

**PRESIDENT'S BUDGET FOR FISCAL YEAR 2019**

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**HEARING**

BEFORE THE

**COMMITTEE ON FINANCE  
UNITED STATES SENATE**

**ONE HUNDRED FIFTEENTH CONGRESS**

SECOND SESSION

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FEBRUARY 14, 2018  
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# **PRESIDENT'S BUDGET FOR FISCAL YEAR 2019**

**WEDNESDAY, FEBRUARY 14, 2018**

U.S. SENATE,  
COMMITTEE ON FINANCE,  
*Washington, DC.*

The hearing was convened, pursuant to notice, at 2:35 p.m., in room SD-215, Dirksen Senate Office Building, Hon. Orrin G. Hatch (chairman of the committee) presiding.

Present: Senators Crapo, Thune, Portman, Heller, Cassidy, Wyden, Cantwell, Menendez, Carper, Cardin, Brown, Casey, Warner, McCaskill, and Whitehouse.

Also present: Republican staff: Jay Khosla, Staff Director; Chris Armstrong, Chief Oversight Counsel; Rory Heslington, Professional Staff Member; Eric Oman, Senior Policy Advisor for Tax and Accounting; Mark Prater, Deputy Staff Director and Chief Tax Counsel; and Nicholas Wyatt, Tax and Nominations Professional Staff Member. Democratic staff: Adam Carasso, Senior Tax and Economic Advisor; Michael Evans, General Counsel; Daniel Goshorn, Investigative Counsel; Ian Nicholson, Investigator; and Tiffany Smith, Chief Tax Counsel.

## **OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. The hearing will come to order. We are gathered here for the second time today to talk once again about the President's proposed budget for fiscal year 2019.

We are very grateful to have Mr. David Kautter with us, the Acting IRS Commissioner, here today. He is going to talk specifically about the President's proposed budget for the IRS.

Mr. Kautter has served admirably in this capacity. He has filled two critical roles with the administration during the busiest time the tax policy world has seen in decades, and this is no easy task. Mr. Kautter deserves our thanks for serving with such distinction.

Now, some of my colleagues may tune me out for the next several minutes, as they have already heard me talk effusively about the success of the new tax reform law, but I hope people are listening, because there has been quite a bit of good news lately.

Any major change to the tax system should be evaluated on the merits, whatever they may be. And by and large, we are seeing great things from tax reform. Some have argued that our tax reform bill, which provides middle-class tax relief and lower taxes on job creators, benefits only the rich or the high-ranking officers of greedy corporations. Well, that is kind of a bogus, stupid comment, but that is common every time you do one of these things.

Others tend to vilify companies' statements about their capital structure, including dividend payments, indebtedness, or share buybacks as things that benefit only the wealthy stockholder or investor. Yet quite often, a business's success or bottom-line results in increased valuations of middle-class retirement accounts and pensions. In fact, our private retirement system has been the biggest generator of middle-class wealth in our Nation's history. And because more than one-third of all corporate stock holdings in the United States are in various forms of retirement accounts, growing businesses contribute directly to the expansion of that middle-class wealth.

So yes, with lower corporate tax rates and other reforms to our business tax system, we have seen some immediate success, as hundreds of major companies have publicly announced their plans to raise wages, distribute bonuses, or boost employee 401(k) contributions. At the same time, today's success is helping to improve the retirements and investments of millions of middle-class Americans. I would say those are really good things.

That said, despite all of this good news, we still have a great deal of work to do to ensure that the tax laws are implemented correctly. The Treasury Department, IRS, and Congress, especially the tax-writing committees, have to work together to ensure that the law is implemented and administered as Congress intended. We look forward to working with the administration and with IRS specifically as they continue to implement this law and issue guidance to us.

This committee will also be examining possible administrative reforms at the IRS, giving the IRS greater flexibility and bringing it into the 21st century. Now, I look forward to continued feedback from the IRS and Treasury on ways we can work to improve the taxpayer system and taxpayer services and administration.

That said, I have made no secret about my disagreements with the Internal Revenue Service over the years. I led, along with my good friend Ranking Member Wyden, the most thorough and comprehensive bipartisan investigation of the IRS in decades. I have gone after the IRS for everything from wasteful spending to political targeting to questionable enforcement practices. No one here needs to remind me about IRS missteps, regardless of which President or Commissioner has been at the helm.

But personally, I think it is high time that Congress reexamines its approach to the agency. Because IRS will bear the brunt of the burden in implementing and administering the tax code and the new tax provisions, it needs sufficient personnel and resources to carry out its important missions at this critical juncture.

Let us keep in mind that the IRS is the only agency in the government that touches every single American every single year. And that is why I have pushed for such robust oversight over the years. It is also why the IRS should get the resources it needs to do its job right. For example, the IRS is still using computer software that is older than most of my committee staff. And you can take a look at them: they are not all millennials. In fact, a number of them are anything but millennials. [Laughter.]

The agency is shedding staff and resources. Agency reductions might be a good thing in some cases, but it should be done through

thoughtful reforms, not the blunt axe of blind budget cuts. The administration in its budget has proposed additional cuts to funding for the IRS. I think that is a mistake. While I have had quite a bit to say over the years about the allocation of resources at the IRS, now, directly after passage of a major overhaul of the tax system, is not a great time to further reduce the taxpayer services' budget of the agency that will do most of the work in implementing the updated tax code.

We need to take a close look at this issue and be fiscally responsible with any solutions. But as we do this, we should also consider what is in the best interests of proper and effective administration of our recently reformed tax code.

Before I close, I do want to state that we have noticed an executive business meeting for this time. If at any point during the hearing a suitable quorum is present, I intend to pause the hearing and move to votes on the nominations of Mr. Dennis Shea and Mr. C.J. Mahoney. Thereafter, we will resume our hearing.

And with that, I will turn to Senator Wyden and give the floor to him.

[The prepared statement of Chairman Hatch appears in the appendix.]

**OPENING STATEMENT OF HON. RON WYDEN,  
A U.S. SENATOR FROM OREGON**

Senator WYDEN. Thank you very much, Mr. Chairman. As we talked about this morning and I think you noted, we have had a spirited discussion so far.

Based on public documents—and this tally, colleagues, is going to be a running one—it is \$120 billion for stock buybacks to \$5 billion for worker compensation. So we will continue to provide updates on that matter.

Less than 2 months ago, Republicans passed legislation making \$10 trillion in tax changes pretty much on the fly, the biggest overhaul in 3 decades, and there was a web of complicated rule changes. Now they are giving short shrift to the IRS, which is the agency that actually has to implement those changes and provide services to American families and businesses based on the new rules.

The IRS said it would need nearly \$400 million to implement the new law, but the Trump budget holds the agency's funding flat. The budget makes a fake reference to increasing enforcement dollars, but it kicks the actual decision to the appropriators in Congress, who are unlikely to fork over the necessary resources. And that comes at a time when tax cheats are looking at the Trump tax law and licking their chops, planning complicated new schemes of abusing the rules to get out of paying their fair share, particularly with the new pass-through loophole. The law is an open invitation for scamsters to game the system, leaving a heavier burden for Americans who do follow the rules.

This is not an academic matter. Denying the IRS the resources it needs to be an effective agency impedes its ability to serve the public. And the Trump administration knows that. By the administration's own projections, as a result of continued budget cuts for taxpayer service, fewer than half the people who pick up the phone

to call the IRS for filing services in 2019 will get through, down from 75 percent in 2018. And that is with lawmakers on both sides already speaking out about the poor service provided to taxpayers by the IRS.

Bottom line: the IRS might not be anybody's favorite Federal agency, but the American people do expect it to function without political agenda or interference.

So that brings me to another issue that needs to be addressed this afternoon. Mr. Kautter, who is here with the committee this afternoon in the middle of a tax-filing system, is the Acting IRS Commissioner. This is supposed to be a nonpartisan job overseeing the administration of tax law. But Mr. Kautter is also currently the Assistant Secretary for Tax Policy, and that position in this administration is about as partisan a position as you can find.

The committee recently spent years investigating accusations of political interference at the IRS. The bipartisan investigation determined that sloppy work by IRS officials led to both conservative and progressive tax groups being subject to unfair scrutiny.

In my view, both sides would agree that the IRS ought to be politics-free when it comes to administering the law. I recall a lot of strong speeches to that effect, particularly from my Republican colleagues.

But now the party in control of the White House has flipped. There is a Republican political appointee running the IRS at the very same time it is implementing an enormously complicated and partisan law his department helped write.

In December, I wrote a letter to Mr. Kautter asking how he would guarantee their politics are not bleeding into the IRS, what policies or safeguards have been created to avoid conflicts, any guidance regarding communication between the White House and the agency, and several other subjects. I have not received a response to these questions.

Given the energy and focus this committee has placed on the issue of political influence at the IRS in the recent past, it would certainly be hypocritical not to take it seriously now.

So, Mr. Kautter, we appreciate your being here. We are going to have questions on those issues. And, Mr. Chairman, I look forward to the hearing.

The CHAIRMAN. Well, thank you, Senator.

[The prepared statement of Senator Wyden appears in the appendix.]

The CHAIRMAN. Today we have the pleasure of being joined by Mr. David J. Kautter, the Acting IRS Commissioner as well as the Assistant Secretary of Treasury for Tax Policy. Mr. Kautter, I want to thank you for being here today and cooperating with the committee.

As one would hope, Mr. Kautter has extensive tax practitioner experience. In fact, he has been a tax practitioner for the past 43 years.

There must be something wrong with you. [Laughter.]

I know there is not. You are great.

Most recently, before his government service, Mr. Kautter was a partner at RSM. He has also taught numerous courses in tax law,

including as an executive in residence for 4 years at the Kogod School of Business at American University.

Prior to teaching, Mr. Kautter provided advice to clients ranging from individuals to small businesses to global multinational companies. For 20 years at Ernst and Young, he provided this type of really competent service. During much of that time, he was the leading tax specialist at the firm with respect to the taxation of compensation and benefits.

Mr. Kautter has also served in the government before as tax legislative counsel to Senator John "Jack" Danforth from 1979 to 1982, one of our colleagues for whom I have tremendous feelings of respect. But during that time, he worked on the Economic Recovery Tax Act of 1981.

Mr. Kautter graduated with a bachelor's degree from the University of Notre Dame and later received his juris doctor from Georgetown University.

Mr. Kautter, we are grateful to have you here, and please proceed with your statement.

**STATEMENT OF HON. DAVID J. KAUTTER, ACTING COMMISSIONER, INTERNAL REVENUE SERVICE, AND ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY, WASHINGTON DC**

Mr. KAUTTER. Thank you, Mr. Chairman.

Chairman Hatch, Ranking Member Wyden, and members of the committee, thank you for the opportunity to discuss the IRS's budget and current operations.

Today, we are 2½ weeks into the filing season, and I am pleased to report that the 2018 filing season began on schedule and is going well so far.

The IRS has successfully received more than 30 million tax returns and has issued \$28.9 billion in tax refunds to over 13 million taxpayers. The average refund so far is a little over \$2,000.

Against that backdrop, the President's fiscal year 2019 budget requests an appropriation of \$11.135 billion for the IRS, plus an additional \$362 million through a program integrity cap adjustment.

The budget balances competing priorities and increases funding to operations support by 6.2 percent. Dedicated funding is needed now to modernize IRS hardware and software so that we have the technology needed to run day-to-day operations, transform the taxpayer experience, improve cybersecurity, and ensure we can continue to safeguard taxpayer data.

The IRS is subject to 2½ million cyberattacks on average each day, 1 million of which are sophisticated attacks. Some of the attacks are efforts to acquire taxpayer data, and some are efforts to disrupt the functioning of the United States government.

Increasing our investment in IRS infrastructure is critical. Fifty-nine percent of IRS hardware and 32 percent of its software are out of date. While the IRS has done a good job of prioritizing its technology spending to safeguard taxpayer data, ward off cyberattacks, and carry out a smooth filing season, we are at a point where greater investment is needed.

Turning to taxpayer services under the budget, the IRS will continue investing in the development of online tools to improve tax-

payer service for the increasing number of taxpayers who prefer to interact with the IRS online.

At the same time, we recognize the importance of serving the needs of all taxpayers, including those who prefer not to interact with us online. So we will continue our efforts to improve service on all our channels, including in person and over the phone.

As I mentioned, protecting taxpayers and their personal data from identity theft is an important aspect of taxpayer service. The IRS has continued increasing taxpayer protections to make the act of filing a tax return as safe and secure as possible and is making solid progress.

The number of victims of tax-related identity theft last year was down to 242,000, a 40-percent drop from 2016. The number of tax-related identity theft victims has fallen nearly 65 percent in the past 2 years. Still, more remains to be done: 242,000 is too big a number.

This year, one of the IRS's highest priorities is implementing the new tax reform law. This will be a major effort for us throughout 2018 and next year as well. Our goal is to ensure that taxpayers and tax professionals can understand and navigate the changes made by the new law. This is a huge undertaking.

We estimate that we will need to create or revise about 450 tax forms, publications, and instructions. We will need to publish extensive guidance, including regulations, notices, and frequently asked questions. And we will need to reprogram about 140 inter-related tax return processing systems to be ready for the 2019 filing season. This work is already well underway.

For this work to be completed on time, we estimate the IRS needs about \$397 million in additional funding over the next 2 years. We are making this request separately from the President's fiscal 2019 budget.

In addition to ensuring adequate funding for the agency, Congress can also help the IRS by enacting three pieces of legislation that will improve tax administration: renewing streamlined critical pay authority, allowing correction procedures for specific errors, and giving IRS authority to require minimum qualifications for paid tax return preparers. These provisions, along with other items highlighted in the budget, will help the IRS continue building on its work to serve the Nation's taxpayers.

I would also ask, as Congress considers proposals for updating and reforming the IRS, that you include provisions giving us the flexibility we need to respond to the evolving needs of taxpayers.

In closing, I would like to make one final observation. Since becoming Acting IRS Commissioner 3 months ago, I want you to know how impressed I have been by the commitment of those I have worked with at the IRS to taxpayer service and to doing the right thing. It is clear to me that the typical IRS employee is dedicated to providing taxpayers with high-quality assistance and being a judicious steward of taxpayer dollars.

I would urge this committee and Congress to give the IRS the funds it needs to effectively carry out its mission.

Chairman Hatch, Ranking Member Wyden, and members of the committee, that concludes my statement. I would be happy to take your questions.

The CHAIRMAN. Well, thank you, Mr. Kautter.

[The prepared statement of Mr. Kautter appears in the appendix.]

The CHAIRMAN. Let me just ask a couple of questions to you. Last December, Congress passed the Tax Cuts and Jobs Act, the most comprehensive tax reform in a generation. The new law included changes across the tax code: lowering individual tax rates across the board, simplifying the tax code for tens of millions of American families, business tax rate cuts, and converting the U.S. tax system away from a worldwide system and toward a territorial one.

These reforms are already making a real difference for taxpayers across the country, but a lot of work remains to be done, and much of it at the IRS as it works with the Treasury Department to implement and administer the new law.

Earlier this month, you issued the 2017–2018 Priority Guidance Plan. The plan outlined an ambitious list of priorities, including initial implementation related to the Tax Cuts and Jobs Act. Can you describe the IRS's Tax Cuts and Jobs Act implementation efforts and how you see implementation affecting agency needs in the near term?

I would also ask that you comment on any additional flexibility or agency reforms that might be helpful to us here today.

Mr. KAUTTER. Thank you, Mr. Chairman. Well, we are requesting \$397 million for implementation of the tax cut act. Seventy-three percent of that money is for technology and hardware. The IRS has 140 integrated programs that operate the systems for the Internal Revenue Service. And 19 percent of the funds we are seeking are for taxpayer assistance, for taxpayer outreach, and education. Four percent of the money would go for guidance, that is about \$15 million, and 4 percent would go for forms, publications, and program management.

The Secretary has been granted 79 different grants of regulatory authority in the Tax Cuts and Jobs Act. We figure that, as I mentioned earlier, we will need to adjust about 450 forms.

What is interesting is, compared to 1986 when we had the last major tax reform bill, there were no personal computers, there was no Internet, and 73 percent of the funds used to implement the 1986 act did not go to technology. But we have now become so dependent on technology that is a critical element of what we have to do.

About 4 percent of the funds, as I said, would go to guidance. We have issued the Priority Guidance Plan after carefully reviewing the legislation and trying to identify those areas of the law where we think taxpayers need the greatest guidance.

In part, our challenge is that, in order to adjust the software, we have to know what the forms are going to look like. And to know what the forms are going to look like, we need some guidance on what the law actually means. So we have already started the process of updating forms where we can without the guidance. And we have gotten a pretty good start, so the wind is at our back.

The CHAIRMAN. Well, good. Let me just ask this question. Congress increasingly recognizes that the IRS is in need of reforms and

improvement, including more money to efficiently and appropriately implement the Tax Cuts and Jobs Act bill.

Recently, congressional leaders reached an agreement to seek adequate funds for IRS in the fiscal year 2018 omnibus and the fiscal year 2019 appropriations bills. Unfortunately, parts of the President's budget appear to move in the opposite direction and request additional cuts to critical areas such as taxpayer services.

Now, effective tax reform implementation is a high priority for this committee, as is IRS customer service and effectiveness. Can you describe for the committee the effect that additional budget cuts might have on both of these priorities?

Mr. KAUTTER. Sure. Well, in developing the budget, Senator, some difficult decisions had to be made. Given the increasing number and sophistication of cyberattacks on the IRS system and the age of some of its hardware and software, the decision was made to increase the amount of funding going toward technology.

There is a small increase in the amount allocated to enforcement. Enforcement since 2010 is down by over 40 percent. We are proposing a small increase in the budget for enforcement. Virtually every category that the IRS audits is down since 2010.

Against that backdrop, the budget allocated more money toward operations support and a slight amount more toward enforcement. That came at the cost of taxpayer assistance.

With \$397 million, we think we can effectively implement the new Tax Cuts and Jobs Act, but it is true that we have a formidable task in front of us.

The CHAIRMAN. Well, thank you.

Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman.

Commissioner, the tax bill passed in December capped State and local taxes at \$10,000. As you know, there have been many news articles about how States might respond to the impact of these changes on State budgeting and revenue. The Secretary, Secretary Mnuchin, stated his intention to, quote, "audit the real estate taxes issue," which certainly has suggested an audit focus on blue States, like maybe Oregon.

So I would like you to tell us, how would these audits work?

Mr. KAUTTER. Well, Senator, at this point, no decision has been made with respect to how the 2017 tax returns would be audited. So it is—that decision will be made as time goes by.

Senator WYDEN. So what should the American people make, like people in my State, of his intention to do this? Is this just kind of empty political talk, or is it a plan? How are you going to go about doing this? Are you guys going to have a meeting, and is there going to be a date when something is offered up to describe how these audits would work?

Mr. KAUTTER. Well, the IRS has a very detailed process of determining who will be audited and how the audits will be conducted. And the formula that the IRS uses is not a matter that is disclosed publicly. So the IRS—

Senator WYDEN. So the American people are basically going to be in the dark on something that implies certainly the consideration of politics. The public is just going to be in the dark.

Mr. KAUTTER. For decades, the IRS has followed the same policy.

Senator WYDEN. Okay. Have you been directed by the Secretary to gear up for these audits?

Mr. KAUTTER. I have not.

Senator WYDEN. So you have not had any discussion with him about this comment that he made publicly?

Mr. KAUTTER. No.

Senator WYDEN. Do you believe it is appropriate for the Treasury Secretary to target taxpayers in the manner this suggests?

Mr. KAUTTER. I think the desire to make sure that we enforce the law as it is written is wholly appropriate.

Senator WYDEN. So you do not think there is anything about this that smacks of any politics at all?

Mr. KAUTTER. Well, my interpretation of the Secretary's comment was that he believed the law applied a certain way and that we should impartially apply the law as it is written.

Senator WYDEN. Well, I have just got to tell you, given the fact that you have told us all of this is going to be determined in the dark, we are going to have a lot of questions about this. Because, you know, we spent a lot of time looking at politics at the IRS, and I think this area and the Secretary's statement is fraught with opportunities for political mischief, so this is not going to be the last time we talk about it.

Now let me turn, if I could, to the implementation of the new pass-through provision. The pass-through deduction, as you know, enacted by the Republican tax bill has left small-business owners tangled up and baffled by a web of complex rules.

Multinational corporations enjoy assurance of their 14-percent rate slash; the small-business owners struggle to figure out if they even qualify for the pass-through deduction. Within the very same provision, the complexity added by Republicans leaves the door wide open to gaming and scheming by the fortunate few. So there is an immediate need for guidance here.

I would like you to confirm the timing of the guidance. And will there be specific guidance for the small businesses?

In my State, we are overwhelmingly small businesses. You can practically count the multinational corporations on the fingers of both hands. We are overwhelmingly a small-business State. So confirm the timing of the guidance on the pass-through provision. And will there be specific guidance for the small businesses, who certainly dominate my State? I have heard Senator Cardin, a ranking member and very knowledgeable on small-business issues, express concern about this, so if you could respond to that question.

We will have some more on pass-throughs later in the afternoon. But confirm the timing of the guidance, and will there be specific guidance for small businesses?

Mr. KAUTTER. Sure. One of our top priorities is to get guidance out on the new pass-through rules. We have not set a target date for issuing that guidance, but we are focused on getting it out as soon as we possibly can. And we will have a focus on small business.

Senator WYDEN. So where we are left on this, and hopefully we will learn some more in the afternoon, multinational corporations enjoy certainty with respect to their 14-percent rate slash, and for small businesses it is, well, we are very interested in it and we

hope to do it soon—another clear example of the double standard established in this bill. The powerful and the most fortunate come first, the small-business people, who are so important in Oregon and elsewhere, maybe they will see some clarity sometime down the road.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Let us go to Senator Cantwell.

Senator CANTWELL. Thank you, Mr. Chairman.

As the budget calls for a decrease of, I think, 1,784 employees, yet at the same time the IRS has received more than 150 million returns, individuals are facing new rates and the withholding schedule. How can we be sure that they are withholding enough in the face of this huge change? What is going to happen? So can you describe the efforts that are currently underway to ensure the transition from the old system to the new system and how that impacts individuals and small businesses?

Mr. KAUTTER. With respect to withholding, Senator?

Senator CANTWELL. Yes.

Mr. KAUTTER. Sure. The withholding tables are adjusted every year. This year we followed the same procedure that we did in prior years, which is a joint effort between Treasury and the IRS.

We have issued initial withholding tables. They have been implemented by many employers. We urge employers to implement them by February 15th.

We are planning to issue a revised withholding calculator at the end of February, which people can find at *IRS.gov*. That withholding calculator will allow individuals to enter their information. They do not have to identify themselves; it is not personal information. They will be able to enter their income, the withholding year-to-date, number of dependents, and calculate how much they are withholding, how many allowances they should claim in order to have their withholding work out pretty close to what is actually owed at the end of the year. So that should be due in February. We are putting a lot of effort into that and view that as a critically important project.

Senator CANTWELL. I know you are just dealing with the aftermath of this, but for us in Washington and other States—well, first of all, I still firmly believe in our deductibility rights as a State to deduct from our Federal tax obligation, but we will see what the courts have to say about that.

But nonetheless, for States like mine, which have been able to deduct and also do not have an income tax, the complexity to the taxpayer who has been using this as an analysis for what they might be owing—I know a lot of people think they are going to come out without owing, but I have news. There are people, because of the change in the law, who are actually going to see a tax increase. So I hope you will work specifically with those States that have these issues so that that calculator helps address some of that. Because I think of it as a very big sea change for States like mine and others in how they are going to be impacted.

Can I ask you about cybersecurity and are we taking enough steps to make sure that we have upgraded our system of protection from hacking of the IRS by outside entities?

Mr. KAUTTER. The focus on cybersecurity at the Internal Revenue Service is constantly evolving. The sophistication of the attacks that are directed to the IRS website continues to grow. The criminals continue to grow in their knowledge and sophistication and the amount of resources that they direct toward the IRS websites.

We specifically asked this year in the budget for an increase of 6.2 percent in the funds allocated to operations support specifically to deal with this sort of an issue. We are very concerned about what we are seeing.

Senator CANTWELL. Do you have the people and the resources then?

Mr. KAUTTER. One of the things we are asking for is streamlined critical pay authority. I do not know if you have dealt with that. But streamlined critical pay authority would allow the IRS to hire people in these critical positions in a fraction of the time it would otherwise take, and it would allow us to pay them more than we would otherwise be able to pay under the government pay scale.

Streamlined critical pay was part of the 1998 restructuring act. We do not have anyone at this point in time under streamlined critical pay, because our authority has expired. That is a very important proposal.

Senator CANTWELL. Well, I am happy to work with you on that. I certainly believe that you should, and we should, protect taxpayers with the best cybersecurity, technology, and personnel that can be hired today.

So thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you.

Let us see, who is next? I guess you are next.

Senator CARDIN. Thank you, Mr. Chairman. I appreciate it.

Let me first follow up on Senator Wyden's point on small business. Clearly, we all have a responsibility to be very sensitive to small-business owners who do not have the same capacity as large companies to understand and comply with laws. We try to simplify things for small businesses, we exempt them from some of the regulatory issues, because we recognize the burden.

And quite frankly, the 20-percent deduction is going to be a challenge for some small businesses, particularly when they do not quite understand exactly how it operates and whether they are using what type of structure for their income. And I would hope that that would be a top priority.

And I can tell you that we want to work with you on that so that the small-business community can have the least burden as possible as they try to figure out these new tax laws.

Mr. KAUTTER. Well, Senator, one of our key areas of focus is revising the forms, the instructions, and the IRS publications. And we try to draft those forms and publications and instructions in such a way that they could be understood by the small-business person.

We are very focused on making those understandable, as much as we can with a complicated tax law. So we are focused on it.

Senator CARDIN. Good. Now, I look forward to working with you then.

I was with my colleagues in the State legislature on Monday. They are trying to wrestle with how to change the Maryland tax code as a result of the Federal tax code. It is very difficult.

You know, one of my principal objections on process is that we have a federalism system where the income tax was allowed as a result of the cooperation with the States on the constitutional amendment. And now we have passed a bill without fully understanding the impact on our State governments.

What services are you providing to our State tax collectors so that they can figure out if they want to change policies, but may not have the same capacity because they have relied upon the pre-2018 tax law? Is there any way that you can work with the State tax collectors so that they can get help in trying to figure out how to now administer things that they before did not have to administer?

Mr. KAUTTER. Sure. The IRS does work with State administrators in a number of areas today. One of them is in identity-related theft, so we do have an existing relationship with all State administrators.

Senator CARDIN. My concern is that, for example, in Maryland, if you do not itemize at the Federal level, you are not allowed to itemize at the State level. A lot less people are going to be itemizing now. The State wants to consider some State itemizations that were not allowed before, but they will not have the same type of verifications that they had because they were relying on the Federal Government. Are you prepared to work with the States on that issue?

Mr. KAUTTER. Yes, sir.

Senator CARDIN. Good. I will put them in touch with you then. Thank you.

I am going to talk about private debt collection.

Mr. KAUTTER. Yes, sir.

Senator CARDIN. The National Taxpayer Advocate just recently issued a report showing that for every \$3 that is spent, we collect \$1 in private debt collection. The total cost of about \$20 million collected \$6.7 million. They go on to say taxpayers' right to be informed, right to quality services, right to pay no more than the correct tax, right to challenge the IRS, right to finality, right to privacy, right to confidentiality, all are compromised by private debt collection by the IRS.

Now, I would hope that we would have learned our lesson when we tried this in the past and it did not work, but here we go again. So I have introduced some legislation, because it is legislation-based, I understand that, to prevent this from happening. There have been some letters written to you and to the Inspector General on this issue by some of my colleagues.

The bottom line is, we all have a responsibility to protect taxpayers' rights and to protect the taxpayers' dollars. And this debt collection, as pointed out by the National Taxpayer Advocate, violates all those conditions.

So when are you going to come in here with a recommendation that we get rid of this thing?

Mr. KAUTTER. Well, Senator, the private debt collection effort this time around is less than a year old. The first cases that were

assigned to private debt collection agencies were last April. Up to this point, we have had no problems with data security or data breaches.

Senator CARDIN. Is the National Taxpayer Advocate wrong when they say improper commissions have been paid for work not performed?

Mr. KAUTTER. I am not familiar that those have been paid, but I can look at it, Senator.

Senator CARDIN. I am just reading from the report. And that the warnings that taxpayers would normally get from the IRS are not being given by the private debt collectors, are they wrong on that issue too?

Mr. KAUTTER. Senator, I am not familiar with those sorts of details on the private debt collection. I am aware of the program overall, and overall it seems to be working well.

Senator CARDIN. Working well? Twenty million dollars spent, \$6 million collected, and the ones that are collected are some of which—we do not believe as a result of the private debt collectors—would have been collected anyway?

Mr. KAUTTER. Well, the only cases that have been assigned to private debt collectors so far are about 240,000 of the toughest cases to collect.

The cost of setting up the program is the \$20-million number that you are citing. That investment will stand the program up for several years. So what we are doing is comparing sort of several years of investment with 1 year of collections.

As I said, the program is less than a year old; it is 10 months old. And I understand that the Taxpayer Advocate has concerns. And I think those concerns are fair concerns, and I need to look into them more closely.

Senator CARDIN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Cassidy?

Senator CASSIDY. Hey, sir, thank you for being here. Thanks for serving our country.

You mentioned that the number of identity theft victims has decreased, but has the amount of money dispensed in fraudulent refunds, has that also decreased? And if so, by how much?

Mr. KAUTTER. Senator, I do not have the exact number, but it has decreased. I mean, we have decreased the number of fraudulent returns entering into the system, and we have decreased the number of improper payments.

Senator CASSIDY. I get that. I guess I want to know, is it low-hanging fruit, you know, a relatively small value? And I am not criticizing, I am just trying to get a feeling for it.

Mr. KAUTTER. Yes, sure.

Senator CASSIDY. And if this is what it was a year or 5 years ago, is it roughly that or is that also down 40 percent?

Mr. KAUTTER. I can get you that number, Senator.

Senator CASSIDY. Next, how much roughly are we dispensing in fraudulent refunds?

Mr. KAUTTER. Well, at this point, we are in the process of gathering that data for the latest year, so that is another number I would prefer to get you a more specific number on than what I have right now.

Senator CASSIDY. And I am not trying to play “got you,” but if you are asking for \$300 million in software or IT systems to combat fraud, but we are losing \$20 billion, then we probably should give you more than \$300 million. You know what I am saying?

Mr. KAUTTER. Yes, sir.

Senator CASSIDY. Lawyers, guns, and money—but let us address this problem.

And what is—I mean, at some point, you are always going to have a certain number of fraudulent returns. Do you have a sense of what the acceptable rate of those returns are?

Mr. KAUTTER. Well, what we would say is, zero would be the acceptable number of returns. We do not know that we will ever get there.

But working with the State and local governments and the tax return preparation software community, as well as tax return preparers, we have made good progress. As I said, we have gotten the number of claims down by about two-thirds in the last 2 years. The number of improper returns at this point is about—

Senator CASSIDY. I heard that, so I am going to move on, not just because I caught that; I listened to what you said earlier.

Mr. KAUTTER. Yes.

Senator CASSIDY. I would like to now change topics away from tax returns and talk about something I have been interested in vis-à-vis trade-based money laundering. And I will start off with transfer pricing between subsidiaries of a multinational corporation.

Now, it is easy to imagine that there could be arbitrage of pricing so that gain is realized in a low-tax country and loss is realized in the high-tax country.

And how does the IRS audit or monitor to make sure that gain or loss is being declared appropriately?

Mr. KAUTTER. Sure. Well, first thing I would say, Senator, is that we are hoping, we are hopeful that the new tax reform legislation will decrease the desire for engaging—

Senator CASSIDY. I accept that, but I am actually more interested in—I am going to follow into trade-based money laundering, but I want to start with something which is legitimate, if you will.

Mr. KAUTTER. Sure. And so we have a division within the Internal Revenue Service that focuses specifically on transfer pricing controversy between U.S. companies and foreign-based subsidiaries or related affiliates.

Senator CASSIDY. Now, is there a standard invoice or declaration form that you can look at and plug into a computer and use analytics on as to whether it seems legitimate or not?

Mr. KAUTTER. Well, the transfer pricing calculation tends to be very case-specific. And there are sort of general guidelines, but it really is case by case.

Senator CASSIDY. Now, case by case does not give itself to big analytics. And it does seem as if—and I say this because, allegedly, \$110 billion a year is moving from the United States down to Mexico related to drug trade. And Treasury has confiscated, best we can tell, about \$7 billion. Now, that is a \$103-billion delta, and some of that is trade-based money laundering. So we are trying to figure out how to get at that. And it is ultimately up to our Federal agencies to cooperate to kind of go after this issue.

So let me ask, to what degree do you all, does IRS, collaborate with Customs to make sure that that which is being declared is actually being shipped as opposed to a double invoice or is as presented on the invoice?

Mr. KAUTTER. Sure. So the IRS does work closely with the Customs Bureau, as does the Treasury Department.

Senator CASSIDY. Now, if you do an audit, I mean, what percent of these transfers are audited?

Mr. KAUTTER. I do not know that number off the top of my head.

Senator CASSIDY. Okay. We will ask for a QFR.

Mr. KAUTTER. Sure.

Senator CASSIDY. And to what degree are we sharing information? You mentioned with other governments, but what about with Mexico?

Mr. KAUTTER. We do have some agreements to exchange information with Mexico.

Senator CASSIDY. Is there a standard invoice that is filed when someone declares the value of a traded object? Or is it, you know, kind of up to their choice as to how to file the information?

Mr. KAUTTER. Well, Customs does have forms, standard forms that are filled out. But the numbers that go on the forms, of course, are subject to the individual filers' view of the value.

Senator CASSIDY. But if you were to look at, say, a multinational, you would look just at what they are declaring, but not necessarily audit to make sure that it is correct?

Mr. KAUTTER. The audit selection criteria that the IRS uses involve a fairly sophisticated formula which we feel is pretty good, but it is constantly being refined. But it is a fairly sophisticated analysis.

Senator CASSIDY. We will follow up, because I hear the tap and I know that I am over, so I will yield back. And I thank you for your answers.

The CHAIRMAN. Well, thank you, Senator. Your time has expired.

Senator MENENDEZ?

Senator MENENDEZ. Thank you.

Thank you, Commissioner.

Commissioner, prior to the passage of the Trump corporate tax bill, was there any prohibition against deducting prepaid State income taxes or local property taxes in the year that they were paid?

Mr. KAUTTER. Yes, sir.

Senator MENENDEZ. There was. And let me ask you this. Then why did section 1142 of the Trump corporate tax bill specifically prohibit the deduction of prepaid State income taxes? Why would the bill prohibit something that was already disallowed?

Mr. KAUTTER. Senator, I cannot answer that question. I do not know the answer to that.

Senator MENENDEZ. Well, it seems pretty illogical to me. Let me ask you this. Is there anything in the tax bill that prohibited the deduction of prepaid State and local income taxes, in the legislation itself?

Mr. KAUTTER. In the legislation itself, no.

Senator MENENDEZ. Okay. So you are saying that, before the legislation, you could not deduct prepaid State income taxes as well?

Mr. KAUTTER. Yes, sir.

Senator MENENDEZ. Let me ask you this. Why is it that corporations will be able to deduct? We hear a lot about them issuing bonuses in 2017. But regardless of whether or not they actually made the payment, they are going to be able to deduct it in 2017. Why is it that a corporation can get the deduction, but a middle-class taxpayer cannot?

Mr. KAUTTER. Sure. Well, under the Internal Revenue Code, most corporations are accrual-basis taxpayers. Under the accrual-basis rules, if an expense is accrued by the end of the year and paid within 2½ months after the end of the year in the compensation area, the corporation is allowed a deduction in the year of accrual.

The real property tax deduction operates under a completely different section of the code. And most of those deductions are claimed by cash-basis taxpayers. So it is a different accounting principle.

Senator MENENDEZ. So the code is written in a way that benefits corporations, but does not benefit middle-class taxpayers.

Mr. KAUTTER. Well, there are two methods of accounting: cash and accrual.

Senator MENENDEZ. Well, can an individual taxpayer create that accounting for themselves and then be subject to the same availability?

Mr. KAUTTER. In certain circumstances, they could be on the accrual basis if they were in a trade or business, but not just as an—

Senator MENENDEZ. But the average person is not in a trade or business.

Mr. KAUTTER. Yes; no, not a—

Senator MENENDEZ. So therefore, the code is written in such a way that middle-class families cannot take the same advantage that a corporation can take, saying, we are going to give you a bonus, not pay that bonus in 2017, and get the deduction, but a middle-class family wanting to pay their State income or property tax in the year cannot get that deduction.

Mr. KAUTTER. Under the Internal Revenue Code, that is how it works.

Senator MENENDEZ. Well, something is wrong with that.

Let me ask you this. Several States have so-called scholarship programs, some of which are nothing more than a thinly veiled ruse designed to strip money from public schools and funnel it to private religious schools. And in order to avoid the separation of church and state constitutional issues, some red States offer dollar-for-dollar State income tax deductions for donations. That makes it appear that the funding source is private, when in fact it is really coming from public dollars.

How does this not violate the IRS's substance over form principle?

Mr. KAUTTER. That practice has been allowed now for several years.

Senator MENENDEZ. Well, just because it has been allowed does not mean—you are telling me I cannot get my property tax payers in New Jersey, who just got screwed under this legislation, to pay their taxes in the year that they wish to and not get a deduction? But just because something has existed does not mean it is right.

Mr. KAUTTER. Well, under the general principles for charitable contribution, if the primary purpose of the contribution is donative, which is a disinterested and detached interest of generosity, then the taxpayer is allowed a charitable contribution. If a State wants to allow a credit for that against its tax liability, it can do that.

Senator MENENDEZ. Well, 32 States already have programs, many of which provide a full 100-percent credit for all contributions. Because, even before the tax bill gutted the State and local property tax deduction, high-paid tax lawyers and accountants already figured out that these State-run programs allow a person to avoid hitting the alternative minimum tax by reclassifying their State income tax deductions, which are limited by the AMT, to so-called charitable contribution deductions, which they are not.

So it just seems to me that the code works against individual families, but works for those who are either in a corporate setting or those who are using this workaround, which I would have thought the IRS would say, oh, wait a minute, substance over form—substance over form, and you cannot do that.

Mr. KAUTTER. Yes, I think the substance over form issue is there, Senator.

Senator MENENDEZ. Well, I do not see how it is not, when they are getting their charitable deduction from Federal income taxes as well, when in fact it is for a totally different purpose.

The CHAIRMAN. Okay. Senator, your time is expired.

We will go to Senator Carper.

Senator CARPER. Thanks, Mr. Chairman.

Welcome. Thank you for your service. How many years of service do you have at the IRS?

Mr. KAUTTER. At the IRS? Three months.

Senator CARPER. Three months. How is it going?

Mr. KAUTTER. Good, good. I am very impressed with the IRS and the people there.

Senator CARPER. Is it challenging for the folks who follow you, the folks on your team, to be asked to take a handoff in terms of a major overhaul of the tax code? And we do it sort of like, at the last minute, at the end of the calendar year, and do not really provide the IRS with additional resources. We do not even, you know, respond to your request for streamlined critical pay authority. Is that demoralizing at all to the folks who work there?

Mr. KAUTTER. One of the things that—

Senator CARPER. It is like, we are going to make your job a lot more difficult. We are not going to give you much time, and we are not going to do this streamlined critical pay authority which allows the IRS to draw on, I think, untapped private-sector expertise in order to attract talent in critical areas. That has to be demoralizing.

Mr. KAUTTER. It is challenging. The Internal Revenue Service, Senator, has a very strong, can-do, positive culture. And so—

Senator CARPER. Well, they must.

Mr. KAUTTER. They do, and whatever is dealt out, they deal with and do it in a forthright manner.

In trying to implement this tax reform legislation, IRS is going about it in a very disciplined, project-managed fashion. We do need

the additional funds; the \$397 million is critical to be able to effectively implement.

Senator CARPER. Give us some examples of what you could do with that and why that makes sense. I have always heard that if we provide the funding that is being sought by the IRS, they could actually provide a return, \$5, \$6 on the dollar. Is that true?

Mr. KAUTTER. In the enforcement areas, that is exactly right.

Senator CARPER. Yes.

Mr. KAUTTER. And under the President's budget, we do ask for an increase in enforcement funds.

But the \$397 million for implementation of the tax reform act is to update the IRS systems. The IRS runs 140 integrated software programs.

Senator CARPER. That is a lot.

Mr. KAUTTER. That is a lot. And they are closely connected and difficult to update.

And then, as I mentioned earlier, 19 percent is for taxpayer assistance, outreach, and taxpayer education.

Interestingly, only 4 percent of the funds are to adjust the forms, the regulations, and the guidance. It is interesting to me how much technology takes of the total spend for implementation these days compared to, say, 1986.

Senator CARPER. Talk to us a little bit more. I know you have already discussed a little bit this streamlined critical pay authority. Just give us some examples of why that is important.

Mr. KAUTTER. Sure. So under streamlined critical pay, the IRS would be able to bring someone on in 6 weeks instead of 6 months. And they could pay someone up to probably a third more than they could otherwise pay if they have brought them in on the general government pay scale.

And when you get into the areas of technology and cybersecurity, having that ability to hire someone in a hurry—I have seen the IRS lose people because of the amount of time it takes to get them onboard, people who were critical who really wanted to serve the government.

So those two in particular—the amount of time it takes to get somebody there and the amount we could pay to attract the talent—are the two key components of why streamlined critical pay matters.

Senator CARPER. Can you think of any reasonable reason on earth why we should not do that?

Mr. KAUTTER. No, sir.

Senator CARPER. All right. You have, I think, another request that does not involve extra funding, but it would better ensure that some of the folks who are preparing tax returns for people are actually knowledgeable, competent, able to do that job well.

Mr. KAUTTER. Yes, sir. Well, about 400,000 paid tax return preparers have no professional certification. And tax return preparers prepare almost 60 percent of all the returns filed. So having tax return preparers who have a minimum level of knowledge and competency with respect to the tax law not only is helpful to the taxpayers themselves, but to the administration of the Internal Revenue Code in terms of efficiency and errors that have to be corrected.

Senator CARPER. All right. Mention one more issue, one more area that you would like for us to focus our time and attention on to enable you to do your job more effectively, more efficiently, please.

Mr. KAUTTER. Well, I would say I would think the key issues for us right now are streamlined critical pay and funding for tax reform implementation.

I would say the increased funding for level of service—

Senator CARPER. Increased funding for—

Mr. KAUTTER. Level of service, our ability to respond to calls from taxpayers. This year in the budget we had to make some choices, and the choice was to allocate a little bit more toward enforcement, a lot more toward systems and infrastructure. And level of service is very important.

And so, if the IRS were to be granted more funding by Congress, I think that is the first place we would put it.

Senator CARPER. Great, thank you so much.

Mr. KAUTTER. Yes, sir.

The CHAIRMAN. Thank you, Senator.

Senator Portman?

Senator PORTMAN. Thank you, Mr. Chairman.

And I appreciate your being here, Mr. Kautter, to talk just a little about implementation.

And we had a good hearing earlier today about some of the positive aspects of the tax reform legislation, and specifically that over 4 million people have now received a bonus or a pay increase and that many people are seeing benefits. And small businesses—the NFIB is reporting more optimism among small businesses than ever in the history of their taking that survey.

And of course, we have heard the announcements from so many larger businesses. Over 350 of them have now come forward and said they are doing something to reinvest in their business, often investing in equipment to make their employees more productive, which, of course, we all know is important to economic growth and higher wages.

I do think that the IRS is under-resourced. And by the way, I made this point, as did some of my colleagues, long before this tax reform bill was even being considered. I think you needed it with the old tax law. And certainly with the new tax law, it would be helpful to have resources. So I agree with what the chairman said at the outset about the fact that the additional resources are necessary to ensure that our constituents are properly taken care of; in other words, that taxpayer service is there so the phone gets answered and that there are capable people, as Senator Carper has indicated, to be able to answer tough questions about a complicated tax code. And it will always be complicated, because it is inherently difficult to determine the appropriate income.

I do think it needs to be coupled with smart reforms. And you have talked about a couple you would like to see. You remember back in the 1990s, mid-1990s, there was an IRS concern about technology. And you have focused on that today. You said your software and your hardware are both out of date.

At that time, there was a concern about, in the 1990s, when, as you indicate, technology was not as important as it is today, that

there were stovepipes not talking to one another and there was, therefore, a lot of money that had been spent and not spent effectively; some said wasted. I remember the figure of \$3 billion on technology because of inability to communicate across lines in the department.

Do you think it is time for another review? At that time, there was a commission which studied this issue for a year or so. It was bipartisan, bicameral. It came out with the IRS reforms that were then passed. Subsequently, the budget has increased for the IRS, but in the context of reform.

There have also been concerns, as you know, on both sides of the aisle about some of the IRS practices, in particular the targeting of conservative groups, which occurred in the Obama administration, I think, which also made it difficult for people to stand up and support additional resources and a sense that there maybe was not accountability.

So you are Acting Commissioner. I know there is discussion of a nominee coming up here soon. And you have 40-some years of practice with the IRS as a private practitioner working with the IRS. Is it time for that kind of an overhaul, or is it just time to say, let us increase the funding and allow the IRS to determine where it goes? I mean, is there an opportunity here to back up and look at your technology and look at your service and look at how to make the IRS a first-rate service organization responding to taxpayers?

Mr. KAUTTER. Thanks. Thank you, Senator. That is a terrific question.

I think the time to back up and take a look at the IRS is here. It has been 20 years since the last IRS restructuring act. Within that act, certain structures were put in place with respect to the IRS and its organization and how it operated.

There is not a private business today that has not revamped itself in the last 20 years. And so for the IRS to have the same operating organizational structure today as in 1998 does not make a lot of sense to me.

I think we could make some changes that would facilitate taxpayer service and efficiency within the IRS if we were to take a step back and take a disciplined, thoughtful look at how the IRS is structured and how it operates, I really personally believe as a practitioner.

So I have been at the IRS 3 months. I do not have a vested interest in how it was structured or why it works the way it does. I am pleasantly surprised at the attitude and dedication of the people who are there.

I am also disappointed that the structure sometimes gets in the way of taxpayer service.

Senator PORTMAN. Three hundred ninety-seven million dollars you are requesting over the next 2 years outside of the budget, as I understand it.

Mr. KAUTTER. Yes, sir.

Senator PORTMAN. And 73 percent is for technology. Is that correct?

Mr. KAUTTER. Yes, sir.

Senator PORTMAN. So that seems to be your top priority in terms of the funding. You also, though, mentioned taxpayer service. Can you tell us, when someone calls the IRS and seeks an answer to a question, a taxpayer question, do you know how often that person gets a prompt and correct answer?

Mr. KAUTTER. So the answer this year—well, last year it was around 75 percent, and this year it should be around 77 percent. Next year, under the budget, it would go down.

Senator PORTMAN. So this means that somewhere between a quarter and a third of the people who are calling in are not getting an answer or not getting an accurate answer and maybe not getting the phone answered—

Mr. KAUTTER. Not getting through.

Senator PORTMAN. Just not getting through.

Mr. KAUTTER. Yes.

Senator PORTMAN. So I think, Mr. Chairman, we are at that point again.

And I hope, you know—I know you are, again, in an acting capacity. And I know all of us are looking forward to the nominee and having the opportunity to go through a hearing and get someone confirmed. But can I make a request today that you submit to the committee—and I hope on a bipartisan basis the committee would follow up on this—what your recommendations would be?

And if you find as you go back you are not able or comfortable doing that, I would still like personally to have that communication with you. Because I think it is time for us to back up and take a look.

I think the chairman and ranking member have said it well that, whether this tax bill had passed or not, it is time for us to put the reforms in place and, with that, provide the necessary resources to be able to allow our constituents to get the kind of service that they deserve.

Mr. KAUTTER. I would very much like to work with you on that.

Senator PORTMAN. All right, thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator McCaskill?

Senator MCCASKILL. Thank you, Mr. Chairman. I do think there is a lot of bipartisan support for us giving the IRS the resources that it needs.

I mean, I cannot imagine that anybody in America thinks it makes any sense that if we have an entity that is operating in a sea of red ink, that the first thing we do is see if we could not just cut and cut and cut the receivables department. I am pretty sure that if a business was in debt, they would be building up their receivables department, not tearing it down.

We have cut, against the objections of many of us, almost a billion dollars from the IRS budget in the last 7 years. If we adjust that for inflation, we have cut it by almost 20 percent.

And one of the things that stood out to me as I was preparing for this hearing was that the worst-performing phone line at the IRS in 2017—do you know what it was?

Mr. KAUTTER. No.

Senator MCCASKILL. Which phone line was the worst performing? It was the one dedicated to taxpayers who want to make a payment. The average length of time that someone had to sit on the phone if they wanted to make a payment in 2017 was 46 minutes. So not only have we cut our receivables department, we clearly are not paying attention to the most important place that we can hope to, in fact, gain the revenue that would make this a level playing field for all Americans, because so many Americans are in fact doing the right thing. But as we all know, right now they are having to, you know, wait a long time.

The line got 2,656,000 phone calls and change, and only 1,071,000 of those ever got to talk to a real person.

Mr. KAUTTER. You know, Senator, it is a terrific point. And I think there are some simple things—they are not all that expensive—that I think the IRS needs to do.

For example, I think when someone calls, there should be a feature on the system that tells you how long the wait is. And secondly, there should be a feature to opt for a call back.

So in many private businesses today, you can say, the wait is 32 minutes. If you would like a call back, leave your number. And we do not even have that feature right now, and I think we need things like that.

Senator MCCASKILL. And in talking to the people who are on the front lines at the IRS who work in Missouri, there is a new phone system that has been put in. And there are a large number of complaints about how efficiently it is working.

I do not know if you have had a chance to dig into that in the short time that you have had the big job. But they say they are so frustrated because someone will be sitting there, and a call will not be dropping into their line, and yet the wait is very, very long. So it is not working right.

And in fact, they used to be able to log in one place and handle the phone call. Now they have to log in on the hard line, then log in on the screen. And if the call drops, they have to go back and log in both places again. So as usual, IT procurement has not quite, I think, met the mark.

I wanted to complete my questioning by asking specifically about Equifax. The IRS found out about the Equifax breach at the same time the rest of America did, even though IRS had a very large contract with Equifax involving an awful lot of sensitive taxpayer data. Equifax claimed it did not need to notify the IRS about the breach because IRS data was not compromised.

In a follow-up in a site visit, IRS went to Equifax and found that it was in fact mishandling and improperly storing IRS data.

You know, I guess—are you all now making changes to your contracting practices and requiring that any breach of one of your contractors, whether it involves the IRS or not, is reported to you?

Mr. KAUTTER. I will have to follow up to see if we include that clause. But your description of the Equifax contract is accurate. I mean, we were informed, and immediately we did a site visit. None of the IRS data had been compromised. We did find that they were storing some taxpayer data—it had not been compromised—that should not have been stored. We have dealt with that issue. That

data no longer exists there. And the Equifax contract has been terminated.

But your suggestion about a clause for future contracts is a terrific suggestion.

Senator MCCASKILL. I would like to look into the contracting practices. And in connection with that, very briefly, you all had to do a bridge contract with Equifax. And I will follow up with questions for the record.

I have some legislation on bridge contracts. I have seen them all over the Federal Government, and they almost always are a huge mistake. And so it is a lack of preparation, it is a lack of preparedness for terminating a contract, because I think too often everyone just assumes they are going to renew a contract, which is, of course, the wrong mindset if we are really trying to get the best value for our dollar.

But I will give you some of those questions for the record.

Thank you, Mr. Chairman, very much.

Mr. KAUTTER. Thank you. Thank you.

The CHAIRMAN. Thank you, Senator.

Senator Whitehouse?

Senator WHITEHOUSE. You are going to have to twist your neck even more to get to me. [Laughter.]

Thank you for coming here.

Mr. KAUTTER. Yes, sir.

Senator WHITEHOUSE. This morning, Mr. Mnuchin was in that seat, and he and I spoke about the problem of income inequality in our country and the role of the tax system as a progressive system so that people who have much higher incomes are paying a higher rate than people who have much lower incomes. I think that has been a policy foundation of our country for a long time. Do you agree?

Mr. KAUTTER. Yes, sir.

Senator WHITEHOUSE. Yes. And one of the things that I asked him was if the IRS, if he could instruct the IRS to go back to publishing the consolidated tax information of the 400 top taxpayers.

Until recently, the IRS took the 400 top taxpayers, combined them into one so they were anonymized, and then took their tax payments and combined that into one so it was anonymized, but at least it gave America a look at how the highest-income folks in America were doing as far as paying income taxes into a progressive system.

What we found out when the IRS was collecting and distributing this data, up until I guess 2014 was the last public report, was that those extremely high-end income earners were actually paying lower tax rates than most people.

And I think that is important information for Americans to know, that the system is not serving them in terms of delivering actual progressivity. I think the latest information we have is that the highest 400 paid the same tax rate that you would pay if you were making about \$70,000 a year. So if you are a moderately successful plumber or a local lawyer in a small community, there you are, and on the other hand you have people who are making hundreds of millions of dollars a year and they are not paying a higher rate than you are.

So I will not put you on the spot right now, but I will ask you, particularly if the Treasury Secretary agrees, to go back to aggregating and publishing that information. Because I think it is a warning sign of a failure in our tax system.

Mr. KAUTTER. Sure, Senator. And I will work with the Secretary to get back to you on that. Thank you.

Senator WHITEHOUSE. Great.

The other thing that I wanted to talk to you about is the problem of foreign influence in our elections. We have been warned repeatedly by law enforcement witnesses, national security witnesses, and some of the very credible, experienced, bipartisan think tanks here in Washington that the easiest way for Russians, for instance, to manipulate our elections is to put money into our elections.

It is a violation of Federal law for a foreign national directly or indirectly to make a contribution in connection with a Federal, State, or a local election or to a political party, or to make an independent expenditure in our elections or an electioneering communication.

Now, a lot of that activity takes place through IRS-regulated 501(c)(4) organizations. What steps does the IRS have in place to make sure that the donors to 501(c)(4) organizations are not foreign nationals or cutouts for foreign nationals or shell corporations hiding foreign nationals?

Mr. KAUTTER. Sure. So at the moment, Senator, 501(c)(4) organizations submit a schedule with a list of donors attached to it.

Senator WHITEHOUSE. Correct.

Mr. KAUTTER. I would have to check to see at this point—

Senator WHITEHOUSE. What do you do with that list?

Mr. KAUTTER. I would have to check to see what we do with the list. I am not aware that we—

Senator WHITEHOUSE. Do you know if you cross-reference with FinCEN?

Mr. KAUTTER. I do not know, but I can check and get back to you.

Senator WHITEHOUSE. Okay. And do you know if there is any secondary look at, say, phony baloney-seeming shell corporations to take a look at who might be behind them?

Mr. KAUTTER. Yes, and—

Senator WHITEHOUSE. Acme Russian Corruption, LLC in Delaware might be a signal. [Laughter.]

Mr. KAUTTER. It could be, Senator. In the short time I have been at the IRS, I have not gotten into that, but I will follow up with you.

Senator WHITEHOUSE. Okay. Do you agree that it is important that we try to enforce that law and to do the investigative work internally to determine whether or not Russian or other foreign nationals are putting money into our elections?

Mr. KAUTTER. I know that it is important for the IRS, I think, to make sure that people comply with the rules and regulations. How this issue should be handled, which agency in the Federal Government is best to handle it—I am not sure it is the IRS.

Senator WHITEHOUSE. But you at least have the information, so you are—without you giving somebody else information, they do not even get off the dime, do they?

Mr. KAUTTER. They would not. And we would have to, I mean, think through that.

Senator WHITEHOUSE. Okay. Well, we will keep working with you on it. I think it is an important thing.

Mr. KAUTTER. Yes, sir.

Senator WHITEHOUSE. I know my time has run out. And I thank the chairman.

Mr. KAUTTER. Thank you.

The CHAIRMAN. Well, thank you, Senator.

I understand that Senator Wyden has a question or two.

Senator WYDEN. Thank you, Mr. Chairman.

I just want to follow up on one other area. It relates to that letter I sent to you, Mr. Kautter, about conflicts of interest.

As you know, I have had concern about your dual roles as Assistant Secretary for Tax Policy and Acting Commissioner of the IRS. It seems to me there is essentially an inherent conflict of interest that is going to make it tough for somebody to navigate these two roles appropriately.

Secretary Mnuchin stated an intention to audit the real estate taxes issue, which is something that inherently focuses on blue States. We talked about that earlier as just kind of one example.

Now, in December I sent you a letter asking about real and potential conflicts. And I must say, I was concerned and troubled by some of your responses. So let me just see, as we wrap up, if we can get some answers to some of the questions that were unanswered.

In your role as Assistant Secretary for Tax Policy, were you party to any decisions intended to disfavor one political constituency over another or disfavor particular States based on the political constituency of those States? That is pretty much a "yes" or "no" answer.

Mr. KAUTTER. No.

Senator WYDEN. Okay. I am puzzled why you would answer straightforwardly today, but we could not get it in the response to my letter. So I am just going to leave it at that; you have answered it straightforwardly today.

In your role as Assistant Secretary for Tax Policy, were you involved in the decision to remove from the Treasury Department's website the May 2012 Office of Tax Analysis Technical Paper 5 which showed that owners of capital rather than workers are the primary beneficiaries of corporate tax cuts?

Mr. KAUTTER. No, sir.

Senator WYDEN. Okay. Since you were elected to serve as Acting IRS Commissioner, have you had any meetings with the President or prepared any written memos, reports, or other materials to be delivered to the President?

Mr. KAUTTER. I have not met with the President. Whether something I have written has made its way to the President, I do not know. But I have not prepared anything directly for the President.

Senator WYDEN. Okay. Now, in your response to my letter, you included references to numerous policies intended to prevent political interference with taxpayer-specific actions like audits and investigations. But as we have seen in this committee, the way tax laws are interpreted by the IRS can affect public confidence.

As the IRS works to implement a \$1.5-trillion tax bill, can you tell us what you are doing there at the agency to make sure it is understood that the decisions are going to be made free of political bias?

Mr. KAUTTER. Well, the implementation of the tax reform act at the Internal Revenue Service is being led by a career IRS employee. All of the individuals on the leadership team are career IRS employees, as are all of the individuals in the business operating divisions.

So I have oversight at the IRS, but I am not directly involved in making decisions with respect to which forms go first or things like that, or even the—

Senator WYDEN. Let me ask you this. As you know, when you were in the private sector, there were some questions about matters that were delegated. You and I had some talks about it, pretty spirited talks. And one of the reasons that I felt that I could support your going forward is that you would make sure that on your watch there were not problems, because as we talked about, in the private sector there were problems.

And you made the argument that you would delegate it. To your credit, you said, you know, I have to be careful about that in the future.

So how do you reconcile what you told me today with what we were concerned about earlier?

Mr. KAUTTER. Well, Senator Wyden, delegation is a very important tool, no question about it. But as we saw before, what happens is, if it is delegation, you know, the buck still stops, you know, with you.

Senator WYDEN. Sure. Sure. So do you, like, review their work or, I mean, how does that work?

Mr. KAUTTER. I do. I am constantly informed of what is going on and how things are progressing. So it is a dialogue, but I have delegated the responsibility for day-to-day operations.

There are two outstanding Deputy Commissioners, and we are in constant contact. We meet almost daily and discuss what is occurring.

Senator WYDEN. Okay. My time is up. And, Mr. Chairman, I appreciate the additional round.

I just want to make it clear, I do not want to hear about problems along the lines of what we saw in that private-sector area, because I was very concerned about the delegation when you were in the private sector. And your response—and you told me it was going to be a new day, and that is why I felt that I could advance your nomination.

I do not want to be back here in a few months and we see political problems and you tell me, well, it was delegated to all these career people and, you know, that was that.

So, I am just putting everybody on notice. And I appreciate the chance to continue this discussion. Thank you.

The CHAIRMAN. Thanks, Senator.

Now, Senator Warner, we had not counted on you coming, but you are going to be the last questioner.

Senator WARNER. Thank you, Mr. Chairman. And, Commissioner, I think you probably thought you were in the clear, but I do have one set of questions.

As Acting Commissioner, you have about 70,000 employees who work for you at this point, is that right?

Mr. KAUTTER. Yes, sir.

Senator WARNER. And given the complexity of the tax code—and I do not fully agree with the chairman's characterization of the tax reform—but clearly there is a lot of work to be done now to try to implement that.

You have really got to recruit good candidates and maintain the quality of the workforce. Isn't that a top priority?

Mr. KAUTTER. Yes, sir.

Senator WARNER. And you have been a tax practitioner most of your life. That is correct, is it not?

Mr. KAUTTER. Yes, sir.

Senator WARNER. And as a matter of fact, most of your employees, I think, with that expertise could actually probably make more money in the private sector, could they not?

Mr. KAUTTER. They could indeed.

Senator WARNER. And to quote, actually, the budget: "Federal employees with professional degrees are actually undercompensated relative to private-sector peers in a CBO analysis."

Now, you have to make sure as well, obviously, that you have a lot—are the majority of your employees college graduates?

Mr. KAUTTER. Yes, sir.

Senator WARNER. Okay. So we have notice that they are underpaid; we know they could make more in the private sector. But I look at the budget that was put out, and the budget cuts retirement benefits for Federal employees, it increases the amount Federal employees have to contribute to their pensions, it increases the number of years tested for determining the value of the pensions, and it eliminates the cost-of-living adjustments once they retire.

So you have a tough job trying to recruit and retain quality employees, and yet the budget that the administration has put forward wants to cut back on their pensions, make it harder for them to retire, not recognize the amount of competition that they have with the private sector.

You know, how can the IRS, with the stress it is under, and hopefully under your leadership the IRS gets back to the kind of service—and I appreciate the chairman's comments earlier saying the kind of wanton meat-axe cuts that have been made to the IRS by Congress recently do not really help the matter—but how are you able to do your job with this kind of budget, which I think would undermine the ability to recruit and retain good employees?

Mr. KAUTTER. Senator, one of the things I have been exceedingly impressed by is the dedication of the people at the Internal Revenue Service to serve the country. And their commitment to excellence and to serving the public, I think, is something any organization would be proud of.

And I think it is a challenge to recruit people into any aspect of government these days for a whole variety of reasons.

We will do the best we can, and the IRS will get the job done. I am confident.

Senator WARNER. Well, one thing, Commissioner, I would just say is that in another—we all sit on different committees. I have another committee that has gotten a lot of attention these days, that has brought up the President's constant request for, you know, knowing people's political affiliation or asking Federal employees to pledge their loyalty to him.

You know, with an agency that is independent and so important as the IRS, I just want to make sure that you are going to assure me that within the responsibilities that you have—and obviously no one dictates what the President says or tweets—that you are going to do your utmost to make sure that the President and this sense of loyalty requirement, political affiliation requirement, which I believe, and hopefully you do as well, flies in the face of what the IRS should be all about in terms of its independence, regardless of who is President, that you will do all you can to combat any impressions that that kind of loyalty test or political affiliation test would become part and parcel of your administration of the IRS.

Mr. KAUTTER. Well, Senator, I take my responsibilities as Acting Commissioner very seriously, including the responsibility to administer and enforce the tax laws in a fair and equitable manner, and in a way that is free from political influence.

And I will give you my assurance that both myself and, to the best of my ability, the IRS will live up to the letter and the spirit of those obligations.

Senator WARNER. Well, thank you. And my time is running out, but I just want to say doing your job well is so important since, on even the administration's current projections, we are going to bring our revenue run rate down to slightly over 16 percent of GDP when we have had historic averages more between 17 and 18. And we will see whether the growth comes about that some have predicted.

I was not supportive of the tax bill, but I hope it does come about. But boy, if it does not, we are going to need to make sure those employees are loyal, dedicated, and can collect every bit of that revenue that is owed the United States Government.

Thank you, Mr. Chairman, for letting me come in late.

And thank you, Acting Commissioner, for answering my questions.

The CHAIRMAN. Well, thank you, Senator. I would like to respond to the comments of some of my friends on the other side regarding the new pass-through deduction known as section 199A.

I want to put this new tax policy in context. It is a newer and more expanded version of former section 199. Millions of small businesses will benefit from the deduction. It is important to note the deduction is simplified for small service providers.

When we passed section 199 in 2004, it was a bipartisan success. There were some glitches, and we fixed them over time. No one defined the policy in section 199 as a loophole because of glitches. Some criticized it as complex, but the businesses it was targeted to, largely manufacturers, grew accustomed to it. I expect we will see the same development with new section 199A.

In the case of section 199A, we need to define it for what it is, a meaningful deduction for pass-through businesses.

The National Federation of Independent Business, NFIB, on December 22nd, 2017 stated, quote: "NFIB fought for decades for a real tax cut for small-business owners. The Tax Cuts and Jobs Act dramatically improves the way small businesses are treated, delivering hundreds of billions of dollars in tax cuts," unquote.

So I will, by unanimous consent, insert in the record a copy of the NFIB statement.

[The statement appears in the appendix on p. 32.]

The CHAIRMAN. And I will note, NFIB represents 325,000 small-business owners in this country.

And what I am hearing from small businesses in my State is consistent with what NFIB said. They welcome the tax relief.

Now, I want to tell you personally how much I have appreciated you appearing here today and the forthrightness with which you testified.

And I will just add this. Since it appears that we will not obtain a quorum here, we will have to postpone the markup scheduled for today to occur during a rollcall vote of the Senate at a location to be determined that will be off the floor. So we will schedule that.

And I want to thank Acting Commissioner Kautter for attending today and being as patient as he has been.

And I want to thank all of my colleagues for their participation in today's hearing.

For any of my colleagues who have written questions, I ask that you submit them by close of business next Wednesday, February 21st.

We are grateful to you, Mr. Kautter. We are grateful for your service to this country. We are grateful for your intelligence and the way you have helped this committee time after time. And we are grateful for the future work that you are going to be doing for us.

So with that, we will just adjourn this hearing. And I think it has been a good hearing, and we will go from there. Thanks so much. I appreciate it.

Mr. KAUTTER. Thank you, Mr. Chairman.

[Whereupon, at 4:10 p.m., the hearing was concluded.]



## APPENDIX

### ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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PREPARED STATEMENT OF HON. ORRIN. G. HATCH,  
A U.S. SENATOR FROM UTAH

WASHINGTON—Senate Finance Committee chairman Orrin G. Hatch (R-Utah) today delivered the following opening statement at a Finance Committee hearing to consider the administration's fiscal year (FY) 2019 budget request for the Internal Revenue Service (IRS). The hearing will include discussions about the agency's critical role in implementing tax reform.

We're gathered here for the second time today to talk once again about the President's proposed budget for fiscal year 2019. We are grateful to have Mr. David Kautter, the acting IRS commissioner here today to talk specifically about the President's proposed budget for the IRS.

Mr. Kautter has served admirably in this capacity. He's filled two critical roles with the administration during the busiest time the tax policy world has seen in decades.

This is no easy task.

Mr. Kautter deserves our thanks for serving with such distinction.

Now, some of my colleagues may tune me out for the next several minutes, as they've already heard me talk effusively about the success of the new tax reform law. But, I hope people are listening, because there's been quite a bit of good news lately. Any major change to the tax system should be evaluated on the merits, whatever they may be. And, by and large, we are seeing great things from tax reform.

Some have argued that our tax reform bill, which provides middle-class tax relief and lowered taxes on job creators, benefits only the rich or the high-ranking officers of greedy corporations. Others tend to vilify companies' statements about their capital structure, including dividend payments, indebtedness, or share buybacks, as things that benefit only the wealthy stockholder or investor.

Yet, quite often, a business's success or bottom line results in increased valuations of middle-class retirement accounts and pensions. In fact, our private retirement system has been the biggest generator of middle-class wealth in our Nation's history. And, because more than one-third of all corporate stock holdings in the United States are in various forms of retirement accounts, growing businesses contribute directly to the expansion of that middle-class wealth.

So yes, with lower corporate tax rates and other reforms to our business tax system, we have seen some immediate success as hundreds of major companies have publicly announced their plans to raise wages, distribute bonuses, or boost employee 401(k) contributions. At the same time today's success is helping to improve the retirements and investments of millions of middle-class Americans.

I'd say that's a good thing.

That said, despite all of this good news, we still have a great deal of work to do to ensure that the tax law is implemented correctly. The Treasury Department, IRS, and Congress—especially the tax writing committees—have to work together to ensure that the law is implemented and administered as Congress intended.

We look forward to working with the administration, and with IRS specifically, as they continue to implement this law and issue guidance.

This committee will also be examining possible administrative reforms at the IRS, giving the IRS greater flexibility and bringing it into the 21st century. I look forward to continued feedback from the IRS and Treasury on ways we can work to improve taxpayer services and administration.

That said, I've made no secret about my disagreements with the Internal Revenue Service over the years. I led—along with my good friend, Ranking Member Wyden—the most thorough and comprehensive bipartisan investigation of the IRS in decades. I've gone after the IRS for everything from wasteful spending to political targeting to questionable enforcement practices.

No one here needs to remind me about IRS missteps, regardless of which President or Commissioner has been at the helm. But personally, I think it's high time that Congress reexamines its approach to the agency.

Because IRS will bear the brunt of the burden in implementing and administering the tax code and the new tax provisions, it needs sufficient personnel and resources to carry out its important mission at this critical juncture.

Let's keep in mind that the IRS is the only agency in the government that touches every single American every single year. And that's why I've pushed for such robust oversight over the years. It is also why the IRS should get the resources it needs to do its job right.

For example, the IRS is still using computer software that is older than most of my committee staff. And, you can take a look at them—they're not all millennials.

The agency is shedding staff and resources. Agency reductions might be a good thing in some cases, but it should be done through thoughtful reforms, not the blunt axe of blind budget cuts.

The administration, in its budget, has proposed additional cuts to funding for the IRS. I think that is a mistake. While I've had quite a bit to say over the years about the allocation of resources at the IRS, now, directly after passage of a major overhaul of the tax system, is not a great time to further reduce the taxpayer services budget of the agency that will do most of the work in implementing the updated tax code.

We need to take a close look at this issue and be fiscally responsible with any solutions, but, as we do this, we should also consider what is in the best interest of proper and effective administration of our recently reformed tax code.

Before I close, I do want to note that we've noticed an executive business meeting for this time. If, at any point during the hearing, a suitable quorum is present, I intend to pause the hearing and move to votes on the nominations of Mr. Dennis Shea and Mr. C.J. Mahoney. Thereafter, we'll resume our hearing.

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### **NFIB Celebrates Hard-Fought Victory on Historic Tax Law**

December 22, 2017

***President's signature marks the end of a decades-long fight for small business tax reform and paves the way for robust growth.***

Washington, DC (December 22, 2017)—The National Federation of Independent Business (NFIB) issued the following statement today on behalf of the president and CEO Juanita Duggan on the Tax Cuts and Jobs Act becoming law:

NFIB fought for decades for a real tax cut for small business owners. The Tax Cuts and Jobs Act dramatically improves the way small businesses are treated, delivering hundreds of billions of dollars in tax cuts.

Small business optimism has been near record highs all year long in anticipation of this moment. Starting in 2018, millions of small businesses will have substantially more money to convert their optimism into investments. They can buy new equipment, increase inventory, pay workers more, create new jobs, and engage in the economic activities that drive the U.S. economy.

The Tax Cuts and Jobs Act is a once-in-a-generation achievement. This is a historic day for small business and the country. We are grateful to President Trump for his leadership on this issue, which started even before he took office. Today he fulfilled his promise to cut taxes for American small businesses.

For more information about NFIB, please visit [www.nfib.com](http://www.nfib.com).

PREPARED STATEMENT OF HON. DAVID J. KAUTTER, ACTING COMMISSIONER, INTERNAL REVENUE SERVICE, AND ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

## INTRODUCTION

Chairman Hatch, Ranking Member Wyden, and members of the committee, thank you for the opportunity to discuss the IRS's budget and current operations, including efforts to improve taxpayer service.

In allocating resources, the IRS strives to balance three competing and overarching priorities: basic tax administration, sustaining our information technology (IT) systems and modernizing our operations. The President's fiscal year (FY) 2019 budget request attempts to balance these priorities by investing in key mission-critical requirements and build on the work the IRS has already begun in FY 2018 to implement the Tax Cuts and Jobs Act.

This piece of legislation was the first major tax reform legislation in more than 30 years. With hundreds of provisions intended to provide relief to American families and make America's businesses more competitive, the new law will require extensive work by the IRS in calendar years 2018 and 2019 to serve the needs of both taxpayers and tax professionals. It is crucial that the IRS receive additional funding this fiscal year to avoid any disruptions during next year's tax filing season.

The IRS remains mindful of the need to do everything possible to provide taxpayers and their representatives with secure, high-quality assistance and services, through every available channel. The agency spends a significant amount of time and resources each year working to fulfill this critical part of our mission, and our workforce remains dedicated to helping taxpayers understand and meet their filing obligations. Taxpayer needs have been evolving, with more taxpayers conducting their business using digital tools at the time and place of their choosing. The FY 2019 budget invests resources to meet these needs by reducing dependency on a single point of entry and ensuring the IRS meets the needs of all taxpayers.

The most visible service the IRS provides each year is delivery of a smooth tax filing season. I'm pleased to report that the 2018 filing season began on schedule on January 29th and is going well so far. During calendar year (CY) 2017, the IRS received more than 150 million individual income tax returns, 87 percent of which were filed electronically. We issued more than 111 million refunds for a total of approximately \$320 billion, with the average refund totaling approximately \$2,800.

## THE PRESIDENT'S FY 2019 BUDGET

The President's FY 2019 budget request of \$11.135 billion includes savings and reductions of \$23.7 million and 2,163 full-time equivalent equivalents (FTE) compared to the FY 2018 Annualized Continuing Resolution level.

The budget invests in high-priority programs to allow the IRS to assist more taxpayers by becoming more efficient and effective. The budget also invests in technology and data analytics, to increase the use of "lighter touch" compliance contacts and focus enforcement on closing the tax gap, and to protect taxpayer refunds from fraud. Importantly, the budget increases funding for security and replacing obsolete hardware to protect taxpayers' sensitive data from growing cyber threats. In addition, the budget requests modest changes to the IRS transfer and reprogramming authority to provide the IRS with the flexibility necessary to manage its resources more effectively.

**Operations Support.** The President's budget request includes \$4.16 billion for operations support programs including rent, cyber and physical security, IT services for all IRS employees, and core tax processing and compliance systems. Within that total, \$2.29 billion is allocated for information services, which is \$217.8 million, or 10.5 percent, above the FY 2018 annualized continuing resolution level.

The management, maintenance, and ongoing enhancement of the IRS's information technology systems are central to the reliability of its operations, and to the successful accomplishment of its mission. The 2019 budget includes dedicated funding to refresh IRS hardware and software to provide a stable foundation for delivering technology services required for day-to-day operations, transforming the taxpayer experience, and modernizing IRS operations.

At the end of FY 2017, more than 59 percent of IRS hardware was past its useful life compared to 64 percent at the end of FY 2016, and 32 percent of software was two or more releases behind the most current commercially-available version. The

FY 2019 budget provides \$187.8 million to enable the IRS to implement critical hardware and software upgrades and reduce system outages and failures.

Sustained investments in IT are also required to improve cybersecurity and ensure the IRS can continue to safeguard taxpayer data. The IRS combats more than 1 million cyberattacks daily, and operates strong network perimeter defenses to mitigate threats, detect vulnerabilities and monitor network security. The 2019 budget includes \$303.7 million for these critical activities.

**Taxpayer Services.** The President's budget request includes \$2.24 billion for taxpayer services, which is \$108.7 million, or 4.6 percent, below the FY 2018 annualized continuing resolution level. The IRS is mindful of the need to continually improve our efforts to ensure taxpayers can file their taxes as quickly and easily as possible. We will continue expanding opportunities for taxpayers and their representatives to complete service and compliance interactions through their preferred channel, be it online, over the phone, or in-person at one of the IRS's many Taxpayer Assistance Centers (TACs).

At the same time, we will continue our investments in improving the use of online tools and offerings and modernizing the taxpayer experience. Over the last several years the IRS has launched a number of digital applications that allow taxpayers to conduct various transactions online, such as paying their tax bill, having access to certain return information, and requesting an online payment agreement. Our work in this area also includes continuing the development, over time, of online accounts at the IRS where taxpayers can log in securely, obtain the information they need about their account and interact with the IRS as needed.

Effectively serving taxpayers who prefer to be served through electronic channels allows the IRS to reduce costs, increases taxpayer satisfaction and frees up funds to serve those taxpayers who prefer to be served differently. Not only that, efforts to continue improving our online offerings will allow the IRS to simplify return filing for the vast majority of taxpayers. Enhancing taxpayer service in this way will in turn increase voluntary compliance, improve tax administration, and increase taxpayer satisfaction.

**Enforcement.** The President's FY 2019 budget includes \$4.63 billion for enforcement programs, which is \$21.2 million, or 0.5 percent, above the FY 2018 annualized CR level. In addition, the budget also includes a program integrity cap adjustment for improving the effectiveness and efficiency of the IRS's overall tax enforcement program.

The IRS remains committed to increasing compliance by assisting taxpayers in fulfilling their tax obligations and enforcing the tax laws. As a result of these efforts, the agency remains one of the most cost-effective investments within the Federal Government. In FY 2017, the IRS collected \$3.4 trillion in revenue to fund the Federal Government, which represents more than 90 percent of all Federal receipts, and resources invested in the agency lead to significant revenue increases for the Nation.

One of the IRS's highest priorities in the enforcement area remains the effort to combat tax-related identity theft and refund fraud. Protecting taxpayers and their personal data from identity theft is a critical aspect of taxpayer service, and the IRS has worked to improve its efforts in this critical area. During FY 2017, the IRS continued increasing taxpayer protections to make filing a tax return as safe and secure as possible. As a result, the number of fraudulent refunds declined and the number of taxpayers reporting to the IRS that they were victims of identity theft has also declined. The number of victim reports declined from 401,000 in CY 2016 to 242,000 in 2017, a drop of 40 percent.

**Business Systems Modernization.** The President's budget includes \$110 million for business systems modernization, which is \$178.0 million, or 61.8 percent, below the FY 2018 annualized continuing resolution level.

To gain efficiencies, secure and protect data, and reduce the resources necessary to maintain existing systems, the IRS will continue efforts to modernize its systems. Our main initiatives in this area are: expanding the digital conversion of paper case files, automating repetitive manual processes, leveraging existing data to detect tax noncompliance earlier, and enabling a strong and secure systems platform for taxpayer-facing applications.

#### **FUNDING REQUEST TO IMPLEMENT THE NEW TAX LAW**

Implementing the Tax Cuts and Jobs Act is one of the IRS's highest priorities. The IRS has established a Tax Reform Implementation Office, led by one of its most

senior leaders, to ensure its successful administration. Preliminary efforts to implement this new law are already underway, and two important pieces of guidance related to the new law have already been issued: on December 29, 2017, the IRS issued notices that address amended section 965 of the Internal Revenue Code and the new section 1446(f).

Additionally, the IRS and the Treasury Department released new withholding guidance indicating that employees should see the tax reform changes reflected in their paychecks as early as this month.

Additional published guidance on the new tax law will be provided as the IRS continues to analyze the law and its impact on tax administration. On February 7th, the IRS and the Treasury Department issued a revised Priority Guidance Plan that includes projects related to the law.

To ensure successful implementation, the IRS will need additional resources in FY 2018. After considering FTE staffing needs and non-labor costs, preliminary estimates indicate the IRS would need at least \$397 million to implement tax reform. This funding is needed immediately to ensure that the IRS can start critical implementation activities on time. The funding should be available for 2 years to ensure contracts can be let appropriately and resources are available throughout the critical testing period of September through December of the calendar year, the first quarter of FY 2019.

Activities to implement tax reform will include: re-programming approximately 140 interrelated return processing systems in conjunction with creating or revising approximately 450 tax forms, publications and instructions; publishing guidance, notices, and Frequently Asked Questions (FAQ); preparing the IRS workforce to help taxpayers understand how the new law applies to them; and importantly, providing taxpayer assistance and outreach.

These estimates reflect one-time costs associated with updating major systems and enabling the IRS to quickly respond to the new tax law changes and anticipated higher taxpayer demand for assistance in 2018 and 2019. As with other major investments, the IRS expects some recurring operations and maintenance costs which will be funded within base appropriations.

The \$397 million funding request for tax law implementation includes the following:

- \$291 million for updating information technology systems;
- \$75 million for taxpayer assistance, education and outreach;
- \$3 million for creating and revising tax forms, instructions and publications;
- \$15 million for developing and issuing published guidance and notices;
- \$8 million for tax and information returns processing; and
- \$5 million for program management.

#### **LEGISLATIVE PROPOSALS IN THE PRESIDENT'S FY 2019 BUDGET**

Along with the funding requested in the President' FY 2019 budget, we are also asking for Congress's help legislatively, particularly in four important areas that would improve tax administration and support the IRS in fulfilling its mission:

**Program Integrity Cap.** In addition to the base appropriations request of \$11.135 billion, the FY 2019 budget proposes a \$362 million program integrity cap adjustment to fund new and continuing investments in expanding and improving the effectiveness and efficiency of the IRS's overall tax enforcement program.

The budget also proposes additional cap adjustments to fund new initiatives and inflation. The investments will generate about \$44 billion in additional revenue over 10 years and will cost about \$15 billion for net savings of \$29 billion. Notably, the return on investment (ROI) likely is understated because it does not reflect the effect that enhanced enforcement has on deterring noncompliance.

**Streamlined Critical Pay Authority.** The IRS Restructuring and Reform Act of 1998 increased the IRS's ability to recruit and retain a small number of key executive-level staff by providing the agency with streamlined critical pay authority. This allowed the IRS, with approval from Treasury, to move quickly to hire well-qualified individuals to fill positions deemed critical to the agency's success, and that required expertise of an extremely high level in an administrative, technical, or professional field. Executives hired under this authority included our former Chief Information Officer, a senior cybersecurity expert, our system architect, the director of our online systems development team and other senior IT executives. This authority expired at the end of FY 2013. The last appointment made under

Streamlined Critical Pay authority expired on September 29, 2017. Without this authority, the IRS continues to face challenges recruiting and retaining top-level talent, especially IT professionals who can help modernize our IT systems and protect taxpayer data from cyberattacks. The President's FY 2019 budget request proposes reinstating this authority through FY 2022.

**Correction Procedures for Specific Errors.** Under current law, the IRS has authority in limited circumstances to identify certain computation mistakes or other irregularities on returns and automatically adjust the return for a taxpayer. At various times, Congress has expanded this limited authority on a case-by-case basis to cover specific, newly enacted tax code amendments. The IRS would be able to significantly improve tax administration—including reducing improper payments and cutting down on the need for costly audits—if Congress were to enact a proposal in the President's FY 2019 budget to provide the IRS with greater flexibility to correct specific errors on taxpayer returns. This proposal would allow the IRS to correct errors in cases when the information provided by the taxpayer does not match the information contained in government databases, or when the taxpayer has exceeded the lifetime limit for claiming a deduction or credit.

**Authority to Require Minimum Qualifications for Return Preparers.** The President's budget request proposes providing the Secretary with explicit authority to require that all paid tax return preparers have a minimum knowledge of the Code. This is especially important to ensure that the estimated 400,000 tax preparers without credentials can meet minimum standards for competency. Incompetent and dishonest tax return preparers harm taxpayers by subjecting them to potential audits and by potentially subjecting them to penalties and interest as a result of incorrect returns. Requiring all paid tax preparers to keep up with changes in the code would help promote high-quality service from preparers, improve voluntary compliance and foster taxpayer confidence in the fairness of the tax system.

Chairman Hatch, Ranking Member Wyden, and members of the committee, that concludes my statement. I would be happy to take your questions.

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QUESTIONS SUBMITTED FOR THE RECORD TO HON. DAVID J. KAUTTER

QUESTIONS SUBMITTED BY HON. CHUCK GRASSLEY

*Question.* Acting Commissioner Kautter, I have concerns with the slow roll-out with the IRS private debt collection program. Several times in 2017, I raised concerns that the number of accounts the IRS planned to release for private collection were woefully inadequate, guaranteeing the program would fall far short of collecting the hundreds of millions in revenue JCT estimates is possible. Unfortunately, this is exactly what has occurred. I understand the need for a testing period to ensure all systems are go, but what concerns me is that we are nearly a year in and the IRS is still placing accounts at little more than a trickle. I am told the program has the capacity to do more than 10 times the volume it is presently operating at.

Why hasn't the IRS implemented the program to the full extent required under the law?

*Answer.* The IRS takes its obligations under the Private Debt Collection program seriously and is working diligently toward a fully engaged Private Debt Collection program that will endure for years to come. The IRS delivered the first Private Debt Collection accounts to the Private Collection Agencies on April 10, 2017. The initial number of assigned cases was small to ensure the protection of taxpayer rights and the secure transmission of sensitive information. Over the next nine months, we increased the number of assigned cases and by the end of calendar year 2017, the IRS had delivered over 240,000 cases with a total of \$1.7 billion outstanding tax debt to the Private Collection Agencies. In 2018, IRS will assign an additional 700,000 to 800,000 individual taxpayer cases. Business cases will be assigned beginning in 2019. By 2019, we expect to have begun assigning all of the various types of cases to Private Collection Agencies.

*Question.* Are there plans to increase the volume of accounts placed with private debt collectors going forward? Please provide information on the planned placement volumes for 2018, including types and a breakdown of dollar sizes of the accounts placed.

Answer. In calendar year 2018, the IRS plans to deliver between 700,000 and 800,000 cases totaling approximately \$5 to \$5.5 billion in total debt. The planned breakdown by dollar (balance due) level is as follows:

	Dollar Levels		
	\$500-\$10k	\$10k-\$50k	\$50k-\$100k
# Cases	512-585k	166-190k	20-24k

*Question.* In its 2017 annual report to Congress, the Taxpayer Advocate raised concerns that commissions may be being paid to private debt collectors for work done by the IRS. Could you please explain the rules and procedures for determining whether commissions are payable?

Answer. The contract with the Private Collection Agencies outlines the rules and procedures for determining whether commissions are payable.

The IRS is contractually obligated to pay commissions on any payment received 11 calendar days or more after the date the account is transferred to the Private Collection Agency, and up to 10 calendar days after the date the account is returned to the IRS.

When the Private Collection Agency Contractor collects less than the total amount of the debt referred, the commission fee is calculated based on eligible dollars collected and applied to accounts. When the debt is collected in installments, the commission rate will be paid to the Private Collection Agency Contractor based on the eligible dollars collected and applied to accounts for each installment payment.

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#### QUESTIONS SUBMITTED BY HON. JOHN THUNE

*Question.* Thank you for making sure the revised withholding tables were issued so promptly last month and for doing so in an impartial manner. Employees are starting to see the benefits of the new law in their paychecks this month, and that's a very good thing. When the new tables were released, the IRS announced that the agency is also working on revising the W-4 form, which employees use to set their paycheck withholding. Can you talk about those revisions and specifically whether they will include a way for employees to take into account the \$2,000 child tax credit or the new \$500 non-child tax credit? It would be ideal if parents and those who care for adult dependents could see the benefit of these credits in their paychecks without having to wait until they file their tax return.

Answer. Yes, the 2018 Form W-4, which was released on February 28th, does allow employees to take into account the expanded child tax credit, as well as the new non-child tax credit. The IRS also released the updated withholding calculator on the same day. This provides a simple and accurate way for employees to check whether they should adjust their withholding to avoid having too much or too little withheld.

*Question.* Mr. Kautter, in your prior life, you focused extensively on taxes and small businesses. With the Tax Cuts and Jobs Act only in effect for 45 days, I suspect many small businesses are still factoring the new rules and tax relief into their business plans. Can you share with us how you expect small businesses to react to changes like the expanded expensing for equipment and inventory under the new law and the broader application of cash accounting for small enterprises?

Answer. Treasury and IRS are working to provide guidance on these (and other) provisions as expeditiously as possible so that small businesses and their tax advisors are aware of the changes in the new law and can plan accordingly. We also expect small businesses to react positively to expanded expensing and broader application of cash accounting under the new law.

*Question.* One of the biggest issues facing South Dakotans when it comes to their Federal taxes is the problem of tax-related identity theft. This not only affects those who have their identity stolen, but also those who find their refund delayed while the IRS verifies their identity. I was pleased to see reports that incidences of tax-related identity theft have fallen, but we need to stay vigilant. Can you talk about the steps the IRS is taking to prevent identity theft and help resolve identify theft cases faster, especially for taxpayers who are entitled to a refund?

Answer. Refund fraud caused by identity theft (IDT) continues to be one of the biggest challenges facing the IRS today. As identity thieves continue to become more sophisticated, the IRS has tightened its security in response to the increased threat. We are making it harder for identity thieves to successfully masquerade as taxpayers and file fraudulent refund claims on behalf of these taxpayers. Over the last several years, the IRS IDT fraud filtering processes has been effective in stopping misuse of information even when data breaches resulted in release of personally identifiable information (PII). Under recently enacted legislation, the due date for filing Forms W-2 and W-3 with the Social Security Administration (SSA) and Forms 1099 reporting nonemployee compensation with the IRS has been accelerated to January 31st, beginning in calendar year 2017. Enhancements to IRS systems that allow income information received from SSA to be processed and, in turn, leveraged for systemic income and withholding verification enable the IRS to identify and stop fraudulent returns and release refunds related to compliant returns quicker.

To help taxpayers resolve IDT cases faster, we centralized our IDT victim assistance policy, oversight, and campus case work in a new Identity Theft Victim Assistance (IDTVA) organization. Benefits to this centralized approach include a common inventory system, reducing hand-offs between multiple IRS functions, improved case processing through streamlined, consistent procedures, and improved communication.

In the victim assistance area, we have reduced the time it takes to resolve a case. For most cases, the average time is now less than 120 days, which is substantially less than 2012, when cases could take over 300 days to resolve. Centralization of IDTVA work significantly reduced case resolution time. Since implementation, we resolve those cases in less than 120 days 75 percent of the time, compared to 34 percent prior to implementation.

We are continuing to develop and implement new procedures to improve the service we provide to IDT victims such as:

- New IDTVA telephone process allowing a taxpayer to make direct contact with the employee assigned to the case (August 2017).
- New procedures to achieve a single point of contact when more than 1 year is open within IDTVA.
- Removing requirement to attach proof of identity documentation, to Form 14039, Identity Theft Affidavit *e.g.*, driver's license, passport, etc., (reducing taxpayer burden).
- Utilizing multiple methods to obtain required information to resolve the taxpayer's IDT complaint (often avoiding requesting additional information or documentation).
- Automatic case assignment (reducing time to resolve the cases).
- Standardizing procedures in the Internal Revenue Manual to allow cross-functional casework.
- Using Correspondence Imaging System for IDT cases with current or past compliance activity (resulting in quicker case resolution).
- Improving the way we track and report the status of IDT cases to quickly identify and make any improvements in the process.
- Revising taxpayer letters to provide more information on case status and actions taxpayers can take to facilitate resolution.
- Cross-training IDTVA assistors enabling additional flexibility to assign cases to assistors with the appropriate skills (reducing transfers and expediting case resolution).

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QUESTION SUBMITTED BY HON. JOHNNY ISAKSON

*Question.* A provision in the Tax Cuts and Jobs Act deals with stock attribution rules as they pertain to inbound companies as well as U.S.-headquartered companies with investments in foreign companies. As the Treasury Department and the IRS issue guidance on the new tax law, I urge its implementation in a manner that is consistent with the provision's historical application and the intent of Congress. Specifically, prior to its repeal in the new tax law, Internal Revenue Code section

958(b)(4) prevented the “downward attribution” of stock ownership from a foreign person to a related U.S. person for purposes of determining the status of a corporation as a controlled foreign corporation (CFC).

The new law’s legislative history—the Senate Finance Committee report; a colloquy between Chairman Hatch and my colleague from Georgia, Senator Perdue; and the Conference Report—shows that Congress intended the modification of CFC rules should not result in income inclusions to a U.S. shareholder of a foreign corporation in cases where the U.S. shareholder is neither in control of the foreign corporation nor related to an affiliated group of which the foreign corporation is a part. The treatment outlined throughout the legislative process is also consistent with the purpose and historical application of the CFC rules over their 55-year history.

Given this clear legislative intent and the grant of regulatory authority to implement such intent, will the Treasury Department and the IRS issue administrative guidance to ensure that the modification of the stock attribution rules is implemented in a manner that is both consistent with its historical application and the intent of Congress?

Answer. We are aware of the legislative history of this provision, and we continue to evaluate how best to implement this provision consistent with the statutory text and other indications of legislative intent.

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QUESTION SUBMITTED BY HON. PAT ROBERTS

*Question.* The IRS has for many years sought to collect the Federal air transportation excise tax, also known as the airline ticket tax, from aircraft management services (AMS) companies that manage and maintain fractional and wholly owned aircraft programs even though they provide private, non-commercial transportation. The IRS has pursued enforcement action for the ticket tax from AMS companies despite lacking statutory authority to do so. In addition, the agency’s collection efforts against AMS companies has been inconsistent and arbitrary, effectively picking winners and losers and resulting in confusion within the AMS industry and an uneven playing field. Along with Senator Portman, I championed a fix for this issue in the recently passed Tax Cuts and Jobs Act (section 13822, H.R. 1) that was included in the final bill and states clearly that AMS companies are not subject to the ticket tax. Our view is that Congress has spoken and that the IRS should respect the law and stop trying to collect the ticket tax from AMS companies. Unfortunately, I understand that the IRS is still pursuing collection of the tax against certain AMS companies for past tax years, undermining the law and creating additional confusion and instability within the AMS industry.

Will you follow the law and the clear intent of Congress by ceasing all ongoing and future collection activity of the air transportation ticket tax against aircraft management services companies?

Answer. Guidance was provided to examiners to not pursue this issue on audits in June 2017 and the IRS is no longer pursuing the air transportation excise tax under Internal Revenue Code section 4261 on fees paid by an aircraft owner to an independent aircraft management company for whole aircraft management services. Audits of this issue were suspended and closed as a no change in 2017. We are also working with aircraft management companies to resolve any claims filed for taxes previously paid on whole aircraft management service fees.

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QUESTIONS SUBMITTED BY HON. SHELDON WHITEHOUSE

*Question.* United States Code 26 U.S.C. § 7206(1) makes it a felony punishable by up to 3 years of imprisonment and \$100,000 in fines for a person who: “[w]illfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter.”

Why is it important to ensure that taxpayers are providing accurate information?

Answer. It is important for taxpayers to provide accurate information to the IRS because our tax system is based on voluntary compliance. Voluntary compliance is essential in ensuring that all taxpayers pay their fair share. If taxpayers could provide false information, without concern about the consequences, compliance with the tax law would likely suffer.

*Question.* Are persons also subject to penalty under the criminal false statement statute, 18 U.S.C. § 1001, if they knowingly make material false statements to the IRS?

*Answer.* Section 1001 is generally not used in the case of a false statement on a return because, if the return is signed under the penalties of perjury, as most are, section 7206(1) of the Internal Revenue Code is considered a more appropriate charge. Because section 1001 is normally used in criminal tax cases involving a defendant's use of false statements or documents, the elements of the offense focuses on false statements or documents, rather than on concealment.

*Question.* What steps does the IRS take to ensure that statements made to the IRS are true?

*Answer.* IRS ensures the accuracy of tax returns by comparing, among other things, filed tax returns with other information received from outside sources submitted on various IRS forms to include Forms W-2, K-1, 1099, etc. IRS Criminal Investigations (CI) also verifies the accuracy of returns by obtaining records from taxpayers and contacting third parties such as banks, witnesses, and payroll companies as part of the criminal investigation process.

*Question.* Does the IRS review other filings and statements the person has made to the IRS to verify that the information regarding material matters is consistent?

*Answer.* Yes, see response to (c) above. IRS-CI also reviews other tax years for consistency and patterns, and if applicable, coordinates with the other IRS divisions to obtain any documents or statements that the taxpayer may have provided.

*Question.* Does the IRS review other filings the person has made to other Federal agencies to verify the information regarding material matters is consistent?

*Answer.* Depending on the facts and circumstances of the investigation, IRS-CI may review filings or documents submitted by the taxpayer to other Federal agencies to either confirm or refute their statements, as permitted by law. For instance, title 12 U.S.C. § 3412(f), Use of Information, allows agencies to disclose certain financial records to the Attorney General or the Secretary of the Treasury when there is reason to believe that the records may be relevant to a violation of Federal criminal law.

*Question.* At the hearing, I asked you to provide information about why the IRS stopped publishing the "The 400 Individual Income Tax Returns Reporting the Largest Adjusted Gross Incomes" data.

Why did the IRS stop publishing this information?

Knowing that this information is useful to the public and to members of Congress, will you commit to reviving this annual report?

*Answer.* The IRS eliminated the Top 400 table for two reasons. First, it posed a number of analytical challenges. Since the number of tax returns filed changes from year to year, based on economic conditions and tax law requirements, changes in the data over time are difficult to interpret. For example, in 1992 the top 400 represented .00035 percent of all returns filed, but this declined to .00027 percent by 2014 because the number of returns filed increased over this period by more than 35 million. Thus, increases or decreases in the share of reported income or tax liability attributed to the top 400 cannot be meaningfully connected to actual economic trends. Nor is the 400 a static group. In addition, over an 18-year period, more than 71 percent of individuals included in the top 400 were present for just 1 year and only 3 percent were present for 10 or more years. This means that the top 400 also cannot be used as a panel to study the changes in income for a fixed group of taxpayers over time. Second, there are disclosure concerns created by producing detailed statistics on such a small group of highly visible taxpayers. The risk that presence or absence of particular data items in the annual table could be exploited by an intruder with access to other information on top earners to generate a credible claim of re-identification has increased over time as the amount of personal information in the public domain increased and the power of computers and analytic capabilities grew.

Beginning with Tax Year 2014, the annual October release of Individual Income Tax Return percentile data was expanded to include a new table (Individual Income Tax Rates and Tax Shares, Table 3). This table contains all of the item content found in the top 400 data release and groups this information by percentiles of the income distribution. This new table shows data for filers at the .001 percentile level—which in 2014 represented the top 1,396 returns. We believe, this is a more

analytically useful tabulation compared to the top 400 tabulation, in that it provides a longitudinally consistent data point relative to the entire percentile distribution. As the number of returns increases with the growth of the economy, the number of returns in the .001 percentile will increase proportionally as well thus allowing for a consistent high-income data series. As a consequence, the top 400 data series was discontinued after Tax Year 2014.

The IRS Statistics of Income Division (SOI) discussed this change with the professional staff of the Joint Committee on Taxation in October 2014 and this change was endorsed for providing both more useful information to the public and better privacy protection than the Top 400 table. SOI presented the plan and proposed new tabulations at a public meeting, hosted by the Committee on National Statistics at the National Academies, that included more than 90 external stakeholders representing nonprofits, research facilities, and academia, as well as more than 19 Federal agencies. Again, there was universal agreement that the new detailed table on tax returns in the top .001 percent of filing population was a much more analytically useful tool than the Top 400 table.

*Question.* According to the IRS, the net tax gap, the difference between what people and companies owe in taxes and what the IRS ultimately collects exceeds \$400 billion per year. This should be the low-hanging fruit of deficit reduction; this is money owed under the law. The budget request notes that an additional \$15 billion for enforcement over 10 years will generate \$44 billion in collections, “yielding a net savings of \$29 billion.” In other words, every dollar spent on enforcement brings in three.

Do you agree that additional enforcement dollars would produce a positive return and help reduce the deficit?

Answer. Yes, we agree additional enforcement dollars along with the associated Operations Support dollars would better support the IRS tax enforcement and compliance programs and would produce a positive return and reduce the deficit. The IRS FY 2019 budget includes, as part of the proposed Program Integrity Cap Adjustment, \$362 million in additional investments to expand and improve the effectiveness and efficiency of the IRS’s overall tax enforcement programs in 2019 as well as additional investments in future years. These investments will generate about \$44 billion in additional revenue over 10 years and will cost about \$15 billion for an estimated net savings of \$29 billion. Of these investments, \$290.1 million are in investments for traditional enforcement and strategic revenue programs, and those investments are projected to generate \$2 billion in revenue once the investments reach full potential in FY 2021 an expected total ROI of \$5.2 to \$1. Notably, this return likely is understated because it includes only amounts directly recovered; it does not reflect the effect that enhanced enforcement has on deterring non-compliance.

*Question.* Are you aware that the FY19 request for the IRS enforcement budget is nearly \$1 billion lower than Congress appropriated for it in 2011?

Answer. The funding level for the enforcement account is not the only indicator of the IRS’s tax enforcement efforts. Technology plays an increasingly important role in the IRS’s enforcement strategy and has increased our capacity to identify and prevent non-compliance while also making it easier for taxpayers to comply voluntarily. The proposed investments in the Return Review Program, expanding online payment applications, and hardware and software for enforcement personnel—activities funded from the Operations Support and Business Systems Modernization accounts—also increase enforcement productivity and revenue.

*Question.* With the potential for enforcement dollars to cut the deficit, why hasn’t the President requested more?

Answer. The 2019 budget includes funding to ensure our infrastructure can sustain our programs, including filing season; that taxpayers are provided the services they need to comply with tax laws; that modernization efforts remain on track to provide taxpayers with the tools they need to interact with the IRS; and that enforcement efforts continue. The FY 2019 request also includes a Program Integrity Cap adjustment of \$362 million in 2019 (as well as additional cap adjustments for new investments in future years) to fund new and continuing investments in expanding and improving the effectiveness and efficiency of the IRS’s overall tax enforcement program.

*Question.* United States Code 2 U.S.C. § 441(e) makes it unlawful for a foreign national to “directly or through any other person to make any contribution of money

or other thing of value, or to promise expressly or impliedly to make any such contribution, in connection with an election to any political office or in connection with any primary election, convention, or caucus held to select candidates for any political office; or for any person to solicit, accept, or receive any such contribution from a foreign national.”

What role does IRS play in ensuring foreign money does not enter our political system through outside organizations like LLCs and tax exempt organizations?

Answer. This questions appears to refer to 52 U.S.C. § 30121 (previously 2 U.S.C. 441(e)), which the Federal Election Commission—not the IRS—is responsible for enforcing.

With respect to tax exempt organizations and LLCs, the IRS ensures compliance with the Internal Revenue Code and implementing regulations.

We note that a section 501(c)(3) organization is not operated exclusively for one or more exempt purposes if it is an organization that participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office. The term candidate for public office means an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office is national, State, or local. Activities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate (political campaign intervention or “PCI”) include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to such a candidate. Treas. Reg. § 1.501(c)(3)–1(c)(3)(iii).

*Question.* Section 501(c)(4) organizations are required to disclose their donors to the IRS. What does IRS do with that information?

Answer. Treasury Regulations require section 501(c)(4) organizations to include Schedule B, Schedule of Contributors, with annual information returns on Forms 990/990–EZ. The IRS maintains this information for use, as needed, in compliance matters.

*Question.* Does IRS review the donor lists to ensure that foreign actors are not funneling money into our elections through 501(c)(4) organizations?

Answer. As noted above, this questions appears to refer to 52 U.S.C. § 30121 (previously 2 U.S.C. 441(e)), which the Federal Election Commission—not the IRS—is responsible for enforcing.

*Question.* Does the IRS coordinate with FinCEN in these efforts?

Answer. The IRS has procedures to provide for referrals to the Exempt Organizations Financial Investigation Unit (FIU) if, during the course of an audit, donor information is necessary to determine if an organization is in compliance with section 501(c)(4). Any requests relating to Treasury’s Financial Crimes Enforcement Network (FinCEN) are performed by the FIU.

*Question.* Does the IRS coordinate with any other Federal agencies to ensure foreign nationals are not prohibited from election activity?

Answer. On a case by case basis, IRS coordinates, through its Criminal Investigation Division, with other Federal agencies, including FBI.

*Question.* Are the current disclosures to the IRS by such groups sufficient to ensure that foreign actors are not funneling money through cutouts or domestic organizations?

Answer. There is no requirement that the nationality of the contributor be shown on the Schedule B, or that an exempt organization request the nationality of its contributors.

*Question.* Does the IRS have sufficient resources to enforce 501(c)(4) rules?

Answer. The IRS administers and enforces the tax laws as in effect with the resources available. The TE/GE FY 2018 Work Plan, dated September 28, 2017, sets forth the Exempt Organizations Division’s FY 2017 accomplishments and its plan for FY 2018 to continue to be an organization whose key elements are “efficiency, effectiveness, and transparency.”

*Question.* Currently the IRS has an 11-factor test to determine if a 501(c)(4) social welfare organization is engaging in political activity.

Would the IRS and social welfare organizations benefit from more clarity regarding what types of activities constitute under the rules and what amount of money groups are able to spend on “political activity”?

Answer. The IRS administers and enforces, and taxpayers are required to comply with, the tax laws as in effect. Section 501(c)(4) provides exemption, in part, for “[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.” An organization “is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.” (Treas. Reg. § 1.501(c)(4)–1(a)(2)(i).) The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office (political campaign intervention, or “PCI”). (Treas. Reg. § 1.501(c)(4)–1(a)(2)(ii).) Accordingly, although engagement in PCI is not prohibited for these organizations, the primary activities of organizations described in section 501(c)(4) must be the promotion of social welfare.

In addition, section 501(c)(4) organizations that engage in PCI may be subject to tax under section 527(f) on their exempt function expenditures. Whether an organization is engaged in PCI depends upon all the facts and circumstances of each case. The IRS has provided examples illustrating facts and circumstances to be considered in determining whether activities are PCI. See, e.g., Rev. Rul. 2004–6; Rev. Rul. 2007–41. The analysis reflected in these revenue rulings for determining whether an organization has engaged in PCI, or has expended funds for a section 527 exempt function, is factual in nature.

*Question.* Does the absence of bright-line rules for political spending by 501(c)(4) groups make prosecutions more difficult?

Answer. As stated above, PCI is a factual determination made during the examination process. PCI are generally not subject to criminal prosecutions.

*Question.* Do you think there should be a bright-line rule?

Answer. Given the limitations imposed in the recent appropriations acts, the IRS currently cannot issue guidance relating to the standard used to determine whether an organization is operated exclusively for the promotion of social welfare for purposes of section 501(c)(4). The IRS will administer any further statutory direction from Congress on this matter.

*Question.* Do the existing 501(c)(4) rules, and the way that they are interpreted within the IRS, hamper your ability to investigate and prosecute cases?

Answer. The IRS administers IRC section 501(c)(4) as currently in effect, processing requests for recognition of exempt status and auditing section 501(c)(4) organizations using existing procedures and applying existing legal guidance. The IRS uses the historical rules that focus on the facts and circumstances in determining whether an organization is engaged in activities that primarily promote social welfare. The IRS provides appropriate training to its employees for this purpose, including mandatory PCI training before each Federal election cycle comprised of written materials, virtual e-learning sessions, and face-to-face, small group technical workshops.

*Question.* Currently no jurisdiction in the United States requires shell companies to disclose their beneficial ownership. Jennifer Fowler, the Deputy Assistant Secretary, Office of Terrorist Financing and Financial Crimes at Treasury recently told the Judiciary Committee that the lack of beneficial ownership information for shell companies is “a vulnerability.” John Cassara, a former Treasury Special Agent and FinCEN Agent, agreed saying, “[R]equiring the real owner of a U.S. company to be named during the incorporation process will cut down, in dramatic fashion, the ability of criminals to finance their crimes.”

Do you agree that the United States’ lack of beneficial ownership collection presents a serious shortcoming in our anti-money laundering regime?

Answer. The IRS has recently made some progress in the area of transparency of entity ownership. Newly effective rules that provide an information reporting requirement for foreign-owned LLCs and revisions to the form used to apply for taxpayer identification numbers all will increase availability of beneficial ownership information.

*Question.* How can shell companies be used by criminals to avoid paying taxes?

Answer. Shell companies are sometimes a vehicle used in business transactions to avoid disclosing the identity of the beneficial owner of an entity and thus allow the entity to operate anonymously. Shell companies are used in lawful activities and in illegal activities.

*Question.* Would having access to beneficial ownership information make it easier for the IRS to investigate tax evasion and other crimes?

Answer. Yes, identifying the beneficial ownership of the assets and the income generated by these activities is essential in determining the correct tax liability and identifying related criminal offenses, both domestically and in assisting our foreign tax treaty partners through exchange of information. Noncompliant taxpayers often spread parts of a transaction among multiple countries and layers of entities to confound determination of ownership and income with respect to the transaction. Robust collection of beneficial ownership information would ease tax examinations by enabling the IRS to look through artificial structures and more clearly determine if the taxpayer was compliant with the tax laws as well as laws related to money laundering.

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QUESTIONS SUBMITTED BY HON. ROB PORTMAN

*Question.* Mr. Kautter, my first question relates to a back-and-forth that we have had on the production tax credit for refined coal facilities. Two years ago, the IRS Chief Counsel's office issued a memorandum that raised issues about the ability to claim the credit depending on the refined coal facilities' ownership structure. A similar memorandum was issued a year later. The analysis used in these memoranda appear to contradict prior rulings and guidance from the IRS, creating uncertainty for investors as to whether the ownership structures of such refined coal facilities would prohibit them from claiming the tax credit. This uncertainty resulted in many facilities being shut down, bringing with them a substantial loss of jobs and benefits within the industry.

Approximately 10 months ago, six Senators—including Senator Enzi, Senator Cassidy, and myself—requested the IRS to issue immediate guidance to the refined coal industry so that investors could structure their investments to comply with the guidance, thereby preventing further harm to the industry. I understand that the office of Chief Counsel agreed to be responsible for this guidance in order to expedite its issuance. It has now been almost a year and, although the Chief Counsel's office has been telling the industry for the past 6 months that issuance of the guidance is imminent, to date this guidance has not been issued. This delay is continuing to be harmful to an industry that Congress intended to incentivize.

Can you commit to have the Chief Counsel's office issue this guidance within the next 30 days?

Answer. The IRS issued this guidance on March 9, 2018.

*Question.* My second question pertains to Notice 2018–13, which was issued by the Treasury Department and the IRS on January 19th to address the rules surrounding the “deemed repatriation” tax. Generally, the new rule requires taxpayers with foreign operations to pay tax on their net CFC earnings, with different applicable tax rates depending on whether those earnings are held in cash or in permanently reinvested assets. I'd like to touch on the “net” part of this calculation.

For the purposes of the rule, businesses are allowed to subtract the losses of CFCs with deficits from the earnings of CFCs with income to calculate an overall number on which tax is owed. Section 3.01 of the Notice provides rules for the treatment of income that has been previously taxed, or PTI. As one would think, PTI is not added to the earnings of earnings CFCs, as it is income that has already been taxed by the United States. However, the Notice states that companies must net PTI from loss CFCs. This leads to a strange result where, for economic purposes, this income is essentially taxed twice: once under subpart F, and again under the deemed repatriation rules. It also leads to strange results, where similarly situated companies that have similar amounts of overall CFC earnings, losses, and PTI have different tax results because of where their PTI is located.

Can you commit to resolving the above-stated issues of double taxation and location-based disparity in the current rules governing PTI?

Answer. Section 965 provides different definitions that apply for measuring positive earnings and for measuring deficits. The definition for measuring positive earn-

ings specifically excludes earnings that were previously taxed under subpart F (referred to as “previously taxed income,” or “PTI”), while the definition for measuring deficits does not. In section 3.01 of Notice 2018–13, the Treasury Department and the IRS provided our interpretation of the statute that in determining the amount of a deficit, PTI is taken into account. That is, PTI can reduce the amount of deficits otherwise available to reduce earnings subject to the transition tax.

The Treasury Department and the IRS requested comments on these provisions described in Notice 2018–13, including the rules described in section 3.01. The Treasury Department and the IRS will consider all comments before issuing final regulations under section 965.

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QUESTIONS SUBMITTED BY HON. DEBBIE STABENOW

*Question.* I often say that we don’t have an economy unless we are growing things and making things here. Small businesses are the ones willing to take the risks that grow the economy to create new jobs and innovations.

I am concerned that the tax bill passed last year was not focused on helping small businesses and instead added new complications for them on their taxes. For instance, there is now a 20-percent pass-through deduction, but a small business is not allowed to take the deduction if the “principal asset of the trade or business is the reputation or skill of one or more of its employees or owners.” If I owned a small business, I would be pretty confused as to whether I qualify for that deduction. One of the reasons most people decide to open a small business is because of their reputation and/or skill.

Is the IRS prioritizing releasing guidelines for small businesses, to help them figure out if they can take the pass-through deduction?

What is the IRS’s plan to get that information out to small business owners?

*Answer.* Guidance in this area is one of our top priorities. This is reflected in the Second Quarter Update to the 2017–2018 Department of the Treasury Priority Guidance Plan published on February 7, 2018, that includes section 199A guidance. This guidance will address the issue of when the principal asset of a trade or business is the reputation or skill of its employees or owners. We are also working with Treasury on various communications, including revisions to Forms, Instructions, and Publications to assist taxpayers, including small businesses, in determining whether they are eligible to claim this deduction for small businesses.

*Question.* What I am hearing out of the IRS currently is not reassuring me that the changes to the tax code are going to make it easier for families to understand their taxes.

The IRS has given employers new withholding tables, but has also said that families need to go to the IRS’s website to make sure the amount of taxes being taken out of their paychecks is correct. Under the previous tax law, more than four times as many Michigan families received a tax rebate compared to those who owed additional taxes.

If an individual or family does not have sufficient taxes withheld, what are the consequences?

*Answer.* In January, we released new withholding guidance under the Tax Cuts and Jobs Act. The withholding guidance was designed to work within the constraints of the existing payroll withholding system in order to minimize the burden on taxpayers and employers. We have encouraged taxpayers to use our withholding calculator to ensure they have the correct amount of withholding. The results of the calculator can be used to determine if they should file a new Form W–4 with their employer.

If individuals or families do not have sufficient taxes withheld, they will owe the additional tax at the time they file their tax return. Payment of the tax with a return filed by the due date will not result in interest being due. However, an underpayment tax penalty might be owed unless the taxpayer qualifies for an exception.

If taxpayers discover their withholding will not be sufficient to pay their tax obligation during the tax year, they may increase their withholding or make estimated tax payments throughout the year. Estimated taxes are generally calculated using the Form 1040–ES, which may be found on *IRS.gov*, along with in-depth information on estimated taxes.

If the taxpayer cannot pay the tax with the return, we encourage taxpayers to request an installment agreement by using our on-line payment application on *IRS.gov*. Interest and failure to pay penalty will apply to late tax payments.

*Question.* What data can the IRS provide about how many taxpayers will be receiving a smaller refund check for their 2018 taxes compared to the one they received for their 2017 taxes, based on the withholding changes?

*Answer.* The Treasury Department's Office of Tax Analysis research suggests that if people do nothing, about the same number will receive refunds for 2018 as would have under prior law. However, because individual circumstances will vary and because many taxpayers receive large refunds (and some owe tax) when they file for any given year, the IRS is encouraging all workers to do a "paycheck checkup" to ensure that they are not having more or less tax withheld than they intend. The withholding calculator found at *IRS.gov* is designed to assist taxpayers in making sure they have the proper amount of tax withheld from their paychecks.

*Question.* Two years ago, the IRS Office of the Chief Counsel issued a memorandum calling into question the eligibility of investors participating in some types of ownership structures for production tax credits for refined coal facilities.

Both the Department of the Treasury and the IRS stated their commitment to quickly issuing guidance to provide certainty to the industry and avoid further shutting down of facilities and losses of jobs. Thus far, the promised guidance has not been forthcoming, even in light of assurances that its issuance was imminent.

Congress created the refined coal production tax credit to encourage the production of coal that is less polluting. However, the uncertainty surrounding the eligibility of this tax credit has led to less investment and shuttering of facilities—the opposite of the legislative intent of this provision.

Can you commit to a firm timeline for releasing guidance on the refined coal production tax credit to provide certainty to the industry moving forward?

*Answer.* The IRS issued this guidance on March 9, 2018.

*Question.* Michigan families are extremely charitable. Eighty-five percent of Michigan families make charitable donations to help their community and those in need. Charitable giving helps feed families that do not have enough to eat, delivers education and support to children, and provides housing to those who are not fortunate enough to have a roof over their head.

However, the tax bill passed last year has caused great concern among charitable organizations. There are countless estimates that the recent tax legislation could reduce charitable giving by billions of dollars every year. As charitable organizations scramble to try to make up the difference, corporations are projecting record profits.

What data will the IRS and/or Treasury be collecting about how this new tax law is impacting charitable giving?

*Answer.* The IRS will continue to collect and publish detailed data from Form 1040, Schedule A filers, including lines 16–19. This data will continue to be reported in detailed tables further disaggregated by filing status, AGI class, etc. IRS will also continue to produce regular statistics on the types of non-cash contributions claimed on Schedule A. In addition, during the 2019 filing season, the IRS will augment current filing season reports (released in late May, mid-July and mid-November on *IRS.gov*) to provide high-level, early statistics on the impact of tax law changes on filing behavior, including for example changes in the number of taxpayers electing the standard deduction. However, it is important to remember that we can only observe charitable contributions claimed as a deduction using data from Form 1040 Schedule A; we will not have any information on charitable gifts made by individuals who claim the standard deduction.

The IRS will also continue producing statistics on the income and balance sheets of charities (that file Forms 990 and 990-EZ) and private foundations (that file Form 990-PF). About 24 percent of all active, IRS-recognized charities file these information returns, and for them, we will be able to track changes in reported contributions over time. The remaining 76 percent, which include churches, religious organizations and organizations with annual gross receipts less than \$50,000 are not subject to detailed filing requirements. It is also important to note that donations received by charities during calendar 2018 will be reported on information returns filed in 2019 or 2020, depending on the accounting period adopted by each charity. This means that complete data on the potential impact of tax reform on

charitable giving to organizations that have a Form 990 filing requirement will not be available for several years.

*Question.* What percentage of people do you estimate will take the charitable deduction after the changes to the tax law passed at the end of last year?

*Answer.* The IRS does not have a projection of the percentage of individual income taxpayers who will claim a charitable deduction for tax years 2018 and beyond.

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QUESTIONS SUBMITTED BY HON. BILL CASSIDY

IDENTITY THEFT

*Question.* While your testimony noted that IRS has reduced the number of fraudulent returns, has the amount of improper payments related to those fraudulent returns also decreased? If so, by how much?

*Answer.* The number of tax returns with confirmed identity theft declined to 597,000 in 2017, compared to 883,000 in 2016—a 32 percent decline. The amount of refunds protected from those fraudulent returns was \$6 billion in 2017, compared to \$6.4 billion in 2016. In 2015, there were 1.4 million confirmed identity theft returns totaling \$8.7 billion in refunds protected. Overall during the 2015–2017 period, the number of confirmed identity theft tax returns fell by 57 percent with more than \$20 billion in taxpayer refunds being protected.

*Question.* How much did Treasury disburse in improper payments related to fraudulent returns for the most recent year available?

*Answer.* The IRS monitors the extent of identity theft refund fraud through our Taxonomy. This research-based effort aims to report on the effectiveness of IRS's identity theft defenses to internal and external stakeholders, help us identify identity theft trends and evolving risks, and refine identity theft filters to better detect potentially fraudulent returns, while reducing the likelihood of flagging legitimate tax returns.

For 2016, refunds attributable to identity theft that were paid are estimated to be between \$1.68 to \$2.31 billion whereas identity theft refunds protected are estimated to be between \$10.56 to \$10.61 billion. Both estimates are lower than they were in 2015 (\$2.24 to \$3.34 billion unprotected refunds and \$12.35 to \$12.88 billion protected refunds).

TRADE-BASED MONEY LAUNDERING

*Question.* What factors does IRS consider in determining whether to pursue a transfer pricing audit? Is potential involvement in a trade-based money laundering scheme considered?

*Answer.* Transfer pricing audits determine whether transactions between related parties comply with Internal Revenue Code 482 and meet the arms-length standard of the section 482 regulations. Factors considered in determining whether to pursue a transfer pricing audit include the volume and type of intercompany transactions, and the risk for income shifting. Transfer pricing cases require a thorough analysis of functions, assets, and risks, and an accurate understanding of the related financial information. Because trade-based money laundering involves a process of disguising criminal proceeds through trade to legitimize their illicit origins, it is not the focus of transfer pricing audits. The IRS has, however, studied the use of trade data in the past to identify transfer pricing issues based on anomalies in such data.

*Question.* What percentage of cross-border transactions are subject to a transfer pricing audit?

*Answer.* As of February 28, 2018, approximately 1,600 out of 8,000 open examination cases in the Large Business and International (LB&I) division involve transfer pricing issues. For Tax Year 2015 (returns filed in calendar years 2016 and 2017), the most recent year for which complete statistics are available, there were more than 6 million Form 1120 series returns filed. Based on the attachment of certain international forms, an estimated 1.9 percent of them have the potential for transactions subject to transfer pricing. It is not possible to precisely estimate how many of these returns have cross-border transactions because these transactions can include a wide range of activities, including sales of tangible and intangible property, certain interest payments, managerial or service fees, commissions, rents, royalties,

and other types of payments, not all of which can be identified from tax data without an audit.

*Question.* Please describe the extent to which IRS exchanges transfer pricing or other data with FinCEN, CBP, DHS, DOJ, and other Federal agencies to assist with their anti-trade-based money laundering activities.

*Answer.* IRS generally does not exchange transfer pricing or other trade-based money laundering (TBML) data due to the restrictions imposed by 26 U.S.C. § 6103; however, the IRS-Criminal Investigation (IRS-CI) special agents that are detailed to law enforcement and intelligence community partner agencies do at times encounter TBML-related data and may share this data with other sections within IRS-CI.

In addition, IRS-CI participates with other Federal law enforcement agencies in significant, impactful money laundering investigations which often have a TBML component.

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QUESTIONS SUBMITTED BY HON. CLAIRE MCCASKILL

*Question.* The recent changes to our tax laws may create new avenues for tax fraud. Does the IRS have the tools needed to identify new and emerging threats?

*Answer.* IRS uses several tools to assist in combating tax-related identity theft and fraud. This includes tools that are specific to addressing taxpayers who have been victims of a data loss of Federal tax information (FTI). Because the data losses involving Federal tax related data can be used to file returns that appear to be coming from the true taxpayer, IRS has implemented measures to address this. IRS's existing models and filters have been updated to address the level of sophistication used to file these fraudulent returns. We have implemented the use of Dynamic Selection Lists that allow IRS to monitor accounts of specific taxpayers who have been victims of an FTI data breach when the data compromised would have a direct impact on Federal tax administration. This allows the IRS to more effectively identify these suspicious returns and results in better protection for taxpayers' Federal tax accounts and increased revenue protection. In addition, there are multiple points in the processing life cycle to identify, prevent, and assist possible IDT victims: pre-filing, at filing, and post-filing.

To prevent IDT returns from even coming in the door (pre-filing), we have worked with tax software providers to improve the procedures that new and returning customers must use to identify themselves in order to minimize the chance that the taxpayer's online account can be taken over by identity thieves. This additional security is one of the most visible signs of increased protection to taxpayers because they will notice password requirements and other website security features. In addition, we have implemented a variety of mechanisms to prevent criminals from using a deceased individual's identity information to perpetrate fraud. We routinely lock the accounts of deceased taxpayers and have locked more than 30 million accounts so far.

At filing, our IDT and fraud detection systems contain complex models and filters developed from historical and newly emerging known fraud characteristics. Address and bank account changes as well as historical taxpayer filing data are characteristics that are used in conjunction with other filters to identify potentially fraudulent/IDT returns. When returns are selected by a filter, the refunds are frozen until additional reviews verify whether the refunds are legitimate.

*Question.* In 2009, the IRS changed longstanding rules for the St. Louis Carpenters Pension Plan, preventing members from receiving pension payments while remaining in covered employment. The Vested Employee Pension Benefit Protection Act (S. 1080) would allow for the IRS to reinstate this practice for some workers. Will you commit to reviewing and reconsidering this earlier IRS ruling?

*Answer.* Code section 6103 generally precludes us from commenting on questions relating to particular taxpayers. However, please let us know if we can provide any other information that is not subject to section 6103.

*Question.* If you recall, the Internal Revenue Service (IRS) found out about the Equifax breach in the news, as the rest of America did. Equifax claimed it didn't need to notify IRS about the breach because IRS data wasn't compromised. Does the IRS now require that contractors notify the IRS if they suffer breaches exposing

data, regardless of whether IRS data is specifically breached? Are there other requirements in place for what a contractor must do if they experience a cyberattack?

Answer. No, the IRS only requires contractors to notify the IRS if they suffer breaches exposing IRS data. However, the IRS extensively updated requirements (*i.e.*, Publication 4812) to strengthen contractor security controls and reduce the agency's exposure to risk as a direct result of the Equifax data breach.

The IRS inserts clause IR1052.224–9008—Safeguards Against Unauthorized Disclosure of Sensitive But Unclassified (SBU) Information (November 2015)—in all solicitations and resulting contracts, agreements and orders, if the contractor (or subcontractor) will have access to SBU information. This clause requires contractors who perform work at contractor (including subcontractor) managed sites using contractor or subcontractor managed IT resources to adhere to the guidance, requirements, and specific security control standards contained in Publication 4812, Contractor Security Controls; IRM 10.23.2—Personnel Security, Contractor Investigations; and IRM 10.8.1—Information Technology (IT) Security, Policy and Guidance.

Below is some relevant language that describes specific reporting requirements in these documents:

*Excerpt from Clause IR1052.224–9008—Safeguards Against Unauthorized Disclosure of Sensitive But Unclassified Information (November 2015):*

- Publication 4812, IRM 10.8.1 and 10.23.2 provide comprehensive lists of all security controls and guidance.
- In addition, if the SBU information is or involves returns or return information, or threatens the safety or security of personnel or information systems, the contractor shall report the incident/situation to the Treasury Inspector General for Tax Administration (TIGTA) hotline.
- The contractor (including subcontractor) shall report any incident/situation in accordance with IRM 10.8.1.4.8.5—Incident Reporting—to the COR. This includes a variety of different levels of incidents such as the installation of malicious code, unauthorized access to a system, or denial of service attacks, when IRS data is breached.

*Excerpt from Publication 4812—Contractor Security and Privacy Controls; Section 18—Incident Response:*

- A data breach is the loss of control, compromise, unauthorized disclosure, unauthorized acquisition, or any similar occurrence where (1) a person other than an authorized user accesses or potentially accesses personally identifiable information or (2) an authorized user accesses or potentially accesses personally identifiable information for an other than authorized purpose.

Whenever there is a compromise of IRS information, it is important to contact the IRS within one (1) hour if an incident or potential incident has been detected. The IRS shall work closely with IRS contractors to quickly respond to a suspected incident of unauthorized disclosure or inspection.

*Excerpt from IRM 10.8.1—Information Technology (IT) Security, Policy and Guidance; Section 10.8.1.4.8.5 (July 8, 2015)—Incident Reporting:*

- All IRS employees and contractors shall be responsible for reducing the impact and severity of security-related incidents by immediately reporting suspicious or anomalous (*e.g.*, uncharacteristic, atypical, inconsistent) events, all losses and thefts of assets, and any disclosures of personally identifiable information (PII) in accordance with policy and procedures specified in the IRS CSIRC organization's Computer Security Incident Reporting Procedures. (IRS-defined)

In keeping with OMB directives, any incident that involves compromised PII must be reported to US-CERT (via the Treasury Computer Security Incident Response Center (TCSIRC)) within 1 hour regardless of the incident category reporting timeframe (TD P 85–01 App G).

*Question.* Using site visits, IRS found that Equifax was mishandling and improperly storing IRS data, although IRS determined that none of the data was exposed. How did the discovery that IRS was mishandling data change the way IRS conducts oversight of contracts or how the IRS develops requirements for future contracts? What changes has the IRS made to its contracting practices?

How did the discovery that IRS was mishandling data change the way IRS conducts oversight of contracts.

Answer. NOTE.—The IRS was not mishandling data. Equifax was improperly storing IRS data in transaction log files in violation of contractual requirements.

The IRS continues to use Publication 4812, Contractor Security Controls, as the framework and guiding principles and processes for conducting security assessment to monitor compliance and assess the effectiveness of a contractors' security controls. The Offices of Information Technology (IT) and Procurement collaboratively identify and prioritize which contracts align with critical applications supporting filing season. If new information technology is being developed in support of an IRS program, a review is conducted before data is shared and then included in the annual prioritization process. IRS IT will conduct on-site Contractor Security Assessments (in accordance with Publication 4812) to assess and validate the effectiveness of security controls established to protect IRS information and information systems. These assessments help to determine if, and when, additional controls or protections are necessary to protect returns and return information or personal privacy, or other SBU information, and organizational assets and operations.

*Question.* How did the discovery that Equifax was mishandling data change how the IRS develops requirements for future contracts?

Answer. The IRS is undertaking various initiatives to improve requirements definition and the procurement process, as well as strengthen contract administration by the Contracting Officers Representative. For example, we have instituted an innovative method for bringing the entire acquisition team together early in the procurement process to discuss and define requirements, adjudicate issues/concerns, leverage "wisdom of crowds," and document complete and accurate acquisition packages and milestone timelines. The acquisition team consists of the contracting officer, requirements owner (business unit and/or IT), legal counsel, policy/quality assurance specialist, and cost and price analyst. Other subject matter experts (such as other Bureaus if Treasury-wide) participate, depending on the requirement, risk, complexity, magnitude, and scope. This is called a Procurement Innovation Team. Additionally, the IRS Cybersecurity team identifies a single point of contact to assist Procurement in understanding any unique or complex security issues. This has improved collaboration and knowledge sharing across all organizations. Furthermore, the Office of Procurement Policy is leading a review of all IRS-specific clauses to verify accuracy, confirm language and requirements are up-to-date, and ensure prescription(s) for use are precise.

*Question.* What changes has the IRS made to its contracting practices?

Answer. The IRS has taken a number of steps to improve its contracting practices, including the development of a new Procurement Strategic Framework. It includes 31 key initiatives to promote proactive, data-driven actions that increase transparency and accountability, improve productivity, and cultivate an agile workforce with the skills to adapt to an evolving acquisition environment. Below are a few examples of actions underway:

#### *Acquisition Planning*

Acquisition planning is the process by which the efforts of all personnel responsible for an acquisition are coordinated and integrated through a comprehensive plan for fulfilling the agency need in a timely manner and at a reasonable cost. We are proactively engaging requirements owners earlier in the acquisition process to strengthen our ability to identify and develop customer requirements, as well as to improve long-term acquisition planning. This includes a specific focus on identifying requirements vulnerable to a cybersecurity attack to assure all required clauses are included in the solicitation and resulting contract.

#### *Risk Identification and Mitigation*

The framework includes the identification of potential risk areas for key acquisitions and the development of strategies to better mitigate these risks. We are collaborating with Treasury's Office of the Procurement Executive to develop risk-based criteria for reviews/approvals instead of using total dollar value as the main determining factor for senior level oversight. Additionally, the Chief Procurement Officer (CPO) initiated a simple method (*i.e.*, CPO Critical Information Requirements) for contracting staff, at any level, to elevate a potential risk or issue immediately through the chain of command.

#### *Use of Government-wide Contracts*

We have developed an implementation plan to migrate actions from IRS stand-alone vehicles to government-wide and Best-In-Class contracts. This approach leverages best industry practices and allows the IRS to benefit from economies of

scale. The plan is continually reviewed and new actions are added as requirements are received.

*Business Process Improvements*

We are streamlining and simplifying processes to improve efficiency and flexibility of procurement operations. This includes taking steps to reduce higher-risk procurement methods, including the use of bridge contracts. We drastically reduced our procurement policies and procedures by deleting over 800 pages of redundant, outdated or overly complex requirements. Additionally, we are automating the pre-solicitation review processes to decrease administrative burden and lessen procurement action lead time.

*Question.* The Federal Information Technology Acquisition Reform Act (FITARA) requires agencies, and specifically Chief Information Officers of agencies, to conduct risk assessments when procuring information technology goods or services. What type of risk assessments did the IRS conduct when reviewing the bid proposals for the contract currently held by Experian?

*Answer.* The contract with Experian was awarded against GSA schedule 520, Financial Business Solutions, as a professional services contract and therefore not subject to FITARA.

Prior to making an award to Experian on July 5, 2017, IRS validated Experian met basic connectivity and transaction interface requirements. After award, we planned to perform a comprehensive on-site security review with Experian prior to sharing data; however, it was put on hold because the protest filed by Equifax on July 7, 2017 triggered an automatic stay of performance with Experian. Immediately following GAO's decision to deny the protest on October 16, 2017, IRS conducted the review as previously planned with Experian. The results identified 16 findings, including one high risk finding. Experian was given 30 days to remediate the findings. The IRS conducted a follow-up review on November 30, 2017 and validated that Experian had corrected 9 findings including the high-risk finding prior to going live. An additional on-site review was performed on March 2, 2018. There are 3 outstanding moderate findings remaining, and the low finding is no longer applicable to the environment.

*Question.* When IRS issued the bridge contract to Equifax, it clearly did not have all of the information it needed to understand the full extent of the security issues. It also seemed that IRS did not build in enough time to account for a possible bid protest. What steps has IRS taken to improve the acquisition planning process to ensure that bridge contracts are truly an option of last resort?

*Answer.* We are developing a new Procurement Strategic Framework with key initiatives that focus on strengthening the IRS's ability to identify and develop customer requirements. An emphasis is on earlier customer engagement in the planning process between Procurement and the customer to ensure acquisition strategies are executable, mandatory contract vehicles are identified, and milestones are defined and agreed to in order to eliminate the need for short-term contract actions. Additionally, we are providing concentrated training in areas that will directly reduce the chance of a protest, such as how to perform best value tradeoffs and how to perform a debriefing after award. Lastly, we are increasing transparency and outreach to industry partners by posting information on FedBizOps, issuing requests for information and draft solicitations, and holding requirement-specific industry days.

*Question.* The Senate Homeland Security and Governmental Affairs Committee recently approved my bill, S. 2413, to bring greater accountability and transparency to bridge contracts.

Notably, the bill requires amending the Federal Acquisition Regulations to develop a common definition of bridge contracts, increases reporting requirements for agencies on their use of bridge contracts, holds senior officials accountable for approving of long-term bridge contracts, and requires public notice when an agency enters into a bridge contract. I believe that this will help to avoid the situation the IRS faced with Equifax. Can you provide a current list of all bridge contracts that the IRS has entered into in the past year, broken down by category of contract, and the amounts and duration of those bridge contracts? What assurances can you provide the committee that the IRS has strengthened its acquisitions and contracting program to avoid a similar instance to the Equifax data breach and bridge contract incident?

Answer. Neither the IRS contract writing system nor the Federal Procurement Data System (FPDS) currently has the capability to distinguish a bridge contract from other types of contracts.

The IRS takes risk management and security issues very seriously and is committed to fulfilling its mission while safeguarding the public's trust. We have taken the opportunity to learn from the Equifax situation and implemented several process improvements and safeguards across the agency. Below are a few examples of actions underway.

*Procurement Strategic Framework*

The Office of Procurement is crafting a deliberate strategic framework that includes 31 tactical initiatives to enhance internal operations and promote proactive, data-driven actions that increase transparency and accountability, improve productivity, and cultivate an agile workforce with the skills to adapt to an evolving acquisition environment.

*Earlier Engagement*

The Office of Procurement is proactively engaging requirements owners earlier in the acquisition process to strengthen the IRS's ability to identify and develop detailed requirements, as well as improve long-term acquisition planning. This includes a new initiative that Procurement has instituted for bringing the entire acquisition team together earlier in the acquisition process to discuss requirements, adjudicate issues/concerns, leverage "wisdom of crowds," and document complete and accurate acquisition packages and milestone timelines. This method is called a Procurement Innovation Team (PIT).

*Elevation of Issues Quickly*

Ensuring information is elevated to the highest levels of the organization quickly has been instituted within the Office of Procurement. The Chief Procurement Officer (CPO) established a process (*i.e.*, CPO Critical Information Requirements) whereby an employee, at any level, can elevate information, unimpeded, through the chain of command as soon as an issue/concern is recognized. This will allow an opportunity for executive involvement and influence prior to actions being executed.

*Incident Response Team*

The value of immediately standing up a multi-disciplinary team with all stakeholders has proved beneficial in sharing information timely and synchronizing various actions. While we recognize this is employed after an incident has occurred, it is a critical component of our risk mitigation strategy.

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QUESTION SUBMITTED BY HON. ROBERT MENENDEZ

*Question.* Mr. Commissioner, in October, 32 members of the House Ways and Means Committee—both Republicans and Democrats—sent a letter to the Treasury Department asking it withdraw IRS Notice 2007–55 which was issued over a decade ago and continues to deter foreign investment in the United States. The notice relates to the Foreign Investment in Real Property Tax Act, or FIRPTA. In short, the notice treats certain distributions from REITs as the sale of REIT assets rather than the sale of REIT stock. The result is that the distributions are subject to tax rates as high as 54 percent. The practical effect is to raise the tax burden on investors in U.S. commercial real estate and infrastructure to levels that are punitive and prohibitive. Cal-Berkeley professor and economist Ken Rosen recently estimated that FIRPTA costs the United States between \$65–125 billion in lost investment and between 147,000–284,000 in lost jobs. This is an infrastructure issue—FIRPTA blocks private investment in U.S. infrastructure. Repealing IRS Notice 2007–55 is a simple and immediate thing that the administration could do to boost private investment in U.S. real estate and infrastructure.

Many of us have been working on this issue for years—no senior official seems willing to defend the current notice, but it just keeps getting kicked down the road.

Could you review this matter and let us know within 30 days, in writing, whether you will repeal section two of the Notice and restore prior law, as dozens of members of Congress have encouraged?

Answer. Thank you for your inquiry. IRS is aware that this long-standing issue is a priority for many members of Congress. We look forward to continuing dialogue with the Treasury Department, members of Congress, and other stakeholders as we work on this issue.

PREPARED STATEMENT OF HON. RON WYDEN,  
A U.S. SENATOR FROM OREGON

Less than 2 months ago, Republicans passed legislation making \$10 trillion in tax changes virtually on the fly—the biggest tax overhaul in 3 decades, requiring a web of complicated rule changes. Now they're giving short shrift to the IRS, which is the agency that actually has to implement those changes and provide service to American families and businesses based on the new rules.

The IRS said it would need nearly \$400 million to implement the new law, but the Trump budget held the agency's funding flat. The budget makes a fake reference to increasing enforcement dollars, but it kicks the actual decision to appropriators in Congress who are unlikely to fork over the necessary resources. And that comes at a time when tax cheats are looking at the Trump tax law and licking their chops, planning complicated new schemes of abusing the rules to get out of paying their fair share. Particularly with the new passthrough loophole, the law is an open invitation for scamsters to game the system, leaving a heavier burden for Americans who do follow the rules.

This isn't an academic matter. Denying the IRS the resources it needs to be an effective agency impedes its ability to serve the American people, and the Trump administration knows it. By the administration's own projections, as a result of continued budget cuts for taxpayer service, fewer than half the people who pick up the phone to call the IRS for filing services in 2019 will get through, down from 75 percent in 2018. And that's with lawmakers on both sides already bemoaning poor service provided to taxpayers by the IRS.

Bottom line, the IRS might not be anybody's favorite Federal agency, but Americans expect it to function without political agenda or interference. That brings me to another issue I need to address this afternoon.

Mr. Kautter, who is here with the committee this afternoon in the throes of tax filing season, is the acting IRS commissioner. That is supposed to be a non-partisan job, overseeing the administration of tax law. But Mr. Kautter is also currently the assistant secretary for tax policy, which in this administration is about as partisan a position as they come.

This committee recently spent years investigating accusations of political interference at the IRS. That bipartisan investigation determined that sloppy work by IRS officials led to both conservative AND progressive tax-exempt groups being subjected to unfair scrutiny. And in my view, both sides would agree that the IRS should be politics-free when it's administering the law. I recall a lot of insistent speeches to that effect, particularly from my Republican colleagues. But now that the party in control of the White House has flipped, there's a Republican political appointee running IRS at the very same time it's implementing a monumentally complicated and partisan law his department helped write.

In December, I wrote a letter to Mr. Kautter asking how he would guarantee their politics aren't bleeding into IRS, what policies or safeguards have been created to avoid conflicts of interest, any guidance regarding communication between the White House and IRS, and much more. I have not received a response to my specific questions. Given the energy and focus this committee has placed on the issue of political influence at IRS in the recent past, it would be awfully hypocritical not to take it seriously now.

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## COMMUNICATION

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### INTRODUCTION

The American Institute of CPAs (AICPA) appreciates the leadership taken by the Senate Finance Committee for your commitment to ensuring the success of the new tax reform laws and for considering various approaches to enable the Internal Revenue Service (IRS or “Service”) to implement those changes while providing quality service to individuals and businesses, as well as their advisers.

As taxpayers face a period of uncertainty regarding the sweeping tax law changes of Pub. L. No. 115-97, it is critical that the IRS has the appropriate resources to proceed as a modern functioning agency that will issue immediate guidance on priority issues,<sup>1</sup> focus on the needs of taxpayers and tax preparers,<sup>2</sup> and implement the legislation in an effective and efficient manner.

In this statement, we provide a series of recommendations that will strengthen tax administration and improve compliance programs while protecting the public. An effective tax administration system should include proper governance and oversight, proficient taxpayer services and a practitioner-focused services unit, which can collectively improve the taxpayer experience while streamlining the tax administration system. Furthermore, the regulation of tax return preparers and the limited use of contingency fees are necessary to promote voluntary compliance and protect taxpayer rights.

### RECOMMENDATIONS

#### 1. IRS Governance and Oversight

As practitioners with vast experience working with the IRS, we have incorporated the lessons learned and built upon the foundation established by the report of the National Commission on Restructuring the IRS (“Restructuring Commission” or “commission”) and outline below governance and oversight recommendations to shape the agency of the future that everyone desires.

*Governance Objectives.* Successful governance of the IRS will include strong leadership, accountability, and transparent policies working collectively towards needed change. In order to hold the IRS accountable, the agency’s governance, management and oversight structure must:<sup>3</sup>

- Develop and maintain a shared vision among all personnel and stakeholders with continuity;
- Set and maintain consistent priorities and strategic direction;
- Impose accountability on senior management;
- Develop appropriate measures of success;
- Ensure that the budget and technology support priorities and strategic direction; and
- Coordinate oversight and identify problems at an early stage.

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<sup>1</sup>See AICPA letter, “Request for Immediate Guidance Regarding Pub. L. No. 115-97,” January 29, 2018.

<sup>2</sup>See AICPA statement, “What the Taxpayers Want or Need From the IRS to Comply With the Tax Laws,” May 17, 2016.

<sup>3</sup>The National Commission of Restructuring the Internal Revenue Service, “A Vision for a New IRS: Report of the National Commission on Restructuring the Internal Revenue Service,” June 25, 1997, page 8.

*Congressional Oversight.* Congressional oversight is a critical process in ensuring executive branch compliance with laws, evaluating performance, and providing the transparency necessary to maintain the public's trust. We recommend reestablishing the annual joint hearing review<sup>4</sup> to focus on the following priorities: (1) strategic and business plans; (2) taxpayer service and compliance; (3) technology and modernization; and (4) filing season.

As once required by statute,<sup>5</sup> the Joint Committee on Taxation should provide a bi-annual report on the overall state of the Federal tax system.<sup>6</sup> However, the statute stipulates that the report is *only required if the necessary resources are appropriated* to carry out the requirement. Such a report would contribute to stability at the IRS and assist it in achieving its mission. Therefore, we urge Congress to appropriate the necessary funds for the report.

*IRS Oversight Board.* The IRS Oversight Board was intended to provide experience, independence, and stability to assist the IRS in moving forward in a focused direction. However, the board received criticism for being “ineffective” and “missing in action” in achieving its stated mission,<sup>7</sup> and suspended operations due to an insufficient number of members to constitute a quorum.

We recommend that Congress require a Government Accountability Office (GAO) review of the private sector board and determine if it is an essential component to providing the trust and continuity that will allow the IRS to become a respected, service-oriented organization. The GAO could provide recommendations to ensure the board has sufficient authority to (1) hold the IRS accountable for successfully fulfilling its mission; (2) oversee the implementation of key recommendations from advisory groups; and (3) ensure the IRS remains independent and non-partisan.

*Human Resources.* Congress should enable and encourage the IRS to utilize the full range of available authorities to hire and compensate qualified and experienced professionals from the private sector, as needed, to improve the Service's ability to meet its mission. It is also crucial for the IRS to designate a senior-level executive dedicated to overseeing and collaborating with the practitioner community in creating a practitioner services unit (*see* discussion below).

## 2. IRS Taxpayer Service

Congress should determine the appropriate level of service it desires and that is needed by the IRS, and dedicate the appropriate resources for them to meet these goals. Agreed upon measures of success are necessary to improve both customer service and voluntary compliance.

To instill trust in the tax administration system, we recommend taxpayer service goals based on the following two guiding principles:

- The IRS should only initiate contact with a taxpayer if the IRS is prepared to devote the resources necessary for a proper and timely resolution of the matter.
- Customer satisfaction must be a goal in every interaction the IRS has with taxpayers, including enforcement actions. Taxpayers expect quality service in all interactions with the IRS, including taxpayer assistance, filing tax returns, paying taxes, and examination and collection actions.<sup>8</sup>

*Resources necessary.* Appropriate hiring, adequate training, skillful management, and the necessary technological tools are essential for the IRS to meet its responsibilities. The leaders of the IRS must have the experience and skills to motivate their workforce and lead them to the realization of the desired vision. Organizational alignment from Congress, the President, the Commissioner, and through the ranks of the IRS, is necessary to delivering the promised goals.

Furthermore, to enable the IRS to achieve the improvements required for a 21st-century tax administration system, the IRS needs a modern technological infrastructure. Currently, the IRS has two of the oldest information systems in the Federal Government making the information technology function one of the biggest con-

<sup>4</sup>Pub. L. 105–206, sec. 4002, expanded IRC section 8022(c) regarding reporting by the Joint Committee on Taxation. Pub. L. 108–311 (October 4, 2004) modified this provision by removing the specifics required for the annual report and eliminating the joint review after 2004 (*also see* IRC section 8021(f)). A statutory change is needed to reinstate the required joint review.

<sup>5</sup>*Id.*

<sup>6</sup>IRC section 8022(3).

<sup>7</sup>Morningstar, Inc., “The IRS Has no Independent Oversight This Tax Season,” April 18, 2016.

<sup>8</sup>Verbatim quote of the two guiding principles. The National Commission of Restructuring the Internal Revenue Service, “A Vision for a New IRS: Report of the National Commission on Restructuring the Internal Revenue Service,” June 25, 1997, page 23.

straints overall for the IRS.<sup>9</sup> Without modern infrastructure, the IRS is unable to timely and efficiently meet the needs of taxpayers and practitioners.

*Customer satisfaction.* Measurement tools are required to achieve customer satisfaction goals, including fairness in enforcement. The IRS made significant progress in measuring taxpayers' opinions in the years following the issuance of the Restructuring Commission. However, in recent years, the Service has stopped reporting on customer satisfaction surveys and analysis. We recommend that customer satisfaction surveys, gauging performance at all levels within the IRS, continue as an appropriate success measure. Congress should utilize the survey results during the oversight and appropriations processes to ensure the Service is continually meeting the needs of taxpayers.

A service-focused approach, with taxpayer education in mind, will require the IRS to take into consideration the needs of both tax practitioners and un-represented taxpayers, and the varying methods needed to interact with them.

### 3. IRS Practitioner Services Unit

The IRS should create a new dedicated "executive-level" practitioner services unit that would centralize and modernize its approach to all practitioners. Over time, the IRS has established a number of functional departments. These individuals are dispersed across the IRS and are not coordinated in a manner that enables practitioners to timely access critical information (such as their clients' account status or the availability of dispute resolution opportunities). Nor do the current teams or processes systematically solicit, gather or evaluate practitioner feedback. Enhancing the relationship between the IRS and practitioners would benefit both the IRS and the millions of taxpayers served by the practitioner community.

A dedicated practitioner services unit would allow the IRS to rationalize, enhance, and place under common management the many current, disparate practitioner-impacting programs, processes, and tools. Moreover, by centralizing these programs, IRS employees would have a consolidated approach to timely resolving issues. This coordination and improved access of information would prevent unnecessary delays and inefficiencies (such as requiring practitioners to submit the same information multiple times to multiple IRS employees). Finally, to ensure success of the practitioner services unit, it is essential for these services to approximate comparable private sector services and allow practitioners to resolve account issues for their clients in a timely and efficient manner.

*Online tax professional account.* The IRS should provide tax practitioners with a tax professional account as part of the IRS's online portal with account access to all of their clients' information (both individual and business accounts) where the practitioner has a valid power of attorney (POA) on file. Additionally, the secure tax professional account should allow the IRS to communicate directly to practitioners the information necessary to improve taxpayer awareness and allow practitioner correspondence with timely acknowledgement of receipt.

Furthermore, a centralized login system allowing for single sign-on authentication of the practitioner and immediate access to all client data, as opposed to practitioner authentication before accessing each client's account, is an indispensable efficiency for the IRS and practitioners alike.

*Secure platform.* The development of the online portal should include a comprehensive, agile platform that protects users' identities and their data, detects threats and immediately responds to potential security breaches. In order to enhance taxpayer protection, practitioners who want access to taxpayer accounts should consent to guidelines such as Circular 230 or other similarly approved requirements. Professional tax practitioners can become particularly active and safe users of online services if the IRS invests early in providing a digital mechanism for POA and disclosure authorization and creates practitioner accounts contemporaneously with individual online accounts.

To continue to improve efficiency, the IRS should also focus its attention on replacing the Centralized Authorization File with a consolidated online solution utilizing electronic signatures and an algorithmic-driven approval process that is as close to real time as possible.

<sup>9</sup>National Taxpayer Advocate, "Annual Report to Congress 2016, Executive Summary: Preface, Special Focus and Highlights," 2016, page 31-32. The report references a 2016 GAO report (GAO-16-468) which found that some of the technology the IRS still relies on was first placed in use 56 years ago.

*Robust practitioner hotlines.* IRS should provide practitioners with a robust practitioner priority hotline (or hotlines) with higher-skilled employees. These employees should have the experience and training to understand and address more complex technical and procedural issues. This expertise would allow the IRS to focus its training on a particular technical area allowing designated employees to resemble its counterparts in the private sector. The IRS should also consider hiring experienced people, such as, graduate students or retired practitioners seeking part-time or seasonal employment.

*Designated customer service representatives.* Under the practitioner services unit, the IRS should assign customer service representatives (also known as a single point of contact) to each geographic area to address unusual or complex issues that practitioners were unable to resolve through the priority hotlines. We recommend allocating the number of representatives based on the number of practitioners in a specific geographic area.

#### 4. Regulation of Tax Return Preparers

The AICPA has always been a steadfast supporter of the goals of enhancing compliance and elevating ethical conduct. We support the use of a preparer tax identification number (PTIN) for all signing tax preparers, and subjecting all tax preparers to Circular 230. To help protect the interests of taxpayers, the AICPA thinks Congress should provide the IRS with a focused and well-defined approach to the regulation of tax return preparers with Congressional oversight.

*Subjection of all tax preparers to Circular 230.* Requiring tax return preparers to follow the Circular 230 standards of conduct as delineated in the *Internal Revenue Service Return Preparer Review* report is essential<sup>10</sup> In the report, the IRS proposed requiring:

. . . all signing and non-signing<sup>11</sup> tax return preparers to comply with the standard of conduct in part 10 of title 31 of the Code of Federal Regulations and reprinted in Treasury Department Circular 230. The authority of attorneys, certified public accountants, enrolled agents, enrolled actuaries and enrolled retirement plan agents to practice before the IRS will not change from the authority they have under current Treasury Department Circular 230.

The remaining tax return preparers will be authorized to prepare returns and to represent a client before the IRS during an examination of any return that the tax return preparer prepared for the client as they are currently permitted under the limited practice provisions in section 10.7(viii) of Treasury Department Circular 230. The conduct of the tax return preparer in connection with the preparation of the return and any representation of the client during an examination will be subject to standard of conduct in Treasury Department Circular 230. Further, inquiries into possible misconduct and disciplinary proceedings relating to tax return preparer misconduct will be conducted under Treasury Department Circular 230.

*Defined parameters for examination and continuing education.* Congress should mandate that the IRS enact a testing and continuing education program similar to the registered tax return preparer program in effect prior to *Loving v. IRS* that would apply exclusively to “unenrolled preparers.” The one-time basic 1040 “entrance” examination to ensure competency in individual income tax return preparation and the requirement for unenrolled preparers to satisfy 15 hours of annual continuing education were both appropriate and necessary to protect taxpayers from incompetence and misconduct, while not raising the bar so high that there are an insufficient number of preparers to assist taxpayers wanting and needing such assistance. Specific parameters and limitations regarding an examination and continuing education are also appropriate to ensure a tax return program does not expand beyond Congress’s goals of protecting the public from incompetent and unscrupulous tax return preparers.

*Limitation on IRS’s Authority to Require a PTIN.* Congress should limit the IRS’s authority to require a PTIN. In order to protect the interests of the public, the IRS should track (through the use of the PTIN) all individuals that sign a tax return. However, in order to prevent potential overregulation and duplicative filing obligations, Congress should (i) exclude non-signers from the requirement to obtain a

<sup>10</sup> *Internal Revenue Service Return Preparer Review*, December 2009, page 37.

<sup>11</sup> See AICPA comment letter, “Chairman’s Mark of a Bill to Prevent Identity Theft and Tax Refund Fraud,” September 15, 2016, position on “Limitation on IRS’s Authority to Require a PTIN,” page 6.

PTIN if those non-signers are supervised by an attorney, CPA, or enrolled agent; and (ii) the supervising professional signs the tax returns or claims for refund prepared by the individual. Such an exclusion from the current PTIN system would recognize the inherent regulatory regime within which CPAs and other Circular 230 legacy practitioners already practice, as well as the fact that CPA firms must stand, as a matter of licensure, behind the work done by the members and employees of their firms.

*Authorization to Revoke PTINs.* The IRS could more effectively utilize their current PTIN system to protect the public from incompetent and fraudulent tax return preparers. We, therefore, recommend that Congress grant the IRS specific authority to revoke a PTIN to efficiently prevent unqualified and unscrupulous preparers from continuing to file inaccurate and fraudulent tax returns.

*GAO Study on IRS's Exchange of Information With State Taxing Authorities.* The AICPA supports directing a GAO study on the impact of increasing the exchange of information relating to return preparers between the IRS and state taxing authorities. Such exchange of information (for example, a list of revoked PTINs and the reasons for the revocations) would improve tax administration by reducing duplicate government resource expenditures and increasing taxpayer compliance.

*Mitigation of Marketplace Confusion.* Congress should also require the IRS to take steps to mitigate marketplace confusion. For example, prior to *Loving v. IRS*, the IRS recognized the potential for marketplace confusion when it required subjecting the currently-unenrolled community to the guidance in Notice 2011-45, 2011-25 IRB 886, with regard to advertising restrictions.

#### **5. Contingent Fees**

Finally, the AICPA opposes any expansion of the use of contingent fee arrangements which are not in the best interest of the public. The AICPA's Code of Professional Conduct and State Boards of Accountancy have rules addressing the appropriate use of contingent fees in tax practice and allow for contingency fees on a limited basis. Allowing tax preparers a financial interest in a tax return (in other words, a contingent fee arrangement), encourages tax preparers to take positions that increase their fee rather than positions supported by the law. The AICPA is available to work with Congress and the IRS in addressing adequate use of contingent fees.

#### **CONCLUDING REMARKS**

The AICPA appreciates the opportunity to submit a statement for the record. We look forward to working with the Committee to ensure that the IRS has the appropriate resources needed to implement the extensive tax law changes through a modernized and effective tax administration system.

The AICPA is the world's largest member association representing the accounting profession with more than 418,000 members in 143 countries and a history of serving the public interest since 1887. Our members advise clients on Federal, state, local and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.