Approximately 70 percent of total program funds are being targeted to help unemployed borrowers, primarily through reinstatement and programs that help homeowners pay their mortgage while looking for work.

We continue to see a need for assistance through the steady pace of permanent modifications, unemployment forbearance plans, and short sale agreements every month. Treasury looks forward to working with Congress to help families stay in their homes while protecting the interests of the taxpayer.

TROUBLED ASSET RELIEF PROGRAM

20. The cost of TARP, as analyzed by the nonpartisan Congressional Budget Office, keeps declining. We are finding that the investments that we made in certain industries actually paid off. What was the original estimate of the cost of TARP, and what do we expect the program to actually cost now?

Over the last three years, the projected cost of the Troubled Asset Relief Program (TARP) has fallen by more than 80 percent. In March 2009, the Congressional Budget Office (CBO) projected that the TARP would have a lifetime cost of \$356 billion. In March 2012, CBO projected TARP's lifetime cost at \$32 billion.

Similarly, in August 2009, the Office of Management and Budget (OMB) projected that TARP would have a lifetime cost of \$341 billion. Treasury's most recent estimate as of February 29, 2012, projects a lifetime cost of TARP at approximately \$60 billion.

The cost of TARP will largely be the cost of Treasury's assistance to homeowners to avoid foreclosure. Both Treasury and OMB estimates assume disbursement of all of the \$46 billion budgeted for Treasury's housing programs, funds that were never intended to be recovered.

Based upon the February 23, 2012 valuation, Treasury estimates a \$14 billion cost for the TARP investment programs, excluding additional common stock Treasury holds in the American International Group outside of TARP. The banking programs have already resulted in a significant gain to taxpayers.

We believe the fact that TARP – and the other crisis response measures taken by the government – will generate minimal cost or possibly even a gain to the taxpayer because the government acted with overwhelming force and speed to confront the crisis, and the responses – carried out by both Republican and Democratic Administrations along with the Federal Reserve – were well designed and managed.

Questions for the Record Submitted by Congressman Mario Diaz-Balart

IRS PROPOSED REGULATION ON REPORTING OF INTEREST PAID TO NON-RESIDENT ALIENS

- 21. IRS Commissioner Shulman testified last week at our Financial Services and general Government Subcommittee and stated that the Non-Resident Alien proposal was part of a broader strategy to share information in response to the Foreign Account Tax Compliance Act (FATCA). But, under the FACTA rules the US has agreed to enter into broader information exchanges with only the 5 Euro nations of France, Germany, Italy, Spain, and the United Kingdom. Wouldn't these agreements make the NRA rule somewhat duplicative?**

The final regulations requiring U.S. financial institutions to report to the IRS the interest paid to non-resident aliens depositors are a critical part of efforts to close the tax gap by combating offshore tax evasion by U.S. taxpayers, which is a top priority of the Administration and Congress. The effective exchange of tax information with other countries is necessary to U.S. efforts to stop offshore tax evasion, and the United States has committed to working with other countries to improve transparency and the effectiveness of information exchange worldwide. The ability to exchange information reciprocally is particularly important in connection with the implementation and enforcement of the reporting provisions commonly referred to as the Foreign Account Tax Compliance Act (FATCA), enacted in 2010 as part of the Hiring Incentives to Restore Employment Act. FATCA seeks to combat offshore tax evasion by requiring overseas financial institutions to identify U.S. account holders and report information directly to the IRS. In most cases, implementing these provisions will require the cooperation of foreign governments to allow for the collection and reporting of information about U.S. accounts under foreign law. The final regulations, by allowing the IRS to collect deposit interest information with respect to non-U.S. accounts, will allow the United States, where appropriate, to better assist foreign governments in addressing their own concerns with tax evasion through the use of undisclosed accounts at U.S. financial institutions. The final regulations are critical to securing the cooperation of foreign governments and are not duplicative of any exchange agreements.

Questions for the Record Submitted by Congressman Kevin Yoder

- 22. As you work to stand up FIO and really set the tone for this office, what other initiatives, either process based like the FOCI or issues based, do you expect to see from FIO this year?**

The Federal Insurance Office (FIO) established the Federal Advisory Committee on Insurance (FACI) made up of state-level regulators and private sector representatives, which held its first meeting on March 30, 2012. FACI will provide FIO with advice and recommendations regarding FIO's duties and authorities.

FIO also recently held a Federal Government Insurance Forum (Forum) at Treasury. The Forum brought together professionals from throughout the federal government who have a role in

supervising a segment of the insurance sector or in administering an insurance program. Attendees included more than 50 individuals from more than 20 agencies. FIO intends to continue and to expand on the Forum in order to facilitate the sharing of best risk management, program administration, and other practices within the federal government.

FIO is also currently building the process by which it will coordinate and develop federal policy on prudential aspects of international insurance matters, including consultation with state regulators and interested parties

With respect to substantive initiatives, FIO's focus in the immediate term is international. FIO is leading the EU-U.S. insurance dialogue, with an expected completion date of December 2012. FIO will participate in and provide U.S. leadership on matters at the International Association of Insurance Supervisors (IAIS) and elsewhere, including within the Common Framework Initiative and the IAIS process to designate globally significant insurance institutions. FIO looks forward to engaging on other international prudential matters including with China, Japan, and Brazil.

FIO's upcoming Modernization Report will further describe FIO's process and substantive focus.

23. What are your highest priorities for FIO and its international mission this year?

The first priority for FIO is the development of resources, including professional staff. On matters of policy, FIO will focus on international prudential matters, including the insurance dialogue between the EU and the United States. For several years, the potential impact of the EU's Solvency II initiative has caused uncertainty that has hampered the strategic planning and growth of insurers in both jurisdictions. In consultation with state regulators and other federal agencies, FIO aims to bring closure to the dialogue by the end of 2012.

FIO has been engaged in the IAIS process for designating globally significant insurance institutions since July 2011. FIO is working to shape international consensus so that the criteria, methodology, and timing align with those of the Financial Stability Oversight Council. It supports the IAIS process and mission. FIO's objective is to promote a level playing field that will allow U.S.-based insurers to compete fairly in the international marketplace.

FIO supports the IAIS initiative to establish a common framework for the supervision of internationally active insurance groups, or ComFrame. As with other financial services, the insurance marketplace is increasingly global, and FIO recognizes the importance of global supervisory collaboration.

In addition, several jurisdictions impose regulatory barriers that unnecessarily limit the ability of U.S.-based insurers to operate and compete in those jurisdictions. FIO recognizes the importance of these issues to the U.S. insurance sector.

24. What assignments and objectives have you specified for FIO?

FIO has received assignments consistent with its duties, as described in Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). FIO has been engaged with its study and report on how to modernize and improve the system of insurance regulation in the United States. We expect that the Modernization Report will highlight many of FIO's domestic and international objectives.

25. What is your process for receiving input and updates from FIO?

FIO Director Michael McRaith speaks and works regularly with Treasury leadership. FIO provides input and updates directly through Director McRaith and through Cyrus Amir-Mokri, Assistant Secretary for Financial Institutions. Director McRaith also provides input and updates to our leadership team in International Affairs.

26. What will be the official titles and duties of the staff at FIO? Can you provide this committee the planned organizational chart for FIO staff?

In addition to a Director, FIO staff will have the expertise to carry out the statutory functions described in Title V of the Dodd-Frank Act. Accordingly, FIO staff will have responsibility to support the office in its roles, including to: (1) monitor all aspects of the insurance industry; (2) monitor the affordability and accessibility of insurance to traditionally underserved communities; (3) serve on Financial Stability Oversight Council; (4) coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters; and (5) advise the Secretary on national and international insurance matters of importance.

Staff titles and duties will be developed consistent with FIO's statutory mission.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

27. Given that Treasury has the oversight of the grants and tax credits provided through the Community Development Financial Institutions (CDFI) fund, what is your opinion on the allocation of how those grants and tax credits are dispersed?

For decades, CDFIs have met the challenge of providing access to capital and credit in communities impacted by economic turbulence and the CDFI Fund has been there to help them meet these challenges. The CDFI Fund is a steward of the public trust and provides several safeguards so that only the most highly qualified entities receive grants and tax credit allocations.

CDFI Fund awards are based on an assessment of strategic business plans. To help make sure the strongest applicants are given priority for awards, applications are rated and prioritized using a peer review process.

Given the very large numbers of highly qualified applicants, it has been the policy of the CDFI Fund to cap award sizes in order to provide a larger number of applicants with needed financial assistance and tax credit allocation authority. This policy has also enabled the CDFI Fund to achieve greater geographic diversity and diversity of awardees than would otherwise be the case. While the CDFI Fund has decided to make smaller awards, the applicants are still held to the highest standards of excellence.

CDFI Program awardees are required to submit information on their financial and community impact performance annually for a three-year period following disbursement of the award. This information is submitted electronically to the Community Investment Impact System, a database maintained by the CDFI Fund. Annual reports from CDFIs include information about the CDFI's financial position, current assets/liabilities, loan purchases/sales, lending, financing activities, portfolio-at-risk, target markets, job creation, businesses financed, development services, award compliance, and summary ratios used for compliance.

28. It is my understanding that since the New Market Tax Credit (NMTC) Program's inception, the CDFI Fund has made 664 awards allocating a total of \$33 billion in tax credit authority to Community Development Entities (CDE's) through a competitive application process. More specifically, based on conversations with CDE's in my district, it has been brought to my attention that a Kansas CDE has never received a NMTC in the entire history of the program. Has any consideration been given to investigating how these decisions are made regarding who receives the tax credits?

The CDFI Fund gives thoughtful consideration to each application, consistent with the competitive process mandated by statute. Neither the location of the applicant nor its principal service area is factored into the scoring or selection process except for statutorily-mandated rules regarding investment in non-metropolitan counties. This approach is consistent with the NMTC authorizing statute, which does not identify state of incorporation or location of the applicant as a consideration when making award determinations.

While a Community Development Entity (CDE) *headquartered* in Kansas has never received a NMTC allocation, Kansas is benefiting from the NMTC Program, as are most other states. Kansas-based organizations are not the only organizations that invest in Kansas projects – many organizations headquartered in other states also invest in Kansas. For example, two different organizations that received New Markets Tax Credit allocations under the CDFI Fund's 2011 allocation round listed Kansas as one of the states in their target markets, even though neither of them was headquartered in Kansas. From 2001 through 2010, the most recent calendar year that data is available, a combined \$27.8 million in NMTCs were invested in communities across the state of Kansas.

The CDFI Fund also works to help make sure that a proportionate share of NMTC investments are made in non-metropolitan counties. For the 2008 to 2011 rounds, one out of every five dollars invested by CDEs with NMTC awards is expected to be invested in rural America, proportionate to the U.S. non-metropolitan population, based on the 2000 census. Under the

2011 round, CDEs committed to investing \$708 million, or 20 percent of the total investments projected in the round, in rural areas.

The FY 2012 Committee Recommendation for the CDFI Fund required that the Government Accountability Office (GAO) conduct a study on the concentration of CDFIs and NMTCs in urban areas. This soon-to-be-released report, “Community Development Financial Institutions and New Markets Tax Credit Programs in Metropolitan and Nonmetropolitan areas,” will provide more information regarding CDFI Fund awardee performance for urban and rural areas.

Demand for NMTC allocations among highly competitive applicants has far exceeded the CDFI Fund’s authority. We strongly support extending the NMTC Program through 2013, raising the total award allocations to \$5 billion each year and permitting the tax credit to be taken against alternative minimum tax liability. Since the program’s inception, NMTC Program applicants have requested tax credit allocation authority that would support over \$202 billion in equity investments – almost seven times the amount of allocation authority available for distribution by the CDFI Fund. During the last round, the CDFI Fund received 314 applications requesting over \$26.6 billion in NMTC allocation authority, far more than the \$3.6 billion available under current law.

29. It is a concern of mine and of my constituents that these NMTC have been awarded unfairly to certain regions while neglecting others that could more greatly benefit from them. Please provide me with a detailed description of the selection process for NMTCs.

New Markets Tax Credit allocations are awarded through a highly competitive allocation process rather than a formula based on state population or other measures. The NMTC Program’s selection process and scoring criteria are detailed in the Notice of Allocation Availability (NOAA) published in the *Federal Register* at the outset of each annual competition. The NOAA for the last NMTC allocation round was published on June 6, 2011 (76 Fed. Reg. 108).

The selection process is entirely merit-based; neither the location of the applicant nor its principal service area is factored into the scoring or selection process except for statutorily-mandated rules regarding investment in non-metropolitan counties. This helps to ensure that only the most highly qualified applicants from across the country are provided with scarce tax credit allocation authority. This approach is consistent with the NMTC authorizing statute.

As specified in the NOAA, each applicant is evaluated and scored separately by three different reviewers, which results in a ranked list of highly qualified applicants. The highest ranked applications are further evaluated through a CDFI Fund panel review process, resulting in awards being made by a selecting official (or reviewing official, in the case of a divergence of recommendations by panel members). Awards are made going down the rank order list, generally sizing the awards to match anticipated capital deployment in three years, until the allocation authority for a given round is expended.

Under the 2011 round, the 70 NMTC award recipients are headquartered in 29 different states and the District of Columbia, but anticipate making investments in 49 different states, as well as the District of Columbia. The remaining state and other U.S. territories are eligible to be served by allocates with a national footprint.

RECOVERY AUDIT CONTRACTORS

With increased budget pressure, it would seem the Department should strongly consider alternative contract models that have been successful at other federal agencies and in states across the country. For example, the use of Recovery Audit Contractors (RACs) charged with identifying and recovering improper payments, which are fully-funded by contingency fees. RACs recovered almost \$800 million in Medicare improper payments over the last year. Similarly, with regards to collections efforts (tax and non-tax), many states have entered into benefits-funded arrangements with contractors to fund their tax modernization projects. These contracts have led to significant revenue gains and cost savings with little to no up-front cost to taxpayers.

30. Is the Department considering such approaches?

The Department does not currently have plans to use Recovery Audit Contractors (RACs) to identify and recover improper payments, but is conducting additional analysis to determine whether RACs might be cost effective for specific programs. Treasury maintains and performs a robust improper payment risk assessment process, in accordance with the requirements of the Improper Payment Elimination and Recovery Act and OMB Circular A-123, Appendix C. Treasury's annual risk assessment process includes a review of pre-payment controls that minimize the likelihood and occurrence of improper payments. Treasury requires each bureau and office to conduct post-award audits and report on activities, contracts issued, improper payments made, and recoveries achieved. Bureaus and offices may use payment recapture audit contingency firms to perform many of the steps in their payment recapture auditing program and identify candidates for payment recapture action. However, no Treasury bureaus have used contractors to perform recapture activities.

Treasury considers both pre- and post-reviews to identify payment errors a sound management practice that should be included among basic payment controls. All of Treasury's bureaus have a process to identify improper payments during post-reviews. At times, bureaus may use Office of Inspector General and Government Accountability Office reviews to help them identify payment anomalies and target areas for improvement. However, because Treasury applies extensive payment controls at the time each payment is processed, recapture activity is minimal.

Separately, Treasury is partnering with the Office of Management and Budget (OMB) to implement the "Do Not Pay List" outlined in the June 2010 Presidential Memorandum (Enhancing Payment Accuracy Through a "Do Not Pay List"). Treasury's Do Not Pay Business Center supports Federal agencies in their efforts to reduce the number of improper payments made through programs funded by the federal government, by providing a one-stop shop for

verifying eligibility and employing fraud detection tools and data analytics to help reduce improper payments.

In addition to the Do Not Pay Business Center, the Treasury Offset Program offsets federal and state payments to satisfy overdue debts owed by payees, including debts arising out of improper payments. The FY 2013 Budget includes three management and administrative reforms that will increase government-wide delinquent debt collections an estimated \$2.9 billion over ten years.

31. If so, what legislative changes would make using these alternative contracting methods easier?

Treasury has not considered legislative changes to make the use of Recovery Audit Contractors easier.

Questions for the Record Submitted by Congressman Jo Bonner

NON-RESIDENT ALIEN DEPOSIT REGULATION

32. Has the IRS considered the administrative reporting burden of the proposed non-resident alien deposit regulation on all U.S. banks, most of which have very little, if any, in such deposits? Please provide copies of that analysis of the cost of the administrative reporting burden?

The regulations do not impose a significant new administrative burden. Under existing law, all U.S. financial institutions have responsibilities to report the same information for depositors who are U.S. citizens, U.S. resident individuals, and Canadian resident individuals, and have developed the systems to perform such reporting. All nonresident alien individual account holders who maintain financial accounts in the United States are already required to complete a Form W-8BEN, declaring their non-U.S. status and the country in which they reside. U.S. financial institutions can use their Form W-8BEN information to produce Form 1042-S disclosures for nonresident alien depositors. Nearly all U.S. banks and other financial institutions that hold deposits have automated systems to produce Form 1099-INT, "Interest Income," for U.S. depositors, and Form 1042-S, "Foreign Person's U.S. Source Income Subject to Withholding," for Canadian depositors. As a result, the information collection requirements in the regulations build on reporting and information collection systems familiar to and already used by U.S. financial institutions for the majority of their account holders. The amount of time required to complete Form 1042 and Form 1042-S is minimal, and the statement that is required to be collected is brief. Accordingly, it should not be a significant burden to adapt current systems to report with respect to depositors who are resident in other countries with which the United States has an information exchange agreement.

33. The proposed regulation states that neither Executive Order 12866 nor section 553(b) of the Administrative Procedure Act applies to it. Would you please explain why you deem that to be the case?

Pursuant to OMB guidance and longstanding agreements between OMB and Treasury, only IRS legislative rules that constitute “significant regulatory actions” are subject to Executive Order 12866 review. Consistent with the foregoing, the proposed regulations are not covered by Executive Order 12866 and therefore were not identified as a “significant regulatory action.”

Section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) (the APA) generally requires agencies to provide public notice of a proposed rulemaking in the *Federal Register* and to permit the public to submit written comments. While the preamble to the proposed regulations states that section 553(b) of the APA does not apply to the proposed regulations, the IRS Notice of Proposed Rulemaking REG-146097-09 does satisfy each of the requirements of section 553(b) of the APA, consistent with the general practice of the IRS and Treasury.

34. Agencies must conduct a cost-benefit analysis of all significant regulatory action under Executive Order 12866, which include regulations that have an annual effect on the economy of \$100 million or more or adversely affect in a material way... a sector of the economy. Has any effort been made to conduct a cost-benefit analysis of the proposal? If so, can you provide the Subcommittee with a thorough cost-benefit analysis of the proposed regulation?

During the course of finalizing these regulations, it was determined that the regulations are not covered by Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment, which generally includes a formal cost-benefit analysis, was not required.

35. How does the IRS plan to share information collected under this regulation with foreign countries? Will countries such as Venezuela be given this information? Please provide the specific safeguards that will be required of foreign governments prior to any exchange of information.

The United States will only share information with countries with which it has entered into an agreement to exchange tax information. The countries with which the United States currently has such an agreement in effect are listed in section 3 of Revenue Procedure 2012-24, released on April 17, 2012. Furthermore, even when a tax information exchange agreement is in effect, the United States will not share any information with a country unless the United States is satisfied that the treaty partner adheres to strict confidentiality standards, will use the information only for purposes of enforcing or administering its tax laws, is willing and able to exchange information with the United States on a reciprocal basis, and can provide and receive information in a usable format.

When an information exchange agreement is in effect, the IRS will evaluate specific requests to share deposit interest information on a case-by-case basis, taking into account the appropriateness of the request under the terms of the agreement and the requesting jurisdiction's compliance with the agreement's requirement to keep exchanged information confidential and to use the information only for purposes of administering and enforcing its tax laws.

In appropriate circumstances, the IRS may agree to exchange deposit interest information on an automatic basis with a country. A determination to enter into an automatic exchange relationship, however, will be made only after further assessment of a country's confidentiality laws and practices and the extent to which the country is willing and able to reciprocate. Section 4 of Revenue Procedure 2012-24 identifies Canada as the only jurisdiction that the IRS and Treasury Department have determined to be an appropriate automatic exchange partner with respect to deposit interest, but the revenue procedure will be updated as additional countries are identified.

While we do have a tax treaty with Venezuela, we do not have an active treaty-based relationship with Venezuela between our respective competent authorities. Thus, we are not engaged currently in information exchange with Venezuela of any kind, nor are we engaged in any government-to-government communication either on general treaty matters or on the resolution of disputes in the context of specific cases. Therefore, we are simply not in a position to evaluate whether or not Venezuela is in conformity with international standards on tax information use and confidentiality. This situation precludes our sharing information with Venezuela.

Questions for the Record Submitted by Congresswoman Barbara Lee

WRITING DOWN UNDERWATER MORTGAGES FHFA

Our economy is regaining strength and slowly adding jobs, but it is still fragile and I believe that the continuing weakness of the housing market is a big part of that.

I fully support the Administration's ongoing efforts to help families refinance to the current low rates, but we need Fannie Mae and Freddie Mac to do much more.

It is way past time for Acting Director of the FHFA, Ed Demarco to allow the Fannie and Freddie to do the same.

36. What are the arguments that Treasury is making to the FHFA to encourage principal reductions or write-downs on mortgages to preserve homeownership, reduce foreclosures, and safeguard taxpayer value in the GSEs?

Principal reduction, when used in combination with a HAMP modification, is a targeted tool to assist underwater borrowers who are struggling to avoid foreclosure. Empirical research has shown that mortgage default is caused by a combination of unaffordable monthly payments and high levels of negative equity. The standard HAMP modification that focuses on lowering

monthly mortgage payments to 31 percent of a borrower's income is designed to address unaffordable monthly payments, bringing a struggling borrower's monthly payments down to manageable levels. Adding HAMP PRA to the menu of available modifications allows negative equity to be addressed as well, thereby increasing the borrowers' likelihood of continuing to pay a manageable monthly mortgage payment amount, and correspondingly reducing re-default rates.

Reducing negative equity gives borrowers the opportunity to regain equity in their properties, further encouraging these homeowners to continue to make monthly payments on the loan, and thereby decreasing the likelihood that they will walk away from the underwater property. Borrowers receiving HAMP PRA modifications to date have had their monthly payments reduced by a median of more than \$580, and their principal reduced by a median of more than \$68,000. In recent months, 70 percent of eligible non-GSE customers entering HAMP have received some form of principal reduction with their modification.

In addition, by avoiding foreclosures, modifications strengthen communities. Preventing foreclosures stabilizes property values, maintains tax revenue, mitigates crime, and reduces the burden of vacant properties. By preventing additional foreclosures in this manner, more borrowers are kept in their homes, thereby preserving the value of the mortgage and the home, and leading to greater stabilization of property values and the integrity of communities, all of which are a net economic benefit to the taxpayer.

37. What are the types of mortgages which should be written down and how many and what percentage of Fannie and Freddie owned mortgages would be impacted?

Treasury continues to assist the FHFA in its analysis of the effects of targeted principal reduction in connection with HAMP modifications of mortgages owned or guaranteed by the GSEs. Treasury believes that the proper way to analyze these effects is to limit the application of principal reduction under the HAMP model to only those modifications where it produces a better overall economic result when compared to a modification without principal reduction. This approach helps to ensure that the application of principal reduction is the best result from an economic standpoint.

We are currently working with FHFA to determine what the impact would be if the GSEs elected to use principal reduction in this manner. It is important for the FHFA to complete its analysis before any determination can be made of the number and type of mortgage loans that might benefit from the application of principal reduction. In addition, this analysis is subject, going forward, to economic conditions, including house prices, unemployment rates, and the availability of credit for refinancing.

ON UNEMPLOYMENT, POVERTY AND THE ECONOMY

There are reports that in the so called recovery of 2010, 93 percent of all income growth was concentrated in the top 1 percent of earners in America.

The average worker in the bottom 99% of incomes saw an average increase of \$80. The average income gain for those in the top 1% was around \$117,000.

And even that is misleading. Blue collar workers are seeing their wages actually fall.

Falling wages for blue collar workers, high unemployment, and increasing poverty do not make for a robust and growing economy.

38. Mr. Secretary, how do income security programs, like Unemployment Insurance, SNAP benefits or other programs to help low-income Americans impact the economy, especially during recessions?

Safety net programs serve two purposes: they provide a vulnerable population with basic necessities that they might otherwise not afford during an economic downturn and they serve as spending stabilizers so that, for example, current job losses do not turn into sharp declines in consumer spending, which could induce future job losses. Social insurance programs target low-income families because they are a more vulnerable population (from a social welfare perspective) and because they have a higher propensity to spend additional dollars. This higher propensity to spend means that resources targeted to low-income households more effectively stimulate aggregate demand compared to money targeted to higher-income, and hence higher-saving, households.

SNAP is a good illustrative example. It is targeted specifically to low-income families, is intended to address a basic necessity (food), and provides in-kind benefits (funds can only be spent on food). These features ensure that SNAP recipients spend their benefits, rather than save them. For example, more than a quarter of households (28 percent) redeem nearly all or all of their monthly benefits in the first week after issuance, and more than half (53 percent) redeem their benefits by the end of the second week of issuance. SNAP also alleviates food insecurity. A recent USDA study on the effects of the Recovery Act found that the temporary SNAP benefits helped lower food insecurity by 2.2 percentage points from 2008 to 2009, despite rising unemployment. Participation in SNAP expands and contracts with growth in the economy. As the economic conditions improve, SNAP participation declines.

39. Would significantly reducing the rate of poverty in America help boost growth in the over-all economy as well?

In addition to being a social welfare concern, poverty has long-term consequences on, for example, health and education, which could, in turn, affect long-term macroeconomic growth. Low-income individuals are more likely to have health trouble that causes them to be absent

from work, which lowers productivity. Education is key to future growth in the increasingly global economy.

These consequences are not just short-term effects on individual adults since poverty is persistent even across generations. Children who grow up in the lowest income quintile are likely to remain there as adults, further reinforcing the intergenerational cycle of poverty. However, this also means that today's poverty alleviation programs can make a difference right now and also in the future.

40. What can the Treasury Department do to specifically target and reduce long-term unemployment and reduce the rates of poverty in America, especially in areas of concentrated poverty?

Through the Small Business Lending Fund (SBLF), Treasury provided over \$4 billion in funding to more than 330 community banks and community development loan funds (CDLFs), including those in rural areas. Community banks and CDLFs specialize in small business relationship lending – meaning more capital to these institutions helps get more money to small businesses so they can expand and hire. This is critical support that will help put Americans back to work and support local economies across the nation.

The Community Development Financial Institutions (CDFI) Fund is an office within Treasury that promotes economic revitalization and community development through investment in and assistance to CDFIs, which provide financial products and services to underserved communities. The CDFI Fund helped finance a variety of local improvement projects, including the conversion of an abandoned factory into a shopping plaza and affordable housing units in San Diego and the expansion of a health care center for low-income residents here in Washington, DC. CDFI funds help improve jobs and wellness in local communities, in effect providing a demand-side complement to the small business-oriented SBLF.

41. How many OFAC staff are assigned to enforcing the Cuba sanctions?

OFAC currently has nine licensing officers that primarily license transactions relating to Cuba that are otherwise prohibited by OFAC regulations. In addition, our Enforcement division has one person primarily dedicated to Cuba-related issues.

42. How many OFAC staff are stationed at the Miami airport or any airport with direct charters to Cuba?

OFAC does not have any personnel stationed at any airports.

43. What percentage of flights and passengers returning from Cuba face a secondary screening and or interviews or screening by OFAC officials?

As noted in the response to question 42, OFAC personnel are not stationed at airports and therefore do not “screen” returning passengers; this function is carried out by U.S Customs and Border Protection. However, if OFAC has reason to believe, generally as a result of a law enforcement referral, that there may be a violation of U.S. sanctions, OFAC may issue a subpoena to any person involved requesting relevant information.

44. How many enforcement actions for Cuba related sanctions were taken by OFAC last year?

During calendar year 2011, OFAC entered into two monetary settlements that related solely to apparent violations of the Cuban Assets Control Regulation (CACR) and three more that involved violations of the CACR along with violations of other sanctions programs. Of those monetary settlements, three involved financial institutions, one involved an insurance company, and one involved a U.S. company whose affiliates dealt in Cuban property or interests in property.

45. How many terrorist attacks were stopped or intercepted due to enforcement of the Cuba sanctions by OFAC?

Although OFAC has no way of knowing or being able to provide a quantitative answer to this question, we will continue to implement and enforce the law as mandated by Congress and the President.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

Mr. Secretary I want to make sure that we continue to leverage the work of CDFIs and maximize the impact of our tax dollars at work in economically distressed communities.

I understand that these are tight budgetary times, but I believe that investments in CDFI's that leverage and multiply that federal investment into our most vulnerable neighborhoods is especially critical during the most difficult times.

46. Mr. Secretary, you launched the very promising Community Development Capital Initiative to increase low cost capital to CDFIs. Will you update us on the impact of that program?

Many communities that are underserved by traditional banks and financial services providers found it harder to obtain credit as the economy began its downturn. Community Development Financial Institutions (CDFIs) exist to provide financing to these communities. In particular, CDFIs focus on providing financial services to low- and moderate- income, minority, and other underserved communities.

Treasury created the Community Development Capital Initiative (CDCI) on February 3, 2010, to help viable certified CDFIs and the communities they serve cope with effects of the financial crisis.

Under this program, CDFI banks, thrifts, and credit unions received investments of capital with an initial dividend or interest rate of two percent, compared to the five percent rate offered under the Capital Purchase Program (CPP). To encourage repayment while recognizing the unique circumstances facing CDFIs, the dividend rate will increase to nine percent after eight years, compared to five years under CPP. CDFIs that participated in the CPP and were in good standing were allowed to exchange securities issued under CPP for securities under the more favorable terms of this program.

Treasury completed investments through this program in September 2010. The total investment amount for the program was approximately \$570 million for 84 institutions. Of this amount, approximately \$363.3 million (\$355.7 million from principal and \$7.6 million from warrants) represented exchanges by 28 banks of CPP securities for CDCI securities.

One example is Greater Kinston Credit Union, which in April repurchased all outstanding CDCI subordinated debentures from Treasury's investments in those institutions, for total proceeds of \$0.35 million plus accrued and unpaid dividends.

47. How much lending to small businesses did the Treasury's efforts help to initiate and do you have any sense of the overall impact on the economy and the jobs that were created through these efforts?

While it is still early in both of the Treasury small business programs, the Small Business Lending Fund and State Small Business Credit Initiative (SSBCI), we have already seen good progress in small business lending around the country.

Through the Small Business Lending Fund (SBLF), Treasury provided over \$4 billion in funding to more than 330 community banks and community development loan funds (CDLFs), including those in rural areas. Community banks and CDLFs specialize in small business relationship lending – meaning more capital to these institutions helps get more money to small businesses so they can expand and hire. This is critical support which will help put Americans back to work and support local economies across the nation.

SBLF participants have made important progress in increasing their small business lending. As of December 31, 2011, participants have increased their small business lending by \$4.8 billion over a \$36.0 billion baseline and by \$1.3 billion over the prior quarter. Increases in small business lending are widespread across SBLF participants, with 84 percent of participants having increased their small business lending over baseline levels (defined by statute as their average small business loans outstanding for the four quarters ended June 2010). A substantial majority of SBLF participants – more than 68 percent – have increased their small business lending by 10 percent or more.

The SSBCI allocates \$1.5 billion to states, territories, and the District of Columbia to support new and existing state programs that provide access to credit. In total, 47 states, five territories, and the District of Columbia submitted applications and were allocated funds.

Wyoming and North Dakota did not submit a notice of intent to apply for SSBCI funds, and Alaska withdrew its application while it was under consideration. Under the Act, municipalities, or consortia of municipalities, were eligible to apply for a state's allocation by submitting an application by September 27, 2011. Treasury has awarded an allocation to Anchorage, Alaska. Applications from two municipalities in Wyoming and two municipalities in North Dakota are currently in stages of internal review.

To date, SSBCI has allocated more than \$1.43 billion, or 98 percent, of total funds available to states, territories, and the District of Columbia. Eligible applicants submitted proposals for more than 140 different programs. Approximately 50 percent of the programs were newly designed for the SSBCI program.

By March 2012, the number of states supporting loans and investments rose to 44 states. Preliminary data show that the cumulative SSBCI funds used to support loans or investments rose to more than \$100 million. If these loans are representative of the states' programs, this deployment of SSBCI dollars should result in over \$1.1 billion in new small business lending.

48. Given that successful track record, shouldn't we be building on that with most support for CDFI's in the budget?

The \$221 million funding level in the FY 2013 President's Budget shows strong support for the CDFI Fund and will enable it to continue providing critical resources to low-income, underserved communities.

Fully funding the Administration's request for the CDFI Fund is especially important given the additional challenges that low-income communities are facing in the aftermath of the recession. The Administration shares your commitment to the CDFI Fund and believes in its power as an economic stimulator.

SMALL BUSINESS AND MINORITY PARTICIPATION IN TREASURY

I appreciate your engagement on ensuring access to contracting opportunities in the TARP and the Term Asset-Backed Securities Loan Facility and the commitment of everyone at Treasury to providing fair and open opportunities for small businesses.

I appreciate that the Treasury Department made sure that prime contractors had small business subcontracting goals included in their contract proposals.

49. Will you report back to the subcommittee a list of all of the contracts where contractors failed to meet small business goals for any and all included small business categories and any performance bonuses withheld or liquidated damages that were levied because of those shortfalls?

Although Treasury is working to automate the process, it currently obtains subcontracting and small business compliance data manually. The Department is developing, and will forward upon completion, a report that includes the information requested. The report is anticipated to be delivered in June of FY 2012.

MINORITY HIRING AND ADVANCEMENT

50. Will you please update the subcommittee on the status of the new Office of Minority and Women Inclusion at the Treasury and tell us about how their work has impacted your Department?

We understand this question as seeking information on the Office of Minority and Women Inclusion (OMWI) for the Treasury Departmental Offices. Treasury has a second OMWI at the Office of the Comptroller of the Currency.

Treasury Secretary Timothy F. Geithner established the OMWI for Treasury's Departmental Offices on January 21, 2011, in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) § 342 (P.L. 111-203). The express statutory authority as it relates to the OMWI for Departmental Offices does not extend responsibility over the bureaus. To maximize its impact on contracting, Treasury assigned Department-wide oversight of Small Business Programs to the OMWI. This is the only area in which the scope of OMWI's responsibilities extends beyond the express statutory responsibility related to Treasury Departmental Offices.

The first major initiative undertaken by OMWI, in collaboration with the Treasury Office of the Procurement Executive, was a Treasury-wide campaign aimed at meeting all of Treasury's FY 2011 small business goals. This included contracting with women-owned small businesses and economically disadvantaged small businesses, which are largely minority-owned. OMWI's small business contracting campaign effort led to a landmark achievement: For the first time ever, Treasury exceeded the overall small business contracting statutory goal, established by the SBA, as well as all four of the statutory (SBA-established) socioeconomic small business contracting goals. Not only was each of these goals exceeded by a substantial margin, but, by all indications, Treasury is the only Cabinet-level agency (aside from SBA) to have met all of its small business contracting goals in FY 2011.

51. Has there been an increase in minority and women hiring, or promotions, especially in the executive ranks, at Treasury?

This Administration has set the record for the most women serving in Senate-confirmed positions at Treasury in its history. For the first time, Treasury has two women serving as Under Secretaries. In addition, the Treasurer of the United States, four Assistant Secretaries, and two Acting Assistant Secretaries are women, including women of color.

52. Please provide a breakdown of the diversity of the staff at the Treasury, by pay grade and executive category and continue to update the subcommittee on the diversity plans, outreach and other efforts the Treasury is making to strengthen the diversity of the Treasury employees, procurement opportunities and prime and subcontractors.

Seventy-three percent of Treasury Departmental Offices permanent employees are at the upper level grades, i.e., federal General Schedule (GS) 13-15 and Senior Executive Service (SES) levels. For FY 2011, data is provided below on minorities and women serving in permanent GS 1-15 and SES level positions in the Departmental Offices workforce.

- **Minority Representation (aggregated):** Minorities serving in Treasury Departmental Offices at the GS 13-15 level (25 percent) and SES (10 percent) represent 24 percent of the total permanent positions at GS 13-15 and SES positions combined.
- **Women:** Women serving in the Departmental Offices at the GS 13-15 level (45 percent) and SES (28 percent) represent almost half (44 percent) of total permanent positions at GS 13-15 and SES positions combined.

Departmental Offices - Grade	Women	Minorities
GS-01	0%	0%
GS-02	0%	0%
GS-03	0%	0%
GS-04	100.00%	50%
GS-05	33.33%	75%
GS-06	0%	100%
GS-07	60.00%	70%
GS-08	100.00%	73.68%
GS-09	67.14%	55.29%
GS-10	55.56%	66.66%
GS-11	61.26%	45.94%
GS-12	64.29%	42.86%
GS-13	50.57%	41.06%
GS-14	45.62%	28.64%
GS-15	42.22%	15.40%
Senior	28.16%	10.68%

Executive	42.86%	7.14%
Total	48.98%	30.70%

*There are no GS-01 or GS-03 employees within the Departmental Offices; there is one GS-02 employee.

Recruitment: OMWI is working to expand outreach efforts, pursue recruitment from the most diverse and well-qualified pool of candidates possible, and cultivate a workplace environment that fosters diversity. The recruitment strategy has traditionally targeted institutions, career fairs and expos, online and printed advertisement materials, and community outreach activities. These efforts will be enhanced to incorporate each of the recruitment strategies identified in the Dodd-Frank Act § 342 (f) (1-6). Although it is difficult to correlate specific recruitment channels and strategies with the resulting diversity of applicant pools for specific positions, we are committed to adopting the best strategies to attract minorities and women candidates.

OMWI will focus its effort on increasing the participation of women and racial and ethnic minorities in mission-critical occupations. At Treasury Departmental Offices, mission-critical occupations include economists, financial analysts, attorneys, information technology specialists, and intelligence specialists.

In FY 2012, OMWI is supporting internship programs aimed at expanding the racial and ethnic diversity of the pool of candidates for student internships throughout Treasury Departmental Offices. Opportunities are being increased for minority students to have meaningful and marketable internship experiences throughout Treasury Departmental Offices. New and expanded partnerships are being developed with various organizations dedicated to educational success of minority and women students.

Contracting: Building on the momentum in small business contracting and goal achievement from FY 2011, Treasury has set out to “Crush the Goals” again in FY 2012. Treasury’s FY2012 statutory goal from the SBA for overall small business contracting has been increased to 32 percent. However, Treasury’s Deputy Secretary and Assistant Secretary for Management have established an aggressive Treasury-wide “stretch goal” for overall small business contracting of 35 percent. In FY 2012, Treasury will continue to employ the strategies that proved successful in FY 2011, including targeted outreach, enhanced leadership accountability, new policies, new tools and resources, and increased intra-agency communication.

EXECUTIVE COMPENSATION

53. Will you update the subcommittee on the status of the companies that were bailed out by the TARP program and specifically how the executive compensation for companies have been handled in the last year?

All TARP recipients are subject to executive compensation restrictions under the Emergency Economic Stabilization Act and the Interim Final Rule for TARP Standards for Compensation

and Corporate Governance (IFR) until they have fully satisfied their obligations to the Treasury and exited the program. Under the IFR, TARP recipients with outstanding obligations to Treasury must comply with restrictions on bonuses, golden parachute payments, and other forms of compensation, as well as requirements to implement clawbacks and certain compensation committee practices, among others. The CEO and CFO for each TARP recipient remaining in the program must certify to the Treasury on an annual basis, on penalty of perjury that the TARP recipient has complied with the restrictions and requirements of the IFR.

In addition to the executive compensation restrictions that apply to all TARP recipients, TARP recipients that have received exceptional assistance must also submit the compensation of their top 100 employees to the review and approval of the Office of the Special Master. Originally, there were seven exceptional assistance recipients: Bank of America, Citigroup, Chrysler Financial, Chrysler, GM, AIG, and Ally Financial (formerly GMAC). Shortly after the 2011 Determination Letters were issued by the Office of the Special Master in April 2011 to the then-four remaining exceptional assistance recipients, Chrysler fully exited TARP, leaving only AIG, Ally Financial, and GM under the jurisdiction of the Office of the Special Master (available at www.financialstability.gov, click on “Executive Compensation”).

On April 6, 2012, the Acting Special Master for TARP Executive Compensation, Patricia Geoghegan, released the 2012 compensation determinations for the top 25 executives at the three remaining exceptional assistance companies (also available under “Executive Compensation” at www.financialstability.gov). The restrictions from prior determinations continue unchanged, such as the prohibition on hedging of stock compensation and the cap on perquisites. Bonuses remain subject to clawback. Notably, the Office of the Special Master approved no increases in compensation for the CEOs. As in past compensation determinations, the Office of the Special Master applied to each decision the principles provided in Treasury’s executive compensation regulations, balancing the needs for each firm to rein in risky compensation practices and also remain competitive and repay the American taxpayer.

The three remaining exceptional assistance companies have made progress repaying taxpayer investments: AIG has reduced its TARP obligations (including through cancellation of undrawn commitments) nearly 50 percent. Treasury has also recovered nearly half of the TARP funds invested in GM and nearly one-third of the TARP funds invested in Ally Financial through repayments and other income.

54. Further, do you have any data on the impact of the “Say on Pay” requirements enacted in Dodd Frank have had on executive pay?

As you have noted, Congress included a “Say on Pay” provision when it passed the Dodd-Frank Act in July 2010. “Say on Pay” refers to a requirement for a nonbinding shareholder vote on a company’s executive compensation. The SEC has authority to implement Say on Pay, and issued final regulations implementing the requirement in January 2011.

Treasury’s regulation of executive compensation for TARP recipients also requires each company that has securities registered with the SEC to permit a separate shareholder vote on the

compensation of executives. The CEO and CFO of each such TARP recipient must certify to Treasury, on penalties of perjury, that such shareholder resolutions have been permitted. OFS monitors these certifications from each TARP recipient.

55. Would changing the tax code so that the size of executive pay packages has more of a direct impact on the bottom line for investors increase the impact of laws like the “Say on Pay” provisions?

“Say on Pay” was one of several proposals, which also included strengthening board compensation committee independence and resources, that have been supported by the Treasury in order to improve corporate governance with respect to executive compensation. We have consistently held and expressed the view that pay should reflect long-term value creation and financial soundness that benefits the economy at large as well as corporate stakeholders. As experience has shown, compensation arrangements that offer corporate executives incentives to take excessive risks or other actions in order to generate rewards they can capture in the short term, regardless of the long-term consequences, can distort decisions with adverse consequences to us all. Specifically, we believe that measures such as requiring holding stock compensation for longer periods, requiring clawbacks where financial statements were materially incorrect, and prohibiting executives from avoiding personal risk with respect to their compensation through hedging or similar activities, are important. To the extent that sound compensation policies like these can be encouraged by proposed revisions to the tax code, we would certainly consider them.

At the same time, except where (as with TARP recipients) the government has a major stake in a company, we are reluctant to put the government in the business of setting pay caps for executives or anyone else. Moreover, changes to the tax code may not always be the most effective way to deal with the problems that have given rise to excessive compensation. Experience suggests that attempting to use tax measures to limit compensation, unless very carefully crafted, may prove to be counterproductive, adversely affecting shareholders or others who are not the intended targets. In other words, in considering any tax code proposals to further limit the ability to deduct executive compensation in the same manner as other business expenses, we must take into account the risk of the unintended adverse consequences that have arisen from other changes in the past.

WITNESSES

	Page
Geithner, Hon. T. F	157
George, J. R	1
Shulman, D. H	79
Thorson, E. M	1



