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INTERNAL REVENUE SERVICE OPERATIONS AND THE 2014 TAX RETURN FILING SEASON

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

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

ONE HUNDRED THIRTEENTH CONGRESS

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INTERNAL REVENUE SERVICE OPERATIONS AND THE 2014 TAX RETURN FILING SEASON

WEDNESDAY, MAY 7, 2014

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

The subcommittee met, pursuant to call, at 10:30 a.m., in Room 1100, Longworth House Office Building, the Honorable Charles Boustany [Chairman of the Subcommittee] presiding.

[The advisory of the hearing follows:]

HEARING ADVISORY

Boustany Announces Hearing on Internal Revenue Service Operations and the 2014 Tax Return Filing Season

1100 Longworth House Office Building at 10:30 AM
Washington, April 30, 2014

Congressman Charles W. Boustany, Jr., M.D., (R–LA), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the Internal Revenue Service (IRS) and the 2014 tax return filing season. **The hearing will take place on Wednesday, May 7, 2014, in Room 1100 of the Longworth house Office Building, beginning at 10:30 A.M.**

The Commissioner of the Internal Revenue Service, the Honorable John Koskinen, will be the only witness at the hearing. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion into the printed record of the hearing.

BACKGROUND:

In fiscal year 2013, the IRS collected over $2.8 trillion in taxes, processed 145.9 million individual tax returns, and issued $364.3 billion in refunds. With the 2014 tax return filing season concluded, the Subcommittee will review IRS performance with a focus on taxpayer service, taxpayer rights, and refund administration.

In conjunction with the review of the current tax return filing season, the Subcommittee will review IRS operations in general. Specifically, the Subcommittee will consider: (1) efforts to prevent waste, fraud, and abuse, including identity theft, (2) the agency's implementation of the Affordable Care Act (ACA), (3) fairness in examinations and tax administration, and (4) whether the agency is pursuing all necessary reforms to address the Treasury Inspector General for Tax Administration's (TIGTA) findings that the IRS targeted certain groups on the basis of name and policy position.

In announcing the hearing, Chairman Boustany said, **"The IRS has a long way to go in restoring public trust after the unprecedented targeting scandal. Beyond that, I am concerned about the agency's ability to effectively deter waste, fraud, and identity theft, as well as its new role in the President's troubled health care law, and the billions of taxpayer dollars it must administer in the Exchanges. The agency is obligated to spend its nearly $12 billion budget wisely, and the Subcommittee is committed to ensuring the IRS is putting these taxpayer dollars to efficient and effective use. The Subcommittee looks forward to discussing these and other important issues with Commissioner Koskinen."**

FOCUS OF THE HEARING:

The hearing will focus on the 2014 filing season and other issues facing the IRS, including efforts to prevent waste, fraud, and abuse, implementation of the ACA, promoting fairness in examinations and tax administration, and changes at the agency to address the findings of targeting by TIGTA and Congressional investigations.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Com-

mittee homepage, *http://waysandmeans.house.gov*, select "Hearings." Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Wednesday, May 21, 2014**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–3625 or (202) 225–5522.

FORMATTING REQUIREMENTS:

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

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

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

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

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

Note: All Committee advisories and news releases are available on the World Wide Web at *http://www.waysandmeans.house.gov/*.

Chairman BOUSTANY. In the interest of time, we are going to go ahead and get started. We are still waiting on the ranking member Mr. Lewis. He should be here shortly. The subcommittee will now come to order, and good morning to everyone. Welcome to the subcommittee on oversight's hearing on the Internal Revenue's operation budget and filing season.

This filing season, millions of taxpayers across America have struggled to meet their tax filing obligations. Doing so has become harder over time as the Tax Code grows in complexity, forcing taxpayers to spend over $6 billion and $160 billion every single year to comply with its filing requirements. At the IRS, hard-working public servants also bear the weight of America's outdated Tax Code.

Despite these challenges and another late start to the filing season, the IRS appears to have carried out the 2014 filing season with success. Initial reports suggest the 2014 filing season was free of problems that have marred previous filing seasons. As of early

April, the Service processed over 98 million returns, issued 80 million refunds, responded to nearly 40 million calls with lower wait times, and all of these are improvements over last year.

Members of subcommittee and I congratulate Commissioner Koskinen and the thousands of dedicated career IRS employees on a successful filing season. We thank them for their hard work under difficult circumstances. In IRS offices across the country, public servants work hard to administer the Nation's tax laws fairly and accurately. This is not an easy task, and we thank them for their service

However, these successes have occurred against the backdrop of the ongoing investigation into the agency's targeting of conservative groups applying for tax-exempt status. As the agency works to recover from the scandal, these kinds of successes will help the agency regain the trust of the American people. It is still a long road, and how the IRS responds to the ongoing investigation will affect the pace of recovery for better or worse. But I have to say, we still have serious concerns with regard to the integrity of the agency based on three findings so far in this investigation.

First, Lois Lerner defied internal IRS controls to target certain taxpayers. This is a serious concern. On April 9th, the committee sent a letter referring former executive—or Exempt Organization Division Director Lois Lerner to the Attorney General Holder for potentially engaging in criminal wrongdoing in her capacity as EO director. One of these actions, in particular, has serious implications for the IRS as it rebuilds. The committee uncovered evidence that shows Ms. Lerner acted in defiance of internal controls developed to ensure that no single IRS employee could target an organization for adverse determination or exam. Ms. Lerner was not only familiar with these internal controls, they were policies she created and touted publicly as a way of commending her agency's impartiality.

The evidence shows that Ms. Lerner knowingly bypassed these controls, reached into her division, and directed that specific organizations be subjected to audit. And yet, as official IRS reports declare—an official IRS report declared, quote, "we have not found evidence of intentional wrongdoing by IRS personnel," end quote.

Given the evidence the committee has uncovered—given the evidence the committee has uncovered so far, this is to the contrary, and I call on the IRS to review the agency's internal controls to ensure that this type of targeting can never happen again.

Second, donors whose names were inappropriately requested by the IRS were audited. Equally troubling is new evidence uncovered by the committee that shows the IRS' exam function may have been used for political purposes. It is well known that the IRS improperly requested donor information from scores of conservative groups. For months, this committee has asked the IRS what it did with these improperly obtained lists and whether those lists were used to target individual donors to right leaning groups. Recently, the committee uncovered new information indicating that after groups provided the information to the IRS, nearly 1 in 10 donors were subject to audit, and the abuse of discretion in audit selection must be identified and stopped.

Because of failures in IRS policy exploited by Lois Lerner and the possible targeting of conservative donors, I have requested that the Government Accountability Office undertake a thorough review of the policies and procedures for audit selection by the IRS' small business and self-employed division. Last year, I made a similar request that GAO audit the Exempt Organizations Division. I understand that audit is already under way.

And Commissioner Koskinen, I call on you to give GAO your unqualified cooperation to the—with these audits so we can shed sunshine on this to begin to restore the public confidence in the IRS.

Third, the IRS has denied some applicants for exempt status their right to an independent appeal. Through the committee's investigation, we have also found the IRS was, until recently, denying certain applicants with tax-exempt status their right to an independent appeal process as guaranteed by the IRS Restructuring and Reform Act of 1998. Ordinarily, if an applicant for exempt status is denied, the applicant can appeal to an independent appeals division. This was mandated by the 1998 IRS Restructuring Act. However, if Washington, D.C., selected an applicant for additional review, an adverse determination was not appealable. The most a disappointed applicant could actually do was protest to the very same officials who denied the group in the first place. Noteworthy is that all of the applicants were subject to extra scrutiny based on the name "Tea Party" or "policy objective" to "Make America a Better Place to Live." These groups had their appeal rights taken away.

This practice would never have come to light but for the committee's thorough oversight of the agency, and as a consequence, the IRS has now pledged to change its practice, and I know, Commissioner, we discussed some of this yesterday. We are gratified by this change, but I call on the IRS, Mr. Commissioner, today, to ensure that all applicants who were denied their right to a fair independent appeal process receive one. Some of these are left sort of in limbo on this, and we hope they will be given due consideration with a fair appeals process.

The IRS cannot be an agency in which one senior executive can easily circumvent policies designed to safeguard taxpayers' due process rights. It cannot be an agency in which taxpayers are denied their right to an appeal based on the location of their file, and it cannot be an agency that audits taxpayers based on improperly obtained information.

Commissioner Koskinen, I do appreciate your hard work under difficult circumstances, but this subcommittee cannot simply take the IRS' assurances at face value. The IRS' problems must be addressed through frank and serious conversations, so I look forward to discussing these matters and more during today's hearing. And again, I applaud the commissioner and the IRS for the good work during the 2014 filing season, and I hope the agency will continue with this success and continue all the work that it is going to take to rebuild the trust of the American people.

With that, I now am very pleased to yield to my dear friend and distinguished ranking member Mr. Lewis.

Mr. LEWIS. Thank you very much, Mr. Chairman.

Mr. Chairman, I want to apologize to you and other Members of the Committee for being a little late here.

Chairman BOUSTANY. No need for apologies.

Mr. LEWIS. Well, thank you very much.

Thank you, Mr. Chairman, for holding this important hearing.

Mr. Commissioner, thank you for joining us today and congratulations to you and the IRS staff on a successful filing season. Over the past year, the IRS has dealt with many serious challenges. I commend you for taking the time to get out into the field to visit and connect directly with IRS staff across the country. Your thoughtful work and outreach has restored the morale of thousands of IRS employees, and I speak for many when I thank you for your efforts to tackle the serious challenges facing the agency.

As we all know, many issues remain. Chief among them is the need to increase the IRS budget. Last month, the Government Accountability office released a report that makes it clear that reducing the IRS budget has cut thousands of staff and hurt taxpayers. The agency sorely needs adequate resources in order to provide our taxpayers with the service they expect and deserve.

When you can't get an answer on the telephone for 20 minutes, taxpayers hang up. When you don't get an answer to your letter for 30 or 60 or even 90 days, you get aggravation. Taxpayers deserve better. There are hard-working Americans who need a functioning IRS and want to have faith in our government.

For the very first time, the Affordable Care Act has opened the doors for millions of Americans to access for healthcare. This will mean more work for the IRS, and we need to make sure that the agency has all of the necessary resources to do their part in a fair and transparent manner. The administration had requested $12.5 billion for the IRS fiscal year 2015 budget. Although that may seem like a lot, the IRS is getting less funding today than they did in 2009, and even if they were fully funded, which we know is unlikely, the GAO estimates this would only bring the IRS back up to 2012 staff levels.

It is important to highlight that providing the IRS with the necessary resources also helps crack down on identity theft and tax cheats. Last year, the IRS examination on individual tax returns declined 5 percent and collection activity declined 3.3 percent—rather, 33 percent. That is a great deal. When we don't fund the IRS enforcement effort, we essentially endorse an unfair playing field and reduce compliance across the board.

Mr. Chairman, I am hopeful that this committee, with us working together, we can find a way to work together and with the commissioner to provide the IRS with adequate resources and to make the IRS the best Federal agency in our government.

Again, Mr. Chairman, thank you for holding today's hearing, and I look forward to working together, as I stated before, in a bipartisan manner for the good of our country and the good of all of our taxpayers. Thank you, and I yield back.

Chairman BOUSTANY. I thank the gentleman for his comments.

Now, it is my pleasure to welcome our one witness for this hearing today, the Honorable John Koskinen, Commissioner of the Internal Revenue Service.

Commissioner Koskinen, thank you for your time today. We welcome the opportunity to discuss a whole host of issues, the state of the IRS with you today, how you see things going forward. The committee has certainly received your written statement, which will be made part of the formal hearing record, and as is customary, we will give you 5 minutes to make an opening statement to deliver your oral remarks, and then we will go forward with questioning.

So, sir, you may begin.

STATEMENT OF THE HONORABLE JOHN KOSKINEN, COMMISSIONER, INTERNAL REVENUE SERVICE, WASHINGTON, D.C.

Mr. KOSKINEN. Thank you, Mr. Chairman.

Ranking Member Lewis, members of subcommittee, thank you for the opportunity to discuss the 2014 filing season and our actions to reduce improper payments. The IRS, as noted, delivered another successful filing season this year, rising to the challenges posed by an incredibly tight budget.

Through April 25th, the IRS received more than 134 million individual income tax returns, of which 87 percent were file electronically. We will have processed nearly 150 million individual returns and sent out well over 100 million refunds when we close the books on this filing season next fall. This is a tremendous accomplishment that does not happen automatically or by accident, but as the chairman noted, as a result of the efforts of our highly experienced, capable, and dedicated workforce.

During this filing season, we were able to improve our phone service somewhat, despite our funding limitations. This was done in large part to the diligent efforts of our employees as well as our improved ability to provide information to taxpayers on our Web site, IRS.gov, and the lack of major tax legislation in 2013.

Because of the dropoff in call volume, we maintained a level of phone service during the filing season of about 71 percent, which is better than last year's average of 60.5 percent but still an unacceptable level of service since it means that about 30 percent of calls did not go through.

Furthermore, now that filing season is over and we no longer have extra seasonal employees, we will have fewer people on the phones, and we expect wait times to increase significantly between now and the end of September. For all of this fiscal year, we expect our level of phone service to drop below 70 percent and end up closer to last year's number.

Looking beyond the filing season, we are concerned that levels of service and enforcement will continue to decline as a result of budget constraints. Our funding for this year was set at $11.29 billion, more than $850 million below our fiscal 2010 level, and $500 million below our presequestration level. We have 10,000 fewer employees today than we did in 2010, even as our responsibilities have continued to expand.

Turning to improper payments, one of our major areas of focus, it remains the fight against refund fraud, especially fraud caused by identity theft. I am pleased to report that over the last couple of years, the IRS has made important progress in this area. In 2013, we suspended or rejected 5.7 million suspicious returns

worth more than $17.8 billion in refunds. Through April 18th of this year, more than 3 million suspicious returns have been stopped.

We have also opened more than 500 new investigations into identity theft and refund fraud screens thus far in fiscal 2014, bringing the total number of active cases to more than 1,800. We will remain vigilant, given the propensity of fraudsters to adapt to changing circumstances and to develop new and more complicated schemes. Even with the progress we have made thus far, I have recently asked our senior leadership team to reevaluate everything we are doing in this area and to consider additional steps we could take to prevent refund fraud, especially that caused by identity theft.

Another way we are working to reduce improper payments is by improving compliance with regard to refundable tax credits, especially the earned income tax credit program. Our programs that focus on EITC combine to protect approximately $4 billion annually. Even so, we continue to be concerned that the improper payment rate for EITC remains unacceptably high. We now have a working group assessing our past and current efforts in this area and exploring new possibilities for improving compliance.

Congress can help us on both refund fraud and EITC by enacting several proposals in this year's budget for the IRS. One would accelerate the due dates of third-party information returns, which would allow us to match up those documents against income tax returns earlier in the tax filing process and to more quickly spot errors and potential fraud. Another proposal would provide the IRS with greater flexibility to address correctable errors, which would allow us to automatically fix more errors on returns than we can do now, thus avoiding costly audits or allowing errors to go uncorrected.

We also urge Congress to enact our proposal to explicitly authorize the IRS to regulate paid tax return preparers. Given that more than half of the returns claiming an EITC refund credit are done by paid preparers, this proposal would be an important addition to our efforts to improve compliance in this area.

Even with these legislative changes, which would be very helpful, the biggest challenge to our efforts to reduce improper payments remains our ongoing lack of adequate resources. Without sufficient funding, our ability to proceed with any new initiatives in this area will be constrained, and it will be increasingly difficult even to maintain current levels of service and enforcement.

This concludes my opening statement. I will be happy to take your questions.

Chairman BOUSTANY. Thank you, Commissioner.

[The prepared statement of Mr. Koskinen follows:]

WRITTEN TESTIMONY OF
JOHN A. KOSKINEN
COMMISSIONER
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT
ON THE 2014 FILING SEASON AND IMPROPER PAYMENTS
MAY 7, 2014

I. INTRODUCTION

Chairman Boustany, Ranking Member Lewis and Members of the Subcommittee, thank you for the opportunity to appear before you today to update you on how the 2014 filing season went for the IRS under our current funding levels and to discuss the issue of improper payments with you.

As you know, the IRS is vital to the functioning of government and to keeping our nation and economy strong. We support the nation's tax system by providing taxpayer service to help people understand and meet their tax responsibilities while ensuring enforcement of the tax laws. The agency plays a unique role in government, and resources invested in the agency lead to significant revenue increases for the nation.

Despite the extraordinary efforts of our employees to ensure a smooth filing season, I remain concerned about the very tight budget constraints under which the IRS has been operating since 2010. Our funding for Fiscal Year (FY) 2014 was set at $11.29 billion, which is more than $850 million below our level in FY 2010. Over the same time period, we lost almost 10,000 full-time permanent employees. It is important to note that the IRS continues to operate at near sequestration levels, with the agency's FY 2014 funding less than one percentage point above FY 2013 levels. The solution to the funding problem we face begins with the Administration's FY 2015 budget request, which, with the inclusion of the program integrity cap adjustment and the Opportunity, Growth and Security Initiative, totals $12.64 billion. This is approximately $1.35 billion above the FY 2014 enacted level. This amount includes a $480 million program integrity cap adjustment to vitalize tax compliance and a $165 million additional investment through the Opportunity, Growth and Security Initiative to deliver performance enhancements that taxpayers deserve. In the absence of these additional resources, our ongoing funding shortfall has major, negative implications for taxpayers and the tax system.

In discussing our budget situation, we recognize that there has been a loss of confidence among taxpayers and particularly within Congress in regard to the

way we manage operations, particularly the management problems that came to light last year in the section 501(c)(4) area. One of my responsibilities is to ensure that we are minimizing risks and quickly solving management and operational problems that may arise, so that Congress can be confident that, when we request additional funding, the money will be used wisely. Taxpayers provide the funds we receive and they deserve to be confident that we are careful stewards of those resources.

II. IRS PERFORMANCE: FY 2013 AND CURRENT FILING SEASON

Despite the limits on our resources, I remain impressed with the professionalism and commitment of our workforce. Our employees have continued, throughout these challenging times, to perform critical work for the IRS and the nation – helping people understand and meet their tax responsibilities while ensuring enforcement of the tax laws. They are making every effort to ensure a smooth experience for taxpayers despite the funding shortfall.

Filing Season

The IRS delivered another successful tax filing season in 2014, rising to the challenges posed by an incredibly tight budget. Through April 25, 2014, the IRS received more than 134 million individual income tax returns, of which about 87 percent were filed electronically.

As the result of concentrating our resources during the filing season, our level of phone service improved this year during filing season as compared to the average for FY 2013. We have been able to maintain a level of phone service of around 70 percent, meaning that about 70 percent of taxpayers who called this filing season got through to the IRS. One reason may be that the volume of calls to our toll-free lines is actually down somewhat. We believe that is largely because there were no significant tax law changes enacted in 2013. In addition, we continue to provide more resources to taxpayers on our website, which we believe offers an alternative to the phone.

However, with the exit of seasonal employees at the end of filing season, wait times will increase, and we expect that the average level for the entire year will drop below 70 percent and end up closer to last year's 60.5 percent. This is an unacceptable level of service that especially concerns our employees, who believe taxpayers deserve better. We will continue to monitor telephone service levels and work to maintain as high a level of phone service as possible within our resource limitations.

Another area of concern this year is the amount of time people have had to wait to get in-person help at our Taxpayer Assistance Centers (TACs). We have had reports from field staff of taxpayers lining up outside TACs well before the

centers open in the morning to make sure they receive service the same day. We also have had reports of people waiting 90 minutes or more to be helped once they arrived inside the TAC and taken a number for service. Unfortunately, given our resource limitations we have few options to drive down these wait times.

Also, with our current resources, it is taking much longer for us to respond to taxpayer correspondence. Historically, 70 percent of letters we receive have been answered within 30 days, but we expect that more than half of all correspondence this year will take more than 45 days to answer.

In short, as *Forbes* magazine recently noted, a reduction in IRS funding that erodes service levels "punishes" taxpayers.

Taxpayer Service

Providing taxpayers with top-quality service and helping them understand and meet their tax obligations remain top priorities for the IRS. In the past 18 months we have updated forms to help taxpayers comply with filing requirements, converted forms for visually impaired taxpayers, and translated more tax products into multiple languages. In addition, the IRS continued its effort to redesign taxpayer correspondence in plain language and in a consistent format to make it easier for taxpayers to understand their obligations.

The IRS continued to provide alternative service options by increasing the amount of tax information and services available on IRS.gov. During the 2014 filing season just completed, taxpayers viewed IRS.gov web pages more than 270 million times. Thus far in 2014, taxpayers have used the "Where's My Refund?" online tool about 162 million times. The IRS also deployed a new telephone and web tool last year called "Where's My Amended Return?" in both English and Spanish that allows taxpayers to check the status of their Form 1040X amended tax returns for the current year and up to three prior years.

This year, we have several new digital applications that expand what taxpayers can do online. An excellent example of these is "Get Transcript", which is a secure online system that allows taxpayers to view and print a record of their IRS account, also known as a transcript, in a matter of minutes. During the 2014 filing season there were more than 7.8 million downloads of this application which otherwise would have required taxpayer calls or personal appointments to request their transcripts, which we would then have to mail to the taxpayers.

The IRS continues to improve and expand on its outreach and educational services through partnerships with State taxing authorities, volunteer groups, and other organizations. Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites provide free tax assistance for low-income individuals, the elderly and disabled, and individuals with limited proficiency in

English. This filing season nearly 90,000 volunteers prepared federal returns at over 12,000 sites across the country.

I am pleased to report that the IRS' technology efforts in relation to improving taxpayer service recently received public recognition. In March, the Excellence.gov Awards Program sponsored by the American Council for Technology and the Industry Advisory Council recognized the IRS' Virtual Service Delivery (VSD) program for Excellence in Customer Experience. VSD technology units allow face-to-face contact between IRS employees and taxpayers at remote sites through two-way video conferencing. These units help the IRS resolve taxpayer issues remotely at understaffed and unstaffed Taxpayer Assistance Centers, Taxpayer Advocate Service sites, and Low Income Taxpayer Clinic locations.

Tax Compliance

This fiscal year the IRS' key enforcement programs will operate well below historical levels. We will perform 100,000 fewer individual audits, and individual exam coverage rates will be at an historic low. There will be similar declines in audits of high wealth-individuals, businesses and partnerships along with an estimated 190,000 fewer collection activities. We estimate that the government will lose almost $3 billion in revenues as a result.

The IRS has continued to focus on service and compliance activities in regard to tax return preparers. Return preparers play a key role in increasing taxpayer compliance and strengthening the integrity of the U.S. tax system. The IRS requires anyone who prepares or assists in preparing federal tax returns for compensation to have a valid Preparer Tax Identification Number (PTIN). PTINs allow the IRS to collect more-accurate data on who is preparing returns, the volume and types of returns being prepared and the qualifications of those doing return preparation. Additionally, PTIN data is essential in determining where to direct compliance and educational outreach efforts for erroneously prepared tax returns. The IRS recently held a successful PTIN renewal season, offering enhanced PTIN system usability, troubleshooting tips, and other tools. As of March 2014, the number of valid PTINs totaled approximately 677,000.

The IRS criminal investigation program examines potential criminal violations of the Internal Revenue Code and related financial crimes such as money laundering and tax-related identity theft fraud. Even with declining resources, our Criminal Investigation (CI) division has already this year initiated 2,015 investigations, recommended 1,663 prosecutions and secured 1,590 convictions.

III. IRS EFFORTS TO REDUCE IMPROPER PAYMENTS

Making Progress on Identity Theft

The IRS has a comprehensive and aggressive identity theft strategy that focuses on preventing refund fraud, investigating these crimes and assisting taxpayers victimized by identity thieves.

Refund fraud detection

The IRS stopped 5 million suspicious returns in Calendar Year 2012 – up from 3 million suspicious returns stopped in CY 2011. This upward trend has continued: in CY 2013 we suspended or rejected 5.7 million suspicious returns, worth more than $17.8 billion. This year, through April 17, about 3 million suspicious returns have been stopped.

In 2008, we began placing an indicator on the accounts of taxpayers who had experienced identity theft. These indicators initially served two primary purposes: to speed up account reconciliation for the legitimate taxpayer, and to reduce the likelihood that a taxpayer's information could be used for a fraudulent refund claim in subsequent years.

In 2011, we launched a pilot program to test the Identity Protection Personal Identification Number (IP PIN). The IP PIN is a unique identifier that authenticates a return filer as the legitimate taxpayer at the time the return is filed. The IP PIN is sent to the taxpayer immediately before the filing season for use on the return that will be filed during that filing season and is valid for only one filing season. The growth in the use of the IP PIN has been significant, from 250,000 IP PINs issued in filing season 2012 to more than 1.2 million IP PINs this filing season. Also this year, we offered a limited pilot program to test the idea of issuing IP PINs to individuals who have not previously been identity theft victims, but who reside in locations with high incidences of identity theft. This could prove to be a valuable initiative for next year's filing season.

Over the last two fiscal years the IRS has made numerous improvements in our efforts to protect identifying information as well as catch fraud before refunds are issued:

- We have implemented new identity theft screening filters to improve our ability to spot false returns before we process them and issue refunds. We have also accelerated, to the extent we can under the present law, the use of information returns in order to identify mismatches earlier.

- In cases where dozens or even hundreds of refunds go to a single bank account or single address, we added identity theft filters last year that flag these multiple refund situations for further review. We plan further actions in this area for the next filing season.

- We have implemented a variety of mechanisms to stop the growing use by criminals of deceased individuals' identity information to perpetrate fraud. We routinely lock accounts of deceased taxpayers, and have locked more than 25 million accounts to date. Also, the Bipartisan Budget Act of 2013 included the President's proposal to limit public access to the Death Master File, the intent of which is to help reduce identity-theft related tax fraud.

- We have developed better procedures to use information about identity theft victims received from law enforcement officials who discover this information in the course of investigating identity theft schemes or other criminal activity. We use the data to flag taxpayer accounts and block returns filed by identity thieves.

- Another important part of protecting taxpayers' identities is the IRS' Social Security Number (SSN) Elimination and Reduction program. Under that program, we eliminate or reduce the use of SSNs within our systems, forms, notices and letters where the collection or the use of the SSN is not necessary. To date, we have eliminated or reduced the use of the SSNs on 70 different non-payment notices that we mail to taxpayers. Also, we recently began to deploy SSN masking on eight additional notices with an annual estimated volume of 36 million notices mailed to taxpayers who request installment agreement payments.

- We have developed procedures to better stop the processing of fraudulent returns from prisoners. We have been helped by a number of actions in this area, including the Bipartisan Budget Act of 2013, which includes the President's proposal to give the Treasury Department the legal authority to obtain the Social Security Administration's (SSA) Prisoner Update Processing System (PUPS) data. Additionally, the IRS has collaborated with the Federal Bureau of Prisons, and also with Departments of Correction (DOC) in states that choose to partner with us, to help identify prisoners who may be engaged in tax fraud. Our authority to share return information with prisons, made permanent in the American Taxpayer Relief Act of 2012, helps us as well.

- We are collaborating with software developers, banks, and others to determine how we can better partner with them to address identity theft and prevent federal monies from reaching the hands of identity thieves. For example, we established the External Leads Program for receiving leads from partner financial institutions. In 2013, we had 286 institutions partnering with us, which resulted in 198,000 returned tax refunds in the amount of $574 million. The IRS has also established relationships with representatives of the prepaid access card industry, which has enabled us to leverage their security protocols designed to detect and prevent

fraudulent use of prepaid cards. In many cases, these companies can identify potentially fraudulent tax refunds and freeze or cancel the cards.

The IRS' current fraud detection capability is strong but is limited by our current funding levels. There has been some recent attention to our computer systems that we use to combat identity theft. I want to note that we are not ending the Electronic Fraud Detection System (EFDS); it remains in operation and continues to perform well in providing protections to taxpayers and the tax system. Additionally, we also use our Dependent Database (DDb) System to identify identity theft returns. The DDb system is flexible, and we are able to program new filters quickly as we identify new schemes. So far this year, we have stopped more than half a million potential identity theft returns through DDb. Our significantly improved refund fraud system, the Return Review Program (RRP) has had its development delayed due to funding constraints. If fully deployed, the program would allow us to adjust our filters during the filing season as new schemes appear, rather than making such adjustments only at the end of filing season.

Even with the progress we have made in the battle against refund fraud, I have asked our senior leadership team to reevaluate everything we are doing and to consider additional steps we could take to reduce refund fraud. As discussed later, this will require some assistance from the Congress with regard to legislative changes.

Assisting victims

Being victimized by identity theft is a frustrating, complex situation. The IRS has 3,000 people working directly on identity theft related cases – more than double the number in late 2011. And we have trained 40,000 employees who regularly work with taxpayers to help with identity theft situations when they arise.

Critical to the IRS' efforts to assist identity theft victims is our Identity Protection Specialized Unit, which provides taxpayers with a single point of contact at the IRS via a special toll-free telephone line. We also have several identity theft specialized groups to assist with processing identity theft cases.

During FY 2012, the IRS reengineered its identity theft process to close cases more efficiently, accurately, and in a less burdensome manner. In FY 2013, taxpayers who became identity theft victims had their situations resolved in roughly 120 days, far more quickly than in previous years, when cases could take over 300 days to resolve. While this marks a significant improvement, we are continuing to find ways to shorten this time and ease the burden identity theft places on these victims. In CY 2013, the IRS worked with victims to resolve and close approximately 963,000 cases. So far in FY 2014, more than 181,000 cases have been closed and our backlog has been reduced from 260,000 last year at this time to 98,000 now.

Investigating fraud-related crimes

The investigative work done by the IRS is a major component of our efforts to combat tax-related identity theft. CI investigates and detects tax and other financial fraud, including fraud related to identity theft. CI recommends prosecution of refund fraud cases, including cases involving identity theft, to the Department of Justice.

So far in FY 2014, CI has opened more than 500 new investigations into identity theft and refund fraud schemes, bringing the total number of active cases to more than 1,800. In addition, there have been 478 recommendations for prosecution and 342 sentences so far this year, with an average time to be served of more than 40 months. Our intensified activity in the criminal investigation area in relation to identity-theft related refund fraud follows a surge in the number of investigations opened in the last two years – 900 in FY 2012 and 1,500 in FY 2013.

State and local law enforcement agencies also play a critical role in fighting identity theft. CI regularly collaborates with these agencies, and, in March 2013, the IRS announced the nationwide expansion of the Law Enforcement Assistance Program, which began as a pilot program in Florida in 2012. This program provides for the disclosure of federal tax returns and return information associated with the accounts of known and suspected victims of identity theft when the victim provides express written consent for disclosure. To date, more than 5,000 waivers have been provided in 44 states.

Improvements to the ITIN Program

Individual Taxpayer Identification Numbers (ITINs) assist with the filing and collection of taxes from foreign nationals, resident and non-resident aliens, and others who have filing or payment obligations under U.S. law but who do not qualify for SSNs.

ITINs play a critical role in the tax administration process, as they are essential to the processing of tax returns that report tens of billions of dollars in taxable income and billions in tax revenue for individuals who have a U.S. tax filing obligation and otherwise would not have a U.S. taxpayer identification number.

The IRS has taken steps to improve the process of issuing ITINs in order to verify the applicant's identity and foreign status. We will continue to strengthen our efforts in this critical and complex area.

ITIN application process

Under procedures in place since last year, the IRS, with few exceptions, only issues ITINs to taxpayers and dependents who provide original documentation, such as passports and birth certificates, or copies of these documents certified by the issuing agency, to verify their identity.

These procedures also include tighter requirements for becoming a Certifying Acceptance Agent (CAA) and remaining in the CAA program. CAAs play an important role in the ITIN application process as intermediaries who review identity documents of the applicant. Under the tighter requirements, CAAs must certify to the IRS that they have verified the authenticity of the original or issuing agency-certified documents supporting the ITIN application. CAAs are also now required to undergo forensics training, and the IRS has begun compliance reviews of CAAs.

Investigating and detecting ITIN fraud

Reducing refund fraud involving the misuse of ITINs, in which individuals use ITINs to file returns claiming tax credits to which they are not entitled, continues to be a priority for the IRS, and we have made important progress in this area. Our CI division has increased investigative time spent on ITIN investigations by approximately 400 percent since 2008. Between 2008 and April 15, 2014, CI identified approximately 2,725 ITIN schemes that encompassed more than 323,000 ITIN returns. Several fraud detection filters are in place specifically to help detect issues with the Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC).

Notably, last year the IRS detected specific patterns indicating potential fraud in returns with ITINs and was able to develop filters on a real-time basis during the filing season to stop these refunds from being issued. In addition, we have developed new methods of clustering suspicious returns together to catch large numbers of returns that appear similar. These clusters include identifying multiple returns using the same address or the same filing and refund patterns.

Strengthening Tax Compliance in Regard to Refundable Credits

Refundable tax credits play an important role in fulfilling Congressional policies, but they are inherently subject to a number of tax administration challenges. There are numerous refundable credits currently administered by the IRS, including the Earned Income Tax Credit (EITC), the CTC and the American Opportunity Tax Credit (AOTC). The IRS has a dual mission when it comes to administering refundable credits. We must balance the mandate to get refunds out as quickly as possible to those who qualify with the need to ensure that the money goes only to individuals who are eligible to receive it.

There are a number of factors that present challenges to our compliance efforts as they relate to refundable credits. They include the following:

- *Complexity*. Complexity in the rules governing eligibility for and the operation of certain refundable credits creates challenges for both taxpayers and the IRS. Mistakes in the application of the law cause a significant portion of claims that are made in error.
- *Lack of Third-Party Data*. In many cases, the IRS lacks real-time third-party data sources that could be used to verify taxpayers' eligibility. In many cases, definitive third-party data verifying eligibility does not exist. Even if data exists, the IRS is often in the position of having to process returns and determine the validity of a refund before receiving the third party data that could be matched against the return to verify data. For example, Form 1098-T, which helps the IRS verify the eligibility for the AOTC, is not due to be filed with the IRS until after most refunds claiming the credit are processed.
- *Cash Payments*. Refundable credits allow for payments beyond income tax liability. This makes refundable credits particularly enticing targets for certain types of fraud.

Given these challenges, the IRS has dedicated significant attention and resources to improving tax compliance in regard to claims made for refundable credits in order to reduce improper payments associated with these credits. One of the biggest enforcement priorities for us in this area is the EITC.

Enforcing EITC rules

Congress created the EITC as part of the Tax Reduction Act of 1975, to offset Social Security taxes. The credit has evolved into an important program that now lifts millions of children and families above the poverty line each year.

To qualify to claim the EITC, individuals generally must: have earned income; have a valid SSN for themselves and for each qualifying child they claim; meet certain filing status and income limits; have investment income of no more than a certain amount ($3,300 for 2013); and be a U.S. citizen or resident alien for the entire year for which the credit is claimed.

The amount of the EITC that an individual may claim varies based on whether the individual has any qualifying children, and if so, the number of qualifying children that the individual is able to claim. For a child to be considered a qualifying child, the following tests must be met:

- *Age:* The child must be under age 19 at the end of the year (under age 24 in the case of a student) and younger than the taxpayer (or younger than both the taxpayer and the taxpayer's spouse if filing a joint return), or the

child must be permanently and totally disabled at any time during the year for which the EITC is claimed;

- *Residency:* The child must have lived with the taxpayer for more than half of the year for which the credit is being claimed, although certain exceptions to this rule apply; and
- *Relationship*: The child must be the taxpayer's son, daughter, stepchild, eligible foster child, brother, sister, stepbrother, stepsister or a descendant of any of these individuals, such as a grandchild, niece or nephew. Adopted children also qualify, including those lawfully placed with the taxpayer for legal adoption.

In addition, a taxpayer claiming the credit cannot be the qualifying child of another taxpayer, and cannot use the "married filing separately" filing status. Additional requirements apply for individuals who do not have qualifying children. Given the complex nature of the rules governing eligibility, the IRS engages in significant education and outreach efforts so that taxpayers are aware of their potential eligibility for the credit.

The IRS' EITC-focused enforcement programs currently protect approximately $4 billion annually. The following programs contribute to the broader strategy of identifying improper EITC refund claims as early in the process as possible:

- *Math error*. This refers to an automated process in which the IRS has been granted statutory authority to identify certain math or other irregularities on the return and automatically adjust the return for a taxpayer.
- *Document matching*. This process involves comparing income information provided by the taxpayer with matching information from third-party returns, such as Form W-2 and Form 1099, to identify discrepancies. The IRS conducted almost 1 million of these reviews in FY 2013, in addition to 500,000 audits.
- *Examinations.* The IRS identifies tax returns and amended returns for examination and in most cases holds the EITC portion of the refund until an audit can be completed. Of the approximately 500,000 EITC audits conducted by the IRS each year, 70 percent are conducted before the EITC portion of the refund is paid. The tax returns to be examined are selected using an effective risk-based audit selection model, resulting in a change rate of more than 90 percent. Examinations protected almost $2.1 billion against improper EITC refund claims each year.
- *Soft notices.* The IRS uses soft notices as a low-cost alternative to audits. They help educate taxpayers on their compliance responsibilities and are an inexpensive way of recovering payments. In FY 2013, the IRS sent more than 110,000 letters to alert taxpayers that an exemption or qualifying child for the EITC claimed on their returns had also been claimed by another person.

- *Two- and 10-year bans*. Under section 32(k), the IRS is authorized to ban taxpayers from claiming the EITC for two years if it determines during an audit that they claimed the credit improperly due to reckless or intentional disregard of the rules. The IRS can impose a 10-year ban in cases of fraud. When a ban is imposed, taxpayers are provided their full appeal rights. Last year there were more than 67,000 two-year bans and 45 10-year bans in effect.

The IRS continues working to improve and expand its existing compliance efforts to stop improper EITC payments. Notably, our increased efforts in regard to identity theft-related fraud detection have helped improve EITC enforcement results.

In spite of these accomplishments, it is important to note the significant degree of difficulty in enforcing compliance with the EITC, which derives in large part from its eligibility requirements. EITC eligibility depends on items that the IRS cannot readily verify through third-party information reporting, including marital status and the relationship and residency of children. In addition, the eligible population for the EITC shifts by approximately one third each year, making it difficult for the IRS to use prior-year data to assist in validating compliance.

Given this situation, and given that approximately 57 percent of the returns claiming the EITC are prepared by tax return preparers, we believe that one of the keys to driving increased EITC compliance continues to be strategic programs addressed to the return preparer community, such as our return preparer initiative referenced above. Other examples of our preparer-related activities include: compliance and warning notices sent before and during the filing season to preparers who preparer large numbers of EITC returns to educate them on their responsibilities and the consequences of noncompliance; preparer audits done by field examiners to make sure preparers are complying with EITC due diligence rules; and "knock-and-talk" visits to preparers by CI agents and auditors, to educate them on EITC laws.

Additionally, the IRS has expanded its traditional treatment of EITC preparers to test a new early-intervention component. Over the previous two years the IRS has used data analytics - including an innovative approach - to significantly reduce improper payments associated with the EITC as well as the CTC.

Using this approach, a small data-driven pilot in 2012 identified a group of tax return preparers with a history of submitting incorrect or potentially fraudulent tax returns falsely claiming the EITC, then designed and implemented interventions with these preparers to stop improper claims. The interventions included letters, calls and site visits to selected preparers, both before and during tax filing season to allow preparers to immediately adjust their practices. These efforts reduced improper EITC payments in 2012 by an estimated $198 million for returns prepared by preparers who received the interventions.

An expanded preparer pilot in 2013 protected an additional $590 million in revenue from being paid out improperly. The 2013 pilot program included a broader set of randomly selected preparers and a broader set of interventions, including the addition of preparer-focused taxpayer audits (for returns that otherwise would have qualified for audit even absent the pilot). Many preparers whose error rates did not improve as a result of interventions during the 2012 pilot did so in 2013 after being subject to additional intervention. Preparers who had improved due to IRS interventions during the initial 2012 pilot generally maintained their improved behavior with respect to EITC and related tax credits claimed on returns and claims filed during 2013. Use of interventions for preparers before and during the filing season continued on an expanded basis in 2014.

Despite all of the efforts described above, we continue to be concerned that the improper payment rate for the EITC has remained too high throughout the program's history. (For FY 2013, the EITC improper payment rate was between 22 and 26 percent.) Therefore, we recently initiated a major review of our activities in this area. As part of this review we are assessing our many past and current efforts, and are exploring new possibilities, such as options for simplifying EITC eligibility requirements and finding more-efficient ways to distinguish valid claims from excessive claims. We also think the legislative proposals presented next will play a critical role in our effort to lower the improper payment rate.

Administration's Green Book Proposals

Congress can help us further enhance our efforts to reduce improper payments, particularly those involving the EITC, by approving the program integrity cap adjustment referenced above and a number of legislative proposals contained in the President's FY 2015 Budget, including the following:

- ***Correctible error authority***. As noted above, the IRS has limited statutory authority, known as "math error authority," to identify certain computation or other irregularities on returns and automatically adjust the return for a taxpayer. These upfront systemic processing checks protect approximately $320 million in improper EITC payments annually. At various times, Congress has expanded this limited authority on a case-by-case basis to cover specific newly enacted tax code amendments. The Administration's proposal would replace the existing specific grants of this authority with more general authority covering computational errors and incorrect use of IRS tables. Further, the proposal would expand IRS' authority by creating a new category of "correctible errors," allowing the IRS to fix errors in several specific situations, such as when a taxpayer's information does not match the data in government databases. Without correctible error authority, any obvious errors in a return can only be fixed after an audit, which requires far more resources than we presently have.

- ***Acceleration of information return filing dates***. Under current law, most information returns, including Forms 1099 and 1098, must be filed with the IRS by February 28 of the year following the year for which the information is being reported, while Form W-2 must be filed with the SSA by the last day of February. The due date for filing information returns with the IRS or SSA is generally extended until March 31 if the returns are filed electronically. The Administration's proposal would require information returns to be filed with the IRS (or SSA, in the case of Form W-2) by January 31, except that Form 1099-B would have to be filed with the IRS by February 15. The proposal would also eliminate the extended due date for electronically filed returns. In addition, it would rationalize income tax return dates so that taxpayers would receive Schedule K-1 before the due date for filing their tax returns.

- ***Authority to regulate return preparers.*** In light of recent court decisions striking down the IRS' authority to regulate unenrolled and unlicensed paid tax return preparers, the Administration's proposal would explicitly authorize the IRS to regulate all paid preparers. In explaining the reason for this proposal, the Treasury Department noted that the regulation of all paid preparers, in conjunction with diligent enforcement, will help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system. Treasury also noted the harms caused by incompetent and dishonest preparers to the tax system, including increased collection costs, reduced revenues, the burden placed on taxpayers by the submission of incorrect returns on their behalf, and a reduction in taxpayers' confidence in the integrity of the tax system.

- ***Preparer penalty***. Under current law, the penalty imposed on preparers for understatement of tax on a federal return due to an unreasonable position taken on the return is the greater of $1,000 or 50 percent of the income derived by the preparer from preparation of the return. A separate penalty can be imposed if the understatement is due to the preparer's willful or reckless conduct. That penalty is the greater of $5,000 or 50 percent of the income derived by the preparer from preparation of the return. The Administration's proposal would increase the penalty in cases of willful or reckless misconduct to the greater of $5,000 or 75 percent of the income derived by the preparer (instead of 50 percent). Treasury has said this proposal is necessary because in many cases, 50 percent of income derived by the preparer is far greater than the fixed dollar penalties imposed, so that, under the present penalty regime, preparers who engaged in reckless or willful conduct would end up paying the same dollar penalty as preparers whose conduct did not rise to that level.

- ***Due diligence***. Return preparers who prepare tax returns on which the EITC is claimed must meet certain due diligence requirements to ensure their clients are in fact eligible to receive this credit. In addition to asking questions designed to determine eligibility, the preparer must complete a due diligence checklist (Form 8867) for each client, and file the checklist with the client's return. The Administration's proposal would extend the due diligence

requirements to all federal income tax returns claiming the CTC and the ACTC. The existing checklist would be modified to take into account differences between the EITC and CTC.

There are a number of other legislative proposals in the Administration's FY 2015 Budget request that would also assist the IRS in its efforts to combat identity theft. They include the following: Giving Treasury and the IRS authority to require or permit employers to mask a portion of an employee's SSN on W-2s, an additional tool that would make it more difficult for identity thieves to steal SSNs; adding tax-related offenses to the list of crimes in the Aggravated Identity Theft Statute, which would subject criminals convicted of tax-related identity theft crimes to longer sentences than those that apply under current law; and adding a $5,000 civil penalty to the Internal Revenue Code for tax-related identity theft cases, to provide an additional enforcement tool that could be used in conjunction with criminal prosecutions.

V. CONCLUSION

Chairman Boustany, Ranking Member Lewis and members of the Subcommittee, thank you again for the opportunity to update you on the 2014 filing season and discuss our efforts to reduce improper payments. To improve our ability to increase enforcement of the tax code, it is vital that we find a solution to our budget problem, so that the IRS can be on a path to a more stable and predictable level of funding. I look forward to working with Congress and this Committee to do just that. This concludes my statement, and I would be happy to take your questions.

Chairman BOUSTANY. I want to cover some of the information and concerns we have with regard to the investigation to start with. I know we had a wide-ranging conversation yesterday, and I do appreciate talking about all of the issues, but the committee's investigation of targeting has yielded a number of insights into op-

erations during that timeframe of the Exempt Organizations Division, and the committee found that EO has been run in a manner that was inconsistent with the IRS Restructuring and Reform Act of 1998, as mentioned in my opening.

The act calls for an independent appeals function that would ensure taxpayers' due process rights. And during the course of the investigation, we found that some groups whose applications were sent to IRS headquarters in Washington automatically lost their right to an independent appeal.

Commissioner, isn't it true that the groups that TIGTA said were targeted on the basis of their name or policy position were sent to Washington, D.C., for review? In other words, bypassed the determinations process in Cincinnati, went straight up to, I think it was EO Technical for review; is that true?

Mr. KOSKINEN. Yes. I am not sure whether all of them went but certainly a number of—significant number went to Washington to that Technical review process.

Chairman BOUSTANY. Right. Did any of those groups that were referred to EO Technical, did they lose their right to an independent appeal as a result—for an adverse determination?

Mr. KOSKINEN. Yes. It is my understanding that in lieu of an appeal, as you noted, they were referred—they did have a right to appeal, but it was to a set of 3 IRS executives, not the appeals process.

Chairman BOUSTANY. Right. And so can you give us your commitment, because part of this oversight activity is to understand where there were breakdowns. Can you give your commitment to these groups that were treated unfairly in this independent appeals process, will they be given an opportunity to have due process?

Mr. KOSKINEN. Yes. We have changed the process. Anyone that comes to Washington—well, retain their appeal rights that they would have had if they were in Cincinnati, and anyone who would like to avail themselves of that appeal process will have it open to them.

Chairman BOUSTANY. Okay.

Mr. KOSKINEN. And going forward, everyone who is given a proposed denial will have the right to appeal.

Chairman BOUSTANY. And I appreciate that reform, and that is going prospectively forward. What about those who are caught in this problem? Will they be given due process?

Mr. KOSKINEN. Yes. Anyone who was caught in that process, would like to come back through and appeal their—the decision. There were relatively few denials. The biggest problem in the process was the lengthy, far too lengthy time that people were stuck in the process, but the handful of those that were denied, if they did not have their appeal right out of the Washington, they can come, and we would give them that.

Chairman BOUSTANY. I thank you for that answer. Now I am going to give you a sampling of some kinds of statements Congress has heard from key IRS officials over the past couple of years. At a hearing before the House Appropriations Committee Subcommittee on Financial Services and General Government in March of 2012, former Commissioner Shulman said, and I quote, "we have the safeguards built into this process so that no one per-

son can decide to examine an organization based on political activities. You can't just get a case, go off in a corner, and run with your own agenda," end quote.

Then, separately, as we embarked on the investigation, Joseph Grant, the former IRS commissioner for TEGE, Lois Lerner's former boss, was asked by our staff in a transcribed interview if it would be appropriate for an IRS manager to refer a specific taxpayer to Exams, and he said, and I quote, "I believe it would not be appropriate to intervene on their own," end quote.

So, Commissioner, the IRS has long insisted, and we have gotten numerous documentation through letters and responses that our subcommittee has received, IRS has long insisted that Americans should not worry about political targeting at your agency because the IRS has layers of internal protections to guard against it.

But in the course of our investigation, however, we found that Lois Lerner acted in defiance of these internal protections to select groups—in order to select groups for adverse determination or audit. She was doing all of this while IRS officials were assuring Congress it wasn't happening. But those assurances ring hollow now, and you have got the responsibility of restoring the trust.

How will you assure the American people that no one IRS employee is going to decide whether or not they are audited and that there are safeguards in place?

Mr. KOSKINEN. I think it is a critical issue. As I said in the past, every taxpayer deserves the right to assume that they will be treated fairly, no matter what their political beliefs, what organization they belong to, who they voted for in the last election.

As I said, if you hear from us, you are hearing from us because of something in your application or in your return, and anybody else with a similar issue would be treated similarly. So there are—and we have reviewed and we look forward to the GAO, and we are delighted to cooperate with the GAO reviews of the entire examination process, the controls that are in place. They are significant controls. No situation and no system self executes, so one of the reasons I have been out to all 25 of the major offices, I have talked to over 10,000 IRS employees is to encourage employees to understand that we need the benefit of their advice and their insights, their suggestions for improvements, but we also need to hear from them when they think something isn't going the way it ought to go. We need to have that information flow easily from the bottom up.

I also, as you know, am a great support of inspectors general. I once chaired the cross-agency Council of Inspectors General for 3 years, and when I was in the private sector, I had the same view that internal auditors, as I tell employees, and inspectors general are management's best friends because they find problems before they get bigger.

So we have to be open to all flows of information and concerns. I have said in the past and I truly believe it, that when we hear from Members of Congress, if we hear from one Member, it is probably about an anecdotal issue. If we hear from several Members of the Congress, that means there is an issue that we should investigate, so I think the process that I hope will reassure Americans is that not only do we have a structure in place, but we are trying

to build a culture that will accept and be welcoming to people who say there is a problem you need to look into. Whether that information comes from frontline employees, managers in the middle, whether it comes from Members of Congress and their constituents, whether it comes from GAO or the IG, we have to be open to that and be prepared to respond.

Chairman BOUSTANY. And then my final line of questioning. I want to address this issue that received some media attention recently with regard to bonuses of IRS employees.

The Treasury Inspector General for Tax Administration recently published an audit report on bonuses awarded to IRS employees who had tax compliance issues themselves. Of course, every agency, most employers have employers—or have employees who owe taxes or may be late in paying their taxes or errors and those kinds of things, but unlike other employers, the IRS has the ability to look into employee tax compliance. It is a special ability, so to speak, because you are—you are bringing in employees who deal with very, very personal tax matters, and a highest level of integrity is necessary in all of this.

So, in fact, I know it is a condition for employment. It is something that—reviews are done several times a year, but the recent TIGTA audit found that in 2011, the IRS awarded 1,100 IRS employees more than $1 million in cash awards, over 10,000 hours of time off, and 69 quality step increases, despite the fact that these employees all had a substantial record of noncompliance with the tax laws, and these were not just employees who paid late or had some issue or they were disputing an issue. These were actually employees who were actually disciplined for their tax delinquency, disciplined by the agency.

I understand that these bonuses were awarded before you became commissioner. I know we are dealing with something in the past, but can you explain the steps you are taking to make sure that IRS employees don't get performance awards if they are disciplined for nonpayment of taxes? I think the American people deserve an explanation, and they also deserve to know what steps are going to be taken to put a halt to this egregious behavior.

Mr. KOSKINEN. I think it is an important issue. We take tax compliance, obviously, very seriously. I think it is fair to say that if we are encouraging others to pay their taxes, we should ensure that IRS employees are paying theirs. The compliance rate at the IRS is over 99 percent, so we have less than a 1 percent noncompliance rate, which is higher than the rest of the Federal Government and Congress and certainly much higher than the public, but that is not the standard. We ought to have the public confident that IRS employees are held to the highest standard.

As you say, when IRS employees join the agency, they sign up to that. We monitor all 90,000 employees to make sure that they are compliant. We have a separate disciplinary proceeding. You are subject to termination if you have a willful violation of the Tax Code, and all of that we take seriously.

As the IG noted, there is no policy across the government or in the IRS that conjoins performance issues with disciplinary issues. We have a program that says for senior executives, if you are behind in your taxes, you are not compliant, you are not eligible for

an award. We are now—timing turns out to be good. We are in the middle of negotiations, near the end of them with the union about a new 5-year agreement. Under the union agreement, we did not take—it was not allowed, we are not allowed to take into consideration tax compliance. We are developing a policy that we will be sharing with the union this week. They have indicated they understand the issue and are willing to negotiate that with us, and I expect we will have that included in the contract so that going forward, if someone has been disciplined for failure to comply with the Tax Code, they will be ineligible for a performance award. I would note again, these are performance awards, so when the pool is established, generally 30 to 35 percent of the employees do not get an award. It is not an automatic bonus. So even if you are in the pool, it doesn't mean you will get one, but I do think it is important for the public to be confident that we take this very seriously.

As I say, we just can quote—conclude by reminding everyone that we are over 99 percent compliant to begin with, but our view is that, in fact, as you say, while—people need to be committed that employees will not be eligible for an award if they are not compliant with—if they have been disciplined for not being compliant with the Tax Code.

Chairman BOUSTANY. And I would agree with you. There are a lot of hard-working people at the IRS. They do their jobs day in and day out. They pay their taxes. Compliance level is high overall. But when you have employees who have actually been disciplined for tax related matters and yet they receive performance awards, that is problematic. And so I am glad to see that you are taking steps to address this. And we will follow up with you and follow it closely, but I appreciate your answer on this.

And now I am pleased to yield to ranking member, Mr. Lewis.

Mr. LEWIS. Thank you very much, Mr. Chairman.

Mr. Commissioner, thank you for your testimony.

Now, Mr. Commissioner, I am deeply concerned about the lack of adequate funding for the IRS. Your workload is getting heavier. The issues you are facing are becoming more and more complex, but your appropriations keep getting smaller. I said it before and I will say it again this morning, you can only get out what you put in, and you cannot get blood out of a turnip.

Identity theft is an important national concern. Tax preparation for low-income, elderly, and disabled taxpayers is on the chopping block, and as a constant increased workload, how would the IRS be able to even to begin to address the real needs of taxpayers? How will your staff be trained and prepared for the challenges and work ahead? Are you being stood up for failure, for disaster?

Mr. KOSKINEN. While we have a very can-do agency of—full of employees dedicated to the mission who will, I think, go down swinging doing their best with the resources, but I am very concerned. As I have said in the past, I spent 20 years in the private sector managing large failed enterprises. I have never dealt with an organization, even major ones in bankruptcy, that is so consistently understaffed across the board. We don't have enough people in any division of the organization, and it is not just a few. Everyone, from counsel on across, is down 10 to 15 percent. We have 4,500 fewer revenue agents and revenue officers than we had 4

years ago. We have 350 fewer criminal investigative officers than we had 4 years. The head of Criminal Investigation is—projection is that he will lose 150 more agents every year.

So, it is—as you say, we are doing more and more, I think, with less and less. There comes a point at which you hit the wall, and the wall isn't because we don't have good employees, and it is not because they are not working hard. It is a wall that you hit because you simply don't have the resources. So this coming year, we are very concerned. We have a statutory obligation to implement the Foreign Account Tax Compliance Act and the Affordable Care Act, and we will do that, but to the extent that our resources remain constrained, the way we will have to fund that is out of declining taxpayer services and taxpayer enforcement.

Mr. LEWIS. Thank you, Mr. Commissioner.

Mr. Commissioner, I have a letter here from a group of civil rights organizations, consumer groups, including the NAACP, the National Council of La Raza, the Consumer Federation of America, and the National Consumer Law Center. They are opposed to a proposal to require the use of a private collection agency to collect taxes. This is an issue on which this subcommittee worked greatly, spent so much time in the past. We listened to examples, a call from private debt collectors, and discussed 130 years of this committee oversight on this issue. It was clear that the best interest of taxpayers was not being upheld and that the collection of Federal income tax is a core government function. It is the mission and purpose of the IRS.

Do you have any views on whether we should have—any feeling or thoughts whether we should have private groups collecting taxes?

Mr. KOSKINEN. While having spent 20 years in the private sector. I am a big believer in the private sector. My concern is—about private debt collection for taxes is we have done that a couple of times in the IRS, in 1996 and in 2006, and part of the problem is that it has a huge expense to it beyond the debt collection because the IRS does have to monitor very carefully the work of people that are not their employees. And private debt collectors are limited because they do not have enforcement authority, so they cannot apply liens or levies when they go out to collect, so almost by definition they are going to be less effective than they would be if they had the tools of the IRS available.

So, the experience in the 1996 experience and 2006 was that it was an inefficient way for the government to collect taxes, that you would be much better off if you hired a few more revenue agents and officers to proceed. In fact, the analysis of 2006 is we actually ended up losing money because of the information technology changes we had to make and the amount of monitoring we had to do to try to make sure the taxpayers were not abused in the process.

An additional problem now that it was not then is, over the last year, one of the major tax scams that we have been trying to warn the public about have been people calling up saying they represent the IRS and demanding that people either make immediate payments to them or provide them personal information. We normally don't contact people by phone to begin with. We send you notices

and letters, so as I have said, as I have traveled across the country, if you are surprised to be hearing from us on the phone, you are probably not hearing from us, which means that it is going to be an additional burden for private debt collectors, if they are retained, to convince the taxpayer that they are legitimate on the phone, and they won't have other means of actually dealing with the taxpayers.

So I think it is going to be an inefficient way to proceed, and it does have problems that we all worried about, which is how do we monitor what the conversations are that those people are having with taxpayers. Our employees are held personally accountable. If there is an issue, taxpayers can complain to us, they can complain to the taxpayer advocate. They can write Congressmen and Senators and will respond. For employees that are not our employees, it is a more complicated oversight problem.

Mr. LEWIS. Well, thank you very much, Mr. Commissioner.

I yield back, Mr. Chairman.

Chairman BOUSTANY. I thank the gentleman.

We are now—we are also joined today by Sam Johnson, who is a subcommittee chairman, and I am going to break precedent and allow him 5 minutes for questioning.

Mr. JOHNSON. Well, thank you.

Thank you, members.

Welcome, Mr. Commissioner. It is good to see you again.

In your prepared testimony for your confirmation hearing before the Senate, you said public trust in the IRS is most important, their most important asset. I couldn't agree more.

Unfortunately, it seems, each week goes by, we learn yet another problem at the IRS which further undermines Americans' trust in the agency. For example, just last month, we learned from the Treasury Inspector General for Tax Administration that the IRS rewarded tax—IRS workers with tax problems with bonuses and other awards, such as time off, and that is outrageous, and you have more or less talked to that. But let me start off by asking, is the IRS right now still paying out bonuses and other awards to those who owe back taxes, yes or no?

Mr. KOSKINEN. Right now, we are not paying bonuses to anyone because we are between the bonus period, and as I said, we are negotiating—about to negotiate with the union to make clear, assuming we can negotiate that out with them, but they have expressed an interest in it that, going forward, anyone disciplined for not paying taxes will not be eligible for a performance award.

Mr. JOHNSON. Okay. Now, for the record, do you agree that the IRS workers who owe taxes should not be getting performance-related awards, and you just said no. Is that in your regulations now?

Mr. KOSKINEN. No. In other words, there is—the IG appropriately noted there are no regulations that the IRS or across the government that did not—would cause someone not to get a performance award if they were not compliant. We have that process for senior executives. We are about to negotiate with the union about making sure that that rule applies to all IRS employees, and I am——

Mr. JOHNSON. Well, then will it be in law?

Mr. KOSKINEN. It will actually be in the contract, and it will be in our regulations and policies.

Mr. JOHNSON. Good.

Now, according to the IG, examples of workers with tax related problems include, quote, willful understatement of tax liability over multiple tax years. As you well know, the IRS Restructuring and Reform Act of 1998 includes the so-called deadly IRS sins for IRS workers. One of those sins is a willful understatement of Federal tax liability. According to the 1998 Act, the commission—commissioner, you, shall fire a worker for this, but instead what happened is that all the IRS rewarded the workers. It is hard for my constituents and folks across the country to understand how this could happen. Do you agree that this was wrong for the IRS to do that?

Mr. KOSKINEN. As I said, we take it very seriously, and I think that going forward—I can't look backwards. I don't know what the decisions were.

Mr. JOHNSON. I hear you.

Mr. KOSKINEN. But going forward, if you have willfully not paid your taxes, you are subject to termination, and we have terminated employees for that. We have a separate disciplinary review, but clearly, going forward, it is our policy, and we hope to be able to negotiate with the union about this, that you will not be eligible for a performance award if you have willfully violated—not been in compliance.

Mr. JOHNSON. But you would fire them if you caught them doing that?

Mr. KOSKINEN. Pardon?

Mr. JOHNSON. You would fire them if you caught them doing that. Is that true?

Mr. KOSKINEN. We have the ability to fire every—you know, there is a wide range of situations in which people find themselves, but the indication, if it is someone for several years willfully underreported, they would in fact be terminated.

Mr. JOHNSON. Finally, you come with a reputation as Mr. Fixit. I appreciate that. And you certainly have your hands full, so I will close by saying I have introduced a bill, No Bonuses for Tax Delinquent IRS Employees Act, to help you restore the public trust in the IRS. It is a simple and commonsense bill, prohibits the commissioner from paying out bonuses and other performance-related awards to workers who owe back taxes. So we are going to try to help you.

Mr. KOSKINEN. As always, legislation is kind of a blunt instrument. That bill, for instance, says even if you have an installment program, which many taxpayers take advantage of when they have difficulties, and we have low-paid employees, like everybody else who aren't tax experts, that legislation as drafted would say even if you are in effect compliant, you are on an installment plan, you would not be eligible for a performance award. I am not sure that those nuances can ever be built in successfully to statute, and as I said, I think you will be satisfied, I hope, with our union negotiations that the policies we have are appropriate and that the public can be satisfied. If you are disciplined for not being compliant with taxes, you are not eligible for a performance award.

Mr. JOHNSON. Thank you, sir.

Thank you, Mr. Chairman.

Chairman BOUSTANY. I thank the gentleman.

By the way, Commissioner, I am going to send a letter to you regarding the Foreign Account Compliance Tax Act with a number of questions because I—we are not going to have the time to get into detail on that here today, but I wanted to give you notice. I will be sending you a letter with a number of questions and look forward to your response.

Mr. KOSKINEN. I will be happy to do that, and I will do my best to respond promptly. As you know, I have a strong view that when I hear from a Member of Congress, A, I should read the letter personally, and B, we should get back to you quickly.

Chairman BOUSTANY. I appreciate that.

All right. Ms. Sánchez, you have 5 minutes.

Ms. SANCHEZ. Thank you, Mr. Chairman, for this hearing today.

And thank you, Commissioner Koskinen. It is good to see you again. I want to begin by commending you for the hard working and—the hard-working Federal employees of the IRS for a successful tax filing season on what we know is a very challenging and inadequate budget for everything that you are being asked to do. I know that working for the IRS is oftentimes a thankless job, and I want to take an opportunity to thank you and the dedicated men and women who are working hard to try to process claims, get information to taxpayers and make the process as painless as possible.

I know that you have been asked to do more and more with less and less, and if I am not mistaken, your current budget is under the sequester level budget. Is that correct?

Mr. KOSKINEN. That is correct. We are about $500 million below where we were before the sequester. We are the only major agency that is operating, in effect, at the post-sequester level rather than at the pre-sequester level.

Ms. SANCHEZ. I think it is important for people to bear that in mind when they ask you to do more and more with less and less.

Because of that cut in funding to your agency, I know that IRS was forced to make many service cuts, and you know, the constituents that I represent, very, you know, hard-working American families, many of them low income or elderly, they are doing their best to file complete and accurate tax returns, but I don't think that we can—we are doing them a big—we are doing them a tremendous disservice when we slash the budget of the IRS and take some tools out of their toolbox in order to help them complete their returns in an accurate way.

I was hoping that you could perhaps speak directly to how the budget cuts at the IRS hurt all of our constituents in terms of the services that they are able to get from the agency.

Mr. KOSKINEN. Well, as I noted, to begin with, I have been surprised. One of the surprises that I have had is how much time, energy, and resources we devote to trying to help taxpayers, trying to make it easier for them to pay, figure out what they owe, respond to their questions, so the most immediate problem and concern I have heard from employees, as I have talked to over 10,000 IRS employees in the 25 offices I have visited, their major concern

is that not that they are overworked, although they probably are, it is that they don't have enough resources to provide taxpayers the services that our employees think the taxpayers deserve.

So, even at 71 percent as a level of service, as I noted, that means 30 percent of the calls aren't going through, and then that builds because if you call and can't get through, then you call again. So now we have got two calls for the price of one. This year, also, in addition, for the first time, we had to tell people we could not answer complicated tax questions, and they are relatively simple complicated tax questions. We had to tell people they either had to go to the Web site, which we are trying to improve, or get private—you know, hire somebody to help them.

Our employees are concerned because I have heard from several of them in call centers saying, But we know how to answer those questions, and I had to explain, but it takes longer, and the longer we take with that person, the more people are sitting in the queue. So, we have had to do that. We don't prepare. We used to, in our taxpayer assistance centers, for people who would walk in, we would help them prepare their returns. We don't do that anymore because we don't have the resources.

On the enforcement side, as I have said, not facetiously, I don't know who got our $500 million of sequester funds, but I am sure they are not going to give back the government the $2 billion to $3 billion we would have given had we had those funds. In our request for 2015, to just hire another 1,200 people, we think we would provide the government $2.1 billion more, which would be more than the entire budget increase we are talking about.

Ms. SANCHEZ. So, if the money were well spent on the enforcement end, you could make up that money and then some in terms of lost revenue that currently we are not able to get because nobody is looking at this.

Mr. KOSKINEN. That is right. Our estimate is that we historically, and nobody is—the argument is whether it is four or six or eight times the amount of investment, but the government, we are the only agency where if you give us money, we give you more money back, and whether it is four times as much, six times as much depends on the issue, but we are the revenue arm of the government. We collect over 90 percent of the money that runs the organization.

So when we have fewer enforcement agents, fewer criminal investigative divisions, it means we are collecting fewer dollars. And when I talk to revenue agents and officers, those that are left, across the country, their concern as well is it is not theoretic. They know that there are returns that owe us money that they can't pursue because we simply don't have enough people.

Ms. SANCHEZ. Right. Really quickly, because my time is almost up. I want to—you and I have discussed EITC—EITC payments and the issue of correctable error authority. I just would like you to quickly, if you can, summarize for the committee how narrowly tailored authority could help the IRS process EITC claims more effectively.

Mr. KOSKINEN. What we have now is what is called math authority, so if your columns don't add up, we can make a correction and send you a notice and say we have adjusted to make sure the

columns add up. Correctable error authority would allow us, when we have independent verification of information that is wrong on your return, would allow us to correct it. So if you say, particularly in the EITC program, I have three children, and we have independent information that you have got one, we would, with correctable error authority, be able to make that correction, send you the notice. You wouldn't lose any appeal rights. If you really thought we had made an error, you could call us up, if you get through, but send us the information and we could make an adjustment, but what happens now is we, in many returns, see that there are errors that we could correct, but the limitation we have is we have to audit you before we can make that correction. If we had correctable error authority for the obvious errors, beyond math authority, we would make those corrections, advise the taxpayer, send a smaller refund, give them an explanation, they could then appeal to us if they disagreed, but we estimate that there are several billion dollars out there that, again, because of resources, we can't audit our way out of it, improper payments are being made, and I think it is a wonderful program, but as I made it clear to people, we need to attack the problem of the rate of improper payments and the amount of improper payments.

Ms. SANCHEZ. Thank you so much for your time.

I appreciate your thoughtfulness.

I yield back.

Chairman BOUSTANY. Thank you. Ms. Jenkins.

Ms. JENKINS. Thank you, Mr. Chair, thank you for holding this hearing.

Commissioner, thank you for being here.

Mr. KOSKINEN. Thank you.

Ms. JENKINS. Commissioner, you suggested that resource constraints affect the ability of the IRS to stop fraud and provide customer service, but the committee understands that the IRS allows employees to spend a total of more than 500,000 hours a year on union activity on the taxpayers' dime. Were you aware that taxpayers were paying for union activity on official time?

Mr. KOSKINEN. Yes. Actually, taxpayers pay for union activity across the government. Wherever there are employee unions, part of the organizational structure of the entire government is that union representatives represent employees, and they do that while they are working, and that is, in effect, on government time.

Ms. JENKINS. But wouldn't you agree that some of those 500,000 hours might have been better spent stopping fraud. For example, how many phone calls do you think the IRS could answer with 500,000 hours of worker time?

Mr. KOSKINEN. That is a little hard to know, but then you would have to ask what would happen to labor-management relationships, the operation of the agency if employees didn't have the ability to deal with their unions when they have problems and issues. As I say, one of the issues, and I have talked to the union about that, is sometimes employees are nervous about reporting a problem directly for fear that, you know, their manager won't like that, and I have encouraged them, A, I have a separate mailbox, they can call me—or contact me, not call me, but email me directly,

but the union performs a very valuable role for us as an intermediary in that area.

So, as I say, it is a little like saying, well, if I didn't pay anybody any awards or if I didn't pay them any pay increases, I would have more money for something else, you would, but you would have to look at the negative implications of what happened when you moved that money. And all I can tell you is, at the budget levels we are, even if I didn't—if I got rid of the union and had those 500,000 hours, I still wouldn't get back to the level of customer service we think is appropriate, and I would have changed significantly the way the organization operates.

Ms. JENKINS. It just seems like with limited choices, we have to—or limited resources, we have to make good choices in government. And this seems like maybe a less than optimal use of taxpayer dollars. And my main concern isn't with your relations necessarily with your employees but looking out for the hard-working taxpayers that I represent, and I am just sad for them that they are having to underwrite that cost.

The Affordable Care Act's premium tax credit subsidy will be based on folks' income estimates, and these estimates will often use the prior year's tax returns. Taxpayers will eventually have to reconcile the premium subsidies that they received with amounts that they are eligible to receive based on their actual income. So in many cases, whether it is due to a salary increase, a move across State lines, or another change in their individual situation, they could find themselves owing thousands of dollars back to the IRS.

So I am just curious, first of all, do you believe that the taxpayers fully understand this risk, and can you explain to us how your agency will handle the reconciliation process?

Mr. KOSKINEN. All right. On the first issue, we are concerned that taxpayers need to understand that. We have already started publicizing the issue. In my—every city I have been to, I have talked with the press and said one of the issues we hope taxpayers will be aware of, if their situation changed for the better—they get a promotion, they get a pay increase, their wife gets a job—something happens and they earn more, they need to call back the exchange and adjust their premium tax credit so they don't owe us a refund.

We will continue to do that through the year to try to make sure that we get taxpayers as much information about this as possible so that they are not surprised when, fortunately, would be a good event on their part if they made more money than they assumed when they first calculated the credit, but we are anxious for them to make those adjustments as they go forward. So we will do the best we can to publicize that. We thought and talked with some about perhaps even providing frequently asked questions and answers for Members of the Congress so they could share that information with their constituents. We have got YouTube video. We have got a Web site that does it.

Secondly, the way the reconciliation will happen is in the filing season, which is why we have a major challenge to make sure next year's filing season is at least as good as this, because everyone is making an estimate. In fact, we all do when we make an estimate for our W-2s, about what they earn. We provided information about

the income for 2012, but the premium credit will be based on what you actually earned in 2014.

So we will, when you file, you will have a form you will fill out, and we will make the adjustment. If you have got too small a credit, you underestimated because you wanted to be careful or some change in your financial circumstances, we will owe you a refund for that, in other words, the additional credit. If you withheld too much, which is the concern we are concerned about with you, you will then have an additional tax owing, and our hope is to minimize that to the extent we can by providing as much public information as we can.

Ms. JENKINS. Thank you.

I yield back.

Chairman BOUSTANY. Mr. Marchant.

Mr. MARCHANT. Thank you, Mr. Chairman.

Commissioner, just recently, I sent you a letter and would like to compliment you. You gave me a very prompt reply, which has not been the case with the last three of your predecessors, and we had a very good visit last week, and I appreciate it.

The issue, as I explained to you in my office that day, is that there are still a number of groups out there that have not received a final determination on their 501(c)(4) request. We are approaching the political season again, and all of these groups are involved in primaries. They are involved in educating the public about candidates. They are involved in educating them on getting out to vote, et cetera, and I just wonder if there is being any progress made on clearing up the backlog of those groups that continue to not have a determination.

Mr. KOSKINEN. We are sensitive to that. We are trying to proceed. Of the more or less 145 backlogged organizations a year ago when the issue was raised, 90 percent of those have been cleared through, so we are down to a relatively small number. Some are suing us, so you know, it depends on what the process of litigation is. As you know, we did have a streamlined proposal Acting Commissioner Werfel put in place last summer that any organization that made a commitment that it was going to spend no more than 40 percent of its resources on political activity would automatically be approved, and about 40 to 45 organizations immediately accepted that process.

So there are a handful left. We are doing our best; although if they are in litigation, it is harder for us to try to resolve those because my sense on all of these is whether we are voting up or down, whether we are saying you are approved or denied, what we need to do is be as quick as we can, as prompt as we can, and so, going forward, that is our commitment. We are trying to redo the 501(c)(3) area, again, to make sure that one way or the other, you get an answer as quickly as we can. And so, as you and I have talked, we will review, and I have asked people to review to make sure that we are doing everything we can to resolve issues that are pending.

Mr. MARCHANT. In this letter that you sent me, and I made it available to my constituents so they could see the response, it was indicated that if a lawsuit was pending, that that could be a factor in the determination. Is that still the case?

Mr. KOSKINEN. If you have got a lawsuit pending and you are suing us, then you know, you can always settle that. We settle litigation without forcing everybody to go to trial. In fact, a lot of these we would be delighted to settle. Litigation is a complicated, expensive way to resolve any issue. So the fact that you have sued us doesn't necessarily mean you can't actually negotiate with us to settle the case.

Mr. MARCHANT. So to be clear, can you issue a determination letter if you are in active litigation?

Mr. KOSKINEN. Well, that gets more complicated. If you have actually sued us and it is in litigation, then you know, we are sort of caught in the litigation process back and forth and there are issues that if we could have resolved them we would have. And so if you are suing us, then it makes it much more difficult while the lawsuit is going on to actually then issue independently that determination.

But it is a case-by-case issue. There probably are some where the issues in the lawsuit are separate from, the determination process in which we could do that, and I have asked people to take a look to make sure that we are not holding things up unnecessarily. As you and I discussed I think there are probably some people who are happy to sue us because it keeps the issue alive longer. We have actually I think reached out as much as we could to organizations trying to resolve issues as quickly as we could.

Mr. MARCHANT. We also—I use the same rule that you do. If I receive any mail from a constituent about a subject, sometimes it is an isolated situation and it is anecdotal and I treat it that way. But, when I receive half of my emails on a particular subject, then I actually take that one much more seriously and I think that it does represent a greater slice of what my constituents are thinking.

And I can, without duplicating what other members have said up here today, this issue of bonuses to IRS employees that have delinquent taxes, is a big issue in our constituencies and in your negotiations with the labor unions, it is something that needs to be resolved, it needs to be addressed. There may be legislation, there may be a law passed before that gets done.

But thank you for your time.

Chairman BOUSTANY. I thank the gentleman.

We will go to Mr. Davis next.

Mr. DAVIS. Thank you very much, Mr. Chairman, and Commissioner, thank you for being here. And I appreciate the work that you have done.

Everything that I have read, seen or heard suggests that we have had a pretty smooth tax filing system and experience this year, notwithstanding any shortages that there may have been relative to man or woman power. So let me compliment you and the agency on that.

I also detect from people I speak with, news reports that I get and what I read, that there has already begun, even though your tenure has been quite brief, a different level of confidence that people feel in the agency and that their experiences and problems are being resolved far more quickly than what they may have experi-

enced in the past, and I want to compliment you and the agency on that.

I want to follow up a little bit on a question that was raised by Representative Sanchez. It is my understanding that maybe 70 to 80 percent of the individuals who are entitled to make use of the Earned Income Tax Credit are doing so. Because of the fact that there is such a large number of individuals who could in fact and do qualify, many of them live in my Congressional District, which has lots of low income people, are there any ways that we can think of that might increase utilization of that opportunity?

Mr. KOSKINEN. It is a major challenge. As I say, we have both sides of the question. On the one hand we want to make sure the payments are properly made to the right people for the right amount and on the other hand we want to make sure that everybody eligible participates. So we do again a significant amount of outreach. I was in Baltimore at the start of filing day. There is an EIT awareness day that we hold across the country in January.

Part of the challenge is that, and it is probably a good sign for the program, about one-third of the people every year rotate in and out of the program, which means they are in the program, they earn enough that they no longer need that subsidy. So part of the challenge is, if it were a stable population, we could probably make bigger inroads. Right now about 80 percent of the eligible people participate. But with a third of them rolling over, it means we have got to keep 20 to 25 percent new people coming in just to sustain ourselves.

So we are again spending a reasonable amount of time and effort trying to give visibility to the program, publicize it through our local sites, work cooperatively with people in communities. But it is a significant challenge to make sure that everybody eligible is aware of the program and participates.

Mr. DAVIS. Thank you very much.

And of course we know that next year the Internal Revenue Service is going to have some additional responsibility for assisting taxpayers with the Affordable Care Act.

Mr. KOSKINEN. Correct.

Mr. DAVIS. How have you been preparing for that?

Mr. KOSKINEN. Well, we are preparing for it—well first, we have a fairly significant technological challenge to adjust all of our systems to be able to absorb the data and process it appropriately in terms of matching what people thought they were eligible for in terms of an advanced premium credit and what they actually were entitled to.

So the technology challenge in our budget for this year was $300 million of technology work. We got zero dollars for it, so we have had to in effect postpone another $300 million worth of work. So I meet every two weeks with the interagency, across-agency group of IT people, policy people, operating people, to make sure we are on schedule to be able to implement.

As I said earlier, we also are anxious to provide as much information to the public as we can about eligibility, about making sure that they are not over—as their income gets better that they don't in effect get too large a premium credit so they will owe more taxes when they file as we go forward.

So, we are doing the best we can. Our concern is we estimate we are going to get 11 million more calls during the filing season next year about the Affordable Care Act, on top of the normal calls we get, and that is a major concern for us going forward. We are trying to make sure our website is as user friendly as we can between now and then so that people will be comfortable, they can go to the website, get simple answers to their questions so they don't have to call us to the extent that we can avoid that.

Mr. DAVIS. Thank you very much.

And I know that my time has run out but could I get a response in writing for this question. 2006 data suggests that there was a big gap of $67 billion unreported of corporate income and I would like to know how we are trying to figure out ways to recapture and collect some of that money.

Mr. KOSKINEN. I would be happy to provide that information.

Mr. DAVIS. Thank you very much.

Chairman BOUSTANY. I thank the gentleman.

Mr. Reed.

Mr. REED. Thank you, Mr. Chairman.

And thank you, Commissioner, for being here today, and thank you for the hard work you are doing in regards to the IRS and overseeing the IRS and I appreciate it. I am glad to see the results of this tax season and your testimony and the stuff we read over last night in preparation for today.

And I know my colleagues have asked about issues that are just important to me as it is to them, but I wanted to narrow down on a kind of a narrow issue that impacts my district and that deals with Native American sovereignty in particular.

I represent the western portion of New York. We have long heritage of the Seneca Nation being part of our area, and what I am concerned with is I have been getting reports from not just that nation, as well as other nations of a general sense or concern about the IRS' operation when it comes to challenging tribal general welfare programs, many of which are nearly identical to programs provided by Federal and State governments. There is a sense that the IRS may be unfairly targeting these Native American nations, but is also not respecting tribal sovereignty, and that is something that I want to bring to your attention.

And I know in 2012, December 2012, the IRS issued guidance on the application of the general welfare exclusion to Indian nations and their citizens and that was viewed as a very positive development. But the guidance still remains in draft form and is deficient in several important respects in my opinion and in the view of many Native American tribes across America.

So my question, Mr. Commissioner, is this: What can Native American nations expect of you as the new Commissioner and the agency you run with respect to these issues and the fundamental relationship between the IRS and tribal nations of America?

Mr. KOSKINEN. I think it is an important issue. Obviously as you said I think it is critical for us to respect the sovereignty of tribal nations, to treat them appropriately, respectfully. I am concerned across the board whenever things take too long, and so I can commit to you that if we have got a draft regulation that has

been out since December of 2012, that we need to get that finalized and I will commit to you.

It is a joint effort when we do regulations with the Treasury Department and the IRS tax policy, it is the domain of the Treasury Department, but I have been trying to make it clear, I have actually asked for a list of everything that has been around for more than a year just to see if we can't expedite it. My experience has been in the private sector and my private life as well, everybody's, is that you are much better off giving people an answer even if it is "no" early than "yes" late, because by the time you get around to it late they are aggravated enough and disappointed enough that it doesn't get you much credit.

So on the outstanding regulation, I am committed we will look at that and get it put into final as quickly as we can.

Mr. REED. Well, I greatly appreciate it, and I greatly appreciate your comment about respecting the sovereignty of the tribal nations, and I think that is something that is critical to the future relationship with the nation and I am glad you shared that belief as I do. So I appreciate the work there.

I wanted to ask just a general operations points of view, and we have had this conversation before and I am a big believer in metrics and asking for, okay, you want more money, you want more staff, okay, what are you going to do with that type of thing.

But one thing I was looking at in preparation, last night for your testimony today is, we have a lot of effort up here on this committee to engage in comprehensive tax reform, and I wanted to know from you as the Commissioner have you looked at what a revised simplified complete rewrite of the code would bring in regards to the relief on your resources, be it staffing, funding levels; that if you had a code, you know, the chairman has put out a draft, we put out a draft after 2½ years of work, that really in my opinion goes a long way to simplify that code, how much of that simplicity have you ever thought about, and if you haven't, I would ask you to consider it, would that mean in relief to your agency when it comes to funding and staffing requests that you are putting forward to us.

Mr. KOSKINEN. I don't have a number for you. As you know, I am a big believer in tax simplification because I do think the most important impact would be it would make it a lot easier for taxpayers to figure out what they owe and compliance I think would go up and we would certainly spend a lot less time and money across the country and across the economy filling out tax returns.

It clearly would make our life simpler, particularly in taxpayer service on the call centers. If you had a relatively simple straightforward Tax Code, we would get a lot fewer calls. It wouldn't mean we wouldn't get any because there will always be issues about filing status, heads of household, other issues. But, a significant part of the calls are related to the complexity of the code. So we would be able to without many additional resources significantly improve our level of service on that end.

On the enforcement end, again, to the extent it was if compliance went up you would expect we would have somewhat lowered enforcement needs, but there again, no matter what it is, because it

is not going to be a simple one line form, my expectation is that a lot of our enforcement activities against people who are actually are consciously trying to cut corners, and whatever the rules are they will keep trying to cut the corners. But, again, I think that the willing-to-pay as we say who are trying to figure out the right amount would in fact be able to do it much more quickly.

Mr. REED. I know my time has expired, and I so appreciate you saying that, and maybe we can work offline having a further conversation about it, what simplicity would mean to you in regards to that deficiency of the agency, and that is where I think there is a lot of common ground. If we all agree that simplicity will result in less need for resources, there will still be a need for that resource but a less need for that resource, be it staff or financial resources, where it is a win-win situation in my opinion, and I look forward to working with you on that, and any information you have in regards to that from your day-to-day operations would be helpful.

So, with that I yield back. Thank you, Mr. Commissioner.

Chairman BOUSTANY. I thank the gentleman.

Mr. Kelly.

Mr. KELLY. Thank you, chairman.

Mr. Koskinen, good to see you again, and as Sam Johnson said, you are the fix it guy. But I think Mr. Reed just hit on the issue. It is the code. It is the code. That is the problem. The problem isn't that you don't have enough people, you don't have enough money, the problem is the code is far too big to work with.

You mentioned fraud, people out there are who are sending letters to people, to taxpayers, and they are unwittingly spending money in, and the reason they are doing it is because they are scared to death.

Here is the problem. Of all the things you are talking about, if we cannot restore faith and confidence in this model Government that we have, of the general public, everything we talk about is just chatter, just idle chatter.

We talk about revenue. We need more revenues. Do we? So let's make it really hard on the people who produce the revenues. Let's make it so damn difficult for them that they are afraid to do their own tax return; not because they don't want to pay their fair share, but they are scared to death that somebody is going to come in and hold them accountable for a mistake they didn't mean to make but happened.

And I got to tell you coming from the private sector as you had, you can be Mr. Fix it everywhere you want, but until this code gets fixed, there ain't no fix. There is no way that anybody can look at our current situation and feel that somehow they can trust and have confidence in what we are doing with them. It is just as impossible, it just can't be done.

I know you are talking about giving credentials to people, now, what is the term, and this is a town that works on all these acronyms, the PTIN. These are the preparers tax identification numbers. In order to get that number you have to make a fee of $63 and take 15 hours of continuing education courses and that was shot down.

Mr. KOSKINEN. That was shot down.

Mr. KELLY. Yes. Okay, so now, now what are we doing? What is the IRS doing now? Is this a suggestion, about having this PTIN or having the people who have the credentials to do these things?

Mr. KOSKINEN. No. What happens is the court said we could ask people to register so we would at least know who was out there holding themselves out as a preparer, and this year we have about 667,000 of them out there, PTINs, as they are called, but we have no other ability to supervise them. So they could be totally incompetent, which a few of them are. Most preparers are well-educated. They do a good job.

Our concern is a lot of people—as somebody once said, hairdressers are regulated in all 50 States, tax preparers are regulated in four, and you ought to be as at least concerned about who is doing your tax preparation as who is giving you a haircut.

Mr. KELLY. No, and I get that. Again, it goes back to what? A code that is so complicated that the average person is scared to death to do it themselves. Now, I got to tell you, the problem isn't that—they don't trust any of us, by the way. You know, approval ratings are not very high and we are all getting painted with the same brush. And I got to tell you, I serve with a lot of really outstanding people, on both sides of the aisle, by the way and I don't know that we talk about ourselves as strong Republicans or strong Democrats, but we talk about ourselves as strong Americans trying to protect something that was given to us. This is a long, long process of people passing on to the next generation something that makes a lot of sense and is the envy of the world.

This particular agency though, for as many good people as you have, you are getting painted with the same brush. And I got to tell you, being from the private sector, if I got a letter in the mail and the outside of the envelope had the IRS address, I was scared to death to open it, because it was never good news.

And we talk about improper payments. Improper payments would also be defined not only underpayment or nonpayment but also overpayment. Right? I mean, so if we are using that definition. I think what we are trying to get to, and, again, as Tommy talked about, and I think this is critical, if we don't get this Tax Code reformed, if we don't get it to the point where people can actually read it and understand it, if we don't get it to the point where they have confidence that the people who are enforcing that code are on their side and not on the other side, then America loses and continues to lose and the gap keeps widening between what the American people have faith and confidence in and what they have been subject to.

That is your toughest job. I know you are a turnaround guy and you are a fix it guy, but, man, you are working with a pretty tough operation right now to get through it. I had a flat tire on the way here yesterday. I got out the owner's manual. Hell, it took me almost 20 minutes just to find the section about changing the spare tire to find out where the tools were and I would have paid somebody else to do it at the time but there was nobody available. So we are having the same problem with people when they do their tax returns.

Mr. Chairman, we are doing a lot of good things here, but the one thing we better decide on really quickly is these are American

problems. This is not a Republican issue or a Democrat issue or a libertarian issue or an independent issue. We are talking about revenues that supply all the vital monies that we need and you know who we are holding hostage and making the trouble maker in this? The taxpayer.

There is something wrong with the model where we continue to do that. I got to tell you there is an old saying, is about don't worry about the mule, just load the wagon. The mule is starting to unhitch himself. He is going to walk away from it because there is just no upside to what we are doing.

Thanks for what you are doing. Good luck and we will keep doing everything we can to make it easier for you to do your job and make it easier for the American people to actually put their head on the pillow at night and know it is not the Government they have to worry about or the IRS coming in their place or some other agency that can destroy their personal life with just a little bit of an investigation.

So, thanks for what you are doing. I yield back.

Chairman BOUSTANY. I thank the gentleman.

Ms. Black.

Ms. BLACK. Thank you, Mr. Chairman, and thank you for this hearing.

This certainly is a very important issue. I do want to just tag a little bit on what my colleague said about trust, and certainly that is something that I think right now the American people have had, broken trust. And I appreciate what you are doing, the efforts that you are making to reestablish that trust in the IRS.

In your opening comments you made a statement that you are making important progress in identity theft, and that, of course, is so, so important and we look at that from so many different realms, not just within the IRS but with a lot of other issues, and banking and even medicine, and identities are being stolen.

Most recently we have started getting information, not particularly in the State of Tennessee but as I look at several of the States and territories that are affected by this and victims of fraudulent tax filings and stolen identities within State medical associations.

Mr. KOSKINEN. Yes.

Ms. BLACK. And it seems to me that this is really, as I look at the number of States, it is a growing issue and I think that certainly it is one that we have got to look at very quickly, because these are physician databases and being uncertain about just where they are getting the information from, how many people that are within this database are also potentially a victim for potential theft, ID theft, and some stolen refunds I understand are occurring right now.

So my question is actually three parts on asking you about whether you will make this a priority, how you seek to resolve this and how you think you might be able to prevent it and whether as you look at this will you look at it as a national issue or because this seems to be regional will you be addressing it more regionally?

How will you let the public know about this, whether this will be a public release that the people can be aware of and watching out for. And then, finally, the concern of the Federal identification numbers, such as the Medicare's national provider ID or the DE

registration numbers for those prescribers of controlled substances. Will you take a look to see is this the cause that is occurring?

So let me go back to the three. Will you make this a priority? Number two, how do you propose to resolve it? And then looking forward, how would you prevent it?

Mr. KOSKINEN. Well, it clearly is a priority. It became an explosion in 2010 to 2012, it overwhelmed law enforcement as well as the IRS, and we have made great progress. It is a high priority. We have 3,000 people who spend no time on anything other than worrying about refund fraud. We have very sophisticated modelers who are developing our ability to look for schemes as they come through the system. As I noted, we stopped three million suspicious returns in this filing season that didn't get through our filters.

As somebody said, because as I noted, I pulled everybody together and said we are making progress but we have got to take a fresh look at what else can we do to fight this battle. I want to see if we can change the rules of the game a little, so we are not fighting in their ballpark, we move it to our ballpark, which is why I have asked for some of the legislative changes we have got.

But as somebody said, we have eliminated a lot of the amateurs who were doing this one or three or five returns. We are now dealing with organized criminals and crime and some nefarious tax preparers. The organized crime people are filing hundreds of these and as we develop filters they are just reverse engineering and figuring out what goes through, what doesn't go through, and they can pretty much figure out where we are and so we are again trying to figure out how to change that.

One of the things that will help will be to get W-2 information earlier. We are a victim of our own success. It used to be the refunds went out in August. Now the technology is such we will say we will give you a refund in 21 days. So we gave 90 million refunds out before the end of the filing season on April 15th, most of those before the third party information got to us. Now, we have sophisticated filters. W-2s won't solve the problem by themselves, but they are very critical.

We are looking at all sorts of E-authentication methods so that in effect we circumvent Social Security numbers. Because part of the problem with preparers, with medical services, as you note, everybody's Medicare card is their Social Security number, and so there are file cabinets around the country full of Social Security numbers.

Hackers have now discovered if I could hack into a tax preparer's databases I have got all of their clients. More important just their name and Social Security number, I have got all of their returns so I can prepare a false return that looks a lot better than the one I just make up as we go.

So it is an ongoing battle. I think that we are holding our own, I would say. I am not sure which is better than we were doing a couple of years ago where we looked like we were overwhelmed.

We have programs going on with financial institutions, with prisons, where it first started, with law enforcement. We have task forces with hundreds and State and local law enforcement agencies. When people get arrested we suddenly discover they have got all sorts of Social Security numbers or debit cards.

You know, one of our problems is how to deal with debit cards. When we send out the refund, the debit cards can all go—you know, somebody can go get debit cards in a grocery store. You just pull them off the rack. And they are harder for us to track. They are virtually untraceable.

So it is a complicated problem. There is no higher priority for us both to stop the fraud and the refund fraud, but also to deal with taxpayers. There is nothing more I think anxiety producing for a taxpayer than to suddenly file their return and get it rejected because somebody already filed with their Social Security number.

So there, as I have noted, we actually used to take almost a year to resolve those. We are now down to 120 days in resolving them. Our backlog has gone from over 600,000 to about 98,000. But we are trying to do better there as well because we understand the burden on the taxpayer.

Ms. BLACK. Thank you.

And Mr. Chairman, if I may, I have another question about minors' Social Security numbers being stolen and how that is being handled. I will put that in a letter form and send it to you. I would really like to hear back from you on that issue as well. That is a really important issue we have to make sure we are addressing.

Thank you.

Chairman BOUSTANY. I thank the gentlelady.

Commissioner, thank you for being here. Thank you for the status report on a whole host of activities. We want to continue to work with you to reform, make improvements, rebuild trust and right size the budget on all this. So we appreciate you appearing before us today.

Please be advised members will submit written questions as has been stated to be answered in writing. All of that will be made part of the formal record as will be your formal statement.

With that, the committee stands adjourned.

[Whereupon, at 11:57 p.m., the subcommittee was adjourned.]

[Submissions for the Record follow:]

SUBMISSIONS FOR THE RECORD

Richard N. Brown

To: Honorable David Camp, Chairman, Oversight Committee, House Ways and Means Committee

Re: May 7, 2014 Hearing regarding IRS and 2014 Filing Season

Subject: IRS Audit policies and efficient use of funds

Purpose of Comments: Comments regarding inefficiencies of IRS Audit Practices

Personal background – I am an Enrolled Agent with 7 years of experience as an IRS auditor, and 30 years of experience as a licensed practitioner. I have never been involved with the formation of national policy, but I believe that it may be helpful for Congress to hear from practitioners in the field, who can provide some insight into what it is like to practice at the level that IRS policies are actually implemented. My issue is the sometimes unnecessary burdens put on taxpayers during IRS audits, which do not further the determination of the correct amount of tax, and may be counterproductive in the overall audit goals of the IRS. This unnecessarily uses scarce IRS resources, and over burdensome audits can have detrimental effects to future compliance of tapayers.

I currently am representing clients in three different audits. In all three of these audits I believe the IRS has overstepped their bounds, and auditors are spinning their wheels in a way which wastes the IRS auditors time, will result in little or no additional tax, but places an unneeded burden on the taxpayers. I would like to use one current audit as an example.

This audit involves an income probe of a couple who each have a small moonlighting business on the side in addition to their regular W2 wages, which are over 200,000 between them. Total gross income for the two Schedule C's is less than $4,000. I did not prepare the original tax return, but when the taxpayers retained me to represent them, and brought me copies of their tax returns to review I could immediately see significant potential problems with expenses. Problems with expenses include some items which are not deductible, some items which are obviously estimates, and may be overstated, and some items which appear to be in the nature of employee business expenses, and need to be re-classified to Schedule A, subject to the 2% threshold, and AMT. The IRS is completely justified in auditing this return, and in opening the prior, and following year for audit to adjust these expenses.

My issue is with their income probe. As someone with 37 years of experience in taxation, I can look at the return and see that is not where the problem is going to be. After having audited a number of similar returns during my time as an auditor, as well has having defended the issue a number of other times, it just isn't there. The taxpayers are showing more than adequate total income on their returns, and each of these Schedule C's is a small part time business. Neither business is a cash business, both receive income from other businesses for which 1099's are issued. There is just nothing there. Is there a possibility that a small amount of cash might have been received on the side? Anything is possible, but if it has happened, it would be a very minor amount.

The initial audit letter did not include a request for bank documents. After contacting the

auditor, and schedule an appointment, a subsequent information request was issued asking for bank records. Hoping to avoid unnecessary work for the auditor, and the taxpayers, and hoping that the auditor has shared similar experiences to mine on audits like this, I requested from the auditor that this request be dropped, which the auditor declined to do. OK, I acknowledge the IRS's right to request bank records, and they were provided for the initial appointment, even though this will be a waste of everyone's time.

In my interview with the taxpayers prior to the audit, the disclosed that they had received some cash from the husband's parents to invest in a corporation being started. This cash was deposited to the taxpayers personal accounts, and then transferred to a corporation account. This corporation was starting a Care Home, for which there are extensive licensing requirements. According to the taxpayer, the license was not received until 2014. In the year in question, 2013, the corporation had no taxable income, and any expenditures would have been non-deductible start-up expenses. This information was disclosed to the auditor.

The result of the initial income probe, per the auditor, there were "unidentified" deposits of about $65,000. Amounts not "identified" included new W2 wages of the husband of about $45,000, which the auditor did not allow as a source since the specific net paychecks were not identified, and deposits in even amounts of a little bit over $20,000, consistent with the taxpayers story of money received from the parents to invest in the corporation. With the 37 years of experience that I have, if I was the auditor, that would be enough right there to stop wasting further time, and write up income as verified, and move on to expenses, where there will be substantial changes. We could be done with this audit right now.

Unfortunately, the auditors are determined to spin their wheels, and I expect it will be six months or more before this is finished. First of all, the auditor requested bank records for the corporation. While I did explain, again, that there would be nothing there, I also took the position that the request to look at the bank records for an entity is an examination of the books and records of that entity, and constitutes an audit. This, as admitted by the IRS group manager, is part of the IRM. I do recognize the authority of the IRS to open a related entity for an audit, but I requested that if the IRS wanted to do so, they need to issue a formal audit letter. That way, at the end of the audit, the corporation gets a "no-change" letter, which makes it very difficult for the IRS to re-open a case at a later time. While this is not the legal protection against double jeopardy that one gets in a criminal case, it is a substantial protection against the IRS demanding to examine the same books on multiple occasions, and is a protection that I feel justified in demanding.

Well … this position has apparently really angered the group manager, that I could challenge the IRS's right to expand the audit without going through proper formalities. At the end of the first meeting, the auditor indicated that, if we could verify the source of the "additional" 65,000 in deposits, income would not be an issue for the related years, but we could focus on expenses, where we both agree there are problems. After forwarding my refusal to provide corporation records without a formal audit notice to the group manager, the manager called me, with attempts to intimidate me. After that, we received a new information request for the prior and subsequent years, with a full demand for bank records, and an income probe for those years as well. Even though, I already have an explanation for, even if not final proof, of the total deposits

for the first year in question.

While I recognize the IRS authority to request "proof" of these items, at this point, we are just spinning our wheels, and we will ultimately get nowhere. Unfortunately, the IRS does not react very well when they are challenged about overstepping their authority, but expect anyone to go along with whatever demands they chose to make. An auditor, or group manager sometimes will do their best to make it difficult for anyone who does not accept any demand that they make.

My view is somewhat different. My feeling is the IRS does need to be challenged when they overstep their authority, and/or request numerous records, which place extra burdens on taxpayers, but are not likely to result in substantial additional changes to tax. Auditors really need to exercise more judgment, created by training and experience, in deciding what issues are worth follow-up, and what items will be a waste of time.

Am I concerned about the results of the audit? Not really. My 37 years of experience tells me that there will ultimately be no adjustments to income after jumping through the hoops demanded by the auditor and group manager. My experience also tells me that, after challenging the manager's authority, we will probably not be able to settle this case at the audit level. I expect that, under the manager's orders, the auditor will probably disallow all, or substantially all expenses claimed, even though quite a few are legitimate. I expect to be able to reach a reasonable compromise at Appeals, at an even greater cost to the IRS (it will cost my clients nothing, as I will not charge them for any additional time required because of my challenge to the IRS authority). I also expect that the taxpayers will have me prepare future returns, where I will claim specific allowable amounts on the correct place on the tax return.

Sometimes I can remember my first six weeks of training as an IRS auditor as if it was yesterday. Some of the basic concepts of that training have stuck with me through all of the subsequent years of my career. A part of that training was a discussion of general audit policy, and an auditors place in the system. The first emphasis was an auditor's job to determine the correct tax liability. A second, but perhaps equally important goal, as taught was to increase future voluntary compliance. There was an acknowledgement back in those days that the IRS will never have the resources to audit every return filed, or even a significant portion of returns filed. The goal of an audit then, besides collecting some extra tax, was to create an atmosphere where the taxpayer would be more likely to voluntarily comply with filing their tax return correctly in the future after an audit. Sadly the IRS seems in the past two generations to have forgotten this of the audit formula.

As I interpreted what I was taught, promotion of voluntary compliance through audit was first about education. Explaining what a taxpayer had done wrong, and what they needed to do in the future. Sometimes, and this is where some judgment is called for, a taxpayer is deliberately gaming the system. In that case a little stronger action is called for, anything from letting a taxpayer know that they have had their hand slapped, to a full criminal investigation. There are taxpayers who will continue to abuse the system, and sometimes putting the fear of the IRS into someone is a needed funtion of conducting an audit.

However, many times a taxpayer, simply does need just some education. Their errors may be

totally out of ignorance of a very complex set of laws, or they may have been made because a taxpayer got bad advice, from a friend, neighbor, etc. or they simply feel that everyone does this, so they should be able to do that also, based on some widely held "urban myths", such as that the "rich" don't pay any taxes, so why should they.

In any case, unneeded requests for information, that go nowhere, do not result in any significant changes to tax, create an unnecessary burden on a taxpayer, even when they are in the wrong in certain areas, and, in at least some cases, a resentment of how they were treated, with sometimes predictable results, that can detrimentally affect future voluntary compliance. In general, if taxpayers feel that they have been treated fairly, even if that treatment involves a spanking, they are more likely to voluntarily to comply in the future, than if they feel the IRS has abused it's power.

Another, and related, part of the audit equation from the auditor's side was a goal to impact as many taxpayers as possible. If they IRS does not have the time to audit a taxpayer, who has made mistakes on their return, that opportunity for education is lost. If an auditor spins their wheels for ten-twelve hours or more in an audit, and ultimately gets nowhere that is ten or twelve hours that they cannot be auditing someone else that they could have had an impact on.

Auditing is not an easy job. It does require judgment calls, and no auditor will come up with the right answer every time. I feel the IRS does need to look at policies and training developed over the past few decades, and see how it can get auditors to more effectively using their time by quickly recognizing key issues, devoting needed time on those issues, and spend less time chasing wild geese. It is possible to achieve some positive results for future voluntary compliance of some attitudes and procedures are changed.

H&R Block

May 7, 2014

The Honorable Charles Boustany, Chairman
The Honorable John Lewis, Ranking Member
U.S. House of Representatives
Committee on Ways & Means
Subcommittee on Oversight
1102 Longworth House Office Building
Washington, DC 20515

Re: May 7, 2014 hearing on Internal Revenue Service Operations and the 2014 Tax Return Filing Season

Dear Chairman Boustany and Ranking Member Lewis:

On behalf of H&R Block, please accept this letter and the attached report for today's hearing record.

H&R Block is the world's largest consumer tax services provider, filing more than 625 million returns worldwide since 1955. Last year, we filed more than 22 million U.S. individual income tax returns — about 15 million returns in our offices and another 7 million through our do-it-yourself (DIY) offerings.

As the world's largest provider of consumer tax services, with both in person tax assistance and DIY software offerings, we have a unique perspective into tax filing trends, including increases in tax fraud and improper payments. To gain further insight into the growing problem of waste, fraud, and abuse in the tax system, we commissioned ORC International to conduct a study on consumer awareness and attitudes on the issues of tax fraud and prevention. We have attached the following report, which summarizes the results of this survey: *Consumer Tax Fraud: Sources & Solutions.*

We would be happy to answer any questions you, other Members of the Committee, or staff may have.

Thank you for your consideration.

Kathy Pickering
H&R Block's Vice President of Government Relations &
Executive Director, The Tax Institute at H&R Block

Consumer Tax Fraud: Sources and Solutions

Survey Findings

March 2014

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ABOUT THE TAX INSTITUTE AT H&R BLOCK

The Tax Institute at H&R Block is the go-to source for objective insights on federal and state tax laws affecting the individual. It provides nonpartisan information and analysis on the real world implications of tax policies and proposals to policymakers, journalists, experts and tax preparers. The Institute's experts include CPAs, Enrolled Agents, tax attorneys and former IRS agents. Building off more than 10 years of research and analysis from a specialized tax research group at H&R Block, the company launched The Tax Institute in 2007.

ABOUT THIS REPORT

This report presents the findings of a telephone survey conducted among a dual national probability sample of 1,005 adults comprising 505 men and 500 women 18 years of age and older, living in the continental United States. Results have a margin of error ±3.1% at the 95% confidence level. Interviewing for this combined landline and cell phone survey was completed during the period October 31-November 3, 2013 by ORC International. The national sample was weighted to ensure the results reflect the general population.

Additional Methodology Notes:
Figure 1: Percentages may not add to 100% due to rounding.
Figure 2: Percentages do not add to 100% because respondents were asked to select up to two options.
Figure 3: Percentages do not add to 100% because respondents were asked to select multiple options.
Figure 4: Represents percent of who said they strongly or somewhat support each statement.

CONTACT INFORMATION

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Letter to our readers:

The U.S. tax law is thousands of pages long, focused on credits, penalties and obtuse rules and regulations, which we at H&R Block decipher and interpret for our clients. For individuals and families, these tax laws manifest themselves on a much more personal level. To many the regulations may just be words and numbers on a page. To most people however, the tax law is a complex web of rules and forms to navigate each spring – holding with it hope and sometimes dismay. For most taxpayers their annual tax filing, whether they receive a refund or make a payment, is often the largest financial transaction they experience during the year. It has a significant effect on their financial outlook and is a deeply personal experience.

Because of the size of the typical tax refund – which is approximately $2,700 according to IRS data – more and more taxpayers find themselves under assault from increasingly sophisticated thieves who file false tax returns under their names. Add this to the growing rate of credit card fraud and compromised Social Security numbers, consumers now have the added worry of someone stealing their tax refund. Even Attorney General Eric Holder is not immune to this as he found himself nearly the victim of tax fraud when two men tried to file a fraudulent tax return under his name this March. Those who have experienced this know full well the litany of paperwork, calls, ID checks and more that it takes to right such a wrong.

Tax fraud and improper payments – which consist of payments made due to deliberate fraud, confusion around complex rules, and basic math errors – are examples of several disturbing trends contributing to a rising level of waste, fraud and abuse in the overall U.S. tax system. Estimates of lost revenue are in the hundreds of billions of dollars. While the IRS Oversight Board has asked consumers how they feel about cheating, no one has asked the question "what can be done to address this?"

The discussion surrounding this problem, and how to solve it, mostly has been limited to tax wonks, policy experts and industry players. Until now. The Tax Institute at H&R Block worked with ORC International to field a national survey to help understand public appetite for grappling with this issue. The results were reassuring and encouraging. In sum, survey results suggest that consumers:

- Are willing to do more to help combat tax fraud;
- Acknowledge that the IRS, Congress, professional tax preparers, the makers of tax preparation software and taxpayers themselves are accountable for addressing fraudulent tax filings;
- Support requiring professional tax preparers to meet minimum training standards;
- Strongly back holding do-it-yourself software to minimum standards.

These results are heartening – consumers are willing to take simple, yet important steps, to preserve the integrity of our tax filing system, which relies largely on voluntary compliance. With billions of dollars lost to fraud and improper payments every year, we – consumers, the IRS and Congress – have the opportunity and frankly the responsibility to address this costly and unnecessary waste.

Kathy Pickering, Executive Director
The Tax Institute at H&R Block

SURVEY FINDINGS

Executive Summary

The Tax Institute at H&R Block commissioned a national survey to measure consumer awareness and attitudes on the issue of tax fraud and prevention. The survey found that:

1. **Taxpayers are willing to do more to help combat tax fraud.** A large majority are willing to take a variety of actions to prevent fraud, whether answering more specific questions in their IRS filings, waiting a little longer for a refund or requiring consistent questions for all filers.

2. **Consumers recognize that there is joint responsibility.** They agreed that it is incumbent on the IRS, Congress, professional tax preparers, the makers of DIY tax preparation software and taxpayers themselves to address fraudulent tax filings.

3. **Consumers support requiring professional tax preparers to meet minimum training standards.** This reinforces the fact that consumers want to know the person they turn to for one of their biggest financial transactions of their year meets consistent and minimum standards for expertise.

4. **Taxpayers who use DIY software/websites are strongly supportive of requiring minimum standards for those software/websites and requiring consistency in forms and documentation across all tax preparation methods.** Consumers indicated that creating this type of parity across all tax preparation platforms is important.

The survey found that U.S. consumers believe that falsely reporting dependents (48%) and income (45%) are the most frequent drivers of fraudulent income tax returns, more so than using a stolen identity to file a false claim (31%), falsifying tax breaks (26%) or tax credits (27%).

86% of consumers support requiring professional tax preparers to meet minimum training standards.

80% of consumers support requiring do-it-yourself (DIY) tax preparation software/websites meet minimum standards.

86% of consumers support requiring that the tax forms and documentation are the same whether using either a professional tax preparer or a do-it-yourself software/website.

61% of consumers would be willing to wait a little longer for their refund to help combat tax fraud; this willingness did not vary across income levels.

94% of consumers using DIY tax preparation software/websites support requiring that tax forms and documentation be the same for professional tax preparers and DIY software.

71% of consumers using DIY tax preparation software/websites would be willing to provide additional documentation with their return to help combat tax fraud.

69% of consumers using DIY tax preparation software/websites would be willing to answer additional questions on their return in an effort to battle tax fraud.

Detailed Findings

Consumer Awareness

U.S. consumers believe that falsely reporting dependents and income are the most frequent drivers of fraudulent income tax returns.

- U.S. consumers are most likely to think that falsifying dependents (48%) and falsifying income (45%) are the most likely to lead to fraudulent returns. Those were higher than using a stolen identity to claim a false refund (31%) and falsifying tax breaks (26%) and tax credits (27%).
  - Consumers who say falsifying income most often leads to a fraudulent return are likely to be:
    - Male (50%)
    - Those who have accidentally made false statements on their tax return (67%)
    - Those who have made mistakes on their tax return that the IRS didn't catch (68%)
  - Consumers who say falsifying dependents most often leads to a fraudulent return are more likely to be:
    - Generation Xers, between the ages 35-44 (58%)

Consumer Attitudes

Overall, consumers have favorable perceptions of tax preparers, particularly those that are regulated.

- They are significantly more likely to believe that fraudulent tax returns are generated from do-it-yourself (DIY) tax preparation software/websites (54%), compared to any tax preparers (36%).
- Only 1 in 10 (9%) think fraudulent tax returns are most likely to originate with specifically regulated professional tax preparers, and this is consistent across men and women.
  - Even users of DIY software are significantly less likely to blame regulated professional tax preparers than they do tax preparation software/websites when it comes to the sources of fraud
  - Only 9% of DIY software users attribute fraudulent returns to regulated professional preparers, while 48% say DIY software is the reason.

There is a tremendous amount of consumer support for minimum standards for both tax preparers and DIY software.

- 86% support requiring professional tax preparers to meet minimum training standards while almost as many support requiring DIY tax preparation software/websites to meet minimum standards (80%).
- More than four out of five (86%) also believe in requiring that tax forms and documentation to be the same when using a professional tax preparer or DIY software.
  - Support is even higher among the users of DIY software, with 94% expressing support for requiring that tax forms and documentation to be the same for professional tax preparers and DIY software.
  - Consumers in the highest household income tier ($100K or more) are more likely to support stricter regulations, with 95% in favor of minimum training standards for professional tax preparers, and 95% also in favor of minimum standards for DIY software. In addition, 94% of those higher income consumers believe that that tax forms and documentation requirements should be the same for both in-person and DIY preparation.

Consumer Actions

Consumers say individual taxpayers themselves, along with the IRS, are most responsible for reducing tax fraud.

- Consumers are most likely to say the IRS is responsible for reducing tax fraud (41%) over Congress (20%), professional tax preparers (20%) and makers of DIY tax preparation software (17%).
- However, over one-third (37%) believe individual taxpayers are most responsible.
    - Women (23%) are just slightly more likely than men (16%) to put the responsibility on professional tax preparers.

General consumers are willing to do more to help combat fraud.

- Nearly all consumers (93%) are willing to take at least one action when preparing their income tax return in an effort to combat tax fraud. To do so, about two out three said they would:
    - Use a professional tax preparer regulated by the IRS (68%).
    - Provide additional documentation with their return (67%).
    - Answer additional questions on their return (65%).
    - Answer questions to confirm their identity when using do-it-yourself (DIY) tax preparation software or websites (64%).
    - Wait a little longer for the refund (61%).
        - This number did not vary dramatically by income level, with 62% of those making under $35,000 saying they would wait, 59% of $35,000-$50,000, 61% of $50,000-$75,000, 63% of $75,000-$100,000, and 67% of those making more than $100,000.
- Women (74%) are more likely than men (62%) to say they'd use a professional tax preparer regulated by the IRS to combat tax fraud.
- Millennials (18-34) (82%) are more likely than other generations to be willing to provide additional information on their returns.
- Those who have stretched the truth when preparing their tax return themselves or know someone who has tend to be more likely to be willing to wait a little longer for a refund (73% vs. 61% of general consumers) and answer questions to confirm their identity when using DIY sites (73% compared to 64% of general consumers) in an effort to combat fraud.

While consumers who prefer DIY software to prepare their taxes are not necessarily willing to give up their independence to combat tax fraud, these DIYers are open to requiring minimum standards for their software.

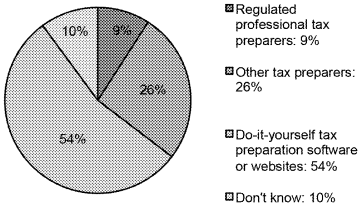
- Less than half (41%) of consumers using DIY software to prepare their taxes are willing to use a professional tax preparer regulated by the IRS to help combat tax fraud.
- However, nearly all (91%) of these DIY software preparers support requiring that the sites meet minimum standards.
- Specifically, a large majority of consumers using DIY software are willing to answer questions to confirm their identity when using the websites (84%), provide additional documentation with their return (71%) or answer additional questions on their return (69%) in an effort to battle tax fraud.

Keep in mind though, consumers who prepare their taxes completely by hand show the most resistance in taking actions that combat tax fraud.

- To combat tax fraud, those who complete their taxes on their own, completely by hand, are less likely to be inclined to provide additional documentation on their returns (57% compared to 67% of general consumers).
- This segment also holds professional tax preparers in a less favorable light.
  - They are more likely to believe fraudulent tax returns originated with tax preparers (47% vs. 36% of general consumers).
  - They are also less willing to use a professional tax preparer regulated by the IRS (53% vs. 68% of general consumers) in battling tax fraud.

FIGURES

Figure 1: **When asked where consumers thought fraudulent returns were most likely to originate, the survey found:**



**61% of respondents use a preparer and 39% self-prepare of which 26% use software and 13% do it by hand.*

Figure 2: **When asked who consumers think is most responsible for reducing tax fraud, the survey found:**

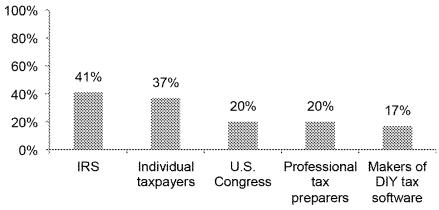


Figure 3: **When asked what consumers were willing to do when preparing their income tax returns to help combat tax fraud, the survey found:**

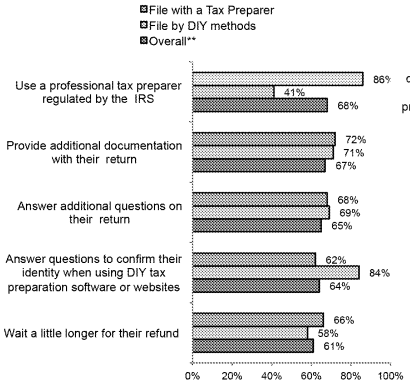
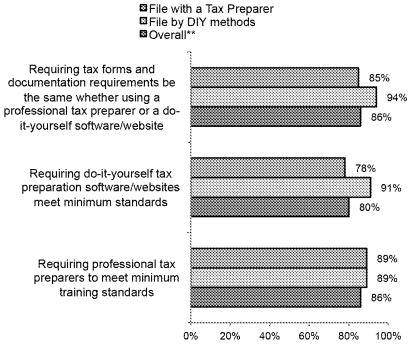


Figure 4: **When asked whether they supported each of these statements, the survey found consumers supported:**



*** Overall includes all consumers: those who prepare entirely by hand, use DIY software/websites, use a professional preparer, work with a family/friend or do not prepare/file taxes each year.*

SURVEY QUESTIONS

1. Which of following do you think most often leads to a fraudulent income tax return? Choose top two.
    - Using a stolen identity to claim a false refund
    - Falsifying tax breaks
    - Falsifying tax credits
    - Falsifying income
    - Falsifying dependents
    - Don't know

2. To help combat tax fraud, which, if any, of the following are you willing to do when preparing your income tax return? Select all that apply.
    - Wait a little longer for your refund
    - Answer additional questions on your return
    - Provide additional documentation with your return
    - Use a professional tax preparer that is regulated by the Internal Revenue Service (IRS)
    - Answer questions to confirm your identity when using do-it-yourself tax preparation software/website
    - None of the above
    - Don't know

3. Where do you think fraudulent tax returns are most likely to originate?
    - Regulated professional tax preparers
    - Other tax preparers
    - Do-it-yourself tax preparation software/websites
    - Don't know

4. Who is most responsible for reducing tax fraud? Select up to two responses.
    - U.S. Congress
    - Professional tax preparers
    - Internal Revenue Service (IRS)
    - Individual tax-payer
    - Makers of do-it-yourself tax preparation software/websites
    - None of the above
    - Don't know

5. Which of following do you think most often leads to a fraudulent income tax return? Choose top two.
    - Using a stolen identity to claim a false refund
    - Falsifying tax breaks
    - Falsifying tax credits
    - Falsifying income
    - Falsifying dependents
    - Don't know

6. How much do you support each of the following?
   - Strongly support
   - Somewhat support
   - Don't support at all
     - Requiring professional tax preparers to meet minimum training standards
     - Requiring do-it-yourself tax preparation software/websites meet minimum standards
     - Requiring that the tax forms and documentation requirements are the same when using either a professional tax preparer or a do-it-yourself software/website

7. Which of the following statements are true for you? Please select all that apply.
   - You have stretched the truth on my tax return
   - You know someone who has stretched the truth on their tax return
   - You have been a victim of identity theft
   - You know someone who has been a victim of identity theft
   - You have accidentally made false statements on my tax return
   - You have had to pay a fine for making an error on my tax return
   - You have made mistakes on your tax return that the Internal Revenue Service (IRS) did not catch.
   - None of the above
   - Don't know

8. Which of the following describes how you prepare and file your United States income tax return each year? Please select all that apply.
   - You prepare your tax return completely by hand, on my own – no software, websites, or help from a professional, family member, or friend
   - You use a do-it-yourself tax preparation software/website
   - You use a professional tax preparer
   - You work with a friend or family member
   - Other, specify
   - You do not currently prepare and/or file my taxes each year
   - Don't know

RAC COALITION

RAC COALITION
STATEMENT FOR THE RECORD
HEARING ON CURRENT HOSPITAL ISSUES
IN THE MEDICARE PROGRAM
MAY 20, 2014

The RAC Coalition commends the Ways & Means Health Subcommittee for holding a hearing on Current Hospital Issues in the Medicare Program on May 20, 2014. The RAC Coalition is encouraged by the Members' determination to evaluate possible changes to the Medicare Recovery Audit Contractor (RAC) program in order to eliminate the program's unintended consequences that are placing unnecessary burdens on the nation's hospitals and taking necessary resources away from patient care. We stand ready to be of assistance in formulating workable solutions to this vexing issue.

The RAC Coalition

The RAC Coalition lobbies on behalf of 14 hospital systems or hospitals which operate more than 70 hospitals across the country. The members of the RAC Coalition lobby are: Adventist Health System/Sunbelt, Inc.; Bon Secours Health System, Inc.; Erlanger Health System; The University of Kansas Hospital; Mercy Health; Memorial Hermann Healthcare; Mount Sinai Medical Center, NY; Oakwood Healthcare, Inc.; Ochsner Health System; OSF HealthCare System; Piedmont Healthcare; Presbyterian Healthcare Services New Mexico; SSM HealthCare of Oklahoma -- St. Anthony Hospital; and Tampa General Hospital.

The mission of the RAC Coalition is to urge Congress to enact reasonable, targeted reforms to the RAC program that will eliminate the program's unintended consequences and increase transparency, improve provider-RAC auditor relations, and promote an efficient Medicare appeals process. All of our member hospitals have had significant experience with Medicare and Medicaid audits, including RAC audits. While the details for each of our hospitals varies, our RAC audit experience has been similar to that of the hospitals whose representatives testified at the May 20th hearing:

- Each of our organizations has diverted significant amounts of manpower and resources away from patient care in order to respond to large volumes of RAC audits of Medicare inpatient claims. Many of our members have formed teams of employees whose new job duties are to receive, respond to and track appeals of RAC audits.
- When we appeal RAC audit results, we have a very high success rate. Our success rate varies from hospital to hospital, but on average we have above a 60 percent success rate.
- Because the current volume of inpatient claim denials on appeal is so large, we are waiting years to obtain a hearing even though the Medicare statute requires a decision within 90 days.
- The financial impact is significant. Many of our members have millions of dollars per hospital of recouped Medicare reimbursement tied up in the appeals process. One of our members, for example, has appealed inpatient claims worth $24 million dollars, yet has been told that no hearing on these claims will be scheduled for an indefinite amount of time.

RAC Audits of Inpatient Hospital Stays

We believe our experience with the RAC program is representative of hospitals around the country. Until CMS temporarily paused RAC activity to award new contracts, RACs were requesting medical records on hundreds of cases every 45 days. This will begin anew once the new RAC contracts are awarded. According to a July 2013 Government Accountability Office report on Medicare contractors, RACs "conducted almost five times as many reviews as the other three contractors [MACs, ZPICs and CERTs] combined." An overwhelming amount of

these reviews focus on whether physicians made the correct decision to admit their patients as inpatients, a decision which until this past year Medicare rules reserved to the complex medical judgment of physicians.

CMS's attempt to bring clarity to the inpatient admission decision with the so-called two midnight rule was well-intended but misdirected. When CMS proposed the two-midnight rule in 2013, the RAC Coalition filed comments with CMS that pointed out that the variation in interpretation of these admission standards was caused by CMS's failure to ensure that the RACs, whose audit review guidelines are not made public and not specifically approved by CMS, were applying consistent guidelines that reflected accepted medical practice. The two midnight rule is not more clear, and it raises just as many audit traps as existed before. We appreciate the Members' questions regarding the need for CMS to explore an alternative Medicare payment methodology that would fairly reimburse hospitals for short inpatient stays. We strongly believe any attempt at payment reform should also include reasonable modifications to the RAC program, as we outline below.

The Medicare Appeals System Is Broken and Providers Need Immediate Relief

A substantial amount of the dialogue at the May 20th hearing focused on the question of the success rate of hospitals in appealing RAC overpayment decisions. The RAC Coalition supports the Members' request for more detailed and current information from CMS and the Office of the Inspector General regarding the appeals success rate. The critical question in our view is not what percentage of the hundreds of thousands of RAC decisions are overturned, the statistic that CMS and the RACs frequently cite. The entire universe of RAC reviews includes numerous, non-controversial decisions such as coding errors that are simply corrected and never appealed. Further, this universe may also include decisions made at the first and second levels of the appeals process, before a matter reaches the ALJ level. The more instructive data will focus on RAC audits of hospital inpatient short stays which, as the Committee understands, is at the heart of the audit-burden problem. The important questions are:

- At what rate are hospitals appealing RAC denials of inpatient claims?
- At what rate are hospitals successful in those appeals? and
- What percentage of the dollars recovered by RACs have been, or can expected to be, returned to hospitals?

In its most recent report on the RAC program, CMS informed Congress that hospital inpatient claims accounted for 91 percent of the $2.3 billion the RAC program claimed to have recovered for the Medicare program in 2012. What CMS did not report was what percent of this $2.1 billion was the subject of appeal and what amount was returned to hospitals because the RACs' audit results were overturned on appeal. If the RAC Coalition experience is representative of the rest of the country, and we believe it is, then the vast amount of overpayment recoveries for which CMS and the RACs are taking credit will ultimately be returned to hospitals, or at least would be if the appeals process were working as it should.

There is no question that the RAC program has had an unintended and negative impact on the Medicare appeals system. RAC denials have flooded the appeals process and overwhelmed the Administrative Law Judges, who are directed by statute to adhere to a 90-day time limit for making a decision. As the Committee knows, in December 2013, the Office of Medicare Hearings & Appeals (OMHA) confirmed that the appeals system has ground to a halt. OMHA temporarily suspended the assignment of ALJs for most new appeals effective July 15, 2013, and it does not expect general assignments to resume for at least 24 months. In a Federal Register notice, OMHA explains that "in 2013, appealed claims related to the RA (Recovery Audit) program grew to over 136,000, further exacerbating the backlog of cases and resulting in a substantial increase in the adjudication time frame."

What does the OMHA shutdown mean for hospitals? For most it is a financial crisis. Hospitals have experienced wide-spread success in appealing RAC denials of inpatient stays that second-guess physician judgment. But a condition of appealing a RAC denial is that the hospital must refund its Medicare payment. Many of the RAC Coalition members have refunded millions of dollars to the Medicare program in order to challenge the results of RAC audits. We have a reasonable expectation of winning most of these challenges and, therefore, expect to see the return of these funds. But due to the OMHA shutdown, these funds are kept out of our reach for an indefinite amount of time. Meanwhile, the RACs who denied the claims have already received their contingency fee, and will hold that contingency fee for what is now an indefinite period of time even though, in the majority of cases, they will ultimately be required to return the fee. The Medicare appeals system should not be used to give hospital-funded interest free loans to RACs, and without some action to immediately remove many of these cases from the appeals system, the financial problems for hospitals will compound daily, imposing greater and greater costs to our health care system. We outline additional proposals below, but we strongly believe that CMS should be authorized to offer providers the option to have a smaller statistical sample of appeals reviewed and decided, and be bound by the results of the decision, as a means to clear the backlog in appeals.

The Need to Realign Incentives and Improve Audit Guideline Transparency

A question was raised at the May 20th hearing as to whether the RAC contingency fee affects the quality of the review of Medicare payments. In our experience, the answer is yes. Each of the members of the RAC Coalition can cite numerous examples of claims for inpatient services that were denied by RAC contractors relying upon an overly technical application of the rules that are easily overturned on appeal (missing physician signatures that can easily be located in the medical record). There are just as many examples in which RAC auditors have reached inconsistent decisions on two similar inpatient claims or have overruled physician judgment or clearly misapplied established medical guidelines. The fact that hospitals are willing to incur the expense of pursuing appeals, and the fact that they win the vast majority of these appeals, demonstrate that the quality of RAC contractor review is low, at least when it comes to inpatient stays.

This poor quality is directly related to how RACs are paid. As was stated at the May 20th hearing, RACs are like fisherman; they "cast a wide net." The hope of a contingency fee incentivizes them to review and deny as many high dollar claims as possible. The fact that they have to return the contingency fee if they are overturned on appeal does not give them incentive to conduct high quality reviews. If anything, it produces the opposite effect. Contractors that work on success fees are incentivized to keep volume high and overhead low (*i.e.*, deny as many claims as quickly and cheaply as possible) in order to maximize the chances of success and minimize the cost of losses.

We believe there are two easy answers as to how to improve the quality of RAC reviews: Realigning financial incentives and improving transparency.

Realigning Financial Incentives: Under the current RAC system, hospitals must refund Medicare payments and wait until they have exhausted their appeals in order to receive proper payment for their services. RACs, on the other hand, receive payment up front, immediately after the funds are recouped, and only return wrongfully collected contingency fees at the end of the appeal. If RACs were made to wait for their fees until after the result of any appeals, then they would have more "skin in the game" and a higher incentive to make overpayment determinations that would survive the test of an appeal (and hospitals would be far less inclined to appeal higher quality decisions) and not clog the appeals system with questionable decisions. The RAC Coalition supports proposals that would realign the RACs financial incentives, such as moving the contingency fee award until after ALJ review or adjusting contingency fees downward for high overturn rates. We appreciate that CMS has moved part-way toward such a reform in the next round of RAC contracting by moving the receipt of RAC contingency fees until after the second or "QIC" level of appeal. This is an important step because it acknowledges that the contingency fee may have unintended consequences. But in the RAC Coalition's

experience, the QICs almost universally and uniformly affirm RAC decisions in complex medical reviews of inpatient claims. To be truly effective, CMS must move RAC payments to follow the first truly independent review of their audit work, at the ALJ level.

Improving Transparency: Greater transparency of the RACs' audit review guidelines would also improve the quality of their claim reviews. Under the current RAC contracts, RACs are required to generate audit guidelines, which CMS also refers to as "review methodologies," for the claims they intend to review. These review guidelines are, in effect, the RACs' interpretation as to how Medicare payment and coverage policy should be applied on a claim-by-claim basis. For example, Medicare's standards for when it will pay an inpatient claim are not diagnosis or case-specific. They call for physicians to use their best medical judgment after considering several factors such as patient history and symptoms. The RACs must translate this standard into audit guidelines in order to give direction to their non-physician reviewers whether to approve or deny an inpatient admission for someone who, for example, has presented with chest pain or received a cardiac procedure.

CMS itself does not approve these specific audit guidelines in advance. In fact, CMS informed Congress in the 2012 RAC report that it recently instituted a policy to require MACs to validate these proposed "review methodologies" in order to minimize incorrect findings. Hospitals do not see and have no opportunity to comment on or provide other input into these review guidelines. According to testimony at the May 20th hearing, medical specialists societies do not have direct input into these guidelines either.

Under the current RAC program, disagreements as to whether RACs are applying review guidelines to inpatient stays that are consistent with Medicare policy are hashed out in the appeals system. These controversies can largely be avoided by opening the review guideline process to public review and input so that consensus is achieved as to whether the review guideline is a correct interpretation of Medicare policy before RACs use the guidelines to request and review hundreds of records from each hospital. Consensus can be achieved in a number of ways, including as having the guidelines reviewed by an independent panel of technical experts or requiring guidelines to be subject to public comment. The immediate priority should be on review guidelines used to review certain types of short-term inpatient stays, such as those associated with cardiac procedures, which, according to CMS's 2012 RAC report to Congress, have received the most audit focus from RACs and which, according to the RAC Coalition members, are most often the subject of an appeal.

Our Reform Proposals

In summary, we urge Congress to enact reasonable reforms to the RAC program to increase transparency, improve provider education, and promote an efficient appeals process:

In response to the OMHA suspension of appeals assignments, we encourage Congress to consider:

- Empowering CMS to offer providers the option to have a smaller statistical sample of appeals reviewed and decided, and be bound by the results of the decision
- A moratorium on recoupment of any overpayments from providers until the appeals system is functioning
- Moving provider recoupment to the end of the process, upon a final and binding overpayment determination

Reasonable, Targeted Reforms of the RAC Process:

- Create a CMS Ombudsman for Provider/Recovery Auditor Relations:
    - Provide an advocate within CMS to work through Recovery Auditor/MAC issues and identify potential areas of improvement in the Recovery Auditor program for CMS and congressional consideration.

- Re-align Recovery Auditor Financial Incentives – Improve Quality of Claims Denials and Align Economic Interests for a Functioning Appeals System:
    - Pay contingency fee only upon final and binding overpayment determination
    - Structure contingency fees to reflect appeals success rate
- Eliminate Controversy Over Medical Necessity Reviews By Adopting Policies and Measures to Achieve Consensus on Recovery Auditor Review Guidelines In Advance of Audits:
    - Technical Expert Panel
    - Ensure review guidelines include relevant medical societies' guidelines and policies
    - Require public comment/participation in developing review guidelines
    - Use "roll out" Probe & Agreement period to confirm that review guidelines include evidence-based standards in advance of audits

We support the reforms in the Medicare Audit Improvement Act (S. 1012/H.R. 1250) and support in particular provisions which would:

- Realign incentives by requiring RACs to pay penalties to hospitals for high error rates
- Limit RAC audits to claim types that meet a minimum error rate
- Lower the current limits on the number of medical records a RAC can request in a 45 day period
- Require RACs to hire physicians to review each claim before denial (a requirement that the HHS imposed when such reviews were performed by Peer Review Organizations)

MATERIAL SUBMITTED FOR THE RECORD

Questions for the Record

COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT

Hearing on IRS Operations and the 2014 Tax Filing Season
May 7, 2014

Questions for the Record

Ms. Jenkins

1. Following the U.S. Court of Appeals' rejection in February 2014 of the IRS's mandatory return preparer regulation program, I understand the IRS is now considering a voluntary credentialing program for tax return preparers.
   a. Can you provide a general update on the return preparer program and the status of the voluntary credentialing program?

Response

The IRS continues to believe mandatory testing and continuing education for tax return preparers is necessary for improving the accuracy of return preparation, improved preparer competency and overall tax compliance. For this reason, we are hopeful that the Congress will support the legislative proposal in the President's Fiscal Year (FY) 2016 Budget to explicitly provide the Department of Treasury and the IRS the authority to regulate all paid return preparers. In the interim, we launched the Annual Filing Season Program (AFSP), a voluntary program designed to encourage uncredentialed tax return preparers to complete continuing education courses to improve their knowledge and understanding of federal tax law relevant to the preparation of federal tax returns. Return preparers with a valid preparer tax identification number (PTIN) for the 2015 filing season, who complete the required continuing education, including a six-hour annual federal tax refresher course, will be issued a "2015 Annual Filing Season Program – Record of Completion." The IRS has issued more than 40,000 Records of Completion for the 2015 filing season.

   b. In light of the court's rejection of the prior regulatory initiative, does the IRS intend to engage with stakeholders before it advances a new voluntary program?

Response

The IRS engaged with stakeholders before launching the new voluntary program. The Return Preparer Office held individual meetings with five national organizations and seven of the largest employers of tax return preparers to share the proposed Annual Filing Season Program (AFSP) concept and to solicit input. Additional meetings were held with the Commissioner and Deputy Commissioner for Services and Enforcement at the request of some stakeholder groups.

Stakeholder input was considered and incorporated, as appropriate, in the program requirements.

c. Before implementing any voluntary system, do you intend to put your proposals out for public comment and hearings? If not, why not?

Response

We engaged the stakeholder community as described in the response to b. above, and adjusted the final program based on the input and feedback received. While we did not solicit comments through a formalized process, it is important to note that participation in the AFSP is voluntary, not mandatory. An individual may be a paid federal tax return preparer even if the individual does not participate in the AFSP.

2. Under the voluntary credentialing program the IRS is considering, would the IRS require competency tests and continuing education? If yes, would the IRS administer the tests and education itself or would it contract these tasks out to third parties?

Response

The AFSP is a continuing education program with all continuing education courses offered and administered by IRS-approved third-party providers. The AFSP includes an Annual Federal Tax Refresher course with a comprehension test that is required for the satisfactory completion of the course. This course and its comprehension test are also provided by IRS-approved providers. The AFSP does not include a basic competency test, like the former mandatory program. Revenue Procedure 2014-42, describes the requirements of the voluntary program in detail.

3. It is my understanding that the principal fraudulent scheme perpetrated by dishonest paid preparers involves a preparer changing the return after the taxpayer has signed the return to increase the refund amount and diverting the extra amount into a preparer controlled bank account. Given that preparers currently have to register for PTINs so they can be accounted for in the preparer community, is the additional certification primarily designed to defeat this fraud scheme or is it aimed at an alternative goal?

Response

The AFSP is primarily designed to improve the knowledge and understanding of federal tax law and filing season requirements for uncredentialed tax return preparers. It will not impede those preparers intent on defrauding the tax system. The IRS is taking numerous actions to reduce return preparer fraud and prevent improper refunds, as detailed in response to Mr. Marchant's inquiry on this issue (response to Marchant question 1.a.).

Mr. Marchant

1. We have seen numerous press releases from the IRS and the Department of Justice announcing that tax return preparers had been convicted, jailed, or shut down for fraudulent conduct. In one press release from April 15, the Department of Justice wrote: "In the past decade, the Tax Division has obtained injunctions against hundreds of fraudulent tax preparers." Despite these injunctions against fraudulent tax return preparers, there continues to be alarming reports of the IRS sending out questionable refunds generated by fraudulent return preparers long after the IRS should have realized there was a problem. For example, there have been reports of thousands of checks being sent to the same address or direct deposited into the same bank account.

    a. What additional steps is the IRS taking over the next year to increase its vigilance against return preparer fraud, to block improper refunds from going out, and to shut down or prosecute fraudulent preparers?

Response

The IRS has a number of efforts underway designed to reduce inaccurate and fraudulent returns submitted by paid preparers. These efforts include due diligence visits, preparer investigations, notices, and injunctions. In addition, the IRS sponsors educational programs covering both substantive tax law and the preparer's obligations under Circular 230.

The IRS screens public complaints of return preparer misconduct and investigates the most egregious instances of return preparer misconduct. Abusive tax schemes promoted by return preparers are identified through data analytics and swiftly investigated. Those engaging in these schemes are subject to criminal prosecution and sanctions such as civil injunctions, penalties, and suspension or disbarment from representing taxpayers before IRS (for those covered under Circular 230) and participation in the IRS's electronic filing program.

This year the IRS plans to conduct over 1600 enforcement visits to tax return preparers to monitor compliance with the earned income tax credit (EITC) due diligence requirements, the requirements for participation in the IRS's certified acceptance agent program to assist taxpayers in obtaining an individual taxpayer identification number (ITIN), and the requirements for participating in the electronic filing program as an electronic return originator.

We continued to improve our fraud and identity theft identification and prevention program for the 2015 filing season. Our plans include the following:

- Beginning in January 2015, we will not deposit more than three tax refunds into a single bank account. Additional tax refunds directed to be deposited to the same bank account will be paid by mailing a paper check to the taxpayer. Data shows multiple refunds deposited to a single bank account is an indication of potential fraudulent or ID theft activity on the tax return because it is easy for the perpetrator to establish and retrieve direct deposits from a single account. We believe this will have a positive impact on our efforts to deter fraud and identity theft. Stakeholders such as the Department of the Treasury Bureau of the Fiscal Service, the Treasury Inspector General for Tax Administration (TIGTA), the banking industry, the practitioner community, and Congress have expressed strong support of this effort.
- We will use "Device ID" information to identify potential identity theft or fraud. The term "Device ID" refers to the unique serial number (or fingerprint) of the device (for example, computer, smart phone, or tablet), and will be incorporated into the software industry electronic tax filing programs. The unique Device ID will be transmitted by the software as part of the electronically filed return and will assist the IRS in identifying the source of fraudulent returns and enable the IRS to associate fraudulent returns that are filed from the same device.
- A unique Electronic Filing Identification Number (EFIN) is issued to each Authorized IRS e-file Provider participating in the IRS's e-filing program. As in past years, the IRS will deactivate any EFIN if it is determined that an identity theft victim's name and Social Security Number (SSN) was used to obtain the EFIN or that the EFIN was used to file fraudulent or identity theft returns. The list of suspected or compromised EFINs can be adjusted throughout the filing season providing flexibility to incorporate new data, insights, and lessons learned. During the 2014 filing season, CI identified more than 500 EFINs for revocation based on a suspicion that the e-file Provider engaged in fraud or identity theft. Fraud and identity theft filters for the 2015 filing season have been enhanced so that returns that use a stolen EFIN will be stopped and worked through the identity theft process.
- We will continue to implement new fraud and identity theft screening filters to improve our ability to spot false returns before we process them and issue refunds. In addition to our filters, we have a specialized group of analysts who will continue to review returns for patterns and schemes. These analysts review characteristics that may not be instantly detectable by the fraud identity theft filters. Any patterns or schemes discovered are added to the fraud and identity theft filters.
- We will continue to conduct compliance activities as part of our EITC-focused paid preparer effort including: Field examiner audits of preparers to determine whether they are complying with preparer due diligence requirements designed to

reduce ineligible EITC claims; so-called "knock-and-talk visits" made by CI agents to preparers to educate them on EITC rules and due diligence requirements; and undercover shopping visits to return preparers suspected of engaging in fraud. For the 2015 filing season, 100 "knock-and-talk" visits are scheduled, some of which have already occurred.

- As in past years, the CI Scheme Development Centers analyze return information from to identify emerging return preparer schemes and quickly disseminate information to the field for review and investigation. In FY 2014 the CI Return Preparer Program had the following results:

Return Preparer Program Investigative Actions	FY 2014
Subject Criminal Investigations Initiated	305
Prosecution Recommendations	261
Indictments	230
Convictions	193
Conviction Rate	96.0%
Sentenced	183
Incarceration Rate	86.3%
Average Months to Serve	28
Publicity Rate	94.5%

The current budget situation is a significant obstacle to more effectively combatting identity theft and refund fraud. The IRS has been operating under very tight budget constraints for years. The FY 2015 appropriations provided $10.9 billion for the bureau. This is almost $350 million, or 3 percent, below FY 2014 enacted and results in total IRS funding that is more than $1.2 billion below FY 2010 levels. The IRS has already reduced permanent staffing levels by 13,000 since 2010.

Several initiatives in the President's FY 2016 Budget address aspects of preparer compliance, fraudulent refund claims, and assistance to victims of identity theft. These include:

- $18.9 million to *Improve Up-Front Identification and Resolution of Identity Theft Returns*, which will expedite resolution of identity theft cases and improve efficiency in review and disposition of leads received from external sources.

- $47.0 million for the Return Review Program (RRP) to provide IRS an integrated and unified system that enhances our capabilities to detect, resolve, and prevent criminal and civil tax noncompliance, including identity theft.

- $82.2 million to provide additional staffing and advanced technologies to *Prevent Identity Theft and Refund Fraud*.
- $24.6 million (within the *Increase Audit Coverage* initiative) for correspondence examination programs including identifying and addressing return preparers who file egregiously non-compliant ITIN returns, and expanding the Real-Time Preparer compliance program.
- $7.2 million (within the *Pursue Employment Tax and Abusive Tax Schemes* initiative) to acquire network analysis tools to improve identification of patterns of noncompliance, which has been successfully tested to match identity theft cases to ghost preparer networks (among other compliance issues).
- $4.3 million to *Ensure Ethical Standards of Conduct for Practitioners* subject to Circular 230 regulations.

2. Commissioner Koskinen, in your testimony in April before the Senate Finance Committee, you said:

"Although the majority of return preparers are competent and operate with the highest ethical standards, the Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA), and the IRS's own research all suggest that our tax system and a large number of taxpayers may be poorly served by return preparers who engage in fraud."

Could fraudulent preparers be assisted in their fraud efforts by obtaining some type of an IRS "validation"? Please discuss your thoughts on this issue.

Response

All tax returns, regardless of preparation method, are subject to the same review processes that identify instances of fraud and identity theft (based on the return's characteristics). Tax returns filed with a 'validation' item, such as a Preparer Tax Identification Number (PTIN) on returns submitted by a preparer, and an EFIN on returns prepared and submitted electronically, are no exception and also undergo review processes to detect fraud including:

- Filters to select tax returns as fraudulent or identity theft if they meet certain characteristics. These returns are stopped and subsequently processed through our Integrity and Verification Operations.
- Review of returns by a specialized group of analysts for patterns and schemes (in addition to our fraud and identity theft filters).
- Continual data analytics, with adjustments to filters and models as necessary.

The EFIN program also has safeguards including:

- EFINs are deactivated when it is determined that the EFIN was established using an identity theft or fraud victim's name and SSN or that the EFIN was used for filing fraudulent identity theft returns.
- Returns that share a compromised EFIN in 2015 will be stopped by the fraud and identity theft filters and worked through the Taxpayer Protection Program.
- We continue to use historical characteristics from confirmed fraud and identity theft returns to protect taxpayers and revenue including EFINs with a significantly high percentage of identity theft in the prior year.

The current PTIN requirement gives the IRS an important and better line of sight into the return preparer community than ever before. PTINs allow the IRS to collect more accurate data on who is preparing returns, the volume and types of returns being prepared and the qualifications of those doing return preparation. Thus, the information obtained through the PTIN process helps us do more to analyze trends and spot anomalies, so that we have a much better understanding of the return preparer community as a whole, and can design appropriate compliance and educational activities in response to the data we collect.

While the preparer PTIN registration requirement is an important advance in our ability to ensure that all return preparers provide the proper level of service to taxpayers, the testing and continuing education components of our return preparer efforts are critical to making even more progress in this area. We continue to believe that the regulation of paid return preparers is important for the proper functioning of the U.S. tax system. Congress can help us further enhance our efforts to reduce tax return preparer-related refund fraud by enacting the following legislative proposals contained in the Administration's FY 2016 Budget:

Authority to regulate return preparers. The Administration's proposal would explicitly authorize the IRS to regulate all paid preparers. The regulation of all paid preparers, in conjunction with diligent enforcement, will help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system. Incompetent and dishonest return preparers increase collection costs, reduce revenues, disadvantage taxpayers by potentially subjecting them to penalties and interest as a result of incorrect returns, and undermine confidence in the tax system.

Increase the preparer penalty for willful and reckless understatements. The Administration's proposal would increase the penalty imposed on paid preparers in cases of willful or reckless understatements to the greater of $5,000 or 75 percent of the income derived by the preparer to more effectively discourage willful and reckless behavior by paid preparers.

Extend preparer due diligence to the child tax credit. The Administration's proposal would extend the preparer due diligence requirements that currently apply with respect to returns claiming the EITC to returns claiming the child tax credit (CTC) and the additional child tax credit (ACTC). Extending the due diligence requirement to the CTC and ACTC, which share many eligibility criteria with the EITC, could improve

compliance without excessively increasing the level of burden on paid preparers or taxpayers.

Mr. Paulsen

I have long been concerned about a potential IRS "real time tax system" in which the IRS would send a taxpayer a pre-filled tax return for their signature. Such a system could be costly, inefficient, and would set up the IRS to be both the tax collector and taxpayer.

The IRS has denied building this system in the past, but last year Acting Commissioner Werfel admitted that the IRS spent approximately $4 million on the system. Some have estimated that actual spending on the program could be as high as $30 million. This is despite repeated report language in the Financial Services Appropriations Bill stating that the IRS should not spend any money on this program.

I was very encouraged by your testimony before the House Financial Services Committee in February, during which you stated that you do not intend to have the IRS construct a "ready return" or bill presentment system. However, you hedged a little bit in your testimony saying that "real time tax system" was a "confusing term," and that the IRS was only working on back-end processing systems.

I was then additionally confused by your testimony last week before the Senate Financial Services Appropriations Subcommittee where you requested budget authority for accelerated W-2 information reporting. It is my recollection that "accelerated tax reporting information" was actually part of the plan to build the real time tax system, including a "ready return bill presentment tax preparation" system.

1. Please provide detail on these back-end processing systems including how much the IRS has spent on them to date.

2. Is one of the key pieces of a real time tax system IRS receipt of accelerated W-2, 1099, SSA, and small business information?

3. Why have you conveyed conflicting messages to the House and the Senate? First, you testified before the House that the IRS wasn't working on a real time tax system, but that you are building back-end processing systems. Then you requested Senate budget authority to accelerate W-2 information reporting but didn't request the same of the House. Any clarity you can provide would be much appreciated.

Response Questions 1-3:

The IRS is not pursuing and has no plans to implement a "real time tax" system to create pre-filled forms or software/products for simple tax return or "ready return bill presentment" preparation.

There has been some confusion about the term "real time tax", which was an IRS exploratory effort that has concluded. During 2011-2013, the IRS explored ways to improve the tax filing process through earlier and more intelligent matching of available data, such as third-party information returns, to income tax returns filed by taxpayers. These activities complied with the U.S. House of Representatives Committee on Appropriations statement (House Report 112-550) that prohibits the IRS from pursuing a simple tax return program.

Challenges with refund fraud and identity theft have led the IRS to advocate for earlier filing of information return documents in support of the Treasury Department's Fiscal Year 2015 Revenue Proposal (Green Book) "Rationalize Tax Return Filing Due Dates So They Are Staggered" (page 246) http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf. This proposal would greatly enhance our ability to identify mismatches earlier in the process, and thus, do a better job of stopping improper payments.

Accelerated information reporting (such as a Forms W-2 and 1099) provides authoritative source data against which the IRS can verify and validate income claimed on a filed return. These information return documents serve an important role in preventing tax return-based identity theft and fraud. Without information reporting documents, return verification is more difficult.

Under current law, most information returns, including Forms 1099 and 1098, must be filed with the IRS by February 28 of the year following the year for which the information is being reported, and Form W-2, Wage and Tax Statement, must be filed with the Social Security Administration (SSA) (or in some cases the IRS) by the last day of February. The due date for filing information returns with the IRS or SSA is generally extended until March 31 if the returns are filed electronically.

The Administration's proposal would accelerate the filing due date by requiring information returns to be filed with the IRS (or SSA, in the case of Form W-2) by January 31, except that Form 1099-B would have to be filed with the IRS by February 15. The proposal would also eliminate the extended due date for electronically filed returns. As you mentioned, this was included in my written testimony from this hearing on May 7, 2014 (see page 14): http://waysandmeans.house.gov/uploadedfiles/irs_testimony_050714os.pdf.

In addition, the Government Accountability Office's (GAO) report titled, *"Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud" (GAO-14-633/JC451109)* recommended that the IRS fully assess the costs and benefits of accelerating W-2 deadlines. We recognize that accelerating the Form W-2 filing deadline would be a significant change to tax administration and that fully assessing the costs and benefits would be helpful. We convened a working group of internal stakeholders and subject matter experts to identify the costs and benefits of accelerating Form W-2 deadlines. The working group will address the current state of IRS systems and work processes and the adjustments or enhancements necessary to meet the objective of using accelerated Form W-2 information. The group will identify and consider the potential impacts on internal and external stakeholders and will identify and evaluate other changes that may be necessary to match Form W-2 data to tax returns prior to issuing refunds.

Ms. Black

1. In February 2014, the U.S. Court of Appeals for the District of Columbia ruled that current statutory law does not give the IRS the authority to regulate tax return preparers. We have seen press reports that in light of this holding, you would favor a "voluntary" system of IRS regulation of return preparers. Since the court held that the IRS does not have the statutory authority to regulate return preparers at all, how would such a "voluntary" system of regulation be consistent with current statutory law?

Response

The IRS continues to believe mandatory testing and continuing education for tax return preparers is necessary for improving the accuracy of return preparation, improved preparer competency and overall tax compliance. For this reason, we are hopeful that the Congress will support the legislative proposal in the President's FY 2016 budget to explicitly provide the Department of the Treasury and the IRS the authority to regulate all paid return preparers. In the interim, we launched the Annual Filing Season Program (AFSP), a voluntary program designed to encourage uncredentialed tax return preparers to complete continuing education courses to improve their knowledge and understanding of federal tax law relevant to the preparation of federal tax returns. It is important to note that participation in the AFSP is voluntary, not mandatory. An individual may be a paid federal tax return preparer even if the individual does not participate in the AFSP. Return preparers with a valid preparer tax identification number (PTIN) for the 2015 filing season, who complete the required continuing education, including a six hour annual federal tax refresher course, will be issued a "2015 Annual Filing Season Program – Record of Completion." The IRS has issued more than 40,000 Records of Completion for the 2015 filing season.

2. More recently, in your testimony last month before the Senate Finance Committee, you noted the Administration's request for legislation providing the return preparer regulatory authority the Court of Appeals rejected. You said the IRS is considering "an interim step" involving a "program of voluntary continuing education."
   a. Why do you label this an "interim step"? Do you presume that Congress will eventually agree to expand the IRS's authority when there have been several recent abuses of its existing authority?

Response

As stated in Revenue Procedure 2014-42, in February 2014, the U.S. Court of Appeals for the District of Columbia in *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014), held invalid the portion of Circular 230 regulating registered tax return preparers (RTRPs) as practitioners practicing before the IRS. Beginning with its FY 2015 Budget, the Administration has proposed that Congress provide the Treasury Department and the IRS with legislative authority to regulate tax return preparers. In the absence of such legislative authority, the Treasury Department and the IRS have established an Annual Filing Season Program designed to

encourage tax return preparers who are not attorneys, certified public accountants, or enrolled agents to improve their knowledge of federal tax law.

b. Since continuing education courses are now widely available for return preparers to take as they wish, how would such a "voluntary continuing education" program be a change from what goes on now?

Response

There are preparers who seek out continuing education on a regular basis and are concerned about their own professionalism and require little incentive from the IRS. This is not true of all preparers. The AFSP serves to motivate those who require more structure and encouragement. Additionally, taxpayers have difficulty determining the qualifications of return preparers. As part of the AFSP, during the upcoming filing season, the IRS will launch a look-up tool which for the first time will allow taxpayers to find the credentials of their preparer. This tool will include credentialed preparers and those participating in the AFSP.

Also, applicants for the AFSP must successfully complete an annual federal tax filing season refresher course that is administered by an IRS-approved continuing education provider, a requirement that is not presently in place for return preparers who take continuing education voluntarily. The refresher course must generally cover tax law and filing requirements relevant to Form 1040 series returns and schedules. The refresher course must be six hours and must include a test of the material presented during the course that is given at the end of the course. The test must be a minimum of 100 questions. To successfully complete the refresher course, the applicant must pass the related test by answering 70% of the questions correctly (or a higher percentage if set forth in forms, instructions, or other appropriate guidance).

Certain applicants are not required to take the refresher course as a condition of eligibility to apply for a Record of Completion. They are: attorneys, CPAs, and EAs; individuals who passed the Registered Tax Return Preparer examination; and tax return preparers who are licensed or registered by any state, territory, or possession of the United States, including a Commonwealth, or the District of Columbia after passing an examination covering federal tax matters, and tax return preparers who have passed an examination covering federal tax matters administered by an entity recognized by the IRS as an eligible entity for purposes of this section. Applicants who qualify for this exception must, upon request, present proof of their license, registration, or passage of an approved examination as required by the IRS in forms, instructions, or other appropriate guidance. Applicants required to complete the refresher course must successfully complete 18 hours of continuing education from an IRS-approved continuing education provider during the calendar year prior to the year for which the Record of Completion is sought. The total hours completed must consist of two hours of ethics or professional responsibility, 10 hours of federal tax law topics, and six

hours of federal tax law updates. Applicants who successfully complete the refresher course will have satisfied the requirement to take six hours of federal tax law updates.

Applicants exempt from the refresher course must successfully complete 15 hours of continuing education from an IRS-approved continuing education provider during the calendar year prior to the year for which the Record of Completion is sought. The total hours completed must consist of two hours of ethics or professional responsibility, 10 hours of federal tax law topics, and three hours of federal tax law updates.

3. From which appropriated funds would the IRS cover the costs of administering any voluntary continuing education program? Would the IRS anticipate collecting fees from test takers or continuing education program participants? Would any part of the program provide any other source of non-appropriated revenue to the IRS?

Response

The IRS is not collecting separate fees for participation in the AFSP. Preparers will continue to pay the user fee for their Preparer Tax Identification Number (PTIN) and the costs for the necessary continuing education for this program are paid directly to the continuing education providers. The refresher course, the related comprehension test, and other continuing education requirements are administered by continuing education providers as defined in section 10.9 of Circular 230 and approved by the IRS in accordance with the requirements of Revenue Procedure 2012-12, 2012-2 I.R.B. 275. Continuing education providers report course completion directly to the IRS. The refresher course is not considered successfully completed and providers do not report completion until a preparer has passed the associated comprehension test.

4. Before implementing any voluntary system of IRS regulation of tax return preparers, do you intend to put your proposals out for public comment and hearings? If not, why not?

Response

Participation in the AFSP is voluntary, not mandatory. The AFSP does not impose any requirement on any preparer before they can complete tax returns for compensation. While we did not solicit comments through a formalized process, we did engage the stakeholder community. The Return Preparer Office held individual meetings with five national organizations and seven of the largest employers of tax return preparers to share the proposed AFSP concept and to solicit input. Additional meetings were held with the Commissioner and the Deputy Commissioner for Services and Enforcement at the request of some stakeholder groups. Adjustments were made to final AFSP requirements based on the input and feedback received.

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