FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2015

WEDNESDAY, APRIL 30, 2014

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Tom Udall (chairman) presiding.

Present: Senators Udall, Coons, Johanns, and Moran.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

STATEMENT OF HON. JACOB LEW, SECRETARY

OPENING STATEMENT OF SENATOR TOM UDALL

Senator UDALL. Good afternoon. The subcommittee will come to order. I am pleased to convene this hearing of the Financial Services and General Government Subcommittee to consider the fiscal year 2015 funding needs of the Department of the Treasury and the Internal Revenue Service. I welcome my distinguished ranking member, Senator Mike Johanns, and other colleagues who I think will be joining us as we go on today.

And let me go to my opening statement here. Okay. Senator Johanns, good to have you here.

Senator JOHANNS. Thank you.

Senator UDALL. Always a pleasure to work with you. And with us today are three distinguished witnesses to present testimony about the resource needs of the Treasury and the IRS. I welcome Secretary Jacob Lew, the Internal Revenue Service Commissioner, John Koskinen, and Treasury Inspector General for Tax Administration, J. Russell George. Thank you for your service, and thank you for accepting your leadership posts in these challenging times.

I welcome the opportunity today to conduct critical oversight of the Treasury Department and its programs and to have a candid discussion of where the Department is today, where it needs to be, and how we can make sure it has the necessary resources to fulfill its important and wide-ranging responsibilities.

PREPARED STATEMENTS

Congress probably exercises its most effective oversight of agencies and programs through the appropriations process. It allows an annual checkup and review of operations and spending. The IRS also has a cadre of important watchdogs to monitor and evaluate its operations and to complement congressional oversight. These include the National Taxpayer Advocate, the IRS Oversight Board, the U.S. Government Accountability Office, and the National Treasury Employees Union. I appreciate their efforts to help critique, promote, and improve the work of the IRS. I invited the top officials of each of these organizations to submit written materials to support the subcommittee's work and to augment the record of these proceedings today, and I would ask unanimous consent that the statements and materials received by the subcommittee from these organizations be made a part of the hearing record. And, no objection, so ordered.

[The statements follow:]

PREPARED STATEMENT OF SENATOR TOM UDALL

Good afternoon. I am pleased to convene this hearing to consider the fiscal year 2015 funding request of the Department of the Treasury and the Internal Revenue Service (IRS). I am joined by my distinguished ranking member, Senator Mike Johanns, and other members of the subcommittee.

With us today are three distinguished witnesses to present testimony about the resource needs of the Department of the Treasury and the Internal Revenue Service. I welcome the Secretary of the Treasury, Jacob Lew, the Internal Revenue Service Commissioner, John Koskinen, and the Treasury Inspector General for Tax Administration, J. Russell George. Thank you for your service and for accepting your key leadership posts in these challenging times.

I welcome the opportunity today to conduct critical oversight of the Treasury Department and its programs, and to have a candid discussion of where the Department is today, where it needs to be, and how we can make sure that it has the necessary resources to fulfill its important and wide-ranging responsibilities.

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TREASURY REQUEST

Most of the $13.8 billion dollars gross funding request for the Treasury Department is for the IRS. The President's budget requests $1.3 billion dollars to fund the other bureaus and offices of the Department, a decrease of $22 million dollars, or about 2 percent less than fiscal year 2014. These bureaus and offices cover a wide variety of activities for the Department, from implementing financial sanctions against our enemies to forecasting economic indicators, and managing the Federal Government's books.

I was pleased to see that the President's budget included robust funding for the Community Development Financial Institutions (CDFI) fund. The budget also proposes to increase the CDFI bond guarantee program to $1 billion dollars, to expand access to capital for community development organizations across the country at no cost to taxpayers. However, the request also includes worrisome cuts for several critical bureaus including the Alcohol and Tobacco, Tax and Trade bureau, which protects consumers, prevents smuggling, and collects revenue to reduce the deficit. I look forward to hearing from you about why Treasury is requesting cuts for this important bureau.

IRS REQUEST

The Internal Revenue Service administers the tax laws and collects the revenues for funding over 95 percent of Federal Government operations and public services. The IRS has nearly 90,000 employees. Each year, they make hundreds of millions of contacts with American taxpayers and businesses. The IRS is the face of Government to more U.S. citizens than any other agency.

For fiscal year 2015, the President's budget requests $11.997 billion dollars in base appropriated funding for the IRS. This is an increase of $706 million dollars, or a 6 percent boost above the fiscal year 2014 enacted level of $11.291 billion dollars. Another $480 million dollars is sought through a program integrity budget cap adjustment, raising the appropriations request to $12.477 billion dollars.

The fiscal year 2015 funding forecast is not encouraging. Budgetary constraints remain in place. This subcommittee faces challenging funding decisions balancing many competing demands for the ensuing fiscal year. It will be helpful to hear Secretary Lew and Commissioner Koskinen's frank appraisals of the minimum resource needs to ensure that the Treasury Department can fulfill its stewardship responsibilities for U.S. economic and financial systems. Moreover, we will be carefully assessing what resources are required to deliver top quality service to taxpayers, and enforce the law with integrity and fairness to all.

I look forward to hearing more about the particular challenges the Department and the IRS face, the consequences of funding shortfalls, and how this subcommittee can be helpful in supporting the Department's vital mission.

PREPARED STATEMENT OF THE INTERNAL REVENUE SERVICE OVERSIGHT BOARD

INTRODUCTION AND EXECUTIVE SUMMARY

Chairman Udall and Ranking Member Johanns, the IRS Oversight Board thanks the subcommittee for this opportunity to present its views and recommendations on the President's fiscal year 2015 budget request for the Internal Revenue Service (IRS).

First, the Board would like to make some broad observations regarding the context in which the current budget debate is taking place and the possible ramifications for the IRS, taxpayers and our Nation.

Last summer's controversy regarding the IRS' use of inappropriate criteria to review certain organizations applying for tax exempt status and the agency paying for large conferences and questionable training videos with taxpayer dollars still cast a long shadow over the IRS' budget.

The IRS was one of only a few Government agencies that did not have its funding restored to pre-sequestration levels under the *Consolidated Appropriations Act of 2014*. In fact, the IRS' fiscal year 2013 post-sequestration funding level was the lowest since fiscal year 2009. For fiscal year 2014, the IRS received approximately $11.3 billion—approximately $1.6 billion less than the President's budget request and $1.8 billion less than the Board's recommendation. The Board believes that this budgetary path is unsustainable.

The Oversight Board hoped the management controls and risk management tools put in place last year by then Acting Commissioner Werfel, coupled with the proven leadership skills of newly appointed Commissioner John Koskinen would dispel any lingering concerns about the IRS' ability to effectively manage taxpayer-provided resources and fairly administer Federal tax laws. Often lost in the discussion is the fact that the IRS accepted and implemented every recommendation contained in the Treasury Inspector General for Tax Administration's reports on the aforementioned incidents and then took additional steps to institute even more safeguards than proposed by TIGTA.

However, in spite of these corrective actions, there are still those who want to punish the IRS and believe the best way to do so is to slash its budget. Last year, the House Appropriations Subcommittee on Financial Services and General Government voted for a drastic 24 percent cut in the IRS' budget. Although largely symbolic, it was indicative of a sentiment that has carried over into 2014 and the fiscal year 2015 budget cycle.

The Board believes we need to have a rational and nonpartisan dialogue about the IRS' budget and the effects—good or bad—appropriated funding levels could have on customer service, enforcement, Business Systems Modernization and human capital. In spite of the often heated rhetoric, we should not shy away from the simple fact that there is a choice about the future of tax administration at the IRS.

The Oversight Board has long contended that attempting to punish the IRS by cutting its budget only punishes honest taxpayers who play by the rules and expect their neighbors and business competitors to do the same.

These taxpayers—and their return preparers—expect the IRS to answer their questions about an ever-changing and complex tax code and resolve their individual tax issues; process their returns efficiently; and promptly issue a refund if they are legally due one.

They also expect the IRS to vigorously and fairly enforce the tax laws—whether it's a tax cheat claiming illegal deductions or refunds, an identity thief engaged in refund fraud, or taxpayers not disclosing money and assets hidden in tax havens.

Taxpayers also expect a variety of customer service channels and Web-based tools tailored to their needs. And increasingly, they want to be able to communicate and conduct transactions with the IRS electronically—much as they already do with other large financial institutions and commercial enterprises.

This begs the question, "How can the IRS meet these basic taxpayer expectations without adequate funding?" The inescapable conclusion is, "The IRS can't."

We are already witnessing an alarming erosion in both customer service and enforcement that shows no signs of abating. Although the 2014 filing season proceeded smoothly, projections show that telephone level of service on the IRS toll-free lines will fall to 60.5 percent by the end of 2014—exactly the same level as last year. In other words, 4 out of 10 taxpayers will be unable to reach an IRS assistor. Average telephone wait times are expected to more than double, according to current IRS estimates.

IRS customer service problems are not limited to phone service. Long lines greeted taxpayers at IRS walk-in centers this filing season. Commissioner Koskinen testified before the House Appropriations Subcommittee on Financial Services and General Government that people were lining up outside the Taxpayer Assistance Centers (TACs) before they opened in the morning to make sure they got service the same day, and once inside, may have had to wait 90 minutes or more for help from an IRS representative.

Tax compliance is also suffering due to the budget cuts and sequestration. The individual audit coverage has now dropped to below 0.9 percent—the lowest in a decade. Business return audits have plummeted by 13 percent. Audit revenues are at their lowest point in a decade. Core enforcement activities, such as liens, levies and seizures are also on the decline. Additionally, although progress has been made, tax-related identity theft and tax refund fraud are still major challenges for the IRS.

The effects of budget cuts go beyond the IRS workforce—the agency's biggest expense. After a successful launch of the initial phase of the Customer Account Data Engine (CADE) 2, the IRS' Information Technology (IT) Program is threatened yet again with insufficient funding to address pressing infrastructure needs.

Meanwhile, the IRS is legally bound to implement the tax-related portions of two major pieces of legislation—the *Foreign Account Tax Compliance Act* (FATCA) and the *Affordable Care Act* (ACA). Due to budget cuts, these duties have become unfunded mandates. Commissioner Koskinen warned that to meet these statutory responsibilities with a flat or reduced budget, he will have no choice but to pull people from both IRS customer service and enforcement functions with serious repercussions in both areas. Congress must realize that robbing Peter to pay Paul is not a viable solution to the IRS' budget problems.

Again, the Board believes we have a choice: stay mired in the past or make the fiscal year 2015 budget debate about the future of the IRS, taxpayers and the integrity of our tax administration system. In this regard, we believe that it is time to invest in the IRS and our country's future. With taxpayer service suffering and appropriate risk management tools in place, it makes little sense to underfund the IRS. This is the time to restore funding so the IRS can improve service, increase enforcement, and continue to modernize its systems and processes.

To this end, in July 2013, the IRS Oversight Board recommended to the Secretary of the Treasury a fiscal year 2015 budget request of $13.590 billion for the IRS. The *IRS Restructuring and Reform Act of 1998* (RRA 98) requires the Board to make such an annual budget submission. Although $1.14 billion higher than the President's budget request of $12.477 billion due to different baselines as starting points, the Board supports the administration's IRS fiscal year 2015 budget request.

The Board believes that the President's recommended funding is sufficient for the IRS to carry out both its dual mission and new statutory responsibilities. It makes targeted and wise investments in many of the same areas suggested by the Oversight Board, such as improving telephone level of service and improving audit coverage.

Finally, the Oversight Board notes that enforcement initiatives are paid through a $475 million program integrity cap adjustment with more than a $4-to-$1 return on investment when enforcement initiatives, such as new hires of revenue officers, are fully realized.

The Board is concerned over the recent track record of such adjustments. Although some discretionary cap adjustments were approved during then IRS Commissioner Everson's tenure, none have been passed over the past 4 years. Cap or no cap adjustment, the IRS simply needs additional funding to conduct more enforcement activities which help to deter non-compliance and close the tax gap, while generating much needed revenue for our country.

THE PRESIDENT'S BUDGET REQUEST

Upon taking office, Commissioner Koskinen said adequate funding for the IRS was probably the most "intractable" and "difficult" issue he would face during his tenure. That is no overstatement, in the Board's view. The IRS is now operating with a budget at close to pre-sequestration levels; the lowest since fiscal year 2009, and when indexed against the rate of inflation, the lowest in history. As the agency notes, its budget has been cut by 7 percent since 2010 while the total number of individual and business tax filers has grown by 4 percent over the same time span.

The IRS has done its best to deal with the underfunding by wringing out as many efficiencies and cost savings as possible. These include employee buy-outs, an exception-only hiring freeze, consolidation of office space, all but case-related travel bans, and steep cuts in training. But this budget strategy is not sustainable. The IRS is now left with no other choice but to make cuts to core programs.

The President's budget seeks to reverse this trend by restoring some of the funding lost over the past 3 years and putting the IRS back on a path of sustained and reliable funding. This is a reasonable and honest budget with a suite of smart, forward-thinking initiatives that address head on areas of concern that the Board has pointed out in customer service, enforcement, IT and human capital. The budget request also supports and is aligned with the IRS Strategic Plan and Treasury Department Priority Goals.

CUSTOMER SERVICE

Customer service is both a great opportunity and challenge for the IRS. Helping taxpayers navigate an increasingly complex and changing tax code and answering tax law and account questions is a major component of the IRS' balanced mission; and taxpayers use and value this service.

The Oversight Board's 2013 Annual *Taxpayer Attitude Survey* showed that 84 percent of respondents said they are likely to call the IRS toll-free telephone line for assistance; 83 percent said they are likely to visit IRS.gov for help; and 74 percent said they are likely to visit an IRS walk-in site (TAC) for help. Moreover, 89 percent of respondents said the tax advice and information provided by an IRS representative was "very or somewhat valuable." This is equal to paid tax professionals. Such an accolade is a great tribute to the dedication, determination and professionalism of the IRS workforce.

In addition to providing traditional customer service channels, the IRS is trying to migrate taxpayers to Web-based, self-serve tools, such as "Where's My Refund?" And in recognition of a diverse and evolving taxpayer base that may not be getting its tax information from traditional media sources, the IRS has been employing social media, such as YouTube and Twitter to push out important service and compliance messages. The IRS also offers a smartphone app, IRS2Go, where users can receive tax news updates and check the status of their refunds.

Although it is difficult to assign a dollar value for customer service return-on-investment, we do know that if taxpayers get their returns right from the start, both the IRS and taxpayers can avoid costly back-end audits. For example, eligibility for tax credits can be extremely confusing and frustrating for taxpayers. Speaking to an IRS representative before claiming a credit could prevent an audit for the taxpayer and potentially costly back taxes, interest and penalties down the road. However, while the overall IRS customer service program is comprised of several components, the funding level for IRS taxpayer assistance, education and outreach decreased by nearly 34 percent from fiscal year 2012 to fiscal year 2013.

Commissioner Koskinen has also testified that the IRS had 11,000 fewer employees working during the 2014 filing season than it had in 2010, while at the same time processing a record number of returns.

The end results of these, and other factors were unacceptable telephone levels of service (LOS), and long lines and wait times at IRS walk-in centers. The projected 60.5 telephone LOS falls far short of the 80 percent the Board believes is the minimum toll-free LOS that taxpayers deserve to help them meet their tax responsibilities.

The IRS is also facing increased backlogs in its written taxpayer correspondence inventory. This is particularly worrisome since the IRS conducts about 75 percent of all examinations by mail, and sends out millions of additional notices each year to taxpayers.

The IRS faces other customer service challenges that may come as a surprise to many. For example, while the number of visits to IRS.gov continued to increase in fiscal year 2013 to more than 456 million Web page visits, customer satisfaction with the Web site has actually declined.

According to the American Customer Satisfaction Index (ACSI), the score for IRS.gov has steadily ebbed, from 73 in 2011 to 69 in 2013. IRS.gov also received lower scores than those of other Federal Web sites overall and those of Internet-based retail and brokerage companies; another downward trend suggesting the IRS is not keeping pace with online advances achieved by the Federal Government and the private sector.

The Board also heard from the annual *Taxpayer Attitude Survey* and its listening sessions at the IRS Nationwide Tax Forums that taxpayers, employees and practitioners are frustrated they can't communicate and conduct more transactions electronically with the IRS.

Given these factors, the Board believes it is critical to fund the IRS so it can deliver a higher level of service to taxpayers who need its assistance in complying with an increasingly complex tax code. Underfunding this critical function endangers not only the IRS' mission, but could ultimately imperil voluntary compliance.

The Oversight Board believes that the President's budget will help provide the resources to bring IRS customer service back to a level where it can meet taxpayer needs and expectations both today and in an ever changing and challenging tax environment.

The President's budget request would provide a total of $211 million for customer service, including resources from the new *Opportunity, Growth and Security Initiative*. This will allow the IRS not only to make up for the lost ground in customer service but will allow the IRS to answer an additional 12 million phone calls from taxpayers seeking answers to their tax law and account questions. This includes a projected high number of calls from taxpayers related to implementation of the *Affordable Care Act*. Overall telephone level of service could rise from today's unacceptable 60.5 percent to exceeding the aforementioned 80 percent goal set by the Board.

The request also includes investments in advanced technology and communications infrastructure at IRS toll-free telephone centers. One welcomed initiative would give taxpayers the option to be called back rather than waiting on hold. Another, dealing with high-speed Internet connection would allow customer service representatives to call up immediately displays of taxpayer information, much as a bank or brokerage house could do.

ENFORCEMENT

To achieve its balanced mission and help ensure overall compliance across taxpayer groups and income brackets, the IRS must run a fair yet vigorous enforcement program. According to the Board's 2013 *Taxpayer Attitude Survey*, approximately 96 percent of respondents cite personal integrity as the main reason for honestly reporting and paying what they legally owe. However, 60 percent also cited the fear of an audit as a reason behind their compliance.

Our tax system is based on self-assessment, also known as voluntary compliance. It depends largely on honest taxpayers believing their neighbors and business competitors are playing by the rules and not trying to game the system. The integrity of our tax administration system would be seriously threatened if compliant taxpayers thought tax cheats were getting away with their crimes.

That is why it is so important to maintain reasonable audit coverage for all taxpayer income classes and to create initiatives, such as the Offshore Voluntary Disclosure Program (OVDP), which act as strong incentives for bringing taxpayers into full compliance with Internal Revenue laws.

Moreover, although the overwhelming majority of gross revenue collected by the IRS comes in voluntarily—through withholding and estimated tax payments, for example—it is important that we do not discount the importance of enforcement revenue. It can help reduce budget deficits and narrow the tax gap.

Enforcement revenue totaled $53.3 billion in fiscal year 2013, and since its inception in 2009, OVDP has brought in $6.5 billion in back taxes, penalties and interest. It also bears noting that there is a high return of investment for enforcement activities. Every dollar invested in IRS enforcement returns four dollars and as much as six dollars and higher for some initiatives. Every dollar not provided for enforcement initiatives means tax evasion grows, refund fraud persists, and the tax gap widens.

However, IRS enforcement has taken some heavy budget blows over the past 3 years. By the end of 2013, the number of revenue officers was the lowest in at least 10 years; the number of revenue agents was the lowest in 9 years. Overall, there has been a 14 percent decline in key enforcement personnel since 2010.

While audits of individuals topped one million for the 7th year in a row, that figure can be misleading. The overall coverage rate fell below 1 percent for the first time since fiscal year 2006. And the audit coverage rate for taxpayers in the highest income bracket—$1 million and higher—showed a steady 13 percent decline since 2011. Tax refund fraud, particularly as it relates to identity theft remains a major challenge for the IRS and the honest taxpayers who have been victimized. In 2013, the IRS identified over 3.5 million identity theft "incidents" as compared 247,000 in 2011.

The President's fiscal year 2015 budget request contains a suite of proposed enforcement initiatives that aggressively address many of these challenges. The initiatives are expected to generate almost $2.1 billion in additional enforcement revenue annually once the new hires reach their full potential in fiscal year 2017. Some of the more prominent programs include:

—*Address International and Offshore Compliance*.—This initiative would help the IRS to ramp up its efforts to identity U.S. taxpayers not disclosing money and assets in bank secrecy jurisdictions. In addition to increasing criminal investigations of international and financial crimes, the additional funding will allow the IRS to expand data and information gathering that will help the agency root out the promoters of these abusive tax avoidance schemes.

—*Expand Audit Coverage of Individuals*.—Audit coverage for individuals now hovers below 1 percent for the first time since fiscal year 2006. The funding would help reverse the drain of key enforcement personnel, including revenue agents, and allow the IRS to perform an estimated 243,000 additional individual examination cases, including correspondence audits. It would also allow for greater document matching to uncover unreported or misreported income.

—*Expand Audit Coverage of High-Wealth Taxpayers and Enterprises*.—Many of these global high net-worth taxpayers are not your typical filers. Some use a web of highly sophisticated and complex financial and cross border tax arrangements. Many of these arrangements are perfectly legal; others hide abusive tax avoidance schemes. The IRS projects that the additional funding will allow it to close an additional 325 of these cases.

—*Prevent Tax-Related Identity Theft and Refund Fraud*.—The additional funding will help the IRS address the increased workload associated with ID theft and tax refund fraud and bring down the ID theft case backlog. The IRS will be able to better assist victims while protecting the revenue through investing in new technology that will help verify potentially fraudulent returns and reduce erroneous payments.

—*Improve Audit Coverage of Partnerships and Flow-Through Entities*.—According to the IRS, partnerships are the fastest growing segment of all tax returns filed. One of the reasons is that many taxpayers believe they can escape audits by choosing to operate as large, widely-held partnerships. The additional funding will allow the IRS to hire examiners with specialized knowledge in partnerships and close an additional 2,800 cases.

—*Enhance Collection Coverage*.—The President's budget would provide additional funding so the IRS can hire new staff, primarily revenue officers, to collect back taxes owed. With these resources, the IRS also wants to reach out taxpayers earlier in the collection process. The IRS projects that it will be able to close an additional 244,000 collection cases. The collection initiative will also provide additional funding to hire the staff to deal with the increasing number of cases involving unpaid employment taxes.

—*Enhance Return Preparer Compliance*.—The President's budget contains a legislative proposal that would explicitly authorize the IRS to regulate all paid tax return preparers, thereby dealing with the legal objections that formed the basis of the *Loving v. IRS* decision. However, while awaiting congressional action on the proposal, the fiscal year 2015 budget request contains additional funding to bolster audits of return preparers and increase monitoring and pursuit of unscrupulous preparers engaged in fraudulent activities, including filing false EITC claims for their clients.

HUMAN CAPITAL AND BUSINESS SYSTEMS MODERNIZATION (BSM)/IT

Human Capital

The IRS confronts a number of serious human capital issues. Commissioner Koskinen has remarked on numerous occasions that he must not only rebuild public trust in the agency, but also employee morale which has suffered greatly over the past 3 years. The *Best Places to Work in Government* survey of Federal employees reported an almost eight point drop for the IRS between 2012 and 2013—from 66 to 54.3.

The decline in morale is due to a number of factors, some of which are directly related to lean budgets and the sequestration, such as the furloughs, exception-only hiring freeze, increased workload, and drastic reductions in training. The Board thought the cuts to training budgets were extreme and unwarranted.

Last year's heated 501(c)(4) tax exempt controversy also took a heavy toll on employee morale. Although it actually involved very few employees, the entire workforce felt it was being blamed and under fire. Employees told the Board at its listening sessions at the Nationwide Tax Forums that they were subject to disparaging remarks by taxpayers, and in some instances, felt physically threatened.

The cuts in training were a major issue for IRS employees, practitioners, and ultimately taxpayers. According to the National Taxpayer Advocate's *2013 Annual Report to Congress*, the IRS training budget was cut by more than 85 percent from fiscal year 2009 to fiscal year 2013. In 2013, less than $250 was spent per-employee on training versus $1,450 in 2009. In some divisions, the training budget cuts were staggering. The Small Business/Self Employed operating division saw its training budget cut by 93 percent over the same timeframe; Appeals was cut by 96 percent.

With travel-related training virtually non-existent, many employees are left with no other option than online training. Managers and employees told the Board at the Nationwide Tax Forums that this new approach to training is not working well for most people.

Many employees felt rushed to complete their online training in light of the increased and more complex workload. Some said that they had not received the training needed to do their jobs; others expressed concern about the quality of the training. They said that new hires especially need face-to-face training; classroom work is critical to their success, as is mentoring.

Employees also said they have limited opportunities to learn from one another and there is no peer networking. Without travel funding, teams of IRS employees working together across operating divisions may never meet each other and managers may not see their subordinates.

The Board is deeply concerned by the state of training at the IRS. The IRS simply cannot build a highly talented, knowledgeable and proficient workforce without quality training; nor can it achieve its strategic goals. Inadequate training means that employees cannot provide quality service for both taxpayers and practitioners, or compete with well-financed tax professionals in adversarial proceedings. The President's budget allows the IRS to invest once again in training. The agency must take full advantage of it.

BSM/IT

The IRS Business Systems Modernization program is a major area of concern, and one which the Government Accountability Office (GAO) placed on its "high-risk" list for almost two decades. However, the GAO recently removed BSM from the list, noting the progress the IRS made in addressing significant IT weaknesses.

The successful delivery of the initial phase of CADE2 and plans for the second phase to address financial material weaknesses involving unpaid tax assessments were cited as reasons behind GAO's actions.

Another major IT milestone occurred in 2014 when the Form 1040 Modernized e-file (MeF) system received and processed 100 percent of individual e-filed returns, enabling the IRS to retire the legacy e-file system.

However, in spite of these and other IT successes, Commissioner Koskinen warned in testimony before the House Appropriations Subcommittee on Financial Services and General Government that fiscal year 2014 funding is inadequate "to address critical technology infrastructure needs." These include improvements to IRS.gov, new tools to combat identity theft, and upgrades to IRS basic computer software.

The Board supports the President's budget request for BSM because it provides a solid commitment to build and deploy IT systems to improve efficiency, enhance productivity, and better serve taxpayers. For example, it would continue the expansion of CADE2 and begin the development of Form 1040X (*Amended U.S. Individual Income Tax Return*) so it can be accepted and processed electronically.

In 2014, the IRS moved the Return Review Program (RRP) and Office of Online Services (OLS) under BSM. Aimed at detecting and preventing tax refund fraud, and using cutting edge technology and data analytics, RRP is one of most promising programs in the IRS' compliance toolbox. The President's budget request would allow BSM to fully develop and deploy RRP and enable the retirement of the outmoded Electronic Fraud Detection System (EFDS).

The President's budget would also allow the development of OLS projects that will build on existing service capabilities to improve the taxpayer's online experience, provide secure digital communications, and add more interactive capabilities to existing self-serve options.

CONCLUSION

The IRS Oversight Board believes that attempting to punish the IRS for past mistakes only hurts taxpayers and the integrity of our tax administration. With significant risk management tools and safeguards now in place, it is time to move beyond controversy to collaboration and consensus. All interested parties must work together and take steps together to give the IRS the resources it needs to carry out at an acceptable level its balanced mission of customer service and enforcement. In this regard, the Oversight Board strongly supports the President's fiscal year 2015 budget request for the IRS. It is forward thinking and reverses years of shortsighted budget cuts to the IRS and puts it on a path of stable funding and continuous improvement. We thank the subcommittee for this opportunity to present our views and recommendations.

PREPARED STATEMENT OF THE GOVERNMENT ACCOUNTABILITY OFFICE

APRIL 21, 2014.

Hon. RON WYDEN, *Chairman,*
Hon. ORRIN HATCH, *Ranking Member,*
Committee on Finance, U.S. Senate, Washington, DC.

Hon. TOM UDALL, *Chairman,*
Hon. MIKE JOHANNS, *Ranking Member,*
Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate, Washington, DC.

Hon. CHARLES W. BOUSTANY, JR., *Chairman,*
Hon. JOHN LEWIS, *Ranking Member,*
Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Washington, DC.

INTERNAL REVENUE SERVICE: ABSORBING BUDGET CUTS HAS RESULTED IN SIGNIFICANT STAFFING DECLINES AND UNEVEN PERFORMANCE

This letter transmits briefing slides based on our work to date in response to your requests for information on our ongoing reviews of the 2014 tax filing season and fiscal year 2015 budget request for the Internal Revenue Service (IRS). See the enclosed briefing slides that include the information used to brief your staff on April 10, 2014. We subsequently updated the briefing slides to reflect more current information.

Our briefing objectives were to (1) analyze IRS funding, staffing, and performance trends for fiscal years 2009 through 2014, including an assessment of IRS's 2014 filing season to date; (2) describe IRS's fiscal year 2015 budget request and workload; and (3) describe IRS's actions to absorb budget cuts and cite opportunities that could help IRS more strategically manage operations.

To conduct this work, we analyzed funding, staffing, and performance trends, including the 2014 filing season to date, and summarized the President's budget requests for IRS from fiscal years 2009 through 2014. We analyzed the fiscal year 2015 justification and other IRS data, including performance data for key IRS operations and full-time equivalents (FTE) for priority programs. We reviewed our prior work and interviewed IRS officials in the Office of the Chief Financial Officer and the Information Technology organization, the National Taxpayer Advocate, and representatives from tax preparation firms.

We conducted this performance audit from January to April 2014 in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We interviewed IRS officials and determined that the data presented in this report were sufficiently reliable for our purposes.

In summary, we found:

—IRS's appropriations have declined to below fiscal year 2009 levels and FTEs have been reduced by about 8,000 since fiscal year 2009. Planned performance in enforcement and taxpayer service has decreased or fluctuated; for example, in the fiscal year 2014 congressional justification the audit coverage target for individual examinations was 1.0 percent for fiscal year 2014, however, the target was lowered to 0.8 percent in the fiscal year 2015 congressional justification. Amidst lower demand, IRS's telephone level of service performance (the percentage of callers seeking live assistance and receiving it) was 73 percent from January 1 through March 15, 2014 compared to 69 percent during the same period last year. However, between fiscal years 2009 and 2013, IRS's telephone level of service fluctuated between 61 percent and 74 percent. Average wait times have almost doubled since fiscal year 2009—from 8.8 minutes to 16.8 minutes as of mid-March 2014.

—Not including other budgetary resources such as user fees, the fiscal year 2015 budget request for IRS is $12.5 billion, which is an increase of 10.5 percent ($1.2 billion) in funding and 8.3 percent in staffing (6,998 FTEs) over fiscal year 2014. According to the President's budget, of the requested $1.2 billion, $480 million is predicated on a cap adjustment—funding above the discretionary spending limit—and largely covers enforcement and infrastructure initiatives. IRS's workload has increased as a result of legislative mandates and priority programs, such as work related to the Patient Protection and Affordable Care Act and identity theft.

—IRS has absorbed approximately $900 million in budget cuts since fiscal year 2010 through savings and efficiencies and by reducing, delaying, or eliminating services. For example, IRS delayed two information technology projects (Information Reporting and Document Matching and Return Review Program) and substantially reduced employee training. To help improve operations, the President requested a large budget increase for IRS in fiscal year 2015. However, additional funding is not the only solution. We have open recommendations on IRS's operations that may help it achieve efficiencies over time, such as developing a long-term plan to improve Web services.

AGENCY COMMENTS

On April 16, 2014, IRS provided technical comments on our findings, which we have incorporated where appropriate.

We plan to send copies of this report to the Chairman and ranking members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. We are also sending copies to the Commissioner of Internal Revenue, the Secretary of the Treasury, and the Chairman of the IRS Oversight Board. The report is available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staffs have any questions about this report, please contact us at (202) 512–9110 or mctiguej@gao.gov or whitej@gao.gov. Contact points for our offices of Congressional Relations and Public Affairs are on the last page of this report. GAO staff members who made major contributions to this report were Libby Mixon, Assistant Director, and Joanna Stamatiades, Assistant Director, and Jehan Chase, Pawnee A. Davis, Mary Evans, Charles Fox, Suzanne Heimbach, LaKeshia Allen Horner, Natalie Maddox, Paul Middleton, Ed Nannenhorn, Sabine Paul, Amy Radovich, Mark Ryan, Erinn L. Sauer, Cynthia Saunders, and Tamara Stenzel.

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Enclosure—1

ENCLOSURE: BRIEFING SLIDES

INTERNAL REVENUE SERVICE: ABSORBING BUDGET CUTS HAS RESULTED IN SIGNIFICANT STAFFING DECLINES AND UNEVEN PERFORMANCE

Prepared for Congressional Committees
April 10, 2014
(Updated April 18, 2014)

OBJECTIVES

Our objectives are to provide interim information on the Internal Review Service's (IRS) fiscal year 2015 budget request and its 2014 filing season performance. This briefing:

—analyzes IRS funding, staffing, and performance trends for fiscal years 2009 through 2014, including an assessment of IRS's 2014 filing season to date;
—describes IRS's fiscal year 2015 budget request and workload; and
—describes IRS's actions to absorb budget cuts and cites opportunities that could help IRS more strategically manage operations.

SCOPE AND METHODOLOGY

—To analyze funding, staffing, and performance trends, including the 2014 filing season, we summarized the President's budgets and IRS's congressional justifications (CJ) from fiscal years 2009 through 2014, and interviewed IRS officials in the Office of the Chief Financial Officer (CFO); analyzed IRS data including full-time equivalents (FTE) and performance data for key IRS operations; and interviewed IRS officials and other stakeholders such as representatives from tax preparation firms on filing season performance and challenges.
—To describe IRS's fiscal year 2015 budget request and workloads, we reviewed the fiscal year 2015 CJ and other budget documents; analyzed FTE data on IRS identified priority programs; and interviewed officials from IRS's Offices of Corporate Budget and the National Taxpayer Advocate.
—To describe IRS's actions to absorb budget cuts and cite opportunities for IRS to more strategically manage operations, we reviewed Office of Management and Budget (OMB) and Department of Treasury guidance on sequestration; interviewed officials from IRS's Office of the CFO and Information Technology organization; and reviewed our prior work.

We conducted this performance audit from January to April 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We interviewed IRS officials and determined that the data presented in this briefing were sufficiently reliable for our purposes.

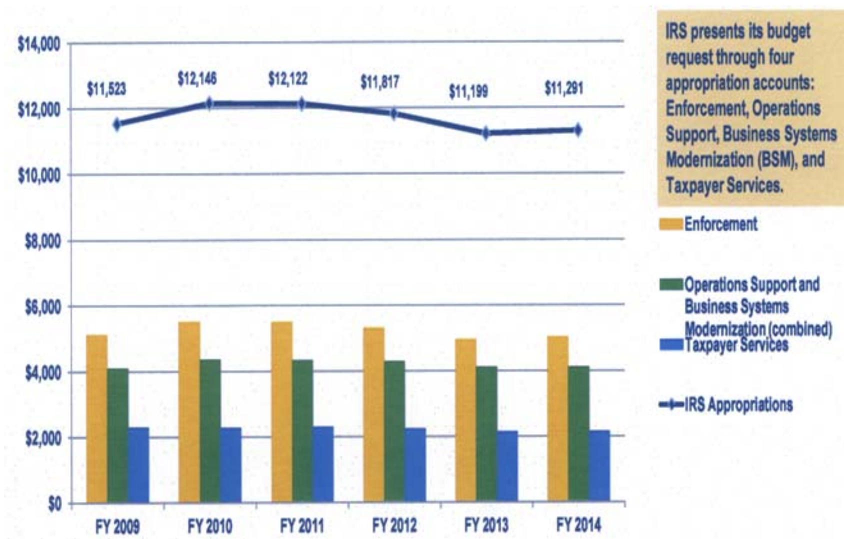
RESULTS IN BRIEF

—IRS's appropriations have declined to below fiscal year 2009 levels. IRS FTEs have been reduced by about 8,000 FTEs since fiscal year 2009. Performance in enforcement and taxpayer service has decreased or fluctuated. IRS is providing a better level of telephone service in 2014 amidst lower demand.
—Not including other budgetary resources such as user fees, the fiscal year 2015 budget request for IRS is $12.5 billion, which is an increase of 10.5 percent ($1.2 billion) in funding and 8.3 percent in staffing (6.998 FTEs) over fiscal year 2014. IRS's workload is dedicated to legislative mandates and priority programs.
—IRS has absorbed budget cuts through savings and efficiencies and by reducing, delaying, and eliminating some services. To improve operations, IRS has requested a large budget increase for 2015. However, additional funding is not the only solution for IRS. We have open recommendations that may help IRS to more effectively manage its operations and achieve some savings over time.

FUNDING TRENDS: IRS'S APPROPRIATIONS HAVE DECLINED TO BELOW FISCAL YEAR 2009 LEVELS

Figure 1: IRS's Appropriations, Fiscal Years 2009 Through 2014

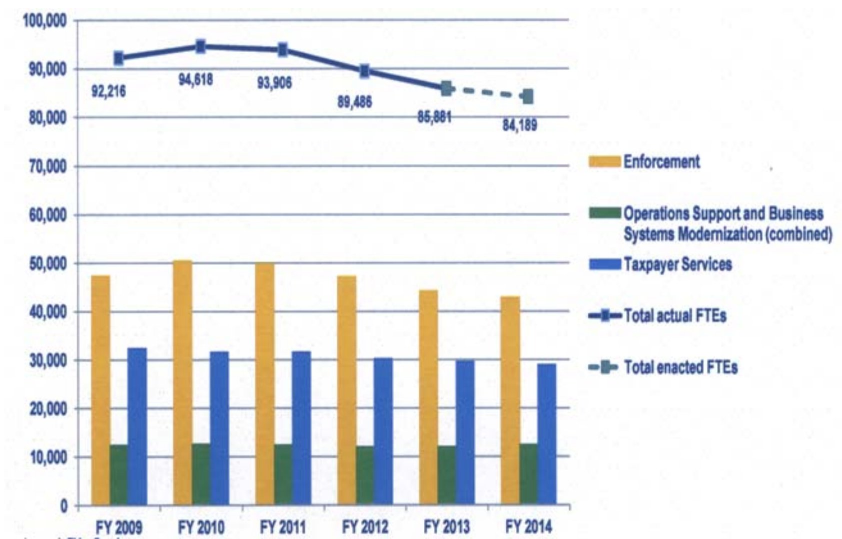
(Dollars in Millions)



Legend: FY = fiscal year.
Source: Fiscal years 2009 through 2014 congressional justification for IRS.
Notes: The fiscal year 2013 levels represent an across the board rescission and reductions required by sequestration. In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million). Amounts shown do not include other budgetary resources, such as user fees.
See appendix I for more information on IRS budget trends, including other budgetary resources.

STAFFING TRENDS: IRS HAS REDUCED FTES BY ABOUT 8,000 (9 PERCENT) SINCE FISCAL YEAR 2009

Figure 2: IRS Full-Time Equivalents (FTE) Funded Through Appropriations, Fiscal Years 2009 Through 2013 Actual and Fiscal Year 2014 Enacted



Legend: FY = fiscal year.

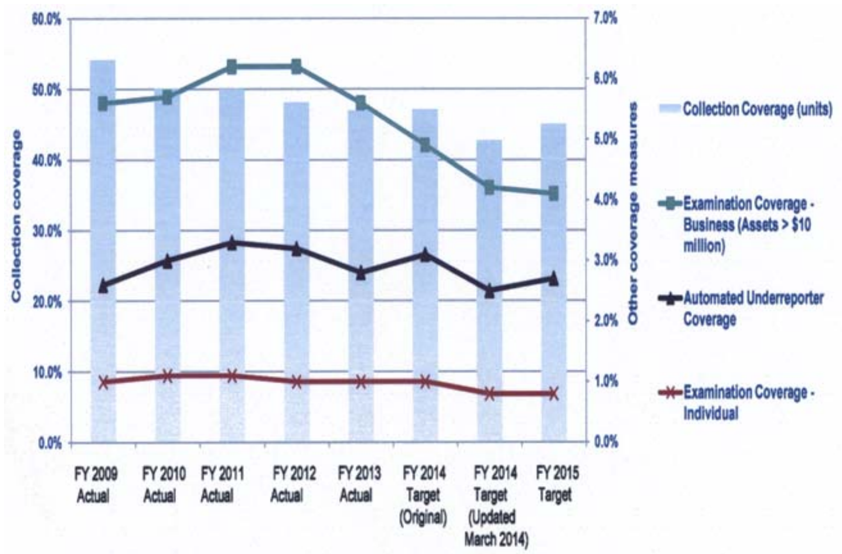
Source: Fiscal years 2009 through 2014 congressional justification for IRS.

Notes: The fiscal year 2013 level represents an across-the-board rescission and reductions required by sequestration. In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million). Amounts shown do not include FTEs funded with other budgetary resources, such as user fees.

See appendix II for more information on IRS budget trends, including other budgetary resources.

PERFORMANCE TRENDS: RETURN EXAMINATION AND COLLECTION COVERAGE MEASURES SHOW DECLINE

Figure 3: IRS Return Examination and Collection Coverage Measures, Fiscal Years 2009 Through 2013 Actual and Fiscal Year 2014 and 2015 Targets



Source: GAO analysis of fiscal years 2009 through 2014 congressional justification for IRS.
For more information on coverage measures, see appendix III.

PERFORMANCE TRENDS: ELECTRONIC FILING CONTINUES TO INCREASE IN 2014

Table 1: Tax Returns Processed, 2009 Through 2014 Filing Seasons (in Thousands)

	2009	2010	2011	2012	2013	2014	Percentage change from 2013 to 2014
Number of individual tax returns processed	89,215	85,210	87,595	96,556	93,103	98,170	5.4
Electronic	70,705	71,153	76,664	85,904	84,443	90,333	7
Paper	18,510	14,057	10,932	10,653	8,660	7,837	−9.5
Percentage electronically filed [a]	79.3	83.5	87.5	89.0	90.7	92.0	n/a
Free File [b]	2,416	2,498	2,344	2,431	2,337	2,573	10.1
Number of refunds issued (millions)	77.7	74.1	75.2	80.4	77.8	78.8	1.2
Amount of refunds (billions)	$210.2	$219.4	$219.8	$224.7	$214.5	$219.9	2.5

Legend: n/a = not applicable.
Source: GAO analysis of IRS data.
Notes: Unless otherwise noted, data are from January 1 of each year through April 3, 2009; April 2, 2010; April 1, 2011; April 6, 2012; April 5, 2013; and April 4, 2014. Numbers may not add due to rounding.

[a] The percentage of returns filed electronically early in the filing season is likely to decline before the filing season is over. Taxpayers filed about 84 percent of all individual returns electronically in 2013. The numbers for electronic filing that we are reporting are for returns processed versus returns received.

[b] IRS offers Free File software for eligible taxpayers to prepare and e-file their federal tax returns online for free at IRS.gov. Free File 2013 and 2014 data are from January 1 through April 8, 2013 and April 7, 2014.

PERFORMANCE TRENDS: IRS IS PROVIDING BETTER TELEPHONE SERVICE IN 2014 AMIDST LOWER DEMAND WHICH IRS ATTRIBUTES IN PART TO FEWER TAX LAW CHANGES

Table 2: Interim IRS Call Volume, Level of Service, and Average Wait Times, 2009 Through 2014 Filing Seasons

	Interim Filing Season [a]					Truncated Interim Filing Season		
	2009	2010	2011	2012	2013	2013 (March 16)	2014 (March 15)	Percent change from March 2013 to March 2014 [b]
CALL VOLUME (IN MILLIONS)								
Total calls to IRS [c]	52.4	48.7	53.3	65.1	59.0	51.1	39.6	−23
Automated calls answered	19.6	23.1	26.8	36.4	32.4	28.7	21.5	−25
Assistor answered calls	14.9	12.6	12.8	10.6	11.2	9.3	6.7	−28
Abandoned, busies, and disconnects	17.9	13.0	13.7	18.1	15.4	13.1	11.5	−13
ACCESS MEASURES								
Level of Service (LOS)—Percentage of callers seeking live assistance who receive it	64	75	75	68	69	69	73	7
Average wait time (in minutes)	8.8	9.9	9.7	15.9	13.8	13.7	12.4	−9

Source: GAO analysis of IRS data.

[a] Unless otherwise noted, data for filing season to date are cumulative for IRS from January 1 of each year to April 4, 2009; April 3, 2010; April 2, 2011; March 31, 2012; and March 30, 2013. Because of time lags in data reporting, to compare this year to last, we used data from January 1 of each year to March 16, 2013, and March 15, 2014, for the truncated interim filing season column.

[b] The numbers in the table are rounded, but the percent change was calculated using exact values.

[c] The numbers in the table include the total automated, assistor answered, abandoned, busy and disconnected account calls, taxpayer account-related and tax law calls, but do not reflect the total number of attempted calls to IRS, nor do they represent total call volume to all IRS functions such as enforcement.

PERFORMANCE TRENDS: IRS IS PROVIDING BETTER TELEPHONE SERVICE IN 2014 AMIDST LOWER DEMAND WHICH IRS ATTRIBUTES IN PART TO FEWER TAX LAW CHANGES (CONTINUED)

Table 3: IRS Key Telephone Actual Performance Compared to its Goals, Fiscal Years 2009 Through 2014

		Fiscal Year (October 1 through September 30) [a]					
		2009	2010	2011	2012	2013	2014
Level of Service (LOS)—Percentage of callers seeking live assistance who receive it	Goal	[b] 77	71	71	61	70	61
	Actual	70	74	70	68	61	[c] 67
Average wait time (in minutes)	Goal	10.4	11.6	11.6	19	14.6	22.0
	Actual	8.8	10.8	13.0	16.7	17.6	[c] 16.8

Source: GAO analysis of IRS data.

[a] Unless otherwise noted, the goals listed are for the entire fiscal year.

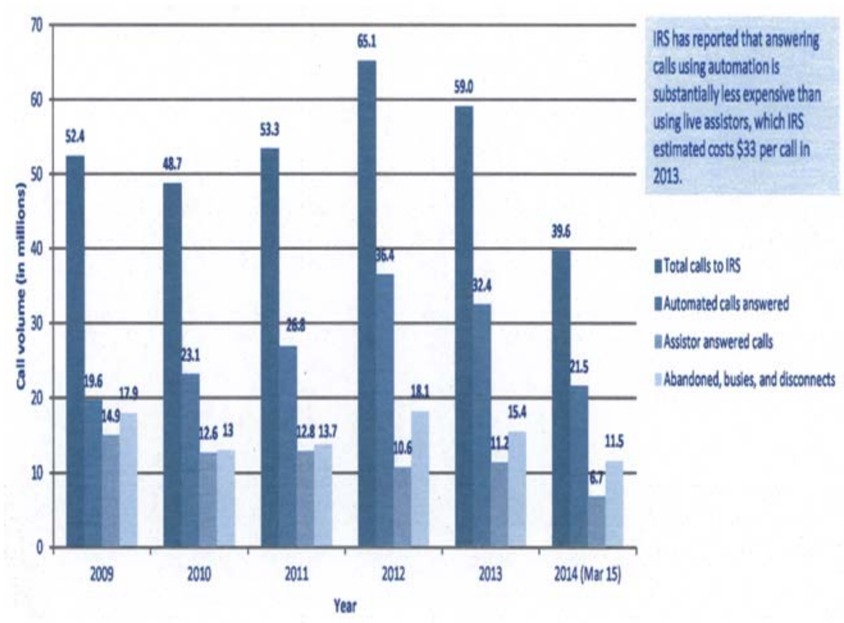
[b] IRS revised its original fiscal year goal of 77 percent down to 70 percent because of high call volume from taxpayers requesting electronic filing authentication information and asking stimulus-related questions.

[c] Unlike the level of service and wait time information reported in Table 2 for 2014, which is from January 1 through March 15, 2014, the corresponding data shown for 2014 in this table are fiscal year to date—October 1, 2013, through March 15, 2014.

PERFORMANCE TRENDS: IRS CONTINUES TO ANSWER MORE AUTOMATED THAN ASSISTOR ANSWERED CALLS IN 2014

(NOTE: Data for Figure 4 is in chart and table format.)

Figure 4: IRS Call Volume (in millions), 2009 Through 2014 Filing Seasons



Source: GAO analysis of IRS data.

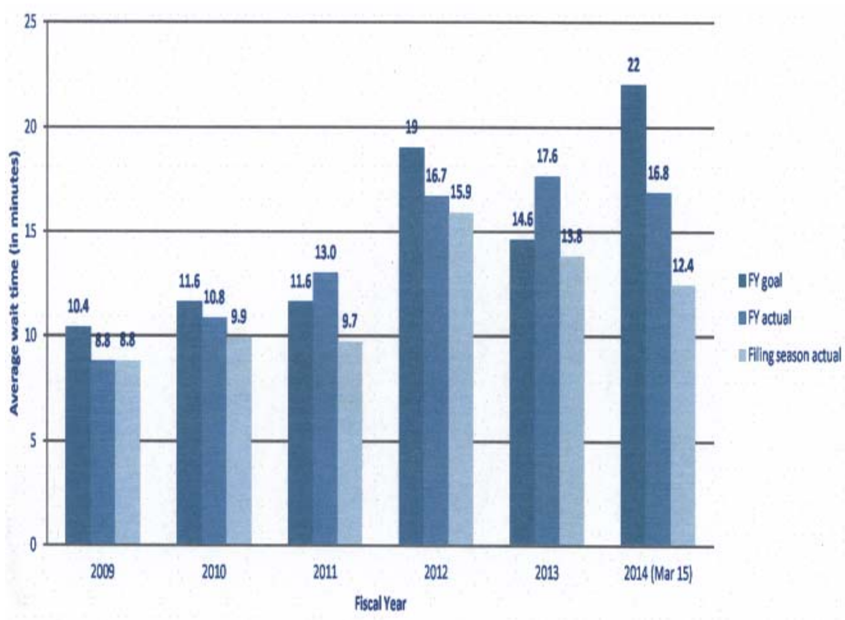
Notes: Unless otherwise noted, data are cumulative for IRS from January 1 of each year to April 4, 2009; April 3, 2010: April 2, 2011; March 31, 2012; and March 30, 2013. For 2014, data are from January 1 through March 15, 2014. The numbers in the graphic include the total automated, assistor answered, abandoned, busy and disconnected taxpayer account-related and tax law calls, but do not reflect the total number of attempted calls to IRS, nor do they represent total call volume to all IRS functions such as enforcement.

Year	Total calls to IRS	Automated calls answered	Assistor answered calls	Abandoned, busies, and disconnects
IRS has reported that answering calls using automation is substantially less expensive than using live assistors, which IRS estimated costs $33 per call in 2013.				
2009	52.4	19.6	14.9	17.9
2010	48.7	23.1	12.6	13
2011	53.3	26.8	12.8	13.7
2012	65.1	36.4	10.6	18.1
2013	59.0	32.4	11.2	15.4
2014 (March 15)	39.6	21.5	6.7	11.5

PERFORMANCE TRENDS: AVERAGE WAIT TIMES HAVE GENERALLY INCREASED SINCE 2009

(NOTE: Data for Figure 5 is in chart and table format.)

Figure 5: Average Wait Time (in minutes), Fiscal Years 2009 Through 2014



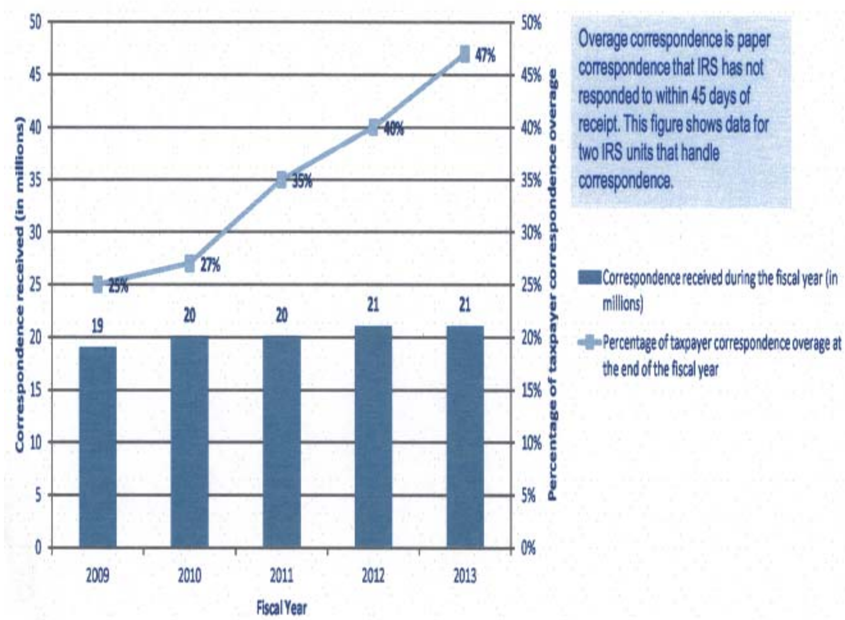
Legend: FY = fiscal year.
Source: GAO analysis of IRS data.
Notes: Unless otherwise noted, data are cumulative for IRS from January 1 of each year to April 4, 2009; April 3, 2010; April 2, 2011; March 31, 2012; and March 30, 2013. For 2014, data are from January 1 through March 15, 2014.

Fiscal year	Fiscal year goal	Fiscal year actual	Filing season actual
2009	10.4	8.8	8.8
2010	11.6	10.8	9.9
2011	11.6	13.0	9.7
2012	19	16.7	15.9
2013	14.6	17.6	13.8
2014 (March 15)	22	16.8	12.4

PERFORMANCE TRENDS: OVERAGE CORRESPONDENCE HAS INCREASED SIGNIFICANTLY SINCE 2009

(NOTE: Data for Figure 6 is in chart and table format.)

Figure 6: IRS Taxpayer Correspondence Performance, Fiscal Years 2009 Through 2013



Source: GAO analysis of IRS data.

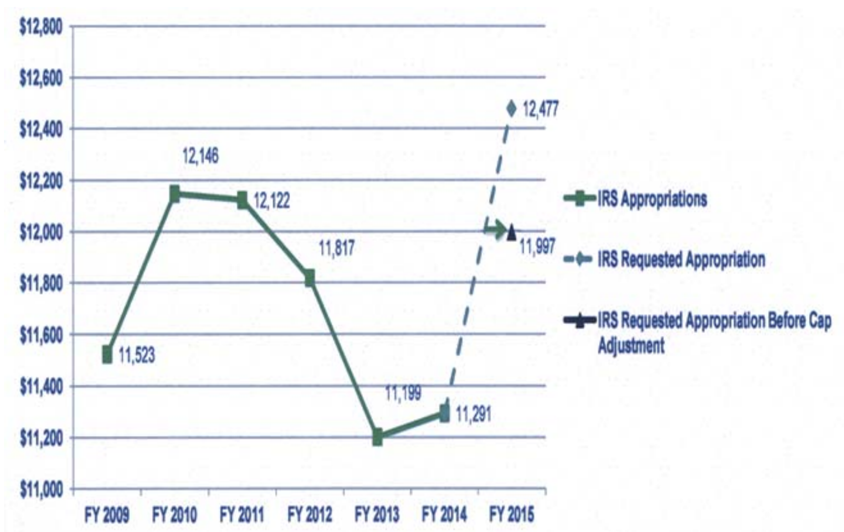
Notes: Aggregate data are from two IRS units that jointly handle taxpayer correspondence. The same employees that provide telephone service are also responsible for responding to correspondence from taxpayers. Data cover equivalent periods for each fiscal year with slight variation in the exact dates depending on the year and data source.

Fiscal year	Correspondence received during the fiscal year (in millions)	Percentage of taxpayer correspondence overage at the end of the fiscal year
Overage correspondence is paper correspondence that IRS has not responded to within 45 days of receipt. This figure shows data for two IRS units that handle correspondence.		
2009	19	25
2010	20	27
2011	20	35
2012	21	40
2013	21	47

FISCAL YEAR 2015 REQUEST: IRS IS REQUESTING $12.5 BILLION IN APPROPRIATIONS, AN INCREASE OF 10.5 PERCENT ($1.2 BILLION) OVER FISCAL YEAR 2014

Figure 7: IRS Enacted Appropriations, Fiscal Year 2009 through 2014, and Fiscal Year 2015 Request

(Dollars in millions)



Legend: FY = fiscal year.

Source: Fiscal years 2009 through 2015 congressional justifications for IRS.

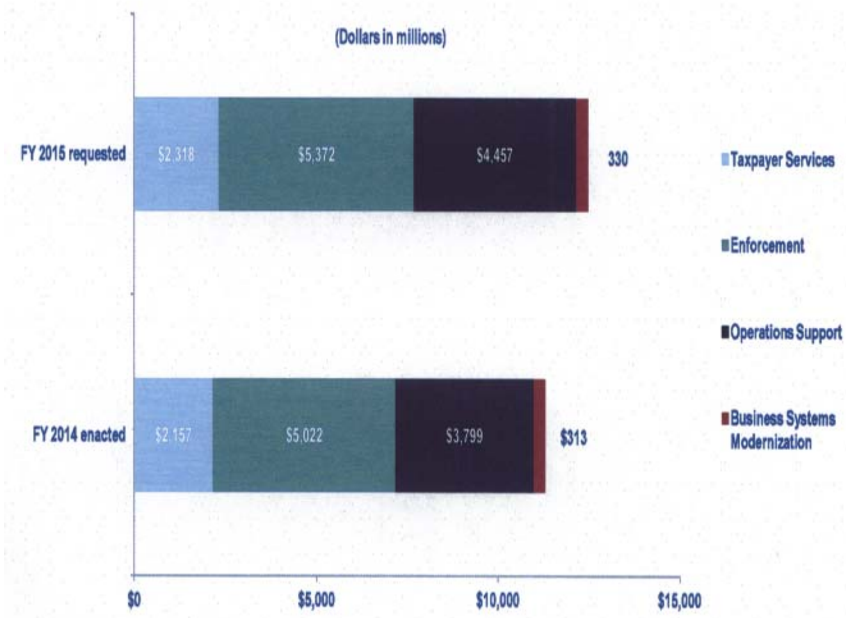
Notes: Fiscal year 2013 levels represent an across-the-board rescission and reductions required by sequestration. In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million). Amounts shown do not include other budgetary resources, such as user fees.

See appendix I for more information on the fiscal year 2015 budget request for IRS, including other budgetary resources.

FISCAL YEAR 2015 REQUEST: IRS'S LARGEST REQUESTED INCREASE IS $658 MILLION FOR OPERATIONS SUPPORT [1]

(NOTE: Data for Figure 8 is in chart and table format.)

Figure 8: Fiscal Year 2015 Budget Request by Appropriation Compared to Fiscal Year 2014 Enacted Appropriation for IRS



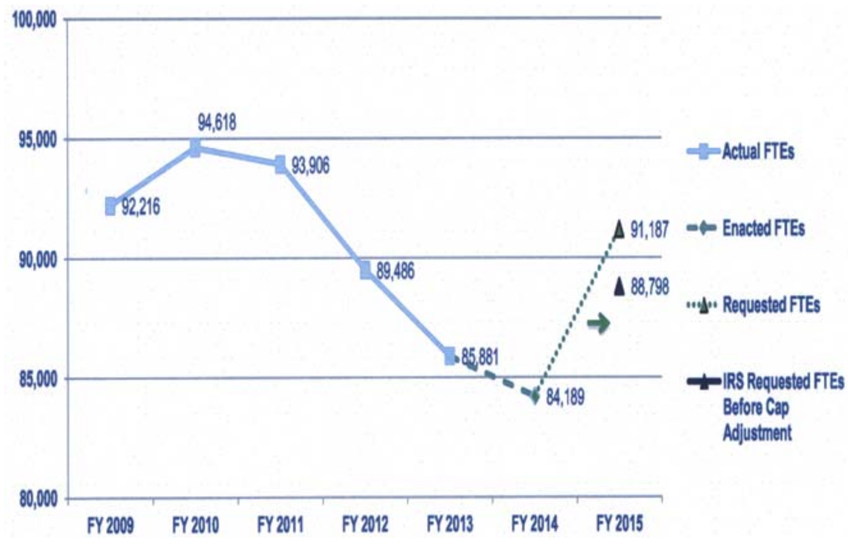
Legend: FY = fiscal year.
Source: Fiscal years 2014 through 2015 congressional justifications for IRS.
Notes: Request includes 22 program initiatives totaling more than $1.1 billion (see appendixes IV through VIII). Amounts shown do not include other budgetary resources, such as user fees.
[1] Operations Support includes IRS's information systems and overall planning, direction, and support for the IRS.
See appendix I for more information on IRS budget trends, including other budgetary resources.

(Dollars in millions)

	Fiscal year 2015 requested	Fiscal year 2014 enacted
Taxpayer Services	2,318	2,157
Enforcement	5,372	5,022
Operations Support	4,457	3,799
Business Systems Modernization	330	313
Totals	12,477	11,291

FISCAL YEAR 2015 REQUEST: IRS PROPOSED INCREASING STAFFING TO ABOUT FISCAL YEAR 2012 LEVELS

Figure 9: IRS Full-Time Equivalents Funded Through Appropriations, Fiscal Years 2009 Through 2013 Actual, 2014 Enacted, and 2015 Request

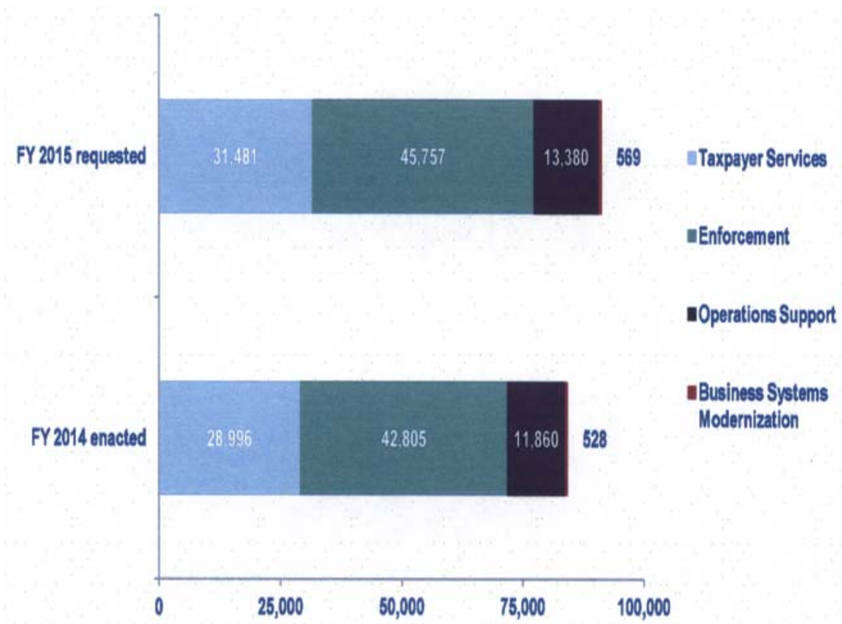


Legend: FY = fiscal year. FTE = full-time equivalent.
Source: Fiscal years 2009 through 2015 congressional justification for IRS.
Notes: Fiscal year 2013 levels represent the across-the-board rescission and reductions required by sequestration. In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million). Amounts shown do not include FTEs funded with other budgetary resources, such as user fees. The FY 2015 initiatives were developed with most FTE costed assuming a January 1 hire date.
See sppendix II for more information for FTEs in the Fiscal Year 2015 budget request for IRS, including other budgetary resources.

FISCAL YEAR 2015 REQUEST: THE LARGEST STAFFING INCREASE IS ABOUT 3,000 FTES FOR ENFORCEMENT

(NOTE: Data for Figure 10 is in chart and table format.)

Figure 10: Fiscal Year 2015 Full-Time Equivalents, Budget Request by Appropriation Compared to Fiscal Year 2014 Enacted Appropriation for IRS



Legend: FY = fiscal year.
Source: Fiscal years 2015 congressional justification for IRS.
Notes: The FY 2015 initiatives were developed with most FTE costed assuming a January 1 hire data.
See appendix II for more information on FTEs in the fiscal year 2015 budget request for IRS, including other budgetary resources.

	Fiscal year 2015 requested	Fiscal year 2014 enacted
Taxpayer Services	31,481	28,996
Enforcement	45,757	42,805
Operations Support	13,380	11,860
Business Systems Modernization	569	528
Totals	91,187	84,189

WORKLOAD: STAFF DEDICATED TO LEGISLATIVE MANDATES AND PRIORITY PROGRAMS

Table 4: Full-Time Equivalents to Implement New Laws and Priority Programs, Fiscal Years 2013 Actual, 2014 Planned, and 2015 Requested

Legislative Mandate/Priority Program	Fiscal year 2013 actual	Fiscal year 2014 enacted	Fiscal year 2015 requested [a]
Refund fraud including identity theft	4,146	4,146	4,603
International and offshore tax administration	2,135	1,819	2,151
Patient Protection and Affordable Care Act [b]	701	[c] 1,954	2,046
Merchant card/cost basis reporting [d,e]	90	128	450
Foreign Account Tax Compliance Act [f]	40	50	394
Return Review Program/Electronic Fraud Detection System	104	137	137
Return preparer oversight	167	80	186
Total FTEs	7,383	8,314	9,967

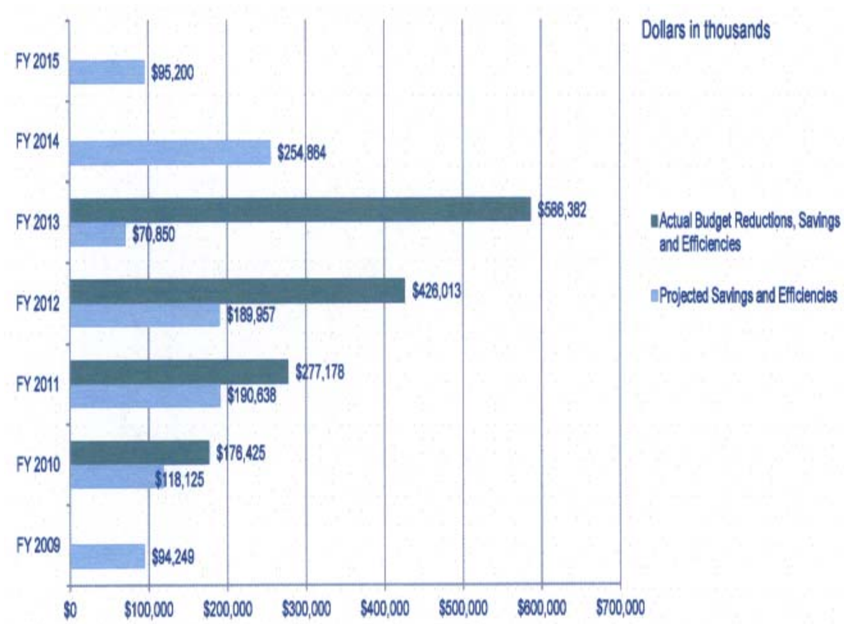
Legend: FY = fiscal year. FTE = full-time equivalent.
Source: IRS Office of Corporate Budget.
Notes: [a] The FY 2015 initiatives were developed with most FTE costed assuming a January 1 hire date. [b] PPACA, Pub. L. No. 111–148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act (HCERA), Pub. L. No. 111–152, 124 Stat. 1029 (Mar. 30, 2010). All references to PPACA include amendments by HCERA.
[c] According to IRS officials, this reflects the number of FTEs requested in the Fiscal Year 2014 President's Budget.
[d] Housing Assistance Tax Act of 2008, Pub. L. No. 110–289, div. C, § 3091, 122 Stat. 2654, 2908–2911 (July 30, 2008).
[e] Energy Improvement and Extension Act of 2008, Pub. L. No. 110–343, div. B, § 403, 122 Stat. 3765, 3854–3860 (Oct. 3, 2008).
[f] Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, Title V, 124 Stat. 71, 97–117 (Mar. 18, 2010).
See eppendices IX and X for more information on PPACA spending.

ABSORBING CUTS: REDUCTIONS TO IRS'S BUDGET GREATER THAN PROJECTED SAVINGS

(NOTE: Data for Figure 11 is in chart and table format.)

—IRS has absorbed approximately $900 million in budget cuts since fiscal year 2010.

Figure 11: IRS Projected and Actual Savings and Efficiencies, Fiscal Year 2009 Through 2015 [a]



Legend: FY = fiscal year.
Source: GAO analysis of fiscal year 2009 through fiscal year 2015 IRS congressional justifications for the IRS.
Note: [a] IRS began calculating actual savings and efficiencies in fiscal year 2012, based on our recommendation.

(Dollars in thousands)

Fiscal Year	Actual Budget Reductions, Savings and Efficiencies	Projected Savings and Efficiencies
2015	—	95,200
2014	—	254,864
2013	586,382	70,850
2012	426,013	189,957
2011	277,178	190,638
2010	176,425	118,125
2009	—	94,249

ABSORBING CUTS: IRS REDUCED OR ELIMINATED SOME SERVICES IN 2014

In 2014, IRS reduced or eliminated services, consistent with our finding in December 2012 that IRS needed to dramatically revise its strategy for providing telephone and correspondence services, and that incremental efficiency gains would not be enough to reverse service declines. IRS:

—limited inquiries to answer only basic tax law questions during the filing season and reassigned assistors to work account-related inquires;
—launched the "Get Transcript" tool, which allows taxpayers to obtain a viewable and printable transcript on www.irs.gov, and redirected taxpayers to automated tools for additional guidance;
—redirected refund-related inquiries to automated services and did not answer refund inquires until 21 days after the tax return was filed electronically or 6 weeks after the return was filed by paper (unless the automated service directed the taxpayer to contact IRS);
—limited access to the Practitioner Priority Services line to only those practitioners working tax account issues;
—limited live assistance and redirected requests for domestic employer identification numbers to IRS's online tool; and
—eliminated free return preparation and reduced other services at IRS's walk-in sites.

ABSORBING CUTS: IRS HAS DELAYED TWO IT PROJECTS IN PART DUE TO BUDGET REDUCTIONS

IRS put two major IT projects, Information Reporting and Document Matching (IRDM) and the Return Review Program (RRP), on hold due to a lack of funding and technical issues (See appendix XI).[1]

—During the hold, IRS will determine the best case management tool to use to meet IRDM's program requirements. It plans to leverage an off-the-shelf solution because IRS believes it will be more cost effective than building one.
—IRS initially planned to release all of RRP by March 2015. The first phase, Transition State 1.0 (TS1), was split into two releases: R1.0 and R1.1. Testing of TS1 R1.0 has been ongoing, and will continue for the remainder of the calendar year. IRS put the next two phases, TS1.5 and TS2.0 on hold until it has analyzed and resolved how to design RRP's architecture more efficiently.
  —IRS is working to develop a plan to move beyond the hold on RRP, and expects to complete the plan in the summer of 2014, and will initiate the plan after that time. Moving forward, this plan will help inform IRS's funding needs for RRP.

[1] Information Reporting and Document Matching (IRDM): IRDM is intended to be used to improve business taxpayer compliance by matching business information (e.g., 1099–K) tax returns with individual tax returns to identify potential income under reporting. Return Review Program (RRP): When RRP is fully deployed it is expected to make use of leading-edge technology to detect, resolve, and prevent fraud.

ABSORBING CUTS: IRS SUBSTANTIALLY REDUCED EMPLOYEE TRAINING

—According to IRS Commissioner Koskinen, since 2010 IRS has reduced training costs by 83 percent and training-related travel costs by 87 percent by limiting employee travel and training to mission-critical projects.
—For fiscal year 2013, IRS reported a savings of $56.2 million by reducing agency-wide, non-technical training and non-case related travel.
—In its fiscal year 2013 Report to Congress, the National Taxpayer Advocate lists training cuts as one of IRS's most serious problems. From fiscal years 2009 through 2013, per-employee spending dropped from $1,450 per full-time equivalent to less than $250.

Table 5: Percentage of Training Reduction for Selected IRS Divisions, Fiscal Years 2009 Through 2013

Division	Percent reduction
Appeals	96
Tax Exempt and Government Entities	96
Small Business/Self-Employed	93
Large Business and International	92
Taxpayer Advocate Service	78
Wage and Investment	74

Source: National Taxpayer Advocate: 2013 Annual Report to Congress, Volume I, (Dec. 31, 2013).

OPPORTUNITIES EXIST TO MORE STRATEGICALLY MANAGE OPERATIONS

Funding is one component of improving operations. Legislative proposals and our prior work provide options to improve IRS operations (see appendixes XII and XIII). For example, the administration proposes legislative changes such as providing IRS with greater flexibility to address correctable errors (broaden math error authority).

In addition, we recommended that IRS:

—outline a strategy that defines appropriate levels of telephone and correspondence service and wait times and lists specific steps to manage service based on an assessment of time frames, demand, capabilities, and resources (GAO–13–156).[1] IRS did not agree or disagree with this recommendation, stating that it already had an objective of providing taxpayers with access to accurate services while managing demand by improving efficiency. However, in recent years, because IRS has not kept up with the demand for its services we maintain our recommendation is valid; a strategy to reverse the trends may require difficult tradeoffs.
—review disparities in the ratios of direct revenue yield to costs across different enforcement programs and across different groups of cases within programs and determine whether this evidence provides a basis for adjusting IRS's allocation of enforcement resources each year. We noted that the better empirical basis IRS planners have for making such judgments, the more confident they can be that they are allocating their limited resources to the best effect (GAO–13–151).[2] IRS agreed with our recommendation. Given the time to develop additional key data, IRS is considering how to apply interim methods, findings, or approximations. They are unsure when this work will be completed; we believe our recommendation remains valid.
—develop a long-term strategic plan for its web services. We noted that a long-term strategy could help managers have a common understanding of IRS's plans, and better assist Congress in understanding what it is being asked to fund and holding IRS accountable for progress (GAO–13–435).[3] In April 2014, IRS reported that a long-term online strategy for improving web services will be completed in February 2015.

[1] GAO, *2012 Tax Filing: IRS Faces Challenges Providing Service to Taxpayers and Could Collect Balances Due More Effectively,* GAO–13–156 (Washington, D.C.: Dec. 18, 2012).
[2] GAO, *Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources,* GAO–13–151 (Washington, D.C.: Dec. 5, 2012).
[3] GAO, *IRS Website: Long-Term Strategy Needed to Improve Interactive Services,* GAO–13–435 (Washington, D.C.: Apr. 16, 2013).

CONCLUDING OBSERVATIONS

IRS has absorbed budget cuts since fiscal year 2010, and the resulting imbalance between service and demand has adversely affected operations. To address this imbalance, IRS has requested a large budget increase for 2015. However, additional funding is not the only solution for IRS. We have open recommendations that may help IRS to more effectively manage its operations and achieve some savings over time.

APPENDIX I: DOLLARS BY APPROPRIATION ACCOUNT, FISCAL YEARS 2009 THROUGH 2015

Table 6: Fiscal Years 2009 Through 2014 Enacted and Fiscal Year 2015 Budget Request for IRS by Appropriation Account

(Dollars in Millions)

Appropriation account	Fiscal year 2009 enacted	Fiscal year 2010 enacted	Fiscal year 2011 enacted	Fiscal year 2012 enacted	Fiscal year 2013 enacted [a]	Fiscal year 2014 enacted [b]	Fiscal year 2015 requested	Dollar change fiscal year 2014 enacted compared to fiscal year 2015 requested	Percent change fiscal year 2014 enacted compared to fiscal year 2015 requested
Enforcement	5,117	5,504	5,493	5,299	4,949	5,022	5,372	350	7.0
Operations support	3,867	4,084	4,057	3,947	3,801	3,799	4,457	658	17.3
Taxpayer services	2,293	2,279	2,293	2,240	2,136	2,157	2,318	161	7.5
Business Systems Modernizaton	230	264	263	330	313	313	330	17	5.5
Health Insurance Tax Credit Administration (HITCA) [c]	15	16	15	0	0	0	0	0	0
Subtotal	11,523	12,146	12,122	11,817	11,199	11,291	12,477	1,186	10.5
Other resources, such as user fees	390	539	655	695	855	815	785	−30	−3.7
Total funding available for obligations	11,913	12,686	12,777	12,512	12,053	12,106	13,261	1,156	9.6

Legend: FY = fiscal year.
Source: Fiscal years 2011 through 2015 congressional justifications for IRS.
Notes: Dollars are nominal and not adjusted for inflation, and numbers may not add due to rounding.
[a] Fiscal year 2013 enacted represents the operating level after applying across-the-board rescisson and reductions required by sequestration and an interappropriation transfer of $73 million transferred from the Enforcement appropriation to the Taxpayer Services ($13 million) and Operations Support ($60 million) appropriations.
[b] In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million).
[c] In fiscal year 2012, administrative resources for HITCA were moved to the Taxpayer Services appropriation under the Consolidated Appropriations Act, 2012, Pub. L. No. 112–74, 125 Stat. 786 (Dec. 23, 2011).

APPENDIX II: STAFFING BY APPROPRIATION ACCOUNT, FISCAL YEARS 2009 THROUGH 2015

Table 7: Fiscal Years 2009 Through 2013 Actual, 2014 Enacted, and 2015 Requested Full-time Equivalents by Appropriation Account

Appropriation account	Fiscal year 2009 actual	Fiscal year 2010 actual	Fiscal year 2011 actual	Fiscal year 2012 actual	Fiscal year 2013 actual [a]	Fiscal year 2014 enacted [b]	Fiscal year 2015 re-quested [c]	FTE change fiscal year 2014 enacted compared to fiscal year 2015 requested	Percent change fiscal year 2014 enacted compared to fiscal year 2015 requested
Enforcement	47,361	50,400	49,920	47,189	44,174	42,805	45,757	2,952	6.9
Operations support	12,101	12,262	12,103	11,499	11,610	11,860	13,380	1,520	12.8
Taxpayer services	32,422	31,607	31,574	30,236	29,646	28,996	31,481	2,485	8.6
Business Systems Modernizaton	322	337	309	562	451	528	569	41	7.8
Health Insurance Tax Credit Administration (HITCA) [d]	10	12	0	0	0	0	0	0	0
Subtotal	92,216	94,618	93,906	89,486	85,881	84,189	91,187	6,998	8.3
Other resources, such as user fees	1,153	752	1,003	2,185	1,884	1,503	1,503	0	0
Total	93,369	95,370	94,909	91,671	87,765	85,692	92,690	6,998	8.2

Legend: FY = fiscal year.
Source: Fiscal years 2011 through 2014 congressional justifications for IRS.
Notes: [a] Fiscal year 2013 actual represents the operating level after applying across-the-board rescission and reductions required by sequestration and an interappropriation transfer of $73 million transferred from the Enforcement appropriation to the Taxpayer Services ($13 million) and Operations Support ($60 million) appropriations.
[b] In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million).
[c] The fiscal year 2015 initiatives were developed with most FTE costed assuming a January 1 hire date.
[d] The administrative resources for HITCA were moved to the Taxpayer Services appropriation under the Consolidated Appropriations Act, 2012, Pub. L. No. 112–74, 125 Stat. 786 (Dec. 23, 2011).

APPENDIX III: IRS ADJUSTED ENFORCEMENT COVERAGE AND EFFICIENCY TARGETS DOWNWARD

Table 8: IRS Enforcement Coverage Measures Fiscal Years 2009 Through 2013 Actual and 2014 and 2015 Targets

	Fiscal year 2009 actual	Fiscal year 2010 actual	Fiscal year 2011 actual	Fiscal year 2012 actual	Fiscal year 2013 actual	Fiscal year 2014 target [a] (Original)	Fiscal year 2014 target (March 2014)	Fiscal year 2015 target [b]
Selected Examination Measures								
Examination Coverage—Individual	1.0%	1.1%	1.1%	1.0%	1.0%	1.0%	0.8%	0.8%
Examination Efficiency—Individual	138	140	139	142	142	145	133	124
Examination Coverage Business (Assets > 10 mil)	5.6%	5.7%	6.2%	6.2%	5.6%	4.9%	4.2%	4.1%
Automated Underreporter Coverage	2.6%	3.0%	3.3%	3.2%	2.8%	3.1%	2.5%	2.7%
Automated Underreporter Efficiency	1,905	1,924	2,007	2,041	2,025	2,001	1,931	1,950
Selected Collections Measures								
Collection Coverage	54.2%	50.1%	50.0%	48.1%	47.0%	47.1%	42,7%	45.0%
Collection Efficiency	1,845	1,822	1,952	1,997	2,057	2,039	2,007	1,900
Automated Collection System Accuracy	94.3%	95.9%	94.9%	94.7%	94.4%	94.5%	94.0%	94.0%

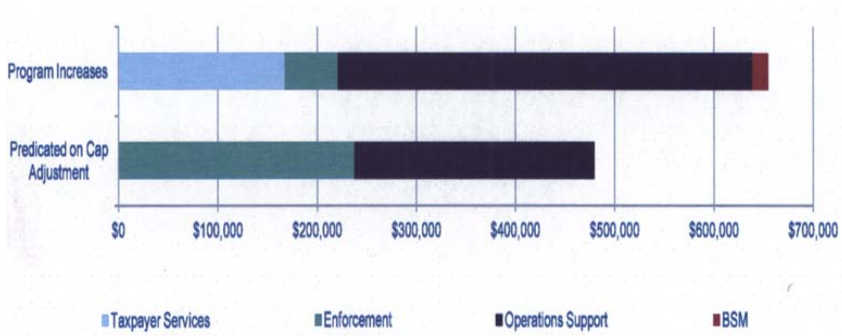
Source: GAO analysis of fiscal years 2014 and 2015 congressional justifications for IRS.
Notes: Coverage measures generally are the number of closed examinations by the number of filings for the prior year. Efficiency measures are generally the total number of cases closed divided by total full-time equivalents used. Automated Collection System Accuracy refers to the percent of taxpayers who received the correct answer to their question.
[a] The fiscal year 2014 target was based on the fiscal year 2014 budget request.
[b] The fiscal year 2015 target was based on the fiscal year 2015 budget request.

APPENDIX IV: OF REQUESTED $1.2 BILLION FOR FISCAL YEAR 2015, $480 MILLION PREDICATED ON A CAP ADJUSTMENT [1]

The fiscal year 2015 request includes 22 new program initiatives—17 of which are predicated on a cap adjustment—with total requested funding of more than $1.1 billion.[2] This includes:

—13 for enforcement ($535 million),
—6 for Infrastructure ($376 million),
—1 for taxpayer service ($221 million), and
—1 for BSM ($17 million).

Figure 12: Funding Requested for New Initiatives Predicated on a Cap Adjustment (Dollars in Thousands)



Source: GAO analysis of fiscal year 2015 congressional justification for IRS.

[1] Congress passes cap adjustments to allow for additional funding above discretionary spending lists for certain activities.
[2] One of the new program initiatives predicated on a cap adjustment is a funding transfer to the Alcohol Tobacco Trade Bureau.

APPENDIX V: IRS PROPOSED 17 INITIATIVES PREDICATED ON A CAP ADJUSTMENT TOTALING $480 MILLION

Table 9: Funding Requested for New Initiatives Predicated on a Cap Adjustment

(Dollars in Thousands)

Description of budget adjustments	Fiscal year 2015 funding requested, by appropriation account				Total	Projected Enforcement ROI for fiscal year 2017	Projected Protected Revenue ROI for fiscal year 2017
	Taxpayer services account	Enforcement account	Operations support account	Business Systems Modernization			
Enforcement Initiatives							
Address International and Offshore Compliance Issues	—	49.037	7,773	—	56,810	4.8	—
Expand Coverage of High Wealth Individuals and Enterprises	—	17,684	3,273	—	20,957	11.3	—
Expand Audit Coverage	—	53,581	44,198	—	97,779	7.1	20.5
Enhance Collection Coverage	—	41,692	25,070	—	66,762	8.5	—
Improve Coverage of Partnerships and Flow-Through Entities	—	28,690	7,849	—	36,539	6.8	—
Expand Compliance Coverage in the Tax-Exempt Sector	—	13,364	2,731	—	16,095	—	—
Pursue Fraud Referrals, Employment Tax, and Abusive Tax Schemes	—	9,275	8,537	—	17,812	—	—
Build Out Tax Return Preparer Compliance and Professional Responsibility Activities	—	14,765	2,772	—	17,537	—	—
Implement Information Technology (IT) Changes to Deliver the Foreign Account Tax Compliance Act (FATCA)	—	—	32,223	—	32,223	—	—
Leverage Digital Evidence for Criminal Investigation	—	698	3,674	—	4,372	—	—
Leverage Data to Improve Case Selection	—	4,052	32,741	—	36,793	[a] 2.0	—
Infrastructure Initiatives							
Implement Information Technology (IT) Services	—	—	10,000	—	10,000	—	—
Implement Campus Consolidation and Revitalization Strategy	—	—	10,000	—	10,000	—	—
Implement e-Government and Other Administration Priorities	—	—	31,011	—	31,011	—	—
Maintain Integrity of Revenue Financial Systems	—	—	12,136	—	12,136	—	—
Expand Virtual Service Delivery (VSD)	—	—	7,701	—	7,701	—	—
Alcohol and Tobacco Tax and Trade Bureau Program Integrity Transfer							
Transfer to TTB for High-Return on Investment (ROI) Tax Enforcement Activities	—	5,000	....	....	5,000	—	—

Table 9: Funding Requested for New Initiatives Predicated on a Cap Adjustment—Continued

(Dollars in Thousands)

Description of budget adjustments	Fiscal year 2015 funding requested, by appropriation account: Taxpayer services account	Enforce-ment account	Operations support account	Business Systems Moderniza-tion	Total	Projected Enforce-ment ROI for fiscal year 2017	Projected Protected Revenue ROI for fiscal year 2017
Total Fiscal Year 2015 Cap Adjustment	....	$237,838	$241,689	....	$479,527	n/a	—

Legend: n/a = not applicable. Note: Numbers may not add due to rounding.
Source: Fiscal year 2015 congressional justification for IRS.
Note: [a] IRS considers leveraging data to improve case selection a revenue-enhancing initiative.

APPENDIX VI: FIVE PROPOSED INITIATIVES FOR $654 MILLION ARE NOT PREDICATED ON A CAP ADJUSTMENT

Table 10: Funding Requested for New Initiatives Not Predicated on a Program Integrity Cap Adjustment

(Dollars in Thousands)

Description of budget adjustments	Appropriation Account: Taxpayer services account	Enforcement account	Operations support account	Business Systems Moderniza-tion	Total	Projected enforce-ment revenue ROI for fiscal year 2017	Projected protected revenue ROI for fiscal year 2017
New Initiatives	$167,382	$53,545	$417,780	$15,679	$654,386	n/a	....
Improve Taxpayer Services and Return Processing	153,482	—	57,776	—	211,258	—	—
Prevent Identity Theft and Refund Fraud	13,900	16,971	34,005	—	64,876	—	22.4
Continue Migration from Aging Tax Administration Systems—Enhance Online Services	—	—	829	15,679	16,508	....	....
Address Impact of Patient Protection and Affordable Care Act (PPACA) Statutory Requirements	—	36,574	19,525	—	56,099	2.3	14.0
Implement Information Technology (IT) Changes to Deliver Tax Credits and Other Requirements	—	—	305,645	—	305,645	....	—
Non-Recur Fiscal Year 2014 Additional Appropriation	−34,000	—	−58,000	....	−92,000	n/a	—
Maintaining Current Levels	46,483	105,719	69,382	1,593	223,177	n/a	—
Base Adjustment	....	−29,221	29,221	....	....	....	—
Savings and efficiencies, net reinvestment	−18,786	−18,233	−42,156	....	−95,200	n/a	—
Total Request Before Cap Adjustment	$2,317,633	$5,133,988	$4,215,169	$330,210	$11,997,000	n/a	—

Legend: n/a = not applicable. ROI = return on investment. FY = Fiscal Year.
Source: Fiscal year 2015 congressional justification for IRS.
Note: Numbers may not add due to rounding.

APPENDIX VII: IRS CONTINUES TO REPORT ACTUAL RETURN ON INVESTMENT (ROI) DATA FOR THREE ENFORCEMENT PROGRAMS

Table 11: Actual Return on Investment (ROI) for Major IRS Enforcement Programs
(Dollars in Millions)

Enforcement program	Fiscal year 2010			Fiscal year 2011			Fiscal year 2012			Fiscal year 2013		
	Cost	Revenue	ROI	Cost	Revenue	ROI	Cost	Revenue	ROI	Cost	Revenue	ROI
Examination	$4,371	$23,563	5.4	$4,333	$18,924	4.4	$4,232	$14,476	3.4	$3,965	$16,662	4.2
Collection	1,948	29,105	14.9	1,939	31,060	16.0	1,742	30,442	17.5	1,660	31,396	18.9
Automated Under-reporter	262	4,924	18.8	270	5,245	19.4	267	5,269	19.7	258	5,287	20.5
IRS total	$6,581	$57,592	8.8	$6,543	$55,229	8.4	$6,242	$50,187	8.0	$5,883	$53,345	9.1

Source: Fiscal year 2015 congressional justification for IRS.
Note: Numbers may not add due to rounding.

—For the fiscal year 2015 congressional justification, IRS continued to calculate direct actual ROI for the Examination, Collection, and Automated Underreporter programs, but has not completed this calculation fro other programs or at lower levels.
—IRS is not yet able to calculate average or marginal direct actual ROI of new enforcement program initiatives, but is in the process of completing a feasibility study to identify steps necessary to measure actual revenue and ROI for new enforcement initiatives.
—IRS will continue to use revenue protection and revenue enhancement ROI projections.

APPENDIX VIII: IRS ESTIMATED FUTURE ROI FOR NEW ENFORCEMENT INITIATIVES

(NOTE: Data for Figure 13 is in chart and table format.)

Figure 13: Prevent Identity Theft and Refund Fraud (Protected Revenue)

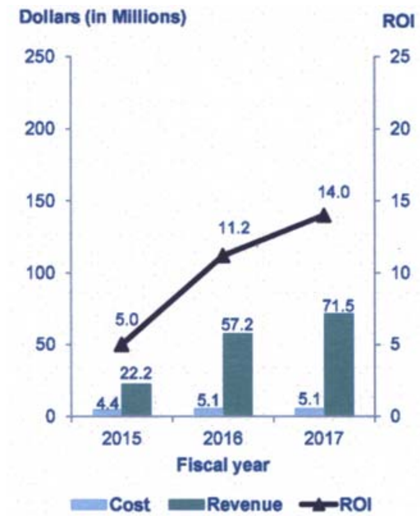
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	64.9	548.0	8.4
2016	65.4	1,097.0	16.8
2017	65.3	1,462.0	22.4

(NOTE: Data for Figure 14 is in chart and table format.)

Figure 14: Address Impact of Affordable Care Act Statutory Requirements
(Protected Revenue)



Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	4.4	22.2	5.0
2016	5.1	57.2	11.2
2017	5.1	71.5	14.0

(NOTE: Data for Figure 15 is in chart and table format.)

Figure 15: Expand Audit Coverage (Protected Revenue)

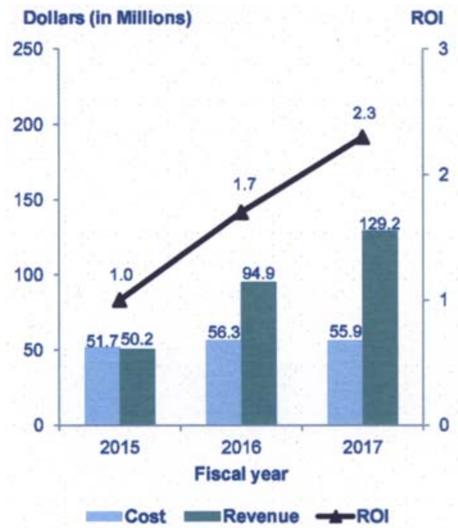
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	4.5	33.8	7.5
2016	5.2	85.3	16.4
2017	5.2	106.6	20.5

(NOTE: Data for Figure 16 is in chart and table format.)

Figure 16: Address Impact of Affordable Care Act Statutory Requirements (Enforcement Revenue)



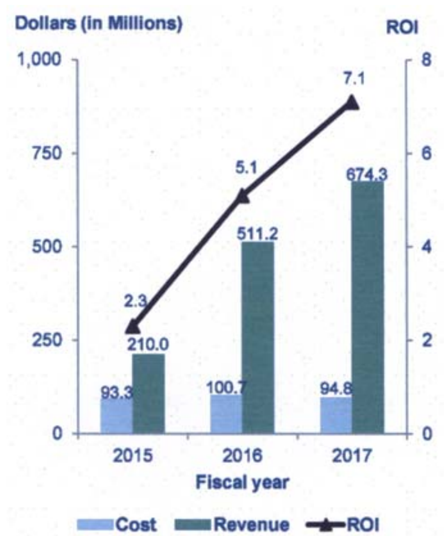
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	51.7	50.2	1.0
2016	56.3	94.9	1.7
2017	55.9	129.2	2.3

(NOTE: Data for Figure 17 is in chart and table format.)

Figure 17: Expand Audit Coverage (Enforcement Revenue)



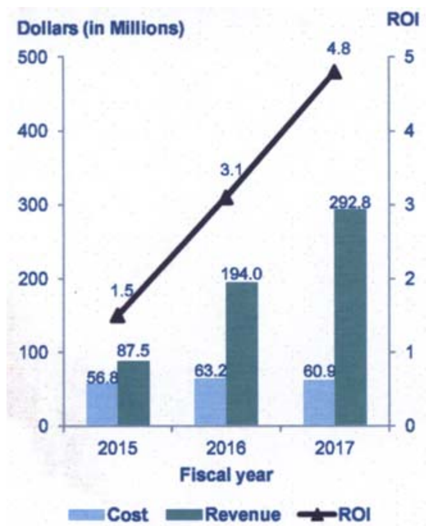
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	93.3	210.0	2.3
2016	100.7	511.2	5.1
2017	94.8	674.3	7.1

(NOTE: Data for Figure 18 is in chart and table format.)

Figure 18: Address International and Offshore Compliance Issues (Enforcement Revenue)



Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	56.8	87.5	1.5
2016	63.2	194.0	3.1
2017	60.9	292.8	4.8

(NOTE: Data for Figure 19 is in chart and table format.)

Figure 19: Expand Coverage of High Wealth Individuals and Enterprises (Enforcement Revenue)

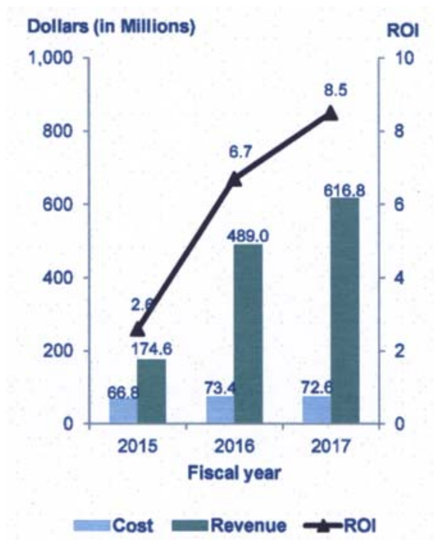
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	21.0	78.5	3.7
2016	23.0	159.9	7.0
2017	21.6	243.9	11.3

(NOTE: Data for Figure 20 is in chart and table format.)

Figure 20: Enhance Collection Coverage (Enforcement Revenue)



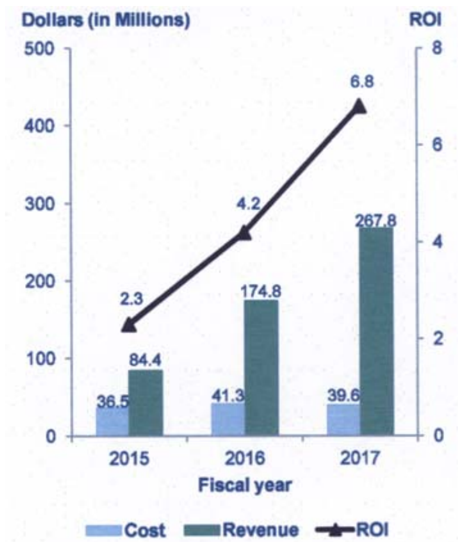
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	66.8	174.6	2.6
2016	73.4	489.0	6.7
2017	72.6	616.8	8.5

(NOTE: Data for Figure 21 is in chart and table format.)

Figure 21: Improve Coverage of Partnerships and Flow-Through Entities (Enforcement Revenue)



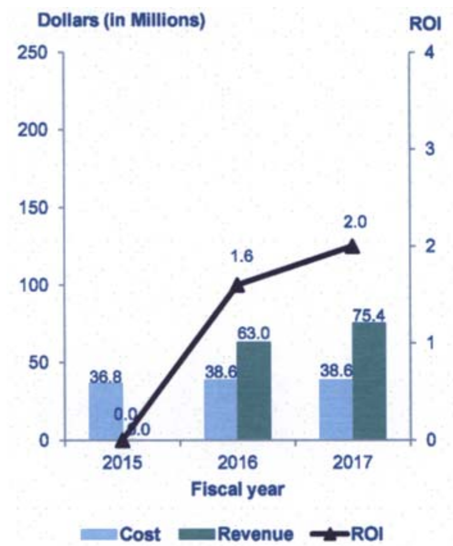
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	36.5	84.4	2.3
2016	41.3	174.8	4.2
2017	39.6	267.8	6.8

(NOTE: Data for Figure 22 is in chart and table format.)

Figure 22: Leverage Data to Improve Case Selection (Enforcement Revenue)



Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	36.8	0.0	0.0
2016	38.6	63.0	1.6
2017	38.6	75.4	2.0

APPENDIX IX: PATIENT PROTECTION AND AFFORDABLE CARE ACT (PPACA)[1] SPENDING, FISCAL YEARS 2010 THROUGH 2012

Table 12: Patient Protection and Affordable Care Act (PPACA) Spending, Fiscal Years 2010 Through 2012 (in Millions)

PPACA Initiatives	Fiscal year 2010 actual	Fiscal year 2011 actual	Fiscal year 2012 actual	Total
Administer new fees on drug manufacturers and health insurers	$0.3	$0.7	$1.1	$2.1
Strengthen oversight of exempt hospitals	0.4	4.5	4.0	9.0
Promoting compliance with other new provisions	0.8	11.6	8.3	20.8
Program management	0.1	8.4	17.9	26.4
Support of implementation of taxpayer issues (e.g. Counsel, Appeals)	2.4	5.0	5.2	12.5
Customer service support (outreach, phones, and other support)	1.3	6.0	4.7	12.0
Information technology, operations, and support and infrastructure, deliver new tax credits and individual coverage requirement	15.3	131.9	258.0	405.2
Total	$20.7	$168.2	$299.2	$488.1

Legend: FY = fiscal year.
Source: Fiscal year 2014 congressional justification for IRS.
Notes: PPACA was enacted on March 23, 2010. IRS received funding for PPACA implementation activities from the Department of Health and Human Services' Health Insurance Reform Implementation Fund in fiscal years 2010 to 2012. Numbers may not add due to rounding.
[1] PPACA, Pub. L. No. 111–148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act (HCERA), Pub. L. No. 111–152, 124 Stat. 1029 (Mar. 30, 2010). All references to PPACA include amendments by HCERA.

APPENDIX X: PPACA SPENDING AND REQUEST BY ACCOUNT AND INITIATIVES, FISCAL YEARS 2013 THROUGH 2015

Table 13: PPACA Spending and Request by Account and Initiative (in Millions)

PPACA Initiatives	Taxpayer Services			Enforcement			Operations Support			Total		
	Fiscal year 2013 actual	Fiscal year 2014 requested	Fiscal year 2015 requested	Fiscal year 2013 actual	Fiscal year 2014 requested	Fiscal year 2015 requested	Fiscal year 2013 actual	Fiscal year 2014 requested	Fiscal year 2015 requested	Fiscal year 2013 actual	Fiscal year 2014 requested	Fiscal year 2015 requested
Improve taxpayer service and meet increased demand (PPACA portion of initiative)	$3.8	$70.3	$58.2	$0	$3.2	$0	$0	$16.0	$15.7	$3.8	$89.5	$73.9
Address impact of PPACA statutory requirements	0.5	1.1	0	19.3	26.1	36.6	11.8	17.2	19.5	31.6	44.4	56.1
Implement IT changes to deliver tax credits and other requirements	0	0	0	0	0	0	248.6	305.6	305.6	248.6	305.6	305.6
Expand telecom infrastructure to handle increased demand	0	0	0	0	0	0	0	0	16.0	0	0	16.0
Total PPACA budget request	$4.3	$71.4	$58.2	$19.3	$29.3	$36.6	$260.4	$338.8	$356.9	$284	[a] $439.6	$451.7

Source: IRS data on PPACA spending for fiscal year 2013 and fiscal years 2014 and 2015 congressional justifications for IRS.
Notes: IRS did not receive funding for PPACA implementation activities in fiscal years 2013 or 2014. IRS received funding from the Department of Health and Human Services in fiscal years 2010 to 2012. Numbers may not add due to rounding.
[a] Actual total fiscal year 2014 PPACA spending through February 28, 2014 is $59.2 million.

APPENDIX XI: SUMMARY OF MAJOR IT INVESTMENTS

Total funding for all investments from fiscal years 2009 to 2015 is about $11 billion.

Table 14: Summary of IRS's Major IT Investments (in Millions)

Investment name	Fiscal year 2014 appropriation [a]	Actual obligations to date [b]	Fiscal year 2015 projected life-cycle cost	Projected useful life (year)
Account Management Services (AMS)				
Enhances customer support by providing applications that enable IRS employees to access, validate, and update individual taxpayer accounts on demand	$17	$11	$204	2017
Patient Protection and Affordable Care Act (PPACA) [c]				
Encompasses the planning, development and implementation of IT systems needed to support IRS's tax administration responsibilities associated with the act [d]	345	651	1,987	2018
Customer Account Data Engine 2 (CADE 2)				
Provides timely access to authoritative individual taxpayer account information and enhances IRS's ability to address technology, security, financial material weaknesses, and long-term architectural planning and viability	165	687	1,022	2020
Electronic Fraud Detection System (EFDS)				
Assists in detecting fraud at the time that tax returns are filed in order to eliminate the issuance of fraudulent tax refunds	16	111	162	2021
e-Service (e-SVS)				
Comprises several web-based self-assisted services that are intended to allow authorized individuals to do business with the IRS electronically	11	173	207	2019
Foreign Account Tax Compliance Act (FATCA)				
Intended to implement provisions of the Foreign Account Tax Compliance Act regarding financial institutions reporting to IRS information about financial accounts held by U.S. taxpayers, or foreign entitites in which U.S. taxpayers hold a substantial ownership interest	47	17	162	2020
Implement Return Review Program (RRP) (Replaces EFDS)				
Currently under development, is intended to maximize fraud detection at the time that tax returns are filed to eliminate issuance of questionable refunds	68	103	253	2020
Individual Master File (IMF)				
Represents the authoritative data source for individual tax account data. All other IRS information systems that process IMF data depend on output from this source. This investment is a critical component of IRS's ability to process tax returns	14	82	166	2019
Information Reporting and Document Matching (IRDM)				
Intended to establish a new business information matching program in order to increase voluntary compliance and accurate income reporting	23	70	186	2019
Integrated Customer Communication Environment (ICCE)				
Includes several projects that are intended to simplify voluntary compliance using voice response, internet, and other computer technology such as the Modernized Internet Employee Identification Number, which allows third parties to act on the behalf of taxpayers	15	482	524	2019
Integrated Data Retrieval System (IDRS)				
Intended to provide systemic review, improve consistency in case control, alleviate staffing needs, issue notices to taxpayers, and allow taxpayers to see status of refunds. It is a mission-critical system used by 60,000 IRS employees	18	202	336	2020
Integrated Financial System/CORE Financial System (IFS)				

Table 14: Summary of IRS's Major IT Investments (in Millions)—Continued

Investment name	Fiscal year 2014 appropriation [a]	Actual obligations to date [b]	Fiscal year 2015 projected life-cycle cost	Projected useful life (year)
Used by IRS for budget, payroll, accounts payable/receivable, general ledger functions, and financial reporting; also used to report on the cost of operations and to manage budgets by fiscal year	15	414	494	2019
Integrated Submission and Remittance Processing System (ISRP)				
Processes paper tax returns, and updates tax forms to comply with tax law changes	10	143	188	2019
IRS End User Systems and Services (EUSS)				
Supports products and services necessary for daily functions for over 100,000 IRS employees at headquarters and field sites	182	705	1,933	2019
IRS Main Frames and Servers Services and Support (MSSS)				
Intended to support the design, development, and deployment of server storage infrastructures, software, databases, and operating systems	406	4,094	7,317	2019
IRS Telecommunications Systems and Support (TSS)				
Supports IRS's broad and local network infrastructure such as servers, and switches for voice, data, and video servicing of about 1,000 IRS sites	302	1,007	2,388	2019
IRS.Gov—Portal Environment				
Provides web-based services such as tax filing and refund tracking, to internal and external users, such as IRS employees and other government agencies, taxpayers, and business partners	16	487	651	2017
Modernized e-File (MeF)				
Provides a secure web-based platform for electronic tax filing of individual and business tax and information returns by registered Electronic Return Originators	40	376	639	2020
Service Center Recognition/Image Processing System (SCRIPS)				
Used as a data capture, management, and image storage system using high-speed scanning and digital imaging to convert data from the 940, 941, K–1, and paper returns from Information Returns Processing, into electronic format	9	157	203	2019

Source: GAO's analysis of fiscal year 2015 congressional justification for IRS.
[a] Fiscal year 2014 appropriation is the amount IRS plans to fund out of its own accounts (e.g., user fees and other budget accounts).
[b] Actual obligations to date through fiscal year 2013.
[c] IRS uses the acronym ''ACA'' to refer to the Patient Protection and Affordable Care Act in its reports.
[d] In this report, we are not evaluating the healthcare.gov initiative headed by the Centers for Medicare and Medicaid Services.

APPENDIX XII: GAO CONDUCTED ANALYSES RELATED TO 12 OF 38 LEGISLATIVE PROPOSALS IN THE FISCAL YEAR 2015 BUDGET REQUEST

Table 15: Legislative Proposals Related to Prior GAO Work (in Millions)

IRS legislative proposals related to prior GAO work	Projected revenues over 10 years	Projected costs over 3 years	Related GAO reports
Modify reporting of tuition expenses and scholarships of Form 1098–T, Tuition Statement.	$606	$0.2	GAO–10–225
Authorize the Department of Treasury to require additional information to be included in electronically filed Form 5500 annual reports and electronic filing of certain other employee benefit plan reports.	No revenue effect	11.2	GAO–05–491
Increase certainty with respect to worker classification.	9,610	1.9	GAO–09–717
Require taxpayers who prepare their returns electronically, but file their returns on paper, to print their returns with a scannable code.	No revenue effect	14.6	GAO–12–33
Allow IRS to absorb credit card processing fees for certain tax payments.	19	9.6	GAO–10–11
Provide IRS with greater flexibility to address correctable errors.	173	1.4	GAO–11–481
Provide whistleblowers with protection from retaliation.	Negligible revenue effect	0	GAO–11–683
Provide stronger protection from improper disclosure of taxpayer information in whistleblower actions.	No revenue effect	0	GAO–11–683
Add tax crimes to the Aggravated Identity Theft statute.	Negligible revenue effect	0	GAO–13–132T
Impose a civil penalty on tax identity theft crimes	Negligible revenue effect	2.7	GAO–13–132T
Explicitly provide that the Department of Treasury and IRS have authority to regulate all paid return preparers.	Negligible revenue effect	Not available	GAO–14–467T, GAO–08–781
Rationalize tax return filing due dates so they are staggered.	2,581	Not available	GAO–13–515

Source: GAO analysis based on IRS fiscal year 2015 congressional justification and Department of the Treasury, General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals (Washington, D.C.: March 2014).

APPENDIX XIII: IMPLEMENTING OPEN MATTERS FOR CONGRESS AND RECOMMENDATIONS TO IRS COULD RESULT IN FINANCIAL BENEFITS

—We highlighted several areas where IRS could achieve cost savings and revenue enhancements in our reports on duplication, overlap, and fragmentation.[1]

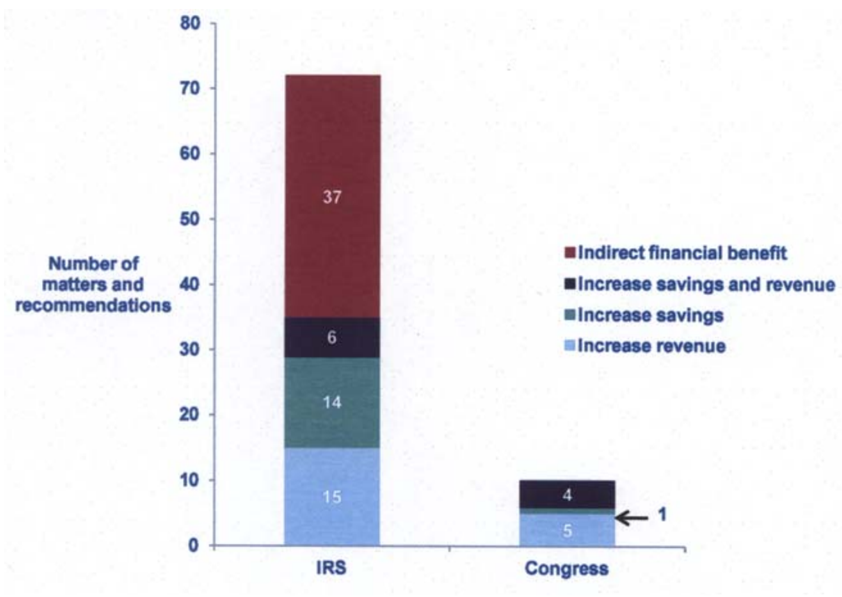
—As of March 2014, 37 GAO products contain 10 matters for Congress and 72 recommendations to IRS with a potential financial benefit. In addition, we have made multiple recommendations that could improve IRS operations if implemented.

—Since March 2013, 34 recommendations were implemented.

[1] See GAO, GAO, 2014 Annual Report: Additional Opportunities to Reduce Fragmentation, Overlap, and Duplication and Achieve Other Financial Benefits, GAO–14–343SP (Washington, D.C.: Apr. 8, 2014).

(NOTE: Data for Figure 23 is in chart and table format.)

Figure 23: Recommendations to IRS and Open Matters for Congress With a Financial Benefit



Source: GAO analysis of GAO open recommendations.

	Number of matters and recommendations			
	Indirect financial benefit	Increase savings and revenue	Increase savings	Increase revenue
IRS	37	6	14	15
Congress	....	4	1	5

PREPARED STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE

Chairman Udall, Ranking Member Johanns, and distinguished members of this subcommittee:

Thank you for inviting me to submit this statement regarding the proposed budget of the Internal Revenue Service for fiscal year 2015.[1]

As you know, the IRS's budget has been cut substantially since fiscal year 2010, and because of sequestration, the cuts last year were the most substantial to date. As a result of these resource reductions, the IRS's ability to meet the service needs of the taxpaying public has been severely impaired, and the agency has made unprecedented and disturbing changes to its delivery of taxpayer service.

The 16-day Government shutdown compounded the impact of these budget cuts and affected the IRS's ability to prepare for the 2014 tax filing season. As a result, the agency delayed the start of the filing season by 10 days, requiring early filers to wait additional time to receive their tax refunds. During the shutdown, moreover, thousands of taxpayers were exposed to IRS enforcement actions but had no ability to contact IRS employees, including the Taxpayer Advocate Service, all of whose employees were furloughed and unable to assist taxpayers who experienced emergencies caused by ongoing enforcement.[2]

On top of all this, the revelations by the Treasury Inspector General for Tax Administration (TIGTA) that the IRS's Exempt Organizations unit had used a "Be on the Lookout" (or "BOLO") list to select applicants with the words "tea party" and other political-sounding names for further review undermined public trust in the fairness and impartiality of the IRS, and led to multiple investigations that are still underway. Getting the IRS back on track requires not merely strong leadership within the agency, but helpful oversight and support from Congress and other key stakeholders. For that reason, I appreciate your holding today's hearing.

In my view, the IRS is often so focused on resolving immediate crises that it is not able to devote sufficient time to setting long-term goals and developing approaches to achieve those goals. In the preface to my most recent annual report to Congress, I attempted to provide my vision of what a 21st century tax administration system should look like.[3]

As a foundational matter, tax administration in the 21st century should be premised on a thematic, principle-based Taxpayer Bill of Rights.[4] If taxpayers believe they are treated, or can be treated, in an arbitrary and capricious manner, they will mistrust the system and be less likely to comply voluntarily. If taxpayers have confidence in the fairness and integrity of the tax system, they will be more likely to comply.

The good news on this front is that the Internal Revenue Code provides dozens of taxpayer rights. The bad news is that most taxpayers have no idea what their rights are and therefore often cannot take advantage of them. That is because taxpayer rights are scattered throughout the code and are not presented in a coherent way. Not surprisingly, in response to a taxpayer survey conducted for our office in

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[1] The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. However, the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

[2] During the shutdown from October 1 through October 16, 2013, taxpayers were subject to the following compliance and enforcement actions: 3,902 levies on Social Security benefits; 5,455 levies on financial or other accounts; 7,025 wage levies; 4,099 Notices of Federal Tax Lien issued; 180,095 Automated Underreporter Statutory Notices of Deficiency; and 102,231 Collection Due Process Levy Hearing Notices issued by the Automated Collection System. Preliminary information from IRS Office of Taxpayer Correspondence, Individual Master File (IMF), and Automated Lien System.

[3] National Taxpayer Advocate 2013 Annual Report to Congress [hereinafter "NTA 2013 Annual Report"], at x.

[4] *See* NTA 2013 Annual Report 5–19 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*); NTA 2011 Annual Report 493–518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); NTA 2007 Annual Report 478–489 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*).

2012, less than half of all U.S. taxpayers said they believed they have rights before the IRS, and only 11 percent said they knew what those rights are.[5]

We can and must do a better job of making taxpayers aware of their rights and enabling them to assert them. Since 2007, I have repeatedly recommended adoption of a Taxpayer Bill of Rights that takes the multiple existing rights embedded in the code and groups them into ten broad categories, modeled on the U.S. Constitution's Bill of Rights.[6] Just as the Constitution's Bill of Rights sets out the relationship between the Federal Government and U.S. citizens and imposes limits on the Federal Government's power, I believe a thematic, principle-based list of core taxpayer rights would provide a foundational framework for taxpayers and IRS employees alike that would promote effective tax administration.

I am very pleased the House of Representatives passed my proposal verbatim last year, with bipartisan support, on a voice vote.[7] While I believe a Taxpayer Bill of Rights should have the force of law, and therefore hope the Senate passes this legislation, the IRS has the authority to adopt a Taxpayer Bill of Rights on its own. I have been working with the IRS leadership to try to get agreement to do so. Particularly when resources are dear, it is important to have a set of foundational principles that guide operations and serve as a framework for effective tax administration.

In my testimony today, I will elaborate on the following key issues:

1. *Taxpayer Services and IRS Funding*.—The IRS is failing badly at meeting taxpayer needs because it lacks resources.[8] Last year, the IRS received some 109 million telephone calls on its customer service lines. The IRS could answer only 60.5 percent of calls seeking to reach a customer service representative (CSR)—and those taxpayers who got through had to wait an average of 17.6 minutes on hold. Initial statistics for fiscal year 2014 through April 15 indicate service has remained at low levels, with taxpayers waiting an average of slightly more than 17 minutes and tax practitioners kept on hold for nearly 27 minutes.[9] The tax collector is rarely the Government's most popular agency, but at the end of the day, IRS funding reductions do not "punish" the IRS nearly as much as they punish the nearly 150 million individual taxpayers and more than 10 million business entity taxpayers who are trying to comply with the tax laws and not receiving the help they need. When the IRS receives 109 million telephone calls, there is no substitute for the funding to hire enough CSRs to answer them. If the IRS does not receive more funding, it will be unable to assist millions of taxpayers seeking assistance from their Government to comply with the tax laws.
2. *Erosion of IRS Employee Training and Skills*.—To deal with a complex, constantly changing tax law and provide taxpayers with accurate and complete service, IRS employees must receive prompt and appropriate training and education. Since fiscal year 2009, budget cuts and sequestration have led the IRS to cut its training budget by over 85 percent. The IRS has reduced its training and education programs to a bare minimum without considering the types of training employees need to perform basic job functions, protect taxpayer rights, and prevent harm to and undue burden for taxpayers.[10]
3. *Identity Theft and Refund Fraud*.—The IRS should establish a meaningful single point of contact for taxpayers who become victims of identity theft. Today,

[5] Forrester Research Inc., *The TAS Omnibus Analysis,* from North American Technographics Omnibus Mail Survey, *Q2/Q3 2012* 19–20 (Sept. 2012).

[6] Congress has passed several pieces of legislation with "Taxpayer Bill of Rights" in the title. *See* Technical and Miscellaneous Revenue Act, Public Law No. 100–647, § 6226, 102 Stat. 3342, 3730 (1988) (containing the "Omnibus Taxpayer Bill of Rights," also known as TBOR 1); Taxpayer Bill of Rights 2, Public Law No. 104–168, 110 Stat. 1452 (1996) (also known as TBOR 2); Internal Revenue Service Restructuring and Reform Act, Public Law No. 105–206, 112 Stat. 685 (1998) (Title III is known as "Taxpayer Bill of Rights III" or TBOR 3). These laws create specific rights in certain instances, but they do not create a thematic, principle-based list of overarching taxpayer rights.

[7] Taxpayer Bill of Rights Act, H.R. 2768, 113th Cong. (2013). In my 2013 report, I suggested some wording modifications, and as discussed below, the Office of the Taxpayer Advocate recently tested our proposed modifications with focus groups of taxpayers and preparers to assess whether the language accurately conveys the gist of the rights we have identified. Based on input from the focus groups, we are currently tweaking the language of a few provisions.

[8] *See* NTA 2013 Annual Report 20–38 (Most Serious Problem: *IRS Budget: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance).*

[9] IRS, Joint Operations Center, Executive Level Summary report (Oct. 1, 2013 through April 15, 2014).

[10] *See* NTA 2013 Annual Report 40–50 (Most Serious Problem: *Employee Training: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill Its Mission).*

21 separate units handle different aspects of identity theft, and although the IRS says it has adopted a single point of contact, no employee has the authority to coordinate the entirety of the taxpayer/victim's case if, as is common, more than one of the 21 units is involved. Thus, taxpayers traumatized by the crime of identity theft are forced to navigate the IRS by themselves, increasing their frustration and despair.[11] The IRS also takes much too long to resolve ID theft cases and issue refunds to legitimate taxpayers. The Taxpayer Advocate Service's experience with identity theft cases demonstrates the soundness of our recommendation that the IRS assign one employee to work with the victim from the beginning, and help coordinate resolution of the case (not merely monitor it) when it requires work by multiple units.

4. *Affordable Care Act*.—As part of the Affordable Care Act (ACA), the IRS is implementing complicated healthcare tax provisions. I believe the IRS has acquitted itself well in meeting its initial responsibilities under the ACA. At the same time, I have concerns about the IRS's approach to addressing taxpayer questions and adequately training employees on the new provisions. In particular, the IRS is not doing enough to educate taxpayers about the importance of updating their information throughout the year with the Exchange if they are receiving a credit. Our office will continue to work with the IRS to ensure that taxpayers are treated properly and fairly in the implementation of the new law. Within the Taxpayer Advocate Service (TAS), we are also training our employees about taxpayer concerns they are likely to see next year, such as the impact of premium tax credit reconciliation and under- and overpayments, so they will be properly prepared to assist taxpayers.[12]
5. *Accelerated Receipt and Use of Third-Party Information Reports*.—Congress should direct the IRS to develop a plan to enable it to match information return data against tax return data before paying out refunds.[13] If the IRS could match Forms 1040 against Forms W–2 in a pre-refund environment, it could dramatically reduce improper payments to identity thieves and other perpetrators of refund fraud, including some improper Earned Income Tax Credit claimants. At the same time, it could make the data available to taxpayers and thereby help them prepare their returns more accurately and easily.
6. *IRS Information Technology Challenges*.—The IRS's Information Technology (IT) function must be adequately funded, not only to deliver on major initiatives like the ACA and Foreign Account Tax Compliance Act (FATCA), but also to deliver on the many small but important improvements and projects that will make a positive difference for taxpayers, employees, and the public fisc. At present, the IRS is focusing its IT resources almost exclusively on the ACA, FATCA, and the 2015 filing season. All other IT requests are subordinate to these three programs. Thus, important taxpayer service and compliance initiatives are at risk because needed improvements cannot be developed or implemented, compounding harm to taxpayers. Furthermore, without dedicated funding to invest in projects that bring us into the 21st century and the digital age, the IRS will increasingly lag behind other tax administrators and the financial services sector.

I. TAXPAYER SERVICES AND IRS FUNDING

The requirement to pay taxes is generally the most significant burden a government imposes on its citizens. For that reason, I believe the Government has a practical and moral obligation to make compliance as simple and painless as possible. Yet the IRS is increasingly unable to meet the service needs of our taxpayers by phone, in person, and by mail. Consider the following:

—Despite the greater availability of information on IRS.gov, the number of telephone calls the IRS receives from taxpayers on its customer service lines has

[11] *See* NTA 2013 Annual Report 75–83 (Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers).*

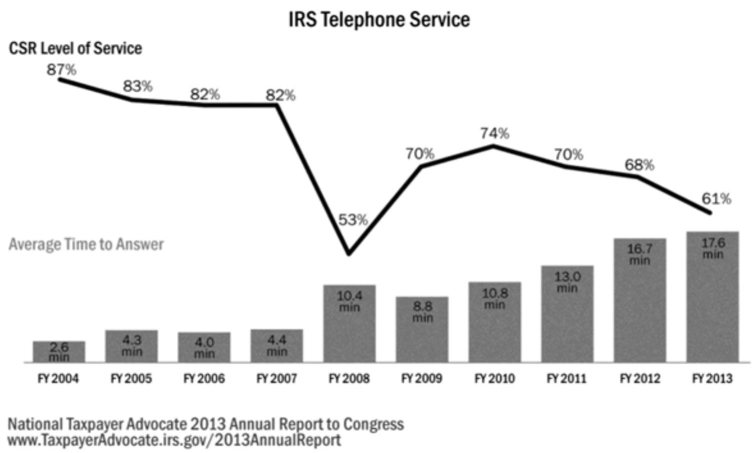
[12] *See generally* National Taxpayer Advocate fiscal year 2014 Objectives Report to Congress 29 (*TAS Prepares for Implementation of Health Care Provisions); IRS: Enforcing Obamacare's New Rules and Taxes: Hearing Before the House Comm. on Oversight & Gov't Reform,* 112th Cong. (2012) (statement of Nina E. Olson, National Taxpayer Advocate).

[13] *See* NTA 2013 Annual Report, vol. 2, 67–96 (Analysis: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*). The National Taxpayer Advocate has been recommending this approach since 2009. *See* National Taxpayer Advocate 2009 Annual Report to Congress 338–345 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing).*

been rising steadily over the past decade—from 71 million calls in fiscal year 2004 to 109 million calls in fiscal year 2013, an increase of 53 percent.[14]

—The IRS lacks the staffing to answer these calls. In fiscal year 2004, the IRS answered 87 percent of calls from taxpayers seeking to speak with a CSR (which, in IRS parlance, is referred to as the "Level of Service" or "LOS"). In fiscal year 2013, the IRS answered only 61 percent of such calls, a reduction of 26 percentage points, or 30 percent, in the LOS. Among those taxpayers lucky enough to get through, hold time increased from 2.6 minutes to 17.6 minutes, a nearly six-fold rise.[15]

Figure 1: IRS Telephone Service Levels, Fiscal Year 2004–2013



—The IRS historically has prepared tax returns for low income, elderly, and disabled taxpayers seeking assistance at its walk-in sites (known as "Taxpayer Assistance Centers," or "TACs"). In fiscal year 2004, the IRS prepared 476,000 returns.[16] Since that time, the IRS has imposed increasing limits on return preparation, and by fiscal year 2013, the number of returns it prepared during the filing season had declined by 59 percent as compared with fiscal year 2004.[17]

—The IRS's ability to timely process taxpayer correspondence has also taken a hit. When the IRS sends a taxpayer a notice proposing to increase his or her tax liability, it gives the taxpayer an opportunity to present an explanation or documentation supporting the position taken on the return. Each year, the IRS typically receives around ten million taxpayer responses, known collectively as the "adjustments inventory."[18] The IRS has established timeframes for processing taxpayer correspondence, generally 45 days. During the final week of fiscal year 2004, the IRS failed to process 12 percent of its adjustments cor-

[14] IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of fiscal year 2013 and fiscal year 2004).

[15] IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for fiscal year 2004 through fiscal year 2013).

[16] This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate's 2007 Annual Report to Congress 162–182 (Most Serious Problem: *Service at Taxpayer Assistance Centers).*

[17] Government Accountability Office, GAO–14–133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (Dec. 2013); GAO, GAO–11–111, *2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 45 (Dec. 2010); GAO, GAO–07–27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (Nov. 2006) (supplemented with IRS data provided to TAS for 2004 through 2006).

[18] In fiscal year 2013, receipts in the Adjustments Inventory were about 8.4 million, as compared with 10.4 million in fiscal year 2012. We are not certain why the number declined. The Adjustments Inventory is one component of the Accounts Management function's overall Paper Inventory. In fiscal year 2013, receipts in the Paper Inventory were about 20.8 million, and the percentage classified as overage at year-end was 47 percent. IRS, Joint Operations Center, *Account Management Information Report (AMIR)—National Summary* (week ending Sept. 28, 2013).

respondence within its timeframes. By contrast, during the final week of fiscal year 2013, the IRS was unable to process 53 percent of adjustments correspondence within these timeframes.[19]

As compared with fiscal year 2013, the IRS's ability to assist taxpayers has suffered further declines in fiscal year 2014:

—For fiscal year 2014 through April 15, the LOS on the phones was 66 percent, down from 71 percent during the same period in fiscal year 2013. Among taxpayers who got through, hold time rose from 13.3 minutes to slightly over 17 minutes. For practitioners calling the Practitioner Priority Service line, the decline was even steeper. The LOS dropped from 82 percent to 72 percent, while hold time rose from 12 minutes to 26.7 minutes.[20]

—In an effort to answer more calls, the IRS posted an announcement on IRS.gov in December that said it will answer only "basic" tax-law questions on its phone lines and in its walk-in sites during the filing season (January through mid-April).[21] It will not answer any questions that are "more detailed" than "basic" during the filing season. Moreover, it will not answer any tax-law questions after mid-April, including "basic" questions from the millions of taxpayers who obtain filing extensions and prepare their returns later in the year.

Here are some examples of "complex" tax law questions that the IRS no longer will answer from its taxpayers:

I deliver pizzas for my employer using my car. How can I deduct my car expenses?

I received a 1099–MISC instead of a Form W–2 for my new job, how do I report this on my tax return?

Do I have to report the inheritance I received?

I have started selling some craft items I make as a hobby. Do I have to report that?

These questions are really directional questions—how should I approach this issue? When the IRS is unable and unwilling to answer questions such as these, it increases the compliance burden on its taxpayers and the risk that taxpayers will get incorrect advice from other quarters. Thus, the decision to answer only basic tax law questions through the filing season, and not answer any "complex" question at all, will have a negative effect on tax compliance.

—Also to conserve resources, the IRS announced that it will no longer prepare any tax returns at its walk-in sites, even for low income, elderly, or disabled taxpayers.[22]

At the risk of vast understatement, it is a sad state of affairs when the Government writes tax laws as complex as ours—and then can answer nothing beyond "basic" questions from baffled citizens who are doing their best to comply.

I realize that some may find it difficult to justify increased funding for the IRS. I personally have concerns about IRS performance, and in fact, I am required by statute to be an "IRS critic" by identifying at least 20 of the most serious problems facing taxpayers in my annual reports to Congress.[23] But I must tell you that I do not see any way the agency can begin to meet the service needs of the taxpaying public without substantially more funding. Most notably, almost twenty million phone calls from taxpayers seeking to speak with a customer service representative went unanswered last year. With phone calls up about 17 percent and IRS funding down 8 percent since fiscal year 2010, there is no way the IRS can answer all these calls without more employees.

In part because of mistakes made in the past, the agency has undergone significant leadership changes in recent months. Many policy changes have been made in response to congressional concerns, and the fiscal year 2014 appropriations act contains new directives. If members have continuing concerns, I encourage you to use

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[19] IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison (fiscal year 2004 through fiscal year 2013).*

[20] IRS, Joint Operations Center, Executive Level Summary reports (comparing the periods of Oct. 1, 2013 through April 15, 2014 with Oct. 1, 2012 through April 15, 2013).

[21] IRS, e-News for Tax Professionals—Issue Number 2013–49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

[22] IRS, e-News for Tax Professionals—Issue Number 2013–49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

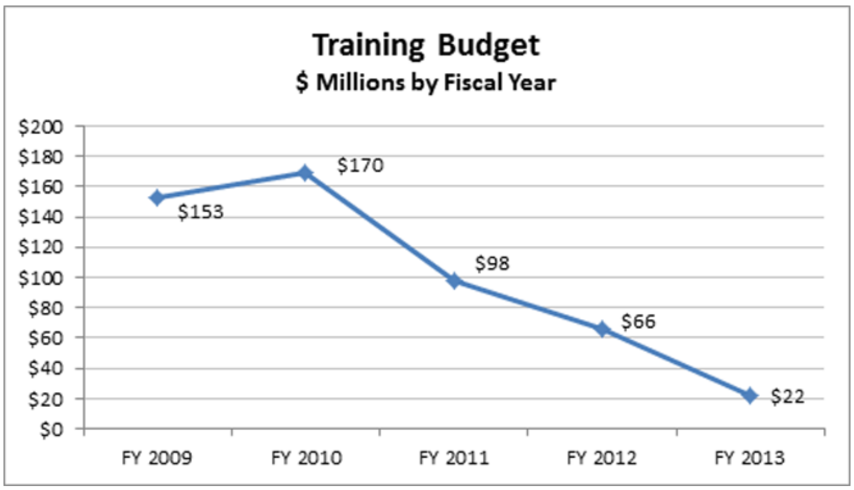
[23] *See* IRC § 7803(c)(2)(B)(ii)(III).

the oversight process to try to address them. But I personally believe it is a mistake to cut the IRS's budget and thereby preclude the agency from providing basic service to millions of taxpayers who seek help each year. When we ask our taxpayers to turn over a significant portion of their incomes to the Government, we owe it to them—the constituents you represent, and the taxpayers for whom I advocate—to ensure we have the infrastructure in place to help them comply with the requirements Congress has imposed by law.

II. EROSION OF IRS EMPLOYEE TRAINING AND SKILLS

The IRS mission is to "provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all." [24] With a complex and constantly changing tax law, it is essential that IRS employees receive prompt and appropriate training and education in order to provide taxpayers with complete and accurate assistance. However, budget cuts and sequestration have led the IRS to reduce its training budget by over 85 percent since fiscal year 2009.[25] Per-employee spending dropped from nearly $1,450 per full-time equivalent employee in 2009 to less than $250 in 2013.[26]

Figure 2: IRS Training Budget, Fiscal Year 2009–2013



Most of the operating divisions that interact directly with taxpayers fared worse than the agency as a whole. The IRS Appeals division reduced its training budget from nearly $6 million in fiscal year 2009 to about $250,000 in fiscal year 2013, or almost 96 percent.[27] During the same period:

—The Tax Exempt and Government Entities (TE/GE) division slashed its training budget by almost 96 percent, or approximately $7 million;
—The Small Business/Self-Employed (SB/SE) division training budget declined by 93 percent;
—The Large Business and International (LB&I) division training budget fell by about 92 percent;
—The Taxpayer Advocate Service (TAS) decreased its training budget by almost 78 percent; and
—The Wage and Investment (W&I) division fared the best, with a decrease of "only" approximately 74 percent.[28]

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[24] Internal Revenue Manual (IRM) 1.1.1.1, *The IRS Mission* (Mar. 1, 2006).
[25] IRS response to TAS research request (Nov. 22, 2013). In fiscal year 2009, the IRS spent $153,155,686 on training versus $22,574,539 in fiscal year 2013, a reduction of 85.26 percent. The IRS training budget includes both training and conferences.
[26] IRS, Human Resources Reporting Center, available *at* https://persinfo.web.irs.gov/(last visited Oct. 22, 2013).
[27] IRS response to TAS research request (Nov. 22, 2013).
[28] *Id.*

Not only has the IRS reduced the funding and number of hours of training for employees, it has also cut the number of courses offered and eliminated entire subject areas. In fiscal year 2009, SB/SE offered over 2,000 different in-person and virtual learning courses to its Revenue Officers (ROs, who conduct all field collection), compared to just over 900 in fiscal year 2013, a nearly 60 percent decrease. Other job series saw even more drastic cuts. TE/GE Tax Examiners were offered 166 in-person training courses in fiscal year 2009 but only three in fiscal year 2013, a 98 percent decrease.[29]

We want the IRS to treat taxpayers fairly and to assess the correct amount of tax and to protect taxpayer rights in its interactions with taxpayers. After several years of continuing and drastic cuts to training, U.S. taxpayers cannot have confidence that IRS employees will be able to fulfill these expectations. IRS funding for training (and travel related to in-person training) must be restored to 2009 levels.

III. IDENTITY THEFT AND REFUND FRAUD

As I have written in nearly every Annual Report I have delivered to Congress since 2004, tax-related identity theft is a serious problem—for its victims, for the IRS and, when Treasury funds are improperly paid to the perpetrators, for all taxpayers.[30] In general, tax-related identity theft occurs when an individual intentionally uses the Social Security number of another person to file a false tax return to obtain an unauthorized refund.[31]

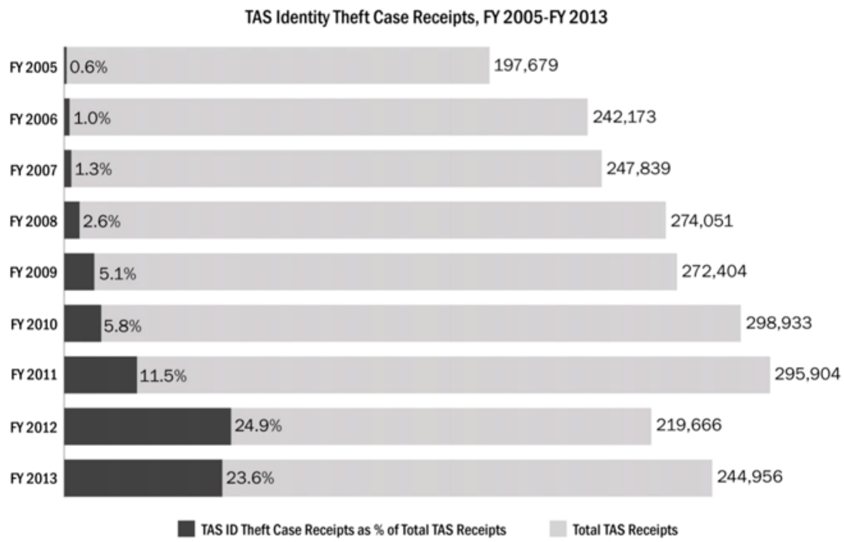
Within my organization, the Taxpayer Advocate Service, identity theft receipts increased sharply over the past decade, accounting for approximately one out of four cases in our inventory in recent years.

[29] *Id.*

[30] *See* National Taxpayer Advocate 2013 Annual Report to Congress 75–83 (Most Serious Problem: *The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 42–67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*); National Taxpayer Advocate 2011 Annual Report to Congress 48–73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*); National Taxpayer Advocate 2009 Annual Report to Congress 307–317 (Status Update: *IRS's Identity Theft Procedures Require Fine-Tuning*); National Taxpayer Advocate 2008 Annual Report to Congress 79–94 (Most Serious Problem: *IRS Process Improvements to Assist Victims of Identity Theft*); National Taxpayer Advocate 2007 Annual Report to Congress 96–115 (Most Serious Problem: *Identity Theft Procedures*); National Taxpayer Advocate 2005 Annual Report to Congress 180–191 (Most Serious Problem: *Identity Theft*); National Taxpayer Advocate 2004 Annual Report to Congress 133–136 (Most Serious Problem: *Inconsistence Campus Procedures).*

[31] The IRS refers to this type of tax-related identity theft as "refund-related" identity theft. In "employment-related" identity theft, an individual files a tax return using his or her own taxpayer identifying number (usually an Individual Taxpayer Identification Number or ITIN), but uses someone else's SSN to obtain employment. Consequently, the wages are reported to the IRS under the SSN of the victim, potentially prompting the IRS to pursue the victim for additional tax on the apparent income. *See* IRM 10.5.3.2(4), *Identity Protection Program Servicewide Identity Theft Guidance* (Feb. 27, 2013). Unlike in 1993, when I first represented a client in an identity theft case, the IRS now has procedures in place to minimize the tax administration impact to the victim in these employment-related identity theft situations. Accordingly, I will focus on refund-related identity theft in this testimony.

Figure 3: Taxpayer Advocate Service ID Theft Cases [32]



When we first started writing about tax-related identity theft in 2004, the IRS had no procedures for its employees to follow when a taxpayer claimed to be a victim of ID theft. Since then, the IRS has established a program office to develop victim assistance procedures and has adopted many of the recommendations we have made over the years. The IRS also has done a better job of developing automated filters that flag suspicious returns and delay the payout of refunds while the refund claims are scrutinized, and it has improved some of its victim assistance procedures.

Yet, the IRS still has much room for improvement in how it addresses identity theft. First, it must recognize that the consequences for victims can be significant. Being victimized by an identity thief is a traumatic life event; when someone steals and uses your identity, it is an invasion of your person. On top of that, the victim must spend time and energy having to prove his or her identity to the IRS and must endure months of aggravation and frustration before receiving his or her tax refund, a delay that can create financial hardships for taxpayers—particularly low income taxpayers—who are expecting and depending on their tax refunds to pay basic living expenses. The IRS's current approach in many ways treats the victim as someone experiencing a minor inconvenience, instead of a frightening personal trauma.

In acknowledging that identity theft is a traumatic life event, the IRS should set up a centralized identity theft unit similar to the innocent spouse unit that assists taxpayers who are seeking relief from joint and several liability. It is important to have a centralized unit with specially trained employees who can remain on the case as a single point of contact with the victim from the beginning to full case resolution. Otherwise, the IRS would be guilty of contributing to the problem and perpetuating the trauma to the victim. When I visited the IRS Identity Protection Specialized Unit (IPSU) unit last summer, I met with front-line employees, many of whom expressed frustration about not truly "owning" a case and having to wait for other functions to take actions on these cases that the IPSU could have easily completed.

In my latest report to Congress, I recommended that the IRS designate the IPSU as the centralized function that assigns a single employee to work with ID theft victims until all related issues are resolved. In my meetings with the new IRS leadership, they have expressed willingness to revisit whether the current decentralized approach is the right one. I have offered to collaborate with the Wage and Investment division to test the effectiveness of creating a meaningful single point of contact for victims of identity theft with cases that require the involvement of multiple IRS functions (for example, where the taxpayer is not only trying to get a current

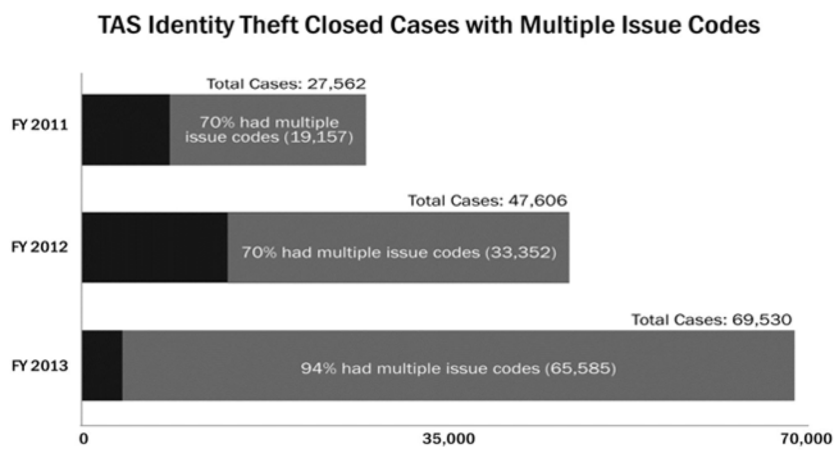
[32] Case receipt data obtained from the Taxpayer Advocate Management Information System (TAMIS) on February 13, 2014.

year's return refund but also seeking abatement of an assessment attributable to a prior year's identity theft return).

The IRS takes much too long to resolve ID theft cases and issue refunds to the legitimate taxpayers, particularly where the case moves back and forth among IRS functions. A 2013 TIGTA report found the IRS took an average of 312 days to work the 100 ID theft cases in the report sample.[33] This included 277 days of inactivity. In other words, though the cases lingered in various IRS units for approximately 10 months, the average case in TIGTA's sample was resolved with just 35 days of direct contact.

The IRS's current approach of using more than 20 specialized units to handle discrete aspects of an identity theft victim's case is simply not working. As far as the victims are concerned, there should be one IRS employee who interacts with the taxpayer. That one employee should maintain control of the taxpayer's case, including all peripheral issues stemming from the identity theft. Because identity theft cases are often very complex, and can involve multiple issues spanning multiple years, too many victims fall between the cracks of the IRS bureaucracy.

Figure 4: Percentage of TAS ID Theft Cases with Multiple Issue Codes, Fiscal Year 2011–2013 [34]



The Taxpayer Advocate Service's experience with working identity theft cases demonstrates the soundness of our recommendation that the IRS should assign one employee to work with the victim from the beginning, and oversee the case when it requires coordination among different units. Instead of taking 312 days to work an identity theft case, TAS case advocates resolve them in 87 days.[35] And even though identity theft cases are complex (with over 94 percent of our identity theft cases closed in fiscal year 2013 involving more than one issue code), TAS case advocates have achieved a relief rate of 87 percent.[36] Furthermore, an overwhelming 94 percent of identity theft victims who came to TAS in fiscal year 2013 have expressed satisfaction with our assistance.[37]

The IRS also needs to do a better job of tracking identity theft case data. The IRS cannot even provide a reliable figure for the number of identity theft victims it has assisted, partly because the various specialized units use different systems to track

[33] *See* TIGTA, Ref. No. 2013–40–129, *Case Processing Delays and Tax Account Errors Increased Hardship for Victims of Identity Theft* (Sept. 26, 2013).

[34] The IRS does not track the number of issues in a given identity theft case because, unlike TAS, it treats each module (year/tax/issue) as a different case. Accordingly, we can provide TAS data only. This chart is meant to illustrate that the vast majority of TAS identity theft cases involve multiple issue codes. The increase in the percentage of cases with multiple issue codes from fiscal year 2011 to fiscal year 2013 may be due to better coding by TAS case advocates to record secondary issue codes; it does not necessarily mean that TAS identity theft cases have become more complex in recent years.

[35] Analysis conducted by TAS Technical Analysis and Guidance of data obtained from TAMIS (Oct. 1, 2013).

[36] *Id.*

[37] Analysis conducted by TAS Business Assessment of customer satisfaction scores reported for fiscal year 2013 (through June 2013); data obtained from TAMIS (Oct. 1, 2013).

cases. Moreover, while some IRS functions track the length of time a case is in their inventory, the IRS still cannot provide an overall cycle time from the taxpayer's perspective. For example, specialized units generally measure cycle time from the date that particular unit received the case; their cycle time measures do not reflect the time elapsed since the taxpayer attempted to file the initial return, or all of the prior interactions the victim may have had with the IRS. In my 2013 Annual Report to Congress, I recommended that the IRS develop a method of tracking cycle time from the perspective of the victim.

IV. AFFORDABLE CARE ACT

As part of the Affordable Care Act (ACA), the IRS is implementing complicated healthcare tax provisions that require new technology and significant rule-making.[38] These provisions would present a serious administrative challenge to any agency, but for one such as the IRS, with its annual and continuing tax administration duties, the added work is daunting. To date, I believe the IRS has acquitted itself well in meeting its initial responsibilities under the ACA. Specifically, the IRS has done a good job of updating information technology (IT) systems, issuing guidance, and collaborating with other Federal agencies. The IRS's actions with regard to ACA implementation demonstrate what the IRS can do when it has sufficient lead time to plan and implement a complex social benefit delivered through the tax system.

While the opening of the Health Insurance Marketplaces[39] on October 1, 2013, was riddled with problems, the one aspect that went better than anticipated was the role of the IRS in providing information to the Marketplace on household income and family size. Originally, the IRS agreed that queries from the Marketplace would have an average response time of less than 5 seconds. However the IRS has been providing an average response time of less than one second.[40] The IRS is to be commended on its ability to surpass expectations thus far.

In order to ensure that ACA design and implementation treat taxpayers—both individuals and businesses—appropriately and fairly, the Taxpayer Advocate Service has been actively involved with the IRS roll-out of the Affordable Care Act tax provisions. I personally sit on the ACA Executive Steering Committee and have staff throughout TAS on the ACA Joint Implementation Teams to ensure the provisions are implemented in a fair and equitable manner and that taxpayer rights are protected.[41]

ACA Taxpayer Service and Training Raise Concerns

The true test for the IRS will be in 2015, when taxpayers begin filing their 2014 tax returns. This will be the first year when individual taxpayers will have to report they have minimal essential health insurance coverage when they file their income tax returns, or that they are exempt from the responsibility to have the required health insurance coverage. If the taxpayer does not have health insurance coverage and is not exempt, then he or she will need to make an individual shared responsibility payment (ISRP) when filing a return.[42] Additionally, many taxpayers will have to reconcile the Premium Tax Credit amounts they are currently receiving with the amounts to which they are entitled based on their actual (as opposed to projected) 2014 income.[43]

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[38] *See* Patient Protection & Affordable Care Act of 2009, Public Law No. 111–148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care & Education Reconciliation Act of 2010, Public Law No. 111–152, 124 Stat. 1029 (Mar. 30, 2010).

[39] https://www.healthcare.gov/marketplace/individual.

[40] This is due, in part, to a lower than anticipated volume of inquiries. Data provided verbally at ACA Executive Steering Committee on Nov. 13, 2013.

[41] The Joint Implementation Teams TAS is represented on are: Customer Service Operations, Tax Return Processing, Information Return Receipt and Processing, ACA Notices and Correspondence, Compliance—Individuals, Compliance—Business, and Collection.

[42] IRC § 5000A. The following individuals in the following categories are exempt from the ISRP: a member of a religious sect that is recognized as conscientiously opposed to accepting insurance benefits; a member of a healthcare sharing ministry; a person not lawfully present in the U.S.; a person incarcerated for at least one day of the applicable month in a jail, prison, or similar penal institution or correctional facility after the disposition of charges; a person who has income below the tax filing threshold; a person who lacks coverage for fewer than 3 months; a person who cannot afford coverage where the required contribution exceeds 8 percent of household income for 2014; members of federally recognized Indian tribes; or persons who have suffered hardship as certified by an Exchange with respect to the capability to obtain minimum essential coverage (including, among others, patients of the Federal Indian Health Service not enrolled in a recognized tribe). See IRC § 5000A(d) and (e).

[43] The Premium Tax Credit is a refundable, advanceable tax credit available to help taxpayers with moderate income purchase health insurance through a Marketplace. IRC § 36B.

While other agencies have telephone or Web chat options, the IRS has adopted a Web-first strategy that acts more as a "Web-only" strategy, limiting taxpayers' access to in-person assistance with tax-related healthcare questions.[44] The IRS has specifically advised its assistors "the best service to the customer is to provide the Web URLs. This is known as the 'Web First' strategy."[45] In comparison, Healthcare.gov has telephone assistors trained to answer questions, as well as a live Web chat option.[46]

Web sites alone may not meet the needs of taxpayers dealing with complicated new provisions for the first time.[47] Moreover, those who are eligible for the Premium Tax Credit may not have the necessary language or computer literacy skills to obtain information in this way,[48] and those who lack Internet access still need IRS assistance through other channels. Obtaining healthcare is an inherently complicated and personal decision that can have a major impact on a taxpayer's life and finances. If the IRS cannot answer tax-related questions, taxpayers may unknowingly make healthcare choices that carry significant tax implications.

The IRS Is Not Adequately Training Assistors to Respond to Taxpayer Questions on Health Care Issues

As discussed above, due to resource constraints the IRS already cannot answer millions of telephone calls or respond timely to volumes correspondence from taxpayers.[49] The new work caused by the ACA will compound this backlog. The IRS estimates it needs almost 2,000 new employees to handle the numerous additional calls and letters that may arrive once applicable provisions take effect.[50] Absent additional employees dedicated to the ACA, the IRS must ensure that the employees it does have —particularly in taxpayer-facing roles—are properly trained to respond to taxpayer inquiries.

The IRS has provided some general ACA information to employees but has not yet engaged in substantive training. The IRS says it is developing training for 2014, but TAS has yet to see or review its training plan. In contrast, TAS has been providing training to its employees on the Affordable Care Act since 2010, to give them time to digest and develop a basic understanding of the new provisions. TAS plans to continue this training through 2014, adding more in-depth sessions and specific case studies. It is my understanding that one of the ACA Implementation Teams is reviewing the ACA training TAS offered this year to see if it meets the needs of the ACA overview all IRS employees should receive. I encourage the IRS to use TAS's training and ensure that all IRS employees receive basic training on the new healthcare provisions.

IRS Outreach Does Not Alert Taxpayers to the Issues Surrounding a Change in Circumstances

The IRS has made strides in its ACA outreach efforts. It has issued several user-friendly publications for taxpayers regarding the Premium Tax Credit, and we understand it plans similar publications for the employer provisions and Individual

[44] *See* Health Insurance Market Place, *Help-Center,* https://www.healthcare.gov/help-center/ (last visited Aug. 12, 2013).

[45] IRS, *Affordable Care Act Web First Strategy: Addressing Health Care Law Inquiries,* http://win.web.irs.gov/field/fadocs/ACA_Web_First_Strat.pdf (last visited Apr. 30, 2013).

[46] *See* Health Insurance Market Place, *Help-Center,* https://www.healthcare.gov/help-center/ (last visited Aug. 12, 2013).

[47] Existing IRS functions, such as Stakeholder Partnership, Education & Communication (SPEC), Stakeholder Liaison, and Taxpayer Assistance Centers may receive questions and even visits from taxpayers who want to know about the ACA. *See* SPEC *Outreach Summary* (Filing Season Jan.-Apr. 2013) (containing 3-pg. ACA Overview); IRS Pub. 5093, *Healthcare Law Online Resources* (1 pg. listing a half-dozen URLs for individuals & employers).

[48] Adults "living in households earning at least $50,000 per year are more likely to have home broadband than those at lower income levels." Pew Res. Ctr., *Home Broadband* 2013, *available at* http://pewInternet.org/Reports/2013/Broadband.aspx (last visited Sept. 17, 2013). As of 2011, only "75.6 percent of households reported having a computer," which means almost a quarter of the Nation's households may be unable to get the information they need from the IRS's Web strategy. U.S. Census Bureau, *Computer and Internet Use in the United States,* P20-569 (May 2013) 1. *See also* National Taxpayer Advocate 2011 Annual Report to Congress 273, 279 (Introduction to Diversity Issues: *The IRS Should Do More to Accommodate Changing Taxpayer Demographics*) ("low income, less educated, minority, elderly, disabled, or rural populations are less likely than others to use the Internet").

[49] *See* NTA 2013 Annual Report 20 (Most Serious Problem: *IRS Budget Cuts Diminish Taxpayer Service*); National Taxpayer Advocate 2012 Annual Report to Congress 34 (Most Serious Problem: *The IRS Is Significantly Underfunded to Serve Taxpayers and Collect Tax*); IRS Joint Operation Center (JOC) Snapshot Report for fiscal year 2013 (Sept. 30, 2013) and JOC Accounts Management Inventory Reports for fiscal year 2013 (Oct. 6, 2012–Sept, 28, 2013).

[50] *See* IRS fiscal year 2014 Congressional Budget Submission, Table 4.9 at 177.

Shared Responsibility Payment.[51] Additionally, the IRS has made efforts to improve the ACA pages on IRS.gov, including by posting new pages on the Premium Tax Credit and the ISRP[52] as well as updated Q&As and legal guidance.[53] The IRS also plans to create a page on the 5000A Individual Shared Responsibility Payment. TAS will continue to work with the IRS on its outreach efforts.

However, we remain concerned that the IRS is not being proactive and educating taxpayers as early as possible on a critical issue: the importance of updating their information throughout the year with the Exchange if they are receiving a credit.[54] To avoid receiving an excess credit, taxpayers must update their information with the marketplace if their incomes or other relevant circumstances change.[55] This is also important for taxpayers who may be eligible for a larger credit due to a reduction in pay or an increase in family size (such as having or adopting a child). Educating taxpayers early and repeatedly about this requirement will help prevent them from owing money to the IRS (or reducing their refunds) or receiving an additional credit amount at the end of the year that they could have received earlier.

Healthcare.gov now has a "Report Life Change" button that allows individuals to modify their health insurance plans (once they are enrolled) if they have experienced a change such as family size, moving, etc.[56] Assuming this option will also allow for a recalculation of the Premium Tax Credit based on these changes, the IRS can easily tie its messages about changing circumstances into this new option.

TAS worked with the IRS to prominently place language in the 2013 Form 1040, *U.S. Individual Income Tax Return,* instructions to alert taxpayers to the importance of updating their information with the marketplaces. However, the IRS still needs to be more proactive. While almost 80 percent of individual returns are refund returns and thus may offset some or all of the reconciliation amount, the IRS should be doing all it can to ensure that as few taxpayers as possible have excessive advanced premium tax credit payments and instead receive the correct amount throughout the year.[57] In addition to preventing taxpayers from owing money, this approach will reduce future costs to the IRS for collection activities.[58]

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[51] Thus far, the IRS has issued several electronic publications, including Pub. 5093, *Health Care Law Online Resources* (July 2013), Pub. 5120, *Facts About the Premium Tax Credit* (flyer) (Sept. 2013), and Pub. 5121, *Facts About the Premium Tax Credit* (brochure) (Dec. 2013). We understand that Spanish versions of the publications are in progress.

[52] The ACA homepage is located *at* http://www.irs.gov/aca. The Premium Tax Credit page is located *at* http://www.irs.gov/uac/The-Premium-Tax-Credit. The ISRP page is located *at* http://www.irs.gov/uac/Individual-Shared-Responsibility-Provision.

[53] http://www.irs.gov/uac/Newsroom/Affordable-Care-Act-Tax-Provisions-Questions-and-Answers.

[54] To apply for a premium assistance credit, an individual goes to an Exchange, which will attempt to verify household income with the IRS. In general, applicable taxpayers seeking health insurance and a premium tax credit through an Exchange will supply names, Social Security numbers, and income data for themselves and their dependents to the Exchange. *See* ACA § 1411(b), 124 Stat. 119, 224 (2010). The Exchange can verify data with HHS, which has authority under the ACA to obtain IRS data, and then disclose any inconsistency to the Exchange. *See* IRC § 6103(l)(21). If IRS information is inaccurate or outdated, the individual may need to present updated documentation or other evidence to HHS to establish eligibility for a premium tax credit. If a taxpayer's household status at year's end is other than anticipated—due either to a change in income or family size—the premium tax credit may be more or less than the amount advanced. Consequently, the IRS may recover the excess as a tax (above a threshold for low income taxpayers), or owe the taxpayer a refund. Section "36B(f)(2)(B) places a graduated set of caps on the additional tax liability for taxpayers with household income under 400 percent of the F[ederal] P[overty] Level]. The repayment limitation amounts range from $600 to $2,500 (one-half that amount for single taxpayers) depending on FPL, and are adjusted to reflect changes in the cost of living beginning in 2015." 76 Fed. Reg. 50931, 50933-934 (Aug. 17, 2011).

[55] Income may change after submission of an application, which reflects the amount on the last tax return, *i.e.,* the one filed in the current year relating to the year that just ended. Thus, a couple of years' worth of life changes may transpire by the time of reconciliation between the advance and ultimate credit amounts. By the same token, certain changed circumstances, such as the birth of a child or a reduction in pay, may increase the credit.

[56] Amy Goldstein, *Administration will allow people to switch health-care plan to a limited degree,* Washington Post (Feb. 7, 2014) *available at* http://www.washingtonpost.com/national/health-science/administration-will-allow-people-to-switch-obamacare-plans-to-a-limited-degree/2014/02/07/56c8bfd2-9015-11e3-b227-12a45d109e03_story.html (last visited Feb. 18, 2014).

[57] IRS Compliance Data Warehouse, Individual Returns Transaction File Tax Year 2012 (Feb. 2014).

[58] TAS looks forward to working with the IRS Office of Research, Analysis and Statistics (RAS) to try to identify the areas and populations of taxpayers most likely to have experienced a change in circumstances. This information can be used by the IRS's SPEC organization, TAS Local Taxpayer Advocates (LTAs), Low Income Taxpayer Clinics (LITCs), and other stakeholders to conduct outreach to these specific populations.

I have additional concerns that other taxpayers will have their returns delayed because they claim a larger Premium Tax Credit than what they received during the year due to a change in circumstances. If the IRS flags these returns as potentially fraudulent, it may hold up legitimate refunds. TAS has seen these issues previously, especially when large dollar amounts are at stake.[59]

While there will always be persons trying to game the tax system, I believe the risk of fraud with respect to the Premium Tax Credit (PTC) is much less than with many other refundable credits. With respect to the Advanced Premium Tax Credit, the credit will be paid to established insurance companies when a policy is actually in place. When a taxpayer claims the PTC on his or her income tax return, it is a reimbursement of amounts already paid; the taxpayer will have to provide proof of a qualified health insurance plan, which the IRS will be able to verify through third-party information reporting. This design minimizes the opportunities for fraud.

TAS is in the final stages of developing an estimator for the Premium Tax Credit that will help taxpayers and practitioners understand how changes in circumstances will impact their credit amounts. TAS hopes to have this tool online and available to the public in the next few months. We have had success with a similar estimator for the Small Business Health Care Tax Credit (SBHCTC), which we launched on the TAS Tax Toolkit in November 2012.[60] The homepage for the estimator received 5,000 page views for October 2013 and over 13,000 page views for October—December 2013.[61]

IRS ACA Audit and Collection Activity May Unduly Burden Low Income Taxpayers

My concerns about the IRS's implementation of the Affordable Care Act (ACA) are similar to concerns I have raised on numerous occasions about the IRS's handling of identity theft claims. Just as the IRS does not resolve identity theft cases through a single point of contact and thereby forces taxpayers to negotiate a maze of various IRS functions to unwind the harm caused by the identity theft, the IRS may not resolve, during routine audits, issues related to the ACA. This case segmentation may prolong the length of time taxpayers must wait to fully and finally resolve their tax liabilities for a given year and burden them with additional IRS contacts. These inefficiencies, some of which appear to be attributable to programming conditions, may disproportionately affect low income taxpayers.[62]

For example, the IRS may audit the return of a taxpayer claiming the Earned Income Tax Credit (EITC).[63] The taxpayer may have also claimed the Premium Tax

[59] National Taxpayer Advocate 2012 Annual Report to Congress 111–133 (Most Serious Problem: *The IRS's Compliance Strategy for the Expanded Adoption Credit Has Significantly and Unnecessarily Harmed Vulnerable Taxpayers, Has Increased Costs for the IRS, and Does Not Bode Well for Future Credit Administration*); National Taxpayer Advocate fiscal year 2012 Objectives Report to Congress 28–32; National Taxpayer Advocate 2011 Annual Report to Congress 687–689 (Case Advocacy: *Policymakers Can Learn from the Implementation of the FTHBC*); National Taxpayer Advocate fiscal year 2011 Objectives Report to Congress 3, 37–43; National Taxpayer Advocate 2010 Annual Report to Congress 15 (Most Serious Problem: *The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs*) (Case Advocacy: *TAS Assists the IRS with the Administration of the First-Time Homebuyer Credit*); National Taxpayer Advocate 2009 Annual Report to Congress 506–509; *Hearing on Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What's Due, Hearing Before the S. Comm. on Finance,* 112th Cong. (statement of Nina E. Olson, National Taxpayer Advocate) (June 28, 2011); *Filing Season Update: Current IRS Issues: Hearing Before the S. Comm. on Finance,* 111th Cong. (2010) (statement of Nina E. Olson, National Taxpayer Advocate) (Apr. 15, 2010); *The National Taxpayer Advocate's 2009 Report on the Most Serious Problems Encountered by Taxpayers: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means,* 111th Cong. (2010) (statement of Nina E. Olson, National Taxpayer Advocate) (Mar. 16, 2010).

[60] http://www.taxpayeradvocate.irs.gov/Businesses/Small-Business-Health-Care-Tax-Credit-Estimator (last visited Feb. 19, 2014). According to Weber Shandwick, which tracks statistics for the estimator, the SBHCTC estimator has received over 23,500 page views since its launch in 2012.

[61] Taxpayer Advocate Service, fiscal year 2014 1st Quarter Business Performance Review.

[62] Programming deficiencies are evident in other, related areas of IRS operations. See letter from Sen. Grassley to Comm'r Koskinen (Apr. 21, 2014) *available at* http://www.grassley.senate.gov/issues/upload/Grassley-to-IRS-Return-Review-Program-4-21-14.pdf, noting that the IRS is not implementing the needed Return Review Program, a fraud detection system especially critical as the refundable Premium Tax Credit becomes available, due to budgetary constraints.

[63] Taxpayers who claim the Earned Income Tax Credit are more likely to be audited than taxpayers in the general population. EITC audits have historically comprised about a third of all individual taxpayer audits. *See* National Taxpayer Advocate 2012 Annual Report to Congress

Continued

Credit.[64] If the IRS determines the taxpayer's income exceeded the allowable threshold for claiming EITC, the taxpayer may also not be eligible for the PTC. However, under current programming conditions, the IRS would not be able to resolve both issues in the course of the audit because it plans to assess liability under the ACA using different software than it uses to process returns. Return-processing software would not recognize and manage tax liabilities arising under the ACA.[65] Consequently, the IRS would "conclude" the audit and assess additional tax because of disallowed EITC only to contact the taxpayer months later and assess additional tax due to disallowed PTC.

Conversely, if a taxpayer inflated his or her income in order to receive a larger EITC refund and the IRS later adjusts the taxpayer's income downward and reduces the claimed EITC amount, the taxpayer might be entitled to additional PTC because of the decreased income. As a result of the audit, the IRS would assess additional tax due to disallowed EITC, but the taxpayer's final liability, determined months later after the PTC issue is addressed, may be lower. The taxpayer might receive demands for payment related to the disallowed EITC in the meantime.

Similar issues arise with respect to the ISRP. A taxpayer may claim EITC and also report liability for ISRP with respect to the same child.[66] If the IRS determines the child was not a qualifying child, it would disallow the claimed EITC and assess additional tax. If the child was also not the taxpayer's dependent, the taxpayer would not be liable for ISRP with respect to that child, but only later would the IRS contact the taxpayer with respect to the assessed ISRP and ultimately reduce the liability. In the meantime, the taxpayer might be burdened with demands for payment and enforced collection action with respect to the disallowed EITC at a time when the true amount of the taxpayer's liability had not yet been established.

The ACA prohibits the IRS from collecting ISRP liabilities through enforced collection action.[67] However, when the IRS takes enforced collection action, such as a levy, to collect non-ISRP liabilities, it may collect more than the taxpayer actually owes.[68] Once the non-ISRP liabilities have been satisfied, the IRS should refund the overpayment to the taxpayer.[69] However, IRS programming conditions may cause the IRS to automatically apply excess levy proceeds to ISRP liabilities. The IRS tested programming intended to prevent this refund offset, but the proposed solution was successful only if the refund offset occurred in the same cycle the levy payment was received, which occurred only 18 percent of the time.[70] Ensuring that levy proceeds are not applied to ISRP liabilities would require manual processing of these accounts.

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vol. 2, *Study of Tax Court Cases In Which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*.

[64] In general, a taxpayer may be eligible for the PTC if the taxpayer's household income for the taxable year is at least 100 percent but not more than 400 percent of the Federal poverty level for the taxpayer's family size. IRC § 36B(c)(1). The 2014 Federal poverty level for a four-person household is $23,850. *See* Federal Poverty Guidelines, *available at* http://aspe.hhs.gov/POVERTY/14poverty.cfm. 400 percent of $23,850 is $95,400. For 2014, joint filers with two qualifying children must have adjusted gross income of less than $49,186 in order to qualify for EITC. *Preview of 2014 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates, available at* http://www.irs.gov/Individuals/2012-EITC-Income-Limits,-Maximum-Credit--Amounts-and-Tax-Law-Updates.

[65] The traditional software used by IRS Exam to conduct audits, Report Generating Software, cannot accommodate the need to assess these tax liabilities resulting from the same audit record.

[66] Under section 5000A(b)(3) of the ACA, the adult or married couple who can claim a child or another individual as a dependent for Federal income tax purposes is responsible for making the payment if the dependent does not have coverage or an exemption.

[67] IRC § 5000A(g)(2)(B).

[68] This may occur, for example, when the IRS imposes a continuous levy on the taxpayer's wages or levies on Social Security benefits and either inadvertently does not release the levy when the tax liability has been satisfied, or releases the levy, but not before the employer or the Social Security Administration has already remitted the payment to the IRS. See IRM 5.11.2.6 (Apr. 15, 2014), noting that "Every reasonable effort will be made to release a notice of levy timely. However, sometimes surplus levy proceeds are received. Surplus proceeds are payments greater than the amount still owed for the liabilities listed on the notice of levy. Example: A refund posts after the levy source has already sent payment for the levy."

[69] *See* IRC § 6342(b).

[70] Wage and Investment Research & Analysis (WIRA) Group 2, Project #2-14-09-A-*206 Refund Offset Adjustment Due to Lien/Levy Overpayment* (April 2014) and attached spreadsheet, showing that out of 11,064 transactions in tax year 2012 in which a levy resulted in an overpayment, in only 2,039 transactions was the overpayment offset to another module in the same cycle and was therefore preventable. 2,039 out of 11,064 is 18 percent. TAS Research has not yet verified the accuracy of these findings.

Delays in Information Matching Show Need for Real-Time Tax System

Last year, the Treasury Department delayed the requirement for certain employers with 100 or more employees to provide coverage to their employees.[71] Due to the delay in implementation, employers will not have to provide information reporting to the IRS regarding the employees they cover.[72] This information reporting will help identify which taxpayers have coverage and which do not (and therefore have to pay a penalty). We do not yet know how the IRS plans to address this lack of information during the 2015 filing season. TAS members on the relevant Joint Implementation Team have been told it will be discussed later.

Without this information, the IRS's job is increasingly difficult. This concern underscores the need for the IRS to develop an accelerated document-matching program, as discussed immediately below.

V. ACCELERATED RECEIPT AND USE OF THIRD-PARTY INFORMATION REPORTS

Accelerated third-party information report processing and upfront document matching would protect revenue, reduce fraud, and improve taxpayer service.

Whether in the context of Premium Tax Credit reconciliation, eligibility for the Earned Income Tax Credit, or returns filed by identity thieves, the IRS faces pressure to satisfy two competing demands: protect the public fisc from erroneous refund claims and meet taxpayer expectations by issuing refunds quickly. Although the IRS has instituted many business rules and filters to identify questionable refunds, it generally matches third-party information reports with tax return data long after it has released any associated income tax refunds.[73]

In 2009, I recommended that Congress establish a timeframe for the IRS to develop a strategy and timeline for accelerating third-party information report processing and providing taxpayers with electronic access to such data.[74] Most recently, a study in my 2013 Annual Report proposed a strategic framework and preliminary recommendations to better structure the filing season to reduce fraud and protect the interests of both the Government and taxpayers.[75] This is a key component of 21st century tax administration.

The Government benefits from the revenue protection aspect of accelerated third-party information report processing and upfront document matching. Third-party information reporting is a crucial element in maximizing tax compliance.[76] By enabling the IRS to match third-party data to tax return information before issuing refunds, the IRS could identify and resolve inaccurate income tax reporting soon after the return is filed and prevent the release of erroneous refunds. This system would deter tax fraud and identity theft by stopping the refund associated with a mismatch.

In addition, accelerated information report processing and upfront matching would substantially improve taxpayer service and reduce taxpayer burden by:

—Providing taxpayers with direct electronic access to the third-party information report data to assist in tax preparation and reduce inadvertent errors;[77]

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[71] Treasury Department Fact Sheet, *Final Regulations Implementing Employer Shared Responsibility Under the Affordable Care Act (ACA) for 2015, available at* http://www.treasury.gov/press-center/press-releases/Documents/Fact%20Sheet%20021014.pdf (last visited April 28, 2014). The requirement was further delayed until 2016 for employers with 50 to 99 employees. Shared Responsibility for Employers Regarding Health Coverage, 79 Fed. Reg. 8544 (Feb. 12, 2014).

[72] Transition Relief for 2014 Under §§ 6055 (§ 6055 Information Reporting), 6056 (§ 6056 Information Reporting) and 4980H (Employer Shared Responsibility Provisions), Notice 2013-45, 2013-31 I.R.B. 116.

[73] For a more detailed discussion of the IRS's processes to review refund returns, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation,* 2013 TNT 92-131, Tax Notes Tax Analysts Tax Notes Today (May 13, 2013).

[74] National Taxpayer Advocate 2009 Annual Report to Congress 338–345; National Taxpayer Advocate 2011 Annual Report to Congress 284–295; National Taxpayer Advocate 2012 Annual Report to Congress 180–191.

[75] NTA 2013 Annual Report vol. 2, 67–96.

[76] Tax gap data show the importance of information reporting compliance, and how third-party reporting is essential to encourage voluntary compliance; specifically, when taxpayers have a choice about reporting their income, tax compliance rates are remarkably low. For example, workers who are classified as employees have little opportunity to underreport their earned income because it is subject to both information reporting on Forms W–2 and tax withholding. In fact, IRS data show that taxpayers report about 99 percent of their wages and salaries. IRS, *Tax Gap for Tax Year 2006 Overview,* Chart 1 (Jan. 6, 2012).

[77] Taxpayers will not realize the full benefits of accelerated third-party information reporting unless the IRS provides taxpayers and their preparers with the ability to access and download their third party data from an online account. To address inadvertent omissions, the IRS should provide access to real-time transcripts of third-party data to aid in return preparation. Tax-

Continued

—Improving taxpayers' ability to answer questions about an underlying economic transaction if the IRS identifies the mismatch within months rather than a year or more after the fact;
—Avoiding IRS collection actions long after taxpayers have spent the refunds;
—Avoiding the long-term accrual of penalties and interest on unintentionally omitted or under-reported items; and
—Reducing vulnerability to identity-theft related refund fraud.[78]

While the IRS has acknowledged the benefits of accelerated third-party information report processing and upfront matching, it has not made any recent progress in developing a long-term plan for such a system.[79] The IRS's lack of progress only delays the significant benefits we outlined throughout the study. Thus, we reiterated our 2009 Legislative Recommendation that Congress require the IRS and Treasury, in consultation with the Taxpayer Advocate Service, to prepare a plan and timeline to achieve an accelerated third-party report processing system.

In addition, to stimulate serious consideration and discussion of the issue, we offered the following administrative and legislative recommendations to achieve a system that allows the IRS to perform upfront matching to protect Government revenue and improve taxpayer service:

—Provide taxpayers with electronic access to real-time transcripts of third-party information reporting data to aid in return preparation.
—Provide a platform from which taxpayers and preparers could download third-party data directly into commercial tax return preparation software.
—To accelerate the processing of Form W–2 data, develop and implement a 1 year pilot to determine whether the IRS can screen Form W–2 data as effectively as the Social Security Administration.
—Because almost 98 percent of information reports are already e-filed, eliminate the March 31 deadline for e-filed information reports.[80] Thus, all information reports, whether e-filed or filed on paper, would be due at the end of February.
—Create a $50 *de minimis* threshold for corrections, which would eliminate the need to file an amended or corrected third-party information report for any adjustments to income below $50.
—Further increase electronic filing by reducing the 250 report threshold in IRC § 6011(e) to 50 reports and offer 2D bar code technology for those who cannot e-file.
—Issue direct deposit and other electronic refunds by April 30 and paper checks by May 31 for taxpayers who file their returns by April 15.

The proposals included in the 2013 study are meant to serve as a "conversation starter" and are based on research conducted by the Taxpayer Advocate Service, including discussions with impacted stakeholder groups and a review of international tax systems. We attempted to address all identified concerns and risks, but we acknowledge that there will be unexpected challenges and risks before a proposal along these lines is implemented. We recognize that the changes necessary to ac-

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payers and preparers could refer to the transcripts to ensure they do not accidentally omit income. One step above the transcript would be to provide a platform from which taxpayers and preparers could download third-party data submitted to the IRS or the Social Security Administration directly into a commercial tax software package or even an improved version of the IRS's Free File Fillable Forms (FFFF). This second option would eliminate transcription errors and provide a one-stop-service to taxpayers who would not need to download the data separately from each third party. In addition, the Government would enjoy the benefits experienced by other tax administrations through pre-filled returns, but would still encourage competition in the tax software industry. For more information on the benefits of electronic access to third-party data and the experience of international tax administrations, see National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67–96.

[78] William Hoffman, *IRS Oversight Board Brainstorms Real-Time Tax System, ID Theft Initiatives,* Tax Notes Today (May 2, 2013); IRS, PowerPoint, *Real Time Tax System Initiative, Public Meeting* 1 (Dec. 8, 2011), *available at* http://www.irs.gov/file_source/pub/irs-utl/rtts_deck.pdf. For more information on identity-theft refund fraud, see National Taxpayer Advocate 2013 Annual Report to Congress 75–83 (Most Serious Problem: *The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden to Such Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 42–67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft).*

[79] For written and oral statements of panelists at the two IRS Real Time Tax System Initiative public meetings, *see* http://www.irs.gov/Tax-Professionals/Real-Time-Tax-Initiative (last visited Feb. 13, 2013).

[80] IRS Pub. 6961, *2013 Update: Calendar Year Projections of Information and Withholding Documents for the United States and Campuses,* Tables 2-4 (Of the 2,288,516,144 information reports received in calendar year 2012, 2,240,335,726 were received electronically).

complish an accelerated third-party reporting system require a great deal of forethought, analysis, and stakeholder engagement.

VI. IRS INFORMATION TECHNOLOGY CHALLENGES

An adequately funded, staffed, and skilled IRS Information Technology (IT) function underpins all of the activities described above. IT resources are the common denominator for performing core IRS functions, including taxpayer service, prompt issuance of refunds, selection and assignment of compliance work, and protecting taxpayers and the public from refund fraud and identity theft. If the IT workforce is not appropriately skilled and staffed, the IRS will not be able to bring itself into the 21st century, much less meet its everyday work demands. Cost overruns will occur if the IRS does not have the skilled staff to undertake the necessary strategic planning or provide adequate project and contract oversight.

For fiscal year 2014 and fiscal year 2015, the IRS is focusing its IT resources on three main areas: implementation of the ACA; implementation of FATCA; and implementation of the 2015 filing season, including delivery of various legislative provisions and extenders. All other requests for IT resources are subordinate to these three "heavy lifts." While I understand the importance of each of these areas to tax administration, at current funding and staffing levels the IRS will not be able to deliver on these programs and also improve or correct core processes and systems. The negative impact to taxpayers of not funding everyday improvements to IRS taxpayer service, revenue protection, and compliance activities is significant.

Moreover, because the IT workforce is stretched so thin, the already glacial pace of the IRS's move into a 21st century technology environment is being slowed further. The IRS's inability to digitally communicate with taxpayers places the IRS far behind other international tax administrations and the financial services sector. The slowdown or shutdown of IT support also compounds the impact of taxpayer service funding reductions by driving taxpayers to make numerous telephonic or correspondence contacts with the IRS just to get information about their accounts. It also forces the IRS to continue using archaic compliance methods like correspondence examinations, when a "virtual" face-to-face audit would bring about better and more accurate results in terms of taxpayer response, issue resolution, and taxpayer education.

The Taxpayer Advocate Service has keenly felt the impact of this IT shortfall, when work on a once-in-a generation revision of its case management system (called TASIS) stopped short on March 31, 2014, due to lack of available funds. The work stoppage was based on the IRS's need to prioritize its IT projects and direct all available resources to the three key priorities—ACA, FATCA, and the 2015 filing season. While work will resume on this system shortly because TAS itself has transferred $1.8 million of its operating budget to cover the shortfall, this stop-and-start approach undermines not only TAS's ability to deliver quality service to taxpayers experiencing significant hardship, but also the IRS's efforts in developing an enterprise case management system.

The IRS currently has about 167 case management systems used by different units. This diversity of systems is one reason it is so difficult for IRS employees and taxpayers to find out precisely what the IRS is doing when an issue crosses different IRS functional units. There is no IRS "integrated" or "enterprise-wide" case management system.

The Taxpayer Advocate Service Information System, or TASIS, was designed with this problem in mind. Over a decade ago, TAS began a major redesign effort of its case management and case assignment system, which soon expanded to include all of its activities, including systemic advocacy and research. The result is TASIS—an integrated case, project, and work assignment system that allows for seamless movement and access to cases, projects, research, and archives. TASIS will have the following capabilities:

—TAS Intake Advocates will be able to conduct a real-time initial interview and perform related case-building, including automatically retrieving relevant information from other IRS systems.[81]

—TAS Case Advocates will have the ability to communicate digitally with taxpayers—both receiving and sending information and documents, and sending

[81] As part of our business process review, TAS created an Intake Advocate position to ensure that TAS cases would be as fully developed as possible at the first contact with the taxpayer for assignment to the appropriate case advocate and to eliminate the delays associated with reassigning cases. TAS has also developed procedures for identifying instances where, with a little guidance from the Intake Advocate, the taxpayer could actually resolve the problem him or herself.

automated reminders to taxpayers or IRS employees as needed to keep cases on track toward resolution.

—Taxpayers will be able to submit electronic requests for TAS assistance—whether for help with an individual problem or with solving a systemic problem—and they will be able to check on the status of their cases or systemic issue online without having to call a TAS employee for an update.

—All significant materials—case files, projects, research studies, communications—will be converted to digital files, promoting ease of access and sharing, and eliminating costs of document storage, shipping, archiving, and retrieval.[82]

—Case Advocacy employees will have an easy-to-use method to identify and elevate systemic issues they encounter in the cases.

—TAS will have a sophisticated ability to search our rich repository of information so that projects and data can be easily identified and retrieved via a library of key terms (metadata) that are applied to both cases and projects.

All of these features were designed to minimize the time spent on duplicative keystrokes and data entry, and manual retrieval or requests for information from other functions, so that TAS employees' limited time can be spent on direct communication with and advocating for taxpayers rather than on mere clerical tasks.

In summary, TASIS is a sophisticated case, project, and work assignment management system that has already been identified by the IRS's Chief Technology Officer as a potential foundation for an IRS Enterprise Case Management System, and it is of sufficient significance that the Senate Appropriations Committee has included it on its list of "major information technology project activities" about which the IRS must report quarterly to the Senate and House Appropriations Committees and the Government Accountability Office.[83]

I write about TASIS in detail partly because of its independent significance but also to illustrate the impact of the funding shortfalls in IT more generally. Although TAS is just one small unit within the IRS, it assists taxpayers who are experiencing significant hardship as a result of IRS actions or inaction.[84] The later deployment of TASIS because of the work stoppage will harm those taxpayers, impeding my employees' ability to effectively communicate and advocate on their behalf. The work stoppage also will cost the IRS more in terms of shoring up an obsolete system, unproductive use of employees' direct time, and higher costs once the program is started up again. This pattern is being reproduced several times over in every business unit of the IRS.

As the National Taxpayer Advocate, I believe it is a key taxpayer need that the IRS's IT function be adequately funded, not only to deliver on major initiatives like ACA and FATCA, but also to deliver on the many small but important improvements and projects that will make a positive difference for taxpayers, employees, and the public fisc. Furthermore, the IRS needs dedicated funding to develop projects that bring us into the 21st century and the digital age. The IRS should be in the vanguard of technology, not bringing up the rear.

VII. CONCLUSION

In my 2013 Annual Report, I stated that the short-term crises of the past year masked the major problem facing the IRS today—unstable and chronic underfunding that puts at risk the IRS's ability to meet its current responsibilities, much less articulate and achieve the necessary transformation to an effective, modern tax agency. The issues I have discussed today clearly illustrate this situation. In this and every filing season, the IRS must carry out its core mission of collecting revenue and helping taxpayers comply with their obligations. At the same time, it must deal with threats such as identity theft, prepare for the new challenges presented by the ACA, and bring its technology into the 21st century.

I am hopeful that the new leadership of the IRS, with continued oversight and support from Congress and the involvement of the Office of the Taxpayer Advocate, can meet these goals. In particular, I believe that the IRS can improve tax administration and the fundamental fairness of the system by embracing the Taxpayer Bill of Rights I have outlined here today and using those principles to help guide the

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[82] Reliance on paper files and documents requires storage and handling of 50 to 60 pages for each TAS case, or approximately 12.5 million pages each year. This includes hard copies as well as records kept on employees' local hard drives. TAS incurs repeated copying and shipping costs for transfers, work reviews, and collaboration. The use of virtual documents will almost eliminate costs associated with paper document-handling and storage, allow immediate access for collaboration, and improve TAS's ability to reference the products or conduct research.

[83] S. Rep. No. 113–80, at 34 (2013).

[84] *See* IRC § 7811.

establishment of agency goals and policies. Thank you for the opportunity to submit this testimony.

PREPARED STATEMENT OF THE NATIONAL TREASURY EMPLOYEES UNION

Chairman Udall, Ranking Member Johanns and distinguished members of the subcommittee, I would like to thank you for allowing me to provide comments on the Internal Revenue Service (IRS) budget request for fiscal year 2015. As president of the National Treasury Employees Union (NTEU), I have the honor of representing over 150,000 Federal workers in 31 agencies, including the men and women at the IRS.

Mr. Chairman, despite the critical role that the IRS plays in helping taxpayers meet their tax obligations and generating revenue to fund the Federal Government, the IRS' ability to continue doing so has been severely challenged due to funding reductions in recent years.

Since fiscal year 2011, funding for the IRS has been cut by nearly $1 billion, a reduction of almost 8 percent. The funding cuts have forced the IRS to operate under an exception-only hiring freeze since December 2010, and forced the Service to reduce the total number of full-time, permanent employees by about 10,000, many of whom are responsible for providing critical services that taxpayers require in order to meet their tax obligations.

IRS FISCAL YEAR 2015 BUDGET REQUEST

NTEU was pleased to see that the administration's budget request for the IRS would provide the agency with a total of $12.4 billion in fiscal year 2015, an increase of more than $1.1 billion over the current fiscal year 2014 level which would help restore funding for important taxpayer service and enforcement activities that have been slashed in recent years. These funding reductions have adversely impacted IRS' ability to meet its mission, and without action by Congress, IRS' ability to serve taxpayers and enforce our Nation's tax laws will continue to erode.

TAXPAYER SERVICES

Providing quality taxpayer service is a critical component of the IRS' efforts to help the taxpaying public understand their tax obligations while making it easier to participate in the tax system. Through a variety of in-person, telephone and Web-based methods, the IRS seeks to help taxpayers navigate an increasingly complex tax code and prevent inadvertent noncompliance. Unfortunately, the IRS' ability to provide excellent taxpayer service has been severely challenged due to reduced funding in recent years and the cuts mandated by sequestration. Without additional resources, further degradation in taxpayer services will occur, jeopardizing our voluntary compliance system.

IMPACT OF INADEQUATE FUNDING ON TAXPAYER SERVICES

In the past few years, many experts in the tax community, including the National Taxpayer Advocate, the IRS Oversight Board and the IRS Advisory Council have all warned of the dangers of underfunding the IRS and the adverse impact it has had on taxpayer service.

In her Annual Report to Congress released earlier this year, National Taxpayer Advocate Nina Olson identified insufficient funding of the IRS as one of the most serious problems facing taxpayers. According to Olson, the lack of adequate funding, coupled with a rising workload has had a devastating impact on IRS taxpayer service. Among the report's findings are:

—Last year, only 61 percent of calls from taxpayers seeking assistance reached a customer service representative, leaving 20 million taxpayers unable to get through—that is a decline from 87 percent a decade earlier, with half the decline occurring since 2010.

—Taxpayers who did get through had to wait on hold approximately 17.6 minutes before speaking with a CSR. That's up from 2.6 minutes 10 years earlier, a nearly six-fold increase, with nearly half the increase occurring since fiscal year 2010.

—An 86 percent drop in tax law questions answered from 795,000 10 years ago to only 110,000 in the 2013 tax-filing season.

—A cut of 87 percent, from $172 million in 2010 to just $22 million last year in employee training.

—The IRS historically has prepared tax returns for taxpayers seeking its help, particularly for low income, elderly, and disabled taxpayers. Ten years ago, it prepared some 476,000 returns. That number declined significantly over the decade, and the IRS recently announced it will no longer prepare returns at all.

—Last year, the IRS received about 8.4 million letters from taxpayers responding to proposed adjustments to their tax liabilities. As of the end of the fiscal year, 53 percent of taxpayer letters in the IRS's "adjustments" inventory were considered "over age" (generally, more than 45 days old). That compares with "over age" percentages of 12 percent 10 years earlier and 28 percent in fiscal year 2010.

—At the same time, the number of individual tax returns grew from 131.4 million in fiscal 2004 to about 146 million in fiscal 2013, an increase of about 11 percent, with about one-third of it having occurred just since fiscal year 2010.

DELAYED START TO FILING SEASON

In late December, the IRS announced it would have to delay the start of the 2014 tax filing season by 10 days to allow the IRS sufficient time to program and test its tax processing system which must be updated annually to reflect tax law updates, business process changes and programming updates in time for the start of the filing season. The annual process for updating IRS systems was significantly delayed by the 16-day Federal Government shutdown which came at the height of IRS' preparations to update its systems. According to the IRS, programming, testing and deployment of more than 50 IRS systems is needed to handle processing of nearly 150 million tax returns. Updating these core systems is a complex, year-round process with the majority of the work beginning in the fall of each year.

However, with roughly 90 percent of IRS operations closed due to the Government shutdown, IRS preparations were delayed nearly three weeks, causing the need to postpone the start of the filing season.

The delayed start to the filing season will have a direct impact on taxpayers who will be forced to wait longer to start the filing process and who are already facing longer wait times to speak to an IRS representative due to the lack of sufficient staffing. According to the IRS, they expect more than 18 million calls to go unanswered this filing season and wait times to rise to around 25 minutes per call, compared with 10 minutes in 2010. Once taxpayers do get through, they may not be able to get the answers they need to resolve their tax issues. The IRS recently announced that due to its budget situation, it would only be able to answer "basic" tax law questions on its telephone lines and in its walk-in sites during the upcoming filing season.

Taxpayers' inability to get the answers they need to understand complex tax issues will almost certainly impact the accuracy of their returns, which could delay refunds to the many taxpayers that depend on their refunds to pay their bills and meet other financial obligations. While returns without any issues may be processed in a timely manner, those returns that are kicked out of the automated process will have to be worked by an understaffed IRS workforce which is down more than 8 percent. A lack of adequate staff to handle these returns will almost inevitably lead to substantial delays in processing refunds for those taxpayers, delaying the financial relief they may require.

With taxpayers unable to receive the assistance they need to resolve their tax questions and accurately prepare their returns, many may be forced to turn to paid preparers for help, resulting in additional expenses for them to simply comply with their tax obligations.

ADVERSE IMPACT OF NEW FILING SEASON INITIATIVE ON TAXPAYERS

Last September, the IRS announced a new fiscal year 2014 filing season initiative that included various procedural changes that the agency plans to implement in fiscal year 2014 at call sites, Taxpayer Assistance Centers (TACs) and campus locations across the country. The changes limit the live assistance that taxpayers receive and direct them to utilize more online services. The changes will primarily impact taxpayers seeking assistance in the following areas: tax law inquiries, tax return preparation, requests for employer identification numbers, requests for transcripts, and updates on the status of their refunds. Below is a summary of changes and the adverse impact they will have on taxpayers this filing season.

—*Tax Law Assistance*—will provide live assistance with basic tax law only, and only through April 15, 2014. All advanced tax law questions, including common complex issues such as estate and trust distributions, the alternative minimum tax (AMT), casualty and theft losses and the qualified State tuition program will be referred to other IRS resources. In addition, all topics related to corporations and partnerships will also be considered "out of scope," thus live assistance will not be available to taxpayers with questions about these difficult topics.

—*Tax Return Preparation*—will direct taxpayers who request return preparation at IRS TACs to other options instead of preparing tax returns for them on site.

—*Employer Identification Number (EIN)*—will refer all new taxpayer EIN requests to the EIN Online Assistant for EIN issuance.

—*Requests for Transcripts*—will redirect all individual taxpayers needing a transcript to the Get Transcript application.

—*Tax Refund Inquiries*—will redirect all taxpayer requests for refund information to *Where's My Refund?* and automated phone channels for the first 21 days after they file.

—*Practitioner Priority Service (PPS)*—will deflect transcript requests made for non-tax account issues to other IRS options.

NTEU believes that limiting the amount of live assistance to taxpayers that are actively seeking help with their tax related issues will be detrimental to efforts to increase compliance with our Nations' tax laws, and only serve to harm those taxpayers that rely on the assistance of qualified and experienced IRS employees to understand and meet their tax obligations.

Mr. Chairman, it is clear funding reductions in recent years have seriously impaired the IRS' ability to provide taxpayers with the services they need. And without the additional funding proposed in the administration's budget request, taxpayers will continue experiencing a degradation of services including difficulty seeking telephone assistance, delays in responses to letters, including those seeking to resolve issues with taxes due, delayed responses to small business owners or individual taxpayers looking to set up payment plans.

That is why we strongly support the President's request of $2.3 billion in funding for taxpayer services in fiscal year 2015, a $195 million increase over the current level. We believe this increase will allow the IRS to further improve customer service to meet rising taxpayer demand and help taxpayers understand their obligations, correctly file their returns, and pay taxes due in a timely manner.

We were also pleased to see the President's request would provide an additional $165 million for IRS taxpayer service as part of the new Opportunity, Growth, and Security Initiative. This funding will support additional IRS customer service improvements, including increasing toll-free telephone level of service by 11 percentage points to over 80 percent, driving responsiveness to taxpayers through correspondence inventory reduction, and bolstering resources to help tackle more labor intensive identity theft and refund fraud cases.

NTEU believes providing quality services to taxpayers is a critical component to our system of tax administration, and that the President's request for additional funding for taxpayer services will help prevent further degradation of services and enable the IRS to provide taxpayers with the services they need to meet their tax obligations.

ENFORCEMENT

Mr. Chairman, the funding reductions to the IRS budget in recent years have also negatively impacted its ability to maximize taxpayer compliance, reduce the tax gap and generate critical revenue for the Federal Government.

IMPACT ON VOLUNTARY COMPLIANCE AND TAX GAP

NTEU believes our system of voluntary tax compliance is most effective when the IRS is able to assist those trying to meet their obligations under the law. In particular, by assisting taxpayers with their tax questions before they file their returns, the IRS can help prevent inadvertent noncompliance and reduce burdensome post-filing actions, such as audits and penalties.

However, funding reductions and the cuts to operating expenses mandated by sequestration have resulted in the inability of millions of taxpayers to get answers from IRS call centers and taxpayer assistance centers (TACs), which lessens their ability to meet their tax obligations.

The National Taxpayer Advocate has previously warned that limited resources were impeding IRS' ability to conduct education and outreach to taxpayers, particularly small business, which is critical to ensuring they are able to understand and comply with their tax obligations. For example, she has repeatedly warned staffing levels at TACs across the country are woefully inadequate, with taxpayers lining up to enter IRS offices well before those offices were even open and with some people being turned away.

Inadequate staffing and the lack of availability of services at TACs has long been a problem at the IRS and disproportionately impacts the most vulnerable populations who use TACs most often, including non-English speaking taxpayers, the elderly and low income individuals and families, who often need additional assistance in understanding and meeting their tax responsibilities. If these taxpayers are not provided the assistance they need to understand their tax obligations, they may inadvertently file an incorrect return which could necessitate the need for IRS to undertake post-filing actions that are costly and burdensome to both the taxpayer and the IRS.

Incorrect filings could also result in taxpayers paying less than they owe, further hampering efforts to close the tax gap, which is the amount of tax owed by taxpayers that is not paid on time. According to the IRS, the amount of tax not timely paid is $450 billion, translating to a noncompliance rate of almost 17 percent.

The adverse impact of insufficient staffing on IRS' capacity to collect revenue critical to reducing the Federal deficit is clear. According to the IRS, every dollar invested in IRS enforcement programs generates between $4–$7 in return, but reduced funding for enforcement programs in recent years has led to a steady decline in enforcement revenue since fiscal year 2007. In fiscal year 2012, IRS enforcement activities brought in roughly $50.2 billion, down $9 billion from the $59.2 billion high in fiscal year 2007. The IRS has noted that the decline in enforcement revenue has come amid a continuing decline in key enforcement personnel staffing. There were 7,400 fewer permanent enforcement personnel in fiscal year 2013 than in fiscal year 2010, including roughly 3,000 fewer revenue agents and revenue officers who are central to Service enforcement efforts.

The IRS has warned that enforcement staffing will continue to be a significant concern under the fiscal year 2014 funding level and has warned that under this insufficient level of funding, audits will decline by an estimated 100,000 and the number of collection activities will decline by an estimated 190,000.

While we know the tax gap can never be completely eliminated, even an incremental reduction in the amount of unpaid taxes would provide critical resources for the Federal Government. At a time when Congress is debating painful choices of program cuts and tax increases to address the Federal budget deficit, NTEU believes it makes sense to invest in one of the most effective deficit reduction tools: collecting revenue that is owed, but hasn't yet been paid.

That is why NTEU was happy to see the administration's budget request would provide a $349 million increase in funding for IRS tax enforcement above the current level. The increased funding is designed to protect revenue by identifying fraud and preventing issuance of questionable refunds, including tax-related identity theft, addressing offshore noncompliance, and improving examination audit and collection coverage rates.

We also support the administration's program integrity cap adjustment of $474 million to help the IRS continue to target international tax compliance and restore previously reduced enforcement levels. A large portion of this increase will be invested in strengthening current Service compliance programs designed to close the tax gap by combating offshore tax evasion, expanding enforcement efforts on noncompliance among corporate and high-income taxpayers. These investments are expected to generate $2.1 billion in additional annual enforcement revenue, resulting in a return on investment (ROI) of nearly 6 to 1, once new hires reach full potential in fiscal year 2017. This estimate does not account for the deterrent effect of IRS enforcement programs, estimated to be at least three times larger than the direct revenue impact.

CONCLUSION

Mr. Chairman, thank you for the opportunity to provide NTEU's views on the administration's fiscal year 2015 budget request for the IRS. NTEU believes that only by restoring critical funding for effective enforcement and taxpayer service programs can the IRS provide America's taxpayers with quality service while maximizing revenue collection that is critical to reducing the Federal deficit.

Senator UDALL. Now, turning to the Treasury request, Secretary Lew, most of the $13.8 billion of gross funding requests for the Treasury Department is for the IRS. The President's budget requests $1.3 billion to fund the other bureaus and offices of the Department, a decrease of $22 million, or about 2 percent, less than the fiscal year 2014. These bureaus and offices cover a wide variety of activities for the Department, from implementing financial sanctions against our enemies, forecasting economic indicators, and managing the Federal Government's books. And, by the way, we had a very good hearing with the Financial Sanctions Section with David Cohen, which Senator Johanns and I were involved in, and many other members, and we were very impressed with their work.

I was pleased to see that the President's budget included robust funding for the Community Development Financial Institutions (CDFI) Fund. The budget also proposes to increase the CDFI Bond Guarantee Program to $1 billion to expand access to capital for community development organizations across the country at no cost to taxpayers.

However, the request also includes worrisome cuts for several critical bureaus, including the Alcohol and Tobacco Tax and Trade Bureau, which protects consumers, prevents smuggling, and collects revenue to reduce the deficit. I look forward to hearing from you about why Treasury is requesting cuts for this important bureau.

Now turning to the IRS request, the Internal Revenue Service administers the tax laws and collects the revenues for funding over 95 percent of the Federal Government operations and public services. The IRS has nearly 90,000 employees. Each year, they make hundreds of millions of contacts with the American taxpayer and with businesses. The IRS is the face of the Government for more U.S. citizens than any other agency.

For fiscal year 2015, the President's budget requests $11.997 billion in base appropriated funding for the IRS. This is an increase of $706 million, or a 6 percent boost above the fiscal year 2014 enacted level of $11.291 billion. Another $480 million is sought through a program integrity budget cap adjustment, raising the appropriations request to $12.477 billion.

Now, the fiscal year 2015 funding forecast is not encouraging. Budgetary constraints remain in place. This subcommittee faces challenging funding decisions. This subcommittee is going to have to balance many competing demands for the ensuing fiscal year. It will be helpful to hear Secretary Lew and the Commissioner's frank appraisals of the minimum resource needs to ensure that the Treasury Department can fulfill its stewardship responsibilities for U.S. economic and financial systems. Moreover, we will be carefully assessing what resources are required to deliver top-quality service to taxpayers and enforce the law with integrity and fairness to all.

I look forward to hearing more about the particular challenges the Department and the IRS faces, the consequences of funding shortfalls, and how this subcommittee can be helpful in supporting the Department's vital mission.

With that, I turn to my very distinguished Ranking Member, Senator Johanns, for his opening statement.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Thank you, Mr. Chairman. Thank you for holding this very important hearing today to review the budget requests of the Department of Treasury and the Internal Revenue Service.

As members of this committee, we have a significant responsibility to ensure the hard-earned tax dollars for millions of Americans are spent wisely and, equally as important, appropriately. That is even more critical as decisions are made to again increase

Federal spending, despite persistent annual deficits and nearly $18 trillion in debt hovering over our children and grandchildren.

Our country is in need of serious budgeting. All too often, Washington loses sight of the fact that every dollar the Government spends is a dollar taken from a taxpayer. All too often, Federal agencies lose sight of the fact that their funding belongs to the American people.

Nowhere is the need for oversight more apparent than in the agencies before us today. The IRS should be working on improving services and making tax compliance easier for taxpayers. However, when the IRS takes actions that represent a serious abrogation of the trust of the American people, it alone is responsible for the damage it has done to its credibility. The IRS has undermined taxpayers' faith in the impartiality of the Agency. This imperils the willingness of taxpayers to comply with a system that relies on them to report their income honestly, freely, and voluntarily.

A year ago, these agencies appeared before this subcommittee. Despite being questioned at the hearing, no one alerted this subcommittee to the inappropriate treatment that was taking place by the IRS relative to certain taxpayers. The only response was an agreement, in principle, that there should be no politics in the execution of our tax laws. Once the information about the inappropriate scrutiny of taxpayers became public 3 short days later, I asked that the hearing be reconvened, and that request was not granted. Detailed questions for the record that I subsequently submitted received very generic and, quite honestly, unresponsive answers.

We have all heard comments that, in essence, say investigations in these—into these issues are distracting and that everyone should let the past go and just move on. Unfortunately to taxpayers, these responses appear to reflect a continued lack of accountability and a lack of leadership. My constituents ask, where is the acceptance of responsibility for your Agency's roles in this matter? This is not an instance where you can simply say, well, one bad actor is gone and another has been reprimanded. All too often, that is the Washington way. There are negative press reports and then some employee is singled out for punishment.

That kind of response to this situation demonstrates a lack of awareness or a deliberate disregard for the seriousness of the problems at the IRS. These actions may have been—irreparably damaged the credibility of the IRS, credibility that is essential if it is to function in a system of voluntary compliance. For there to be hope for any effort to repair that damage, there has to be a fundamental change in the culture of the Agency that has given rise to these issues.

Unfortunately, just last week, in the report on the IRS award system, there was again evidence of an Agency culture that, quite frankly, is out of touch. Many no longer trust the IRS to enforce tax laws impartially without regard to an individual's exercise of their constitutional rights.

On top of that, try to explain to my constituents in Nebraska that his hard-earned tax dollars are going to pay bonuses to IRS employees who did not pay their own taxes or committed serious misconduct. There is not an American that would understand that.

And then try to explain that the IRS will need to do a study just to determine whether conduct can be a factor in whether employees receive awards in the future. It just defies common sense.

But awards seem to be an important priority at the IRS. In the fiscal year 2014 bill, which was recently enacted, the IRS received a $92 million increase for the entire Agency. Ninety-two million. So what happened then? One of the IRS' first actions after the enactment of the appropriations bill was to announce they would pay out $63 million in awards to employees, almost 70 percent of the $92 million increase all to awards and bonuses. Once again, IRS management seems to have forgotten that their most important customers are not their employees. It is the American people.

It is disappointing to see that the IRS budget request this year is also equally unrealistic. The President's request for IRS for fiscal year 2015 is about $12.5 billion. This is about $1.1 billion over the 2014 enacted level. Under the changes enacted to the Budget Control Act last fall, overall discretionary spending for the entire Federal Government is due to rise by less than $1.4 billion. So with $1.4 billion available for both defense, domestic spending increases, the IRS tells us that they want 80 percent of it. It just boggles the mind.

Also troubling is the inclusion of a request for a program integrity cap adjustment of $479 million. Treasury and the IRS are fully aware that such cap adjustments were not included in the Budget Control Act of 2011. And no cap adjustment for the IRS was authorized in the budget agreement last fall. Such a completely unrealistic request sets unreasonable expectations, and they are not credible.

Mr. Chairman, again I thank you for calling this hearing. I look forward to working with you as we always have on fiscal requests as we move forward to solving the riddle of the 2015 budget. But I have to tell you, there is so much about what we are going to be hearing about today that I have concerns about, and I appreciate the hearing to ask the appropriate questions. Thank you.

Senator UDALL. Senator Johanns, thank you so much. And now, Secretary Lew, I invite you to present your remarks on behalf of the Department of the Treasury.

SUMMARY STATEMENT OF JACOB LEW

Secretary LEW. Thank you very much, Chairman Udall, Ranking Member Johanns, members of the subcommittee. Thank you for the opportunity to speak about the Treasury budget. I appreciate your cooperation in rescheduling this hearing, and I am going to keep my opening remarks short.

Let me start by saying what an honor it is to work with the dedicated men and women at the Department of the Treasury. They are talented public servants who are focused on strengthening our country. They have performed with excellence under difficult circumstances in recent years, and I want to thank them for their service and commitment.

Our economy has been strengthening over the past 4½ years, but we still have work to do to help increase growth, create jobs, and restore opportunity. And today's advance report on Gross Domestic Product (GDP) just underscores how much we must keep at this.

The President's budget offers proven strategies that invest in the economy to propel growth now and promote longer-run prosperity. To help make sure that prosperity is widely shared, the President will emphasize the importance of raising the minimum wage today. Congress has an opportunity to help make sure no American who works full time has to raise a family in poverty, and we hope Congress will pass legislation to increase the Federal minimum wage to $10.10 an hour as soon as possible.

The request for Treasury is part of the administration's comprehensive blueprint to move our Nation forward. This request will allow the Department to help maintain a strong economy, sensibly manage the Government's finances, foster greater investment in American communities and small businesses, protect our national security, monitor risks to the financial system, and promote conditions that support economic growth and stability at home and abroad.

Over the past 5 years, Treasury has met its responsibilities efficiently and at lower cost. Today's budget request builds on that progress and includes even more ways to reduce costs and achieve savings while offering carefully designed proposals to increase the Department's effectiveness. For instance, we are seeking a second round of funding for the State's Small Business Credit Initiative, which has been enormously successful in strengthening small businesses across the country. We are working to reduce the risks from cybersecurity attacks by helping to improve the financial sector's resilience to such attacks and investing in Treasury's own defenses and infrastructure. And we are requesting sufficient funding for the Internal Revenue Service so it can provide the kind of quality service that American taxpayers deserve.

As we consider what is in the best interests of taxpayers, it is important to note that it has been 5½ years since Fannie Mae and Freddie Mac went into conservatorship. And today's stress tests show taxpayers could still be on the hook in the event of a severe economic downturn. Now is the time to reform our housing finance system, and I want to encourage the Senate Banking Committee to continue making progress on this very complex issue.

Since the financial crisis, Treasury has played a central role in designing and implementing the most comprehensive reforms to the financial system since the Great Depression. A major piece of unfinished business is housing finance reform, and we need legislation that protects taxpayers, ensures continued widespread availability of consumer-friendly mortgage products, like the 30-year fixed-rate loan, provides liquidity during times of economic stress, and facilitates the availability of affordable housing in an explicit and transparent manner.

Before I take questions, I would like to talk briefly about Ukraine. The United States and the international community have made it clear that we will continue to stand with the Ukrainian people during this critical time. That is why we are united in our effort to impose costs on Russia for its unlawful and provocative acts.

PREPARED STATEMENT

On Monday, the United States responded to Russia's latest actions with additional sanctions, which will increase the impact we have already begun to see on Russia's economy from U.S. and international sanctions. We urge Russia to pursue a diplomatic solution to the situation, especially as Ukraine moves forward with the presidential elections next month.

With that, let me thank you for the opportunity to appear before you today, and I look forward to answering your questions.

[The statement follows:]

PREPARED STATEMENT OF HON. JACOB LEW

Chairman Udall, Ranking Member Johanns, members of the subcommittee, thank you for giving me the opportunity to speak about the Treasury budget. The President's fiscal year 2015 budget requests $13.8 billion to fund the Department's operating bureaus. This includes an important increase for the Internal Revenue Service and a decrease for the rest of the Department, which I will cover in more detail below.

Let me start by saying what an honor it is to work with the dedicated men and women at the Department of Treasury. They are talented public servants who are focused on strengthening our country. They have endured much over recent years including a Federal pay freeze, sequestration, and the Government shutdown, and I want to thank them for their service and commitment.

I would now like to turn to an overview of the economy and the substantial progress we have made toward recovering from the worst recession since the Great Depression. We have now experienced nearly 5 years of growth. A stronger private sector is helping grow the economy and drive deficits lower. Our businesses have added 8.9 million jobs over the last 49 months. The housing market has improved. Home prices are rising, and millions of homeowners are no longer under water on their mortgages. Household balance sheets continue to heal, exports are growing, and manufacturing is making solid gains. And healthcare costs are growing at the slowest rate in 50 years.

I want to take a moment and quickly applaud the Senate Banking Committee for beginning their markup of important legislation to reform our housing finance system yesterday. Now is the time to reform our housing finance sector. Housing starts, new home sales, and existing home sales all reached multi-year highs last year, rates of mortgage delinquency and foreclosure have declined to near pre-recession levels, and the appreciation we have seen in home prices has substantially reduced the share of mortgages that are underwater. But we need to build on that progress, and the pent up demand from years of low household formation combined with generally housing affordability can spur a step up in new construction to reverse the downward trend we have seen in home sales since mid-2013. A resurgent housing sector would boost the economy and generate new jobs, and a successful reform to housing finance would reinforce that cycle.

Five and a half years after the Government Sponsored Enterprises (GSEs) were put in conservatorship, we still face a housing finance system that does not adequately meet the needs of the American people. Far too many potential homeowners do not have access to credit, and will not until there is a clear path to a new system that provides certainty to all participants. The system today continues a flawed dynamic where taxpayers must support future losses at Fannie Mae and Freddie Mac should there be another downturn in home prices. We need to start reform now—and we need legislation to achieve the fundamental reforms that protect both consumers and taxpayers. The longer we put it off, the easier it is to forget the damage to the economy, loss of housing wealth, and instability a system with misaligned incentives and inadequate taxpayer and consumer protections.

As the President said in his State of the Union address, we are now better positioned to meet the demands of the 21st century than any other nation.

There is considerably more that needs to be done. While corporate profits have been hitting all-time highs and the stock market has been vibrant, too many in the middle class and those striving to get into the middle class, are struggling to make ends meet.

The President's budget addresses these challenges. It puts forward proven, pro-growth initiatives to expand opportunity for all Americans. And it fulfills the President's pledge to make this a year of action, while offering a framework for long-term prosperity and competitiveness.

As part of this proposal, the President's request for the Treasury will allow the department to carry out its mission to maintain a strong economy and responsibly manage the Government's finances. It will also allow Treasury to foster greater investment in American communities and small businesses, protect our national security, monitor risks to the financial system, and promote conditions that support economic growth and stability at home and abroad.

STRENGTHENING THE ECONOMY AND JOB CREATION, PROTECTING THE FINANCIAL SYSTEM

For nearly 20 years, Treasury's Community Development Financial Institutions (CDFI) Fund has been attracting economic development and job creation to America's underserved communities. This year's request includes $225 million for the CDFI Fund, just over $1 million below last year's request, including a proposed 1 year extension of the CDFI Bond Guarantee program, which provides a source of long-term capital to financial institutions that support lending in underserved communities. Of the total request, $35 million for the Healthy Food Financing Initiative will support the growth of businesses that improve the availability of affordable, healthy food options in low-income communities.

We are also supporting small business growth by requesting a second round of funding for the State Small Business Credit Initiative (SSBCI), which was enacted in 2010 to empower States to help small companies grow. Just last week, I saw the positive difference SSBCI can make in our communities when I visited New Center Stamping in Detroit. New Center Stamping utilized SSBCI funding to grow and hire new employees, and demonstrates how targeted policies and programs can drive growth, strengthen the middle class, and bolster local economies.

The program's original funding of $1.5 billion is expected to result in up to $15 billion in new investments in small businesses by leveraging $10 in private capital for every $1 of Federal support, and during 2013 States more than doubled their use of these funds. To continue our support for State economic development agencies' work with small businesses, the budget proposes a new investment of $1.5 billion for the SSBCI. This additional funding would be awarded in two allocations: $1 billion awarded on a competitive basis to States best able to target underserved groups, leverage Federal funding, and evaluate results; and $500 million awarded according to a need-based formula based on economic factors such as job losses and the pace of economic recovery.

In the coming year, Treasury will continue to rebuild and reform our financial system. Reforms like the Volcker Rule are transforming the way Wall Street operates, while strengthening our financial system and making our economy an engine of economic growth once again. Going forward, we must remain vigilant to potential new threats to the stability of the financial system, constantly monitoring how risks change and evolve. Treasury will continue to wind down the remaining investments in the Troubled Asset Relief Program (TARP), often recovering more than the original support extended, and continue the operation of TARP's housing programs to help struggling homeowners avoid foreclosure.

The budget also proposes to extend the Terrorism Risk Insurance Program and to implement programmatic reforms to limit taxpayer exposure and achieve cost neutrality. The extension will preserve the long-term availability and affordability of property and casualty insurance for terrorism risk.

Finally, we seek to improve the protection and resilience of the critical infrastructure in the financial sectors with a special focus on reducing the risks associated with cybersecurity incidents. Working with industry and government partners, we promote best practices, develop incident management plans, and identify, analyze, and share timely and actionable information. Further, this budget includes $11 million for investments in enhancing Treasury's own cyber-preparedness and the security of Treasury's vast array of unclassified sensitive, classified, and very sensitive intelligence information. We must also ensure that our vital systems and services remain operational even under severe circumstances. As stewards of this information and IT services, it is our responsibility to ensure it is properly secure both from continuously evolving external and insider threats. These improvements to our own systems, and Treasury's continued work with our private sector partners to advance cybersecurity in the financial industry are vital to ensuring continued economic growth.

BOOSTING RESOURCES FOR TAXPAYER SERVICES AND ENFORCEMENT MEASURES, FINDING NEW EFFICIENCIES ACROSS TREASURY PROGRAMS

The President's budget makes substantial investments in improved taxpayer service and enforcement at the Internal Revenue Service (IRS), as well as in technology that will drive IRS efficiencies in the future. The Budget also builds on Treasury's ongoing efforts to improve efficiency, reduce costs, and streamline operations. The IRS continues its commitment to carrying out its responsibilities, providing quality service to taxpayers and preserving the public's faith in our tax system, but the lack of sufficient funding in recent years has made it difficult to provide the kind of services American taxpayers deserve. While the IRS is working hard to provide the highest possible level of taxpayer service within its limited resources, its funding situation is causing taxpayers to face longer wait times on the phone, and it is taking longer to respond to taxpayer correspondence. A sustained deterioration in taxpayer service combined with reduced enforcement activity could create serious long-term risk for the U.S. tax system, which is based on voluntary compliance.

To counter these effects, Treasury's budget request includes substantial investments to help strengthen taxpayer service, enforcement, and technology at the IRS. The fiscal year 2015 Treasury budget includes $2.3 billion for taxpayer service, supporting initiatives designed to improve the IRS' ability to provide timely and accurate responses to taxpayer inquiries, as well as make more information accessible in a secure digital environment.

The request for the IRS includes a $1.2 billion increase, of which $480 million is financed by a proposed program integrity cap adjustment for enforcement initiatives that provide a high return on investment. This proposed cap adjustment funds strategic investments that will help close the tax gap and will return 6 dollars for every 1 dollar invested, once fully implemented. The proposed cap adjustment will yield $2.1 billion in additional enforcement revenue in 2017 and is projected to reduce the deficit by $35 billion over the next 10 years.

Treasury's request also includes $452 million for initiatives that are critical to full and effective IRS implementation of the Affordable Care Act, which the Congressional Budget Office has projected will lower the deficit substantially over the next two decades. Thanks to the Affordable Care Act (ACA), 8 million people have signed up for private insurance through the Health Insurance Marketplace, 3 million young adults have gained coverage by being able to stay on their parents' plan, and millions more have secured coverage through Medicaid and the Children's Health Insurance Program. The law is also providing greater security to Americans who already have coverage, making discrimination based on pre-existing conditions and lifetime limits on coverage a thing of the past.

The fiscal year 2015 Treasury budget builds on our commitment over the past 5 years to deliver core services more efficiently and at a lower cost to the taxpayer. In fact, the department has been able to propose more than $1.1 billion in savings in its budget submissions over the past 4 years. Excluding the IRS, the fiscal year 2015 Treasury budget reflects a decrease of 1.7 percent below the fiscal year 2014 enacted level and identifies $154.2 million in efficiency savings and program reductions.

One area where we have made progress has been our multi-pronged effort to expand the use of electronic transactions in conducting the business of Government, including electronic payroll savings bonds, electronic benefit payments, and electronic tax collection. These efforts have reduced costs, improved customer service, and decreased susceptibility to fraud. The "Paperless Treasury" initiative has saved the Government hundreds of millions of dollars through electronic payment of benefits and increases in the electronic filing rate for tax returns.

It is important to note that the President's budget also includes a separate Opportunity, Growth, and Security Initiative. This Initiative includes pro-growth investments that are fully paid for by cutting spending and closing tax loopholes. Treasury investments under the Initiative will support progress in the areas of taxpayer service, fiscal transparency, and global food security. This includes $165 million to support additional IRS customer service improvements, including increasing annual toll-free telephone service levels to over 80 percent, driving responsiveness to taxpayers through correspondence inventory reduction, and bolstering resources to help tackle more highly burdensome identity theft and refund fraud cases.

PROTECTING NATIONAL SECURITY INTERESTS AND PREVENTING ILLICIT USE OF THE FINANCIAL SYSTEM

I want to end by highlighting the Treasury budget's proposals to protect our national security interests and continue the department's financial intelligence and enforcement activities.

The Treasury budget proposes $105.9 million for the Office of Terrorism and Financial Intelligence (TFI), within the Departmental Offices, to oversee and marshal Treasury's intelligence, enforcement, and economic sanctions functions in support of U.S. national security policies and interests. Our funding request reflects Treasury's continued efforts to safeguard financial systems against illicit use and combat rogue nations, terrorist facilitators, money laundering, and other threats to our national security.

In particular, TFI conducted a sustained sanctions campaign against Iran, its agents, and its front companies in response to Iran's continued defiance of United Nations Security Council resolutions related to its nuclear program. As a result, banks around the world have continued cutting off Iran from the international financial sector; this isolation has played an essential role in bringing Iran to the negotiating table.

Last year, we completed more than 500 actions under our sanctions authorities in an effort to disrupt and dismantle the financial networks that support terrorists, narcotics traffickers, transnational organized crime, and the proliferators of weapons of mass destruction. Our sanctions programs are effective because they stand on a foundation of reliable intelligence analysis, strong systemic safeguards in the financial sector, and robust engagement with our financial sector, foreign governments, and foreign financial institutions.

The Ukrainian people have demonstrated tremendous courage as they have charted an independent course for their country and demanded a government that reflects the will of the people. The United States has been at the forefront of building international support for Ukraine, and of holding Russia accountable for its attempts to destabilize Ukraine. And Treasury has played a key role in these efforts, not just through our carefully designed sanctions program but also in monitoring the impacts to U.S. economic interests, pushing forward the U.S. loan guarantee for Ukraine, offering technical assistance to the Government of Ukraine, and encouraging support from partners and international institutions such as the International Monetary Fund.

The United States very much wants to see Ukraine prosper. It is in our economic interest and it is in our strategic interests to stand with the people of Ukraine in their time of need.

CONCLUSION

The fiscal year 2015 Treasury budget reflects a careful balance of savings proposals and targeted investments in key priorities.

The proposed savings will be achieved through a combination of efficiency improvements and increased streamlining of operational processes, making Treasury even leaner and more effective as it continues to deliver essential services to the American people.

The Treasury budget is balanced, responsible and carefully designed. It adheres to the President's strategy to make our economy stronger while keeping our fiscal house in order. And I am eager to work with you to put it into action.

Thank you and I look forward to answering your questions.

Senator UDALL. Secretary Lew, thank you very much. And I would just remind all of us, we have three panels, and I believe we still have votes at 4:00, so we are going to try to move along. We are going to have 7-minute rounds and try to move through these three panels, and hopefully finish up before 4:00.

STRENGTHENING ECONOMY TO HELP MIDDLE-CLASS AMERICANS

Secretary Lew, in your statement, you highlight the recent growth in the economy. The nonpartisan Congressional Budget Office reported that the annual budget deficit as a percentage of GDP has dropped for the fifth year in a row, the housing market is beginning to rebound, the unemployment rate is dropping but still higher than before the recession. Our economy is recovering, but it still has a long way to go, particularly for middle-class Americans. I hear that all the time from New Mexicans, where I was just home the last couple of weeks, and people talking to me about that. Can you explain how Treasury's fiscal year 2015 budget request will continue to strengthen our economy and particularly help middle-class Americans?

Secretary LEW. Well, Senator, I think that I can answer that both in terms of the Treasury budget, but also in the larger frame of the President's budget. You know, we are very pleased that the economy is doing much better. You compare the economy today to a few years ago, and it is a world of improvement. But we still have a lot of progress to make. Until every American who wants a job can find a job, and a job that pays a decent wage, we still have more work to do.

In the Treasury budget, we have a number of programs that are, I think, working quite effectively. I mentioned a couple. The State Small Business Credit Initiative (SSBCI) is actually making a real difference in either guaranteeing loans or providing support for collateral for loans for small businesses to create jobs.

Just last week, I visited one borrower, a firm in Detroit, that stamps machine parts. Because of an SSBCI loan, we are making replacement—manufacturer replacement parts for American autos in the United States and not overseas. That is the kind of work SSBCI does and can do if it gets the support to have another round of loans. Our CDFI program, similarly, is supporting communities that are working to develop economic foundations for small business in job creation.

And in the larger picture, I would say that the President's budget has a very clear direction this year, which is that we need to build a foundation for growth, and we all know what it is. We know that it is about building infrastructure because we need to have roads and ports and airports that are ready for the 21st century. That will create short-term jobs in the construction industry, but it will create longer-term foundations for growth. So working together on a bipartisan basis to fund infrastructure will make a difference.

I think that there are other things in the budget, like skills training, that are critically important. We have a lot of jobs open in this country, and we have a lot of people looking for work. There is a gap there that can be closed with skills training, marrying people and jobs.

You know, the third thing I would mention, while it is not in this subcommittee's jurisdiction, immigration reform. We know that immigration reform is a driver of economic growth in this country. It has always been a driver in our history, and we have seen a study from the Congressional Budget Office that shows it will affirmatively help grow our economy and reduce our deficits.

So those are a number of things in this budget. Obviously there is a lot of work to do, but I hope on a bipartisan basis we can do it.

Senator UDALL. Thank you very much, and I could not agree with you more. And it would seem to me an area where we could cooperate a lot would be in infrastructure. I think everybody realizes that it—you get short-term jobs, but you also do lay the foundation for growth. So I am hoping that we will be able to work and find some ways there.

TAX-EXEMPT STATUS FOR SOCIAL WELFARE GROUPS

I wanted to turn my attention here to these tax-exempt organizations. I have long supported the need to make meaningful changes to ensure that the rules to qualify for tax-exempt status are abundantly clear. We need a bright line test to replace the guidance that has led to over a half-century of confusion and inconsistent application. It is 100 percent unacceptable for the IRS to ever unevenly enforce rules based on ideology, politics, or other bases. The same rules should apply equally and equitably to all applicants. But it is also unacceptable for political operatives, regardless of political affiliation, to use 501(c)(4) organizations as de facto political action committees in order to hide their donors' identities and circumvent campaign finance law disclosure requirements.

I understand the IRS is currently evaluating an enormous volume of comments generated in response to proposed rules published last November designed to bring long-needed clarity to the determination of eligibility for tax-exempt status of social welfare groups. What are your current plans for going forward with finalizing the proposed rules? What timetable is the IRS following for further action? And until the rules are changed, what tests or criteria is the IRS using to evaluate applicants for tax-exempt status as social welfare groups?

Secretary LEW. Mr. Chairman, as I said at the time and as I have said since, the actions that were reported on in terms of the 501(c)(4) program were unacceptable. It is unacceptable for there to be any targeting in our tax enforcement based on belief or partisan views. And we went about following the recommendations of our Inspector General, who will be testifying here later. And I am pleased to say we implemented all of the recommendations, and that includes replacing all of the senior officials who were responsible, and issuing guidance to try and create some clarity in an area where ambiguity was at the root of the problem.

The proposed rule that was put out was in many regards an incomplete rule because it was asking for comment to inform what a final rule would look like. There is a lot of work to be done between now and issuing a final rule. There is the need to review 150,000 comments. There is going to be the need ultimately to publish a new final rule. And there are going to be a number of things between now and then where the IRS will be reaching out for comment.

I think that the partisan debate over this has, frankly, obscured what the rule really does. And what the rule does is it restricts discretion in an area where too much discretion caused the problem. Now, that is a hard thing to do, and we do not pretend that it is final. But we look forward to working together and responding to comments to get to the point where we can together say that the problem that underlay the events, that came out, that we all are agreeing were unacceptable, can never happen again.

Senator UDALL. Thank you very much for that answer. Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman. Mr. Secretary, welcome. Good to see you again.

As you know, the IRS did single out certain groups, Tea Party groups. They got special scrutiny when they applied for tax exempt status, something they had a lawful right to do. Now, I think to everybody that is extremely troubling that this Agency that has such a huge impact on the lives of millions and millions of Americans would be executing the laws in a manner that targets anybody because of their political views.

But equally troubling is the fact that the IRS acknowledged that this activity, just days after you and Acting Commissioner Miller appeared before this subcommittee to testify about the fiscal year 2014 budget request, there was absolutely no indication of the disclosure that was to come. In fact, Mr. Secretary, as you know, you were asked a question about reports of politically motivated activity, and your statement was, "No politics in the execution of our tax laws," should be there. Would you please explain to us on this subcommittee why you did not make the subcommittee aware of what was to come just 72 hours later?

Secretary LEW. Senator, first, I stand by the statement that it is unacceptable for there to be any political interference in the enforcement of our tax code. And to this day, I have seen no evidence that there were any politically appointed officials who had any say in anything. It was terrible behavior and very bad judgment, but it was not on the part of political—or politically affiliated, you know, political appointees.

Senator JOHANNS. But let me stop you there if I might, Mr. Secretary, because you are drawing an inside-the-beltway distinction that only people like you and I would understand. You are saying political appointees, we have no evidence that they were involved. That does not mean that there is not somebody within the IRS who has a certain political bent, or somebodies——

Secretary LEW. Senator, there was very bad judgment, and I would note that it was applied to groups on the right and groups on the left, in terms of identifying organizations in unacceptable ways. So I am agreeing——

Senator JOHANNS. No, I am not going to let you get away with that because, quite honestly, people on the left, that was so rare as to be almost nonexistent. To Tea Party groups, it was consistent. It was group after group after group. They were held up in trying to get their tax exempt status.

Secretary LEW. Senator, there were an awful lot of applications pending at the time that was not an even distribution of applications, but there was evidence that it was bad judgment applied to both right and left. And that is—it is unacceptable, so I am agreeing that it is unacceptable. In terms of the testimony that I gave last year, I want to point out that I was not aware of the circumstances until our Inspector General briefed me on it.

Senator JOHANNS. Were you briefed before the hearing?

Secretary LEW. And I did not feel at liberty to speak on a subject that was going to be the subject of an Inspector General report until it was issued. And I have spoken to many committees of Congress about it since.

Senator JOHANNS. No, you have not spoken to me. I have sat in your place at one point in my career as a Cabinet member. I have faced this kind of scrutiny. I cannot imagine sitting there having knowledge of something this important, this explosive, and not at least stopping by the ranking member's office or the chairman's office, or both, and saying, look, here is what is going on. I do not want to mislead anybody. This is what is coming. We would have held that in confidence. Why would you not do that?

Secretary LEW. Well, Senator, the fairly well-accepted practice is not to interfere in any way with Inspector General reports, and that, I think, is appropriate as a policy. And I have tried to be very open in discussing this matter with Members of Congress, and following after that.

Senator JOHANNS. I followed that same rule when I was in your position. Inspector General had an investigation, we stayed as clear away from that as we possibly could. But if I was asked a direct question at a hearing, I felt I had the liberty to sit down with them, unless otherwise instructed by the Inspector General, to say, look, I can at least inform you that there is an investigation going on. I would appreciate your confidence. We would have kept that confidence. I can assure you of that. I do not understand why we had to learn from the media that this was going on.

Secretary LEW. Senator, the report obviously was a matter that was taken very seriously by both the administration, by the Department, and by the Congress. We have respected the independence of the Inspector General throughout the process. I think that is the appropriate thing, and I look forward to working with you to make sure that we have the kinds of conversations that give you visibility into what is appropriate as we can.

Senator JOHANNS. Let me ask you another question. The Internal Revenue Service, beyond a shadow of a doubt, has damaged its credibility. I do not think anybody could disagree with that. And it just seems to be one bad story after another. But having said that, they are circling back around now trying to do something with tax exempt organizations. They put this proposed rule out, and I understand it is proposed. And they get an avalanche of comments. I think by anybody's definition, 150,000 comments is a huge number of comments.

Were you—will you assure me, Mr. Secretary, that all comments will be taken seriously, will be reviewed, will be thoughtfully analyzed before any further action is taken on this rule?

Secretary LEW. Senator, that was the intent all along, was to elicit comment, broad comment. I think the number of comments probably exceeds expectation, but I will note that a lot of them are form responses, so the actual number of individual comments is lower. But there are a lot of comments, and I think the IRS and our Office of Tax Policy will be very careful in reviewing comments.

We want to get this right. This—and I would just say, in terms of confidence in the IRS, this was a very small number of people at the IRS who exercised bad judgment. And it—that judgment has been—they have been held accountable, and that judgment is, I think, universally being criticized by this committee, by the administration.

The question of the performance of the IRS, more generally, in fairness to most of the 90,000 people who work at the IRS, is not colored by that experience. We just had a filing season, where under terrible circumstances, late enactment of legislation, Government shutdown, we had a smooth filing system where the American people were able to file electronically, and get quick refunds, under very adverse budget circumstances. We are implementing a new law, Foreign Account Tax Compliance Act (FATCA). People are putting enormous energy into doing it effectively. And around the world, I heard that FATCA should become a global standard now.

So the men and women at the IRS are dedicated public servants, and I just think it would be wrong to look at the 501(c)(4) experience and extend that to all of the men and women of the IRS.

Senator JOHANNS. Not doing that. Not even suggesting that. But I can assure you the American people are dismayed by the activity at the IRS.

Secretary LEW. And I do not disagree, Senator, that there is a lot of work to regain confidence.

Senator UDALL. Thank you, Senator Johanns. Senator Coons.

ACCOUNTABILITY WITHIN THE IRS

Senator COONS. Thank you, Mr. Chairman. And thank you, Mr. Secretary, for your service and for being with us today.

If I might just follow on that general theme, I think we all share a deep concern about the use of inappropriate criteria in determining whether certain political organizations are qualified for 501(c)(4) status. Could you just clarify for us who has been held accountable? What sort of consequences have there been that allow you or that allow me to have any confidence that the IRS and the folks who exercised very poor judgment have seen some real consequences for this——

Secretary LEW. Well, Senator, at—when this report came out, the immediate action was replacing the Acting IRS Commissioner with a new Acting IRS Commissioner, Danny Werfel, who has served with great distinction until Commissioner Koskinen was confirmed. All of the SES—the senior executives in between the Commissioner and the program were relieved of their responsibilities and, in many cases, separated from the Federal service.

I think that we are now in the process of having a conversation about how to make sure this never happens again, and the rule writing is a joint process between the IRS and Treasury's Office of Tax Policy. It is being approached with the greatest seriousness of purpose where we want to fully take into account views, right and left and center, wherever they come from, and get this right because restoring confidence in the IRS is critical. You cannot have, you know, the kind of strong confidence in Government that we need if people do not trust the IRS, which is the point of connection that so many people have with the U.S. Government. So I share the very strong belief that making it clear that this has been fixed is critical.

In the interim, and the Chairman asked me this question, there is a process of self-certification where individuals who apply get to certify their eligibility. So there is not the case-by-case review going on the way it was. We have got to get to a place with a clear standard that is transparent and simple and that takes away some discretion, because right now I think this is an area where too much discretion is not a good thing.

Senator COONS. Well, thank you, Mr. Secretary, and thank you for your persistent engagement in ensuring some accountability on these actions.

ECONOMIC SANCTIONS AND OFAC

Let me move, if I could, to sanctions. You mentioned in your statement the important role the United States is playing in helping the citizens of Ukraine to stand up to Russian aggression. We previously on this subcommittee held a hearing in which David Cohen, the Under Secretary for Terrorism and Financial Intelligence, testified about the terrific work that the folks under him, and in particular, OFAC, the Office of Foreign Asset Control, perform.

I was struck by the range in scope of actions, more than 500 sanctions enforcement actions they have undertaken, the very difficult and important work that those folks do to ensure that sanctions against Iran, as well as against now Russia, and Syria, and North Korea, and many other countries, are investigated and enforced.

The whole situation in the Ukraine and the sanctions against Russia have emerged since the budget submission. I sent a letter to the full committee chair back on April 10 urging a reconsideration of the budget request. I do think, as we will discuss with the IRS Commissioner, there are customer service reasons to really focus on an increased investment in IRS responsiveness and customer service.

I think there is an equally, if not a greater, compelling reason for us to increase the enforcement funding so that this particularly important grouping within the Department is able to enforce aggressively sanctions against Russia, against Iran, against Syria, against North Korea. The Under Secretary bravely offered answers to my questions, suggesting that there was surge capacity and that folks could be borrowed from other agencies.

My assertion to you is simply this. If there is any time for us to demonstrate that we have pre-funded, that we have ramped up to be able to vigorously enforce sanctions against Iran, it would be this moment.

STATE SMALL BUSINESS CREDIT INITIATIVE

If I could turn our attention to the SSBCI last. In general, I want to commend you for the focus on resilience in cyber preparations, the importance of GSE reform, the importance of extension of the Terrorism Risk Insurance Program. But I wanted to encourage you to speak for a moment to the State Small Business Credit Initiative. You said you had recently visited a small business, I think, in Detroit that had benefitted from it.

I was at the ribbon-cutting for the Frankford Bakery in Delaware that also benefitted from it. My State has taken advantage of it. I think it offers great opportunity to leverage private funds. So please speak a little bit more, if you would, about what an extension of the SSBCI program might do for job creation.

Secretary LEW. Well, Senator, you know, I can just use an example like the place that I visited or the firm that you visited. There would be a vacant building with broken windows in Detroit if they had not gotten an SSBCI guaranteed loan to essentially buy existing, but unused, equipment to put people in Detroit back to work. And those jobs would have been somewhere else, probably outside of the United States. You know, they did not have collateral that they could go to a bank with, so they needed collateral to be backed by an entity. And the State used the SSBCI money to do that. They are now expanding, putting in conveyor belts to be able to cut from eight hours to one hour how long it takes to switch dyes. Well, that is going to mean more output, more efficiency, and more jobs.

I am using that example because I happened to be there last week. I am sure you could use the example of the bakery that you visited. All over the country, we are seeing businesses that would not be there, but for this support. And I think, redoubling the effort is important.

COMBATTING TERRORIST FINANCING

Can I go back, Senator, to just—and respond very briefly on the Terrorism and Financial Intelligence (TFI) question or comments that you made? We have an extraordinary group of people who work in Terrorist Finance at Treasury. You know, David Cohen, his predecessor, Stuart Levy, has built an institution that did not exist 10 years ago into a powerful tool for the United States to use to carry forward its policies and project its influence in meaningful and important ways.

The team works very hard—OFAC works very hard. I do not think it escaped anyone's attention that in the middle of all the work they are doing on Russia, we cited two more firms yesterday in Iran. They are multitasking. They are working on all fronts. They have the resources they need. I am not saying they have more than the resources they need. But they are doing an extraordinary job, and the American people really should understand what a great asset we have there.

And I did not mean to take you off of your intended question, but I could not let it go by.

Senator COONS. Well, thank you, Mr. Secretary. I do think the SSBCI program is worthy of some extension and support because it leverages private sector dollars 10 to 1 with public dollars.

Secretary LEW. Yes.

Senator COONS. It is locally administered. I have seen its effectiveness in my State. As for your comment on sanctions enforcement, I just would urge you to searchingly reconsider whether we have all the resources we need for this critically important fight at this time. Thank you.

Senator UDALL. Okay, Senator Coons. Thank you so much. And in order to move through all the witnesses, I think we are finished with our questioning here. We are going to excuse you, Secretary Lew, and call the Commissioner forward. Thank you very much for your testimony.

Secretary LEW. Thank you, Mr. Chairman.

Senator UDALL. Really appreciate your service. Mr. Koskinen, I invite you now to present your remarks on behalf of the Internal Revenue Service.

INTERNAL REVENUE SERVICE

STATEMENT OF HON. JOHN KOSKINEN, COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. KOSKINEN. Chairman Udall, Ranking Member Johanns, Senator Coons, thank you for the opportunity to provide you with an overview of our proposed fiscal 2015 budget and what we hope to accomplish with those resources.

In discussing the IRS budget, we remain concerned about the constraints under which the IRS has been operating since 2010. Our funding for fiscal year 2014 was set at $11.29 billion, which is more than $850 million below fiscal year 2010 and $500 million below our pre-sequester level. I think it is important to note the IRS is the only major Federal agency operating at close to our post-sequester level, rather than returning to the higher pre-sequester level, as other agencies were allowed to do.

A solution to the funding problem faced by the IRS begins with the administration's fiscal year 2015 budget request, which totals $12.64 billion, approximately $1.35 billion above the fiscal year 2014 enacted level. In the absence of these additional resources, our ongoing funding shortfall has major negative implications for taxpayers and the tax system.

FILING SEASON

We are particularly concerned about next year's filing season. This year, when all is said and done, we will have processed approximately 148 million individual tax returns. This is a tremendous accomplishment, and does not happen automatically or by accident, but is a result of the work done by our highly experienced, dedicated, and capable workforce.

The 2013 filing season, which just ended, went extremely smoothly. We were able to improve our phone service somewhat, despite our funding limitations. In part, this was a result of our improved ability to provide information on our web site and the lack of major tax legislation in 2013. Because of the modest drop in call volume, we maintained a level of phone service during the filing season of about 71 percent, better than last year's overall average of 60.5 percent, but still an unacceptable level of service since that means that almost 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 fiscal year 2014, we expect our level of phone service to drop below 70 percent and end up closer to last year's 60.5 percent.

We are already beginning to prepare for next year's filing season, and we are concerned that delivering a smooth filing season in 2015 may be significantly more difficult. In a normal year, preparing for filing season takes several months. The advanced work to get our systems ready for 2015 will be more challenging than last year because of the need to accommodate major system changes for important statutory provisions going into effect under the Affordable Care Act and FATCA. We would use a portion of the administration's 2015 budget request, about $394 million, for implementing the Affordable Care Act and FATCA.

IT UPGRADES

A large portion of this is for Information Technology (IT) upgrades. For example, we need to build new technology systems to process and analyze the reports coming to us from financial institutions under FATCA. Investments in IT are also needed to continue implementing Affordable Care Act (ACA) provisions. I want to stress that we are mandated to implement the Affordable Care Act and FATCA, so if we do not receive this funding, we must take it from taxpayer service and enforcement. We have no other choice.

On top of the planning needed for ACA and FATCA, we also need to adjust our systems for numerous additional tax law changes if Congress passes a package of tax extender provisions. Therefore, if there is going to be a tax extender package this year, it would be very helpful if Congress could pass it as soon as possible, to give the IRS maximum lead time to get our systems ready for these changes.

About $400 million of the administration's request for additional funding would go to taxpayer service programs. We estimate this would allow us to answer an additional 12 million taxpayer calls with an approximately 2,400 additional full-time equivalents hired, and cause our level of phone service to exceed 80 percent. The additional calls answered would include calls from those seeking help with the tax-related provisions of the Affordable Care Act. In the absence of additional funding, we estimate that our level of service will plunge to about 53 percent.

About another $334 million of the additional request would go to enforcement programs. With this funding, we estimate closing more than 500,000 additional cases, including individual audits, employment tax exams, and collection activities. Through these activities, we estimate we would collect an additional $2.1 billion a year in enforcement revenues, to a large extent as a result of hiring about 1,200 additional revenue officers and agents. These increased collections would more than pay for the entire additional funding being sought for 2015.

An important subject of enforcement is the fight against refund fraud caused by identity theft. About $65 million of the additional request would go to this area. We estimate that, through improved identity theft fraud detection, we would protect an additional $360 million a year in revenue from going out the door. We would also close an additional 13,000 cases where taxpayers have been victimized by identity thieves.

I want to emphasize that we take very seriously the need to be careful stewards of the funding received. As Senator Johanns said, we are well aware of the fact that these are taxpayer dollars we are spending, and they deserve to be confident that we are spending them wisely. It is my responsibility to ensure that that funding is used wisely.

PREPARED STATEMENT

I would be delighted to report back to the subcommittee, as fiscal year 2015 unfolds to discuss with you what the American taxpayer, in fact, received from additional investments in our Agency.

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

[The statement follows:]

PREPARED STATEMENT OF HON. JOHN KOSKINEN

Chairman Udall, Ranking Member Johanns and members of the subcommittee, thank you for the opportunity to appear before you today to update you on the Internal Revenue Service's (IRS') performance under our current funding levels for fiscal year 2014 and to provide you with an overview of our fiscal year 2015 budget and what we hope to accomplish with those resources.

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.

In fiscal year 2013, the IRS collected $2.9 trillion in gross revenue to fund the Federal Government, approximately 91 percent of all Federal receipts. Moreover, for fiscal year 2013, we processed more than 147.6 million individual income tax returns and issued more than 118 million refunds to individual taxpayers totaling nearly $314 billion. This is a tremendous accomplishment, especially given that processing such a high volume of returns is an annual occurrence for this agency. It is important to remember that this does not happen automatically or by accident, but occurs as a result of the efforts of our highly experienced and capable workforce.

The IRS has made major progress since fiscal year 2010 in finding hundreds of millions of dollars in cost savings and efficiencies. However, even with these savings, the fiscal year 2014 IRS budget approved by Congress continued a funding shortfall for the agency that has major implications for taxpayers and the tax system, both for this year's tax season and beyond. It is important to note that the IRS continues to operate at near sequestration levels, with the agency's fiscal year 2014 funding less than 1 percentage point above fiscal year 2013 levels. Our current level of funding is clearly less than what the agency needs, especially to provide the level of taxpayer services the public has a right to expect.

This year, millions of taxpayers continue to see longer wait times on the phone to get basic questions answered and resolve tax issues, though IRS employees are working diligently to reduce those wait times as much as possible. Further, as a result of fewer staff and reduced enforcement activities, the IRS estimates it will not be able to collect billions of dollars in enforcement revenues. The IRS is committed to carrying out its core responsibilities and working to preserve the public's faith in the essential fairness and integrity of our tax system, yet continued funding reductions will pose serious challenges to these efforts.

The IRS remains committed to being as efficient as possible and spending taxpayer dollars wisely, and we will continue to find savings wherever we can. At the same time, the fiscal year 2015 President's budget will allow us to invest in strategic priorities so that we can continue to fulfill our dual mission of strong enforcement of the tax laws and excellent customer service.

To summarize, the budget funds the following activities and programs: improving service to taxpayers; increasing our efforts against refund fraud, especially fraud caused by identity theft; making our compliance efforts more strategic, using new tools, data and capabilities to conduct a balanced enforcement program; and investing in advanced technology to enhance both service and enforcement activities. The IRS will also continue to implement and administer tax-related provisions of major legislation, including the Foreign Account Tax Compliance Act (FATCA) and the Affordable Care Act (ACA).

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.

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.

IRS PERFORMANCE: FISCAL YEAR 2013 AND CURRENT FILING SEASON

Through both taxpayer service and enforcement programs, the IRS remains committed to making the tax laws easier to access and understand and to improving voluntary compliance and reducing the tax gap—the difference between taxes owed and taxes paid on time. Taxpayer service supports and protects the trillions of dollars in revenue that come into the Treasury each year voluntarily from taxpayers by helping them understand their obligations under the tax law. Enforcement pursues those who evade or misrepresent their tax responsibility.

Filing Season

One of the most important activities the IRS undertakes each year is delivering a smooth and successful filing season. The IRS delivered another successful tax filing season in 2013, rising to the challenges posed by tax legislation enacted on January 2 of that year. The filing season began on January 30, 2013, less than 1 month after the passage of legislation that affected more than 600 tax products needed for the filing season. The IRS took the necessary steps to minimize disruptions for taxpayers, including working around the clock to update our forms and computer systems.

As noted, during 2013 the IRS processed more than 147.6 million individual income tax returns and issued 118.7 million refunds totaling almost $314 billion. In addition, IRS employees responded accurately to 95.7 percent of tax law questions and 96 percent of taxpayer account questions. Largely as a result of the ongoing decline in agency funding and the late tax law changes, for fiscal year 2013, the telephone level of service for taxpayers trying to reach the IRS' toll-free lines dropped to 60.5 percent, the lowest level since fiscal year 2008. That means that approximately 40 percent of taxpayers who called were unable to reach an IRS employee.

The 2014 filing season, which began on January 31, started strongly and ran very smoothly. Through April 11, 2014, the IRS received more than 112 million individual income tax returns and issued more than 85 million refunds for approximately $234.5 billion.

Our level of phone service has appeared to improve this filing season as compared to the average for fiscal year 2013. We have been able to maintain a level of phone service of around 70 percent so far, 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 and because tax return processing has gone relatively smoothly. In addition, we continue to provide more resources to taxpayers on our Web site, which we believe offers an alternative to the phone. However, increases in volume will negatively impact these results, and we expect that for the year we will drop below 70 percent and end up closer to last year's 60.5 percent. 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.

An 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.

Taxpayer Service

Providing taxpayers with top quality service and helping them understand and meet their tax obligations remained top priorities for the IRS in fiscal year 2013. During fiscal year 2013, the IRS 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 in fiscal year 2013 by increasing the amount of tax information and services available on IRS.gov. In fiscal year 2013, taxpayers viewed IRS.gov Web pages more than 1.87 billion times as they used the Web site and mobile applications to obtain forms and publications, get answers to tax law questions, and check the status of their refunds.

Taxpayers used the "Where's My Refund?" online tool in 2013 nearly 201 million times to check refund status, an increase of 51.6 percent from 2012. Last year, the IRS enhanced the "Where's My Refund?" tool to allow taxpayers to find out when their tax return was received, when the refund was approved, and when the refund was sent.

The IRS also deployed a new telephone and Web tool 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 3 prior years. The tool also provides taxpayers with other information, such as when their amended return was received, adjusted, and completed, as well as specific information regarding offset conditions, such as a previous IRS tax liability or a past due obligation.

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. In fiscal year 2013, more than 91,800 volunteers prepared 3.4 million Federal returns, 95.3 percent of which were filed electronically, and more than 2.5 million State returns. The IRS also teamed up with its national partners to offer a remote filing method—Facilitated Self-Assistance (FSA)—at VITA sites. More than 82,000 FSA returns were filed at the 330 VITA sites offering the FSA remote filing model.

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.

With the IRS budget now in its fourth year of relative decline, significant effects on taxpayer services will become more apparent in fiscal year 2014. The IRS has had 11,000 fewer people working during the 2014 filing season than it had in 2010 while processing the largest number of tax returns in the agency's history.

In addition to our concerns about the overall level of phone service noted above, we estimate that taxpayers may see average wait times of 25 minutes per call, compared with 10 minutes in 2010. Given current resources, we also expect that it will take 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.

As Forbes magazine recently noted, a reduction in IRS funding that erodes service levels "punishes" taxpayers.

Tax Compliance

In fiscal year 2013, as a result of the impacts of sequestration and furloughs, the IRS delivered key enforcement programs well below historical levels. Total individual audits fell 5 percent from 1.48 million in 2012 to 1.40 million, while audits of high-income individuals declined from 179,000 to 172,000. This translated to an individual coverage rate below 0.9 percent, a historical low. Likewise, business return audits dropped 13 percent from 70,000 to 61,000.

Collections related to all enforcement activities totaled $53.3 billion in fiscal year 2013, an increase of $3.1 billion over fiscal year 2012. This was the fourth consecutive year the IRS exceeded $50 billion, for a total IRS-wide return on investment (ROI) of $4.8 to $1. Most of the increase came from a $2.6 billion rise in revenue from our appeals function which, due to the timing of the appeals process, generally relates to examinations occurring in previous years. Revenue from the collection function, the levels of which also frequently rise and fall in tandem with the overall health of the economy, increased by nearly $1 billion in fiscal year 2013.

While the overall receipts from enforcement increased in 2013 compared to the prior year, the total is still down by more than $4.3 billion from 4 years ago. The reason for this decline is primarily due to a decline in revenue from audits, which dropped nearly $400 million in fiscal year 2013 to $9.83 billion, the lowest level in a decade. This decline in audit revenue is attributable to a decline in the number of returns audited.

We are concerned the decline in core enforcement activities during fiscal year 2013 that was noted above is expected to continue in fiscal year 2014, given the ongoing challenging budget environment. For example, we expect audits to decline by an estimated 100,000 from fiscal year 2013 and the number of collection activities to decline by an estimated 190,000.

Despite the circumstances, the IRS has made significant progress in a number of major enforcement areas. One of these is international compliance. Strategic enforcement efforts and the parallel Offshore Voluntary Disclosure Program (OVDP) give U.S. taxpayers with undisclosed offshore assets or income an opportunity to become compliant with the U.S. tax system and avoid potential criminal charges. The OVDP has resulted in more than 43,000 disclosures and the collection of about $6.5 billion in back taxes, interest, and penalties since the program was first established in 2009.

The IRS also 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.

In fiscal year 2013, the IRS continued to educate and inform return preparers on tax law compliance in a number of ways, including: making visits to more than 3,000 return preparers around the country, including 300 compliance visits to preparers who handled large numbers of returns claiming the Earned Income Tax Credit (EITC); and addressing preparers who were found to have made egregious errors through education and outreach and through a variety of methods to ensure appropriate penalties and/or sanctions were imposed.

A critical area of focus involves stopping erroneous claims for refundable tax credits, particularly the EITC. We are concerned that the improper payment rate has remained unacceptably high throughout the program's history. Therefore, we initiated a major review of our activities in this area earlier this year. If Congress enacts the proposal in the administration's fiscal year 2015 budget to provide the IRS with greater flexibility to address "correctable errors," we will have additional tools to stop erroneous claims and, as a result, we believe we will be able to make a real reduction in the improper payment rate.

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. In fiscal year 2013, the IRS completed 5,557 investigations; achieved a conviction rate of 93.1 percent; maintained a Department of Justice case acceptance rate of 95.5 percent, which compares favorably with other Federal law enforcement agencies; and obtained 3,311 convictions.

Refund fraud related to identity theft continues to be a major focus for us and touches nearly every part of the IRS. In fiscal year 2013, the IRS continued to focus on a comprehensive and aggressive strategy to identify and combat tax-related identity theft. Last year, the IRS conducted a number of activities in this area. These included: issuing Identity Protection Personal Identification Numbers (IP PINs) to more than 770,000 taxpayers for the 2013 filing season; conducting 191 identity theft outreach events with tax and accounting practitioners, the general public, and the media; and working with victims to resolve and close more than 963,000 identity theft cases.

Business Systems Modernization

IRS modernization efforts during fiscal year 2013 continued to focus on building and deploying advanced information technology (IT) systems, processes, and tools to improve efficiency and productivity. Fiscal year 2013 modernization successes included the following:

—The IRS' Customer Account Data Engine 2 (CADE 2) posted more than 139 million returns and issued more than 111 million refunds totaling $281 billion during the filing season. Daily processing and posting of individual taxpayer accounts—which improved on the prior system of weekly processing and posting—enabled faster refunds for millions of taxpayers.

—Modernized e-File (MeF) Release 8 deployed for the filing season and was the sole e-file platform used as the IRS processed 224.7 million individual returns, and 16.8 million Business Master File returns.

—The IRS launched the Information Return Document Matching program and began selecting casework in January 2013. This program matches new information returns, such as Form 1099–K, Payment Card and Third Party Network Transactions, with both individual and business tax returns to identify potential income underreporting or non-reporting.

—The IRS launched a new Web portal that improved taxpayer access to IRS.gov. The Integrated Enterprise Portal accommodated a 22 percent increase in visits and a 6 percent increase in page views in fiscal year 2013 compared to fiscal year 2012.

Looking ahead, we believe that IRS IT operations in fiscal year 2014 will suffer a significant negative impact from the continuing tight budget environment. We anticipate that fiscal year 2014 funding will not be sufficient to address critical technology infrastructure needs such as: additional improvements to IRS.gov; new identity theft prevention tools; and upgrades to the basic computer software used by our employees that are needed to reduce system vulnerabilities.

Implementing Enacted Legislation

Within its budget constraints, the IRS nonetheless has an obligation to carry out the legislative responsibilities Congress has approved over the last several years, particularly ACA and FATCA. Implementation activities involving both statutes carried out in fiscal year 2013 will evolve and continue through fiscal year 2014 and into fiscal year 2015.

With regard to ACA implementation, I am pleased to be able to tell you that the systems and processes that the IRS developed to support enrollment in the new Health Insurance Marketplace were launched on schedule and are working as planned. We continue to focus on two significant provisions that go into effect in 2014: the premium tax credit and the individual shared responsibility provision. These two provisions will have a profound impact on IRS forms and procedures beginning with the 2015 filing season, and will require additional taxpayer services and education activities.

Preparation is already well underway to modify forms and instructions, enhance education and outreach to taxpayers and their advisors, and update our systems and processes in time for the 2015 filing season. The IRS is also focusing on ensuring that returns that erroneously or fraudulently claim refundable premium tax credits (or fail to reconcile advance payments of the credit) are efficiently identified and addressed using Marketplace information available during the filing season as well as the ever-improving IRS tools used for all returns to address errors and fraud.

Another major initiative is implementation of FATCA, which is an important new tool in our offshore compliance efforts. FATCA requires foreign financial institutions (FFIs) to report information to the IRS about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. Withholding requirements under FATCA go into effect on July 1, 2014. It is important to note that legal restrictions in some countries prevent FFIs from fulfilling the reporting, withholding and account disclosure requirements. For that reason, the Department of the Treasury (Treasury), with assistance from the IRS, is advancing an intergovernmental approach to FATCA implementation that is focused on bilateral agreements that address these legal impediments, simplify practical implementation and reduce the costs to FFIs. As of last week, there were 28 signed intergovernmental agreements. In addition another 27 jurisdictions had been publicly identified as having reached agreements in substance, bringing the total number of countries considered to have agreements in effect to 55.

The IRS FATCA registration Web site opened in August 2013 to allow financial institutions to begin to enter data. In January 2014, financial institutions were able to begin submitting their electronically signed FATCA agreements. Going forward, one of the IRS' biggest challenges involves having the resources to build and maintain systems that can effectively process all the incoming data. Beyond building these systems, we also will need additional staff to analyze the information and develop compliance programs around the new data.

Exempt Organizations

The IRS is continuing the efforts it began in fiscal year 2013 to implement broad managerial and operational improvements in the determination process for tax-exempt status. In this work we are focusing on applications for recognition of tax-exempt status under both sections 501(c)(3) and 501(c)(4).

We continue to address the issues and concerns surrounding the determinations process for section 501(c)(4) applications. In fiscal year 2013 and continuing into this fiscal year, the IRS has made important progress in responding to the recommendations made by the Treasury Inspector General for Tax Administration (TIGTA) in a May 2013 report describing problems with the processing of these applications. As of the end of January 2014, the IRS completed action on all nine TIGTA recommendations contained in that report.

Our responses to the TIGTA recommendations include the actions we have taken to reduce the inventory of section 501(c)(4) applications, including the group of 145 cases in the "priority backlog"—those that were pending for 120 days or more as of May 2013. As of March 13, 2014, 126 of those cases, or 87 percent, have been closed. Of the closed cases, 98 of them were approved, including 43 organizations that took advantage of a temporary self-certification procedure we offered in summer 2013. Of the remaining 28 closed cases, most were closed either because the organization withdrew the application or it failed to respond to our questions. To date, three applications have been formally denied. The 19 cases still open generally fall into one of two categories: either the taxpayer has asked for and received additional time to respond to our questions, or the case is being litigated. None of these 19 organizations opted to accept the self-certification procedure used by 43 organizations to obtain prompt approval of their applications.

Also consistent with the response to the TIGTA recommendations, draft proposed regulations were released in November 2013 that are intended to provide clarity in determining the extent to which an organization's political activity is consistent with tax-exempt status as a social welfare organization. I believe it is extremely important to make this area of regulation as clear as possible, not only because it will help guide the IRS in proper enforcement, but because it will also give a better roadmap to applicants and help those that already have section 501(c)(4) status understand the applicable standards and properly administer their organizations.

As Treasury has noted in the past, the central purpose of any Notice of Proposed Rulemaking is to solicit public comments on proposed regulations, and we intend to consider all public comments we have received on these proposed regulations before moving forward in the regulatory process. Indeed, we received more than 150,000 comments on these proposed regulations, which is a record for an IRS rulemaking comment period. In addition, while I do not control the regulatory process, I am committed that any final regulation should be fair to everyone, understandable and easy to administer. It is also important that every taxpayer be confident that, whenever they interact with the IRS, they will be treated the same as any other taxpayer, no matter what their beliefs, what organizations they belong to or whom they voted for in the last election. Taxpayer trust in the integrity of the IRS is our most important asset, and my primary goal is to do whatever is necessary to restore whatever trust has been lost as a result of the inappropriate criteria used to scrutinize some 501(c)(4) applications.

Improving the section 501(c)(3) application process has been another significant area of focus for our agency, and we have been working diligently to make the process less burdensome for applicants in a number of ways. We presently have a backlog of 60,000 section 501(c)(3) applications, many of them well over a year old.

Our Exempt Organization (EO) group consistently receives more than 60,000 applications per year, consisting primarily of applications for section 501(c)(3) status. The agency has experienced a substantial rise in applications since 2010, due in large part to automatic revocations of tax-exempt status that occurred under the 2006 Pension Protection Act beginning in 2011, and the subsequent requests for reinstatement, which have added more than 50,000 cases to EO's workload since fiscal year 2010.

We have taken a number of actions to deal with the backlog in 501(c)(3) applications. On January 2, 2014, the IRS issued Revenue Procedure 2014–11, which makes the reinstatement process more efficient for organizations whose status was automatically revoked and allows a majority of revoked organizations to use a streamlined process to apply for retroactive reinstatement of their exempt status.

Looking beyond the issue of automatic revocations, the IRS has recently developed another way of making the determination process more efficient for section 501(c)(3) organizations. The Interactive Form 1023, Application for Recognition of Exemption under section 501(c)(3), which was made available online in September 2013, should result in more complete applications. This will thus reduce processing time by minimizing the IRS' need to request additional information to make a determination.

We have also taken all applications that were more than a year old as of last fall and devoted the necessary resources to resolving virtually all of them in the next months. We also are working to have no applications still pending at the end of this year that have been filed more than 9 months earlier. Ultimately, we want to process all applications within a 6-month timeframe, with a backlog of less than 30,000 cases at any time.

To make this possible we are also examining the feasibility of creating a streamlined application process for certain organizations seeking tax-exempt status, in particular small organizations that pose a low risk of noncompliance. The goal is to come up with a new procedure this summer that is more efficient without introducing major risks into the system for approving applications. These streamlined applications could be processed in a matter of weeks rather than months.

THE ADMINISTRATION'S FISCAL YEAR 2015 BUDGET REQUEST

The budgetary constraints under which the IRS has been operating since 2010 continue to pose very serious challenges to our efforts to enforce the tax laws and provide excellent customer service. Our fiscal year 2014 enacted appropriation was $11.29 billion, which is more than $850 million below the fiscal year 2010 funding level in nominal dollars, or over $1 billion in real dollars. This represents a 7 percent cut in our annual budget since 2010 while the total population of individual and business filers grew by more than 4 percent over the same time period.

Essentially, the Federal Government is losing billions of dollars in revenue collection to achieve budget savings of a few hundred million dollars. In general, the IRS estimates that for every $1 invested in the IRS budget, it produces $4 in enforcement revenue, which is a $4-to-$1 return on investment to the American taxpayer. This year, for example, the IRS estimates it would have returned to the Federal Government over $2 billion more in collections had we received the remaining $500 million that our budget was cut as a result of the sequester.

The solution to the funding problems faced by the IRS begins with the President's fiscal year 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 fiscal year 2014 enacted level of $11.29 billion. 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.

The aim of the President's proposal is twofold. First, it is designed to reverse the erosion in the IRS budget over the last several years. In so doing, it will help taxpayers get the service they expect. It will also strengthen compliance in key areas, such as international tax compliance, high-wealth individuals and flowthrough entities, in large part by halting the recent declines in the number of key enforcement personnel. Longer term, the proposal also positions the IRS well for the future by allowing the agency to invest in necessary basic infrastructure, as well as advanced technology.

The budget request also provides funding to: implement enacted legislation; enforce return preparer compliance; expand criminal investigation capabilities; address compliance issues in the tax-exempt sector, including employee retirement plans, exempt organizations, and direct-pay bonds; and provide appropriate and balanced coverage by improving examination audit and collection coverage rates.

In regard to compliance, increased resources for IRS enforcement programs yield direct, measurable results through activities that provide a high return on investment. It is important to point out that this request includes a $480 million program integrity cap adjustment that will reduce the deficit through above-base funding for high-return tax enforcement and compliance programs, of which $5 million will be transferred to the Alcohol and Tobacco Tax and Trade Bureau. The $475 million requested for the IRS fiscal year 2015 enforcement initiatives funded through this program integrity cap adjustment is expected to generate nearly $2.1 billion in additional annual enforcement revenue once the new personnel hired reach full potential in fiscal year 2017. At full performance, these resources requested for enforcement initiatives are expected to generate a return on investment of nearly $6 to $1, not including indirect deterrence effects estimated to be at least three times the direct revenue impact. Over the 10-year budget window, the proposal is expected to generate $52 billion in additional revenue while costing $17 billion, thereby reducing the deficit by $35 billion.

It is fair to ask what value the American taxpayer would receive for the increase in funding requested by the President of approximately $1.2 billion over the fiscal year 2014 enacted level. Let me detail for you how the IRS intends to spend these additional funds in various categories:

Improve taxpayer service: $211 million—This additional funding will allow the IRS to meet the expected increase in demand for taxpayer services in fiscal year 2015. Combined with Opportunity, Growth and Security Initiative resources, the additional funding will allow us to answer about 12 million additional calls from taxpayers seeking our help, including taxpayers seeking assistance in regard to the ACA, and will cause our level of phone service to exceed 80 percent. It also includes $19 million that will be invested in advanced technology to further expand and improve the services taxpayers receive when they call the IRS. For example, this additional funding will allow the IRS to enhance its automated phone system to let taxpayers elect to be called back instead of waiting on hold, and will allow customer service representatives to call up immediate displays of taxpayer information on their computers, improving response time.

Prevent refund fraud and identity theft: $65 million.—This additional funding will allow the IRS to help more taxpayers who have been victims of identity theft resolve their cases. We will also invest in advanced technology to further our efforts in identifying potentially fraudulent returns, allowing us to reduce improper payments. We project that investments in these activities will protect nearly $1.5 billion in revenue by fiscal year 2017, an ROI of more than $22 to $1.

Address offshore tax evasion: $57 million.—This additional funding will allow us to expand our efforts to identify and pursue U.S. taxpayers with undisclosed offshore accounts. It will also help the IRS expand criminal investigations of international tax and financial crimes, and expand information gathering to identify those who promote or facilitate abusive offshore schemes. We estimate that this investment will enable the IRS to close an additional 6,600 cases and produce additional, direct annual enforcement revenue of approximately $293 million once the new hires carrying out these activities reach full potential in fiscal year 2017. That is an ROI of $4.8 to $1.

Expand audit coverage of individuals: $98 million.—This additional funding will allow the IRS to hire additional personnel to improve our examination efforts in regard to individuals. With these new resources, the IRS will be able to do more exams, match more documents to detect misreported or unreported income, and invest in advanced technology to make our work more efficient by, for example, using barcoding so that some paper documents we receive can be electronically processed. As a result, we estimate that we will be able to close an additional 243,000 individual examination cases. Through these activities, we expect to collect $674 million more in direct enforcement revenue once the new hires reach full potential in fiscal year 2017, an ROI of $7.1 to $1.

Expand audit coverage of high-wealth taxpayers: $21 million.—This additional funding will allow the IRS to hire more enforcement personnel to continue our focus on high-wealth taxpayers. This is a challenging area, as these taxpayers frequently operate complex enterprises containing many interrelated businesses that often have international components. We estimate that, with this investment, we will be able to close an additional 325 cases and produce additional annual enforcement revenue of $243.9 million once the new hires reach full potential in fiscal year 2017—an ROI of $11.3 to $1.

Improve audit coverage of partnerships and flow-through entities: $36 million.—This additional funding will allow the IRS to hire additional staff to keep pace with this segment of taxpayers, the most rapidly growing portion of all tax returns filed. In particular, this will allow us to increase the number of tax examiners with specialized knowledge about partnerships. We estimate that we will be able to close an additional 2,800 cases involving partnerships and produce $268 million more enforcement revenue annually once the new hires reach full potential in fiscal year 2017, an ROI of $6.8 to $1.

Enhance collection coverage: $67 million.—This additional funding will allow the IRS to hire new staff to improve our efforts to work with taxpayers to collect back taxes owed. With the additional funding, we will be able to take a more proactive role in reaching out to taxpayers earlier in the collection process. We estimate that this will allow us to close an additional 244,000 collection cases. The funding also will provide additional staff to handle an increasing number of cases involving unpaid employment taxes, which we estimate will allow us to close an additional 45,000 employment tax cases. As a result, we project additional annual, direct enforcement revenue of $617 million once new hires reach full potential in fiscal year 2017, an ROI of $8.5 to $1.

Improve efforts in the tax-exempt sector: $16 million.—With this additional funding, the IRS will be able to continue its focused oversight of the tax-exempt sector and improve service to make voluntary compliance easier. We estimate these additional resources will allow us to reach our goal of cutting our backlog of 501(c)(3) applications in half and reducing the processing time for all applications to a period of 2 weeks or less for smaller organizations and no more than 6 months for all applications.

Pursue fraud referrals and tax schemes: $18 million.—This additional funding will be dedicated to improving our efforts in the core enforcement areas of corporate fraud, employment tax, and abusive tax schemes by increasing the number of convictions and assessments of unpaid tax. A portion of the funding will be for the use of computer software that will allow the IRS to apply so-called network analysis to detect corporate fraud and abuse. With this software tool, the IRS will be able to identify schemes by linking together multiple potentially fraudulent returns or information items. These efforts are expected to help us achieve a conviction rate in this area for fiscal year 2015 of 92 percent.

Enhance return preparer compliance: $17 million.—This additional funding will allow the IRS to increase service and compliance activities in regard to tax return preparers. The IRS will be able to increase audits of preparers and increase monitoring and pursuit of preparers engaged in fraudulent activities, including those who prepare large numbers of returns involving EITC claims. We estimate we will be able to conduct 200 additional preparer visits and more than two dozen additional investigations into fraudulent activity.

Use technology to enhance criminal investigation: $4 million.—This additional funding will allow the IRS to automate the processing of evidence gathered by our criminal investigators by implementing a virtual digital evidence processing environment. This new system will allow for more secure and efficient evidence processing nationwide, and reduce travel by IRS agents and investigative specialists.

Use technology to improve audit case selection: $37 million—This additional funding will enable the IRS to improve the way we gather and use electronic data, which will in turn allow us to do a better job of selecting cases for audit and focusing on issues that need to be examined. This is important because the IRS needs to continually adapt to changing taxpayer behavior to prevent tax fraud and abuse. Under the initiative we envision, we will significantly increase the digital availability of tax return information and then employ technology to analyze this information in order to better detect noncompliant taxpayer behavior.

Expand Virtual Service Delivery (VSD): $8 million.—This additional funding will create a secure, Web-based digital communications channel through the Internet using online messaging that ultimately will allow the IRS to communicate directly with taxpayers while they are at work or at home, or using their mobile device. This will improve the taxpayer experience in resolving difficult issues with their accounts.

Enhance online services: $16 million.—With this additional funding, the IRS will develop additional digital applications that will further improve taxpayers' online interactions with the IRS. This technology investment will help provide secure digital communications, and add more interactive capabilities to existing Web self-service and mobile products.

Implement ACA: $452 million.—This additional funding, the majority of which is for required information technology upgrades, will allow the IRS to increase efforts to ensure compliance with a number of tax-related provisions of the ACA, and also perform outreach and educational activities so that taxpayers will understand what these provisions require, as well as covering additional phone calls made by taxpayers inquiring about the ACA. The funding will also assist the IRS in continuing to implement a major ACA provision going into effect in 2014—the premium tax credit, which will help millions of Americans purchase affordable coverage.

Implement FATCA: $32 million.—With this additional funding, the IRS will invest in advanced technology to allow the agency to continue implementing FATCA, which in turn will provide more information to us on offshore accounts of U.S. citizens. As mentioned above, FATCA includes new reporting and withholding requirements for foreign financial institutions. To properly process and analyze the data we receive as a result of these new requirements, the IRS will need to build new technology systems and modify existing systems.

Enhance information technology services: $10 million.—This additional funding will enable the IRS to continue upgrading its computer systems, and in particular convert the agency's operating system to a less complex standard, which will decrease our need for computer hardware. These investments will result in a more stable computing environment and reduce delays in providing service to taxpayers.

Consolidate and revitalize IRS office space: $10 million.—With this additional funding, the IRS will be able to consolidate office space in Atlanta, Georgia, and design a new, modernized facility for processing tax returns at the IRS campus in Covington, Kentucky. These activities, in turn, will allow the agency to improve efficiencies and achieve long-term savings.

Enhance IRS procurement and security systems: $31 million.—This additional funding will allow the IRS to improve the efficiency of our procurement processes and also improve security for our employees and our resources.

Improve IRS financial accounting systems: $12 million.—This additional funding will help the IRS ensure more timely and accurate reporting of data on the revenue we collect. The funding will also allow the IRS to make necessary system and programming changes to comply with various Federal mandates, and to stay current with internal changes made to IRS' tax processing systems for tax administration that also affect financial reporting.

CONCLUSION

Chairman Udall, Ranking Member Johanns and members of the subcommittee, thank you again for the opportunity to update you on IRS operations and discuss the fiscal year 2015 President's budget request for the IRS. 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 subcommittee to do just that. In order to ensure that the IRS can continue to deliver on its dual mission of providing quality taxpayer service and ensuring compliance with the Nation's tax laws, I hope that one of the legacies of my term as IRS commissioner will be that we put the agency's funding on a more solid footing. This concludes my statement, and I would be happy to take your questions.

IDENTITY THEFT

Senator UDALL. Commissioner, thank you very much for your testimony. You know, one of the things that—and for your service today—the big issues that you face are refund fraud and identity theft. And these are serious, pervasive problems in the United States, and I think they are probably daunting task for the IRS.

Taxpayers are harmed when identity thieves file fraudulent tax documents using stolen names and Social Security numbers and wrongfully receive refunds. Identity theft can be devastating for victims whose legitimate refunds are blocked, forcing them to spend months untangling their account problems with the IRS. The rapid growth of tax related identity theft has resulted in a backlog. My understanding, it is about 140,000 cases.

What is the IRS' strategy for dealing with identity theft and refund fraud? Is it comprehensive and aggressive enough to keep pace with fraudsters? And what is your plan for tackling the backlog? What measures make it easier for the IRS to better detect fraud and halt refund fraud schemes in their tracks? And what additional resources, both technology and human capital, does the IRS need to expedite case resolution for innocent victims, who often wait months for their rightful refunds?

Mr. KOSKINEN. It is a critical problem that exploded, really, in 2010 to 2012, and overwhelmed both the IRS and law enforcement. We have made great progress since then, particularly in protecting and working with taxpayers whose identities have been stolen. It used to take, when this first started, over 360 days to resolve a case. We now have those cases being resolved in less than 120 days. The backlog at this time last year was 260,000 cases. The end of this filing season, the backlog was under 100,000 cases, reduced by over 60 percent.

Our problem is that these are not individuals filing false returns. This is organized crime around the world that is filing hundreds, if not thousands, of returns at the same time, stealing Social Security numbers in various ways. We have developed fraud detectors that have allowed us to detect trends. Last year in the filing system overall, we stopped $17 billion of fraudulent refunds from going out the door. We continue to adjust those filters.

One of the technology changes which we hope to fund would allow us to change those filters on the run, rather than only once a year. Our system is somewhat archaic, and it is like running a Model-T. And so, we can only adjust the filters once a year. With more technology expenditures, which we hope to devote to this activity, we will be able to adjust those filters on the run and try to keep ahead of them.

Even though we have made great progress, I have asked our senior executive team—we have had two meetings on this—to step back and ask what else can we do? One of the things we can do, and we have asked for legislative support, is move the receipt for W–2s to the IRS from mid-March to the end of January. All employees get their W–2s by the end of the January. We would like to have the IRS have access to those W–2s at that time because what has happened is we are a victim of our own success. In the old days, which I remember, you used to get your refund in a check from the IRS sometime in August through October.

And by that time, all the third-party information was into the IRS. You now have improved the technology enough that we tell you if you file in January or February, within 21 days we will give you a refund, and we have met that standard. Ninety million people got refunds by April 15. So we leapfrogged the third party information. We need to have the W–2 information earlier so we can have some of the third-party information earlier. 1099s are too complicated to try to get that information much earlier.

We need to reconsider how we handle refund requests. We need to actually adjust those so we can get them in a reasonable time. We are working very well. We have partnerships with law enforcement at the State and local level. We have partnerships with financial institutions, with the prisons where a lot of this originally started, which is one of the reasons we are getting our arms around the problem.

We also have significant enforcement activity going on. In fiscal year 2011, we had 300 criminal investigations. Last year, we had almost 1,500. We have over 500 already in this filing season. We have moved to—we had 1,000 indictments last year with 438 sentences. Those are for multi-year sentences. This year already, just in the filing season, we have had 412 indictments and 342 convictions. And as I say, people are going to jail for 5, 10, 15 years.

So to some extent, one of the reasons we think we are getting our arms around this is we have sent a lot of criminals to jail. And these are not, as I say, people filing one return at a time. These are people filing 50, 100, 5,000 of them at a time. But we need to be continually vigilant. We need to continually devote resources to it.

PROPOSED 501(C)(4) REGULATIONS

Senator UDALL. Thank you. Obviously, a very serious issue. The—we had a lively exchange up here on the tax exempt. And I do not want to rehash a lot of that, but the one thing that I am wondering about with the proposed rule out there, until the rules change, what tests or criteria is the IRS using to evaluate applicants or tax exempt status as a social welfare group?

Mr. KOSKINEN. Last summer, to try to resolve the backlog of applications that had been pending far too long—some of them, 2 years—an interim measure was adopted that said if you will simply state and affirm that you are not going to spend more than 40 percent of your resources and revenues on political activities, you could, in fact, pass through. That has continued. So people applying today, if they simply say they are not going to spend more than 40 percent of their funding on political activities, can be reviewed and processed immediately.

We have, as the Secretary noted, implemented and adopted all of the recommendations of the Inspector General. There is training and re-training for people around every election cycle, which will not happen until later this year. But at this point, there are provisions making sure that any applicant that does not want to sign the 40 percent attestation and wants to be reviewed on the facts and circumstances, goes through review process, to make sure that no individual has the ability to stop one of those applications.

Senator UDALL. Thank you. Senator Johanns.

POLITICAL ACTIVITY BY TAX-EXEMPT ENTITIES

Senator JOHANNS. Mr. Commissioner, welcome. Who defines political activity?

Mr. KOSKINEN. Part of the problem is the facts and circumstances of political activity have been vague. There are, if you look in the regulations and the advice from the IRS over the years, there are 12 or 14 examples of what is in and what is out.

One of my concerns—and I share everybody's interest in this regulation which was drafted before I was confirmed—is that we need to have a clear standard, and not just for people applying. We need to have a clear standard for people running these organizations. They ought not to have to look over their shoulder, worrying that somebody is going to say the facts and circumstances have changed, you are now doing something that puts your tax exemption in——

Senator JOHANNS. Mr. Commissioner, I do not have much quarrel with what you just said. But you just informed us that if I file under 501(c)(4) and I attest to you that no more than 40 percent of our resources will go to political activity, then I go right on through.

Mr. KOSKINEN. Right.

Senator JOHANNS. But if I am 42 percent, I will not go right on through. Now, political activity, who defines it? Do you define it? Who in your office is responsible for saying, Mike——

Mr. KOSKINEN. As I said, there is public information about a range of examples of what is political activity. Advocacy, for instance, historically has not been viewed as political activity. One of the goals of the new regulation, and my commitment to it is, as the chairman noted earlier, that any final regulation ought to be fair to everybody. It ought to be clear on just this question and any other question, and it ought to be easy to administer. We ought not to be in the business of making subjective determinations of when you are over the line of political activity.

Senator JOHANNS. But I think today you are. It sounds extremely arbitrary and capricious to me that you have set a 40 percent limit, and you have told everybody out there that if they are at 41 percent or 40.5 percent, then they are going to get some kind of special scrutiny from the IRS. On the other hand, if you are at 40 percent or 39 percent, zip right on through. But I cannot figure out what is political activity. You are not expressing that, and that to me sounds arbitrary.

Mr. KOSKINEN. No. As I said, there is public information giving a wide range of examples of what is and is not political activity. As I said, advocacy has been held not to be political activity. The standard is are you primarily a social welfare organization, and "primarily" has never been defined in terms of what percentage it is. The 40 percent was just taken as an idea that that was a lot of resources to put into political activity, and in this interim period it would be a way of streamlining the process.

But you are exactly right. The problem is what the definition of political activity is, and how much of it should you be allowed to engage in before you are no longer a social welfare organization. And that is exactly what the regulation process is meant to decide and provide.

Senator JOHANNS. Well, if I was at 41 percent and I were a private citizen out there, I would be hollering like crazy because I think you are treating that person different for their activity versus the person who is at 39 percent. And we should not be doing that.

Mr. KOSKINEN. The issue is, unless you want to say that everybody can spend as much as they like on political activity and still be a social welfare organization, the statute says you should primarily be a social welfare organization. So whatever the line is, historically, that has been drawn, if you are over the line, you are not viewed as a social welfare organization. You are discriminated against because of your political activity, and you are not qualified. That is the way it has been for 50 years.

The problem is it has been extremely unclear for 50 years, and what, hopefully, we will get out of the regulatory process when we reissue, and I think we will reissue a new draft for public comment, is a regulation that is, in fact, more understandable, more transparent, easier for people applying and easier for people who are running organizations to know what is allowed and what is not allowed.

There is a definition right now in the present regulation of what political activity is, and we have got over 150,000 comments, a lot of them addressing whether that is the right definition. But it is a pretty clear definition. It is not a definition that people—a lot of people have felt it is broad, and that is a position that has been held on both ends of the political spectrum.

But it is clear. I think what we have in a redraft of this should be equally clear, but it should take into consideration the 150,000 comments, and we will do that.

FISCAL YEAR 2015 BUDGET REQUEST

Senator JOHANNS. Let me—quite honestly, you are talking in circles, but let me go on to the budget. According to the changes in the Budget Control Act that resulted from the Ryan-Murray agreement last fall, total discretionary spending will rise from $1 trillion and $12 billion to $1 trillion and $14 billion. The actual increase is smaller than a $2 billion difference. It is closer to about $1.4 billion.

In your budget alone, you are asking for an almost $1.2 billion increase. Even without the requested cap adjustment of $480 million, you are still asking for a $700 million increase, which would be more than half of the total increase in discretionary spending for everything, from fiscal year 2014 to fiscal year 2015.

It just strikes me that that is not consistent with reality. I cannot imagine as the Secretary of Agriculture walking into OMB and saying to them, I want half of every increase in discretionary dollars in agriculture. I think I would have been thrown out of the office.

Mr. KOSKINEN. The difference is, and it is an important difference for this subcommittee and an important difference for the country, is the Secretary of Agriculture with his $700 million, is not going to give you money back. The IRS returns four to six times back to the Government for every dollar it gets.

As I have said, if we had our pre-sequester $500 million, I have testified we would have provided $2 billion to $3 billion more into the Treasury than we are now able to provide. Our enforcement revenues are going to go down. We have 4,500 fewer revenue agents and revenue officers, whose only job is to collect revenue. If we do not have those people, they will not collect the revenue.

So it is not as if we are spending this money on a social welfare program. This money in the IRS budget is designed to assist taxpayers to make it as easy as possible to pay and to assist the Government in collecting the money that is owed to it. We collect on average over the years $50 billion to $60 billion just in our collection efforts, which is four to five times the budget of the IRS. As our budget is constrained, the amount of revenue to the Government is going down by a multiple of four to five.

Senator JOHANNS. Your argument seems to be going along the lines of you should just give us an unlimited amount of money, and we will just keep collecting and collecting and collecting. But Congress decides that, and we have decided with the Ryan-Murray agreement, and you are not even showing even a close attempt to live within that agreement, in my judgment.

Mr. KOSKINEN. The President's budget decisions are made by the administration and by OMB. Our position is simply that we have told you what you will get when you give us the resources. We have told you what you will not get if you do not give us the resources. It is a judgment you will have to make. All we want to do is make sure you understand the negative impacts on taxpayer services, the negative impacts on collection that are going to result if we end up with the—anything like the same budget we have now.

Senator JOHANNS. Thank you, Mr. Chairman.

Senator UDALL. Senator Moran, if you are prepared to proceed, we are actually right at—I do not want to put you on the spot. We can start——

Senator MORAN. I think you have already done that.

Senator UDALL. No, no, no. We can do another round. I am just saying if you——

Senator MORAN. That is fine. If you would go ahead, Mr. Chairman, I would wait.

Senator UDALL. Okay. Okay. Great. I just—I did not know whether your staff scheduled you so well that you just walk in and start your questioning. So but anyway, thank you.

Senator MORAN. Did you do that? Apparently not.

Senator UDALL. Okay. Okay.

Mr. KOSKINEN. If they do that, I would like to borrow your staff once in a while.

OVERSEAS TAX EVASION INITIATIVES

Senator UDALL. You know, they end up, Commissioner, they can watch the TV and see everything that is moving along, and then move you right in, and set it down in front of you. But it takes a lot of juggling, and our staffs are always good at that. Our staff is very good at that.

Let me—I think—this is—this whole issue of these organizations troubles me, and I want to kind of tell you what I see from the practical side happening. Congress passed a law—we are talking this tax exempt social welfare organization—passes a law. And it says that these organizations are established, and this is the quote from the law, "exclusively for the promotion of social welfare." So that is what the law said.

Mr. KOSKINEN. Right.

Senator UDALL. Well, the way you guys got yourselves, and it was not you, but the way the IRS got themselves in a mess is they interpreted the word "exclusively" to means "primarily." So to me, that is a big jump from "exclusively" to "primarily." And so, then you have had to come up with this political test and all those kinds of things and the 40 percent.

What is happening out there, and I think people should understand this, is that these 501(c)(4)s, money is contributed, and the donors are not publicly available. And so, what can happen, and this is, in a sense, in my opinion, money laundering, is that a 501(c)(4) can start with this intention of doing political activity. And the money flows in, and nobody knows how that money is connected to the political system in any way.

The 501(c)(4) can close its doors and then put that money into a super Pac, and you will end up having no evidence of who were the donors, and that is what the big problem is. And it is growing to a huge proportion. I think in the last elections it was $400 million, which is really what people are calling out there, and I agree with this—secret money, dirty money, that kind of thing.

So anyway, that is—I just want to tell you that is the issue that you are tackling is that we have always had a political system where we knew who was supporting whom. And we are getting a long ways from that when we have these organizations. And I think when you look at all these comments and get your congressional input, you really need to look at how this is impacting the core of our democracy really.

So with that, let me shift, and I am not asking for a comment on that. I want to talk a little bit about offshore tax invasion. U.S. taxpayers can hold offshore accounts for legitimate reasons, but they must comply with their tax obligations. Catching overseas tax dodgers is a top priority of the IRS, and you know that very well, and it is to make sure honest taxpayers are not footing the bill for those hiding assets offshore.

The IRS has operated some successful offshore compliance programs, such as the offshore voluntary disclosure program that has recouped $6 billion in back taxes, penalties, and interests, and provided an opportunity for 43,000 tax dodgers to come clean. These programs have also provided the IRS with a wealth of information on various banks and advisors assisting people with offshore tax evasion.

The IRS' 2015 funding request of $56.8 million to support overseas tax evasion initiatives is conditioned on securing funds that would exceed the available budget cap. Without 2015 funding, the IRS will lack critical resources to meet overseas tax collection priorities.

So my questions are these. What have been the benefits for the IRS in conducting the various overseas voluntary disclosure programs? What is the IRS doing now in 2014 to implement strategies to address international tax compliance issues? Can you confirm that as presented in your 2015 budget justification the $56.8 million in requested funds for overseas compliance initiatives depend on securing resources above the statutory budget cap, and how will the IRS devote resources to the overseas initiatives in 2015 if the requested funds are not appropriated?

Mr. KOSKINEN. Well, I would begin by agreeing with you that the benefits of the Foreign Account Tax Compliance Act are broader than just the amount of money we have collected. It is important for the average taxpayer to know when they are writing their check that everybody is paying their fair share, and they do not have to think, well, if I had a really fancy lawyer or a good accountant, I could hide my money somewhere and not pay taxes on it. They need to know that we take tax evasion seriously; that if you, in fact, willfully are not paying your taxes, we will track you down, and we are going to find you. And that includes in overseas tax havens.

We are working with the Department of Justice very closely, our Criminal Investigation Division, on the criminal side of this issue. We have been working on the civil side. We need funding to implement FATCA. We are about to start to get reams, volumes of data on individual taxpayer accounts from banks around the world.

But I would say, and money is in this request, and as I said earlier, the implementation of the Foreign Account Tax Compliance Act and the implementation of the Affordable Care Act are statutory mandates. So if we do not get the funding that we need in the budget, we will have to take the funding from our discretionary areas, which are taxpayer services and enforcement, because we are mandated to implement FATCA and the Affordable Care Act.

But what we need to have everybody understand is, this year, in 2014, we got zero dollars to implement the Affordable Care Act. So we have had to find $400 million in the budget to continue with that implementation, which is met primarily from IT resources. Three hundred million dollars of important IT projects, including some related to identity theft and fraud, are not being done. If we go forward into 2015 without sufficient resources, we will implement FATCA. We will implement the Affordable Care Act. And it will come at the cost of taxpayer service and other enforcement.

Senator UDALL. Thank you. Senator Johanns.

PERFORMANCE AWARDS

Senator JOHANNS. Mr. Commissioner, in February you made the decision to spend $62.5 million in fiscal year 2014 funds to pay out performance awards to employees for fiscal year 2013. $43.4 million went to bargaining unit employees, and about $19.1 million went to other employees, including managers at the IRS.

Now, your—the previous commissioner had made the decision to suspend those awards because of funding pressures and the need to fund other crucial priorities. Could you explain to us why you reached a different decision, and why you decided to spend this money in that direction versus some of the priorities that you have testified to at this hearing?

Mr. KOSKINEN. I would be delighted to. The previous decision had been made when the IRS was challenged to meet the sequester levels. It had to find almost $600 million to take out of the budget. It ended up with furlough days. It ended up with almost no training to employees anywhere during the year. And it ended up making a decision under the contract which provided for 1.75 percent as a performance award pool to change it to zero.

The union, under the contract, then filed an unfair labor practice and grievance and a lawsuit. When I came, all of that was pending. We were spending money on that. We were able to settle the claim that under the contract we needed to provide 1.75 percent as the award. The performance award pool was changed to make it 1 percent to be consistent with what the Government-wide number is, so that, in fact, the $40 million, give or take a little, that we paid to the bargaining unit employees, was probably $25 million to $30 million less than we would have paid if we had lost that lawsuit.

So it was a settlement of a disagreement that was in the courts that saved us money in litigation and the risk that we would end up paying more. It also seemed to me an important investment in our workforce. These are people who had not gotten a pay raise in 4 years. They had just had the shutdown, furlough days, were doing critical work for us across the board. But it was a settlement of litigation that it seemed to me at the time was appropriate, and if I had to do it again, I would do it again.

Senator JOHANNS. We have received information, which I would like you to verify or not verify, that in paying out the awards, awards were given to employees within the Tax Exempt and Government Entities Business Unit. These awards were paid out despite an ongoing investigation relative to the disparate treatment of taxpayers that we have talked about.

Why did you decide it was important to pay out the awards to a group under investigation, even though that had not been concluded at the moment? It is hard to tell when it will be concluded. And I would just offer a comment. I think to the average person in America, that just seems extremely tone deaf.

Mr. KOSKINEN. Well, I think it is important to understand there are over 800 people in that unit. Seventy to 80 percent of that unit's work is on 501(c)(3)s, not on (c)(4)s. So to say that we would not provide any of them a performance award—these are not bonuses, they are performance awards. Only two-thirds to 70 percent of the employees get those awards, and the average award for bargaining units employees is about $950. So nobody is making a fortune off of this. And to deny everybody in the organization, whether they were near the (c)(4)s or not, their performance award possibility, it would not have made any sense.

Also the significant people involved in this are no longer in the IRS. They did not get awards. The fact that people have been involved in the process under investigation, but have not been found that they themselves engaged in erroneous work, it seems to me it would be unfair to them to then say, while it is all pending, and we do not know whether there is anything further coming out, nobody gets an award.

If it turns out people performed badly—and that is why I am hoping that we will get reports out of the six investigations going on—we will look at those facts, and we will respond appropriately. If there are people who are found to have performed badly, they will not be eligible for performance awards. But we need to know what the findings are. We cannot simply say everybody involved in any investigation by anybody for anything is, therefore, not going to get an award.

Senator JOHANNS. Mr. Commissioner, it gets worse, though. Recently, there was a review of IRS performance awards, which I am guessing you are familiar with, between 2010 and 2012. During that time, more than 2,800 employees with recent substantiated conduct issues resulting in disciplinary action received more than $2.8 million in monetary awards, more than 27,000 hours in time off awards, and 175 quality step increases.

EMPLOYEE TAX COMPLIANCE

Among these, more than 1,100 IRS employees with substantiated Federal tax compliance problems—in other words, they are not paying their taxes—received more than a million dollars in cash awards, more than 10,000 hours in time off awards, and 69 quality step increases within a year after the IRS substantiated their tax compliance problems.

Now again, to the average American, the thought that you would—not you, but the IRS—would award an employee who is not paying their taxes is just incomprehensible.

Mr. KOSKINEN. We take tax compliance very seriously, obviously. The compliance rate of IRS employees is over 99 percent. That is significantly better than anybody else in the Federal Government, significantly better than people on the Hill, and it is, clearly, substantially better than the public.

Notwithstanding that, when an employee comes to work for the IRS, they commit that they will pay their taxes. We monitor all 90,000 employees regularly. As the IG reported, there is no policy across the Government that says you should or should not take conduct into consideration, or tax payment into consideration. We have a separate disciplinary process, and anybody who willfully does not file their taxes is subject to dismissal, and we have dismissed people for that.

But I agree—we agreed with the IG's recommendation, notwithstanding the absence of a general policy. We should have a policy in the IRS, and we will develop that and we are about to start. We are in the middle of a negotiation with the union about our next 5-year contract because a big bulk of this deals with union employees. And we have advised the union, and they said they are prepared to discuss with us the proposal we are developing, which we will discuss with them in the next few weeks because I do think it is exactly right. The reason we take it so seriously is if we are chasing you for your taxes, we should be paying our taxes.

And as I would stress again, over 99 percent of the IRS employees are compliant with their taxes. Those that are not compliant oftentimes have the same issues everybody has. They have got an issue about whether they declared head of household correctly. They may not have put a 1099–R in about a pension payment or outside income that they got. There may be issues about deductibility of dependents. So a lot of those, and a number of those thousand, were in the group of those who had differences of views as to what were appropriate taxes. They had not paid, and they were appealing it. They were then singled out as they had not paid.

Ultimately, I think that it is appropriate for people to say if you are in the IRS, you should pay your taxes. Some people might say if you are in the Government you should pay your taxes.

Senator JOHANNS. Thank you, Mr. Chairman.

Senator UDALL. Thank you, Senator Johanns. And, Commissioner, I really appreciate you taking this matter seriously. Based on the recent TIGTA filing, certain past bonus decisions were troubling and questionable, and I am glad you are making it a priority to revise the policies and practices. Senator Moran.

Senator MORAN. Chairman, thank you very much. Thank you for giving me the moment to collect my thoughts and listen to what the Commissioner had to say.

Commissioner, thank you very much for joining us. Let me follow up just a moment on the line of questioning that Senator Johanns had with you. My understanding is that you believe that the policy was absent and needed to be put in place to prevent the bonuses from being paid to employees at the IRS who have not or did not pay their taxes. That is what your testimony is?

Mr. KOSKINEN. Yes, sir. We have had a policy for senior level employees and executives that if they are not compliant, they are not eligible for awards. But we are developing a broader policy, and I think we should develop, although we have to negotiate it with the union. We have advised them that we should have a policy that basically says if you willfully are not compliant with your taxes, you should not be eligible for a performance award.

Senator MORAN. When were these performance awards granted in relationship to your arrival as Commissioner at the IRS?

Mr. KOSKINEN. The performance was for the fiscal year 2013, which was before I arrived. The decision, as Senator Johanns and I were talking about, to actually make the awards or create the pool that would allow somewhere between 65 and 70 percent of people to receive these awards was made in February by me.

Senator MORAN. So the determination about who would receive the award was made before you arrived. The ultimate decision to have the pool that was necessary to make the awards actually occur occurred after your arrival.

Mr. KOSKINEN. That is right. These were for determinations already made. The way the process for bargaining unit employees works is it begins as a recommendation, and it has two levels of review to make sure that, in fact, there was performance that merited an award. A third to sometimes 40 percent of employees get no award.

Senator MORAN. In your review of this circumstance, did you determine that there was a realization on the part of the individuals—the management at the IRS that made the decision to include these employees in receiving a bonus, that there was an awareness that these employees had not paid their taxes?

Mr. KOSKINEN. No, I do not——

Senator MORAN. They did not know that?

Mr. KOSKINEN. My understanding is that, historically, as in the rest of the Government, that performance issues are separate from any disciplinary issues, on the theory, I guess, that if you get disciplined you get disciplined, but in the meantime your performance is whatever it was. So in determining those performance awards, as a general matter, there was not a process that said, okay, what are the disciplinary issues.

Some managers may have been aware of whether the employees were tax compliant or not, although again, as a general matter, we protect taxpayer information very carefully. So if you are an IRS employee and you have a problem with your taxes, that information, as a general matter, will not be available to anybody else, even in the IRS.

Senator MORAN. I do not know that I will phrase this correctly, but the people involved in disciplinary actions at the IRS would have known this——

Mr. KOSKINEN. Yes.

Senator MORAN [continuing]. But not the management of these individuals—not the managers of these individual employees.

Mr. KOSKINEN. As I said, some of them, obviously, would be, depending on the nature of the disciplinary action. If you were a manager and your employee had been disciplined, you might have been the disciplining agent. You may have known about it otherwise as you went forward. But the process at the time did not require them, and, in fact, did not allow them to say, well, as a result I am changing my view of your performance because of this other issue.

Senator MORAN. Is this change in policy that you have determined as necessary, is it subject to negotiations with the union?

Mr. KOSKINEN. Yes, it is. The bargaining unit agreement has a provision right now that says the only time you can take any of these things into consideration is when it affects the integrity of the Agency. And historically that has not been interpreted to be a standard disagreement about taxes. So we are developing a proposal. We have told the union that we want to include that in the negotiations, and the union has said that they are prepared to consider it.

Senator MORAN. So when you indicated to the committee that you support a change in policy, that does not at this point necessarily mean it will occur. Negotiations still have to occur between the bargaining units.

Mr. KOSKINEN. No. The policies apply to the executives and senior level employees already. We are developing them to make sure it goes down through managers. Bargaining unit employees are subject to the contract, and I think that, you know, our——

Senator MORAN. So that is to be determined.

Mr. KOSKINEN. That is to be determined. But you know, my view is employees understand they work for the IRS. They are held to a higher standard than if they worked anywhere else in the Government or in the private sector. And I think it is appropriate—I agree with the Senator and others—that people ought to be comfortable if I work for the IRS and I am chasing you for your taxes, I should have paid mine.

AFFORDABLE CARE ACT

Senator MORAN. Let me change topics. A letter was written to you, Commissioner, on February 10. I do not expect you to know this off the top of your head, but you have not responded, and I would encourage you to do that. It is a letter from six United States senators generally led by Senator Coburn of Oklahoma.

But we are in what I think is a very straightforward, pretty apolitical kind of way asking questions of you as to the enforcement of the individual mandate based upon the circumstances that you now find yourself in with the delays and extensions that have been announced and provided for the enforcement of the Affordable Care Act.

And there are seven specific questions that are outlined in this letter that I think would helpful for us as Members of Congress to know how you intend to enforce the individual mandate. And so, I wanted to use this opportunity to bring to your attention this letter.

Mr. KOSKINEN. I am sorry we have not responded. My view is that we ought to respond to every letter promptly. I know of that letter. There is a clearance process for complicated issues. Tax policy is an issue controlled by the Treasury Department, not by us.

I will make sure that we get you that answer promptly because I do believe, and my commitment in my confirmation hearing was, if you write me a letter, I am going to read it. I have looked at that letter. And secondly, if you write to me, not only will I read it, I will try to get back with you as quickly as we can, and this is too long in delay.

Senator MORAN. Commissioner, thank you very much. I appreciate that attitude and very much would like to see that policy implemented. I became a member of the Appropriations Committee when I became a United States Senator, shortly thereafter. And one of the reasons was that the committee that makes spending decisions, maybe we are spending too much money, we can spend less. We certainly have the opportunity to prioritize.

But also an important feature of the role that I think my colleagues and I have is the ability to question the agencies that we are responsible for funding. And it seems to me that, and I have not been an appropriator prior to this Administration. This is not—I do not have anything to compare it to. But it is troublesome to me the number of instances in which agency heads and Department secretaries are asked for language—asked to respond in language to questions that we have asked that go unanswered. And I very much appreciate the suggestion that that is not your practice, and that you will respond to this letter. I would encourage your colleagues to do the same.

Mr. KOSKINEN. I cannot control anybody else, but I will tell you as well, if you get a letter from me and you do not think it is responsive, you should let me know. My goal is to not only respond promptly, but to be responsive.

Senator MORAN. Well, I am really interested in making certain that we do our jobs appropriately. Information is key to the ability to do that. And in my view, this is a letter that is not intended to create any political climate, score any political points. It is just how are you going to do this so that we know how to respond. And this committee has a responsibility to make certain we do it right. I thank you, Commissioner.

Mr. KOSKINEN. Thank you.

Senator UDALL. Thank you, Commissioner. Senator Moran, we are trying to get in one more panel before the 4:00 vote, so if you have any additional questions——

Senator MORAN. Mr. Chairman, I have questioned the Commissioner sufficiently.

Senator UDALL. Great. Thank you very much. Commissioner, thank you for your testimony.

Mr. KOSKINEN. You are welcome.

Senator UDALL. I understand that you are going to stay here during the testimony of the Inspector General. We very much appreciate that. And I would call forward Inspector General George, and as soon as you get up here and get situated, I would invite you to present your remarks. Please proceed.

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

STATEMENT OF HON. J. RUSSELL GEORGE, INSPECTOR GENERAL

Mr. GEORGE. Thank you, Mr. Chairman. Chairman Udall, Ranking Member Johanns, and Senator Moran, thank you for the opportunity to appear today. During my testimony I will address three key issues: first, the Internal Revenue Service's fiscal year 2015 budget request; second, TIGTA's recent work related to the most significant challenges currently confronting the IRS; and third, the fiscal year 2015 budget request for TIGTA.

The proposed IRS budget requests approximately appropriated resources of $12.5 billion. This is an increase of over $1.2 billion from the fiscal year 2014 enacted level. The IRS is faced with several challenges as it administers our Nation's tax laws and a reduced budgetary environment.

Let me start with the topic of providing quality customer service, which is the first step to achieving taxpayer compliance. We have seen a decline in the IRS' ability to provide a sufficient level of customer service in each of the ways that taxpayers interact with the IRS, namely by telephone, walk in, and correspondence. Many taxpayers use the telephone to contact the IRS. Addressing their questions with reduced staffing continues to be a struggle, resulting in long wait times, abandoned calls, and taxpayers' redialing the IRS' toll free telephone lines multiple times.

At its walk-in offices, known as taxpayer assistance centers, the IRS has decided to eliminate certain services, such as tax return preparation, that can be obtained through other channels. The IRS assisted over six and a half million taxpayers at these centers in fiscal year 2013, but plans to assist 14 percent fewer—that is 840,000—taxpayers this year.

The IRS' ability to process taxpayer correspondence in a timely manner has also declined while the backlog of paper correspondence inventory has substantially increased. The over-age inventory rose from 181,000 at the end of 2010 to almost 1.2 million at the end of 2013.

Tax fraud related identity theft continues to be a growing problem that results in billions of dollars of improper payments. For tax year 2011, we identified 1.1 million undetected returns that have potentially refunds totaling $3.6 billion. Now, while this is a decrease of $1.6 billion from the prior year, indicating that the IRS is making some progress, significant improvements are still needed.

Implementation of tax law changes associated with the Affordable Care Act will also present many challenges to the IRS in the coming years. For example, the ACA provides for a refundable credit, known as a premium tax credit, to offset an individual's health insurance expenses. In September 2013, we reported that a fraud mitigation strategy is not in place to guide Affordable Care Act's systems development.

The IRS informed us that two new systems are under development that will address fraud risk. However, until these new systems are successfully developed and tested, we remain concerned that the IRS' existing fraud detection system may not be capable of identifying and preventing refund fraud.

We are also concerned about the protection of confidential taxpayer data that will be provided to the exchanges. The IRS' role in providing customer service in this area will become more significant in 2015. We continue to monitor IRS implementation of the ACA and help identify and correct any problems early in the process.

The tax gap is also a continuing challenge. The most recent IRS assessment is that the gross tax gap is about $450 billion annually. Most of this amount—$376 billion—is attributable to taxpayers under reporting their tax liabilities.

Finally TIGTA's fiscal year 2015 proposed budget request requests approximately—resources in the amount of $157 million, an increase of less than 1 percent compared to the fiscal year 2014 enacted budget. TIGTA's budget priorities include mitigating risks associated with tax refund fraud and identity theft, monitoring the IRS' implementation of the ACA and other tax law changes, and assessing the IRS's ability to provide quality taxpayer service and address the tax gap.

PREPARED STATEMENT

In addition, we will continue to give priority to investigating allegations of serious misconduct and criminal activity by IRS employees, ensuring IRS employees are safe and IRS facilities, data, and infrastructure are secure and not impeded by threats of violence and protecting the IRS against attempts to interfere with tax administration.

Chairman Udall, Ranking Member Johanns, Senator Moran, thank you for the opportunity to share my views.

[The statement follows:]

PREPARED STATEMENT OF HON. J. RUSSELL GEORGE

REVIEW OF THE PRESIDENT'S FISCAL YEAR 2015 FUNDING REQUEST FOR THE DEPARTMENT OF THE TREASURY AND THE INTERNAL REVENUE SERVICE

Chairman Udall, Ranking Member Johanns, and members of the subcommittee, thank you for the opportunity to testify on the Internal Revenue Service's (IRS) fiscal year[1] 2015 budget request, our recent work related to the most significant challenges currently facing the IRS, and the Treasury Inspector General for Tax Administration's (TIGTA) fiscal year 2015 budget request.

The Treasury Inspector General for Tax Administration, also known as "TIGTA," is a nationwide organization. We are statutorily mandated to provide independent audit and investigative services necessary to improve the economy, efficiency, and effectiveness of IRS operations, including the oversight of the IRS Chief Counsel and the IRS Oversight Board. TIGTA's oversight activities are designed to identify high-risk systemic inefficiencies in IRS operations and to investigate exploited weaknesses in tax administration. TIGTA's role is critical in that we provide the Amer-

[1] The Federal Government's fiscal year begins on October 1 and ends on September 30.

ican taxpayer with assurance that the approximately 95,000[2] IRS employees who collected over $2.9 trillion in tax revenue, processed over 241 million tax returns, and issued $364 billion in tax refunds during fiscal year 2013,[3] do so in an effective and efficient manner while minimizing the risks of waste, fraud, or abuse.

TIGTA's Office of Audit (OA) reviews all aspects of the Federal tax administration system and provides recommendations to: improve IRS systems and operations; ensure the fair and equitable treatment of taxpayers; and prevent and detect waste, fraud, and abuse. The Office of Audit places emphasis on statutory coverage required by the IRS Restructuring and Reform Act of 1998 (RRA 98),[4] the American Recovery and Reinvestment Act of 2009,[5] and other laws, as well as areas of concern raised by Congress, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other key stakeholders. The OA has examined specific high-risk issues such as identity theft, refund fraud, improper payments, information technology, security vulnerabilities, complex modernized computer systems, tax collections and revenue, and waste and abuse in IRS operations.

TIGTA's Office of Investigations (OI) protects the integrity of the IRS by investigating allegations of IRS employee misconduct, external threats to employees and facilities, and attempts to impede or otherwise interfere with the IRS's ability to collect taxes. Misconduct by IRS employees manifests itself in many ways, including extortion, theft, taxpayer abuses, false statements, financial fraud, and identity theft. The OI places a high priority on its statutory responsibility to protect all IRS employees located in over 670 facilities nationwide. In the last 4 years, threats directed at the IRS have become the second largest component of OI's work. Physical violence, harassment, and intimidation of IRS employees continue to pose significant challenges to the implementation of a fair and effective system of tax administration. The OI is committed to ensuring the safety of IRS employees and the security of IRS facilities.

TIGTA's Office of Inspections and Evaluations (I&E) provides responsive, timely, and cost-effective inspections and evaluations of challenging areas within the IRS, providing TIGTA with additional flexibility and capability to produce value-added products and services to improve tax administration. Inspections and Evaluations' work is not a substitute for audits and investigations. In fact, its findings may result in subsequent audits and/or investigations. Inspections are intended to monitor compliance, assess the effectiveness and efficiency of programs and operations, and inquire into allegations of waste, fraud, abuse, and mismanagement; evaluations are intended to provide in-depth reviews of specific management issues, policies, or programs. In the last year, I&E has reviewed the IRS's implementation of the Telework Enhancement Act of 2010, assessed the costs and frequency of IRS executives' temporary duty travel and the associated travel taxability, and determined that the IRS needs to improve the comprehensiveness, accuracy, reliability, and timeliness of the Tax Gap estimate.

OVERVIEW OF THE IRS'S FISCAL YEAR 2015 BUDGET REQUEST

The IRS is the largest component of the Department of the Treasury and has primary responsibility for administering the Federal tax system. The IRS's budget request supports the Department of the Treasury's Strategic Plan and agency priority goal of focusing on expanding the availability and improving the quality of customer service options. The IRS's Strategic Plan goals are to: (1) Deliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance and (2) Effectively enforce the law to ensure compliance with tax responsibilities and combat fraud. The IRS's role is unique within the Federal Government in that it collects the revenue that funds the Government and administers the Nation's tax laws. It also works to protect Federal revenue by detecting and preventing the growing risk of fraudulent tax refunds and other improper payments.

To achieve these goals, the proposed fiscal year 2015 IRS budget requests appropriated resources of approximately $12.5 billion.[6] The total appropriations amount

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[2] Total IRS staffing as of April 5, 2014. Included in the total are approximately 19,000 seasonal employees.

[3] IRS, *Management's Discussion & Analysis, Fiscal Year 2013.*

[4] Public Law No. 105–206, 112 Stat. 685 (1998) (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

[5] Public Law No. 111–5, 123 Stat. 115 (2009).

[6] The fiscal year 2015 budget request also includes approximately $101 million from reimbursable programs, $27 million from non-reimbursable programs, $396 million from user fees, $265

Continued

is an increase of $1.2 billion, or approximately 11 percent more than the fiscal year 2014 enacted level of approximately $11.3 billion. This increase is illustrated in Table 1. The budget request includes a net staffing increase of 6,998 full-time equivalents (FTE)[7] for a total of approximately 91,187 appropriated FTEs.

TABLE 1—IRS FISCAL YEAR 2015 BUDGET REQUEST INCREASE OVER FISCAL YEAR 2014 ENACTED BUDGET

[In thousands]

Appropriations account	Fiscal year 2014 enacted[8]	Fiscal year 2015 request	$ change	Percent change
Taxpayer Services	$2,156,554	$2,317,633	$161,079	7.5
Enforcement	5,022,178	5,371,826	349,648	7.0
Operations Support	3,798,942	4,456,858	657,916	17.3
Business Systems Modernization	312,938	330,210	17,272	5.5
Total Appropriated Resources	11,290,612	12,476,527	1,185,915	10.5

Source: TIGTA analysis of the IRS's fiscal year 2015 Budget Request, Operating Level Tables.

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

As a result of the Balanced Budget and Emergency Deficit Control Act, as amended,[9] the IRS was required to reduce planned spending from its appropriations by $594 million for fiscal year 2013 as a result of sequestration.[10] The IRS was also required in fiscal year 2013 to reduce planned spending from its appropriations by $24 million as the result of an across-the-board rescission.[11] These funding reductions represented a total decrease of $618 million to the IRS's budget of $11.8 billion, resulting in a revised annual budget for fiscal year 2013 of $11.2 billion.

The IRS achieved these budgetary savings by cuts in key spending areas such as personnel compensation ($276 million), including not issuing bargaining unit employee awards during fiscal year 2013 and furloughing employees for three days, travel ($92 million), and equipment ($50 million). We are currently assessing the IRS's steps to plan for and implement the reductions in its fiscal year 2013 budget due to sequestration.[12]

Implementation of the sequestration mandated cuts, coupled with a trend of lower budgets, reduced staffing, and the loss of supplementary funding for the implementation of the Patient Protection and Affordable Care Act of 2010 (hereinafter referred to as the ACA or Affordable Care Act),[13] impacted the IRS's ability to effectively deliver its priority program areas, including enforcement activities. For example, examinations of individual tax returns declined from 1,481,966 in fiscal year 2012 to 1,404,931 in fiscal year 2013, an approximate 5 percent decrease. Further, collection activities initiated by the IRS, such as taxpayer liens, levies, and property

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million in available unobligated funds from prior years, and a transfer of $5 million to the Alcohol and Tobacco Tax and Trade Bureau for a total amount of $13.3 billion in available resources.

[7] A measure of labor hours in which one FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year.

[8] Fiscal Year 2014 enacted includes $92 million in funding ($34 million in Taxpayer Services and $58 million in Operations Support). The $92 million was a nonrecurring appropriation increase in the Consolidated Appropriations Act 2014. The additional funds were granted to improve the delivery of services to taxpayers, improve the identification and prevention of refund fraud and identity theft, and address international and offshore compliance issues.

[9] Public Law No. 112–25, 125 Stat. 240 (2011).

[10] Sequestration involves automatic spending cuts of approximately $1 trillion across the Federal Government that took effect on March 1, 2013.

[11] A rescission cancels part of an agency's discretionary budget authority and is usually established as a percentage reduction to the budget authority.

[12] TIGTA, Audit No. 201310030, *Implementation of fiscal year 2013 Sequestration Budget Reductions,* report planned for May 2014.

[13] Public Law No. 111–148, 124 Stat. 119 (2010) (codified as amended in scattered titles of the U.S.C.).

seizures declined from 3,669,663 in fiscal year 2012 to 2,457,647 in fiscal year 2013, an approximately 33 percent decrease.

KEY CHALLENGES FACING THE IRS

In this section of my testimony, I will discuss several of the most significant challenges now facing the IRS as it administers our Nation's tax laws.

TAXPAYER SERVICE

Providing quality customer service is the IRS's first step to achieving taxpayer compliance. One of Congress' principal objectives in enacting RRA 98 was to mandate that the IRS do a better job of meeting the needs of the taxpayers. In the past, TIGTA has evaluated the IRS's efforts in providing quality customer service and made recommendations for areas of improvement. Although the IRS has implemented certain procedures to better assist the American taxpayer, funding reductions pose a significant challenge.

Overall, the IRS's fiscal year 2013 enacted budget was over $1 billion less than its fiscal year 2010 enacted budget as a result of the fiscal year 2013 sequestration and rescission and declines in its fiscal year 2011 and fiscal year 2012 budgets. These budget constraints continue to result in the IRS cutting service to taxpayers which make it difficult for the IRS to effectively assist taxpayers. As demand for taxpayer services continues to increase, resources devoted to customer service have decreased, thereby affecting the quality of customer service that the IRS is able to provide. I would like to provide you with some specific examples.

First, the IRS continues to struggle in providing high-quality customer service over the phone. These struggles result in long customer wait times, customers abandoning calls, and customers redialing the IRS toll-free telephone lines[14] for service. Despite other available options, most taxpayers continue to use the telephone as the primary method to make contact with the IRS. For the 2014 Filing Season as of March 8, 2014, approximately 46.3 million taxpayers contacted the IRS by calling the various customer service toll-free telephone assistance lines seeking help to understand the tax laws and meet their tax obligations. IRS assistors have answered 6 million calls and have achieved a 74.7 percent Level of Service[15] with an 11.7 minute Average Speed of Answer.[16] The Level of Service for the 2013 Filing Season was 67.9 percent. The IRS forecasted a 70.2 percent Level of Service for the 2014 Filing Season.

Although the IRS is reporting an increase in the Level of Service, IRS numbers continue to show a decline in the total number of taxpayers who contact the IRS who are actually assisted. As of March 8, 2014, the number of taxpayers actually assisted has dropped from 56.1 percent to 51.6 percent as of the same time last year.[17] We previously reported that the Level of Service measure does not accurately reflect total call demand (i.e., total number of taxpayers attempting to call the IRS).[18] The Level of Service only measures the percentage of calls in the queue waiting to be answered by an assistor that are actually answered. The Level of Service does not measure the success of taxpayers attempting to call the IRS to use the IRS's automated services. The IRS can manage the Level of Service by increasing or decreasing the number of calls it allows into the assistor queue.[19]

Second, the IRS's ability to process taxpayer correspondence in a timely manner has also declined. The over-age correspondence inventory rose from approximately 181,000 at the end of Processing Year 2010 to almost 1.2 million at the end of Processing Year 2013, representing an increase of 556 percent.[20] IRS management indicated that the continued increase in the over-age correspondence inventory is the result of reduced resources. The allocation of limited resources requires difficult decisions with the focus on maximizing taxpayer assistance on the toll-free telephone

[14] The IRS refers to the suite of 29 telephone lines to which taxpayers can make calls as "Customer Account Services Toll-Free."

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

[16] The average amount of time for an assistor to answer the call after the call is routed to a call center staff.

[17] Using automation or live assistance, the IRS answered 31.6 million of the 56.3 million calls received as of March 8, 2013 (56.1 percent) and 23.9 million of the 46.3 million calls received as of March 8, 2014 (51.6 percent).

[18] TIGTA, Ref. No. 2009–40–127, *Higher Than Planned Call Demand Reduced Toll-Free Telephone Access for the 2009 Filing Season* (Sept. 2009).

[19] TIGTA, Ref. No. 2014–40–029, *Interim Results of the 2014 Filing Season* (Mar. 2014).

[20] Numbers have been rounded. The percentage of change is based on the actual inventory volumes as of the end of Processing Years 2010 and 2013.

lines during filing season while concentrating any remaining resources toward various priority programs such as identity theft and aged work.[21]

Third, the number of taxpayers assisted by Taxpayer Assistance Centers (TACs) will decrease this fiscal year. The IRS assisted more than 6.5 million taxpayers in fiscal year 2013 and plans to assist 5.6 million taxpayers in fiscal year 2014, which is 14 percent fewer than in fiscal year 2013. The IRS indicated that budget cuts and its strategy of not offering services at TACs that can be obtained through other service channels, such as the IRS's Web site, result in the reduction of the number of taxpayers the IRS plans to assist at the TACs.

In fiscal year 2014, the IRS eliminated or reduced services at TACs. Currently, TACs are not preparing tax returns. Instead, taxpayers seeking this assistance will be referred to Volunteer Income Tax Assistance sites or other free preparation options. TAC assistors will only answer basic tax law questions during the filing season and will not answer any tax law questions after April 15, 2014. After April 15, 2014, the IRS will direct all tax law inquiries to alternative services such as IRS.gov, TeleTax, commercial software packages, or a tax professional. In addition, TACs will no longer answer taxpayers' tax refund inquiries unless the taxpayer has waited more than 21 days for the refund. Taxpayers with refund inquiries will be referred to the "Where's My Refund?" application on IRS.gov. Finally, the TACs are transitioning to no longer provide transcripts upon request without extenuating circumstances. For the 2014 Filing Season, TACs will still provide transcripts but are encouraging taxpayers to obtain them through other sources.[22]

The reduction in services was implemented without completing the required taxpayer burden risk evaluation for the taxpayers most likely to visit a Taxpayer Assistance Center, such as low-income, elderly, and limited-English-proficient taxpayers. The purpose of such an evaluation is to assess the burden that service changes can have on taxpayers.

IMPROPER PAYMENTS

The Improper Payments Information Act of 2002[23] requires Federal agencies, including the IRS, to estimate the amount of improper payments made each year and to describe the steps taken to ensure that managers are held accountable for reducing these payments. Agencies must also report to Congress on the causes of and the steps taken to reduce improper payments and address whether they have the information systems and other infrastructure needed to reduce improper payments. The Improper Payments Elimination and Recovery Act of 2010[24] (IPERA) amended the Improper Payments Information Act of 2002 by redefining the definition of improper payments and strengthening agency reporting requirements. TIGTA is required to review annually the IRS's compliance with the Act's reporting requirements.

The Office of Management and Budget has declared the Earned Income Tax Credit (EITC) Program a high-risk program that is subject to reporting in the Department of the Treasury's Agency Financial Report. The IRS estimates that 22 to 26 percent of EITC payments were issued improperly in fiscal year 2013. The dollar value of these improper payments was estimated to be between $13.3 billion and $15.6 billion.

In March 2014,[25] we reported that the IRS continued to not provide all required IPERA information to the Department of the Treasury for inclusion in the Department of the Treasury's Agency Financial Report for fiscal year 2013. For the third consecutive year, the IRS did not publish annual reduction targets or report an improper payment rate of less than 10 percent for the EITC. IRS management indicated that on March 20, 2014, the Office of Management and Budget approved the establishment of supplemental measures for use in evaluating the incremental reduction in EITC improper payments. The IRS is in the process of developing these supplemental measures.

Finally, although risk assessments were performed for each of the programs that the Department of the Treasury required the IRS to assess, the risk assessment process still may not provide a valid assessment of improper payments in tax administration. As such, the EITC remains the only area considered at high risk for improper payments. There continues to be no effective process to address the continued risks associated with improper tax refund payments resulting from other re-

[21] TIGTA, Ref. No. 2014–40–029, *Interim Results of the 2014 Filing Season* (Mar. 2014).
[22] TIGTA, Ref. No. 2014–40–029, *Interim Results of the 2014 Filing Season* (Mar. 2014).
[23] Public Law No. 107–300, 116 Stat. 2350.
[24] Public Law No. 111–204, 124 Stat. 2224.
[25] TIGTA, Ref, No. 2014–40–027, *The Internal Revenue Service fiscal year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act* (Mar. 2014).

fundable tax credits[26] and tax refund fraud. Improper payments due to identity theft are the most significant example of a category that is not estimated by the IRS. As such, we believe the IRS's identification of EITC as the only program of high risk of improper payments may significantly underestimate the risk of improper payments to tax administration. IRS management indicated that on March 20, 2014, the Office of Management and Budget provided guidance exempting improper refunds made without relation to any refundable tax credit program from improper payment requirements. We plan to evaluate the impact of the Office of Management and Budget guidance in an upcoming review.

IDENTITY THEFT AND TAX REFUND FRAUD

While refundable tax credits increase the risk of potentially fraudulent tax refunds, other issues concerning tax administration can also pose a significant risk for improper payments. The IRS continues to be challenged with the rapidly growing problem of identity-theft tax refund fraud, including tax fraud related to the use of stolen Employer Identification Numbers (EIN).[27] Efforts to identify and detect tax returns with these characteristics are hampered by the IRS's lack of third-party information to effectively verify income and withholding when tax returns are processed.

Identity Theft

The IRS has described identity theft as the number one tax scam for 2014.[28] The IRS has made this issue one of its top priorities and has made some progress; however, significant improvements are still needed.

As of December 28, 2013, the IRS had identified more than 2.9 million incidents of identity theft in calendar year 2013. As of December 31, 2013, the IRS reported that during the 2013 Filing Season it stopped the issuance of more than $10.7 billion in potentially fraudulent tax refunds associated with over 1.8 million tax returns classified as involving identity theft.

In September 2013, TIGTA reported that the impact of identity theft on tax administration continues to be significantly greater than the amount the IRS detects and prevents.[29] Using the characteristics of tax returns that the IRS has confirmed as involving identity theft and income and withholding information the IRS received in 2012 late in the filing season and in early 2013, we analyzed tax year 2011 tax returns processed during the 2012 Filing Season and identified approximately 1.1 million undetected tax returns where the primary Taxpayer Identification Number on the tax return was a Social Security Number. The undetected tax returns have potentially fraudulent tax refunds totaling approximately $3.6 billion, which is a decrease of $1.6 billion compared to the $5.2 billion we reported for tax year 2010.[30]

In addition, we expanded our tax year 2011 analysis to include tax returns where the primary Taxpayer Identification Number on the tax return is an Individual Taxpayer Identification Number (ITIN).[31] We identified more than 141,000 tax year 2011 tax returns filed with an ITIN that have the same characteristics as IRS-confirmed identity-theft tax returns. Potentially fraudulent tax refunds issued for these undetected tax returns totaled approximately $385 million, which is in addition to the approximately $3.6 billion referred to earlier. In total, the IRS could issue potentially fraudulent refunds of approximately $4 billion annually as a result of identity-theft tax refund fraud.

A common characteristic of tax returns filed by identity thieves is the reporting of false income and withholding to generate a fraudulent tax refund. Another aspect to this problem is that many individuals who are victims of identity theft may be

[26] A refundable credit is not limited to the amount of an individual's tax liability and can result in a Federal tax refund that is larger than the amount of a person's Federal income tax withholding for that year.

[27] An EIN is a Federal Tax Identification Number used to identify a taxpayer's business account. The EIN is used by employers, sole proprietors, corporations, partnerships, nonprofit associations, trusts and estates, government agencies, certain individuals, and other types of businesses.

[28] IRS Press Release, IR–2014–16 (Feb, 19, 2014), *available at* http://www.irs.gov/uac/Newsroom/IRS-Releases-the-"Dirty-Dozen"-Tax-Scams-for-2014;-Identity-Theft,-Phone-Scams-Lead-List.

[29] TIGTA, Ref. No. 2013–40–122, *Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds* (Sept. 2013).

[30] TIGTA, Ref. No. 2012–42–080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).

[31] An ITIN is available to individuals who are required to have a taxpayer identification number for tax purposes, but do not have and are not eligible to obtain a Social Security Number because they are not authorized to work in the United States.

unaware that their identity has been stolen and used to file fraudulent tax returns. These individuals are typically those who are not required to file a tax return.[32]

The IRS continues to expand the number of identity-theft filters it uses to identify potentially fraudulent tax returns and prevent the issuance of fraudulent tax refunds from 80 filters during Processing Year 2013 to 114 filters during Processing Year 2014. The identity-theft filters incorporate criteria based on characteristics of confirmed identity-theft tax returns. These characteristics include amounts claimed for income and withholding, filing requirements, prisoner status, taxpayer age, and filing history.

Tax returns identified by these filters are held during processing until the IRS can verify the taxpayer's identity. The IRS attempts to contact the individual who filed the tax return and, if this individual's identity cannot be confirmed, the IRS removes the tax return from processing. This prevents the issuance of many fraudulent tax refunds. For Processing Year 2014 as of February 28, 2014, the IRS reported that it identified and confirmed 28,076 fraudulent tax returns and prevented the issuance of nearly $143 million in fraudulent tax refunds as a result of the identity-theft filters.[33]

In January 2012, IRS Criminal Investigation created the Identity Theft Clearinghouse (the Clearinghouse). The Clearinghouse was created to accept tax fraud-related identity-theft leads from the IRS's Criminal Investigation field offices. The Clearinghouse performs research, develops each lead for the field offices, and provides support for ongoing criminal investigations involving identity theft. Since its inception, the Clearinghouse has received 5,287 identity-theft leads that have resulted in the development of 568 investigations.

Finally, the IRS has significantly expanded the number of tax accounts that it locks by placing an indicator on the individual's tax account.[34] In Processing Year 2011, the IRS began locking taxpayers' accounts where the IRS Master File[35] and Social Security Administration data showed a date of death. The IRS places a unique identity-theft indicator to lock the individual's tax account if he or she is deceased. Electronically filed tax returns using the Social Security Number of a locked account will be rejected (the IRS will not accept the tax return for processing). Paper tax returns will be processed; however, the tax returns will not post to the taxpayer's account due to the account lock, and a refund will not be issued.

Between January 2011 and September 2013, the IRS had locked approximately 11 million deceased taxpayer accounts, which will assist the IRS in preventing future identity-theft fraudulent tax refunds from being issued. For Processing Year 2014 as of February 28, 2014, the IRS had rejected 67,079 e-filed tax returns. As of September 30, 2013, the IRS had prevented the issuance of approximately $10 million in fraudulent tax refunds since the inception of the lock on paper tax returns. In November 2013, the Chairman of the Senate Finance Committee proposed restricting access to the Social Security Administration's public death data—the Death Master File, which would help the IRS's efforts to reduce tax fraud via the use of a deceased individual's Social Security Number.

Despite these improvements, the IRS could continue to expand the use of characteristics of confirmed identity-theft cases to improve its ability to detect and prevent the issuance of fraudulent tax refunds. As we reported in July 2008,[36] July 2012, and again in September 2013, the IRS is not in compliance with direct-deposit regulations that require tax refunds to be deposited into an account only in the name of the individual listed on the tax return. Direct deposit, which now includes debit cards, provides the ability to receive fraudulent tax refunds quickly, without the difficulty of having to negotiate a tax refund paper check. The majority of the tax year 2011 tax returns we identified with indicators of identity theft (84 percent) involved the use of direct deposit to obtain tax refunds totaling approximately $3.5 billion. There are indications that abusive practices are ongoing. For example, one bank account received 446 direct deposits totaling over $591,000.[37]

To improve the IRS's conformance with direct-deposit regulations and to help minimize fraud, TIGTA recommended that the IRS limit the number of tax refunds

[32] Individuals who generally are not required to file a tax return include children, deceased individuals, the elderly, and individuals who earn less than their standard deduction or earn non-taxable income such as some Social Security benefits.

[33] TIGTA, Ref. No. 2014–40–029, *Interim Results of the 2014 Filing Season* (Mar. 2014).

[34] When an account is locked, tax refunds are not processed.

[35] The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

[36] TIGTA, Ref. No. 2008–40–182, *Processes Are Not Sufficient to Minimize Fraud and Ensure the Accuracy of Tax Refund Direct Deposits* (Sep. 2008).

[37] TIGTA, Ref. No. 2013–40–122, *Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds* (Sep. 2013).

being sent to the same direct-deposit account. As of December 2013, the IRS is still considering this recommendation, but the IRS did develop new filters for the 2013 Filing Season to identify and stop tax returns with similar direct-deposit and address characteristics. As of March 3, 2014, the IRS indicated that it had identified 395,468 tax returns using these filters and prevented approximately $1.3 billion in tax refunds from being issued.[38] Recently, the IRS indicated it is developing a systemic restriction to limit to three the number of deposits to a single bank account. After three deposits to a single account, including situations where refunds are split, the entire refund amount will be sent by paper check to the taxpayer at the address of record.

In addition, the IRS implemented a pilot program in January 2013 with the Department of the Treasury's Bureau of Fiscal Service[39] designed to allow financial institutions to reject direct-deposit tax refunds based on mismatches between the account name and the name on the tax return. Once the refund is identified by the institution, it is sent back to the Bureau of Fiscal Service to be routed back to the IRS. As of the end of calendar year 2013, there have been 20,898 refunds returned from financial institutions totaling more than $67 million. This is a promising first step in recovering fraudulent tax refunds issued via direct deposit.

Identifying potential identity-theft tax fraud is the first step. Once the IRS identifies a potential identity-theft tax return, it must verify the identity of the individual filing the return. However, verifying whether the returns are fraudulent will require additional resources. Using IRS estimates, it would cost approximately $22 million to screen and verify the more than 1.2 million tax returns that we identified as not having third-party information on income and withholding. Without the necessary resources, it is unlikely that the IRS will be able to work the entire inventory of potentially fraudulent tax returns it identifies. The net cost of failing to provide the necessary resources is substantial, given that the potential revenue loss to the Federal Government of these tax fraud-related identity theft cases is in the billions of dollars annually.

TIGTA Criminal Investigations of Identity Theft and Impersonation Scams

Identity theft has a negative impact on the economy, and the damage it causes to its victims can be personally, professionally, and financially devastating. When individuals steal identities and file fraudulent tax returns to obtain fraudulent refunds before the legitimate taxpayers file, the crime is tax fraud, which falls within the programmatic responsibility of IRS Criminal Investigation. TIGTA's Office of Investigations focuses its limited resources on investigating identity theft characterized by any type of IRS employee involvement, the misuse of client information by tax preparers, or the impersonation of the IRS through phishing[40] schemes and other means. Where there is overlapping jurisdiction, TIGTA OI and IRS Criminal Investigation will work together to bring identity thieves to justice.

Currently, TIGTA is investigating several cases that involve identity theft. A recent example of this activity involved two hospital employees who conspired with each other to defraud the United States by filing false Federal income tax returns using the personal identifiers of patients at the hospital where they were employed and directing more than $400,000 in tax refunds to be deposited into bank accounts they controlled, or accounts linked to prepaid debit or gift cards.[41] One individual was sentenced to a total of 81 months of imprisonment for his role in the conspiracy and aggravated identity theft.[42] The other individual was sentenced to 57 months of imprisonment for his role in the conspiracy.[43] Both were ordered to pay restitution to the IRS in the amount of $116,404.[44]

IRS employees are entrusted with the sensitive personal and financial information of taxpayers. Using this information to perpetrate a criminal scheme for personal gain negatively impacts our Nation's voluntary tax system and it can generate widespread distrust of the IRS. TIGTA aggressively investigates IRS employees involved in identity-theft-related tax refund fraud and refers these investigations to the De-

[38] Statistical information provided by the IRS Wage and Investment Division Return Integrity and Correspondence Services.

[39] Formerly the Department of the Treasury Financial Management Service.

[40] Phishing is an attempt by an individual or group to solicit personal and financial information from unsuspecting users in an electronic communication by masquerading as trustworthy entities such as government agencies, popular social Web sites, auction sites, online payment processors, or information technology administrators.

[41] E.D. Va. Indictment dated Aug. 7, 2013.

[42] E.D. Va. Judgment dated Jan. 13, 2014.

[43] E.D. Va. Judgment dated Jan. 24, 2014.

[44] E.D. Va. Restitution Orders dated Jan. 10, 2014, and Jan.24, 2014.

partment of Justice for prosecution. Many of these employees face significant prison sentences as well as the loss of their jobs if convicted.

For example, in November 2013, TIGTA special agents arrested an IRS Tax Examining Technician for aggravated identity theft and conspiracy.[45] The IRS employee conspired with another individual to divert a tax refund belonging to another taxpayer by changing the taxpayer's mailing address without the taxpayer's permission, causing a refund of $595,901 to be mailed to her co-conspirator.[46] Further criminal action is pending.

TIGTA also investigates tax preparers who misuse their clients' information to commit identity theft-related refund fraud. For example, TIGTA investigated a tax preparer who stole the personal identifiers of her clients and filed numerous fraudulent tax returns without their permission or knowledge. The tax preparer, who was indicted in April 2013 on charges of aggravated identity theft, wire fraud, mail fraud and false claims, prepared and filed more than 200 fraudulent tax returns and defrauded the U.S. Government of more than $1 million in tax refunds. She used the proceeds from the fraudulently obtained tax returns to purchase 20 real properties in Arizona.[47]

In addition to these TIGTA investigations, the IRS announced in February 2013 the results of a nationwide effort with the Department of Justice and local U.S. Attorneys' offices focusing on identity theft suspects in 32 States and Puerto Rico, which involved 215 cities and surrounding areas. This joint effort involved 734 enforcement actions related to identity theft and refund fraud, including indictments, informations, complaints, and arrests.

Criminals have been impersonating the IRS for years. While the fraud schemes may change, the motive remains the same: to bilk honest taxpayers out of their hard-earned money. Scammers and thieves often prey on immigrants and the elderly and sometimes even resort to threats. For example, in the late summer of 2013, TIGTA began noticing numerous complaints from around the country about suspicious callers claiming to be IRS employees collecting taxes from recent IRS audits. The callers demanded that the tax payments be made to pre-paid debit cards and threatened arrest, suspension of business or driver's licenses, and even deportation if the callers' demands were not met. In many cases, the callers became hostile and insulting. As of April 2014, the TIGTA Hotline has received tens of thousands of reports related to this scam, and it is estimated that the scheme has resulted in over $2 million in payments made by the victims. TIGTA special agents are actively reviewing these complaints.

Tax Refund Fraud

Verification of Income and Withholding

Access to third-party income and withholding information at the time tax returns are processed is the most important tool the IRS could use to detect and prevent tax fraud resulting from the reporting of false income and withholding. While the IRS has increased its detection of fraudulent tax returns at the time tax returns are processed and has prevented the issuance of billions of dollars in fraudulent tax refunds, it still does not have timely access to third-party income and withholding information needed to make any substantial improvements in its detection efforts.

Expanded access to the National Directory of New Hires could immediately provide the IRS with this type of information that could help prevent tax fraud. Currently, the IRS's use of this information is limited by law to just those tax returns that include a claim for the EITC. The IRS has included a legislative proposal for expanded access to this information in its annual budget submissions for fiscal years 2010 through 2014 and has once again included this proposal in its fiscal year 2015 budget submission. In an effort to combat identity theft, the Chairman of the Senate Finance Committee proposed in November 2013 granting the IRS authority to use the Department of Health and Human Services (HHS) National Directory of New Hires to verify employment data.

Improvements can also be made to the income and verification processes when tax returns are identified by the IRS as potentially fraudulent. In August 2013, we reported[48] that ineffective income and withholding verification processes are resulting in the issuance of potentially fraudulent tax refunds. Our review of a random sample of 272 tax returns sent for verification found that ineffective verification proc-

[45] N.D. Ga. Executed Arrest Warrant dated Nov. 26, 2013.
[46] N.D. Ga. Crim. Compl. dated Nov. 25, 2013.
[47] S.D. Cal. Indict. filed Apr. 13, 2013.
[48] TIGTA, Ref. No. 2013–40–083, *Income and Withholding Verification Processes are Resulting in the Issuance of Potentially Fraudulent Tax Refunds* (Aug. 2013).

esses resulted in the issuance of the potentially fraudulent tax refunds associated with these tax returns.

Stolen or Falsely Obtained Employer Identification Numbers

Individuals attempting to commit tax refund fraud commonly steal or falsely obtain an EIN to file tax returns reporting false income and withholding. A valid EIN for the employer must be provided in support of wages and withholding reported on individual tax returns. Individuals who report wages and withholding on a tax return must attach a Form W–2, Wage and Tax Statement,[49] to a paper-filed tax return to support the income and withholding reported. For an e-filed tax return, the filer must input the information from the Form W–2 into the e-filed tax return.

TIGTA identified 767,071 tax year 2011 e-filed individual tax returns with refunds based on falsely reported income and withholding using a stolen or falsely obtained EIN.[50] TIGTA estimates that the IRS could issue almost $2.3 billion annually in potentially fraudulent tax refunds based on these EINs. There were 285,670 EINs used on these tax returns. Of these:

—277,624 were stolen EINs used to report false income and withholding on 752,656 tax returns with potentially fraudulent refunds issued totaling more than $2.2 billion.

—8,046 were falsely obtained EINs used to report false income and withholding on 14,415 tax returns with potentially fraudulent refunds issued totaling more than $50 million.

These 767,071 returns with potentially fraudulent refunds issued are in addition to the approximately 1.2 million undetected tax year 2011 tax returns we identified as having characteristics of an identity-theft tax return discussed earlier in our testimony.

The IRS has developed a number of processes to prevent fraudulent refunds claimed using stolen and falsely obtained EINs. As previously noted, third-party information is not available to effectively detect the reporting of false income and withholding at the time tax returns are processed. Nonetheless, the IRS has both tax information and other data that can be used to proactively identify tax returns with income reported using a stolen or falsely obtained EIN. Using these data, the IRS could have identified 53,169 tax returns with refunds issued totaling almost $154 million that had income reported with a stolen or falsely obtained EIN. IRS management agreed with our recommendation to update fraud filters using the tax information and other data we identified such as the Suspicious EIN Listing.[51]

IMPLEMENTATION OF THE AFFORDABLE CARE ACT

The Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010[52] contain an extensive array of tax law changes that will present many challenges for the IRS in the coming years. The ACA provisions provide incentives and tax breaks to individuals and small businesses to offset healthcare expenses. They also impose penalties, administered through the tax code, for individuals and businesses that do not obtain healthcare coverage for themselves or their employees. The ACA represents the largest set of tax law changes in more than 20 years and represents a significant challenge to the IRS.

ACA-related Customer Service

In December 2013, we issued a report on the IRS's ACA customer service strategy,[53] which is a collaborative and coordinated effort between the IRS and multiple Federal and State agencies. The Department of Health and Human Services (HHS) will serve as the "public face" for customer service at the Exchanges[54] until calendar year 2015. Individuals who contact the IRS for ACA assistance will be referred to the HHS's public website (Healthcare.gov) and toll-free telephone assist-

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[49] The IRS requires employers to report wage and salary information for employees on a Form W–2. The Form W–2 also reports the amount of Federal, State, and other taxes withheld from an employee's paycheck.

[50] TIGTA, Ref. No. 2013–40–120, *Stolen and Falsely Obtained Employer Identification Numbers Are Used to Report False Income and Withholding* (Sep. 2013).

[51] The Suspicious EIN Listing is a cumulative listing of EINs that the IRS has confirmed as suspicious. The IRS has confirmed 6,333 EINs as suspicious since January 2003.

[52] Public Law No. 111–152, 124 Stat. 1029 (codified in scattered titles of the U.S.C.).

[53] TIGTA, Ref. No. 2014–43–006, *Affordable Care Act: The Customer Service Strategy Sufficiently Addresses Tax Provisions; However, Changes in Implementation Will Create Challenges* (Dec. 2013).

[54] Exchanges are intended to allow eligible individuals to obtain health insurance, and all Exchanges, whether State-based or established and operated by the Federal Government, will be required to perform certain functions.

ance lines. The IRS will also refer individuals to its own recorded telephone messages and self-assistance tools. In calendar year 2015, the IRS will take the lead in providing customer service when individuals begin filing their tax year 2014 tax returns. The IRS's customer service strategy includes sufficient plans to: (1) perform outreach and education; (2) update or develop tax forms, instructions, and publications; and (3) provide employee training to assist individuals in understanding the requirement to maintain minimum essential coverage and the tax implications of obtaining the Premium Tax Credit.

However, changes in the implementation of ACA tax provisions may result in increased demand for customer service assistance resulting in more contacts with the IRS. Depending on the nature of any changes made to ACA tax provisions, the IRS's strategy and plans to provide adequate customer service could be affected. Attempting to mitigate the effect that implementation changes may have on its ability to provide adequate customer service, the IRS has developed oversight and monitoring processes and procedures to alert management at the earliest possible time of actions that may affect its operations.

Security of Federal Tax Data

The information technology and security challenges for the ACA are considerable and include implementation of interdependent projects in a short span of time, evolving requirements, coordination with internal and external stakeholders, cross-agency system integration, and testing. ACA implementation will have a significant impact on existing systems, so there must be bandwidth to support all provisions. Finally, projects must be staffed with personnel who have the required knowledge and skills to efficiently deploy new technologies. To manage these challenges, the IRS created a Project Management Office for the ACA within the Information Technology program area.

The Exchanges are forwarding requests for income and family size information for each applicant and their family members who are qualified to apply for health insurance to the IRS. The Department of Health and Human Services' Data Services Hub provides the connections for the Exchanges and all other Federal agencies, including the IRS.

The IRS, using Federal tax data, will determine the applicant's historical household income, family size, filing status, adjusted gross income, taxable Social Security benefits, and other requested information. The IRS will then transmit the Federal tax data to the HHS Data Services Hub for delivery to the appropriate Exchange. The Exchanges use the IRS information along with other available data to verify the information provided by the applicant.

TIGTA issued a report on the IRS Income and Family Size Verification Project and found that the project was on schedule and the IRS was managing known information technology risks at the time the audit was conducted.[55] TIGTA recommended that the IRS: (1) improve the management of ACA changes to requirements; and (2) use an integrated suite of automated tools to manage ACA requirements and application test cases.

TIGTA remains concerned about the protection of confidential taxpayer data that will be provided to the Exchanges. The Federal tax data provided to HHS and the Exchanges will be protected through the IRS's Safeguard Review Program. TIGTA is currently conducting an audit of the IRS's Safeguard Review Program and will issue a report on its operations in fiscal year 2014.[56] TIGTA has concerns that the Safeguard Review Program may lack sufficient staffing or funding to adequately expand its operations to include the addition of the Federal and State Exchanges.

Protection Against Fraudulent ACA Claims on Tax Returns

The Affordable Care Act provides for a refundable tax credit to offset an individual's health insurance expenses. Beginning in tax year 2014, some low to moderate income individuals eligible to obtain health insurance through one of the State Exchanges or the Federal Exchange may be eligible for a refundable credit to assist them in paying monthly insurance premiums. The amount of the credit is determined by an individual's income in relation to the Federal poverty level, among other factors. In October 2013, the IRS began working with the Exchanges to provide a computation of individuals' estimated maximum monthly Premium Tax Cred-

[55] TIGTA, Ref. No. 2013–23–034, *Affordable Care Act: The Income and Family Size Verification Project: Improvements Could Strengthen the Internal Revenue Service's New Systems Development Process* (Mar. 2013).

[56] TIGTA, Audit No. 201320029, *Review of the Internal Revenue Service's Office of Safeguards,* report planned for July 2014.

it.[57] Individuals can elect the amount of credit they want advanced up to the maximum credit for which the Exchange has approved them to receive. Qualified individuals can elect to either: (1) have the monthly credit sent directly to their insurance provider as an advance payment (Advance Premium Tax Credit)[58] to lower the amount of monthly premiums they would pay out-of-pocket; or (2) wait to receive the credit when they file their tax year 2014 tax return. As of March 31, 2014, the Department of Health and Human Services reported that more than $1.4 billion in Advance Premium Tax Credits have been paid to insurers.

Like other refundable credits, there is a risk for improper payments with the Premium Tax Credit. For example, Advance Premium Tax Credits are computed using a number of factors, including an individual's projected 2014 income, family size, etc. The Exchanges will use income and family size information received from the IRS, as well as information provided by the applicant and other data sources, to project the income and family size amounts used to determine eligibility for the credit. The Exchanges also rely on the IRS's computation of the maximum available credit based on the projected income and family size when assisting applicants in choosing a health insurance plan. TIGTA is currently evaluating the accuracy of the data that the IRS provides to the HHS for use in enrolling individuals and calculating the Advance Premium Tax Credit, and plans to issue a report this year.[59] We plan to assess the protection of Federal tax data provided by the IRS in the future.[60]

It is not until the individual files his or her tax year 2014 tax return during calendar year 2015 that the IRS will know the individual's actual income for 2014 and the amount of the tax credit the individual is entitled to receive. Individuals who receive an Advance Premium Tax Credit will reconcile the amount received to the amount of Premium Tax Credit they are eligible to receive based on their actual 2014 income and family size when they file their tax year 2014 tax return.

Individuals who are eligible to receive the Premium Tax Credit but did not receive a credit in advance can claim the credit on their tax year 2014 tax return. Individuals who received more than they were entitled in the form of an Advance Premium Tax Credit will be responsible for repaying all or part of the advanced credit received. The IRS will assess the additional credit on the taxpayer's account and attempt to collect it.

TIGTA is concerned that the potential for refund fraud and related schemes could increase as a result of processing ACA Premium Tax Credits unless the IRS builds, implements, updates, and embeds ACA predictive analytical fraud models into its tax filing process. The IRS has developed a plan to prevent, detect, and resolve fraud and abuse during ACA tax return processing. The plan, when fully developed and implemented, is designed to leverage third-party reporting from the Exchanges and new computer analytical capability built into the Return Review Program.[61] The plan calls for the development of the ACA Validation Service, which will be used to identify improper ACA-related refunds. The ACA Validation Service will be designed to perform screening for improper refunds and will also identify fraudulent schemes that include multiple returns. The IRS plans to rely on the Electronic Fraud Detection System and/or the new Return Review Program to provide the systems to identify and prevent ACA-related refund fraud.

The applications for processing electronic and paper tax returns will need to be modified before January 2015 in order for the IRS to be able to use the new ACA Validation Service to determine if a taxpayer claiming the Premium Tax Credit also purchased insurance through the Exchanges or received an Advance Premium Tax Credit in 2014, and if any math errors exist.

We have developed a multi-audit strategy to evaluate the IRS's implementation of the Premium Tax Credit. To date, we have completed evaluations of the IRS's development of needed information systems and the adequacy of the IRS's plans to provide customer service to individuals seeking assistance with the Premium Tax Credit. In September 2013, we reported that a fraud mitigation strategy is not in

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[57] A Premium Tax Credit is a refundable tax credit to assist individuals and families in purchasing health insurance coverage through an Exchange.

[58] An Advance Premium Tax Credit is paid in advance to a taxpayer's insurance company to help cover the cost of premiums.

[59] TIGTA, Audit No. 201340335, *Affordable Care Act: Accuracy of the Income and Family Size Verification and Advanced Premium Tax Credit Calculation,* report planned for May 2014.

[60] TIGTA, Audit No. 201420302, Security Over Federal Tax Data at Health Insurance Exchanges, report planned for September 2014.

[61] The Return Review Program is the key automated component of the IRS's pre-refund initiative and will implement the IRS's new business model for a coordinated criminal and civil tax noncompliance approach to prevent, detect, and resolve tax refund fraud, including refundable ACA premium tax credits.

place to guide ACA systems development, testing, initial deployment, and long-term operations.[62] The IRS informed us that two new systems are under development that will address Affordable Care Act tax refund fraud risk. However, until these new systems are successfully developed and tested, TIGTA remains concerned that the IRS's existing fraud detection system may not be capable of identifying Affordable Care Act refund fraud or schemes prior to the issuance of tax refunds.

ACA Provisions Impacting the Current 2014 Filing Season

Several ACA tax-related provisions became effective for calendar year 2013 that affect individuals with high incomes including the creation of a new net investment income tax,[63] and an increase in the employee-share of the Medicare tax (i.e., Hospital tax).[64] The ACA also increased the income limit for qualifying medical and dental expenses taken as an itemized deduction. In prior years, individuals could take an itemized deduction for qualified medical and dental expenses that exceeded 7.5 percent of their Adjusted Gross Income. Beginning in calendar year 2013, the qualifying expenses must exceed 10 percent of Adjusted Gross Income.

Taxpayers began filing tax returns with these tax changes on January 31, 2014. In addition to reprogramming its computer systems to properly reflect these changes, the IRS had to issue guidance to taxpayers and tax return preparers explaining each of these provisions and revise or develop new tax forms, instructions and publications to reflect the tax law changes. In an ongoing review, we will determine whether the IRS has correctly implemented these provisions, which includes analyzing tax returns to ensure that they are accurately processed.[65]

IRS TAX GAP

A serious challenge confronting the IRS is the Tax Gap, which is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a tax year. The most recent gross Tax Gap estimate developed by the IRS was $450 billion for tax year 2006, which is an increase from the prior estimate of $345 billion for tax year 2001. The voluntary compliance rate[66] decreased slightly from 83.7 percent in 2001 to 83.1 percent in 2006.

The largest component ($376 billion or approximately 84 percent) of the Tax Gap is based on taxpayers' underreporting their taxes due. The IRS addresses this gap by attempting to identify questionable tax returns when they are received and processed and by conducting examinations of tax returns filed to determine if there are any adjustments needed to the information reported on the tax returns. Additional taxes are assessed and collected.

The next component ($46 billion or 10 percent) of the Tax Gap is based on taxpayers underpayment of taxes due. The IRS addresses this gap by issuing notices and contacting taxpayers to collect the delinquent taxes. The IRS is authorized to take enforcement action, such as filing liens and seizing assets, to collect the taxes.

The smallest component ($28 billion or 6 percent) of the Tax Gap is based on taxpayers who do not file tax returns when they are due. These taxpayers also may not have taxes withheld or make estimated taxes. The IRS analyzes data from third parties (such as Forms W–2 or Forms 1099) to identify taxpayers who should have filed a tax return, and either prepares a substitute tax return or contacts the taxpayer to obtain the delinquent tax return.

The scope, complexity, and magnitude of the international financial system also present significant enforcement challenges for the IRS. At the end of calendar year 2012, foreign business holdings and investments in the United States were $25.5 trillion, an increase of nearly $135 billion over calendar year 2011, while U.S. business and investments abroad grew to over $21.6 trillion, an increase of nearly $1.5 billion during the same period. The numbers of taxpayers conducting international business transactions continues to grow as technological advances provide opportu-

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[62] TIGTA, Ref. No. 2013–23–119, *Affordable Care Act: Improvements Are Needed to Strengthen Systems Development Controls for the Premium Tax Credit Project* (Sep. 2013).

[63] The ACA created a new tax that is equal to 3.8 percent of an individual's net investment income for the tax year or the excess of the individual's Modified Adjusted Gross Income over $200,000 ($250,000 for married individuals filing jointly).

[64] The ACA increased the employee-share of the Medicare tax to 0.9 percent of an individual's covered wages in excess of $200,000 ($250,000 for married individuals filing jointly). The ACA also increased the Medicare tax on self-employment income to 0.9 percent of an individual's self-employment income over $200,000 ($250,000 for married individuals filing jointly).

[65] TIGTA, Audit No. 201440014, *2014 Filing Season Implementation,* report planned for September 2014.

[66] The voluntary compliance rate is an estimate of the amount of tax for a given year that is paid voluntarily and timely.

nities for offshore investments that were once only possible for large corporations and wealthy individuals.

The IRS is increasingly challenged by a lack of information reporting on many cross-border transactions that have been rendered possible by advancing technology. In addition, the varying legal requirements imposed by different jurisdictions lead to the creation of complex business structures that are not easy to understand, making the determination of the full scope and effect of cross-border transactions extremely difficult.

As this global economic activity increases, so do concerns regarding the International Tax Gap.[67] While the IRS has not developed an accurate and reliable estimate of the International Tax Gap, non-IRS sources estimate it to be between $40 billion and $133 billion annually. To address the International Tax Gap, the IRS developed an international tax strategy plan with two major goals: (1) to enforce the law to ensure that all taxpayers meet their obligations and (2) to improve service to make voluntary compliance less burdensome.

The IRS also currently faces the challenge of implementing the Foreign Account Tax Compliance Act (FATCA).[68] FATCA was enacted to combat tax evasion by U.S. persons holding investments in offshore accounts. Under FATCA, a United States taxpayer with financial assets outside the United States will be required to report those assets to the IRS. In addition, foreign financial institutions will be required to report to the IRS certain information about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. The IRS is developing a new international system, the Foreign Financial Institution Registration System, to support the requirements of FATCA. This system is intended to register foreign financial institutions to assist in achieving the primary objective of FATCA which is the disclosure of U.S. taxpayer foreign accounts. TIGTA reviewed the development of this system and reported that the program management control processes did not timely identify or communicate system design changes to ensure its successful deployment.[69]

Concerns about the International Tax Gap have also led to increased enforcement efforts on international information reporting requirements and increased assessments of related penalties. For example, the IRS has automated the penalty-setting process for the Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, which has resulted in a total of $215.4 million in late-filed Form 5471 penalty assessments during fiscal years 2009 through 2012.[70]

In addition, the IRS established the International Campus Compliance Unit to expand its audit coverage of tax returns with international aspects and to increase compliance among international individual taxpayers. For fiscal year 2011 through March 13, 2013, the International Campus Compliance Unit conducted almost 18,000 audits and assessed approximately $36 million in additional tax. Despite its accomplishments, TIGTA found that the International Campus Compliance Unit has no specific performance measures for its operations.[71]

We reviewed enforcement revenue trends and noted that in fiscal year 2007, the IRS collected over $59 billion in taxes, penalties and interest, but the dollars collected dropped during the next 2 years before increasing again in fiscal year 2010. The, dollars collected decreased to just over than $50 billion in fiscal year 2012. While the IRS did not track the reason for the increase in fiscal year 2010, it did receive additional funds to hire more than 1,500 revenue officers between June 2009 and February 2010.

One enforcement program whose resources have been significantly reduced is the Automated Collection System (ACS). The ACS function attempts to collect taxes through telephone contact with taxpayers before cases are assigned to revenue officers who make in-person visits to collect delinquent taxes. The ACS has 16 call sites in the Small Business and Self Employed and the Wage and Investment Divisions. However, ACS staff was reduced by 24 percent, from 2,824 contact representatives in fiscal year 2010 to 2,140 contact representatives in fiscal year 2013. In addition,

[67] The International Tax Gap is the taxes owed but not collected on time from a U.S. person or foreign person whose cross-border transactions are subject to U.S. taxation.

[68] Public Law No. 111–147, §§ 501–541, 124 Stat 71 *96–116 (2010) (codified in scattered sections of 26 U.S.C.).

[69] TIGTA Ref. No. 2013–20–118, *Foreign Account Tax Compliance Act: Improvements Are Needed to Strengthen Systems Development for the Foreign Financial Institution Registration System* (Sept. 2013).

[70] TIGTA, Ref. No. 2013–30–111, *Systemic Penalties on Late-Filed Forms Related to Certain Foreign Corporations Were Properly Assessed, but the Abatement Process Needs Improvement* (Sept. 2013).

[71] TIGTA, Ref. No. 2013–30–113, *The International Campus Compliance Unit Is Improving Individual Tax Compliance* (Sept. 2013).

three call sites were taken off-line in February 2013 to work Accounts Management inventory (other than identity theft cases) because Accounts Management began devoting more of its resources to work the growing inventory of identity theft cases. This shift in resources to Accounts Management was originally scheduled to continue for 3 months but was subsequently extended through the end of fiscal year 2013 and was still ongoing as of February 2014. As a result of these combined reductions, the number of ACS contact representatives in fiscal year 2013 was 41 percent fewer than in fiscal year 2010.

Another impact on the ACS program is how resources are applied to its growing workload. In fiscal year 2013, the ACS prioritized answering telephone phone calls from taxpayers over working delinquent accounts, which resulted in the ACS spending only 24 percent of its resources on working inventory and 76 percent on answering taxpayers' questions. The shift from working inventory has had consequences on the ACS's core mission of collecting delinquent taxes. In an ongoing audit, we reviewed ACS business results from fiscal year 2010 through fiscal year 2013 and determined:

—New inventory is outpacing closures, so the inventory is growing.
—Inventory is taking longer to close, and the cases are older.
—When cases are closed, more are closed as currently not collectible.
—Fewer enforcement actions are taken.
—More, and older, cases are being transferred to the growing inventory of cases available to be assigned to Collection Field personnel.[72]

Leveraging external resources, such as whistleblowers, can help improve tax compliance. The IRS Whistleblower Program also plays an important role in reducing the Tax Gap and maintaining the integrity of a voluntary tax compliance system. However, TIGTA reported that the program continued to have internal control weaknesses with respect to processing whistleblower claims. For example, information captured from multiple systems and entered into a single inventory control system was potentially erroneous, and the quality review process for the new inventory system was not sufficient to ensure that claims were accurately controlled. Additionally, TIGTA determined that timeliness standards for processing claims were not sufficient. Without adequate oversight of the Whistleblower Program, the IRS is not as effective as it could be in responding timely to tax noncompliance issues.[73]

Modernizing information systems could potentially allow the IRS to post more comprehensive tax return information to its computer systems, which could facilitate the examination process and expedite taxpayer contacts for faster resolution. The IRS considers the Customer Account Data Engine 2 (CADE 2) program to be critical to its mission and it is the IRS's most important information technology investment. TIGTA reported that the implementation of CADE 2 daily processing allowed the IRS to process tax returns for individual taxpayers more quickly by replacing existing weekly processing.[74] The CADE 2 system also provides for a centralized database of individual taxpayer accounts, which will allow IRS employees to view tax data online and provide timely responses to taxpayers once it is implemented. The IRS's modernization efforts also include developing computer programs to conduct predictive analytics to reduce refund fraud.[75] The successful implementation of the IRS's modernization program should significantly improve service to taxpayers and enhance Federal tax administration.

Simplifying the tax code could also help taxpayers understand and voluntarily comply with their tax obligations and limit opportunities for tax evasion. Finally, penalties are an important tool because they discourage taxpayer behavior that contributes to the Tax Gap. Congress provided numerous penalty provisions in the Internal Revenue Code that the IRS can use to help remedy the noncompliance that contributes to the Tax Gap. The IRS can assess accuracy-related penalties for negligence, substantial understatement of income tax, or substantial valuation misstatement. The IRS estimated that the underreporting of tax contributed $376 billion (84 percent) of the $450 billion total gross Tax Gap, including $235 billion from individual income taxes. To deter this type of behavior, the IRS reported that during fiscal year 2011 it assessed over 500,000 accuracy-related penalties, involving over $1 billion against individuals.

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[72] TIGTA, Audit No. 201330017, *Review of the Automated Collection System Inventory Management,* report planned for August 2014.
[73] TIGTA, Ref. No. 2012–30–045, *Improved Oversight Is Needed to Effectively Process Whistleblower Claims* (Apr. 2012).
[74] TIGTA, Ref. No. 2012–20–122, *Customer Account Data Engine 2 System Requirements and Testing Processes Need Improvements* (Sep. 2012).
[75] These are computer models that analyze extremely large quantities of data to seek out data patterns and relationships that could indicate potential tax fraud schemes.

MANAGEMENT ACTIONS IN RESPONSE TO PRIOR REPORTED ISSUES

TIGTA follows up regularly on management actions in response to recommendations in our reports. One notable example that we are currently following up on is the report on Exempt Organizations. TIGTA previously reported [76] that the IRS used inappropriate criteria for selecting and reviewing applications for tax-exempt status. This resulted in substantial delays in processing certain applications and the issuance of unnecessary information requests being issued to certain organizations.

The IRS Commissioner reported in January 2014 that the IRS completed action on all nine recommendations contained in our May 2013 report. TIGTA is currently assessing the actions the IRS has taken in response to our recommendations.[77]

TIGTA BUDGET REQUEST FOR FISCAL YEAR 2015

As requested by the subcommittee, I will now provide information on our budget request for fiscal year 2015.

TIGTA's fiscal year 2015 proposed budget requests appropriated resources of $157,419,000, an increase of 0.67 percent from the fiscal year 2014 enacted budget. TIGTA will continue to focus on its mission of ensuring an effective and efficient tax administration system in this lean budget environment. The fiscal year 2015 budget resources include funding to support TIGTA's critical audit, investigative, and inspection and evaluation priorities, while still maintaining a culture that continually seeks to identify opportunities to achieve efficiencies and cost savings.

During fiscal year 2013, TIGTA's combined audit and investigative efforts have recovered, protected, and identified monetary benefits totaling $16.6 billion,[78] including cost savings, increased revenue, revenue protection [79], and court-ordered settlements in criminal investigations, and affected approximately 3.9 million taxpayer accounts. Based on TIGTA's fiscal year 2013 budget of $143.8 million, this represents a Return on Investment of $116-to-$1.

In fiscal year 2014, TIGTA received approximately $7 million above its requested amount of $149.4 million. This additional funding will enable TIGTA to (1) restore staffing to pre-sequestration levels; (2) increase training expenditures for auditors and special agents to meet required standards; and (3) upgrade and improve our technology infrastructure. The additional funding will allow TIGTA to continue to support critical audit, investigative, and inspection and evaluation priorities. The additional funds have also enabled the Office of Audit to immediately initiate audits that require travel to various IRS locations—travel that had previously been placed on hold due to budget constraints. In addition, the Office of Audit has been able to immediately initiate audits in critical areas such as international tax compliance and identity theft. As additional law enforcement staff is hired, the Office of Investigations will be able to conduct more proactive initiatives to uncover fraud in IRS operations and identify threats to IRS employees and infrastructure. In addition, the Office of Investigations will be able to investigate more complaints of IRS employee misconduct, fraud, waste, and abuse.

IRS Implementation of the ACA

Several key ACA provisions will become effective in fiscal year 2014, and the IRS must ensure that the taxpayer system is able to fully implement these provisions. TIGTA's oversight requires close coordination among the Audit, Investigations, and Inspections and Evaluations functions. Each program office brings unique skills and experience, but TIGTA's overall success depends greatly upon these offices' close collaboration. As such, TIGTA has implemented a multi-year oversight strategy that includes audits, evaluations, and investigative resources to assess and to proactively deter efforts to impede the IRS's implementation of the ACA. This strategy includes coordination with other agencies, including the Department of Health and Human Services Office of Inspector General.

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[76] TIGTA, Ref. No. 2013–10–053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 2013).

[77] TIGTA, Audit No. 201410009, *Status of Actions to Improve Identification and Processing of Applications for Tax-Exempt Status—Follow-Up.*

[78] This figure includes dollars potentially compromised by bribery; dollar amount of tax liability for taxpayers who threaten and/or assault IRS employees; dollar value of IRS and resources protected against malicious loss; dollar amount of embezzlement or taxpayer remittance theft; dollar value of Government property recovered; dollar value of court ordered criminal and civil penalties, fines, and restitution; and dollar value of seizures, forfeitures, and recoveries from contract fraud.

[79] Recommendations made by TIGTA to ensure the accuracy of the total tax, penalties, and interest paid to the Federal Government.

For example, TIGTA is conducting or planning to initiate 10 ACA-related audits during fiscal year 2014 and fiscal year 2015. For TIGTA's investigators, our experience has shown that the IRS's expanded role under the ACA may spark a new wave of animosity directed toward IRS employees that could result in threats of violence, or the actual assault of IRS employees and attacks on IRS facilities. For example, TIGTA has investigated threats made by taxpayers to IRS employees as a result of the IRS offsetting their Federal tax refunds for the repayment of student loans or court-ordered child support payments. As ACA provisions start to take effect, additional resources will be dedicated to investigating related threats.

Shortly after the Supreme Court upheld the constitutionality of the ACA, the media reported that criminals impersonated a Federal agency in an attempt to fraudulently obtain personally identifiable information from unsuspecting taxpayers to further their identity theft schemes and other crimes under the guise that the sensitive information was required for ACA compliance. Based upon our experience investigating this type of criminal activity, TIGTA anticipates a significant increase in the number of ACA-related impersonation attempts as the IRS begins its role in ACA compliance activity.

TIGTA's Audit Priorities

TIGTA's audit priorities include mitigating risks associated with tax refund fraud and identity theft, monitoring the IRS's implementation of the Affordable Care Act and other tax law changes, and assessing the IRS's ability to provide quality taxpayer service and address the Tax Gap.

Recent audit work has shown that the IRS could develop or improve processes that will increase its ability to detect and prevent the issuance of fraudulent tax refunds resulting from identity theft. In addition, TIGTA has concerns over the security of tax data provided to the Exchanges and is also concerned that the potential for refund fraud and related schemes could increase as a result of processing ACA Premium Tax Credits.

TIGTA's Investigative Priorities

TIGTA's investigative priorities include investigating allegations of serious misconduct and criminal activity by IRS employees; ensuring IRS employees are safe and IRS facilities, data and infrastructure are secure and not impeded by threats of violence; and protecting the IRS against external attempts to corrupt or otherwise interfere with tax administration.

IRS employees are entrusted with the sensitive personal and financial information of taxpayers. It is particularly troubling when IRS employees misuse their positions in furtherance of identity theft and other fraud schemes. TIGTA will continue to proactively review the activities of IRS employees who access taxpayer accounts for any indication of unauthorized accesses that may be part of a larger fraud scheme and conduct investigations into suspected wrongdoing.

Between fiscal years 2010 and 2013, TIGTA processed over 11,391 threat-related complaints and conducted over 5,500 investigations of threats made against IRS employees. TIGTA will continue to aggressively investigate individuals who threaten the safety and security of the IRS and its employees.

As mentioned earlier, the TIGTA Hotline has received over 30,000 reports from taxpayers victimized by individuals impersonating IRS employees in an effort to defraud them. To date, thousands of victims have paid over $2 million to the scammers. TIGTA will continue to investigate these crimes against taxpayers and alert the public to this scam to ensure that innocent taxpayers are not harmed by these criminals.

We at TIGTA take seriously our mandate to provide independent oversight of the IRS in its administration of our Nation's tax system. As such, we plan to provide continuing audit coverage of the IRS's efforts to operate efficiently and effectively and investigate any instances of IRS employee misconduct.

Chairman Udall, Ranking Member Johanns, and members of the subcommittee, thank you for the opportunity to share my views.

STATUS OF IRS CORRECTIVE ACTION ON TIGTA TAX-EXEMPT ORGANIZATIONS WORK

Senator UDALL. Thank you for your testimony today. And, Inspector General George, I want to focus on this issue again of these tax exempt applications. Last May, your office published an audit and made findings delineating the use of inappropriate case screening criteria in 501—in processing IRS processing of applications for tax exempt under Section 501(c)(4) of the Tax Code. TIGTA's report outlined delays in case disposition, weak internal controls, communications breakdowns, and management deficiency.

Your report recommended nine specific corrective actions, including the issuance of procedures and guidance and development of training to address the problems identified. I note particularly recommendation number eight directing that guidance on how to measure the "primary activity of IRC Section 501(c)(4), social welfare organizations, be included for consideration in the Department of the Treasury priority guidance plan."

A couple of questions. It has been nearly a year since the report was issued. What is the status of the IRS' efforts to address the problems? How has the IRS satisfactorily implemented all of the corrective actions TIGTA recommended? And if no, what remains uncompleted, and what other actions would you recommend the IRS undertake to correct any deficiencies in this area?

Mr. GEORGE. Very important questions, Senator. I have to make it clear that the Department of the Treasury has a directive that limits that tax policy is within the ambit of the Assistant Secretary for Tax Policy—final tax policy, and I would have to defer to him to give you a definitive response to some of the questions that you raised. Other parts I can address.

We are in the process now of conducting an assessment of the IRS' implementation of our recommendations. As you know, one, and you pointed this out at the outset, was that clarification be given as to the amount of activity that can take place. That is most definitely a tax policy question, but there is no question that their proposal, which has gone much further than the nine recommendations that we made did include that recommendation amongst one or two others.

The Commissioner, and to his credit, the Acting Commissioner, Danny Werfel, and this current Commissioner, Mr. Koskinen, have made repeated public comments that they were going to fully address our recommendations. And I anticipate conducting that review on an expedited basis, and will not wait another year to get back to you on it, and I will let you know as soon as we get the information from that review.

Senator UDALL. Great. Thank you very much. Senator Johanns.

Senator JOHANNS. Mr. Inspector General, good to see you here today.

Mr. GEORGE. Thank you, sir.

Senator JOHANNS. Soon after your report came out in that early timeframe, the—kind of the response of certain people with the IRS and I think others was this is a limited group, they are in the Cincinnati office, very, very closely confined problem. Did you agree with that assessment based upon your investigation?

Mr. GEORGE. Sir, this is—I have to be very diplomatic here because, one, I cannot acknowledge that there is an ongoing investigation by my office. I can acknowledge obviously that the FBI is undertaking an investigation. We are helping in their review on this matter.

This was such a fluid situation, and then there was some very inaccurate statements, and you were right about that. But I to this day hold the position that it is too premature to come to any conclusive finding as to what happened here. We did—because we conducted an audit and not a review/investigation at the outset of this, and our audit did find, you know, inappropriate criteria used. We did conclude that there was gross mismanagement on the part of senior IRS executives. As the Commissioner has pointed out, actions were taken against those individuals who were a part of that. But this is still an ongoing matter, sir.

Senator JOHANNS. The actions taken did extend beyond the Cincinnati office, though. Is that fair to say?

Mr. GEORGE. Oh, yes. Yes.

Senator JOHANNS. As you know, this matter has also been the subject of numerous hearings, and I have seen you on TV. You have participated in some of those hearings, a lot of those on the House with the House Oversight. Have you cooperated with that committee in terms of their request for information, documents? Are you assisting that process in any way?

Mr. GEORGE. To the extent that we are allowed to. Title 26 of the United States Code, section 6103 places severe restrictions on the type of information that my organization and the IRS can hand over to various committees in Congress. Namely, it says that we can only provide taxpayer information to the chairman of the Senate Finance Committee and the chairman of the House Ways and Means Committee. They in turn can determine what type of information they would like to share.

If I were to share 6103 information with either the chairman of the House Oversight Committee or every other committee except for the one that I noted, I am subject to criminal penalties. And so, if there is a document that has non-6103 information on it and they are simply asking for clarification, while I personally have not had, especially during the course of the audit, had no contact with them directly, members of my staff have. And so, and then to the extent of those communications, I would defer to them, some of whom are in the room, sir, but——

IRS PROCEDURES FOR PROCESSING 501(C)(4) APPLICATIONS

Senator JOHANNS. During the Commissioner's testimony, he talked about his attempt to clarify the 501(c)(4) application process, I guess. He stated now—surprised me; I was not aware of this—that the IRS now has a rule that if, I think to paraphrase his testimony, if you are using less than 40 percent of your resources for "political activity," then, man, your application zips on through.

Do you find any support that you are aware of in the tax laws, regulations that would allow that kind of division? I mean, I tried to ask, so 41 percent is a problem, but 39 percent is not a problem. Do you know of anything that would support the IRS handling applications really for any tax exempt status with—and create a rule of that nature? It struck me as arbitrary and capricious.

Mr. GEORGE. To directly answer your question, I am not aware of any rule that either permits nor prohibits it, so I would not be clear about that. And as you may know, this was an attempt by Danny Werfel, the Acting Commissioner, to address the backlog, and it was a severe backlog some years in the making for applicants of the 501(c)(4) status.

So this was, I believe, an attempt on his part to be even-handed. I am sure he worked with the Office of Chief Counsel at the IRS. But it is something that I have no additional information about, sir.

EARNED INCOME TAX CREDIT

Senator JOHANNS. Mr. Inspector General, let me, if I might, go to another topic here, not that I might not return to this. But the earned income tax credit has been subject to a lot of analysis and criticism by your office. And if I remember the numbers correctly, about 20 percent of what is paid out annually is fraudulently sought and paid out, totaling $15 billion or some huge amount of money.

Give us your best advice as to how we can address that issue. There was a piece of legislation recently that was going to be used as an offset on something. And my goodness, the debate was you are taking food out of the mouths of children. Well, nobody wants to do that, but I think we should not be paying out taxpayer money that is fraudulent, if you know what I am saying, that is fraudulently sought. Give us your best advice on that.

Mr. GEORGE. Once again, sir, I have to preface that is a tax policy question. So I am going to answer your question, but I would have to defer to the Assistant Secretary for Tax Policy. You are right, it is in the tens of billions. It is under $20 billion, so the teens.

Senator JOHANNS. Fifteen to $18 billion.

Mr. GEORGE. Yes, something like that. It has, believe it or not, gone down in recent years. But with any credit, especially a refundable credit, it is extraordinarily hard for the IRS to administer this because that means, again, you may not owe taxes, but the money, you can claim it, and the money goes out. And as the Commissioner noted, when they sometimes do not have third party information from people until months after these checks have gone out the door, it is almost impossible to reclaim the money, to claw it back. And that is part of the problem here.

Senator JOHANNS. Would it help to just require that the name of the person, the individual involved that qualifies for that credit be listed together with a social security number?

Mr. GEORGE. Not only would that be helpful, but a truly troubling aspect, because we made recommendations on this for quite some time. A lot of the individuals who use this credit, and I do not know if you have seen the instructions. I think they are about 30 pages long on how to apply for the earned income tax credit, which means that a lot of the individuals who receive this have the benefit of outside or third party people assisting them with their taxes.

And we have found examples of those individuals whether on purpose or not, you know, in cahoots with the individuals or not, siphoning money off to the side. This is not just one individual, one family engaged in, you know, inappropriate tax behavior, sir. It is more than that. And so, this is something that demands to be looked at. It is not the only one. There are other refundable credits out there that have similar problems.

The Congress did change the law so that it made it clear who was eligible for that whereas in the past it was not clear whether somebody who was not entitled to certain public benefit could not receive them. That has been clarified. There are other refundable credits where that is still not clarified. So this is a big issue.

Senator JOHANNS. You know, my—and I am going over my time, I hope you do not mind. It is just the two of us here.

Senator UDALL. That is all right.

Senator JOHANNS. But I think this is an enormously, enormously important discussion. I do not want one single American who is entitled to a tax credit not to get it. The law provides to it. They are entitled to get it. They apply for it. We should send it to them. I have got no issue with that whatsoever.

I get crazy over this notion, and I think people figure this out. And they make application fraudulently, and the money goes out the door, and chances of recovery are very, very slim, as you know. I do not know if this subcommittee is the appropriate subcommittee, but this warrants a hearing process where we ask you and others at the IRS how do we fix this, because I think the fixes would be pretty straightforward.

And here we are fighting with each other over revenue necessary to run the Agency, while billions of dollars are slipping out the door. It makes no sense to me. Like I said, it drives me crazy. It is such a waste of money.

Mr. GEORGE. Sir, there are two—and, again, I do not want to belabor the chairman's—step on his time either. But giving the IRS quicker access to information and actually giving them access to a database that is run by the Department of Health and Human Services, which would assist them in gathering third party information. The earlier the third party information is available to the IRS, the quicker they can help address and stem some of these problems.

Senator JOHANNS. Yes, great. Thank you, Mr. Chairman.

Senator UDALL. Thank you very much, Senator Johanns. Just a quick comment on the earned income tax credit. The earned income tax credit is one of the Federal Government's largest benefit programs for low income working families and individuals. You know that very well. Workers, self-employed people, and farmers who earn $51,567 or less last year could receive larger refunds if they qualify for the EITC.

The EITC has been making the lives of workers a lot easier for more than 38 years. Yet there have been challenges in the implementation of this credit, and that is what we have been talking about here. We have recently heard of examples of fraud and misuse that are troubling, and I know that you are working to address that.

On the flip side, the IRS also estimates that nationwide, one in five eligible workers still miss out on the EITC either because they do not claim it when filing or do not file a tax return. I think it is critical we ensure that this credit is reaching those in the most need and protected for the hardworking families struggling to make ends meet. And very much appreciate, Senator Johanns, your comments on that.

IDENTITY THEFT AND REFUND FRAUD

Inspector General George, the question, you heard me have a discussion with the Commissioner on refund fraud and identity theft. Do you consider IRS' current strategy for dealing with identity theft and refund fraud to be satisfactory? What measures should the IRS pursue with greater vigor to improve its response to the growing problem of refund fraud and identity theft?

Mr. GEORGE. As I have indicated in various public settings, this is one of the fastest-growing threats to our systems—our Nation's system of tax administration. As I pointed out in my written testimony, the IRS has made progress in identifying tax returns that should not go out that some of which have characteristics of identity theft and others, for example, people in jail who may not be claiming to be someone else, may be claiming to be themselves, but claiming refunds for money they are not entitled to. So this is an amazingly growing problem.

I, my mother, my father, we have all gotten these phone calls demanding that we pay the IRS money, or they are going to—all three of us were going to be arrested. So I mean, I know we are not the only ones. We have reported over 1 million or 2 million calls requesting millions of dollars, tens of thousands of dollars in these types of fraud. And this thing is just growing exponentially.

So it is almost like a moving—excuse me—almost like a moving target for the IRS. They can skim it down. They can put clamps down here, and then the balloon expands or it goes to this other area. This is not solely a domestic problem. It is an international problem. But this is something that if we do not want to completely undermine people's trust in their Nation's system of tax administration, you know, the IRS with declining resources and additional responsibilities is truly going to have to make some tough choices, sir.

Senator UDALL. Do you share the concern expressed by the National Taxpayer Advocate that victims still face the same, and they use this language, a labyrinth of procedures and drawn-out timeframes for resolution that they faced 5 years ago?

Mr. GEORGE. We actually issued an audit more recently which reconfirmed her findings. So the answer is an unqualified yes.

SECURITY OF TAXPAYER INFORMATION

Senator UDALL. Now, computer security has been problematic for the IRS since 1997. The Treasury Inspector General for Tax Administration has identified security of taxpayer data employees is one of the top three management challenges facing the IRS. The Government Accountability Office (GAO) has highlighted the need for improvements as well. Significant deficiencies make the IRS systems vulnerable to unauthorized access. This can adversely affect the confidentiality, integrity, and availability of financial and sensitive taxpayer information.

What are your key concerns about the adequacy of information security measures IRS has put in place to protect its systems from the threat of cyber attack?

Mr. GEORGE. Well, once again, and this ties into the issue of identity theft and the massive increase in the number of those cases. As a matter of fact, we are required every year under the Reports Consolidation Act to list the top 10 management challenges confronting the IRS, every IG of major agencies. For years, the IRS' tax systems modernization was the number one concern that we had, but in the recent years, they have made improvements. I am not in the position at this very moment to outline exactly what those improvements are, sir, but they have made improvements.

But again, with technology growing in a nano second, they are going to have to stay on top of this, and in an environment of declining resources they have some tough choices to make. But it is still a problem. I mean, but it is not the same—to the same extent. You may recall the tax system modernization effort, billions of dollars were expended on a system that did not work. And so, they had to recreate the entire thing from the get-go, and they were able to do so.

Senator UDALL. Great. Thank you very much for that answer. Senator Johanns.

Senator JOHANNS. If I could just offer kind of a concluding comment. First of all, I just want you to know I respect what you folks do. I have worked with the Inspector General myself, and, you know, and sometimes that oversights gets a little irritating, if you know what I am saying, if you are the person in charge. But having said that, it is the right thing because it forces people to be paying attention.

The second thing I wanted to say on this earned income tax credit, again I want to make this very clear. I want every person in America who is entitled to receive it under the law to get it. And if there are people not getting it, we should do whatever we can to do outreach or whatever to properly inform them that it is available and they have a right to claim it.

But 20 percent of the earned income tax credit under your own analysis, 20 percent of the payments each year are improperly paid out. That is appalling, and it is not a small amount of money. It is $13 billion to $15 billion according to my notes. We cannot justify that. We cannot justify that, and if that can be fixed, and I believe it can quite easily be fixed, we in Congress should be fixing it. It is as simple as that.

So that, again, drives me crazy that deserving people are not getting it. Undeserving people are fraudulently claiming it and receiving it. We pay it out to them, and I just think that is flat wrong. Just flat wrong. Thank you.

Senator UDALL. Senator Johanns, thank you so much today for your participation and involvement here. We have almost gone two full hours, and I just want to tell you how much I appreciate it.

I want to echo his comments on the inspectors general. I mean, I think they play a tremendously important function in our government and a real watchdog out there and help us. And I very much appreciate the Commissioner staying and listening to your testimony. It shows his commitment, I think, to try to get things right there at the IRS.

I want to thank all who participated in preparing for this hearing. I appreciate the hearing from the top officials, so the Treasury Department, about resource needs and the opportunity to explore a number of important and, I think, very timely issues. Today's discussion has provided helpful insights into the Treasury and IRS' critical operations and challenges. This information will be instructive as Congress moves forward with our work on the fiscal year 2015 funding.

The other thing I want to say is I think the staff has done on both sides excellent work in preparing us for this hearing.

ADDITIONAL COMMITTEE QUESTIONS

The hearing record will remain open until next Wednesday, May 7, at noon for subcommittee members to submit statements and questions to be submitted to the witnesses for the record. And we would very much appreciate you giving timely responses to those.

[The following questions were not asked at the hearing, but were submitted to the Departments for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO HON. JACOB LEW

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

FINANCIAL STABILITY OVERSIGHT COUNCIL

Question. Secretary Lew, when the Financial Stability Oversight Council (FSOC) released its final rule for the designation of nonbank financial firms, it acknowledged that the asset management industry was different and instructed the Office of Financial Research (OFR) to do a report on the industry. Specifically, the FSOC asked the OFR to determine whether any threats to financial stability could arise from asset management; whether they are significant enough to warrant a regulatory response; and what form that response should take.

—What risks have the FSOC or OFR identified?

—Why does the FSOC believe designation of one or two asset management firms is a more effective solution to address these risks than an activity-based approach by the primary regulator?

Answer. The Council is still evaluating the extent to which there are potential threats to U.S. financial stability arising from asset management companies or their activities and what, if any, measures are appropriate to address those threats. I would not want to prejudge the outcome of that analysis while it is still ongoing.

The September 2013 Office of Financial Research (OFR) study on asset management is only one of many inputs that the Council will consider as it continues its review of the asset management industry and its various activities. Further, it is important to note that the Council did not ask the OFR to make recommendations regarding any regulatory response that the Council or other regulators should take in response to any risks in the asset management industry. The Council hosted a public conference on May 19 to discuss the asset management industry and its activities. At the conference, we heard directly from the industry and other stakeholders, including academics and public interest groups, on this issue, and we welcome continued engagement from across the spectrum as the Council continues its careful assessment of potential risks to U.S. financial stability.

To the extent that the Council identifies risks posed by asset managers or their activities that could pose a threat to financial stability, the Council has a number of potential responses, including highlighting potential emerging threats in its annual reports to Congress, making recommendations to existing primary regulators to apply heightened standards and safeguards, and designating individual firms on a company-specific basis. If the Council identifies risks that require action, it will seek to deploy the most appropriate remedy.

CYBERSECURITY

Question. The Treasury Department and financial sector have access to a significant amount of personal and sensitive data that must be protected from both external and internal threats. However, over the past few years, the Treasury Inspector General has audited the Department's cyber security and repeatedly found vulnerabilities, particularly within the Office of the Comptroller of the Currency.

The President's budget requests a significant increase of $11 million dollars to combat these cyber security threats.

—Please explain how the funds would be used to address cyber security threats, and in particular, the vulnerabilities identified by the Inspector General.

Answer. There are many cyber threats confronting Treasury. The $10.9 million requested is directed at four key areas within Departmental Offices (DO) and the Department-wide Systems and Capital Investments Program:

1. Insider Threat Monitoring, $3.3 million;
2. DO Local Area Network Cybersecurity Improvements, $2.6M;
3. Government Security Operations Center, $3.5 million; and
4. Data Leakage Protection System, $1.5 million.

The Department's Insider Threat Program is being implemented in accordance with Executive Order 13587, the National Insider Threat Policy and Minimum Standards, and Treasury Order 105-20, and in coordination with the National Insider Threat Task Force (NITTF). To comply with these authorities, Treasury intends to institutionalize its insider threat audit and monitoring system on its top secret/secret compartmented information network and build an insider threat analysis cell to review data from all parts of the Department. This will assist the Office of the Comptroller of the Currency (OCC) as well as all other Bureaus.

The DO local area network (LAN) cybersecurity improvements will provide comprehensive network access control to mitigate cybersecurity risks against the DO Local Area Network. The DO LAN is the primary computing network used by DO. Its current cybersecurity features are robust, but they require improvement to address the ever-increasing worldwide cyber threat. Funds will support hardware, system audit and monitoring software, password management software, and FTEs.

The Government Security Operations Center currently serves as the Department-wide cyber incident response organization, responsible for monitoring, detecting, and addressing incidents, which includes monitoring the Department's Trusted Internet Connections and Managed Trusted Internet Protocol Service gateways. It works in coordination with Bureau security organizations to defend against traditional and advanced cyber attacks directed at the Department's systems and users, most notably advanced phishing-type attacks. Funds will be used, in part, to recruit technical analysts focused on data mining, who will analyze the technical aspects of cyber attacks in order to formulate detection, actionable defense, and mitigation strategies, which are generally outside the scope of the analytical work performed elsewhere in the Department. Funds will also support security intelligence analysis and advance cyber threat detection.

Data Leakage Protection System funds in the amount of $1,500,000 are requested in fiscal year 2015 budget for specialized technical services to implement a Data Leakage Protection (DLP) tool at non-IRS Internet perimeter points. The DLP will examine data, including e-mail being sent from the Department, to identify whether any sensitive data, such as personally identifiable or classified information, is being inadvertently transmitted.

Separately, OCC-specific investments include an increased focus by the Comptroller and OCC's senior IT staff on the effectiveness of OCC's cybersecurity program. OCC recently hired a new Chief Information Security Officer (CISO) with extensive cybersecurity experience in the banking, financial, and payment services sectors. Through the new CISO's leadership, OCC is pursuing several new cybersecurity technology initiatives in fiscal year 2015 and fiscal year 2016 to improve its capabilities to monitor and protect its sensitive information and data. OCC has also begun recruiting additional cybersecurity professionals with new skill sets needed to update and manage its security-related processes related to improving OCC's risk-based information security continuous monitoring capabilities.

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

Question. Treasury's Alcohol and Tobacco Tax and Trade Bureau (TTB) regulates alcohol and tobacco products by approving product labels and formulas to protect consumers from unsafe products, and collect significant revenue for the Treasury. In fiscal year 2013, TTB collected nearly $23 billion in excise taxes, which is a return of $243 dollars for every dollar spent to operate the bureau. However, the fiscal year 2015 budget proposes to cut funding for the TTB by $3 million, and then provide an additional $5 million under the program integrity cap adjustment.

—Why does the budget cut funding for this bureau— while the alcohol market continues to grow rapidly, and this bureau continues to collect significant revenue for the Treasury?

—Why is the budget cutting funding in the base budget, while proposing an increase under a cap adjustment that is not currently authorized?

Answer. The fiscal year 2015 President's budget includes a proposal to amend section 251 of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, to provide a program integrity cap adjustment of $5 million (of which $2 million will be used for agent support) for the Alcohol and Tobacco Tax and Trade Bureau (TTB)'s tax enforcement and compliance program to narrow the tax gap in the tobacco and alcohol industries and reduce the deficit through revenue collections. The budget proposes an increase in its alcohol and tobacco enforcement program, while working to increase operational efficiencies to support businesses getting their products to market. We recommend that Congress pass the proposed program integrity cap adjustment for both TTB and the Internal Revenue Service. The proposed cap adjustment for TTB tax enforcement and compliance activities includes $5 million in new revenue-producing tax compliance initiatives in fiscal year 2015 and $5 million in new initiatives each year from fiscal year 2016 to fiscal year 2019 and continued through fiscal year 2024. TTB will target known points in the supply chain that are susceptible to diversion activity and prioritize forensic audits and investigations of high-risk entities in the alcohol and tobacco industries. Because these new initiatives, as well as current enforcement activities, must be sustained over time in order to maximize their potential taxpayer returns, the total above-base adjustment funding is $193 million over the 10-year period. These additional investments will generate $285 million in additional tax revenue over the 10-year period. The net savings from these investments is $92 million.

HOUSING MARKET

Question. The Troubled Assets Relief Program of 2008, known as TARP, created several programs at Treasury to stabilize the housing market. The Making Homes Affordable program and Hardest Hit Fund help homeowners avoid foreclosure through refinancing and other mortgage relief. Though the housing market is showing signs of recovery, many homeowners are still struggling. The Government Accountability Office (GAO) recently reported that participation rates in these programs are declining.

—Do you believe these TARP programs continue to effectively help struggling homeowners?

—As the remaining TARP funds are expended and these programs begin to wind down, what will be the ongoing role of the Treasury Department in the housing market?

Answer. Under Making Home Affordable (MHA), there have been over 2 million homeowner assistance actions, including more than 1.3 million permanent mortgage modifications, to date. In addition, MHA has indirectly assisted millions more by setting new standards and prompting changes in industry practices that have led to more affordable and sustainable private modifications. In total, through government programs and additional private sector efforts, more than 6.9 million families have received help.

Although the housing market is recovering, many homeowners and communities are still dealing with the aftermath of the housing crisis. On average, 15,000 homeowners entered the program each month in 2013. The extension of MHA to December 31, 2015 will benefit many additional families, while maintaining clear standards, consumer protections, and accountability for the mortgage servicing industry.

Treasury remains focused on helping as many people as possible through the housing programs under TARP. We will continue to evaluate our programs in an effort to assist homeowners and communities who still need help. We will also ensure that as the programs wind down, they are done so in an efficient and well organized manner.

"MY RA" AND RETIREMENT SAVINGS

Question. This year's State of the Union address, the President announced a new initiative to encourage Americans to save for retirement. The "My RA" program would allow employees to set up automatic contributions from their paychecks to an IRA account, backed by the Government with the same interest rate offered to Federal employees.

—When will this program be available to employees and employers that want to use it?

—How much will it cost the Treasury Department to implement this new initiative?

Answer. Treasury is working to launch *my*RA in late 2014 with broader and scaled rollouts occurring in intervals over 2015 and 2016.

Treasury is currently in the process of evaluating proposals from potential financial agents to manage the program, and we are unable to provide an estimate of such costs until that process is complete. Treasury expects that there will be a minimal cost to operating the program, but we cannot provide an accurate estimate until we have actual data, including take up by *my*RA savers and the average duration of time these securities are held by participants.

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. A proposal requiring the Secretary of Treasury to enter into contracts with private collection agencies (PCAs) to collect Federal taxes is included in Sec. 6304 of the draft "Tax Reform Act of 2014" introduced by Chairman Camp, as well as in Sec. 305 of S. 2260, the "Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act" now pending in the Senate.

What was the result of a similar initiative that was in effect from 2006 to 2009?

Answer. The IRS has determined that the previous PCA initiative in effect actually lost money because the initiative imposed significant administrative costs on the IRS and resulted in the IRS' resources being diverted from higher priority collection cases to lower priority collection cases. To prepare for the 2006 to 2009 initiative, the IRS expended significant start-up costs. Although the Internal Revenue Code permits the IRS to retain 25 percent of the amount collected by PCAs, this amount proved insufficient to cover the costs of the 2006 to 2009 initiative and the IRS needed to use appropriated funds to maintain the initiative, decreasing the amount of funds the IRS could use to collect taxes from higher priority cases. During the 2006 to 2009 initiative, the IRS had a policy of attempting to resolve any cases that came back unresolved from the PCAs. IRS collection employees were therefore assigned to work lower-priority collection cases where the PCAs were unsuccessful. Ultimately, after taking all costs into account, the IRS concluded that the program lost revenue.

Question. Is it true that the IRS currently has the authority to use PCAs, but has chosen not to use that authority? Why?

Answer. Section 6306 of the Internal Revenue Code, which was added to the Code in 2004, permits, but does not require, the Secretary to enter into a "qualified tax collection contract." The 2006 to 2009 initiative was undertaken pursuant to this authority. As noted in the previous response, the 2006 to 2009 initiative lost revenue, taking all activities into account. In addition, taxpayers are not entitled to the same protections when PCAs attempt to collect tax debts as they are when the IRS does so. For example, the IRS is required to make its processes and procedures public, which it does by issuing the Internal Revenue Manual (IRM). IRS employees are required to follow the IRM, which prohibits aggressive collection practices. PCAs are not required to make their processes public, nor are they required to follow the IRM. During the 2006 to 2009 initiative, at least some PCAs were accused of using aggressive collection practices, such as exerting psychological pressure on taxpayers. In addition, IRS employees can be fired, fined, and/or imprisoned for the improper use or disclosure of tax return information; PCAs are not subject to these consequences for the improper use or disclosure of tax return information. So for reasons of revenue outcomes and taxpayer service, IRS has not chosen to use PCAs in the last few years.

Question. What are your agencies' positions on the proposal to require Treasury to use PCAs to collect Federal taxes?

Answer. Treasury has both administrative and policy concerns with the proposal requiring Treasury to use PCAs to collect Federal taxes, and does not support the proposal. From an administrative standpoint, requiring Treasury to use PCAs would impose significant start-up costs on the IRS to evaluate PCAs and enter into qualified tax collection contracts, and ongoing costs to monitor PCAs' collection activities. Because the proposal does not provide additional funding for the IRS, these costs would decrease the funds available to the IRS for other priorities, including its ongoing enforcement activities. Moreover, previous experience with PCAs has taught us that the IRS has a much higher return on investment than PCAs, making this proposal a less effective use of taxpayer dollars. We are especially concerned that making the use of PCAs mandatory requires the Treasury to continue using the program, even if the evidence demonstrates that using PCAs loses revenue. From a policy perspective, we have several concerns with the proposal. Most significantly, the types of tax receivables excluded from qualified tax collection contracts are too limited (for example, the proposal does not exclude cases where collection could result in economic hardship). In addition, the proposal does not contain adequate safeguards to protect taxpayer rights. PCAs are not subject to the same requirements as the IRS for safeguarding tax return information and are not subject to the same consequences as IRS employees if they improperly use or disclose tax return information.

Question. What impact could this requirement to use PCAs to collect Federal taxes have on taxpayers, specifically low-income taxpayers?

Answer. We have several concerns about the impact of this requirement, including that (1) it could result in economic hardship for taxpayers who have an outstanding tax liability that they cannot currently afford to pay in full, and (2) the lack of due process and other taxpayer protections similar to those that apply when the IRS collects a tax liability could lead to potential abuse by PCAs and reduce future voluntary compliance by affected taxpayers.

To determine the extent to which the proposal would affect low-income taxpayers, IRS used parameters similar to those in the proposal and prepared a preliminary estimate of individual taxpayers who could be affected by the proposal. This analysis determined that the overwhelming majority of individual income taxpayers potentially affected by the proposal would have incomes below 250 percent of the Federal poverty level. We are concerned that low-income taxpayers could be pressured into committing to payment schedules that they cannot afford to keep, which could damage their credit rating and their ability to remain current with respect to their tax liabilities. Moreover, unlike the IRS, PCAs have no incentive to engage in taxpayer outreach and education, which is particularly beneficial to low-income taxpayers and other underserved populations and which may help promote future tax compliance.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

Question. Describe the role of your agency's Chief Information Officer (CIO) in the oversight of IT purchases. How is the CIO involved in the decision to make an IT purchase, determine its scope, oversee its contract, and oversee the product's continued operation and maintenance?

Answer. The Deputy Assistant Secretary (Information Systems)/CIO is responsible for implementing Federal policy contained in the Clinger-Cohen Act, Federal Information Security Management Act, Paperwork Reduction Act, E-Government Act, Government Paperwork Elimination Act, and other IT-related statutes and Executive Orders. The CIO's functions and responsibilities include:

1. providing advice and other assistance to the Secretary of the Treasury and other senior management personnel of the Department to ensure that information technology is acquired and information resources are managed consistent with the policies and procedures of Clinger-Cohen;
2. developing, maintaining, and facilitating implementation of a sound and integrated information technology architecture for the Department;
3. promoting effective and efficient design and operation of all major information resources management processes for the Department;
4. chairing the Treasury CIO Council and Treasury Technical Investment Review Board to ensure sound decisionmaking;
5. developing, maintaining, and facilitating implementation of Departmental IT guidance, including policies, procedures, manuals, and/or guidelines relative to the Department of the Treasury classified and sensitive but unclassified telecommunications security and unclassified computer security programs of all Departmental elements;
6. promoting effective use of information technology for public access to public information and facilitating Treasury-wide electronic information dissemination programs in accordance to statutes and regulations;
7. establishing and implementing sound information management activities as they relate to the Department's records management and information collection programs;
8. monitoring the performance of information technology programs of the agency, evaluating the performance of those programs on the basis of the applicable performance measurements, and advising the Secretary regarding whether to continue, modify, or terminate a program or project;
9. assessing and determining the strategy for ensuring adequate IT workforce capabilities; and
10. partnering with the Department's Chief Financial Officer (CFO) to ensure that the capital planning and investment are integrated into the budget process.

Question. Describe the existing authorities, organizational structure, and reporting relationship of the IRS Chief Information Officer. Note and explain any variance from that prescribed in the Information Technology Management Reform Act of 1996 (aka, The Clinger-Cohen Act) for the above.

Answer. The IRS Chief Technology Officer reports directly to the IRS Deputy Commissioner and has a dotted line relationship with the Treasury Deputy Assistant Secretary for Information Services and Chief Information Officer. Coordination, oversight, and compliance are conducted in part through the Treasury Technology Investment Review Board (TTIRB), which is a monthly review by a committee composed of officials from across the Department. Further coordination and consolidated Department-wide reporting is managed through the TTIRB and Treasury CIO Council, which includes all bureau-level CIOs and is chaired by the Treasury CIO. In addition to reporting in accordance with the Clinger-Cohen Act, Federal Information Security Management Act, Paperwork Reduction Act, E-Government Act, Government Paperwork Elimination Act, and other IT-related statutes and Executive Orders, the Treasury CIO has embedded annual performance metrics into the bureau CIOs/Chief Technology Officers (CTOs) performance plans, including the IRS CTO's plan. The IRS's separate appropriation provides the IRS with significant independence in managing their IT portfolio in the context of supporting their unique mission.

Question. What formal or informal mechanisms exist in your agency to ensure coordination and alignment within the CXO community [1] (i.e., the Chief Information Officer, the Chief Acquisition Officer, the Chief Finance Officer, the Chief Human Capital Officer, and so on)? How does that alignment flow down to agency subcomponents?

Answer. Treasury's new 2014–2017 strategic plan represents the goals and strategies for the diverse financial and economic activities of the Department, including achieving organizational excellence in support of Treasury's operational mission. The plan enables members of the CXO community to align themselves to a clear set of Departmental management goals and corresponding strategies, including increasing workforce engagement, performance, and diversity; supporting effective data-driven decisionmaking; promoting efficient use of resources; and creating a culture of customer service.

To improve alignment of these Departmental goals and priorities, it is Treasury policy that the functional program heads at Departmental Offices establish additional Department-wide strategic goals and objectives, as well as individual performance expectations and uniform language, which is incorporated into the performance plans of Bureau functional program heads (CXOs).

Finally, there are numerous forums, councils, and policies that enable coordination and alignment across the CXO community and within each functional area, including alignment from headquarters to bureaus. For example, since 2010, Treasury has been conducting quarterly performance reviews in support of Government Performance and Results Act (GPRA)-Modernization Act to drive accountability and produce results in the management space. Departmental program heads also regularly convene their bureau counterparts through forums such as "HR Stat" and the "CFO council" to discuss policy and ongoing events in each CXO area of expertise.

Question. How much of the agency's budget goes to Demonstration, Modernization, and Enhancement of IT systems as opposed to supporting existing and ongoing programs and infrastructure? How has this changed in the last 5 years?

Answer. In fiscal year 2015, 23 percent of Treasury's IT budget will go to Development, Modernization, and Enhancement (DME). Generally Treasury has seen an increase in DME spending from fiscal year 2011 where 19 percent of Treasury's IT Budget was applied to DME.

Question. Where and how is the IRS taking advantage of this administration's "shared services" initiative? How do you identify and utilize existing capabilities elsewhere in government or industry as opposed to recreating them internally?

Answer. IRS has actively participated in the Federal Government Shared Services initiative over the past several years. Currently IRS primarily utilizes Federal Government shared services through the Treasury Franchise Fund (TFF) that is supervised and managed by the Department of the Treasury. The fiscal year 2014 estimate for the IRS shared services provided by the TFF is $95 million. Some of the services IRS receives through the TFF include:

[1] The CXO Community is a peer-to-peer community exclusively for C-Level executives (CEO, COO, CPO, CFO, CIO, CTO, CKO, CMO, CAO, CVO, CRO, CLO, CSO, CDO, President, Chairman and MD).

—HR Connect, which delivers human capital services and interfaces with the Department of Agriculture's National Finance Center, which provides payroll processing and support;
—Web Solutions, which provides collaboration sites and support for IRS Webmasters and content managers;
—Treasury Enterprise Identity Credential & Access Management provides Personal Identification Verification, Physical Access Controls, Logical Access Controls for local, remote & mobile devices;
—Government Secure Operations Center serves as the focal point for management of cyber incidents and is responsible for security detection, analysis & incident management lifecycle practices; and
—A number of other smaller programs that provide non-IT services, including the Office of Small and Disadvantaged Business Utilization, which advises and aids the bureaus on small business policies and initiatives; Treasury Operations Excellence, which provides Lean Six Sigma training and other services to help Treasury and other Federal agencies use entrusted resources more effectively and efficiently; and the Privacy, Transparency, and Records program, which provides assistance to Treasury customers to collect, protect, retain, preserve, disclose, and provide access to Treasury's information resources pursuant to U.S. laws.

IRS also offers shared services to other agencies through Reimbursable Agreements. These include procurement services and use of Call Centers by FEMA for disasters.

Question. Provide short, two-page, summaries of three recent IT program successes—projects that were delivered on time, within budget, and delivered the promised functionality and benefits to the end user. How does the IRS define "success" in IT program management?

Answer.—

Project #1: IRS.gov/Enterprise Portal

In August of 2011, the IRS Information Technology organization set out to deploy enhanced Web services including a straightforward, manageable Web environment, established end-to-end operational accountability and visibility, and a cost-effective program structure.

Additionally, the IRS sought to address the following challenges:
—Exponential growth of online electronic filings and taxpayer access to information;
—Difficulty balancing system capability to meet demand (scaling horizontally);
—Inconsistent user experiences for the taxpayer and tax preparer;
—Limited ability to share data and content between the IRS user communities;
—Difficulty focusing on serving end users (taxpayers and preparers) in an end-to-end fashion, and
—Multiple portals with numerous services to maintain.

The solution was the Integrated Enterprise Portal (IEP), an innovative, cost-effective system that provides a scalable, managed private cloud capability to the IRS, enabling one-stop, Web-based services to internal and external users. The IEP has transformed the way the agency creates, launches and administers its taxpayer- and employee-facing applications. At its most basic operational level, it allows the IRS to get business-critical applications to the live environment more quickly, while enhancing cost predictability and security.

Recent IEP Program Successes:
—*Registered User Portal (RUP) Deployment.*—RUP, deployed on-time and within budget in September 2013, implemented a secure, FISMA-moderate (Federal Information Security Management Act framework risk classification), scalable, managed private cloud which provides a shared portal infrastructure that consolidates the IRS platforms under a single, flexible, and scalable platform. The RUP is the IRS external portal that allows registered individuals and third party users, where registration and login authentication are required for access, to interact with selected tax processing and other sensitive systems, applications, and data.
—*Filing Season 2014.*—The 2014 tax filing season marked the IRS's first season fully "in the cloud." Going into tax season there was uncertainty driven by the fact that deployment occurred just a few short months earlier—a period of time made even shorter by a 3-week Government shutdown. Additionally, the IEP was predicted to face an unprecedented amount of traffic and filings. Despite these circumstances, the IEP not only delivered, but exceeded expectations han-

dling the highest number of electronic returns and traffic ever—all with 100 percent availability and zero Priority 1 or Priority 2 incidents. This was a season of unprecedented peaks for the IRS that set a new standard for tax seasons to come. For example, on 2/6/14 the IEP successfully handled the "Where is My refund" application peak of 5.8 million unique daily visitors at a peak volume of 15,000 transactions/minute. Detailed statistics are as follows:

Portal key performance metrics January 11 to April 17, 2014:

—224.1 million total returns submitted (Federal + State);
—1.025 billion IRS.gov page views/263 million IRS.gov site visits; and
—132.7 million page views during seasonal peak week.

"Where's My Refund" accessed via IRS.gov Web site:

—136 million page views;
—112 million site views; and
—15,000 peak transactions/minute.

—*New Technical Capabilities to support the Affordable Care Act (ACA) effort*.—A new Transactional Portal Environment (TPE), which is a series of capabilities that reside within the IEP, was needed to support the new Affordable Care Act (ACA) program. The ACA TPE supports secure Application-to-Application (A2A) interfaces between Health and Human Services (HHS) Centers for Medicare & Medicaid Services (CMS) and the IRS. The new portal solution was implemented on-time and on-budget to support the beginning of open enrollment in the Marketplaces in October 2013. The IRS achieved the business objective to deploy a TPE solution providing CMS access to ACA services and providing 24/7 monitoring and support, daily reporting, and confirmation that initial traffic was within anticipated thresholds.

Key metrics for October 1, 2013 to April 15, 2014:

—TPE successfully processed 45 million requests for Income and Family Size Verification (IFSV) and Premium Tax Credit (PTC) computation services in real time from CMS.

—*Employee User Portal (EUP)*.—In late December 2013, a production IRS Employee User Portal (EUP) environment was successfully transitioned to the IEP. The IRS completed this transition ahead of schedule in response to a request by the IEP Governance Board to pull in the transition schedule in order to begin transitioned production operations prior to the beginning of Tax Filing Season 2014. Production operations of the newly transitioned environment were supported without a Priority 1 or 2 incident throughout the 2014 Tax Filing Season (January 2014 to April 2014). In addition to supporting transition and filing season operations of the existing EUP infrastructure, the IRS conducted initial analysis and concept of operations discussions about the future state of the EUP that would align with the goals of data center optimization and consolidation.

Definition of "Success"

Success was clearly defined on this program with deliverables completed on time, within budget, and with the promised functionality to achieve the Authority to Operate (ATO) recommendation from Cyber Security and planned business results.

Project #2: CADE 2

The Customer Account Data Engine 2, known as the CADE 2 program, is implementing a single, data-centric solution that provides daily processing of taxpayer accounts.

A critical component of the CADE 2 program is an authoritative database for individual taxpayers that provides more efficient and effective tax administration. The new database is the heart of the solution. It will transform the way the IRS approaches tax administration into the future. It improves taxpayer services by providing the capability to view taxpayer account data stored in the CADE 2 database with on-line viewing by IRS customer service representatives, as well as analytical reporting for more meaningful business intelligence and expanded opportunities to increase compliance.

As the IRS continues to invest in its data-centric vision in fiscal year 2015, CADE 2 will enable an enterprise-wide data environment that extends business capabilities, promotes efficiency, and increases productivity by ensuring the fidelity, security, and understanding of IRS data. This is essential to effectively enable the IRS to leverage 21st century technologies such as cloud computing, Web services, electronic submissions, e-Authentication, big data and data analysis, and computing as a commodity, to name a few.

With deployment of CADE 2 Transition State 1 (TS1), the IRS took a leap forward from a technology standpoint, moving the management of IRS's individual taxpayer account data from 1960's sequential flat-files stored on magnetic tapes, to state-of-the-art relational database technology. The IRS is now conducting transactional processing of account data for over 270 million individual taxpayers and over a billion tax modules on a modernized DB2 relational database. The IRS data is now stored in relational formats dictated by a state-of-the-art data model that maintains historical values never before retained on taxpayer account transactions and facilitates daily viewing of taxpayer account data by IRS customer service representatives. CADE 2 TS1 is offering faster refunds, faster notices, faster payment postings, and improved service for millions of taxpayers as well as a solid foundation for our data-centric vision. As of the end of April 2014, CADE 2 had posted 116.97 million returns and issued 101.67 million refunds totaling $269.30 billion for filing season 2014.

The IRS is now well positioned to take the essential next step in its data-centric vision—rewriting its core taxpayer account processing applications so they can leverage the benefits of the new, high-powered CADE 2 relational database environment. Prototypes are being conducted to validate our assumptions about our approach to this effort. Once our applications are re-written into a modern programming language and are able to effectively populate the new CADE 2 relational database based on its modernized data model, it will become the authoritative source for individual taxpayer account data for the IRS. This CADE 2 effort, called Transition State 2 (TS2), will enable the IRS to address its longstanding unpaid assessments financial material weakness which has added substantial risk to IRS custodial accounting and clean audit opinion for nearly 20 years.

TS2 will ensure the long-term viability of the IRS tax processing systems by addressing the limitations and risks associated with the aging architecture and the design of our legacy core tax processing systems, as well as the outdated programming languages that are difficult to maintain.

Investments in CADE 2 TS2 are already delivering benefits to taxpayers with the rollout of the Penalty & Interest (P&I) common code base on January 2, 2014. After years and years of discrepancies among various systems in calculating penalty and interest, a new application is now calculating penalty and interest consistently on individual and business accounts for taxes that are not received by the due date across our master files (Business Master Files and Individual Master Files). It is also providing service improvements for taxpayers such as more accurate notices, consistent penalty and interest calculations, and enhanced service, as Customer Service Representatives have more accurate information and are better able to assist taxpayers in meeting their tax filing and payment obligations. The solution uses the existing master file common code modules as baselines and incorporates additional requirements for the Integrated Data Retrieval System (IDRS).

CADE 2 is a game changer for the IRS, and once complete it will enable many opportunities for the IRS to transform the way we approach tax processing today and into the future.

Project #3: Filing Season

At the core of the IRS's operations is an IT infrastructure that has been foundational to administering the U.S. Federal tax code since the early 1960's. Deployment of IT infrastructure in support of Filing Season 2014 resulted in many successes, in spite of a tough budget environment that resulted in three agency furlough days, hiring freezes and a 16-day Government shut down that delayed the opening of filing season. Through collaborative efforts of hundreds of IT and Business staff and consistent assessment of risks and mitigation of impacts, the IRS was able to continue its record of timely deployment of IT systems for filing season 2014, enabling improved taxpayer services, increased compliance, and enhanced security against threats to the Nation's tax system, with marked improvements in production statistics over previous years.

The IT infrastructure for Filing Season 2014 is extraordinarily large and complex, putting it in a class of its own in comparison to other tax systems around the world. The IRS deployed 67 critical filing season systems comprised of thousands of programs written in many programming languages and technology platforms that have been developed over decades to support the growing tax code. These complex systems provided the intelligence and capacity to process about 250 million tax returns submitted electronically and on paper between January 2 and April 15, filtering out fraud and generating over a million refunds totaling roughly $250 billion. These systems capture and move massive amounts of data from program to program under strict limitations set by service level agreements that govern the complex tax return process. They support filing season core tax processing, collection, and exam activities for every taxpayer in the country, and then send the appropriate financial data to IRS's general ledger to execute fiduciary responsibilities and ensure integrity in management of U.S. Government funds. Underlying the critical systems is a complex communications infrastructure of local and wide area networks, with computer hardware and other IT devices and supporting systems that successfully routed over 58 million taxpayer telephone calls with 100 percent system uptime, providing 24x7 taxpayer access to the IRS for Filing Season 2014. The IRS also maintains various technology components and processes that mitigated hundreds of cyber incidents and ensured the continued security posture of our systems, networks, computers and printers, including thwarting three serious cyber threats (e.g., "Heart-bleed", Microsoft Word and Microsoft Internet Explorer) during peak tax processing season.

Readiness activities to prepare the IRS's labyrinth of IT systems and processes for Filing Season 2014 included identifying and training IT specialists to implement world class system end-to-end monitoring, control room 24x7 coverage, and enhanced incident management to support filing season execution. Modernized systems using new technologies were developed and successfully deployed in Filing Season 2014, and hundreds of programming changes were made to our core systems, updating them to incorporate changing tax law. Updates to infrastructure configurations and upgrades to hundreds of computer hardware components, software applications, databases, operating systems, networks, communication devices, and procedures were necessary for smooth execution and protection from hackers and intruders. Systems Acceptability Testing (SAT) and Final Integration Testing (FIT) was completed for 133 projects, including execution of 62,000 test cases to provide assurance of a successful launch.

A Processing Year Delivery Assurance Executive and program management office provided leadership over the Filing Season 2014 activities within the IT organization, and over the many suppliers who assumed responsibilities in development and execution. An integrated Filing Season 2014 governance framework provided enterprise risk and readiness assessments to address and mitigate every issue. Filing Season readiness standard operating procedures were followed, with weekly and then daily operational meetings across the breadth and depth of the enterprise using red/yellow/green reporting for each critical system. Readiness certifications were required at all levels of the organization to signify readiness and ensure stakeholder accountability in execution.

Operational results in Filing Season 2014 show many successes and significant improvements over Filing Season 2013:

—Priority One incidents were down 42 percent from previous Filing Season.

—Modernized e-File (MeF) system had one of the best filing seasons on record, enabling taxpayers to electronically submit over 221 million individual returns along with over 12.5 million Business Master File returns (as of 5/27/2014)—an increase of 3.08 percent for submitted returns compared to the same period in 2013.

—CADE 2 had a smooth filing season launch of its core processing systems in Filing Season 2014 and continues to demonstrate full integration into Filing Season Operations.

  —CADE 2 database is feeding 16 downstream systems, and allowing over 50,000 Customer Service Representatives and other IRS users to view CADE 2 data.

—IRS.gov enabled more taxpayers to avoid wait times on phones. With no interruption in service, usage on the Web site from 3/1–5/31/2014 includes 595 million IRS.gov page views and 143.2 million Web site visits.

—"Where's My Refund" inquiries using IRS.gov equated to 6.7 million page views and 5.8 million site visits from 3/1–5/31/2014.

—The "Get Transcript" application delivered over 11 million transcripts to taxpayers and IRS customers from 1/13–5/28/2014, allowing them to view/print a PDF file of their transcript.

—E-Services enhancements enabled State users to get copies of transcripts for individuals who are victims of ID Theft. Previously, only IRS employees could request these transcripts.

—Enhancements to Enterprise eFax service (EEFax) increased the number of faxes that can be delivered to taxpayers at one time and reduce annual expenses for hardware, software and telecommunication lines.

—New End to End (E2E) application and infrastructure monitoring and auto-ticketing enhanced operation of many Filing Season Critical Systems.

—Enhancements to the Online Payment Agreement (OPA) program were successfully implemented in Filing Season 2014 making it easier for the online user to navigate the OPA Web page and establish installment agreements.

Question. What "best practices" have emerged and been adopted from these recent IT program successes? What have proven to be the most significant barriers encountered to more common or frequent IT program successes?

Answer. Many IT best practices have emerged from our successes at the IRS, particularly in the last few years when IRS executives, architects, engineers, and subject-matter experts have taken more of a lead role in program leadership, systems design, applications development, and systems integration. While many of the best practices are shared across various program management offices—enabled by sharing of toolkits, post-implementation reviews, and collaboration (cross-membership) among governance bodies, etc.—the following are best practices reported by the three specific program offices that reported their successes in the previous question above:

Project #1: IRS.gov/Enterprise Portal

The portal team used best practices such as:

—*Elastic Scalability*.—A recent best practice that resulted in an IT program success was our use of elastic scalability on demand. This "on-demand" capability was successfully utilized to scale the "Where's My Refund?" application on a peak day by 300 percent in a matter of hours. This approach is being successfully applied to business critical applications inside the IRS firewall for Filing Season 2015.

—*Overcoming Barriers*.—One of the key barriers to adopting rapid cloud provisioning was overcome by striking a good balance between maintaining the stability of the applications and limiting the changes during filing season.

Project #2: CADE 2

With regard to best practices, CADE 2 was sponsored at the highest level . In 2009, the IRS Commissioner himself formally launched the CADE 2 program and each Commissioner since then has strongly endorsed it since its inception.

CADE 2 has been managed under a delivery partner operating model, jointly led and governed by IRS executives across Information Technology and the technology industry. With the flexibility, to use critical pay and other authorities to recruit industry leaders and experts with a mix of knowledge in legacy and modernized systems, augmented by a small cadre of in-house subject matter experts, the program was staffed with the right mix of people.

—CADE 2 established a governance model that includes an Executive Steering Committee with representation at the highest levels of the organizations; a Governance Board that has the expertise to enable them to make critical decisions and assume accountability for the outcome of the program; an Executive Oversight Team that meets regularly with accountability for day-to-day identification of risks and progress in addressing those risks across the program; and advisory councils that provide technical advice and subject matter expertise as needed.

—The CADE 2 Program Management Office (PMO) serves with clear authority and lines of accountability assigned to the Business and IT delivery partners. This collaborative program management model was supplemented by high performing workshops early on in the program to develop techniques such as granted trust, generous listening, and rules of effective engagement, which has resulted in growing an in-house capability to manage complex systems using industry best practices that keeps decisionmaking on the side of the government.

—The CADE 2 PMO produced four foundational documents that drive the program:

  —Program Charter describes who we are—mission, goals, operating principles;
  —SolutionsArchitecture documents where we are now and where we are going—aligned with agency architecture;
  —Program Roadmap outlines how we are going to transition to target state; and
  —Program Management plan defines management principles, practices, and processes that will be used.

—The program institutionalized a solid process around messaging to ensure open, accurate and consistent communication with regular report-outs to ensure full transparency and ongoing understanding of progress and risks on the program by all oversight bodies, audit agencies, agency top executive team, delivery and business partner executives, and stakeholders.

—The CADE 2 PMO engaged people IRS-wide in an organizational readiness plan to support the new solution in order to gain maximum benefits and results. Many organizational readiness activities were conducted, such as training sessions on the new production process and how to address and resolve issues within a short timeframe, a control room staffed 24x7 with subject matter experts to provide production support, and formulation of special teams charged with driving testing to complete prior to deploying.

Overcoming Barriers:

—Previous barriers such as getting the business to the table to build requirements and own decisions along the way were mitigated through the comprehensive governance model.
—Burden from audits and other oversight reporting requirements was mitigated by inviting the Treasury Inspector General for Tax Administration (TIGTA) and the Government Accountability Office (GAO) to partner with us throughout the full life-cycle of the program to address risks and building solutions to mitigate them in real-time.
—Issues around funding were managed at the highest levels of the IRS, to get the resources that were needed in a timely manner to meet the program objectives.
—Cultural issues around "change" and "ownership" were addressed by the CADE 2 program manager and other IRS executives encouraging shared commitment for the success of the program.
—Individuals and work teams that previously worked with siloed knowledge of IRS systems were brought together to understand the "big picture" to effectively implement the CADE 2 integrated solution.
—The CADE 2 program manager and other IRS executives personally conducted workshops and coaching sessions using high performance communications techniques and contextual leadership to provide the vision and "line of sight" to break down silos and barriers within the IRS.

Project #3: Filing Season 2014

Many of the best practices used in other large IT programs have been adopted by the Filing Season Readiness program, including:

—Right-sized governance bodies that included stakeholders from IT and business organizations that are at the appropriate level of their organizations where they can readily represent their organization's interest and make decisions.
—Dedicated Filing Season program management office (called the Processing Year Delivery Assurance function) with lead executive that assumed point of accountability for success:
    —Enabled strengthened supplier management and engagement resulting in more tightly integrated incident and problem management.
    —Used various disciplines to promote data-based decisionmaking, such as Filing Season Readiness dashboards, and simulation/predictive modeling to project volumes and impacts.
    —Conducted regular preparatory meetings with all stakeholders, with accelerated frequency as filing season approached, where action items with tracked to completion.
—Enhanced organizational readiness with tabletop exercises to help anticipate Filing Season operational organization and process issues.
—Lessons Learned captured that resulted in over 250 recommendations for improvement/action in 31 areas:
    —Implemented IT Filing Season Readiness Framework—a repeatable process for cross-organizational management of readiness—including defining Filing Season Readiness SOP.
    —Created and validated a Control Room SOP based on experience and best practices that is now available to guide establishment of Control Rooms for other business systems.
—Obstacles were overcome using aggressive risk mitigation framework:
    —Integrated risk and readiness assessments into the Filing Season delivery cadence, strengthening evidence-based decisionmaking capabilities.

Question. Describe the progress being made in your agency on the transition to new, cutting-edge technologies and applications such as cloud, mobility, social networking, and so on. What progress has been made in the CloudFirst and ShareFirst initiatives?

Answer. In 2010, Treasury was the first civilian agency to move key Web assets to a commercial cloud provider with the launch of Treasury.gov, as well as other

Web sites. It has become the go-to solution for offices and Bureaus within Treasury needing to establish Web sites or Web applications, and it is poised to grow further. Treasury is also currently working to establish a private (Treasury) cloud infrastructure so that any application or data hosted by a Treasury bureau can quickly be migrated to the private cloud and be securely provisioned for use by Treasury's many constituencies.

Treasury has a long history of being a shared services provider offering essential services (both business and technical) to constituencies both within and external to our Department. HR Connect is one of the six approved Federal Office of Personnel Management (OPM) Human Resource Lines of Business (HR LoB) Shared Service Centers providing HR-related services in the Federal Government. HR Connect currently services 22 entities, 6 of which have been fully integrated in the last 5 years. BPD's Administrative Resource Center (ARC) is recognized across government as a leader in multiple service lines. Of particular note, ARC is approved by OMB as a Center of Excellence for Financial Management and a public key infrastructure shared service provider. Additionally, ARC is designated as a Human Resource Line of Business Shared Service Center, through its partnership with Treasury's HR Connect, and recognized by the General Services Administration (GSA) as an Information Systems Security Line of Business Shared Service Center for Security Assessment services.

Question. How does your agency implement acquisition strategies that involve each of the following: early collaboration with industry; Request for Proposals (RFP) with performance measures that tie to strategic performance objectives; and risk mitigation throughout the life of the contract?

Answer. The Department of the Treasury strongly encourages early collaboration with industry to facilitate best meeting customer requirements through effective planning and contracting. As appropriate for the complexity and dollar value of a specific procurement, Contracting Officers may utilize one or more tools to facilitate early communications with industry, to include (but not be limited to) meetings with vendors, issue of a Request for Information (RFI), and/or hosting of a pre-solicitation conference or Industry Day. Collaborative actions most suitable to a requirement should be identified early in the acquisition process and addressed in the acquisition plan.

In coordination with the internal customer (requiring activity), the Contracting Officer develops specific deliverables and metrics appropriate for the type, complexity, strategic objectives, and desired outcomes of each contract to ensure the best outcome for the Government.

By focusing pre-award and post-award, we can help mitigate risk. Prior to issue of a solicitation and subsequent contract, the Contracting Officer works with the internal customer to ensure use of the most appropriate contract type, inclusion of appropriate internal controls and risk-mitigating strategy in the performance work statement and/or solicitation, and development of a comprehensive and effective plan for Government monitoring of contractor performance. These decisions and actions should be addressed in the acquisition plan for the specific procurement. After award of a contract, risk mitigation is achieved primarily through performance monitoring conducted by the Contracting Officer Representative (COR); immediate Government action on any unsatisfactory performance issues; and, a thorough review by the Contracting Officer prior to the exercise of any option on a multiple year contract to ensure that the Government's requirement remains unchanged and the vendor is performing in accordance with the contract.

Question. According to the Office of Personnel Management, 46 percent of the more than 80,000 Federal IT workers are 50 years of age or older, and more than 10 percent are 60 or older. Just 4 percent of the Federal IT workforce is under 30 years of age. Does your agency have such demographic imbalances? How is it addressing them? Does this create specific challenges for attracting and maintaining a workforce with skills in cutting-edge technologies? What initiatives are underway to build your technology workforce's capabilities?

Answer. Treasury has similar demographic imbalances. In September 2013, 3 percent of Treasury's IT workforce was under the age of 30 versus 54 percent being over the age of 50 and 13 percent being over the age of 60. Over the last several years, Treasury has utilized buyouts as a method for addressing this imbalance in the workforce. Treasury uses the Pathways program, including internships, recent graduates, and the Presidential Management Fellows program as a method to build the technology workforce.

It is Treasury's human capital vision to be widely recognized as an employer of choice and to employ an engaged workforce that sets the standard for excellence in the Federal Government. Treasury will develop and manage innovative human capital business practices that help supervisors/managers and employees deliver results—focused outcomes that support the strategic goals and objectives of the Department by improving workforce productivity, diversity, leadership effectiveness, and individual development.

Question. What information does your agency collect on its IT and program management workforce? Please include, for example, details about current staffing versus future needs, development of the talent pipeline, special hiring authorities, and known knowledge gaps.

Answer. Treasury's Office of the Chief Human Capital Officer (CHCO) is piloting a workforce-planning model that uses a guided inquiry approach to assist managers in evaluating their current workforce and to make projections regarding future workforce requirements. The approach relies on identification of staffing levels and competencies needed in the future; analysis of the present workforce; comparison of the present workforce to future workforce needs in order to identify gaps and surpluses; development of strategies for building the workforce needed in the future; and an evaluation process to assure that the workforce plan remains valid and that objectives are being met to ensure the long-term sustainability of the organization.

Once the data is consolidated, it will be aggregated to create a strategic action plan that will be provided to the CIO and the CHCO for review and analysis of crosscutting issues. Such issues could result, for example, in the identification of opportunities to realign employees across bureaus or identify efficiencies that might be gained through restructuring, e.g., consolidating multiple bureau contracts into a single Department-wide contract.

Treasury utilizes the Federal Acquisition Certification for Program and Project Managers (FAC–P/PM) program for its acquisition and project management workforce. FAC–P/PM tracks program and project managers' certifications and skills through training, experience, and other developmental activities related to acquisition and project management. Tracking of FAC–P/PM training and certification is done in the Federal Acquisition Institute Training Application System (FAITAS).

QUESTIONS SUBMITTED TO HON. JOHN KOSKINEN

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

RESTORING IRS STREAMLINED CRITICAL PAY AUTHORITY

Question. As part of the 1998 restructuring of the IRS, Congress authorized some special personnel flexibilities to help the IRS recruit and retain highly skilled employees with specialized expertise.

"Streamlined critical pay authority" permits the IRS Commissioner to bring in up to 40 uniquely qualified experts for 4 year appointments to revitalize and enhance the IRS workforce.

Use of the authority is permitted only under certain conditions: (1) the positions must require expertise of an extremely high level in an administrative, technical, or professional field and critical to the IRS's successful accomplishment of an important mission; and (2) exercise of the authority must be necessary to recruit or retain an individual exceptionally well-qualified for the position.

The original authority had a 10 year sunset and was renewed in 2008 for 5 additional years, but has now lapsed as of September 30, 2013. The President's fiscal year 2015 budget seeks language to reinstate the authority.

How has the IRS used streamlined critical pay authority?

Answer. The IRS has found streamlined critical pay (SCP) authority to be an enormously useful tool in recruiting top-tier talent, especially in helping us to recruit information technology experts from the private sector. The IRS used SCP authority to attract executives for high-demand Information Technology (IT) programs, as well as other specialized functions requiring state-of-the art skills and specialized expertise. SCP authority allowed the IRS to streamline the hiring process and offer additional incentives to high-level executives and technical experts needed for key positions. It was included in the Internal Revenue Service Restructuring and Reform Act of 1998 as a means of assisting the IRS in attracting private-sector experts to bring their knowledge and skills to the IRS for a period of time.

Question. What types of positions has this authority enabled the IRS to fill?

Answer. Currently, over 82 percent of SCP positions are related to IT areas, such as: systems architecture development, migration of new integrated processing systems, design and delivery of innovative Web capabilities and mobile applications, cybersecurity, risk management, infrastructure support, and Enterprise Portfolio Management.

The IRS also used SCP authority to recruit for key positions outside the IT field which include: Director of the Office of Professional Responsibility/Standards of Tax Practice, Senior Advisor to the IRS Commissioner (Compliance Analytics Initiatives), Director of Compliance Analytics, Strategy and Implementation Program, and the Senior Technical Advisor to the Deputy Commissioner for Services and Enforcement.

Question. What have been the benefits to the IRS and the public it serves?

Answer. SCP authority enabled the IRS to meet the challenge of recruiting executives with certain high-demand skills. It has clearly helped to improve, modernize and secure the information technology capabilities of the IRS. Executives the IRS brought in under the SCP authority have significantly updated the core tax processing system, developed and implemented Modernized e-file systems, and implemented the Treasury Network (TNET). One of the best examples of the benefits achieved through use of SCP talent was the implementation of the Customer Account Data Engine, Transition State 1 (CADE TS1). CADE2 TS1 changed a 50-year-old weekly batch cycle processing design into a daily processing system and moved the data of over 140 million taxpayers to an updated computer system. This achievement transformed the way the IRS serves our Nation's taxpayers by providing faster access to data and the ability to issue tax refunds more quickly.

SCP Executives bring a talent that is highly complementary to the talent already on board within the IRS. This melding of career Federal Executives and expertise from the private sector has been instrumental in moving the IT organization to be world-class in the people process and technology areas. Another example of the success of this approach was demonstrated in January 2013 when the Government Accountability Office (GAO) removed the IRS Modernization from their Federal High-Risk Programs list. GAO acknowledged that the IRS took necessary steps to fix weaknesses by creating cross-functional working groups to fix at-risk control areas, improved the encryption of information transferred between accounting systems and upgraded the Cybersecurity of internal systems. Additionally, the IRS addressed its outdated operating system and application software, improved its auditing and monitoring capabilities of its general support system and tested its general ledger system for tax transactions in its current operating environment. These accomplishments were a direct result of the collaboration and leadership provided by a combination of Senior Executive Service (SES) and SCP Executives. Without this authority, the IRS's ability to successfully deliver critical functions is at risk.

Question. What are your concerns if this now-expired authority is not renewed?

Answer. Absent the SCP authority, the IRS's ability to attract and recruit individuals, especially in the IT field, who have current, relevant private-sector experience in successfully developing and delivering cutting edge projects and programs has been hampered significantly.

The IRS utilized the SCP authority to not only meet its short and long range goals, but also to keep pace with the technological advances needed to provide world class services to America's taxpayers. Without SCP authority, the IRS's ability to perform certain vital functions will be hampered, including:

—Ensuring the IRS has top talent required by components of the IRS mission that need cutting edge talent in technology;
—Providing executive leadership for all highly complex, mission critical information systems that underpin our Nation's tax administration system;
—Administering internal IRS systems, as well as driving changes for the interface of the IRS information systems with those of multiple external partners;
—Applying state-of-the-art tools and industry best practices to implement robust programs to meet increased challenges of cybersecurity as the agency continues to make progress toward the goal of increasing use of the Internet as a primary means of taxpayer contact; and
—Performing compliance analytics and implementing related strategy solutions, as well as administering and enforcing the regulations established for the legal and tax professional community.

TELEPHONE LEVEL OF SERVICE—ENHANCED ONLINE SERVICES

Question. Providing access to quality customer service helps taxpayers understand their obligations so they can pay the right amount on time. Staffing shortages due to budget cuts in recent years coupled with increased call volumes have adversely impacted IRS's capacity to respond to taxpayers' phone calls. The level of service has been severely declining. In 2004, the IRS answered 87 percent of calls seeking to reach a phone assister, with an average wait time of 2½ minutes. In 2013, IRS answered just 61 percent of its calls, and those who got through spent an average of nearly 17 minutes waiting on hold.

What does the IRS consider to be an "acceptable" level of service for taxpayers calling for assistance on the toll-free phones?

How will the funding increase of $137.3 million dollars in the IRS's fiscal year 2015 request help attain an acceptable level of service?

What factors could impede the IRS from attaining its level of service goal of 71 percent for 2015?

What setbacks might the IRS experience if resources in 2015 fall short of the request? What are the practical consequences of those setbacks for taxpayers?

Answer. The IRS strives to provide high-quality service to as many taxpayers as possible, given limited resources. The agency develops telephone plans after consideration of many factors, including: historical demand adjusted for known anomalies; the types and anticipated lengths of calls we expect to receive; assumptions concerning upcoming events, such as known or pending legislation or trends in customer behavior; and the availability of existing or new automation and other alternative services. These plans are then matched with available or anticipated resources to determine the level of service (LOS) the IRS can provide. For instance, this year the lower than anticipated filing season demand was likely due to relatively few tax law changes and more people using IRS.gov to get answers to many basic tax law questions. As a result, the IRS expects to exceed its projected fiscal year 2014 LOS of 61 percent.

The fiscal year 2015 budget request of $12.6 billion, including $165 million in additional investments through the Opportunity, Growth and Security Initiative, would allow the IRS to increase the projected LOS in fiscal year 2015 from 53 percent to 80 percent. The IRS expects to receive additional assistor telephone contacts related to the Affordable Care Act (ACA) in fiscal year 2015. Other factors, such as known or pending legislative changes, could also adversely affect the IRS's ability to deliver the planned LOS.

Without the funding requested in the President's budget, we estimate the increase in demand will result in a 53 percent LOS. This means approximately five out of every 10 taxpayers who call the IRS for service would not get through to an assistor. Those who do get through will then be subjected to long wait times. Because of this extraordinarily low projected LOS, the IRS expects that a higher than normal number of taxpayers will call back when they are unable to reach an assistor. These additional callbacks or re-tries will further compound the strain on the IRS telephone systems and may drive the LOS even lower than the projected levels. Also, taxpayers abandoning the telephone lines will likely turn to walk-in services or send correspondence, straining other IRS service channels.

Each year, taxpayers call the IRS for assistance expecting a prompt and accurate response to their questions. The IRS continually explores improvement opportunities to provide customers with easy access to accurate, user-friendly account services. Our objective is to proactively manage customer demand by improving contact center efficiency, referring customer demand to the most efficient service resource, and equipping the workforce with the tools to be productive. To continue to efficiently serve the maximum number of taxpayers possible, the IRS implemented the 2014 Service Approach to align taxpayer demand with the most cost-effective resource to provide the needed service. The 2014 Service Approach accomplished this by referring taxpayers to self-service resources, such as Where's My Refund and Get Transcripts via www.irs.gov while preserving telephone and in-person service for taxpayers that needed to speak to an assistor.

In a recent report, the GAO identified some opportunities for the IRS to potentially realize hundreds of millions of dollars in cost savings and increased revenues. One such idea is by enhancing online and interactive Web services to improve service to taxpayers and encourage greater tax law compliance.

Question. Commissioner Koskinen, is it your view that advancements to IRS online services would improve service to taxpayers and encourage greater tax law compliance?

Answer. Yes, the easier it is for taxpayers to get the information they need, the more likely it is that taxpayers will be compliant and online services make it easier for taxpayers to get the information they need. Over the past few years, there has been a significant expansion in the use of IRS online services, such as Where's My Refund, to provide account information to taxpayers. For example, the Where's My Refund service had 136 million page views and 112 million site views via our IRS.gov Web site from January 11–April 17, 2014 and enabled millions of taxpayers to avoid the long wait times when calling the IRS. The IRS also offers several online options for tax law assistance on IRS.gov, such as the Interactive Tax Assistant, IRS tax publications, the IRS Tax Map, Tax Topics, and Frequently Asked Questions. Taxpayers can also download the IRS2Go application on an iPhone or Android device to interact with the IRS using their mobile device. The widespread usage of these various online options demonstrates that taxpayers have an appetite for expanded online capabilities.

Question. What initiatives is the IRS currently undertaking or contemplating to make progress in enhancing online services?

Answer. The IRS has recently launched several new applications, such as Direct Pay and Get Transcript, and we are working toward the creation of an interactive online account. This online account will serve as a platform for taxpayers to securely interact with the IRS to obtain historical tax return data, submit payments, and receive status updates. In addition to these new online tools, the IRS is working closely with external tax service providers (tax professionals, online service providers, transmitters, and third parties) to improve online service delivery to taxpayers.

Question. What impediments prevent the IRS from doing more to improve online services for taxpayers?

Answer. While the IRS has made great strides in improving online services, there are several impediments that slow the speed of development and deployment of new and improved services:

—Budgetary/resource constraints;
—Integrating online tools with legacy systems;
—Policy/regulatory restrictions;
—The need to protect privacy and prevent identity theft and fraud; and
—Competing mandates, such as the filing season and the implementation of new legislation.

Question. What resources would be required for the IRS to do more in this area?

Answer. The President's fiscal year 2015 budget requested $23 million within the Business Systems Modernization appropriation ($16.8 million capital and $6.2 million labor) for the continued development of Online Services applications, which would improve service to taxpayers and encourage greater tax law compliance. Due to budget cuts in recent years, the IRS has had to do significant re-planning, across the board, to address the stark realities around our capability to deliver our strategic priorities, along with the significant legislative requirements to which we were committed.

In addition, development of new online applications creates additional demand on our current IT infrastructure, which is already at risk due to inadequate funding needed to maintain, replace and upgrade the infrastructure. This additional demand threatens deployment of new capability and capacity upgrades needed to support the IRS's current business needs.

VOLUNTEER INCOME TAX ASSISTANCE (VITA) SERVICES FOR SMALL BUSINESS

Question. Almost all businesses (over 90 percent) start out as a sole proprietorship or as self-employed businesses. Unless incorporated or part of a partnership, self-employed business income is subject to taxation through calculations performed on "Schedule C" (or C–EZ). Each year, some 20 million self-employed businesses file a Schedule C or C–EZ. Schedule C is basically a one-page profit and loss statement that every business needs to understand.

In August 2010, the IRS, in partnership with the National Community Tax Coalition and Self-Employed Tax Initiative, launched the Schedule C VITA Pilot for the 2011 tax season. This pilot, conducted at 12 sites, was designed to determine the feasibility of restructuring IRS policies governing low-income self-employment tax preparation at VITA sites.

What were the findings of the Schedule C VITA pilots?

Answer. In 2010, the IRS collaborated with the National Community Tax Coalition and Corporation for Enterprise Development to develop a Schedule C Pilot. The purpose of the pilot was to test the effectiveness of possibly expanding the parameters of Schedule C tax return preparation by Volunteer Income Tax Assistance (VITA)/Tax Counseling for the Elderly (TCE) programs.

Currently, all VITA/TCE sites can provide basic income tax return preparation services to low to moderate income taxpayers who generally make $52,000 or less. These services include preparing Schedule C returns meeting the Schedule C–EZ $5,000 expense limitation (later increased to $10,000 for tax year 2013 returns). However, VITA/TCE sites cannot prepare a Schedule C–EZ or Schedule C return if:

—operating results of the business was a loss for the tax year;
—section 179 expense is claimed;
—the business has inventory;
—the business has employees;
—the business operations on the accrual method of accounting; or
—the taxpayer claims depreciation or vehicle expenses other than the standard mileage rate.

The Schedule C pilot was limited to participating VITA sites. TCE sites did not participate in the pilot. The pilot allowed participating VITA sites to prepare returns with the following characteristics, as long as total business expenses did not exceed $25,000:

—business losses confined to the current tax year;
—business use of home by day care providers; and
—section 179 expenses.

The following table provides the results from the pilot for Tax Years 2010–2012.

SCHEDULE C PILOT TAX YEARS 2010–2012

	Tax Year 2012	Tax Year 2011	Tax Year 2010
Total Schedule C Returns prepared by all VITA/TCE sites (including pilot returns)	196,349	195,020	184,853
Number of participating Schedule C pilot partners	16	16	12
Number of participating Schedule C pilot sites	32	32	24
Number of Schedule C pilot returns	4,656	4,033	4,160
Accuracy of Schedule C pilot returns [1]	Not available	90%	94.7%

[1] IRS employees conducted return reviews of 20 Schedule C pilot returns reviewing the accuracy of the returns' expenses and income. These reviews determined the accuracy of results.

Question. What steps or initiatives can be taken to reach more of America's underserved business start-ups, many of whom have no place to turn for affordable and competent business tax preparation assistance?

Answer. The IRS offers a wide range of products, tools and initiatives designed to assist business start-ups in understanding and meeting their Federal tax responsibilities. On IRS.gov, small businesses have access to valuable information and resources 24 hours a day, 7 days a week. For example, Small Business Taxes: The Virtual Workshop explains how to meet Federal tax obligations in nine easy-to-understand lessons. The IRS.gov Small Business Tax Center provides free educational products and services via numerous online resources including videos, Webinars, and multiple social media outlets. Small businesses can also subscribe to E-News for Small Businesses, an electronic newsletter with helpful information, including reminders and tips to assist small businesses with tax compliance. For example, for Small Business Week, May 12–16, 2014, the IRS provided the following:

—Two informational Webinars for small business owners (which are archived on IRS.gov and available through the IRS Video Portal):
  —Payments to Independent Contractors.
  —Avoiding the Biggest Tax Mistakes.
—Video that provides tour of the online Small Business Tax Center.

The IRS provides E-News to almost 306,000 subscribers. E-News is also used to increase awareness of the tools and products available to small businesses. The IRS also provides on IRS.gov the Online Small Business Tax Calendar, with links to due dates and events to help small business owners meet tax deadlines.

The IRS continues to develop and implement compliance assistance programs to assist business start-ups and improve their knowledge of the tax code. For example, when users apply for a new employer identification number (EIN) via IRS.gov, we provide a link to a one-stop resource, the Small Business Tax Center which is the small business/self-employed landing page on IRS.gov. We provide small business tax workshop training materials in English, Spanish and new for 2014, Chinese for our partners, such as SCORE (a nonprofit dedicated to helping small businesses succeed), Small Business Development Centers (SBDC), Latino Tax Professional Association, and many others (to use in presenting these workshops). We also identify small business issues for review by Federal advisory groups and implement approved recommendations. In 2013, Federal advisory groups (Internal Revenue Service Advisory Group, Information Reporting Program Advisory Committee, Taxpayer Advocacy Panel, and Electronic Tax Administration Advisory Committee) worked the following issues: Online Payment Agreements, Business Identity Theft, Decreasing Non-Filers, and Bankruptcy Compliance. Implemented recommendations include improvements to the Voluntary Classification Settlement Program (VCSP). The VCSP assisted thousands of small business owners in correctly making employee determinations. The above Federal advisory groups assisted with the IRS's implementation of the Fresh Start Initiative, which, for the first time, allows businesses to apply for streamlined installment agreements.

The IRS routinely partners with agencies that interact with start-up businesses (e.g., State and local government agencies, local SCORE and SBDC) to place the IRS tax center links on their Web sites.

The IRS has also developed outreach initiatives for new entrepreneurial businesses, including young entrepreneurs under the age of 30 who are starting new businesses in increasing numbers. These initiatives include establishing partnerships with entrepreneurial organizations that will include IRS information in their curriculum and publications, and will leverage our partnerships with schools/educational ventures that promote an entrepreneurial skill set to include how to develop a business plan, recordkeeping and other necessary skills to establish a successful and compliant business. During this fiscal year so far, we developed customized materials, such as Small Business Taxes—the Virtual Workshop, and coordinated small business key message delivery for over 162 small business forums reaching over 3,100 participants, including many new business owners. Through our leveraged partnerships with industry leaders, we have distributed materials to over 100 national, State, and local organizations via email distribution lists. Future plans include identifying and partnering with additional industry and business organizations and delivering more customized outreach materials.

Question. Does the IRS plan to extend and expand the original pilot project more broadly to other VITA sites to reach more small businesses?

Answer. The IRS is conducting an assessment of the Tax Year 2013 Self-Employment Tax Initiative (SETI). The assessment includes evaluation of date and demographic/filing profiles of all VITA/TCE Schedule C filers, the accuracy of the Schedule C returns prepared under the program, and the quality of the training and certification test for VITA/TCE preparers participating in the program. We anticipate completing the assessment in August 2014.

HELPING OUR MIDDLECLASS ENTREPRENEURS (HOME) ACT

Question. Last year I introduced a bipartisan bill to help business owners who operate primarily out of their homes deal with the often-complicated process of filing income taxes. Under the current system, home-office business owners often struggle to calculate expenses, depreciation, and carryovers on their homes.

The IRS has recently made claiming the home office deduction easier but that was not a permanent fix. I believe our Nation's entrepreneurs deserve the certainty of knowing that they can continue claiming the home office deduction without complicated bureaucratic red-tape. My proposal would allow business owners to take an optional standard deduction of $1,500 dollars.

How have the recent changes affected the number of filers claiming the home office deduction?

Answer. The Tax Year 2013 filing season, the first year that the Office in the Home (OIH) optional safe harbor method (as allowed by Revenue Procedure 2013-13, 2013-6 I.R.B. 478) was available, has not yet concluded (generally October 15 is the last day individuals can file with an extension). Given taxpayers taking an OIH deduction may have a more complex return, it is likely many OIH filers may still be on extension. Therefore, we do not have the complete information upon which to perform an analysis.

Question. Is the IRS planning to make further improvements to claiming the home office deduction?

Answer. As stated in response to question above, we do not have complete information upon which to make a determination on what improvements, if any, need to be made at this time. However, the regulations under Internal Revenue Code section 280A (relating to expenses in connection with business use of a home or rental of vacation homes) regarding deductions for expenses attributable to the business use of homes and rental of vacation homes is an item on the Treasury/IRS's Priority Guidance Plan. This guidance will be in addition to, but will not replace, the guidance provided under Revenue Procedure 2013-13.

GENERAL WELFARE EXEMPTION

Question. I recently met with tribal leaders from across Indian Country to discuss economic development challenges and successes. During these discussions, tribal leaders raised concerns with the IRS audits of services to tribal members. In particular, several leaders expressed their frustration in working with the IRS as it develops clear and appropriate guidelines for tribal application of the General Welfare Exemption.

For several years now, the IRS has been engaged in a consultation process with tribal leaders. Where in this consultation and guidance process is the IRS?

Answer. In response to concerns raised by Indian tribal members in consultation with Treasury and the IRS, Notice 2012-75 and Revenue Procedure 2014-35 were issued to provide guidance and safe harbors for the general welfare exclusion to income. The Department of Treasury and the IRS issued the Notice in 2012 as interim guidance on which tribes could rely. The Notice addressed comments and concerns expressed by tribal leaders and others during previous consultation sessions and set forth a list of programs that would qualify under the general welfare exclusion to income. It also asked for comments prior to the guidance being issued in its final form. In all, over 120 comments were received and consultations were held, which were taken into account in preparing final guidance, Revenue Procedure 2014-35, which was issued on June 3, 2014. Based on the submitted comments, we think the recently issued final guidance addresses the key questions raised by Indian tribes and organizations. Treasury and the IRS will continue communicating with Indian tribal representatives and organizations to ensure clarity in this and other areas of tax policy.

Question. What does it expect the timeline going forward to be?

Answer. The final guidance, Revenue Procedure 2014-35, was released June 3, 2014 and will be printed in the June 23, 2014 edition of the Internal Revenue Bulletin.

Question. Additionally, does the IRS have a summary of the outreach efforts, including a list of the tribal entities consulted, that it has undertaken as part of this process that it can share with the committee?

Answer. The IRS, through its Indian Tribal Governments Office, in conjunction with the Treasury point-of-contact for tribal matters, has made itself available, formally and informally, throughout the process. Representatives of the IRS and the Treasury Department consulted with tribal leaders and members of Indian tribes concerning application of the general welfare exclusion to programs of Indian tribal governments. In Notice 2011-94, 2011-49 I.R.B. 834, the IRS invited comments concerning the application of the general welfare exclusion to Indian tribal government programs that provide benefits to tribal members.

The IRS received over 85 comments from Indian tribal governments and other individuals and groups describing various Indian tribal government programs for tribal members and how the general welfare exclusion should apply to those programs. In response to those comments, the IRS issued Notice 2012-75, 2012-51 I.R.B. 715, which proposed a revenue procedure that would provide safe harbors under which the IRS would conclusively presume that (i) the individual need requirement of the general welfare exclusion would be met for specific benefits provided under described Indian tribal governmental programs, and (ii) certain benefits an Indian tribal government provides under other described programs are not compensation for services. In response to Notice 2012-75, the IRS received over 40 comments from Indian tribal governments and other individuals and groups. The more than 120 comments and consultations were very helpful in preparing Revenue Procedure 2014-35.

Throughout the process, the IRS and Treasury engaged in face-to-face consultations that were open to the public. We also conducted call-in consultations in order to be available to individuals, tribes and organizations that were unable to travel. In addition to those formal consultation efforts, we met on an informal basis with Indian tribal leaders and organizations at various gatherings such as those conducted by the National Congress of American Indians (NCAI), the Native American Finance Officers Association (NAFOA), and the United South and Eastern Tribes (USET). Since December 2012, we have consulted with over 700 individuals, Indian tribes, and Indian tribal organizations.

ASSISTING VICTIMS OF TAX-RELATED IDENTITY THEFT AND REFUND FRAUD

Question. The National Taxpayer Advocate has recommended that the Internal Revenue Service establish a meaningful single point of contact for taxpayers who become victims of identity theft. According to the Taxpayer Advocate, 21 separate units handle different aspects of identity theft and no employee has the authority to coordinate the entirety of the taxpayer/victim's case if, as is common, more than one of the 21 units is involved.

What is the current process and timetable that a victim of tax-related identity theft or refund fraud experiences in resolving their case with the IRS and securing the refund to which they are entitled?

Does the IRS agree with the Taxpayer Advocate's recommendation that the IRS should designate a single point of contact with an IRS staff representative to a victim of tax-related identity theft and/or refund fraud?

What are the IRS's plans for adopting the single-point-of-contact recommendation?

What are the impediments for instituting a process whereby a victim of identity theft and refund fraud is assigned a single point of contact within the IRS to guide the casework through the process to resolution?

Answer. Refund fraud caused by identity theft is one of the biggest challenges facing the IRS today, and the harm it inflicts on innocent taxpayers is a problem we take very seriously. The IRS has a comprehensive and aggressive identity theft strategy focusing on preventing refund fraud, investigating these crimes, and assisting taxpayers victimized by identity theft. The IRS's Identity Protection Specialized Unit (IPSU) is critical to our efforts to assist identity theft victims. The IPSU provides taxpayers with a consolidated office to contact at the IRS via a distinct toll-free telephone line that specializes in identity theft victim assistance. Budgetary constraints do not allow for a single individual to be assigned to each victim of identity theft. In addition, specialized teams throughout the enterprise acknowledge identity theft claims and provide contact information. The point of contact may be an individual or group of individuals trained and able to provide the information on the victim's case.

The IRS continues to explore opportunities to improve the services available to victims of identity theft and the time it takes to resolve their cases. In calendar year 2013, the IRS worked with victims to resolve and close approximately 963,000 cases, and the time for resolving these cases is decreasing. During the past fiscal year, taxpayers who became identity theft victims had their situation resolved in roughly 120 days, far more quickly than in previous years, when cases could take over 300 days to resolve.

The IRS recently proposed further centralization of identity theft victim casework in the Wages and Investment (W&I) Division in May 2014. If adopted, the proposal would position W&I as wholly responsible for all identify theft victim assistance work. By further centralizing this function, we anticipated that service to victims of identity theft will continue to improve. While budgetary and resource constraints do not allow a single individual point of contact from receipt of the claim through determination and/or account resolution, the centralized W&I process will serve victims more timely and completely by ensuring consistency of the processes.

PROCESSING OF APPLICATIONS FOR TAX EXEMPT STATUS UNDER I.R.C. SECTION 501(C)(4)

Question. In May 2013, the Treasury Inspector General for Tax Administration published audit findings delineating the use of inappropriate case screening criteria in IRS's processing of applications for tax-exempt status under section 501(c)(4) of the Tax Code. I have long supported the need to make meaningful changes to ensure that the rules to qualify for tax-exempt status are abundantly clear. It is 100 percent unacceptable for the IRS to ever unevenly enforce rules based on ideology, politics, or other bases.

In June 2013, the IRS initiated a new process whereby certain taxpayers whose applications for section 501(c)(4) tax-exempt status as a social welfare organization have the option of obtaining an approval if they self-certify that they will meet certain guidelines. An organization is permitted to self-certify if they represent that the organization devotes 60 percent or more of both spending and time to activities that promote social welfare as defined by section 501(c)(4), that the organization devotes less than 40 percent of both spending and time to political campaign intervention, and that the organization ensures the above thresholds apply for past, current and future activities.

Initially, optional expedited processing was offered to 501(c)(4) applicants whose applications had been pending for more than 120 days as of May 28, 2013. This applied to organizations whose showed potential involvement in political campaign involvement or issue advocacy, and did not present any private inurement issues. In guidance issued in December 2013, the IRS extended the optional expedited processing to all 501(c)(4) applicants whose applications indicate that the organization may be involved in political campaign intervention or in providing private benefit to a political party and that otherwise do not present any issue with regard to exempt status.

What benefits are available to an organization by securing tax-exempt status approval from the IRS through either the traditional application process or the self-certification process?

Answer. Organizations that have received a determination letter from the Internal Revenue Service stating that they are described in section 501(c)(4) of the Code, as well as those that hold themselves out as described in section 501(c)(4), can claim exemption from Federal income tax (other than tax on unrelated business income).

An organization that has received a determination letter is entitled to rely upon that determination, provided there is no relevant change in the applicable law and the organization did not omit or misstate material information or operate in a manner materially different from that originally represented in its exemption application (and, in the case of participants in the optional expedite process, from the signed representations). If the organization is later examined by the IRS, this reliance limits the retroactive application of a revocation.

Organizations that have not received a determination letter do not have the protection against retroactive revocation of their exempt status that such a letter can afford.

Question. May an organization operate as 501(c)(4), including publicly describing itself as a 501(c)(4) organization, without having to apply for or receive formal approval from the IRS?

Answer. Yes. An organization that meets the requirements of exemption under section 501(c)(4) may operate as such without applying for recognition of that status by the Internal Revenue Service. Such an organization must comply with the requirements of tax-exempt status each taxable year in order to be tax-exempt during that year. In addition, if a section 501(c)(4) organization does not file the annual return or notice it is required to file (Form 990, Form 990-EZ or the Form 990-N e-Postcard) for three consecutive years, its tax-exempt status is automatically revoked as of the due date for the third annual return or notice.

Question. In each of the past 3 tax years, of the total number of organizations filing an annual Form 990 and claiming section 501(c)(4) status, what proportion have been formally granted such status through a favorable determination letter or other written approval issued by the IRS?

Answer. In fiscal year 2010, 72,693 organizations claiming 501(c)(4) status filed annual Forms 990, of which 7,065, or 10 percent were from organizations whose status as 501(c)(4) organizations formally had been approved by the IRS. In fiscal year 2011, 69,255 organizations claiming 501(c)(4) status filed annual Forms 990, of which 7,815, or 11 percent were from organizations whose status as 501(c)(4) organizations formally had been approved by the IRS. In fiscal year 2012, 71,643 organizations claiming 501(c)(4) status filed annual Forms 990, of which 9,185, or 13 percent were from organizations whose status as 501(c)(4) organizations formally had been approved by the IRS.

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. A proposal requiring the Secretary of Treasury to enter into contracts with private collection agencies (PCAs) to collect Federal taxes is included in sec. 6304 of the draft "Tax Reform Act of 2014" introduced by Chairman Camp, as well as in sec. 305 of S. 2260, the "Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act" now pending in the Senate.

What was the result of a similar initiative that was in effect from 2006 to 2009?

Answer. The Government lost money as a result of the PCA initiative in effect from September 2006 to February 2009. During the previous initiative, the IRS assigned balance due accounts with the lowest priority to PCAs for collection. Assigning these cases to PCAs resulted in collections of $98.2 million in revenue, $63.4 million of which was remitted to the Treasury, with the PCAs receiving $16.5 million and the IRS retaining $18.3 million. However, the IRS incurred direct costs of $30.7 million to administer the program. We therefore absorbed the difference of $12.4 million out of appropriated funds. The $30.7 million also does not include start-up costs of approximately $55.4 million for business and information technology development. Thus, the IRS spent $67.8 million of appropriated funds on this initiative, which exceeded the $63.4 million that was remitted to the Treasury, resulting in a $4.4 million loss to the Government.

In addition, during the previous initiative, taxpayers were not entitled to the same protections when PCAs attempted to collect tax debts as they are when the IRS is collecting the debt. For example, the IRS is required to make our processes and procedures public, which we do by issuing the Internal Revenue Manual (IRM). PCAs are not required to make their processes public, nor are they required to follow the IRM. During the 2006 to 2009 initiative, some PCAs were accused of using aggressive collection practices, such as exerting psychological pressure, on taxpayers. These practices are prohibited by the IRM and IRS employees can be fired for using them.

Question. Is it true that the IRS currently has the authority to use PCAs, but has chosen not to use that authority? Why?

Answer. Yes, section 6306 of the Internal Revenue Code, which was added to the Code in 2004, permits, but does not require, the Secretary to enter into a "qualified tax collection contract." The 2006 to 2009 initiative was undertaken pursuant to this authority. The IRS has not undertaken to exercise this authority since 2009 because of revenue outcomes, taxpayer service and cost effectiveness.

The 2006–2009 initiative lost revenue, taking all activities into account. Additionally, the PCAs do not provide the same protections to taxpayers from aggressive collection practices and anecdotal evidence suggested some taxpayers were being subjected to aggressive collection practices by at least some PCAs. Further, the results of an internal cost-effectiveness study of the 2006–2009 Private Debt Collection program, which was published in March 2009, showed that when working similar inventory, collection efforts are more cost-effective using IRS employees rather than outside contractors. IRS employees also have a much wider range of options available to them to resolve difficult collection cases. This internal study was supported by an independent review.

Question. What are your agencies' positions on the proposal to require Treasury to use PCAs to collect Federal taxes?

Answer. The IRS has administrative and policy concerns with the proposal and does not support it. Requiring the IRS to use PCAs would impose significant startup costs on the IRS to evaluate PCAs and enter into qualified tax collection contracts, and additional costs to monitor the PCAs' collection activities. Because the proposal does not provide additional funding for the IRS, these costs would decrease the funds available to the IRS for other priorities, including its ongoing enforcement activities. Moreover, previous experience with PCAs has taught us that the IRS has a much higher return on investment than PCAs, making this proposal a less effective use of taxpayer dollars. The proposal also does not provide the IRS with sufficient discretion on the types of cases that should be referred to PCAs. For example, the proposal does not exclude cases where collection could result in economic hardship to the taxpayer.

Additionally, the proposal does not protect taxpayers from certain aggressive collection practices employed by at least some PCAs, but prohibited by IRS processes and procedures. Further, a comprehensive review shows that IRS collection practices are more cost effective than PCAs. Thus, more revenue would be generated and taxpayers would receive better service if Congress would provide additional funding for IRS collection activities, not by diminishing our already limited resources to implement another PCA initiative.

Question. What impact could this requirement to use PCAs to collect Federal taxes have on taxpayers, specifically low-income taxpayers?

Answer. The IRS did not study the impact PCA use had on taxpayers generally or low-income taxpayers specifically in connection with the PCA legislation in the American Jobs Creation Act; however, when we decided not to continue with the PCA initiative in 2009, we were aware of taxpayer complaints that at least some PCAs had used overly aggressive collection practices (for example, intimidation, harassment, or violation of taxpayers' rights, the Fair Debt Collection Practices Act, or the Privacy Act). Additionally, our most recent analysis of the potential impact of assigning all inactive cases to PCAs, based on data we extracted on April 28, 2014, estimates that 79 percent of individuals in 2013 and 77 percent of individuals in 2014 who had inactive delinquent accounts had an adjusted gross income less than 250 percent of poverty level.

We also are concerned that the use of PCAs could result (1) in economic hardship for taxpayers who have an outstanding tax liability that they cannot currently afford to pay in full, and (2) in a reduction in future voluntary compliance by taxpayers who are subjected to overly aggressive collection activities by PCAs. And, unlike the IRS, PCAs have no incentive to engage in taxpayer outreach and education, which is particularly beneficial to low-income taxpayers and other underserved populations and which may help promote future tax compliance.

QUESTIONS SUBMITTED BY SENATOR MIKE JOHANNS

Question. To what extent and how could the IRS use social security numbers as an enforcement tool to reduce improper payments to filers receiving payments because of a claim made pursuant to a refundable tax credit?

Answer. There are numerous refundable credits currently administered by the IRS, including the Earned Income Tax Credit (EITC), the Additional Child Tax Credit (ACTC) and the American Opportunity Tax Credit (AOTC). The IRS has a dual mission when it is administering refundable credits. We must balance ensuring that those who qualify claim and receive the credit with ensuring that the money goes only to those eligible to receive it.

When the law requires a valid Social Security Number (SSN) for a refundable credit, the IRS uses its current math error authority to prevent improper payments during return processing. However, a valid SSN is not a requirement for all refundable credits. Current law does not require the taxpayer or a qualifying child to have an SSN to be eligible to receive the Child Tax Credit (CTC), ACTC or AOTC. For those credits, the taxpayer and each qualifying child are only required to have a taxpayer identification number (TIN). For this purpose, a TIN can be an individual taxpayer identification number (ITIN).

An individual is eligible to obtain an ITIN only if the individual is ineligible to obtain an SSN and requires a number for Federal tax purposes. This means that current law does not prohibit a resident alien, who does not have an SSN, from being eligible to claim the CTC/ACTC or AOTC.

In addition to the SSN issue, the rules for children for EITC and CTC/ACTC are also not consistent. There is no uniform definition of a qualifying child that would make it easier for taxpayers to understand and claim the credits (if they are eligible) and avoid errors, and for the IRS to administer the credits. The age, residency, and support requirements for children, as well as rules for divorced or separated parents, under these provisions vary.

Another challenge faced by the IRS is the inability to correct clear errors related to refundable credits. Providing the IRS with correctable error authority, a proposal included in the General Explanations of the Administration's fiscal year 2015 Revenue Proposals (the "Greenbook"), would allow us to correct clear errors without lengthy and expensive audits if:

—the information provided by the taxpayer does not match the information contained in a Government database;
—the taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or
—the taxpayer has failed to include with his/her return documentation required by statute.

Through existing math error authority, the IRS protects almost $300 million in EITC refund claims annually; however, we believe that correctable error authority would greatly improve our efforts in this area.

Question. At the hearing on April 30, 2014, you mentioned that applicants for 501(c)(4) status that certify that no more than 40 percent of their resources would be devoted to political activity would be granted the status sought.

In response to a question from Senator Udall, you noted that

> ". . . if you will simply state and affirm that you are not going to spend more than 40 percent of your resources and revenues on 8 political activities, you could, in fact, pass through."

Are you concerned that applicants that may not so certify will be subject to additional scrutiny despite being well within their legal rights to claim the status?

Answer. We have taken steps to ensure that we provide uniform and fair treatment to organizations that choose not to use the optional expedited process. We have done this by issuing written procedures that now guide the processing of all such applications. In brief, our procedures provide that any issues presented by these applications will be analyzed as quickly as possible under current law. The specific procedures are set forth in Interim Guidance Memo TEGE–07–0613–08 (June 25, 2013), as amended by Interim Guidance Memo TEGE–07–0713–12 (July 18, 2013), and in Interim Guidance Memo TEGE–07–1213–24 (December 23, 2013), all of which are available in the electronic reading room at IRS.gov.

Further, on May 19, 2014, we issued Interim Guidance Memo TEGE–07–0514–0012 (also available in the electronic reading room at IRS.gov). This memo provides that an organization—including organizations eligible for the optional expedited process—that receives a proposed adverse determination letter will have the right to request the Office of Appeals to review its application for recognition of tax-exempt status.

Additionally, we have closed 130 cases in the original backlog (nearly 90 percent of the total), as of April 18, 2014. Ninety-nine of these cases received favorable determination letters, including 56 applicants that chose not to participate in the optional expedited process.

Question. What rationale, if any, did the IRS use in its selection of the 40 percent threshold?

Answer. The IRS selected the 40 percent threshold to balance reasonable standards for a safe harbor with appropriate use of resources for tax administration.

Question. Please provide an update regarding the IRS' multi-year agreement with the free-file alliance, including the IRS' intent to conclude a new agreement or otherwise continue the program.

Answer. In February 2014, IRS leadership met with the leaders of Free File, Incorporated (FFI), formerly known as the Free File Alliance, to discuss a 1-year extension of the expiring Memorandum of Understanding (MOU) to allow time for negotiations on a new multi-year Agreement/MOU. The extension was signed on May 2, 2014 and is valid from October 30, 2014, to October 30, 2015.

The 1-year extension agreement includes specific language that a full renegotiation of the 5 year Agreement/MOU will begin in June 2014 with a goal to conclude those negotiations by December 2014 and enter into a new multi-year Agreement/ MOU before the expiration of the 1-year extension on October 30, 2015. FFI has played a key role in the IRS's strategy for growing e-file. The 1-year extension provides the IRS and FFI time to shape a longer term agreement to include innovations to the 12-year-old Free File program.

Question. In your testimony, you mentioned the need to ". . . move the receipt for W–2s to the IRS from mid-March to the end of January." Have you made this request in pursuit of the capacity within the IRS to prepare returns or portions of returns for filers?

Answer. No, the IRS is not pursuing and has no plans to implement a system to create pre-filled forms or software/products for simple tax return preparation.

During my testimony, I referenced the administration's fiscal year 2015 Revenue Proposal "Rationalize Tax Return Filing Due Dates So They Are Staggered." This proposal would require information returns to be filed with the IRS (or Social Security Administration, in the case of Form W–2) by January 31. Accelerating the IRS's receipt of third-party information will facilitate detection of non-compliance earlier in the filing season and allow the IRS to address identity theft and refund fraud more effectively before refunds are paid.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

Question. Describe the role of your agency's Chief Information Officer (CIO) in the oversight of IT purchases. How is the CIO involved in the decision to make an IT purchase, determine its scope, oversee its contract, and oversee the product's continued operation and maintenance?

Answer. The IRS Chief Technology Officer (CTO) has the authority to govern all areas related to information resources and technology management, including acquisition of information technology (IT) and the management of information resources. The CTO has management and oversight responsibility for both the IT organizational functions and the evaluation, selection and management of vendors, ensuring that the goods and services received not only align with, but can help drive forward, the critical operational and information technology (IT) priorities of the business strategy.

This responsibility combines a thorough knowledge of the Federal acquisition system and a deep understanding of the dynamic commercial IT marketplace. The Vendor Management Organization (VMO), which is under the authority of the CTO, is solely focused on this activity and has a straightforward mission—to maximize IT investments. This is accomplished by developing a set of repeatable, sustainable processes with goals that focus on:

—Achieving greater transparency around organizational structures, roles, and responsibilities to ensure accountability and limit "surprises";
—Committing more time and energy to limit supplier advantage, e.g., through competitive bidding processes, market research on rates, and internal staff training;
—Cultivating existing vendor relationships that drive value by effectively managing the vendor throughout the contract lifecycle, from sourcing and selecting the vendor, to establishing contracts, purchasing and managing payments;
—Maintaining focus on value delivery by making sure that the benefits promised are the beginning of a project or investment are delivered; and
—Managing spending to create visibility that enables repeatable savings opportunities.

The CTO also has a well-established IT Governance structure to align IT with business strategy and to ensure that investments stay on track to achieve our strategies and goals, with measures to monitor performance.

The Infrastructure Executive Steering Committee (IESC) within the CTO organization ensures that project objectives are met, risks are managed appropriately, and the expenditure of IRS resources is fiscally sound. The CTO has also established an Enterprise Software Governance Board (ESGB) to develop a standardized approach to software acquisition management practices. An ESGB working group is also in place to gather and document existing software acquisition processes, document a proposed software lifecycle, gather software usage metrics, and evaluate and recommend a software asset/license management tool, all of which will identify installed software products, match products to licenses and confirm compliance status of those products. This governance ensures that all stakeholders' interests are taken into account and that processes provide measurable results.

Question. Describe the existing authorities, organizational structure, and reporting relationship of the IRS Chief Information Officer. Note and explain any variance from that prescribed in the Information Technology Management Reform Act of 1996 (aka, The Clinger-Cohen Act) for the above.

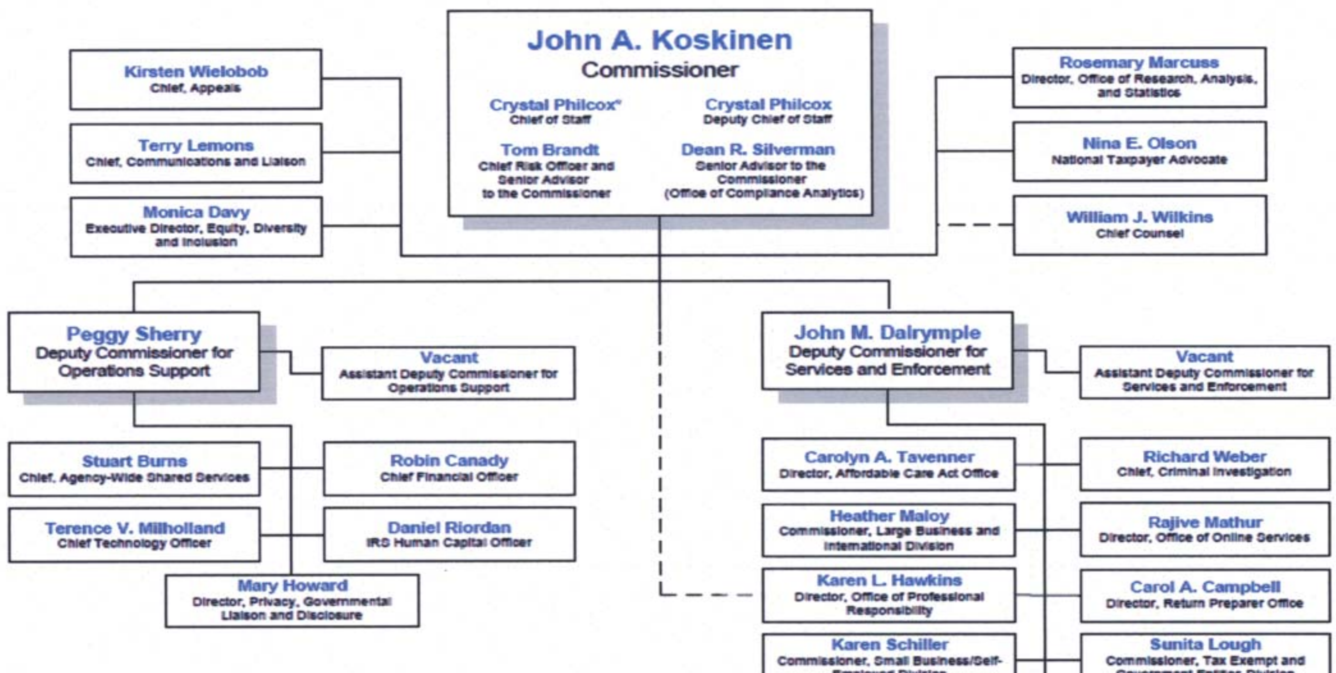
Answer. Pursuant to Delegation Order 2–1 (formerly DO–261, Rev. 1), Internal Revenue Manual Section 1.2.41.2 (08–17–2000), the IRS Commissioner gives the IRS CTO authority to govern all areas related to information resources and technology management, and authority to perform those functions that the Commissioner is authorized to perform having Servicewide impact and relating to, or concerning, the acquisition of information technology (IT) and the management of information resources, other than the duties delegated to the Assistant Commissioner (Procurement).

With regard to organizational structure and reporting relationship, under Internal Revenue Manual Section 1.1.12.1 (05–19–2012), the IRS CTO is accountable to the Commissioner of the IRS to lead the IT organization. While the CTO performs and is accountable to the Commissioner as outlined in the IRM and in accordance with the Information Technology Reform Act of 1996 (Clinger Cohen Act), the CTO also has line reporting to the Deputy Commissioner for Operations Support, along with the Chief Officers, i.e., Chief Financial Officer; Human Capital Officer; Chief, Agency-wide Shared Services; and Director, Privacy, Governmental Liaison and Disclosure. This enables collaboration and alignment among the Chief Officers in building a strategic foundation for organizational excellence. This strategic foundation is critical in delivering the IRS's objectives and goals outlined in the IRS strategic plan.

There are no variances from the requirements of the Information Technology Management Reform Act of 1996 (aka, the Clinger-Cohen Act). Following are charts that show organizational structure:

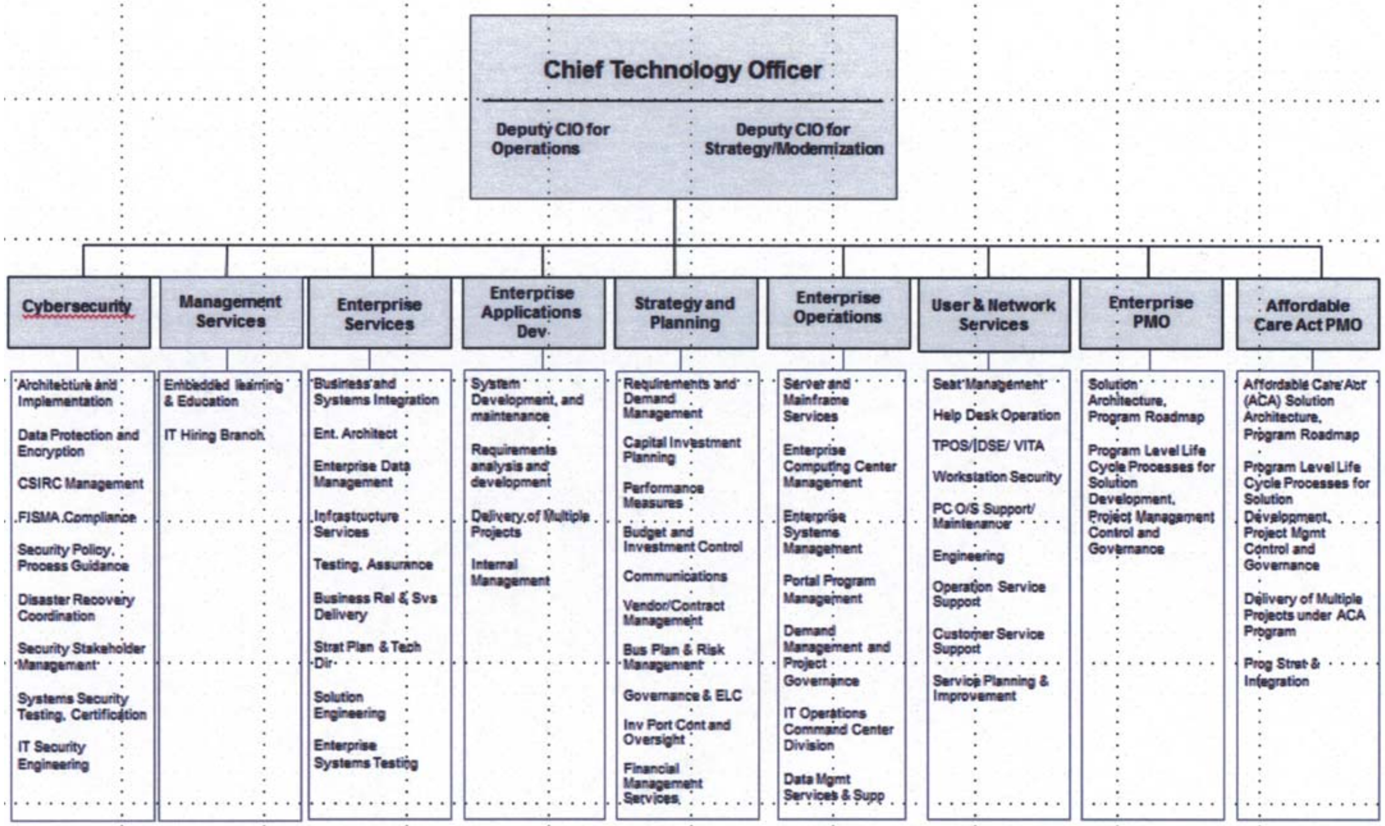
DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Organization and Top Officials

As of: June 2014



*Denotes Acting Assignment

NOTE: With respect to tax litigation and the legal interpretation of tax law, the Chief Counsel also reports to the General Counsel of the Treasury Department. On matters solely related to tax policy, the Chief Counsel reports to the Treasury General Counsel.


Chief Technology Officer
Deputy CIO for Operations
Deputy CIO for Strategy/Modernization
Cybersecurity
Architecture and Implementation
Data Protection and Encryption
CSIRC Management
FISMA Compliance
Security Policy, Process Guidance
Disaster Recovery Coordination
Security Stakeholder Management
Systems Security Testing, Certification
IT Security Engineering
Management Services
Embedded learning & Education
IT Hiring Branch
Enterprise Services
Business and Systems Integration
Ent. Architect
Enterprise Data Management
Infrastructure Services
Testing, Assurance
Business Rel & Svs Delivery
Strat Plan & Tech Dir
Solution Engineering
Enterprise Systems Testing
Enterprise Applications Dev
System Development, and maintenance
Requirements analysis and development
Delivery of Multiple Projects
Internal Management
Strategy and Planning
Requirements and Demand Management
Capital Investment Planning
Performance Measures
Budget and Investment Control
Communications
Vendor/Contract Management
Bus Plan & Risk Management
Governance & ELC
Inv Port Cont and Oversight
Financial Management Services
Enterprise Operations
Server and Mainframe Services
Enterprise Computing Center Management
Enterprise Systems Management
Portal Program Management
Demand Management and Project Governance
IT Operations Command Center Division
Data Mgmt Services & Supp
User & Network Services
Seat Management
Help Desk Operation
TPOS/IDSE/ VITA
Workstation Security
PC O/S Support/ Maintenance
Engineering
Operation Service Support
Customer Service Support
Service Planning & Improvement
Enterprise PMO
Solution Architecture, Program Roadmap
Program Level Life Cycle Processes for Solution Development, Project Management Control and Governance
Affordable Care Act PMO
Affordable Care Act (ACA) Solution Architecture, Program Roadmap
Program Level Life Cycle Processes for Solution Development, Project Mgmt Control and Governance
Delivery of Multiple Projects under ACA Program
Prog Strat & Integration

Question. What formal or informal mechanisms exist in your agency to ensure coordination and alignment within the CXO [1] community (i.e., the Chief Information Officer, the Chief Acquisition Officer, the Chief Finance Officer, the Chief Human Capital Officer, and so on)? How does that alignment flow down to agency subcomponents?

Answer. The Commissioner chairs an agency Senior Executive Team (SET) meeting monthly. It includes the Deputy Commissioner for Services and Enforcement (DCSE), Deputy Commissioner for Operations Support (DCOS), and Functional Operating Division Chiefs and their deputies, including the entire CXO community. The SET meetings are designed to ensure top-level strategies and policies are driven down into the organization with consistency, and to enable coordination and alignment on enterprise and cross-organizational initiatives, risks, and current events facing the agency.

The DCOS also meets each week with her direct team, which includes CXO community chiefs. These meetings are conducted to build a collaborative community of leaders under the DCOS to ensure coordination and alignment as a strategic foundation for organizational excellence and in delivering on the objectives and goals outlined in the IRS strategic plan. Cross-organizational strategies and priority initiatives are discussed, organizational risks, impacts, and mitigation strategies are brought to the table for discussion, administrative requirements and recent items of significance are shared, and general updates on current events are covered during these meetings.

DCOS also holds working sessions with the CXO community several times a year. These sessions are designed to build and gain alignment on various themes/strategies that require concerted time, deeper thinking and cross-coordination among the team members. Subject matter discussed in these meetings is usually specialized and high priority with potentially large impacts on the CXO community and the entire IRS.

DCOS conducts quarterly Business Process Reviews (BPRs) with each of the individual organizations within the CXO community. These reviews enable the DCOS to get a comprehensive update on high-priority programs and initiatives, to review program results and performance measures, and to drive down guidance and preferences in managing various aspects of the programs. Action items are noted in BPRs and implemented with follow-up reporting at subsequent meetings.

Actions, initiatives, and messaging from the above framework of meetings are driven down within the CXO community through weekly senior staff meetings and numerous working groups. The senior staff, in turn, drives any formal guidance and direction down through their organizations as part of their direct reports meetings, functional area reviews, and communications strategies. Ongoing functional responsibilities that need cross-organizational coordination and alignment among CXO community organizations and beyond are handled with an additional level of structure via governance boards and working groups.

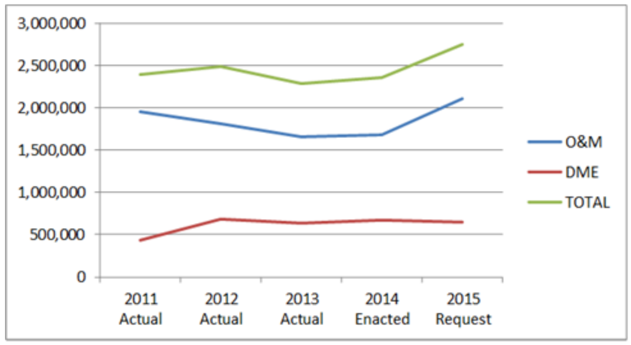
Question. How much of the agency's budget goes to Demonstration, Modernization, and Enhancement of IT systems as opposed to supporting existing and ongoing programs and infrastructure? How has this changed in the last 5 years?

Answer. The Chart below depicts the IRS spending for Development, Modernization, and Enhancement (DME) and Operations and Maintenance (O&M) for the past 5 years. The trend shows higher spending in DME and less O&M. Due to the IRS's budget cuts for the past several years, decreased spending in O&M has created a critical need to invest in the aging IT infrastructure. Inadequate spending to replace and maintain the IT infrastructure will not only increase maintenance costs, system downtime, and availability, but threatens deployment of new capability and capacity upgrades needed to support operational resiliency and security. This creates risk for disaster recovery, information security and encryption.

The fiscal year 2015 Budget Request reflects the IRS's plan to increase investment in infrastructure, causing a deviation from the downward spending trend. If sufficient funding is provided in fiscal year 2015, we expect to get back on track with a higher allocation of our budget in DME in the out years.

[Dollars are in thousands]

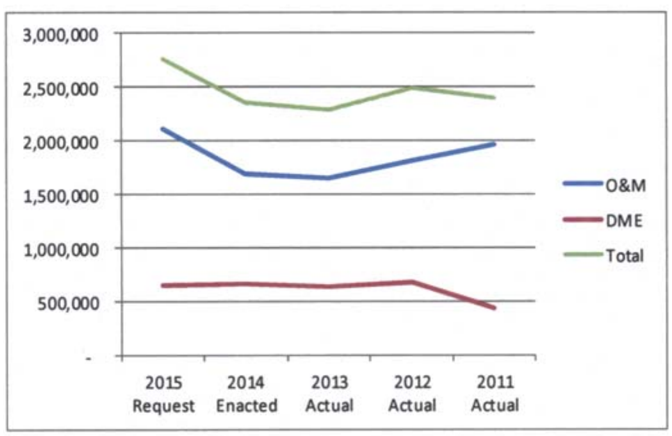
	O&M	DME	Total	DME %	O&M %
2011 Actual	1,960,391	428,262	2,388,653	17.93	82.07
2012 Actual	1,807,405	679,898	2,487,303	27.33	72.67
2013 Actual	1,652,447	632,382	2,284,829	27.68	72.32
2014 Enacted	1,684,867	668,733	2,353,600	28.41	71.59
2015 Request	2,104,831	650,225	2,755,056	23.60	76.40



In 2011, IRS spent 18 percent of its total budget on DME. Since 2011, DME spending has increased to approximately 28 percent of IRS IT spending due to legislated programs and decreasing budgets. In 2015, assuming above the budget cap funding is provided, this percentage will decrease to 24 percent to accommodate the need to invest in IT Infrastructure.

[Dollars are in thousands]

	O&M	DME	Total	DME %	O&M %
2015 Request	2,104,831	650,225	2,755,056	23.60	76.40
2014 Enacted	1,684,867	668,733	2,353,600	28.41	71.59
2013 Actual	1,652,447	632,382	2,284,829	27.68	72.32
2012 Actual	1,807,405	679,898	2,487,303	27.33	72.67
2011 Actual	1,960,391	428,262	2,388,653	17.93	82.07



In 2011, IRS spent 18 percent of its total budget on DME. Since 2011, DME spending has increased to approximately 27 percent of IRS IT spending due to legislated programs and decreasing budgets. In 2015, assuming above the budget cap funding is provided, this percentage will decrease to 24 percent to accommodate the need to invest in IT Infrastructure.

Note: Above includes all IT funds, including ACA activity.

Question. Where and how is the IRS taking advantage of this administration's "shared services" initiative? How do you identify and utilize existing capabilities elsewhere in government or industry as opposed to recreating them internally?

Answer. The IRS has actively participated in the Federal Government Shared Services initiative over the past several years. Currently the IRS primarily utilizes Federal Government shared services through the Treasury Franchise Fund (TFF) that is supervised and managed by the Department of the Treasury. The fiscal year 2014 estimate for the IRS shared services provided by the TFF is $95 million. Some of the services IRS receives through the TFF include:

—HR Connect, which delivers human capital services and interfaces with the Department of Agriculture's National Finance Center providing payroll processing and support;
—Web Solutions, which provides collaboration sites and support for IRS Webmasters and content managers;
—Treasury Enterprise Identity Credential & Access Management provides Personal Identification Verification, Physical Access Controls, Logical Access Controls for local, remote & mobile devices;
—Government Secure Operations Center serves as the focal point for management of cyber incidents and is responsible for security detection, analysis and incident management lifecycle practices; and
—A number of other smaller programs that provide non-IT services, including the Office of Small and Disadvantaged Business Utilization, which advises and aids the bureaus on small business policies and initiatives; Treasury Operations Excellence, which provides Lean Six Sigma training and other services to help Treasury and other Federal agencies use entrusted resources more effectively and efficiently; and the Privacy, Transparency, and Records program, which provides assistance to Treasury customers to collect, protect, retain, preserve, disclose, and provide access to Treasury's information resources pursuant to U.S. laws.

The IRS also offers shared services to other agencies through Reimbursable Agreements. These include procurement services and use of Call Centers by FEMA for disasters.

Question. Provide short, two-page, summaries of three recent IT program successes—projects that were delivered on time, within budget, and delivered the promised functionality and benefits to the end user. How does the IRS define "success" in IT program management?

Answer.—

Project #1: IRS.gov/Enterprise Portal

In August of 2011, the IRS Information Technology organization set out to deploy enhanced Web services including a straightforward, manageable Web environment, established end-to-end operational accountability and visibility, and a cost-effective program structure.

Additionally, the IRS sought to address the following challenges:

—Exponential growth of online electronic filings and taxpayer access to information;
—Difficulty balancing system capability to meet demand (scaling horizontally);
—Inconsistent user experiences for the taxpayer and tax preparer;
—Limited ability to share data and content between the IRS user communities;
—Difficulty focusing on serving end users (taxpayers and preparers) in an end-to-end fashion; and
—Multiple portals with numerous services to maintain.

The solution was the Integrated Enterprise Portal (IEP), an innovative, cost-effective system that provides a scalable, managed private cloud capability to the IRS, enabling one-stop, Web-based services to internal and external users. The IEP has transformed the way the agency creates, launches and administers its taxpayer- and employee-facing applications. At its most basic operational level, it allows the IRS to get business-critical applications to the live environment more quickly, while enhancing cost predictability and security.

Recent IEP Program Successes:

—*Registered User Portal (RUP) Deployment.*—RUP, deployed on-time and within budget in September 2013, implemented a secure, FISMA-moderate (Federal Information Security Management Act framework risk classification), scalable, managed private cloud which provides a shared portal infrastructure that consolidates the IRS platforms under a single, flexible, and scalable platform. The RUP is the IRS external portal that allows registered individuals and third party users, where registration and login authentication are required for access, to interact with selected tax processing and other sensitive systems, applications, and data.

—*Filing Season 2014*.—The 2014 tax filing season marked the IRS's first season fully "in the cloud." Going into tax season there was uncertainty driven by the fact that deployment occurred just a few short months earlier—a period of time made even shorter by a 3-week Government shutdown. Additionally, the IEP was predicted to face an unprecedented amount of traffic and filings. Despite these circumstances, the IEP not only delivered, but exceeded expectations handling the highest number of electronic returns and traffic ever—all with 100 percent availability and zero Priority 1 or Priority 2 incidents. This was a season of unprecedented peaks for the IRS that set a new standard for tax seasons to come. For example, on 2/6/14 the IEP successfully handled the "Where is My refund" application peak of 5.8 million unique daily visitors at a peak volume of 15,000 transactions/minute. Detailed statistics are as follows:

Portal key performance metrics January 11 to April 17, 2014:

—224.1 million total returns submitted (Federal + State);
—1.025 billion IRS.gov page views/263 million IRS.gov site visits; and
—132.7 million page views during seasonal peak week.

"Where's My Refund" accessed via IRS.gov Web site:

—136 million page views;
—112 million site views; and
—15,000 peak transactions/minute.

—*New Technical Capabilities to support the Affordable Care Act (ACA) effort*.—A new Transactional Portal Environment (TPE), which is a series of capabilities that reside within the IEP, was needed to support the new Affordable Care Act (ACA) program. The ACA TPE supports secure Application-to-Application (A2A) interfaces between Health and Human Services (HHS) Centers for Medicare & Medicaid Services (CMS) and the IRS. The new portal solution was implemented on-time and on-budget to support the beginning of open enrollment in the Marketplaces in October 2013. The IRS achieved the business objective to deploy a TPE solution providing CMS access to ACA services and providing 24/7 monitoring and support, daily reporting, and confirmation that initial traffic was within anticipated thresholds.

Key metrics for October 1, 2013 to April 15, 2014:

—TPE successfully processed 45 million requests for Income and Family Size Verification (IFSV) and Premium Tax Credit (PTC) computation services in real time from CMS.

—*Employee User Portal (EUP)*.—In late December 2013, a production IRS Employee User Portal (EUP) environment was successfully transitioned to the IEP. The IRS completed this transition ahead of schedule in response to a request by the IEP Governance Board to pull in the transition schedule in order to begin transitioned production operations prior to the beginning of Tax Filing Season 2014. Production operations of the newly transitioned environment were supported without a Priority 1 or 2 incident throughout the 2014 Tax Filing Season (January 2014 to April 2014). In addition to supporting transition and filing season operations of the existing EUP infrastructure, the IRS conducted initial analysis and concept of operations discussions about the future state of the EUP that would align with the goals of data center optimization and consolidation.

Definition of "Success"

Success was clearly defined on this program with deliverables completed on time, within budget, and with the promised functionality to achieve the Authority to Operate (ATO) recommendation from Cyber Security and planned business results.

Project #2: CADE 2

The Customer Account Data Engine 2, known as the CADE 2 program, is implementing a single, data-centric solution that provides daily processing of taxpayer accounts.

A critical component of the CADE 2 program is an authoritative database for individual taxpayers that provides more efficient and effective tax administration. The new database is the heart of the solution. It will transform the way the IRS approaches tax administration into the future. It improves taxpayer services by providing the capability to view taxpayer account data stored in the CADE 2 database with on-line viewing by IRS customer service representatives, as well as analytical reporting for more meaningful business intelligence and expanded opportunities to increase compliance.

As the IRS continues to invest in its data-centric vision in fiscal year 2015, CADE 2 will enable an enterprise-wide data environment that extends business capabilities, promotes efficiency, and increases productivity by ensuring the fidelity, security, and understanding of IRS data. This is essential to effectively enable the IRS to leverage 21st century technologies such as cloud computing, Web services, electronic submissions, e-Authentication, big data and data analysis, and computing as a commodity, to name a few.

With deployment of CADE 2 Transition State 1 (TS1), the IRS took a leap forward from a technology standpoint, moving the management of IRS's individual taxpayer account data from 1960's sequential flat-files stored on magnetic tapes, to state-of-the-art relational database technology. The IRS is now conducting transactional processing of account data for over 270 million individual taxpayers and over a billion tax modules on a modernized DB2 relational database. The IRS data is now stored in relational formats dictated by a state-of-the-art data model that maintains historical values never before retained on taxpayer account transactions and facilitates daily viewing of taxpayer account data by IRS customer service representatives. CADE 2 TS1 is offering faster refunds, faster notices, faster payment postings, and improved service for millions of taxpayers as well as a solid foundation for our data-centric vision. As of the end of April 2014, CADE 2 had posted 116.97 million returns and issued 101.67 million refunds totaling $269.30 billion for filing season 2014.

The IRS is now well positioned to take the essential next step in its data-centric vision—rewriting its core taxpayer account processing applications so they can leverage the benefits of the new, high-powered CADE 2 relational database environment. Prototypes are being conducted to validate our assumptions about our approach to this effort. Once our applications are re-written into a modern programming language and are able to effectively populate the new CADE 2 relational database based on its modernized data model, it will become the authoritative source for individual taxpayer account data for the IRS. This CADE 2 effort, called Transition State 2 (TS2), will enable the IRS to address its longstanding unpaid assessments financial material weakness which has added substantial risk to IRS custodial accounting and clean audit opinion for nearly 20 years.

TS2 will ensure the long-term viability of the IRS tax processing systems by addressing the limitations and risks associated with the aging architecture and the design of our legacy core tax processing systems, as well as the outdated programming languages that are difficult to maintain.

Investments in CADE 2 TS2 are already delivering benefits to taxpayers with the rollout of the Penalty & Interest (P&I) common code base on January 2, 2014. After years and years of discrepancies among various systems in calculating penalty and interest, a new application is now calculating penalty and interest consistently on individual and business accounts for taxes that are not received by the due date across our master files (Business Master Files and Individual Master Files). It is also providing service improvements for taxpayers such as more accurate notices, consistent penalty and interest calculations, and enhanced service, as Customer Service Representatives have more accurate information and are better able to assist taxpayers in meeting their tax filing and payment obligations. The solution uses the existing master file common code modules as baselines and incorporates additional requirements for IDRS.

CADE 2 is a game changer for the IRS, and once complete it will enable many opportunities for the IRS to transform the way we approach tax processing today and into the future.

Project #3: Filing Season

At the core of the IRS's operations is an IT infrastructure that has been foundational to administering the U.S. Federal tax code since the early 1960's. Deployment of IT infrastructure in support of Filing Season 2014 resulted in many successes, in spite of a tough budget environment that resulted in three agency furlough days, hiring freezes and a 16-day Government shut down that delayed the opening of filing season. Through collaborative efforts of hundreds of IT and Business staff and consistent assessment of risks and mitigation of impacts, the IRS was able to continue its record of timely deployment of IT systems for filing season 2014, enabling improved taxpayer services, increased compliance, and enhanced security against threats to the Nation's tax system, with marked improvements in production statistics over previous years.

The IT infrastructure for Filing Season 2014 is extraordinarily large and complex, putting it in a class of its own in comparison to other tax systems around the world.

The IRS deployed 67 critical filing season systems comprised of thousands of programs written in many programming languages and technology platforms that have been developed over decades to support the growing tax code. These complex systems provided the intelligence and capacity to process about 250 million tax returns submitted electronically and on paper between January 2 and April 15, filtering out fraud and generating over a million refunds totaling roughly $250 billion. These systems capture and move massive amounts of data from program to program under strict limitations set by service level agreements that govern the complex tax return process. They support filing season core tax processing, collection, and exam activities for every taxpayer in the country, and then send the appropriate financial data to IRS's general ledger to execute fiduciary responsibilities and ensure integrity in management of U.S. Government funds. Underlying the critical systems is a complex communications infrastructure of local and wide area networks, with computer hardware and other IT devices and supporting systems that successfully routed over 58 million taxpayer telephone calls with 100 percent system uptime, providing 24x7 taxpayer access to the IRS for Filing Season 2014. The IRS also maintains various technology components and processes that mitigated hundreds of cyber incidents and ensured the continued security posture of our systems, networks, computers and printers, including thwarting three serious cyber threats (e.g., "Heart-bleed", Microsoft Word and Microsoft Internet Explorer) during peak tax processing season.

Readiness activities to prepare the IRS's labyrinth of IT systems and processes for Filing Season 2014 included identifying and training IT specialists to implement world class system end-to-end monitoring, control room 24x7 coverage, and enhanced incident management to support filing season execution. Modernized systems using new technologies were developed and successfully deployed in Filing Season 2014, and hundreds of programming changes were made to our core systems, updating them to incorporate changing tax law. Updates to infrastructure configurations and upgrades to hundreds of computer hardware components, software applications, databases, operating systems, networks, communication devices, and procedures were necessary for smooth execution and protection from hackers and intruders. Systems Acceptability Testing (SAT) and Final Integration Testing (FIT) was completed for 133 projects, including execution of 62,000 test cases to provide assurance of a successful launch.

A Processing Year Delivery Assurance Executive and program management office provided leadership over the Filing Season 2014 activities within the IT organization, and over the many suppliers who assumed responsibilities in development and execution. An integrated Filing Season 2014 governance framework provided enterprise risk and readiness assessments to address and mitigate every issue. Filing Season readiness standard operating procedures were followed, with weekly and then daily operational meetings across the breadth and depth of the enterprise using red/yellow/green reporting for each critical system. Readiness certifications were required at all levels of the organization to signify readiness and ensure stakeholder accountability in execution.

Operational results in Filing Season 2014 show many successes and significant improvements over Filing Season 2013:

—Priority One incidents were down 42 percent from previous Filing Season.

—Modernized e-File (MeF) system had one of the best filing seasons on record, enabling taxpayers to electronically submit over 221 million individual returns along with over 12.5 million Business Master File returns (as of 5/27/2014)— an increase of 3.08 percent for submitted returns compared to the same period in 2013.

—CADE 2 had a smooth filing season launch of its core processing systems in Filing Season 2014 and continues to demonstrate full integration into Filing Season Operations.

  —CADE 2 database is feeding 16 downstream systems, and allowing over 50,000 Customer Service Representatives and other IRS users to view CADE 2 data.

—IRS.gov enabled more taxpayers to avoid wait times on phones. With no interruption in service, usage on the Web site from 3/1–5/31/2014 includes 595 million IRS.gov page views and 143.2 million Web site visits.

—"Where's My Refund" inquiries using IRS.gov equated to 6.7 million page views and 5.8 million site visits from 3/1–5/31/2014.

—The "Get Transcript" application delivered over 11 million transcripts to taxpayers and IRS customers from 1/13–5/28/2014, allowing them to view/print a PDF file of their transcript.

—E-Services enhancements enabled State users to get copies of transcripts for individuals who are victims of ID Theft. Previously, only IRS employees could request these transcripts.

—Enhancements to Enterprise eFax service (EEFax) increased the number of faxes that can be delivered to taxpayers at one time and reduce annual expenses for hardware, software and telecommunication lines.
—New End to End (E2E) application and infrastructure monitoring and auto-ticketing enhanced operation of many Filing Season Critical Systems.
—Enhancements to the Online Payment Agreement (OPA) program were successfully implemented in Filing Season 2014 making it easier for the online user to navigate the OPA Web page and establish installment agreements.

Question. What "best practices" have emerged and been adopted from these recent IT program successes? What have proven to be the most significant barriers encountered to more common or frequent IT program successes?

Answer. Many IT best practices have emerged from our successes at the IRS, particularly in the last few years when IRS executives, architects, engineers, and subject-matter experts have taken more of a lead role in program leadership, systems design, applications development, and systems integration. While many of the best practices are shared across various program management offices—enabled by sharing of toolkits, post-implementation reviews, and collaboration (cross-membership) among governance bodies, etc.—the following are best practices reported by the three specific program offices that reported their successes in the previous question above:

Project #1: IRS.gov/Enterprise Portal

The portal team used best practices such as:
—*Elastic Scalability*.—A recent best practice that resulted in an IT program success was our use of elastic scalability on demand. This "on-demand" capability was successfully utilized to scale the "Where's My Refund?" application on a peak day by 300 percent in a matter of hours. This approach is being successfully applied to business critical applications inside the IRS firewall for Filing Season 2015.
—*Overcoming Barriers*.—One of the key barriers to adopting rapid cloud provisioning was overcome by striking a good balance between maintaining the stability of the applications and limiting the changes during filing season.

Project #2: CADE 2

With regard to best practices, CADE 2 was sponsored at the highest level . In 2009, the IRS Commissioner himself formally launched the CADE 2 program and each Commissioner since then has strongly endorsed it since its inception.

CADE 2 has been managed under a delivery partner operating model, jointly led and governed by IRS executives across Information Technology and the technology industry. With the flexibility, to use critical pay and other authorities to recruit industry leaders and experts with a mix of knowledge in legacy and modernized systems, augmented by a small cadre of in-house subject matter experts, the program was staffed with the right mix of people.

—CADE 2 established a governance model that includes an Executive Steering Committee with representation at the highest levels of the organizations; a Governance Board that has the expertise to enable them to make critical decisions and assume accountability for the outcome of the program; an Executive Oversight Team that meets regularly with accountability for day-to-day identification of risks and progress in addressing those risks across the program; and advisory councils that provide technical advice and subject matter expertise as needed.
—The CADE 2 Program Management Office (PMO) serves with clear authority and lines of accountability assigned to the Business and IT delivery partners. This collaborative program management model was supplemented by high performing workshops early on in the program to develop techniques such as granted trust, generous listening, and rules of effective engagement, which has resulted in growing an in-house capability to manage complex systems using industry best practices that keeps decisionmaking on the side of the Government.
—The CADE 2 PMO produced four foundational documents that drive the program:
  —Program Charter describes who we are—mission, goals, operating principles;
  —SolutionsArchitecture documents where we are now and where we are going—aligned with agency architecture;
  —Program Roadmap outlines how we are going to transition to target state; and
  —Program Management plan defines management principles, practices, and processes that will be used.
—The program institutionalized a solid process around messaging to ensure open, accurate and consistent communication with regular report-outs to ensure full

transparency and ongoing understanding of progress and risks on the program by all oversight bodies, audit agencies, agency top executive team, delivery and business partner executives, and stakeholders.

—The CADE 2 PMO engaged people IRS-wide in an organizational readiness plan to support the new solution in order to gain maximum benefits and results. Many organizational readiness activities were conducted, such as training sessions on the new production process and how to address and resolve issues within a short timeframe, a control room staffed 24x7 with subject matter experts to provide production support, and formulation of special teams charged with driving testing to complete prior to deploying.

Overcoming Barriers:

—Previous barriers such as getting the business to the table to build requirements and own decisions along the way were mitigated through the comprehensive governance model.

—Burden from audits and other oversight reporting requirements was mitigated by inviting TIGTA and GAO to partner with us throughout the full life-cycle of the program to address risks and building solutions to mitigate them in real-time.

—Issues around funding were managed at the highest levels of the IRS, to get the resources that were needed in a timely manner to meet the program objectives.

—Cultural issues around “change” and “ownership” were addressed by the CADE 2 program manager and other IRS executives encouraging shared commitment for the success of the program.

—Individuals and work teams that previously worked with siloed knowledge of IRS systems were brought together to understand the “big picture” to effectively implement the CADE 2 integrated solution.

—The CADE 2 program manager and other IRS executives personally conducted workshops and coaching sessions using high performance communications techniques and contextual leadership to provide the vision and “line of sight” to break down silos and barriers within the IRS.

Project #3: Filing Season 2014

Many of the best practices used in other large IT programs have been adopted by the Filing Season Readiness program, including:

—Right-sized governance bodies that included stakeholders from IT and business organizations that are at the appropriate level of their organizations where they can readily represent their organization’s interest and make decisions.

—Dedicated Filing Season program management office (called the Processing Year Delivery Assurance function) with lead executive that assumed point of accountability for success:

  —Enabled strengthened supplier management and engagement resulting in more tightly integrated incident and problem management.

  —Used various disciplines to promote data-based decisionmaking, such as Filing Season Readiness dashboards, and simulation/predictive modeling to project volumes and impacts.

  —Conducted regular preparatory meetings with all stakeholders, with accelerated frequency as filing season approached, where action items with tracked to completion.

—Enhanced organizational readiness with tabletop exercises to help anticipate Filing Season operational organization and process issues.

—Lessons Learned captured that resulted in over 250 recommendations for improvement/action in 31 areas:

  —Implemented IT Filing Season Readiness Framework—a repeatable process for cross-organizational management of readiness—including defining Filing Season Readiness SOP.

  —Created and validated a Control Room SOP based on experience and best practices that is now available to guide establishment of Control Rooms for other business systems.

—Obstacles were overcome using aggressive risk mitigation framework:

  —Integrated risk and readiness assessments into the Filing Season delivery cadence, strengthening evidence-based decisionmaking capabilities.

Question. Describe the progress being made in your agency on the transition to new, cutting-edge technologies and applications such as cloud, mobility, social networking, and so on. What progress has been made in the CloudFirst and ShareFirst initiatives?

Answer. With regard to new technologies, the IRS embraces every opportunity to be a leader in Government. The pace in which we can embrace new practices, technologies, and tools must be balanced against the existing funding and resource capacities. Even with these constraints, the IRS has made significant investments in end-to-end lifecycle traceability, data architecture, security tools, and internal collaboration tools.

In the spirit of CloudFirst, the IRS already embraces an internal cloud concept with infrastructure-as-a-service virtualization. The same principle of elasticity is gained by being able to increase hardware for critical filing season needs and reallocating hardware to other purposes outside of filing season. IRS.gov is already using a private cloud for all non-personally identifiable information (PII). We have used the FedRAMP approved public cloud offerings for several tests, including performance testing of end-to-end filing season systems and scaling of new applications. We continue to leverage the cloud offerings where it makes the best sense according to a project's lifecycle, type of data and privacy considerations, and integration with existing IRS applications.

Regarding ShareFirst, we have regular meetings with the Treasury Department to discuss opportunities to leverage work between the IRS and the other bureaus. Beyond Department-wide sharing, we have an extensive program and governance mechanism for intra-agency sharing. The IRS has a standards-based enterprise architecture that ensures adoption of common platforms and tools to minimize product sprawl. The IRS also has a software lifecycle with the appropriate checks in place to ensure new initiatives leverage existing products, licenses and services.

Beyond intra-agency sharing, the IRS participates in inter-agency sharing by using Data.gov. Data.gov is the central repository for the Federal Government to post free datasets for the public to research and develop Web and mobile applications. The IRS posts aggregate data cleansed of any personally identifiable information (PII). Examples include summary tax data by zip code, and tax exempt statistics of the changes in the numbers of tax and exemptions across States/counties. This type of information can be used to create new visualizations and can be combined with other data from across the Federal Government.

The IRS has over 30 datasets posted on data.gov, which are shared with the public, as well as other government agencies.

Question. How does your agency implement acquisition strategies that involve each of the following: early collaboration with industry; RFP's with performance measures that tie to strategic performance objectives; and risk mitigation throughout the life of the contract?

Answer. To bring these increased capabilities online at the IRS, we created standardized training and development opportunities and established the Vendor Management Organization (VMO), a small cadre of acquisition professionals with the specialized knowledge and experience to expedite complex IT acquisitions across the enterprise. The VMO has an over-arching organizational concept of strategically managing procurements and suppliers to maximize IT investments in key commodities, while at the same time minimizing business risk. The VMO manages all vendor relationships and all IT contracts, using a single system for documentation, tracking vendor contract renewal dates and option years, and developing metrics and measuring vendor performance.

The VMO also use a Performance-Based Acquisition strategy for most acquisitions. This technique structures all aspects of an acquisition around the purpose and outcome desired, as opposed to the process by which the work is to be performed. Under this technique, the VMO develops a Statement of Objectives (SOO), which describes the requirements in terms of measurable outcomes rather than by prescriptive methods. The VMO then develops Measurable Performance Standards defining what is considered acceptable performance to determine whether performance outcomes have been met.

A more strategic relationship with our vendors using this technique enables us to use remedies or procedures to manage performance that does not meet standards. To this end, the VMO has developed a Supplier Assessment Management tool, which is a scorecard that tracks performance based on set criteria which was developed and is overseen by the Supplier Management Advisory Board. This governance is essential to ensure that the IRS is maximizing the value of its vendor relationships, reducing risks, and measuring performance to achieve desired results.

Question. According to the Office of Personnel Management, 46 percent of the more than 80,000 Federal IT workers are 50 years of age or older, and more than 10 percent are 60 or older. Just 4 percent of the Federal IT workforce is under 30 years of age. Does your agency have such demographic imbalances? How is it addressing them? Does this create specific challenges for attracting and maintaining a workforce with skills in cutting-edge technologies? What initiatives are underway to build your technology workforce's capabilities?

Answer. The IRS Information Technology organization performs extensive ongoing workforce analyses. Below is a summary of the IRS's IT organization's demographics, which reflects a somewhat higher percentage of older IT workers at IRS than OPM's analysis of the overall Federal IT workforce:

—The number of IT workers who are over 50 years of age is 4222 (out of 7294 total employees), or 58 percent of the current workforce.
—The number of IT workers who are over 60 years of age is 979 (out of 7,294 total employees), or 13 percent of the current workforce.
—Two percent of the IRS IT workforce is under 30 years of age (132 employees out of 7294 total).

The IRS pursues the following to ensure the proper technology capabilities for its workforce:

—IT performs extensive contractor-provided and on-the-job training and coaching where needed to ensure skills of the existing workforce are commensurate with work demands;
—IT has active frontline and senior leadership readiness programs to ensure there are leadership candidates in the pipeline;
—IT has an active leadership-mentoring program in place;
—IT has an active "ambassador" program for new hires to link new employees with seasoned employees for mentoring and coaching;
—IT's recent Direct Hire Authority provides IT with increased abilities to hire employees with specific skills for critical projects such as in support of the Affordable Care Act;
—Where possible and when funding allows, IT seeks new external talent while adhering to Federal recruitment practices such as "veteran's preference";
—Having recently completed negotiations with our union, special appointing authorities (such as "Pathways") will provide more flexibility to IT to attract students into entry-level positions;
—IT has launched a competency/skill/proficiency assessment process for all technical employees. The data will help IT make decisions about needed training and development; and
—IT is in the process of implementing a workforce planning tool concept, which would allow for an enterprise-wide view of talent, skills, capacity, and availability for better utilization of current staff across organizational boundaries.

Question. What information does your agency collect on its IT and program management workforce? Please include, for example, details about current staffing versus future needs, development of the talent pipeline, special hiring authorities, and known knowledge gaps.

Answer. The IRS currently performs IT workforce analyses about:

—IRS population trends, retirements, and other attrition losses, including those that affect the IT organization.
—Competency, skill, and proficiency information on the existing workforce. We are currently linking such information to position and business process to help analyze where development might be needed or where shifts in IT priorities are required.
—Hiring demand. The date is collected and mapped to business processes, competency and skill. Unfunded hiring needs tell us where gaps in IT positions and skills exist.
—Legacy systems requiring skills that are not readily available outside of the IRS (e.g., older programming languages such as COBOL and ALC).
—The IRS's need for JAVA-programmers, which continues to be a much needed skill. Our Direct Hire Authority has assisted us in improving on this skill-base.

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER A. COONS

Question. In fiscal year 2013, the telephone level of service for taxpayers trying to reach the IRS' toll-free lines dropped to 60.5 percent. Roughly 40 percent of taxpayers who called were unable to reach an IRS employee. Can you discuss what steps you are taking to solve this? We must ensure that taxpayers are able to communicate with the IRS in a timely and efficient way.

Answer. The IRS strives to serve as many taxpayers as possible, given limited resources. Telephone plans are developed after consideration of many factors, including: historical demand adjusted for known anomalies; the types and anticipated lengths of calls we expect to receive; assumptions concerning upcoming events, such as known or pending legislation or trends in customer behavior; and the availability of existing or new automation and other alternative services. These plans are then matched with available or anticipated resources to determine a measure for the IRS's telephone level of service (LOS). For instance, this year there was a lower than anticipated filing season demand for telephone assistance, which was likely due to relatively few tax law changes and more people using IRS.gov to get answers to many basic tax law questions. As a result, the IRS expects to exceed its projected fiscal year 2014 LOS of 61 percent.

The fiscal year 2015 Budget request of $12.6 billion, including the Opportunity, Growth and Security Initiative, would allow the IRS to increase the projected LOS in fiscal year 2015 from 53 percent to 80 percent. The IRS projects demand related to the Affordable Care Act (ACA) to result in appropimately 10.5 million new calls to the IRS in fiscal year 2015. Without the funding requested in the President's budget, we estimate that nearly five out of every 10 taxpayers who call the IRS for service will not get through to an assistor. Those who do get through will then be subjected to long wait times. Because of this extraordinarily low projected LOS, the IRS expects that a higher than normal number of taxpayers will call back when they are unable to reach an assistor. These additional callbacks or re-tries will further compound the strain on the IRS telephone systems and may drive the LOS even lower than the projected levels. Also, taxpayers abandoning the telephone lines will likely turn to walk-in services or send correspondence, straining other IRS service channels. Other factors, such as legislative changes, could also adversely affect the IRS's LOS for fiscal year 2015.

Each year, taxpayers call the IRS for assistance expecting a prompt and accurate response to their questions. The IRS continually explores improvement opportunities to provide customers with easy access to accurate, user-friendly account services. Our objective is to proactively manage customer demand by improving contact center efficiency, referring customer demand to the most efficient service resource, and equipping the workforce with the tools to be productive. To continue to efficiently serve the maximum number of taxpayers possible, the IRS implemented the 2014 Service Approach to align taxpayer demand with the most cost-effective resource to provide the needed service. The 2014 Service Approach accomplished this by referring taxpayers to self-service resources while preserving telephone and in-person service for taxpayers that needed to speak to an assistor.

Question. I am concerned about some of the treatment that groups seeking 501(c)(4) status have received. I believe that we must ensure that staff that acted inappropriately are held accountable and correct any failures that allowed this behavior to happen. We have to be guaranteed that the IRS provides unbiased service to all taxpayers. Can you comment on the steps you have taken to ensure that this situation is fixed?

Answer. Last year, the Treasury Inspector General for Tax Administration (TIGTA) issued a report related to the determination process and the processing of applications for tax exempt status, Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review.

Since then, we have taken substantive corrective actions to address the problems TIGTA had identified. We have:

—Created an expedited approval process for 501(c)(4) organizations that has significantly reduced our backlog.
—Established an Accountability Review Board to assess individual employees' conduct and recommend discipline where appropriate.
—Installed a new management team in the Exempt Organizations (EO) division.
—Developed new training and conducted workshops on a number of critical issues, including the difference between issue advocacy and political campaign intervention, and the proper way to identify applications that require review of political campaign intervention activities.
—Established a new process to document the reasons why applications are chosen for further review.
—Issued guidelines for EO specialists on how to process requests for tax-exempt status involving potentially significant political campaign intervention.
—Created a formal, documented process for EO determinations personnel to request assistance from technical experts.

Additional detail on our efforts is available at: http://www.irs.gov/uac/Newsroom/IRS-Charts-a-Path-Forward-with-Immediate-Actions.

Subsequent to the TIGTA report, more than 250 IRS employees have spent more than 120,000 hours working directly on compliance with the six related investigations of the issues described in the TIGTA report—at a direct cost of nearly $10 million. I hope these investigations can be concluded in the very near future. Once we have the resulting reports, we can then take further corrective action, where necessary. Completion of the reports is important for us to learn from, address, and move beyond the problems and concerns identified.

QUESTIONS SUBMITTED TO HON. J. RUSSELL GEORGE

QUESTIONS SUBMITTED BY SENATOR MIKE JOHANNS

Question. According to your audits the IRS continues to report that more than 20 percent of Earned Income Tax Credit (EITC) payments are issued improperly each year. In fiscal year 2013, the IRS estimates it issued between $13 and $15 billion in improper EITC payments.

Do you believe there is the potential for similar problems with implementation of the ACA's premium tax credits?

Answer. As is the case with other refundable credits, there is a risk for improper payments with the Premium Tax Credit. TIGTA is concerned that the potential for refund fraud and related schemes could increase as a result of processing Premium Tax Credits provided by the Affordable Care Act unless the IRS builds, implements, updates, and embeds Affordable Care Act predictive analytical fraud models into its tax filing process. In September 2013, we reported that a fraud mitigation strategy is not in place to guide Affordable Care Act systems development, testing, initial deployment, and long-term operations. The IRS informed us that two new systems are under development that will address Affordable Care Act tax refund fraud risk. However, until these new systems are successfully developed and tested, TIGTA remains concerned that the IRS's existing fraud detection system may not be capable of identifying Affordable Care Act refund fraud or schemes prior to the issuance of tax refunds.

Question. Are you aware of any effort on the part of the IRS to synthesize or otherwise generate the technical capacity or resources to perform full or partial return preparation for filers?

Answer. No. We are not aware of any such effort.

SUBCOMMITTEE RECESS

Senator UDALL. So with that, the subcommittee hearing is hereby adjourned.

[Whereupon, at 3:55 p.m., Wednesday, April 30, the subcommittee was recessed, to reconvene subject to the call of the Chair.]