

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2018

WEDNESDAY, JULY 26, 2017

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

The subcommittee met at 10:01 a.m., in room SD-138, Dirksen Senate Office Building, Hon. Shelley Moore Capito (chairwoman) presiding.

Present: Senators Capito, Moran, Boozman, Lankford, Daines, Coons, Durbin, Manchin, and Van Hollen.

DEPARTMENT OF THE TREASURY

STATEMENT OF HON. STEVEN T. MNUCHIN, SECRETARY

OPENING STATEMENT OF SENATOR SHELLEY MOORE CAPITO

Senator CAPITO. Want to go ahead and come up. We will just go ahead. Oh, we are going to do Secretary—I am sorry—Secretary Mnuchin first. Okay. Well, welcome to everybody and good morning. Senator Coons and Senator Lankford.

Today we had the opportunity to review the budget requests of the Department of Treasury and the Internal Revenue Service. As we begin this important hearing, we welcome our witnesses today, Treasury Secretary Steven Mnuchin, IRS Commissioner John Koskinen—I should know that from our common alma mater—and the Treasury IG for Tax Administration, Russell George. Thank you for being here.

The Department of the Treasury has an important mission. Its work is to promote economic growth and stability and safeguard our financial system, which is critical to maintaining a strong economy and creating economic opportunity. Equally important is its work to combat terrorism, the proliferation of weapons of mass destruction, money laundering, drug trafficking, and other national security threats.

The Internal Revenue Service has the significant role of administering our Nation's tax laws. To carry out these responsibilities effectively, taxpayers must have the faith that the IRS will do its job without regard to an individual's exercise of their constitutional rights. The IRS must also protect taxpayers' personal information and privacy. As the IRS continues to evolve and make changes to its service delivery systems, there must be improvements in its

ability to manage that change without adversely affecting taxpayers or compromising their personal information. We look forward to hearing from all of our witnesses today about the details of your budget requests, as well as your plans to address cyber security threats and vulnerabilities within Treasury and in our Nation's financial sector.

In addition, we also want to learn more about Treasury's plan to make a comprehensive approach to regulatory relief. Hopefully those efforts will help spur economic growth and job creation.

Thank you and I will now turn to my Ranking Member, Senator Coons, for his opening statement.

STATEMENT OF SENATOR CHRISTOPHER A. COONS

Senator COONS. Thank you, Chairwoman Capito, for convening this hearing. I appreciate the opportunity we have on this subcommittee to examine a very wide diverse range of interests across many agencies, and in particular, the Department of Treasury. And I look forward to finding common ground and strengthening our partnership. And I would like to welcome our witnesses, Secretary Steve Mnuchin, Commissioner John Koskinen, and Inspector General Russell George. Thank you for joining us this morning and for your service to our Nation.

Today we are considering the budget request by the Treasury Department, a Department that is central to our Government's stability and operations, that helps sustain our country's fiscal health and protect our national security from collecting taxes and processing over \$3 trillion in Federal payments to pursuing financial crimes here in the United States and identifying individuals here and abroad that would promote terror.

I am concerned the budget request we are considering would undermine the Department's ability to fulfill all these critical roles. In the non-IRS parts of Treasury, the budget requests \$1.3 billion, 26 percent less than current levels, and to achieve that reduction, the budget would rely on staff cuts achieved through Department wide hiring freeze. My concern is that this might not result in a strategic realignment of resources, but instead drain the Department's best and brightest to meet an arbitrary budget goal.

The budget also cuts some common-sense investments like cyber security improvements and upgrades to financial systems that I think the entire Federal Government relies on for Treasury services. I am also concerned about proposed cuts to the Office of Terrorism and Financial Intelligence, which it helps enforce economic sanctions and reductions in the Financial Crimes Enforcement Network, which combats domestic and international money laundering. I think these are all areas of your Department worthy of full investment.

I have continually called upon this administration and its predecessor to crack down on Iran and North Korea and other regimes that support terror. And although there have been some mixed signals, I believe the administration shares and strongly supports these goals and I would be interested in hearing whether the requested funding levels are sufficient for these vital bureaus.

The budget also proposes to eliminate grants to CDFIs, to Community Development Financial Institutions, which support develop-

ment and create jobs in underserved neighborhoods around our country and cuts funds for entities created in the wake of the financial crisis, an 8 percent cut for FSOC, or Financial Stability Oversight Council, and 25 percent to the Office of Financial Research, both of which I think have real value. But let us look at the majority of the budget before us, which is the IRS.

No government agency is more visible, more impactful to the American people than the Internal Revenue Service, which collects the revenues that fund more than 95 percent of the Federal Government's operations and public service. And each year more than 80,000 public servants at the IRS make hundreds of millions of contacts with American taxpayers. There have been 7 consecutive years of either budget freezes or budget cuts to IRS. And the proposal we are reviewing today would continue that trend by cutting I think \$260 million from an under resourced agency. And my concerns are not based on the partisan politics of this.

To put the scale of this proposed cut in context, President Trump's level for the IRS falls \$400 million short of what President Bush asked for in 2009. And I think the predictable impact of this reduction would be the loss of more than 4,000 staff in taxpayer services, which would significantly diminish the services for taxpayers seeking pre-filing and post-filing guidance in order to timely and accurately meet their tax obligations.

The level of service in the upcoming year if this cut is enacted would drop to nearly 40 percent, 45 percent during peak filing. That would mean more than 6 out of 10 callers—that more than 6 of 10 callers will not be helped on toll-free lines as they seek guidance. My office hears from Delawareans frustrated when their calls to IRS go unanswered and when it takes a long time to connect with an IRS official. I imagine many other Senate offices hear from constituents with similar concerns. And I think the solution is to give the agency the resources to meet these constituent needs.

So I look forward to hearing more about why the Department and the IRS think it is a good idea to reduce service delivery rates and what we might do together to address that. We have a lot more to discuss today. Let me just move to the end and say in the absence of a funding agreement on our subcommittee, we will continue to work here. I am grateful for your service and look forward to your testimony. And I know that our respective constituents expect no less than a highly efficient and well-functioning IRS and Department of Treasury. And I look forward to working with you, Chairwoman Capito, as we move forward in our 2018 process. Thank you.

Senator CAPITO. Thank you, Senator Coons.

And Secretary Mnuchin, I now invite you to present your remarks on behalf of the Department of the Treasury.

SUMMARY STATEMENT OF HON. STEVEN T. MNUCHIN

Secretary MNUCHIN. Thank you and good morning. Chairwoman Capito, Ranking Member Coons, and Members of the subcommittee, thank you for inviting me today. I look forward to working with this subcommittee on funding key priorities for the benefit of the American people.

One of the President's promises to the American taxpayer was that he would make sure that their money was spent wisely. A budget should not be an end in itself, but a means of improving the lives of Americans. More money does not necessarily translate into better policy. The President has challenged every agency and department to identify greater efficiencies and savings that can be realized both immediately and in coming years.

The administration is proud to submit a budget that achieves this goal. This budget makes some difficult choices because of some necessary constraints. We carefully evaluated the allocation of resources to each of the Department's important functions and made prudential reductions where needed. These choices in no way diminish our ability to operate the Government effectively. The President made it clear: national security is a top priority, and in accordance, the Treasury's request prioritizes national security and cyber security programs.

Another top goal of Treasury is creating sustained economic growth. This much-needed growth will be achieved through a combination of tax reform, regulatory reform, and trade. We will work with Congress to pass legislation that allows American taxpayers to keep more of their hard-earned paychecks. If we develop the right policies today, we will secure a prosperous future for our children and grandchildren. The difference between recent sluggish growth and a return to 3 percent or higher GDP is trillions of dollars into the economy, making a meaningful difference in the lives of all Americans.

This budget prioritizes funding for Treasury's wide array of economic and financial tools, including sanctions. As our enemies have changed, so too have our weapons to combat them. We are honing the economic and financial tools in our arsenal to disrupt the financial resources and procurement capabilities of those who wish to do us harm. This includes actions against destabilizing regimes, terrorist networks, and drug traffickers. Stopping the flow of funding to dangerous non-state actors, working with foreign partners to keep their financial systems secure, protecting our own financial system—these key programs are critical to the continued safety and stability of the Nation.

Protecting Treasury and the financial system from cyber attacks is critical to our financial stability. Cyber attacks against our agency or the financial system have the potential to impact markets, the economy, and our national security. The Cybersecurity Enhancement Account makes investments into enterprise-wide cybersecurity capabilities that allow Treasury to better defend against cyber attacks and more efficiently respond and recover when they do occur. This account also makes investments in critical infrastructure protection, allowing Treasury to work collaboratively with the financial services sector to increase their operational resilience.

In recent months, our Office of Terrorism and Financial Intelligence agreed with the Gulf counterparts on the intent to establish a Terrorist Financing Targeting Center, a bold new initiative to fight terrorist financing. The TFTC is a key outcome of the President's Summit in Saudi Arabia and will enhance cooperation with Gulf countries. It will support the administration's priority to fight

terrorism, counter Iran's influence, and deprive terrorists globally of the access to Gulf countries.

As I mentioned earlier, tax and regulatory reform are marquee items for economic growth and job creation. It has been over 30 years since we have had comprehensive tax reform in this country. We are committed to changing that. Such reform means a simplified code that will provide simpler taxes and relief to middle income Americans, while making our business competitive again.

We have taken a comprehensive approach to regulatory relief, meeting with hundreds of business people across the financial industry, including community, regional, and large financial institutions, consumer advocacy groups, academics, think tanks, trade groups, and insurers. We have heard about what works and what does not. Our reforms will spur economic growth by increasing access to credit and providing relief for community banks and making regulations more efficient, effective, and appropriately applied. We will do this while ensuring that our financial system is secure and stable and does not put taxpayers at risk.

We have the opportunity to do great things for the American people and I look forward to working with Members of this subcommittee on these important issues. Thank you very much and I am happy to answer any questions today.

[The statement follows:]

PREPARED STATEMENT OF HON. STEVEN T. MNUCHIN

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Senator CAPITO. Thank you, Mr. Secretary.

And at this time, we will proceed to our questioning where each senator will have 5 minutes. So I am going to begin the questioning and I would like to welcome you and thank you also for the visit, recent visit to my office. I appreciate the opportunity to get to know you and see your vision of where the Department of Treasury is going to go.

Let us talk about regulatory reform. You mentioned it in your remarks. I know that you have talked to stakeholders all around the country: independent, regional, and large banks, regulators, FSOC members, consumer advocates, academics, analysts, and investors, the whole range, to get a clearer picture of what the regulatory framework is now. What would you say is your most significant challenge that you have encountered to this point to getting real meaningful regulatory relief?

Secretary MNUCHIN. Thank you very much. First of all, let me just say under the President's Executive order, we have examined regulatory changes for the financial system. While this looks at many aspects of Dodd-Frank, it goes much further than Dodd-Frank. So we are pleased we delivered the first report on banks and credit unions and we look forward to delivering three more reports as it impacts other areas.

I think for us the biggest challenge is making sure we deal with the issue of regulatory overlap and making sure that the regulators are working together. And that is something that as Chair of FSOC, I am very focused on. I am pleased to report that we have had very good reception from both sides of the aisle on our suggestions in the report and we look forward to working with Congress on some meaningful changes, particularly for community banking.

I think, as you know, the top institutions account for about 50 percent of the assets in the banking system in the United States. We need to create a system where community banks and regional banks can thrive. We also look forward to working with the regulators on many of the proposals.

Senator CAPITO. Thank you. And I appreciate your emphasis on community banks, as somebody from a smaller State where com-

munity banks really are the life blood of a small community, by providing access to credit, familiarity with regions and areas, and customers. We want to preserve that model for those of us who do not have large bank entities, you know, close by. And I know, as a former member of the Financial Services Committee on the House side, this was a topic of great concern to all of us to make sure that we can provide flexibility and reasonable regulation and not a one size fits all. So I appreciate that.

I would like to, first of all, we talked the other day that I am proud of the work that is being done in Parkersburg, West Virginia at the Bureau of Fiscal Services. We have 2,000 folks there that are doing a lot of great things. And one of the things that they are doing is to promote Government efficiency through a shared services model. And I would like to, first of all, invite you to come and visit Parkersburg and the Bureau of Fiscal Service there, but also would like to see a commitment from you that you are willing to kind of push this concept of shared services. I think it has been rather successful in the beginning and we would like to see it grow for obvious reasons. Do you have any comments on that?

Secretary MNUCHIN. Well, first of all, thank you for the invitation. I will take you up on that.

Senator CAPITO. Great.

Secretary MNUCHIN. I look forward to visiting the facility. It is a very important facility of ours. I very much appreciate the model we have at the Fiscal Service, where it provides shared services across the government. I think that it is our obligation to look at other areas that we can use a similar approach. One of them, I believe, is technology. We have too many different technology departments in the different agencies. We do not have consistent technology. I fully support a shared services model for technology across the executive branch, amongst other ideas.

Senator CAPITO. Sounds great. Thank you very much. I know we are going to have other questions on cybersecurity, so I would like to kick it off because I think we are all very—probably each one of us on the dais here has been affected by, in some way, a breach of our own personal information or our financial access to maybe one of the cards that we have. Very frustrating from a consumer standpoint and at the same time it can be very frightening and damaging to an individual's financial stability.

I know you are doing a lot. Is there one particular thing you would like to highlight that might make us rest a little bit easier at night on this particular issue?

Secretary MNUCHIN. Well, unfortunately, I do not want to let you rest too easy on it because it is a significant issue. I will tell you it is something I have spent a lot of time on. I do have experience in technology, having served as the CIO of Goldman Sachs. I do bring technology experience to the Treasury.

I am very focused on two aspects of it. One is our internal infrastructure, whether it be at the IRS or at Treasury. We obviously are responsible for keeping many taxpayers' information secure. So within the budget, we have prioritized technology spending within the IRS. I have also worked very closely with the financial infrastructure of our banking systems, whether it is with the Financial and Banking Information Infrastructure Committee (FBIIC) or

through our other interagency processes. We are very focused on various mechanisms to make sure we can respond to a technology crisis within the financial sector.

Senator CAPITO. Thank you so much.

Senator Coons.

Senator COONS. Thank you, Chairwoman Capito. I would just like to ask unanimous consent that a written statement submitted by Anthony Reardon, President of the National Treasury Employees Union, be included in the record.

Senator CAPITO. Without objection.

[The statement follows:]

PREPARED STATEMENT OF ANTHONY M. REARDON
NATIONAL PRESIDENT
NATIONAL TREASURY EMPLOYEES UNION

Chairwoman Capito, Ranking Member Coons and distinguished Members of the subcommittee, I would like to thank you for allowing me to provide comments on the administration's fiscal year 2018 budget request for the IRS. As President of the National Treasury Employees Union (NTEU), I have the honor of representing over 150,000 Federal workers in 31 agencies, including the men and women at the IRS.

Madam Chairwoman, since fiscal year 2010, IRS funding has been cut by almost \$1 billion. The funding reductions have forced the IRS to operate under an exception-only hiring freeze since December 2010, and has forced the Service to reduce the total number of full-time employees by approximately 18,000 across every State in the country. The lack of sufficient staffing has strained IRS' capacity to meet its mission of providing America's taxpayers top quality service by helping them understand and meet their tax responsibilities, and to enforce the law with integrity and fairness to all.

The drastic cuts to IRS' budget come at a time when the IRS workforce is already facing a dramatically increasing workload with staffing levels down almost 20 percent below what they were just 6 years ago. In 2010, the IRS had 92,148 full-time employees to administer tax laws and process 230 million tax returns. By the close of 2016, that number had fallen to 74,151 to administer a more complicated tax code and process 244 million much more complex tax returns and other forms.

In addition, over the last several years the IRS has had to implement a number of significant legislative mandates, nearly all of which came with no additional funding. These include the Affordable Care Act (ACA), the Foreign Account Tax Compliance Act (FACTA), the Achieving a Better Life Experience (ABLE) Act, reauthorization of the Health Coverage Tax Credit (HCTC), the seriously delinquent debt certification program and the 2015 Protecting Americans from Tax Hikes (PATH) Act.

NTEU was disappointed that the administration's fiscal year 2018 budget calls for reducing IRS funding by an additional \$260 million below the fiscal year 2017 enacted level and reducing overall staffing by more than 4,200. NTEU knows any further reductions in funding and staffing will further exacerbate the adverse impact previous cuts have had on IRS' ability to provide taxpayers with the service they need and enforcement of our Nation's tax laws. We believe that in order to continue to make improvements in taxpayer services while handling a growing workload and increasing collections, it is imperative to reverse the severe cuts in IRS staffing levels and begin providing adequate resources to meet these challenges. With the future workload only expected to continue to rise, the IRS will be under a great deal of pressure to improve customer service standards while simultaneously enforcing the Nation's tax laws.

IMPACT OF INADEQUATE FUNDING ON TAXPAYER SERVICES

Madam Chairwoman, providing quality taxpayer service is a critical component of the IRS' efforts to help the taxpaying public understand its Federal tax obligations while making it easier to comply with the tax system. Unfortunately, the IRS' ability to provide excellent taxpayer service has been severely challenged due to reduced funding in recent years. Since fiscal year 2010, overall funding for the IRS has declined by more than \$900 million (7 percent), while the number of individual taxpayers has increased by 10 million, or more than 6 percent. These reductions have resulted in a reduction in the number of employees assigned to answer telephone calls from 9,400 in 2010 to 6,200 in 2015, a 34 percent drop.

In a letter to Congress following the close of the 2015 filing season, the IRS highlighted some of the adverse impacts these reductions had on its' ability to deliver taxpayer services during the filing season. These include:

- A reduction in the percentage of callers seeking live assistance who received it (telephone level of service) to 38 percent—down from 74 percent in fiscal year 2010.
- Taxpayers waited about 23 minutes on average for an IRS representative to get on the line, and more than 60 percent of calls were never answered. This represents a sharp decline from 2010, when the IRS answered three-quarters of calls and had an average wait time of just under 11 minutes.
- The IRS was not able to answer any tax-law questions except “basic” ones during the filing season, and now that the filing season is over, it will not answer any tax-law questions at all, leaving the roughly 15 million taxpayers who file later in the year unable to get answers to their questions by calling or visiting IRS offices.
- The IRS historically has prepared tax returns for taxpayers seeking its help, particularly for low income, elderly, and disabled taxpayers. Eleven years ago, it prepared some 476,000 returns. That number declined significantly over the past decade, and in 2014 the IRS announced it would no longer prepare returns at all.

Additionally, because funding reductions forced the IRS to shorten the period of employment for their seasonal employees who help answer taxpayer correspondence, the IRS' inventory of correspondence from taxpayers in 2014 and 2015 grew significantly above what it normally would have been to more than 900,000.

For fiscal year 2016 and fiscal year 2017, the IRS was provided with \$290 million to improve the customer service representative level of service (LOS) rate, among other things. With this funding, the IRS was able to hire additional temporary telephone assistants which drastically reduced taxpayer wait times and helped the IRS raise the phone level of service from 38 percent during the 2015 filing season to 72 percent during the 2016 filing season and to 79 percent during the 2017 filing season. The additional funding also freed up more resources to help the IRS reduce the correspondence inventory to 690,000 by the end of fiscal year 2016, a drastic reduction from just 2 years prior.

Despite the clear evidence that providing the IRS with additional funding enabled them to drastically reduce taxpayer wait times and improve the phone level of service during the 2016 and 2017 filing seasons, the administration's fiscal year 2018 budget request actually calls for reducing taxpayer services seasonal staffing costs by \$239 million and overall taxpayer services staffing by almost 2,200 FTEs. The administration's request seems to acknowledge the adverse impact that these reductions will have on IRS' ability to provide quality service by noting the target level of service for all of fiscal year 2018 is just 39 percent, a drop of 25 percent from the fiscal year 2017 level. It is clear that the administration's proposed reductions in funding and staffing for taxpayer services will simply reverse the gains made in recent years and leave the IRS unable to provide taxpayers with the assistance they need.

The importance of providing taxpayers with timely assistance over the phone or in person is also of particular importance for victims of identity theft and other types of tax refund fraud. These cases are extremely complex cases to resolve, frequently touching on multiple issues and multiple tax years, and the process of resolving these cases can be very frustrating for victims.

While the IRS has made considerable progress in this area, additional work remains. Fighting identity theft is an ongoing battle as identity thieves continue to create new ways of stealing personal information and using it for their gain. Therefore, it is critical that the IRS has the resources and staffing necessary to prevent refund fraud from occurring in the first place, to investigate identity theft-related crimes when they do occur, and to help taxpayers who have been victimized by identity thieves as quickly as possible.

Madam Chairwoman, it is clear that drastic funding reductions in recent years have seriously eroded the IRS' ability to provide taxpayers with the services they need. Without additional funding, taxpayers will continue experiencing a degradation of services, including longer wait times to receive assistance over the telephone, increasing correspondence inventories, including letters from victims of identity theft and taxpayers seeking to resolve issues with taxes due or looking to set up payment plans.

IMPACT ON ENFORCEMENT & EFFORTS TO REDUCE THE FEDERAL DEFICIT

NTEU believes a strong enforcement program that respects taxpayer rights, and minimizes taxpayer burden, plays a critical role in IRS' efforts to enhance voluntary compliance, combat the rising incidence of identity theft, and reduce the tax gap.

Unfortunately, funding reductions in recent years are undermining the Service's ability to maximize taxpayer compliance, prevent tax evasion and reduce the deficit. The adverse impact of insufficient funding on IRS' capacity to collect revenue critical to reducing the Federal deficit is clear. In fiscal year 2016, operating on a budget of \$11.2 billion, the IRS collected \$3.3 trillion, roughly 93 percent of Federal Government receipts. According to the IRS, every dollar invested in IRS enforcement programs generates roughly \$6 in increased revenues, but reduced funding for enforcement programs in recent years has led to a decline in enforcement revenue since fiscal year 2007. In fiscal year 2016, IRS enforcement activities brought in \$54.3 billion, down almost \$5 billion from the \$59.2 billion of fiscal year 2007.

The reduction in revenue can be partly attributed to a reduction in the total number of IRS enforcement personnel, including revenue officers and revenue agents—two groups critical to efforts to reduce the Federal budget deficit. Since fiscal year 2010, the total number of revenue officers and revenue agents fell more than 32 percent from 20,510 to 13,791, a reduction of almost 6,800 positions.

Without sufficient staffing to effectively enforce the law to ensure compliance with tax responsibilities and combat fraud, our voluntary tax compliance system is at risk. And as the IRS Commissioner has repeatedly noted, a simple one-percent decline in the compliance rate translates into \$30 billion in lost revenue for the Government.

Sufficient enforcement staffing is also critical if the IRS is to make further progress on closing the tax gap, which is the amount of tax owed by taxpayers that is not paid on time. According to the IRS, the amount of tax not timely paid is \$450 billion, translating to a noncompliance rate of almost 17 percent.

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

Despite the clear evidence that reductions to enforcement funding and staffing have had on the Service's efforts to generate revenue and to enforce our Nation's tax laws, NTEU was disappointed to see the administration's fiscal year 2018 budget request would slash funding for enforcement by \$50 million from the current level, and result in the loss of more than 2,100 enforcement FTEs. With enforcement staffing already down by more than 30 percent since fiscal year 2010, these additional proposed reductions will simply further reduce IRS' ability to enforce our Nation's tax laws, maximize taxpayer compliance, combat identity theft and other types of fraud, and generate revenue collection that is critical to reducing the Federal deficit.

Madam Chairwoman, the adverse impact of recent funding cuts on the IRS' ability to provide taxpayers with the service they need and enforce our Nation's tax laws is clear. NTEU strongly believes that only by providing the IRS with additional resources will the IRS be able to meet the rising workload level, stabilize and strengthen tax compliance and customer service programs, and allow the Service to address the Federal deficit in a serious and meaningful way.

PRIVATE TAX COLLECTION

Madam Chairwoman, I would also like to note NTEU's strong opposition to the resumption earlier this year of the use of private collection agencies (PCAs) to collect taxes on a commission basis. NTEU believes this twice failed program is a waste of taxpayer's dollars, invites overly aggressive collection techniques, jeopardizes the financial privacy of American taxpayers, and may ultimately serve to undermine efforts to reduce the deficit.

As you know, in late 2015, Congress approved a long-term highway funding bill which offset part of the costs of the bill by requiring the Treasury Department to contract with PCAs to collect Federal tax debt on a commission basis despite the objections of the administration, the National Taxpayer Advocate and a coalition of civil and consumer rights groups.

The use of PCAs to collect tax debts has repeatedly been shown to be a waste of taxpayer dollars. The first attempt to use PCAs to collect Federal taxes came in 1996 and 1997, when Congress authorized IRS to conduct a 2 year pilot project testing the use of PCAs to collect tax debts. The 1996 pilot was so unsuccessful it was

cancelled after 12 months. Contractors participating in the pilot programs were found to have regularly violated the Fair Debt Collection Practices Act (FDCPA), and the program resulted in a \$17 million net loss.

Under legislation enacted in 2004, the IRS again attempted the use of PCAs to collect Federal taxes in 2006. In September of that year, the IRS began turning over delinquent taxpayer accounts to three PCAs who were permitted to keep between 21–24 percent of the money they collected. While the program was projected to bring in \$2.2 billion in new revenue, data from the IRS showed that the program resulted in a net loss of almost \$4.5 million to the Federal Government, after subtracting \$86.2 million in program administration costs and more than \$16 million in commissions to the PCAs.

Before terminating the program in March 2009, an independently-reviewed study by the IRS found that IRS employees are three times more efficient at collecting taxes than private tax collectors.

In addition to being fiscally unsound, allowing PCAs to collect tax debt on a commission basis led to taxpayer abuse. According to the IRS, between September 2006 and March 2009, the IRS received dozens of taxpayer complaints against the PCAs, five of which were confirmed by an IRS Complaint Panel to be serious violations of law. In addition, one of the three original private contractors was dropped by the IRS for dubious practices despite the Service's previous assurance that its oversight would prevent abuse, and penalties totaling at least \$10,000 were imposed by the IRS on the PCAs for violations against taxpayers. In one instance, private collectors made 150 calls to the elderly parents of a taxpayer after the collection agency was notified he was no longer at that address. I would note that one of the four companies currently under contract with the IRS to collect taxes lost its contract with the U.S. Department of Education in 2015 for providing inaccurate information to student loan recipients.

Concerns that this latest attempt to turn over tax collection to private contractors could lead to taxpayer abuse were reinforced recently after a review of the call scripts used by the PCAs to contact taxpayers exposed potential violations of taxpayer privacy protections. The review, undertaken by a group of four Senators concerned the PCA program could lead to taxpayer abuse, showed the scripts may include implied threats to taxpayers, violations of taxpayer privacy protections due to information shared with third parties, and inadequate responses to taxpayer cease and desist requests. Concerns over their findings led the group of Senators to recently request the Federal Trade Commission to investigate whether the collection agencies are violating the Fair Debt Collections Practices Act.

In addition to concerns that the PCAs could be violating the FDCPA, NTEU is concerned that given the proliferation of tax schemes in recent years, allowing private companies to contact taxpayers on behalf of the IRS will lead to confusion among taxpayers and invite aggressive tax schemes.

In February the IRS released its annual "Dirty Dozen" list of tax scams for 2017 which highlights various illegal schemes that taxpayers may encounter throughout the year. Among the top scams the IRS warned taxpayers to guard against were aggressive and threatening phone calls from criminals impersonating IRS agents. The IRS has seen a surge of these phone scams in recent years as con artists threaten taxpayers with police arrest, deportation and license revocation, among other things. While the IRS has historically preferred to contact taxpayers by letter and not by phone, often saying that "if you are surprised to be hearing from us, then you're not hearing from us," under the private debt collection program, private collection firms are now calling taxpayers directly and identifying themselves as contractors of the IRS. This will simply confuse taxpayers that have been told repeatedly they will not receive calls from the IRS.

I would note that in April the Treasury Inspector General for Tax Administration (TIGTA) announced 11 people had been charged with crimes involving schemes to impersonate IRS agents and steal money from innocent taxpayers by claiming they owed back taxes. Furthermore, in recent testimony before Congress, both TIGTA and the National Taxpayer Advocate warned that the use of private debt collectors could exacerbate or widen the impersonation scam and noted their offices would be closely watching this issue as the outsourcing of taxpayer cases to PCAs continues to ramp up.

We also believe this latest attempt to turn over tax collection to private contractors will unfairly target low-income taxpayers. The IRS has estimated that almost 80 percent of the cases that would be referred to the PCAs would involve taxpayers with incomes below 250 percent of the Federal poverty level. Furthermore, a review by the National Taxpayer Advocate of returns of those taxpayer cases to be assigned to the PCAs showed the median reported income was about \$32,000 and more than one-third of the returns reported incomes of less than \$20,000.

Subjecting taxpayers that are struggling to make ends meet and can't afford legal representation to private contractors whose sole motivation is to maximize their own profits at the taxpayers' expense is simply unfair. In the words of the National Taxpayer Advocate, this would "place a bulls-eye on the back of low income taxpayers."

IRS employees, unlike the PCAs, have a variety of tools at their disposal with which they can help delinquent taxpayers meet their tax obligations, in particular, those facing financial difficulties. These include the ability to postpone, extend or suspend collection activities for limited periods of time; making available flexible payment schedules that provide for skipped or reduced monthly payments; the possibility of waiving late penalties or postponing asset seizures and Offers In Compromise (OIC), an agreement between a struggling taxpayer and the agency that settles a tax debt for less than the full amount owed.

In contrast, the PCA's sole interest is to collect from a taxpayer the balance due amount they have been provided. They have no interest in whether the taxpayer owes other taxes or may not have filed required returns, nor do they have access to any other taxpayer records, so they are unable to answer any questions, provide any advice or use any of the tools IRS employees have, such as extensions or offers in compromise. In the current economic climate, it is more important than ever that taxpayers be able to deal with the IRS directly to work through any financial hardships they may be experiencing.

Upon ending the latest attempt to use PCAs in 2009, the IRS committed to working the tax cases recalled from the PCAs. As part of its 2013 Annual Report to Congress, the National Taxpayer Advocate undertook a study that analyzed the results the IRS obtained while working the inventory recalled from the PCAs and analyzed whether the IRS or the PCA performed better when working the PCA inventory. The study found the IRS collected about 62 percent more than the PCAs (\$139.4 million compared to \$86.2 million), and was significantly more effective in collecting taxes. The study noted that the results likely understated the difference in effectiveness, since the PCAs worked the cases first and collected the easy dollars while the IRS only got cases the PCAs had already handled.

NTEU is not alone in our opposition to private tax collection program. Opposition to allowing private companies to collect taxes on a commission basis has been voiced by a number of public advocacy groups, tax experts, former IRS Commissioners as well as the National Taxpayer Advocacy Panel. In addition, the National Taxpayer Advocate, an independent official within the IRS, previously identified the IRS private tax collection initiative as one of the most serious problems facing taxpayers and repeatedly called on Congress to repeal the IRS' authority to outsource tax collection work to private debt collectors.

Outsourcing the collection of taxes to private companies has also been opposed by a number of public advocacy groups including, Consumer Federation of America; NAACP; National Active and Retired Federal Employees Association; National Consumer Law Center; National Consumers League; Citizens for Tax Justice; OMB Watch, AFSCME, National Council of La Raza; and the U.S. Public Interest Research Group.

Madam Chairwoman, NTEU understands and commends efforts to ensure that all taxpayers pay their fair share of taxes. Without a doubt, rank and file IRS employees are committed to achieving this goal in the most cost-effective manner while providing a high level of customer service to American taxpayers. But the facts make clear that the use of private tax collection companies is not in the best interest of American taxpayers, could potentially undermine future efforts to close the tax gap, and should be terminated immediately.

CONCLUSION

Madam Chairwoman, thank you for the opportunity to provide NTEU's views on the administration's fiscal year 2018 budget request for the IRS. We believe that to ensure the IRS is able to continue making improvements in taxpayer services while handling a growing workload and increasing collections, it is imperative that the agency is provided with the resources necessary to meet these challenges. With the complexity of tax administration and future workloads only expected to rise, the IRS will be under a great deal of pressure to improve customer service standards while simultaneously enforcing the Nation's tax laws.

Senator COONS. Secretary Mnuchin, thanks for our conversation before this hearing and for your service. I just want to ask five questions quickly, if I might.

First, just there has been some concern that the administration is directing Cabinet secretaries to not respond to requests from the

minority party despite a longstanding tradition upheld by both parties. Will you commit to responding to questions from both the majority and minority?

Secretary MNUCHIN. I will and I believe we have been responsive—

Senator COONS. You have.

Secretary MNUCHIN [continuing]. To that already, but we will continue to do so.

Senator COONS. Thank you very much, Mr. Secretary. I wanted to talk about the Office of Terrorism and Financial Intelligence and the Financial Crimes Enforcement Network and the TFTC that you mentioned in your opening remarks. I view these as highly valuable. As we spoke about, I think enforcing sanctions is a critical role that your Department plays, but the budget proposes modest, but reductions in these funding—funding in these agencies.

Do you think this budget provides sufficient funding for these two bureaus given their vital missions and given that there is other places—we talked about South Sudan, but there is places in the world where you are not currently prioritizing them because there is so many others, whether it is North Korea or Russia or sanctions that are currently being enforced against a whole range of other nations? Do you think you have asked for sufficient funding for these two bureaus?

Secretary MNUCHIN. Well, let me first comment. I very much believe in the sanctions authorities and what we do within the Treasury. I am probably spending 50 percent of my time on this area because it is so important and so critical to what we are doing.

When we submitted the budget, and again, we had to manage the President's priority, which was additional money for the military and look for cuts where appropriate. When we did that, the intent was to keep TFI flat. I think actually it went down slightly because we got a little bit more money this year than we had expected at the time. So the intent was to keep it flat, was not to reduce it.

Now, I might add, as I mentioned to you when we had the opportunity to meet, since we submitted the budget, we do have other requirements. One of them, as I mentioned, is the Terrorist Financing Targeting Center, where we are seeking additional funds for that. I think it is a very, very important investment over the next 10 years and very effective. And this is something that Secretary Tillerson and Secretary Mattis fully support.

Senator COONS. Thank you. I look forward to exploring that further, but I think we have a shared enthusiasm for vigorous sanctions enforcement in partnership with our allies, both here and in other parts of the world.

Let me move to the Community Development Financial Institutions, CDFIs. The fund that supports them has strong bipartisan support because CDFIs have a record of creating jobs in underserved communities. They leveraged Federal funds roughly 12 to 1 in the last oversight analysis, investing about \$3 billion a year. That is why last year's appropriations bill increased their funding 6 percent, but the fiscal year 2018 budget proposes to eliminate them.

Would you commit to following congressional intent in fully utilizing all of the funds that we provided in the fiscal year 2017 appropriations? And help me understand why you would eliminate a program with a proven record of economic growth. Was this making tough choices in the context of a difficult budget environment or do you think they actually should not be funded?

Secretary MNUCHIN. This was, as I mentioned, in the context of making difficult choices. I do agree that CDFIs have played an important role in the community. This was merely a function of us making difficult decisions across.

Now, the one thing I would also add is that when we came out with our recommendation on financial reforms, one of the areas that I recommended that we look at is the Community Reinvestment Act. So one of the things we want to make sure is as banks are dedicating significant money under the CRA that it is being used appropriately. We want to make sure we meet with community groups and advocates because that is a big area of investment that we think can be more effective.

Senator COONS. Two quick questions if I might, Mr. Secretary. First, I want to make sure you have answered the question, but will you commit to follow congressional intent in the funded—

Secretary MNUCHIN. Yes.

Senator COONS. Thank you. There is also a proposed cut to the Alcohol and Tobacco Tax and Trade Bureau, an area actually strongly supported by industry because it helps them get their products to market faster. Are you concerned that those budget cuts would reverse an area where the industry actually supports more action by the Treasury Department?

Secretary MNUCHIN. Well, again, let me just emphasize. I have personally met with that group. I think they perform a very important function. It is actually quite effective what they do. They manage it under a very reasonable budget. And again, we have scaled back their budget slightly. This is in no way intended to signal that it is not important. It is, quite frankly, very important what they do.

Senator COONS. Thank you, Mr. Secretary. As we spoke about, the U.S. reached the debt limit in March and you are using extraordinary measures to avoid default. Do you agree allowing the Government to default on its debts is a terrible idea that would have significant consequences for our market and economy and even the threat of default has the potential for costly implications for the Government and undermines our credibility?

Secretary MNUCHIN. Senator, yes. Thank you for asking that question which is on one of my favorite subjects and was also one of the previous Secretary's favorite subjects. So, let me again emphasize that the United States credit is of utmost important. We are the reserve currency and we must pay our bills on time.

So as I have suggested in the past, based upon our best estimate at the time, we do have funding through September, but I have urged Congress to take this up before they leave for the recess.

Senator COONS. I appreciate your leadership on that and I will ask one last question if I might or should I—

Senator LANKFORD. You are the Ranking Member. I am the fill-in Chairwoman.

Senator COONS. You are the fill-in Chairwoman for the moment. I will ask one last question about level of service for the IRS. As you heard in my opening remarks, I am concerned that the cuts proposed to the IRS would reduce service levels, but do you think it is acceptable to provide a level of service where more than 4 out of 10 callers will not connect to an account representative as they are trying to meet their legal obligations to pay their taxes?

Secretary MNUCHIN. So, let me just comment on that. First of all, I think as you know, tax reform is a major focus of ours. On the personal side, our objective is to simplify tax reform, cutting down the number of brackets. Under our proposed plan, 95 percent of Americans will be able to fill out their taxes on a simple postcard. While I agree with you the service levels are an issue, my view, the solution is two-fold. One is let us simplify our tax system so not as many people need to call, and two, how do we use technology more effectively as opposed to having to use call centers, how can we communicate with the taxpayers electronically.

Senator COONS. Thank you, Mr. Secretary.

Senator Lankford.

Senator LANKFORD. Thank you. Let me ask you a couple of questions. I want to pick up where Senator Coons left off on the issue on debt ceiling. We are currently using extraordinary measures. Do extraordinary measures have a cost to the taxpayer?

Secretary MNUCHIN. Yes, they do.

Senator LANKFORD. Give me a good guess of what extraordinary measures cost the taxpayer when we move past the debt ceiling limit time period and wait and delay that decision on that action.

Secretary MNUCHIN. Well, there is a significant cost and it is two-fold. The first cost is a real cost, which is right now effectively, as opposed to borrowing in the market at lower rates, we are borrowing and making our trust funds whole at slightly higher rates, so there is a real cost to doing that. There is also an implied cost of uncertainty into the market. The longer we wait, the more than uncertainty will be. So, again, I full urge Congress to deal with this issue as soon as possible.

Senator LANKFORD. So I will talk through a couple of things on that. The best guess that I have in working with your team and trying to get an accurate number of the cost of extraordinary measures is around \$2.5 billion to the taxpayer in real dollars that we pay in because we are covering our own interest to be able to do that. That is a significant cost and a loss to the taxpayer.

The second thing is, as you and I have spoken about before, we should and will do a debt limit issue because that is taking care of already when budget decisions are made. There is something that has to be resolved at that point. My request to you is to be able to work with Congress to be able to figure out a way that when we get to a debt limit moment we do address the issue of debt because we cannot just ignore that and continue to be able to pile on debt and assume there is no consequence. But those key moments should be with the fiscal year decisions that we make and how we resolve those issues and to be able to find some sort of a consistent calendar.

What I have recommended is a 2-year debt limit time period that every 2 years we have to address this and it has to come up and

to try to determine do we have the deficit going up or down. If the deficit is going down, then the President has the authority to be able to make the decision on the debt limit. If the deficit is rising or is static, then Congress has to debate it. That forces us to get back to how are we dealing with the issue of deficit.

For me, we have half a trillion dollars in overspending this year. We cannot just pretend that is going to go away. We do have to address it and I believe a debt ceiling moment is a moment to address it, but if we are actually cutting away at the deficit, I think that should be a process that is ongoing and very, very predictable. The only time it is not predictable is the moment when the deficits are rising or static because then there is something has to be addressed at that moment and we have to be able to take that on. We will have further conversations on this because I want to continue to press on this.

Let me ask you a question, again, following up on some of the things that Senator Coons was saying as well about some international actions. Outline the steps for me that Treasury is taking right now to deal with the finances of Hezbollah. This has been a focus in previous administrations that I think needs continued attention. What are we doing currently to be able to deal with the finances of a known terrorist organization like Hezbollah and what are we doing to be able to limit their access to the world market?

Secretary MNUCHIN. Well, let me just assure you that it is a major focus of ours. I do not want to go through in this public environment the specifics of what we are doing, but I am happy to meet with you privately and provide you a classified briefing.

Senator LANKFORD. Great.

Secretary MNUCHIN. I can assure you that it is a major focus of mine and this administration.

Senator LANKFORD. Terrific. We will get a chance to visit another time in a closed session on that. You have mentioned to Senator Capito as well some of the actions that you are taking to deal with community banking. I would like to ask you two specific issues on that. If we are going to release the economy and some of the regulatory issues that you have mentioned both in public statements and in your written statement today, one of the things is going to be community banking and community lending again.

What recommendations would you make to Congress of actions that we need to take that you are limited on and cannot respond to the issues with community banking that we need to respond to? And the second one is the Qualified Mortgage issue, what can be done to be able to help? In my State, there are very few banks now that do mortgage lending anymore which used to be the anchor for a rural State like Oklahoma, but few banks can do it anymore because of the QM rules. So recommendations you would make to Congress for things that we need to do for community banking and the QM rules.

Secretary MNUCHIN. Thank you. Those are very important issues and I look forward to working with you on it.

We do have a laundry list of items that we recommended to Congress. Some of them, I would highlight, are raising the \$50 billion threshold so that we can have regional banks that can continue to grow. I think that is too low of a limit under the current Dodd-

Frank rules. I know there has been bipartisan support for raising that, so I look forward to working with Congress on that.

You also mentioned the Qualified Mortgage exemption. That is also something we think needs to be looked at, and more importantly, housing reform. Right now we have Fannie Mae and Freddie Mac that have existed in conservatorship. As I have said publicly before, I am committed that we have a long-term solution to housing and that these are not controlled by the Government for the next 4 years, and also looking at FHA as a part of that.

I am concerned that FHA has gone from a 10 percent market share to 20 percent market share and has displaced proper bank lending. Community banks know how to make loans. They should be encouraged to make loans and keep them on their balance sheet and not be forced to make loans to be securitized or turned into FHA or Fannie or Freddie.

Senator LANKFORD. Well, I would completely agree. They can keep it on their books and that's a very safe way to be able to protect the economy and what is happening within that bank. Forty percent of the banks in Oklahoma no longer make mortgage loans any more, 40 percent and rising because of the QM rules that have been put on them. That is very toxic for those communities. Thank you.

Senator CAPITO. Thank you.

Senator Manchin.

Senator MANCHIN. Thank you, Madam Chairman, and thank you, Secretary, for being here.

First of all, the national debt is almost \$20 trillion now, 100 percent of GDP, and no end in sight. I think it is projected by 2027 that we would have an annual debt of \$1.5 trillion. And I know you all worked on a proposal, tax proposal overhaul, which I agree wholeheartedly. I am concerned about the seriousness of working on this debt. I mean, that debt is going to eat us alive. And the question I asked the first time I was here and in Senate was Mike Mullins who was the head of the Joint Chiefs of Staff, what was the greatest threat the United States faces. And he says—I thought he was going to say China or Russia, you know, one of the countries. He said, "The national debt will be the greatest threat we face."

So, with that being said, you had a rate of, what, 15 percent corporate, kind of you all threw out and you were talking about you had three rates of 10, 25, 35, and there was no rate on repatriation. But it was kind of vague, but I know that is—I can follow the path you all were going. But everybody scored that as adding a tremendous more debt to us and I knew you would probably be—you were probably looking at more of dynamic scoring on that to help raise that or change that, which we cannot score dynamically. What is your thought process on the debt load we are carrying?

Secretary MNUCHIN. Well, Senator, first of all, thank you because I think that is a very important question that you have raised.

First of all, I do share your concern about the national debt. The fact that it has gone from \$10 trillion to \$20 trillion is very concerning. I think it is critical for Congress to look at this in the long-term issues, and that is one of the reasons why the administration

submitted a budget that eventually gets to a balanced budget. So I think that is critical.

I would say that the number one threat is not the debt. The number one threat is economic growth. If we continue to have lackluster economic growth, that will not fund our economy and opportunities for Americans and our leadership in the world. We are very focused on creating economic growth. Having said that, we are also sensitive to increasing the debt. And I look forward to working with you and other Senators. We are very close to releasing a detailed plan and I can assure you that we believe that that detailed plan will be responsible as we look at the impact on the economy and the cost to the debt.

Senator MANCHIN. Well, the Bowles Simpson movement a few years back was the only one that went in depth, I think, in trying to find a pathway for bipartisan. And it failed, but it was close. I am thinking some type of a commission. Do you all support some type of a Bowles Simpson, or call it whatever you may, commission that would look at this and try to support the movement you are having? To gain more support here might be of help.

Secretary MNUCHIN. Well, I do not have a view as to whether it should be a commission or not a commission, but I do have a view of getting towards a balanced budget is something that is a very important goal.

Senator MANCHIN. Let me say—ask another question. Marketplace fairness.

Secretary MNUCHIN. I am sorry.

Senator MANCHIN. Marketplace fairness, which is basically the taxation through the Internet. Probably 50 percent or more of the goods that are being sold or purchased in States and we receive no income from that to support our local State functions, but we expect every small business and every established business in our State to collect that tax for us. Do you all support fair taxation on Internet States for State by State, which is marketplace fairness?

Secretary MNUCHIN. This is an issue that we have been looking at very carefully within the administration and we expect to come out with a position shortly. I will tell you that I think, as you know, many States do have a use tax that goes along with the sales tax, so this is really more of a function of collection. I am encouraged that Amazon is now charging tax I believe on their own sales, but not the Marketplace. Not sure I understand the consistency—

Senator MANCHIN. Right.

Secretary MNUCHIN [continuing]. On that, but I respect the States' ability that there is an awful lot of money that is not being collected that is in fact due to them under a use tax. This could be a very important means for the States to fund infrastructure, which is critical.

Senator MANCHIN. It is going to be almost a salvation to most of the States, especially rural States that do not have the expertise or the far-ranging ability to chase down all these Internet sales that are coming in. But if it was a State—if it was a national movement we think it would give us the support we need to make sure that collections would be made. And I would hope that you would look at that seriously for the salvation of our States.

The final question I have is on CFIUS. You all just—you have oversight on CFIUS. This subcommittee examines the national security implications of certain foreign investment transactions. It usually involves critical infrastructure, proximity to national security assets or sensitive trade secrets. You all just recently—CFIUS approved the sale to a Chinese conglomerate of the Chicago Stock Exchange. Can I have your thoughts on that?

Secretary MNUCHIN. Again, let me assure you that I take my role as chair of CFIUS very seriously, that I have examined many transactions since I have been in office. There are many transactions that have been withdrawn. It is a confidential process, so I am not comfortable talking about any one transaction, but I can assure you it is something that I take very seriously.

Now, one other thing I may advocate is I have had the opportunity to meet with Members in Congress about talking about certain changes to the legislation of CFIUS that I think are important to consider. One of the areas in particular are joint ventures are not covered and I think they should be. There is other areas. I know that there is many people in Congress who want us to look at a lot more transactions. And one of the things I think perhaps as we get through the next budget cycle is perhaps CFIUS should have central funding, because it is a very important function, that can be doled out on the inter agencies. But again, we fully support the CFIUS function and think this is something that we need to work with Congress to review.

Senator MANCHIN. I was just concerned about CFIUS taking the approach maybe of not national security, but having a Chinese conglomerate having all this information into our financial economic wherewithal. It is just very concerning to me that we allowed that.

Secretary MNUCHIN. Again, I can assure you that when we look at CFIUS cases we take into account national security very seriously. Again, in this setting, I cannot comment on any—

Senator MANCHIN. Well—

Secretary MNUCHIN [continuing]. Particular transaction, but look forward to working with you.

Senator MANCHIN. Maybe we can talk further on that in closed session. Thank you.

Senator CAPITO. Thank you.

Senator MORAN. Thank you, Chairman. Mr. Secretary, thank you for joining us. I would join Senator Manchin's comments about CFIUS. I corresponded with you on a CFIUS issue, a case. You responded. I appreciate that. I am pleased to hear how seriously you take those responsibilities. I applaud the seriousness behind my request.

I also would follow up with the Chairwoman as well as Senator Lankford's comments about community banks. Your predecessors have been in front of this subcommittee and then as a Member of the Banking Committee I visited with your predecessors and all the variety of regulators that affect our financial institutions, credit unions, and banks, in particular. But I would highlight just so that you would know how important it is, so that you have heard at least from a third Senator this morning.

Senator Lankford talked about lack of mortgage lending. To me, that is one of the most egregious examples of overregulation. Banks

do not make—do not not make loans because it is not a credit-worthy borrower. They do not make loans because of the overregulation, the burden, the cost, and the associated penalties of a minor error. That is not anything that rural America in particular can withstand. We have looked to our local lenders to be the pillars of our community to provide that funding for someone who wants to buy or remodel or build a home and it is not happening.

And then secondly, particularly today with commodity prices in the agriculture sector at the levels that they are, I have great concern that because of consequences of Dodd-Frank and just the regulator environment generally, that what has happened in the past when times are tough is that long time relationships between lenders and farmers and ranchers, know the family, know the business plan, have a sense of their character. That has been a part of the decisionmaking that has occurred when loans are made.

If we get to the point in which community banks are making loans based upon some kind of computer program and you punch in the numbers and none of the other factors are taken into account, we will not survive the agriculture crisis that we face today with low commodity prices. We will have a financial crisis as well, particularly damaging to places like my home State. So I am pleased to hear you reiterate, and you do not need to do it a third time, the efforts that are under way to alter.

I am here to encourage, insist, demand. I have asked every regulator that has been in front of me, give me an example of something you have done that reduces the burden to a community bank. And without exception, no regulator has been able to give me an example. They will talk about how they have a committee, a task force, someone to advise them on community banking, but nothing seems to happen much at the Fed, at the FDIC, or the Office of the Comptroller of Currency. So I would ask you to redouble your efforts in that regard.

On a much more specific topic, let me turn to a question that I asked the SEC Chairman Clayton in a similar setting here just a few days back. I am concerned about the negative impact that the European Union's MiFID II regulations could have on the ability of U.S. firms to provide investment research in the EU. Many small and mid-cap companies depend on that research to attract investment. And EU rules that impede the provision of research could have a direct impact on job creation here in the United States.

I just wanted to gauge your awareness of that issue. And given your broad responsibilities at Treasury, would you commit to me that you are willing to work with EU and the SEC to find a path forward that could prevent negative impacts to investments in U.S. markets and companies? Do you see a role for the Treasury Department in potentially brokering some kind of agreement so that U.S. entrepreneurs and innovators are not excluded from this important analysis?

Secretary MNUCHIN. Thank you. Well, let me first say I will take an opportunity to mention for the third time how much I appreciate the support for community banking that there is from this subcommittee. This is an area that I have had personal experience in having managed banks, and I look forward to working with this

subcommittee and others to making sure that we get the right regulatory balance that community banks can lend and that they are safe, particularly in the agricultural communities.

These are the parts of our country that need to have access to credit and community banks know how to lend. They do this. It is not a function of just relationship lending. It is a function of they understand the agricultural market. These are not loans that should be securitized and sold off. These are loans that should be on the books of the banks and be held, so look for it.

Senator MORAN. I liked your previous two answers and I especially appreciate your third. Thank you, Mr. Secretary.

Secretary MNUCHIN. Okay. Now, on the EU issue, I very much look forward to working with you and Treasury is happy to be helpful in brokering a solution.

Senator MORAN. Thank you very much.

Senator CAPITO. Thank you.

Senator Van Hollen.

Senator VAN HOLLEN. Thank you, Madam Chairman. Mr. Secretary, good to see you here in Appropriations. We have had a chance to talk a little bit in the Budget Committee and Banking Committee. And I had not planned to say anything about the overall budget, but you made the statement that the Trump administration budget balanced in 10 years. I think it is important that the public and Members know that the CBO looked at that and said that just is not so and that you were way off.

So I do want to say I appreciate your efforts on the debt ceiling and I do think it is really important that the Congress not engage in political games with something that has such an impact on our economy, so thank you for your voice in that debate.

I want to reinforce the comments that Senator Coons made regarding CDFIs. I was pleased to hear that was not a cut made on the merits, but it just did not—I guess it just did not meet your overall priority list in the budget. I would say in Maryland and I think many communities around the country CDFIs have played a really important role in local economic development, so I hope this committee will work to restore those cuts.

Just on inversions, and Senator Durbin has been very involved in this, I know we are looking to tax reform. In the meantime, I hope we can do everything possible to prevent people engaging in inversions and the Obama administration put in place some provisions, some rules to reduce that. I hope you will preserve those rules. I think we would like to go further in shutting down some of these inversions.

Let me say a word about North Korea. And first I want to thank your team at Treasury. Senator Toomey and I have been working on bipartisan legislation. In fact, we have introduced a bill on North Korean sanctions that will be in the Banking Committee and we appreciate the input we have gotten from your team on that.

As you know, and another report in the Washington Post today about the North Korea and the ICBM program moving at a faster pace than people previously anticipated, they already have nuclear weapons. I appreciate the action that administration took with respect to the Bank of Dandong. We also know from the February report of a U.N. panel of experts that there is incredible leakage in

the international sanctions regime against North Korea. China is clearly the number one culprit in this effort.

I think we are going to need to move much more aggressively with respect to letting China know that if they are going to continue to evade the international sanctions that they are not going to have such access, their banks, to our markets. I understand the challenges there. Let me ask you this. The House has passed a sanctions bill on North Korea. Does the administration support that part of the bill?

Secretary MNUCHIN. Again, thank you for your comments. I do want to just comment first on the CBO scoring, and I think the issue of the CBO is they just believe in lower growth than we do, but—

Senator VAN HOLLEN. Mr. Secretary, it is not a question of belief. It is a question of reasonable projections.

Secretary MNUCHIN. Well, we—

Senator VAN HOLLEN. I was going to let that—but your projections are out of line with the projections of every institution in our country and overseas with respect to growth rates. And I know you are going to say all the policies you guys are going to put forward are going to somehow change that trajectory. All we have is a one page document about your tax reform bill. So can we just go to North Korea because I have limited time?

Secretary MNUCHIN. Well, we can, but I am just going to say—

Senator VAN HOLLEN. Okay.

Secretary MNUCHIN [continuing]. We will note for the record that we respectfully disagree on this. I would just comment that our financial projections of growth are significantly lower than what the Obama administration used. I hope we all have a goal to get back to 3 percent GDP and can work together on that.

But, in any event, on North Korea. I will tell you I have spent a lot of time on this issue. We have had various significant discussions at the National Security Council. I participated in a trilateral meeting with the President in Hamburg with Japan and with South Korea, the Republic of Korea. I can tell you this is a very big issue that the President is focused on.

The Bank of Dandong was a very significant effort. That is something that had been considered previously and there were concerns. When this action came to my attention, we moved forward with it very quickly. I can assure you without highlighting what we will do going forward, there are lots of things we are looking at and we will continue to use sanctions to the maximum amount allowable by law independent of what bills get passed by Congress.

Senator VAN HOLLEN. If I could, do you—does the administration support the North Korean sanctions legislation passed by the House which I actually think is not as strong as it should be, but it is an important first step? And do you also support the Russian sanctions passed by the House? It is just a question, yes or no, at this point.

Secretary MNUCHIN. Yes. Again, what I will say on this is we will use sanctions to the maximum amount available. We have certain concerns about the reach into the executive powers and certain limitations, but we fully support sanctions on North Korea, on Russia, on Iran. We will use these super aggressively.

Senator VAN HOLLEN. Will the President sign the legislation that passed by the House if adopted by the Senate and sent to the President?

Secretary MNUCHIN. I do not know the answer to that. I have not had that discussion with the President, so I cannot comment on it. But again, there is concern about limitations on the executive authority on sanctions which through both Democrat and Republican Presidents they have previously had.

Senator VAN HOLLEN. Thank you.

Senator CAPITO. Senator Boozman.

Senator BOOZMAN. Thank you, Madam Chair, and thank you for holding this important hearing. We appreciate you being here. I appreciate also your obvious knowledge of community banks and what they represent. We hear a lot about small business being the backbone of America, but the backbone of small business is the community bank. So, again, thank you for understanding and continuing to work on that.

I would like to talk a little bit about Iran and tell us the steps that Treasury is trying to respond to in the sense of, their illicit activities with all of the things we know: terrorism, arms trafficking, human rights abuses, et cetera. Can you tell us what exactly you are doing in regard? What is Treasury's response in helping out in that area?

Secretary MNUCHIN. Sure. Well, let me first comment. The activities in Iran are very concerning. As the President has said and I agree with him, we have significant concerns about the JCPOA. My opinion is that sanctions worked. That is the only reason why they came to the table and I wish we had held out for a significantly better deal. Having said that, at the moment we are working within the constraints of the agreement which allow us to do sanctions outside of the nuclear efforts. We have just continued to roll out sanctions on areas of ballistic missiles, on areas of terrorism. So we will continue to aggressively pursue sanctions.

I have also had conversations with all my foreign counterparts about this and our view of working together. And I can assure you, as you have heard from the President, the agreement is top of mind every time it comes to the certification. There is a lot of discussion and we will aggressively pursue our options against Iran.

Senator BOOZMAN. Part of the Omnibus appropriations bill that, many of us supported requested that you review all sanctions, designations over the past 2 years and determine whether these entities have engaged in any prohibited activities since the removal of sanctions. Then also Treasury was requested to either sanction entities engaged in prohibited activity or explain why not. Are you committed to following through with that process now?

Secretary MNUCHIN. Again, we look forward to working with you whether the bill is passed or not. I will comment. Just as we did not have the TFTC, the Terrorist Financing Targeting Center request, to the extent the bill is passed we will come back for additional funding to work with you, but we believe in the sanctions, as I have said, to the maximum amount available.

Senator BOOZMAN. Right. So that is current law though.

Secretary MNUCHIN. I am sorry.

Senator BOOZMAN. So that is current law.

Secretary MNUCHIN. Yes. And under the current law, we will continue to work with you as we are, absolutely.

Senator BOOZMAN. Do you have an estimate of what—has Treasury done an estimate of what sanctions relief, the impact that that has had on their economy?

Secretary MNUCHIN. Again, we have done analysis on both the impact of the JCPOA and other areas on their economy. Again, in a classified session we are happy to come and talk to you about some of the intelligence issues.

Senator BOOZMAN. Okay. Thank you very much. And again, thank you for being here. Thank you, Madam Chair.

Senator CAPITO. Thank you.

Senator DURBIN.

Senator DURBIN. Thank you, Madam Chair. Let me say at the outset that with you in the Chair seat and the Acting Ranking, this is the boldest move by West Virginia since Robert Byrd left the Appropriations Committee.

Senator CAPITO. Are you saying it takes two of us?

Senator DURBIN. I will let you be the judge of that.

Senator CAPITO. I got it.

Senator DURBIN. Mr. Secretary, thank you for being here. Let me mention a couple of things. First, on the Marketplace Fairness Bill, which I have been cosponsoring with Senator Enzi for years and we have passed in the Senate, bogged down in the House. The use tax problem I want to tell you is pretty obvious. We have a use tax in Illinois and you know what it says? When I file my income tax, I decide to voluntarily declare how much I owe in sales tax to my State. And you can imagine, compliance is very low. So if you have collection at point of sale, it is dramatically different.

And I might also add that Amazon does collect. They support marketplace fairness and Amazon does collect sales tax on their sales. On third party vendors, no. On their sales, yes. So I hope that you will take a look at that. It is very important.

Secretary MNUCHIN. Yes. I can assure you we are looking at it. We have had a lot of discussions on it. Again, I may be one of the few people in the world who have actually filed use tax, so I am aware of that.

Senator DURBIN. Well, because——

Secretary MNUCHIN. Again, I am not sure why Amazon is not collecting on the Marketplace. They can voluntarily start doing that.

Senator DURBIN. They did voluntarily on their own direct sales, but it is a policy.

Secretary MNUCHIN. But we——

Senator DURBIN. But they support the bill. In fairness to them, they support the bill.

Secretary MNUCHIN. As I said, the administration is looking very closely at this issue. We look forward to having discussions with you and we understand the issue and we do think that the States getting more money in one format or another is very important.

Senator DURBIN. Thank you. I would like to hit two issues and I have 3 minutes, so it may not be possible, but I will try. Economic growth. Here is the reality. Corporate profits in the United States of America as a share of GDP have never been higher. Corporate taxes as a share of GDP have never been lower. Now we are talk-

ing about cutting corporate tax rates. What we are missing in this conversation is an element of growth that really touches people, and it is this. Despite the growth in corporate profits in America, there has not been a parallel growth in earning power and wages of the people who are working for these corporations.

Simply devising a strategy to reduce corporate taxes and increase corporate profits and CEO salaries is no guarantee that the average working family in America will feel this growth. And they have not for more than a decade. So I urge you as you take a look at economic growth look at it not in terms of the boardroom, but look at it in terms of the family room and the families that are working and falling further and further behind despite their best efforts. I hope you will translate your thinking in economic growth in that area.

Secretary MNUCHIN. Well, thank you, Senator, and I assure you I am. I had the opportunity to travel extensively with the President during the campaign and I did see that. The last 8 years have been a terrific time for rich people and financial markets, but the average American has not seen their wages increase and that is something we are very, very focused on with economic growth.

I will just tell you the problem we have right now with the corporate tax system. We have one of the highest corporate taxes in the world, but the effective rate is much, much lower. Many of our corporations leave money offshore because they get to defer the tax and not pay anything here. Our main priority is to change that system to a territorial system so trillions of dollars come back, can be invested here, and it will benefit workers.

Senator DURBIN. And our last experience in repatriation proved that unless you are careful in how you do that the money profits will be repatriated and will go out the back door in dividends and corporate salaries instead of what you just said, reinvestment in our economy. I want to work with you to make sure the reinvestment takes place.

Secretary MNUCHIN. Well—

Senator DURBIN. I would like to raise, if I could—I am sorry, but I am running out of time here, but one last issue which has already been noted. Corporate inversions. When corporations decide to move their headquarters, strictly a paper transaction, to some foreign capital to avoid paying U.S. taxes it is hurtful to our revenues, hurtful to our economy, and fundamentally unfair. They are still doing business in the United States. They still have the best market in the world. They still use our infrastructure. They still count on our national defense. They just do not want to pay taxes.

So the Obama administration decided to go at that head on and they changed regulations in the Department of Treasury and made it more difficult for these inversions to take place and they slowed down dramatically. President Trump on the campaign trail was outspoken on this issue. I think he may have even tweeted on this issue, he feels so passionately about it, about these inversions. So how do we explain the Executive order from this administration which really weakens the regulations and changes that came out of the last administration when it came to inversions? It seems like the President is saying we do not want them, yet his Executive order is saying we are going to start to look the other way.

Secretary MNUCHIN. Well, Senator, I look forward to working with you on this, and first of all, let me say that I assure you that the President is very focused on us fixing the problem, not just through a regulation, but as I mentioned, to changing the tax system.

Now, I can tell you this may be the first President that has ever picked up the phone and called CEOs when factories move, so I can assure you——

Senator DURBIN. Good for him.

Secretary MNUCHIN [continuing]. It catches his attention when headquarters move. He is going to do everything in his power, whether it is in our trade negotiations or whether it is in our tax plan to make sure that——

Senator DURBIN. May I stop you there? Everything in his power?

Secretary MNUCHIN [continuing]. American companies are here.

Senator DURBIN. Excuse me, but everything in his power? Why would he weaken existing regulations which are helping to lessen the number of inversions? If he is using everything in his power, it would be not only his regulatory authority and his statutory suggestions. Wouldn't he do both?

Secretary MNUCHIN. Well, again, I look forward to talking to you more about this. I can assure you that we are going to make sure that American companies stay here.

Senator DURBIN. Thank you.

Senator CAPITO. Senator Daines.

Senator DAINES. Thank you, Madam Chair. Secretary Mnuchin, welcome. Nothing is more iconic of self-defeating policy than our Tax Code. And I say that as somebody who has spent most of my professional career in the private sector, most of that time running global operations. It is a relic of 1986. No one in Congress will stand by the status quo. From base erosion to fundamental fairness, the Tax Code's seven bracket overall rates simply are not competitive in the 21st century global economy.

I spent a lot of time in Asia. I spent 6 years living in China with Proctor & Gamble. I just was over there in April. I will tell you what. More Americans need to go over and see what is going on around the world. We need to wake up as a nation and recognize it is game on in terms of global competitiveness for American companies to win. And I applaud your efforts going forward here on reforming our Tax Code. Tax policy has a tremendous impact on appropriations because it determines Congress' ability to reinvest through public funds, whether it is healthcare or defense.

The question, Secretary Mnuchin, is this. As you stated, we are one of the few countries with an overall corporate tax rate in excess of 35 percent. In fact, 75 countries, 75 countries have corporate tax rates between 0 and 20 percent. How much economic growth do you estimate will accrue by reducing overall rates to 20 percent?

Secretary MNUCHIN. Thank you, Senator. I think significantly. My comment, as you have highlighted, although our tax rate is 35 percent, many, many multinational companies do not pay anything close to that, as I have mentioned, because of either the issue of deferrals or tax havens, so we look forward to working with you on that. And now that you have highlighted you spent 6 years in

China, I am going to come and visit you and we will put you to help us on our China negotiating team.

Senator DAINES. Well, thank you. I would be happy to do that. I believe it is—they are the second largest economy in the world now. When I was over there with Proctor & Gamble in the nineties when we first moved there, their GDP was about \$500 billion. Today, \$11.3 trillion. So I would be happy to work with you together as we go forward.

The question is what place does overall tax rate reduction play in President Trump's efforts and the administration to attain a 3 percent plus economic growth?

Secretary MNUCHIN. Tax reform is an enormous part of that, as I mentioned. It is a combination of tax reform, regulatory relief, and trade, but tax reform is critical. I very much look forward to very soon working with Congress. As I mentioned, we have been working since January on coming out with a combined plan with the House and the Senate and we look forward to working with you and getting this passed this year.

Senator DAINES. One of your observations which I completely agree with is that a high tax rate drives behaviors. And one issue of particular interest to me is certainly keeping us competitive and doing that by having a territorial tax system. We are the only developed country with a worldwide tax system, which incentivizes foreign takeovers. Since 2015 alone, at least 12 corporations have inverted overseas. In your discussions with the White House, where is the transition to territorial tax system in your priorities?

Secretary MNUCHIN. Very, very, very high.

Senator DAINES. I like the additional two verys on that. Thank you. Has Treasury calculated the economic growth spurred by adopting such a policy?

Secretary MNUCHIN. So we have over 100 people working on the tax plan in Treasury. We are scoring lots of different scenarios, and yes, we are working closely on that. We look forward to working with you, sir.

Senator DAINES. Thank you for the three verys. I will add one more. Add me for the fourth very on that.

My last question relates back to an issue I have back in Montana. Winter wheat is one of our biggest crops. Montana truly does feed the world. Seventy percent of our wheat harvest goes overseas, most of that to Asia. Low grain prices are dogging our farmers in this country. Think about who put President Trump in the White House. It was hardworking American people fighting day to day where the month is often longer than the paycheck, and that includes our farmers and our ranchers. One of the provisions in the House tax blueprint was immediate expensing and it can achieve two tax objectives, simplification as well as helping rancher's and farmer's bottom lines. Based on your tax reform discussions, how likely is it that immediate expensing would be included?

Secretary MNUCHIN. Well, it is something that we are having active discussions on. Although no decisions have been made, I will tell you we are very sensitive to this as it relates to farms and agricultural and small businesses. So we are very focused on that issue, even more so than we are on that issue for giant multinationals.

Senator DAINES. All right. Thank you, Secretary Mnuchin.

Senator CAPITO. Well, thank you for your testimony today, Secretary Mnuchin. We are going to excuse you, Secretary Mnuchin, and call forward our next panel, Commissioner Koskinen and Inspector General Russell George.

Secretary MNUCHIN. Thank you very much.

Senator CAPITO. Thank you so much for your testimony. Given our time constraints, I ask that you summarize your statements so that we can have an opportunity to proceed with questioning. Thank you very much, Mr. Secretary.

All right. Let's get started. Commission Koskinen, thank you for coming, and I now invite you to summarize your remarks on behalf of the Internal Revenue Service.

INTERNAL REVENUE SERVICE

STATEMENT OF HON. JOHN KOSKINEN, COMMISSIONER

Mr. KOSKINEN. Chairman Capito, Ranking Member Coons, Members of the subcommittee, thanks for the opportunity to appear before you today for the last time to discuss the IRS budget and current operations. I am happy to summarize my opening statement, but I would like the full opening statement admitted to the record if that would be appropriate.

Senator CAPITO. We will submit that without objection. Thank you.

THE PRESIDENT'S FISCAL YEAR 2018 BUDGET REQUEST

Mr. KOSKINEN. We look forward to working with Congress as you continue to determine the IRS' appropriate funding level for the next fiscal year. As you know, my term as IRS Commissioner ends in November, so all but a few weeks of the agency's fiscal year 2018 budget will cover the term of the next IRS Commissioner. I feel it is my obligation to do everything I can to make sure the new Commissioner starts with sufficient resources for the agency to meet its responsibilities to the Government and to taxpayers.

The President's fiscal year 2018 budget request for the IRS is \$10.975 billion, a \$260 million cut from our 2017 budget. While we support the administration's budget reform efforts, it is also important to note that years of sustained funding reductions have left the IRS with critical personnel and infrastructure requirements. Our budget is now \$900 million below the level 8 years ago in 2010. We are now 18,000 full-time employees fewer than we had in 2010. And under the proposed budget, we expect to lose another 3,000 employees this year.

The effects have been felt throughout the agency. For example, by not hiring any significant number of new employees since 2010, we now have only 3,000 employees under age 30 out of a workforce of 80,000, creating a major challenge in years to come as we look for the next generation of IRS managers and executives. We have lost over 5,500 revenue officers, revenue agents, and criminal investigators, resulting in a proposed overall audit rate for the fiscal 2018 year of .5 percent, down from 1.2 percent in years past, and a decline of hundreds of criminal investigations and prosecutions.

The IRS fiscal year 2018 budget submission seeks less costly ways of delivering taxpayer service and maintaining enforcement using technology, training, and internal efficiencies. However, even with these efforts to maintain current performance levels in fiscal 2018, the IRS' budget would need to be \$220 million above fiscal year 2017 just to cover scheduled pay raises and inflationary costs.

IRS INITIATIVES TO IMPROVE EFFICIENCY

In highlighting these critical needs, I would point out that the IRS understands how important it is for us to be careful stewards of the fundings we receive from Congress. In that regard, the IRS for several years has achieved major savings and efficiencies in a number of areas. For example, tax return processing. As more people file their returns electronically, we have reduced the number of locations where we process tax returns from 10 to 5. Over the next several years, we will further reduce those locations from 5 to 2.

With regard to real estate, since 2012, the IRS has reduced its space inventory by approximately 3 million square feet. If we still occupied that space, the cost would be \$81 million more for rent.

The fourth area is taxpayer services. In response to taxpayer demand, we have been increasing options for taxpayers to get information and interact with us online. We have hundreds of millions of hits on our IRS application Where's My Refund? Online services are also a source of significant savings. It costs us about \$50 to answer a question on the phone or in person and less than 50 cents to provide that same information online.

IDENTITY THEFT REFUND FRAUD

Finally, I would note that a critical problem facing the IRS and mentioned earlier and taxpayers when I began as Commissioner about 4 years ago was the amount of identity theft and the filing of false refund claims. Thanks to the good work of IRS employees and the contributions made through our new partnership with the private sector and State tax administrators, the number of taxpayers identifying themselves as victims of identity theft for tax season 2016 dropped by 46 percent from the previous year. We were delighted and somewhat amazed to see that number of victims dropped another almost 50 percent this past filing season so that the overall decline in victims over the 2 years has been reduced by about two-thirds.

PROPOSED LEGISLATIVE CHANGES

Along with providing adequate funding for the IRS, Congress can also help the agency by passing legislation to improve tax administration. In that regard, the President's budget request contains a number of legislative proposals that I urge Congress to approve including: renewing streamlined critical pay authority, adding correction procedures for specific areas, and giving the IRS authority to require minimum qualifications for paid tax preparers.

Chairman Capito, Ranking Member Coons, and Members of the subcommittee that concludes my statement. I would be happy to take your questions after you hear from the Inspector General.

[The statement follows:]

PREPARED STATEMENT OF HON. JOHN A. KOSKINEN

INTRODUCTION

Chairwoman Capito, Ranking Member Coons, and Members of the subcommittee, thank you for the opportunity to appear before you today to discuss the IRS's budget and current operations.

Let me start by saying we look forward to working with Congress as you continue to assess the IRS's appropriate funding level. It is important to note that, since my term as IRS Commissioner ends in November, all but a few weeks of the agency's fiscal year 2018 budget will cover the term of the next IRS Commissioner. I want to do everything I can to help ensure that the budget situation for the agency will be as strong as possible for the new Commissioner.

The IRS remains very appreciative of Treasury Secretary Mnuchin's support for the IRS to have appropriate resources, and in particular for upgrading our information technology (IT) systems. We also strongly support the administration's efforts to reduce the Federal budget deficit. We recognize that the IRS must always appropriately analyze and control our expenditures, and continue to be as efficient as possible with the funding granted by Congress.

At the same time, I would note that the IRS remains one of the most cost-effective investments in the Federal Government; resources invested in the IRS increase revenue collections. This unique and critical role is vital to the function of the Government and to keeping the Nation and economy strong. In fiscal year 2016, the IRS collected more than \$3.3 trillion in tax revenue, processed more than 244 million tax returns and other forms, and issued more than \$426 billion in tax refunds. The IRS's enforcement programs collected more than \$54.3 billion in fiscal year 2016, a return on investment (ROI) of about \$5 for every dollar invested in the agency.

While we will continue to look for efficiencies in our operation, it is important to recognize that the IRS remains one of the most efficient tax administrators in the world. For every \$100 collected in taxes, the IRS spends about 35 cents, which is far less than most other developed countries, according to statistics compiled by the Organization for Economic Cooperation and Development (OECD).

As the IRS budget has declined over recent years, we have consistently found ways to increase our efficiency to meet expanding workloads and new challenges. From 2010 to 2015, the number of returns filed grew by more than 10 million (or nearly 7 percent).

Further increasing our workload, the IRS during this period has had to implement a number of significant legislative mandates, nearly all of which came with no additional funding. This list includes: the Affordable Care Act (ACA); the Foreign Account Tax Compliance Act (FATCA); the Achieving a Better Life Experience (ABLE) Act; a new certification program for professional employer organizations; reauthorization of the Health Coverage Tax Credit (HCTC); the registration requirement for newly created 501(c)(4) organizations; and the Private Debt Collection program. Legislative mandates carry significant costs, in particular the technological changes required to successfully integrate them into the tax system.

Because more than 70 percent of the IRS's budget is personnel, the agency has dealt with the funding cuts through an exception-only hiring freeze that has been in effect since fiscal year 2011. This has left us unable to replace most employees who retire or leave for other jobs in government or the private sector. As a result, the agency has lost about 18,000 full-time employees since 2010.

I am concerned that continued erosion of the IRS workforce will threaten the agency's effectiveness and its ability to provide appropriate taxpayer service, enforcement of the tax laws, and ultimately, our ability to collect the revenues the Government depends upon for operations.

Against this backdrop, we are appreciative of the funding flexibility provided by Congress in 2016, which continued in 2017 to improve taxpayer service, increase cybersecurity and improve our efforts against identity theft.

In the cybersecurity area, we implemented the use of monitoring and other capabilities that are more sophisticated than what we had used previously. This has helped us detect suspicious activity in our various online tools and applications more quickly.

In regard to identity theft, we put many new taxpayer protections in place for the 2016 tax filing season that produced significant results. We had fewer false returns entering our systems, fewer fraudulent refunds issued, and fewer tax-related identity theft victims. Most important, the number of people who reported to the IRS that they were victims of identity theft declined from 698,700 in Calendar Year 2015 to 376,500 in 2016—a drop of 46 percent. Preliminary indications are that this number is again declining in 2017.

THE PRESIDENT'S FISCAL YEAR 2018 BUDGET

The President's fiscal year 2018 budget request for the IRS is \$10.975 billion, which is \$260 million, or 2.3 percent, below the fiscal year 2017 enacted budget. The IRS will continue to seek less costly ways of delivering taxpayer service and maintaining enforcement using technology, training and internal efficiencies. Major areas outlined in the President's budget request include the following:

Operations Support

A priority in the President's budget is helping the IRS improve information services by addressing its antiquated IT systems. Approximately 63 percent of IRS IT hardware systems are aged and out of warranty, and 32 percent of software products are two or more releases behind the industry standard, with 15 percent more than four releases behind. The importance of keeping systems updated was demonstrated recently with the spread of the "WannaCry" virus to IT systems around the world.

The President's budget request includes \$3.9 billion for operations support. Within that total, \$2.07 billion is allocated for information services, \$216.1 million, or 11.6 percent, above the fiscal year 2017 enacted budget. This funding will allow the IRS to take the initial steps needed to bring our IT infrastructure up-to-date.

With the growing reliance on IT as an integral part of the solution to provide improved taxpayer service and enforcement, the IRS will continue to modernize to harness new information delivery models and manage data. Infrastructure modernization is necessary to increase agility, efficiency and service quality, ultimately reducing operational cost.

Taxpayer Services

The President's budget includes \$2.21 billion for taxpayer services, which is \$153.4 million, or 6.5 percent, below the fiscal year 2017 enacted budget. While the IRS will continue to provide service to taxpayers across all channels, we will emphasize improving and expanding the use of online tools and offerings such as virtual tax assistance sites, which will help the agency operate in a cost-effective manner.

The IRS has, in fact, been working to increase our online offerings for several years, in response to increasing taxpayer demand. We provide a wealth of tax information on IRS.gov, which was visited more than 500 million times during fiscal year 2016, and more than 354 million times so far in fiscal year 2017. Taxpayers use IRS.gov to get forms and publications, find answers to their tax questions, and perform transactions such as paying their tax bill. The most heavily used part of our website is the "Where's My Refund?" electronic tracking tool, which was used about 300 million times in fiscal year 2016, and more than 264 million times already this year.

The IRS will continue working toward a more proactive and interactive relationship with taxpayers by enhancing and expanding our communications with them. This includes offering taxpayers and tax professionals more services, tools and support that are both innovative and secure, and specific to their needs, especially in relation to online and virtual interactions.

Enforcement

The President's budget includes \$4.71 billion for enforcement programs, which is \$153.5 million, or 3.2 percent, below the fiscal year 2017 enacted budget.

The IRS remains committed to increasing compliance and reducing the tax gap, while minimizing burden on the vast majority of taxpayers who pay their taxes accurately and on time. The tax gap represents the difference between taxes owed and taxes paid on time. In fiscal year 2016, the IRS released updated tax gap estimates for tax years 2008 through 2010, and found that the annual average gross was an estimated \$458 billion, and the estimated voluntary compliance rate was 81.7 percent.

Business Systems Modernization

The President's budget includes \$110 million for business systems modernization, which is \$180 million, or 62.1 percent, below the fiscal year 2017 enacted budget. As noted above, this decline is a result of reallocating funding to IT infrastructure systems to decrease the backlog of deferred software and hardware updates, which is a critical priority, and must be accomplished before development and modernization of new systems.

With the fiscal year 2018 request, the IRS will continue operating the Return Review Program (RRP) which has significantly enhanced fraud detection capabilities. In fiscal year 2018, RRP will make a wider array of data available to other systems for expanded fraud detection.

The IRS will also continue developing web applications to simplify the taxpayer's online experience, provide secure digital communications and add more interactive capabilities to existing web self-service products. This includes continuing the development of online account capabilities for taxpayers. The initial features of the online account, launched during fiscal year 2017, include allowing taxpayers to check if they have a balance due, make payments and see prior payment and other tax records.

LEGISLATIVE PROPOSALS IN THE PRESIDENT'S BUDGET

Along with the funding request, we are also asking for Congress's help legislatively. In that regard, let me highlight several important legislative proposals in the President's fiscal year 2018 budget that would improve tax administration and support the IRS in fulfilling its mission:

Streamlined Critical Pay Authority

The IRS Restructuring and Reform Act of 1998 increased the IRS' 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. After having been renewed several times by congressional appropriators, this authority expired at the end of fiscal year 2013 without being renewed. The President's fiscal year 2018 budget proposes reinstating this authority through fiscal year 2021. It is my hope that this critical program, which ran effectively for 14 years before it expired, will be renewed.

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 budget to replace the existing specific grants of this authority with authority to correct specific errors instead. This would allow the IRS to fix errors where we have reliable information that a taxpayer has an error on their return in areas such as the Earned Income Tax Credit (EITC) program, educational tax credit programs or child tax credit programs.

Authority To Require Minimum Qualifications For Return Preparers

The President's budget proposes providing the Secretary with authority to require all paid tax return preparers to have a minimum knowledge of the tax code. Requiring all paid preparers to keep up with changes in the Code would help promote high quality service from return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system.

Chairwoman Capito, Ranking Member Coons and Members of the subcommittee, that concludes my statement. I would be happy to take your questions.

Senator CAPITO. Thank you. Thank you. And next we will turn to the Inspector General, Russell George. I now invite you to summarize your statement. Thank you.

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

STATEMENT OF HON. J. RUSSELL GEORGE, INSPECTOR GENERAL

Mr. GEORGE. Thank you.

Senator CAPITO. Thank you for coming.

Mr. GEORGE. Chairwoman Capito, Senator Manchin, thank you for the opportunity to appear today.

My testimony addresses the Fiscal Year 2018 IRS budget request and significant cyber security challenges confronting that agency. The proposed IRS budget is a decrease of \$260 million from the Fiscal Year 2017 enacted level. In the request, the IRS realigned approximately \$179 million from the business systems modernization appropriation to the operation support appropriation to address needed technology hardware and software updates.

There are many challenges facing the IRS, the top challenge of which is protecting security over taxpayer data. The IRS processes and stores a vast amount of taxpayer data that is a prime target for domestic and international criminals.

For example, in March 2017 because of significant suspicious activity, the IRS deactivated the online Free Application For Federal Student Aid Data Retrieval Tool. This tool is designed to be used by students and parents to obtain tax information needed to complete a student aid application. This incident is just the latest in several brazen attempts by bad actors to steal taxpayer data, to file fraudulent tax returns, and receive illegitimate tax refunds.

Since May 2015, the IRS has experienced breaches to its Get Transcript and Identity Protection Personal Information Number applications. For online taxpayer access, the IRS has a difficult task of balancing the need to authenticate a taxpayer's identity with the need to make the applications accessible when taxpayers need them.

The threat landscape against the IRS is ever changing. Bad actors continually seek different ways to take advantage of systems and processes and in an effort to access tax information without proper authorization. Therefore, the IRS must continually update its systems and processes to combat the threat. The risk of unauthorized access to tax accounts will continue to be significant as the IRS increases its efforts to deliver new online tools to taxpayers via its Future State initiative. These current efforts to exploit online systems have also highlighted the need to seek the capability to improve or build better systems. One element toward that end is hiring individuals with proven skills, knowledge, and abilities related to cyber security.

The IRS's streamlined critical pay authority expired at the end of 2013. We reviewed whether the IRS subsequently used the government wide critical pay position authority which has been available since 1990 to fill technical positions such as those within a cyber security operation. We found that the IRS had not used this authority which could assist in recruiting highly qualified experts.

TIGTA also continues to be concerned about cyber security in general at the IRS. Our audits have shown some problematic areas. An audit from 2016 showed that significant improvements are needed with security monitoring to detect deficiencies which could leave its computing infrastructure vulnerable to intrusion by hackers and malicious software. We also found that improvements are needed to ensure that all systems have secure configurations and that security vulnerabilities are addressed on a timely basis.

We are also concerned about the significant percentage of information technology infrastructure at the IRS that is beyond its use-

ful life. Such hardware is prone to failure over time. Moreover, older technology brings unnecessary security risks to an organization because manufacturers may not provide active support and hackers have a longer period to identify and exploit vulnerabilities.

We have an ongoing audit that will evaluate how effective the IRS is addressing the operational challenges of replacing outdated hardware in the computer area. We expect to issue this report in September of this year.

This concludes my statement. Chairwoman Capito, Senator Manchin, thank you for the opportunity to share my views.

[The statement follows:]

PREPARED STATEMENT OF HON. J. RUSSELL GEORGE

Chairwoman Capito, Ranking Member Coons, and Members of the subcommittee, thank you for the opportunity to testify on the Internal Revenue Service's (IRS) fiscal year¹ 2018 budget request, our recent work related to the most significant challenges currently facing the IRS, and the Treasury Inspector General for Tax Administration's fiscal year 2018 budget request.

The Treasury Inspector General for Tax Administration (TIGTA) was created by Congress in 1998 to ensure integrity in America's tax system. It provides independent audit and investigative services to improve the economy, efficiency, and effectiveness of IRS operations. TIGTA's oversight activities are designed to identify high-risk systemic inefficiencies in IRS operations and to investigate exploited weaknesses in tax administration. TIGTA plays the key role of ensuring that the approximately 85,000 IRS employees² who collected more than \$3.3 trillion in tax revenue, processed more than 244 million tax returns, and issued more than \$400 billion in tax refunds during fiscal year 2016,³ have done so in an effective and efficient manner while minimizing the risk of waste, fraud, and abuse.

TIGTA's Office of Audit (OA) reviews all aspects of the Federal tax administration system and provides recommendations to: improve IRS systems and operations; ensure the fair and equitable treatment of taxpayers; and detect and prevent waste, fraud, and abuse in tax administration. The OA places an emphasis on statutory coverage required by the IRS Restructuring and Reform Act of 1998 (RRA 98)⁴ and other laws, as well as on areas of concern raised by Congress, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other key stakeholders. The OA has examined specific high-risk issues such as identity theft, refund fraud, improper payments, information technology, security vulnerabilities, complex modernized computer systems, tax collection and revenue, and waste and abuse in IRS operations.

TIGTA's Office of Investigations (OI) protects the integrity of the IRS by investigating allegations of employee misconduct, external threats to employees and facilities, and other attempts to impede or otherwise interfere with the IRS's ability to collect taxes. The OI investigates misconduct by IRS employees which manifests itself in many ways, including extortion, theft, taxpayer abuses, false statements, financial fraud, and identity theft. The OI places a high priority on its statutory responsibility to protect all IRS employees located in approximately 540⁵ offices. In the last several years, threats directed at the IRS have remained the second largest component of the OI's work. Physical violence, harassment, and intimidation of IRS employees continue to pose challenges to the implementation of a fair and effective system of tax administration. The OI is committed to ensuring the safety of IRS employees and of taxpayers who conduct business in IRS facilities. As will be discussed in more detail later in the testimony, over the past several years, the OI has been conducting an investigation of a massive IRS impersonation scam that has impacted over 2 million people.

TIGTA's Office of Inspections and Evaluations (I&E) provides responsive, timely, and cost-effective inspections and evaluations of challenging areas within the IRS, providing TIGTA with additional flexibility and capability to produce value-added products and services to improve tax administration. The I&E's work is not a sub-

¹ The Federal Government's fiscal year begins on October 1 and ends on September 30.

² In fiscal year 2016, the IRS employed, on average, approximately 85,000 people, including more than 16,000 temporary and seasonal staff.

³ IRS, *Management's Discussion & Analysis, Fiscal Year 2016*.

⁴ Public Law No. 105-206, 112 Stat. 685.

⁵ IRS, *Management's Discussion & Analysis, Fiscal Year 2016*.

stitute for audits and investigations. In fact, its findings may result in subsequent audits and/or investigations. Inspections are intended to monitor compliance with applicable law, regulation, and/or policy; assess the effectiveness and efficiency of programs and operations; and inquire into allegations of waste, fraud, abuse, and mismanagement. Evaluations, on the other hand, are intended to provide in-depth reviews of specific management issues, policies, or programs.

OVERVIEW OF THE IRS'S FISCAL YEAR 2018 BUDGET REQUEST

The IRS is the largest component of the Department of the Treasury and has primary responsibility for administering the Federal tax system. The IRS's role is unique within the Federal Government in that it collects the revenue that funds the Government and administers the Nation's tax laws. It also works to protect Federal revenue by detecting and preventing the growing risk of fraudulent tax refunds and other improper payments.

The Department of the Treasury (Treasury) is in the process of developing a new strategic plan for fiscal years 2018–2022. The IRS will publish its fiscal year 2018–fiscal year 2022 strategic plan by June 2018, which will serve as a roadmap to guide future IRS operations. To achieve these goals, the proposed fiscal year 2018 IRS budget requests appropriated resources of approximately \$11 billion.⁶ The total appropriation amount is a decrease of \$260 million, or 2.3 percent below the fiscal year 2017 enacted budget level of approximately \$11.2 billion.⁷ A comparison of next year's request with the current budget is shown in Table 1.

TABLE 1.—COMPARISON OF IRS FISCAL YEAR 2018 BUDGET REQUEST TO FISCAL YEAR 2017 ENACTED BUDGET LEVEL

[In thousands]

Appropriations Account	Fiscal Year 2017 Enacted Budget	Fiscal Year 2018 Request	\$ Change	% Change
Taxpayer Services	\$2,365,544	\$2,212,311	(\$153,233)	– 6.5%
Enforcement	\$4,860,000	\$4,706,500	(\$153,500)	– 3.2%
Operations Support	\$3,719,446	\$3,946,189	\$226,743	6.1%
Business Systems Modernization	\$290,000	\$110,000	(\$180,000)	– 62.1%
Total Appropriated Resources	\$11,234,990	\$10,975,000	(\$259,990)	– 2.3%

Source: IRS's Fiscal Year 2018 Budget Request, Operating Level Tables and Fiscal Year 2017 Enacted Budget.

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

Appropriations Changes

As shown above, the Taxpayer Services, Enforcement, and Business Systems Modernization appropriations decreased by \$153 million, \$154 million, and \$180 million, respectively, for an overall decrease of \$487 million compared to the fiscal year 2017 level.

The IRS realigned approximately \$179 million and 266 Full-Time Equivalents (FTEs)⁸ from the Business Systems Modernization appropriation to the Operations Support appropriation to address a backlog of deferred information technology hard-

⁶The fiscal year 2018 budget request also includes approximately \$122 million from reimbursable programs, \$30 million from non-reimbursable programs, \$526 million from user fees, and \$269 million in available unobligated funds from prior years for a total amount of \$11.9 billion in available resources.

⁷The fiscal year 2017 enacted budget of \$11.2 billion includes \$290 million in Section 113 Administrative Provision funding in the following amounts: \$209 million in Taxpayer Services and \$81 million in Operations Support.

⁸A measure of labor hours in which one FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year.

ware and software updates. The Business Systems Modernization appropriations request decreased by 62 percent from fiscal year 2017.

As a result, the Operations Support appropriation request for fiscal year 2018 increased by \$227 million compared to the fiscal year 2017 level. The largest component of this increase is the realigned funds of \$179 million to address deferred information technology updates. Overall, the IRS's fiscal year 2018 budget request reflects a total decline of appropriated resources of \$260 million compared to fiscal year 2017.

CHALLENGES FACING THE IRS

In this section of my testimony, I will briefly discuss several of the key challenges now facing the IRS as it administers our Nation's tax laws.

Security Over Taxpayer Data

As cybersecurity threats against the Federal Government grow, protecting the confidentiality of taxpayer information will continue to be a top concern for the IRS. The increasing number of data breaches in the private and public sectors means more personally identifying information than ever before is available to unscrupulous individuals. Many of the data are detailed enough to enable circumvention of most authentication processes. For example, in March 2017, as a result of significant suspicious activity, the IRS announced that it was deactivating its online Data Retrieval Tool (DRT) to protect sensitive taxpayer data.

The DRT allows students and parents to access their adjusted gross income (AGI) information from the IRS to complete the Free Application for Federal Student Aid (FAFSA) by transferring the data directly into their FAFSA application form from the IRS website. Identity thieves used personal information of individuals that they obtained outside the tax system to start the FAFSA application process form in an attempt to secure the AGI tax information through the DRT. On March 3, 2017, the IRS reported that they disabled the DRT due to privacy concerns and to protect sensitive taxpayer data. As of April 25, 2017, the IRS reported that it identified approximately 8,000 suspicious returns with refunds issued totaling \$32 million that it was reviewing for fraud. In addition, as of May 16, 2017, the IRS reported it stopped 67,000 tax returns filed in 2017, before refunds were issued, that appeared to have been filed using stolen taxpayer identification information from the incident. According to the IRS, they confirmed that 31,000 of those tax returns were fraudulent because the true taxpayers indicated they did not file them. The remaining 36,000 tax returns were still being evaluated to determine if they were fraudulent.

Recently, TIGTA Special Agents conducted search warrants and arrested two individuals for their use of stolen DRT information in furtherance of a Stolen Identity Refund Fraud scheme. TIGTA is conducting a joint investigation of this exploitation with IRS Criminal Investigation and the Department of Education Inspector General.

The risk of unauthorized access to tax accounts will continue to be significant as the IRS proceeds with its Future State initiative⁹ which includes expansion of online tools it makes available to taxpayers. The IRS's goal is to eventually provide taxpayers with dynamic online tax account access that includes viewing their recent payments, making minor changes and adjustments to their tax accounts, and corresponding digitally with the IRS. Increased online access will increase the risk of unauthorized disclosure of tax data. As such, the IRS's processes used to authenticate individuals' identities must promote a high level of confidence that tax information and services are provided only to individuals who are entitled to receive them.

TIGTA reported in November 2015 that the IRS had not established effective authentication processes and procedures for its online services.¹⁰ This includes not performing risk assessments when required or, when performed, not ensuring authentication processes and procedures are implemented that are commensurate with the assessed level of risk. For example, we reported that the IRS did not complete the required authentication risk assessment for its Identity Protection Personal Identification Numbers (IP PIN)¹¹ application. In March 2017, we further reported that

⁹Preparing the IRS to adapt to the changing needs of taxpayers is described generally as the IRS Future State initiative. A key part of this effort is for taxpayers to have a more complete online experience for their IRS interactions.

¹⁰TIGTA, Ref. No. 2016-40-007, *Improved Tax Return Filing and Tax Account Access Authentication Processes and Procedures Are Needed* (November 2015).

¹¹An IP PIN is a six-digit number assigned to taxpayers that allows their tax returns/refunds to be processed without delay and helps prevent the misuse of their Social Security Numbers to file fraudulent Federal income tax returns.

the IRS also did not complete a sufficient risk assessment for the IP PIN application after discovering, on May 17, 2015, that this application had been breached by unauthorized users.¹²

In addition, we reported that the level of authentication that the IRS uses for its various services is not consistent, increasing the risk of unscrupulous individuals accessing and obtaining personal taxpayer information and/or defrauding the tax system. This was one of the main factors in the Get Transcript breach in which hundreds of thousands of tax accounts were accessed by unauthorized users. We reported that the IRS assessed the risk of the Get Transcript application as required but concluded that the risk was low to both the IRS and taxpayers. As a result, the IRS implemented single-factor authentication to access the Get Transcript application. The IRS now knows that the authentication risk was in fact high to both the IRS and taxpayers and should have required multifactor authentication.

We have an ongoing review of the online Transcript Delivery System, which also provides access to tax return and tax account information, to assess whether authentication controls protect against unauthorized disclosure of tax information.¹³ We expect to issue our final report in October 2017.

The IRS continues to take steps in response to TIGTA's recommendations to provide for more secure authentication, including strengthening application and network controls.¹⁴ However, we remain concerned about the IRS's logging and monitoring abilities over all connections to IRS online systems. We are currently assessing the IRS's efforts to improve its authentication.¹⁵ This includes evaluating whether the IRS has properly implemented secure eAuthentication in accordance with Federal standards for public access to IRS online systems and whether it has effectively resolved identified control weaknesses. We expect to issue the final report in September 2017.

Providing Quality Taxpayer Service

For the 2017 Filing Season, the IRS began accepting and processing individual tax returns on January 23, 2017, as scheduled at five Wage and Investment Division Submission Processing sites.¹⁶ As of May 5, 2017, the IRS received approximately 138.9 million tax returns—123.2 million (88.7 percent) were filed electronically and 15.7 million (11.3 percent) were filed on paper. The IRS has issued 101.6 million refunds totaling approximately \$281.7 billion.

Similar to prior filing seasons, the IRS was challenged with the implementation of new tax law changes. For the 2017 Filing Season, tax law changes include the continued implementation of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010¹⁷ (collectively referred to as the Affordable Care Act or ACA), and those provisions of the Protecting Americans from Tax Hikes Act of 2015¹⁸ (PATH Act) specifically intended to reduce fraudulent and improper refundable credit claims. TIGTA has multiple reviews¹⁹ to evaluate IRS actions to implement key provisions of the PATH Act.

Providing quality customer service that taxpayers expect will continue to present significant challenges for the IRS. At the same time the IRS is actively steering taxpayers to its website and other online tools to obtain assistance, the IRS is continuing to cut its traditional services. The IRS offers self-assistance options that taxpayers can access 24 hours a day, seven days a week. The IRS reports 329.4 million

¹²TIGTA, Ref. No. 2017-40-026, *Inconsistent Processes and Procedures Result in Many Victims of Identity Theft Not Receiving Identity Protection Personal Identification Numbers* (March 2017).

¹³TIGTA, Audit No. 201640032, *Review of the IRS's Transcript Delivery Service*, report planned for October 2017.

¹⁴TIGTA, Ref. No. 2016-20-082, *Improvements Are Needed to Strengthen Electronic Authentication Process Controls* (September 2016).

¹⁵TIGTA, Audit No. 201720004, *Review of E-Authentication to IRS Online Services*, report planned for September 2017.

¹⁶IRS Submission Processing sites in Fresno, California; Kansas City, Missouri; and Austin, Texas, will process paper-filed and e-filed tax returns. Sites in Andover, Massachusetts, and Philadelphia, Pennsylvania, will process only e-filed tax returns.

¹⁷Public Law No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Public Law No. 111-152, 124 Stat. 1029.

¹⁸Consolidated Appropriations Act of 2016, Public Law No. 114-113, Div. Q, (2015).

¹⁹TIGTA, Ref. No. 2017-40-042, *Processes Do Not Maximize the Use of Third-Party Income Documents to Identify Potentially Improper Refundable Credit Claims* (June 2017), TIGTA, Audit No. 201640023, *Individual Taxpayer Identification Number Deactivation Process*, report planned for August 2017; TIGTA, Audit No. 201740005, *2017 Filing Season*, report planned for September 2017; TIGTA, Audit No. 201740031, *Implementation of Refundable Credit Integrity Provisions Phase 2*, report planned for October 2017.

visits to IRS.gov this filing season, as of May 6, 2017, as well as continued increases in the use of various other social media channels (e.g., Twitter, Facebook, and YouTube).

However, the IRS continues to receive many more calls than could be answered. As of May 6, 2017, the IRS reports that 40.6 million call attempts were made to its various customer service toll-free lines during business hours from taxpayers seeking help to understand the tax law and meet their tax obligations. A total of 19.6 million calls were answered with automation, and telephone assistants answered nearly 11 million calls and provided a 78.9 percent Level of Service²⁰ with a 6.9 minute Average Speed of Answer. In comparison, the Level of Service for the 2016 Filing Season was 72 percent.

In addition to telephone assistance, many taxpayers also seek assistance from one of the IRS's 376 Taxpayer Assistance Center (TAC) walk-in offices. Although the IRS reported that it had 376 TACs for the 2017 Filing Season, 24 TACs were not open because they had not been staffed. The IRS estimates that the number of taxpayers it will assist at its TACs will continue to shrink this fiscal year. The IRS plans to assist approximately 3.4 million taxpayers at the TACs in fiscal year 2017, which represents an approximately 23.6 percent decrease from fiscal year 2016.

However, the IRS has implemented initiatives in an effort to better assist those individuals seeking assistance from a TAC. For example, in Calendar Year 2015, the IRS began providing services at select TACs by appointment. For the 2017 Filing Season, the IRS has transitioned all TACs to appointment service. The IRS reports that, as of April 29, 2017,²¹ IRS employees answered over 2.1 million calls from taxpayers seeking to make an appointment, resulting in approximately 945,000 that necessitated an appointment. The IRS notes that taxpayers who travel to a TAC without an appointment are assisted if there is availability. As of April 29, 2017, the IRS reported that they provided a walk-in exception to the requirement for an appointment to nearly 264,000 taxpayers.

The IRS also offers Virtual Service Delivery, which integrates video and audio technology to allow taxpayers to see and hear an assistant located at a remote TAC. For the 2017 Filing Season, the IRS is offering Virtual Service Delivery at 28 partner site locations, which represents a decrease from the previous year when this service was offered at 35 locations.²² The IRS reports that as of April 29, 2017,²³ 1,673 taxpayers have used the service. Finally, the IRS has an initiative to co-locate staff with the Social Security Administration (SSA) to better assist taxpayers. For the 2017 Filing Season, the IRS has placed employees in four SSA locations. TIGTA is planning a follow-up audit to assess the IRS's efforts to expand customer service options to taxpayers seeking face-to-face assistance.

The IRS also continues to devote significant resources to assisting victims of identity theft. Tax-related identity theft occurs when an individual uses another person's name and Taxpayer Identification Number (TIN)²⁴ to file a fraudulent tax return. This adversely affects the ability of innocent taxpayers to file their tax returns and timely receive their tax refunds, often imposing significant financial and emotional hardship. Individuals can also learn that they are victims of employment-related identity theft if they receive a notification from the IRS of an income discrepancy between the amounts reported on their tax returns and the amounts employers reported to the IRS.

In July 2015, the IRS created the Identity Theft Victim Assistance (IDTVA) Directorate to combine into one directorate the skills of employees working tax-related identity-theft cases in multiple functions. In June 2017, we reported that the centralization of identity theft victim assistance reduced case closure timeframes and tax account errors.²⁵ However, we also reported in March 2017 that the IRS did not consistently update the tax accounts of victims to ensure that IP PINs were generated as required.²⁶ We identified more than 2 million taxpayers for which the IRS

²⁰The primary measure of service to taxpayers. It is the relative success rate of taxpayers who call for live assistance on the IRS's toll-free telephone lines.

²¹For fiscal year 2017—October 1, 2016, through April 29, 2017.

²²For the 2017 Filing Season, the IRS is no longer offering Virtual Service Delivery at IRS locations. Access to this service is only available through external partner locations.

²³For fiscal year 2017—October 1, 2016, through April 29, 2017.

²⁴A nine-digit number assigned to taxpayers for identification purposes. Depending upon the taxpayer, the number can be an Employer Identification Number, a Social Security Number, or an Individual Taxpayer Identification Number.

²⁵TIGTA, Ref. No. 2017-40-036, *Centralization of Identity Theft Victim Assistance Reduced Case Closure Time Frames and Tax Account Errors* (June 2017).

²⁶TIGTA, Ref. No. 2017-40-026, *Inconsistent Processes and Procedures Result in Many Victims of Identity Theft Not Receiving Identity Protection Personal Identification Numbers* (March 2017).

did not update their tax accounts even though they confirmed that the taxpayer was in fact a victim of tax-related identity theft.

Our work has also identified that further improvements are needed by the IRS to improve its assistance to victims of employment identity theft. In August 2016, we reported that, during the period February 2011 to December 2015, the IRS identified almost 1.1 million taxpayers who were victims of employment-related identity theft, but were not notified of that fact.²⁷ During this audit, the IRS announced that it would reverse its existing position and would begin notifying victims of employment identity theft in January 2017. However, the IRS plans to limit its notification to only those newly identified victims and not include the almost 1.1 million identified prior to January 2017. TIGTA is currently conducting a review to assess the IRS's actions to notify victims of identity theft, and we plan to issue our draft report in November 2017.²⁸

In June 2017, we further reported that the number of employment-related victims is significantly greater than what the IRS identified.²⁹ For example, IRS processes do not identify employment identity theft when processing paper tax returns. We reviewed a statistically valid sample of paper tax returns filed in Processing Year 2015 and projected that the IRS did not identify 272,416 victims of employment identity theft for the 685,737 paper tax returns filed by Individual Taxpayer Identification Number (ITIN)³⁰ holders reporting wages in Processing Year 2015. The IRS agreed to establish processes to identify employment identity theft when processing paper tax returns.

Nonetheless, we have certain concerns with the IRS's response to our June 2017 report. Management did not agree to establish a process to notify the parents or legal guardians of 229,755 dependents whose Social Security Numbers (SSN) were used by an ITIN filer to gain employment. We believe the IRS has this capability and has taken this action in other instances. For example, the IRS issued letters to the parents or guardians of dependents involved in the Get Transcript breach to notify them of the risk to their dependents' Personally Identifiable Information.³¹

Detecting and Reducing Refund Fraud

For the 2017 Filing Season, the IRS transitioned fraud detection and selection capabilities from the Electronic Fraud Detection System (EFDS) to the Return Review Program (RRP). The IRS stated that the RRP provides real-time new and improved capabilities in its fraud detection and prevention processes. It should be noted that the IRS did not fully retire the EFDS, as it continues to use the EFDS case management functionality because the RRP does not have this capability. We have an ongoing review to ensure that the EFDS fraud detection capabilities were incorporated into the RRP.³²

Refund fraud continues to evolve and become more sophisticated for both individual and business tax return filings. As such, the IRS will need to continue to adopt strategies to address the perpetrators of this crime. As of May 6, 2017, the IRS reported that it identified 195,941 tax returns with over \$2.1 billion claimed in fraudulent refunds and prevented the issuance of nearly \$2 billion of those refunds. The IRS continued to expand its processes to prevent fraudulent tax returns from entering the tax processing system. For example, as of May 15, 2017, the IRS locked approximately 33.9 million taxpayer accounts of deceased individuals. The locking of a tax account results in the rejection of an e-filed tax return and the prevention of a paper-filed tax return from posting to the Master File if the SSN associated with a locked tax account is used to file a tax return. According to the IRS, as of April 30, 2017, it rejected 24,474 fraudulent e-filed tax returns and, as of May 4, 2017, it stopped 4,672 paper-filed tax returns from posting to the Master File.

Unscrupulous individuals stealing identities to file individual and business tax returns for the sole purpose of receiving a fraudulent tax refund continue to be prevalent. Our ongoing audit work shows that the IRS is making progress in detecting fraudulent identity-theft tax return filings. Most recently, we reported in February

²⁷TIGTA, Ref. No. 2016-40-065, *Processes Are Not Sufficient to Assist Victims of Employment-Related Identity Theft* (August 2016).

²⁸TIGTA, Audit No. 201740033, *Notification Letters to Victims of Employment Identity Theft*, report scheduled for November 2017.

²⁹TIGTA, Ref. No. 2017-40-031, *The Number of Employment-Related Identity Theft Victims Is Significantly Greater Than Identified* (June 2017).

³⁰The IRS created the ITIN to provide Taxpayer Identification Numbers, when needed for tax purposes, to individuals who do not have and are not eligible to obtain an SSN.

³¹Any information that, either alone or in combination with other information, can be used to uniquely identify an individual.

³²TIGTA, Audit No. 201740029, *Processing Year 2017 Fraud Detection Activities*, report planned for January 2018.

2017 that IRS efforts are resulting in improved detection of identity-theft individual tax returns at the time returns are processed and before fraudulent tax refunds are released.³³

For the 2017 Filing Season, the IRS used 197 identity-theft filters to identify potentially fraudulent individual tax returns and prevent the issuance of fraudulent tax refunds. These filters incorporate criteria based on characteristics of confirmed identity-theft tax returns, including amounts claimed for income and withholding, filing requirements, prisoner status, taxpayer age, and filing history. Tax returns identified by these filters were held during processing until the IRS could verify the taxpayer's identity. As of April 29, 2017, the IRS reported that it had identified and confirmed 75,797 fraudulent tax returns and prevented the issuance of \$581.6 million in fraudulent tax refunds as a result of its identity-theft filters.

However, the IRS recognizes that new identity-theft patterns are constantly evolving and that, as a result, it needs to continuously adapt its detection and prevention processes. These evolving identity-theft patterns affect not only individuals, but also businesses. The IRS defines business identity theft as creating, using, or attempting to use, a business's identifying information without authority, in order to claim tax benefits. In September 2015, we reported that the IRS recognized the growing threat of business-related identity theft and, in response, was implementing processes to detect identity theft on business returns at the time tax returns are processed.³⁴ For example, in response to TIGTA's recommendations, the IRS expanded its filters to identify business identity theft for the 2017 Filing Season and used 25 identity-theft filters to identify potentially fraudulent business tax returns and prevent the issuance of fraudulent tax refunds. As of June 1, 2017, the IRS reported that it had identified and confirmed approximately 4,000 fraudulent tax returns for Tax Years 2015 and 2016 and prevented the issuance of \$390 million in fraudulent tax refunds as a result of these business identity-theft filters. TIGTA is conducting a follow-up audit to assess the IRS's efforts to expand on its processes and procedures to detect business identity theft.³⁵

Finally, refund fraud associated with the use of prisoner SSNs continues to remain a significant problem for tax administration. The IRS identified more than 24,000 fraudulent tax returns using a prisoner SSN in Calendar Year 2015. The refunds claimed on those tax returns totaled more than \$1.3 billion. Since 2005, my office has issued a number of reports that address the IRS's efforts to identify and prevent prisoner tax fraud. Although the IRS has taken a number of steps to improve its processes in response to TIGTA's recommendations, further improvements are needed in the IRS's identification of prisoner returns.

To combat refund fraud associated with tax returns filed using prisoner SSNs, the IRS compiles a list of prisoners (the Prisoner File) received from the Federal Bureau of Prisons and State Departments of Corrections. The Prisoner File is the cornerstone of the IRS's efforts to prevent the issuance of fraudulent refunds to individuals filing false tax returns using a prisoner SSN. To further its efforts to identify prisoner tax returns, the Bipartisan Budget Act of 2013,³⁶ enacted in December 2013, amended the Improper Payments Elimination and Recovery and Improvement Act³⁷ to authorize the IRS to use prisoner information provided by the Social Security Administration (SSA). The IRS is using the SSA prisoner file as part of the 2017 Filing Season prisoner identification process.

In July 2017, we reported IRS processes do not effectively ensure that the Federal Bureau of Prisons and the State Departments of Corrections comply with prisoner reporting requirements.³⁸ TIGTA identified 861 prisons that reported to the SSA but did not report to the IRS. TIGTA also identified 272,931 prisoners who were in Federal Bureau of Prisons or State Departments of Corrections but were not reported to the IRS. Approximately \$48 million in potentially fraudulent refunds were claimed by 16,742 individuals incarcerated in institutions that did not report to the IRS.

In addition, we identified that the IRS processes to validate and use prisoner data limits the ability to detect potentially fraudulent tax returns. For example, the IRS

³³ TIGTA, Ref. No. 2017-40-017, *Efforts Continue to Result in Improved Identification of Fraudulent Tax Returns Involving Identity Theft; However, Accuracy of Measures Needs Improvements* (February 2017).

³⁴ TIGTA, Ref. No. 2015-40-082, *Processes Are Being Established to Detect Business Identity Theft; However, Additional Actions Can Help Improve Detection* (September 2015).

³⁵ TIGTA Audit No. 201740037, *Business Identity Theft Follow-Up*, report planned for May 2018.

³⁶ Public Law No. 113-67, § 204.

³⁷ Public Law No. 112-248, 126 Stat. 2390.

³⁸ TIGTA, Ref. No. 2017-40-041, *Actions Need to be Taken to Ensure Compliance with Prisoner Reporting Requirements and Improve Identification of Prisoner Returns* (July 2017).

does not use prisoner records where the information provided by the reporting institutions for a prisoner is not valid to process tax returns. As such, any return filed using the mismatched prisoner information will not be evaluated for potential prisoner fraud. Our review of the 1.1 million records that the IRS identified as having a mismatch found 471,864 (41 percent) contained a valid SSN (*i.e.*, SSN was issued by SSA) in IRS files, which could be indicative of a prisoner's use of a stolen SSN.

TIGTA also identified that the validation process incorrectly identified 4,158 prisoner records as not matching IRS records when in fact the information provided by the Federal Bureau of Prisons and State Departments of Corrections did match IRS records. As a result, any tax return filed using one or more of these prisoner identities will not be assigned a prisoner indicator or evaluated using the prisoner fraud filters. TIGTA identified 1,113 tax returns with refunds totaling more than \$1.7 million that were not identified as prisoner tax returns as a result of this error.

Reducing Refundable Credit Improper Payments

Although refundable credits provide benefits to individuals, the unintended consequence of these credits is that they can result in the issuance of improper payments and can be the targets of unscrupulous individuals who file erroneous claims. Refundable credits can result in tax refunds even if no income tax is withheld or paid; that is, the credits can exceed an individual's tax liability. Consequently, they pose a significant risk as an avenue for those seeking to defraud the Government.

The IRS issued an estimated \$25 billion in potentially improper Earned Income Tax Credit (EITC),³⁹ Additional Child Tax Credit (ACTC),⁴⁰ and American Opportunity Tax Credit (AOTC)⁴¹ payments in fiscal year 2016. This represents a significant loss to both the Federal Government and taxpayers. TIGTA remains concerned with the IRS's inability to significantly reduce these payments.

In April 2017, we reported that the IRS concluded that the ACTC and AOTC presented a medium risk of improper payments for fiscal year 2016.⁴² However, the IRS's medium risk rating continues to be contrary to its own compliance data, which shows in fact that both the ACTC and AOTC programs present a high risk of improper payments. Our review of these revised assessments found that they still do not include the use of available IRS compliance data to quantify erroneous payments. Because the IRS does not rate these programs as high risk, it is not required to establish a corrective action plan to reduce the improper payments.

Using the IRS's own compliance data, we computed the fiscal year 2016 potential estimated improper payment rate for the ACTC and AOTC. We estimate that 25.2 percent (\$7.2 billion) of ACTC payments were improper⁴³ and 24.1 percent (\$1.1 billion) in AOTC payments were improper.⁴⁴ The IRS is not required to perform a risk assessment of the EITC because the EITC is designated as a high-risk program by the Office of Management and Budget. For fiscal year 2016, the IRS estimates EITC payments totaling \$16.8 billion were issued improperly.

Congress enacted the PATH Act on December 18, 2015, which includes "program integrity provisions" intended to reduce fraudulent and improper EITC, Child Tax Credit,⁴⁵ ACTC, and AOTC payments. For example, one of the PATH Act's provisions is intended to ensure that the IRS has the information and time needed to verify the income of individuals claiming the EITC and ACTC before the related refund is issued. According to the House Committee on Ways and Means, these integrity provisions are projected to save roughly \$7 billion over 10 years by reducing fraud, abuse, and improper payments in refundable credit programs.

³⁹The EITC was created in 1975 as part of the Tax Reduction Act of 1975 §204, 26 U.S.C. §32. The EITC is used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment.

⁴⁰The ACTC is intended to reduce the individual income tax burden for families, better recognize the financial responsibilities of raising dependent children, and promote family values.

⁴¹The AOTC is intended to help offset the costs of higher education for taxpayers, their spouses, and dependents who qualify as eligible students.

⁴²TIGTA, Ref. No. 2017-40-030, *Revised Refundable Credit Risk Assessments Still Do Not Provide an Accurate Measure of the Risk of Improper Payments* (April 2017).

⁴³We estimate that the potential ACTC improper payment rate for fiscal year 2016 is between 22.7 percent and 27.8 percent and the potential improper payment dollars is between \$6.5 billion and \$7.9 billion.

⁴⁴We estimate that the potential AOTC improper payment rate for fiscal year 2016 is between 19.6 percent and 28.7 percent and the potential improper payment dollars is between \$900 million and \$1.3 billion.

⁴⁵A tax credit for families with dependent children that is used to reduce the individual income tax burden for families, better recognize the financial responsibilities of raising dependent children, and promote family values.

In September 2014,⁴⁶ we reported that the IRS has developed a strategy to reduce EITC improper payments. This strategy focuses on early intervention to ensure that individuals who claim the credit are in compliance with the EITC rules and includes education and outreach, enforcement actions, a paid tax return preparer compliance initiative, and legislative proposals. The IRS also performed compliance studies which found that EITC improper payments primarily result from two root causes—authentication and program design.

Authentication errors include errors associated with the lack of available data to which the IRS can verify self-employment income, authenticate qualifying children, and verify filing status. Verification errors relate to instances in which the IRS is unable to identify underreporting and overreporting of income, and errors that arise when more than one individual can claim a qualifying child. Our analysis of Tax Year 2012 EITC claims, for which taxpayers claimed wages as the source of income to support the EITC, identified 676,992 tax returns for which third-party Forms W-2 were not sent to the IRS by the employer for either the taxpayer or spouse listed on the tax return. These tax returns claimed EITCs totaling more than \$1.7 billion.

However, as we continue to report, IRS compliance resources are limited and consequently, the IRS does not address the majority of potentially erroneous EITC claims. This is despite the fact that the IRS has established processes that identify billions of dollars in potentially erroneous EITC payments. Although the PATH Act gives the IRS more time to verify EITC and ACTC claims before refunds are issued, it did not expand the IRS's authority to systemically correct erroneous claims at the time tax returns are processed. Currently, under the Internal Revenue Code, the IRS's math error authority is limited to systemically addressing erroneous EITC claims to correct mathematical or clerical errors on such claims. For example, it can correct entries made on the wrong line on the tax return or mathematical errors made in computing income or the EITC. However, the majority of potentially erroneous EITC claims that the IRS identifies do not contain the types of errors for which it has math error authority. To address those potentially erroneous EITC claims identified that cannot be addressed using math error authority, the IRS must conduct an audit. The IRS estimated that it costs \$1.50 to resolve an erroneous EITC claim using math error authority compared to \$278 to conduct a pre-refund audit.⁴⁷

The IRS, in conjunction with the Assistant Secretary of the Treasury for Tax Policy, has each year since fiscal year 2013 set forth a legislative proposal requesting additional error correction authority as part of its annual budget submission. Such authority, if provided by law, would allow the IRS to correct, during processing, tax returns when the information provided by the taxpayer does not match the information contained in Government databases (e.g., income information reported on the tax return does not match Forms W-2 from the Social Security Administration). Without this additional error authority, billions of dollars in identified potentially erroneous claims will continue to go unaddressed each year.

Tax Compliance

Despite IRS efforts to reduce it, the Tax Gap remains a serious and persistent challenge. The IRS estimated that the average annual Tax Gap for Tax Years 2008 through 2010 to be \$458 billion. TIGTA reviews have identified several areas that have contributed to the IRS's inability to reduce the Tax Gap. For example, in September 2016 we reported that nearly \$9 billion in backup withholding tax was not withheld as required by payers⁴⁸ submitting information returns with missing or incorrect TINs based on our review of TY 2013 information returns.⁴⁹ Our review identified that the IRS's use of its authority provided by law has been extremely limited. IRS management speculated that the subsequent restructuring of the IRS in Calendar Year 1998, and other reorganizations that have followed, have resulted in unintended gaps in the enforcement of backup withholding as responsibilities were separated among multiple programs/organizations without adequate coordination. Enforcing payer backup withholding requirements is essential to ensuring that

⁴⁶ TIGTA, Ref. No. 2014-40-093, *Existing Compliance Processes Will Not Reduce the Billions of Dollars in Improper Earned Income Tax Credit and Additional Child Tax Credit Payments* (September 2014).

⁴⁷ Cost to use math error authority as of June 25, 2014, as provided by the IRS. The IRS provided the cost of a pre-refund audit based on fiscal year 2010 financial data, which is the most current estimate available.

⁴⁸ "Payers" making certain payments to payees must withhold and pay to the IRS a specified percentage of those payments under certain conditions. For example, financial institutions (such as banks and brokerage firms) are payers that are required to withhold taxes.

⁴⁹ TIGTA, Ref. No. 2016-40-078, *Due to the Lack of Enforcement, Taxpayers Are Avoiding Billions of Dollars in Backup Withholding* (September 2016).

the Government is able to collect taxes on all appropriate income, particularly income that is not usually subject to withholding.⁵⁰

In addition, employment tax noncompliance is steadily growing. As of December 2015, 1.4 million employers owed approximately \$45.6 billion in unpaid employment taxes, interest, and penalties. In March 2017, TIGTA reported that the Trust Fund Recovery Penalty (TFRP) is an enforcement tool the IRS can use to discourage employers from continuing egregious employment tax noncompliance and provides an additional source of collection for unpaid employment taxes.⁵¹ In fiscal year 2015, the IRS assessed the TFRP against approximately 27,000 responsible persons—38 percent fewer than just 5 years before as a result of a decline in the number of revenue officers. In contrast, the number of employers with egregious employment tax noncompliance (20 or more quarters of delinquent employment taxes) is steadily growing—it has more than tripled in a 17-year period.

We also reported in July 2017 that billions of dollars of potential employer underreported taxes are not being addressed because most discrepancy cases identified by the IRS are not worked.⁵² Discrepancy cases result when employers' wage and withholding information reported on filed Forms W-3/W-2 do not match what was reported on the employers' employment tax return. Our analysis found that the IRS did not work discrepancy cases that had a potential underreported total tax difference of more than \$7 billion.⁵³ We plan to perform a separate review to assess the IRS's actions to resolve these cases.

Telephone Impersonation Scam

Since the fall of 2013, a significant amount of our OI workload has consisted of investigating a telephone impersonation scam in which over 2 million intended victims have received unsolicited telephone calls from individuals falsely claiming to be IRS or Treasury employees. The callers demand money under the pretense that the victim owes unpaid taxes. To date, over 10,800 victims have reported to TIGTA that they have been victims of this scam. Our investigations have determined that victims have paid almost \$58 million to the scammers.

The telephone impersonation scam continues to be one of TIGTA's top priorities; it has also landed at the top of the IRS's "Dirty Dozen" tax scams. The numerous complaints we have received about this scam have cemented its status as the largest, most pervasive impersonation scam in the history of our agency. It has claimed victims in every State.

Here is how the scam works: the intended victim receives an unsolicited telephone call from a live person or from an automated call dialer. The caller, using a fake name and sometimes a fictitious IRS employee badge number, claims to be an IRS or Treasury employee. The scammers use Voice over Internet Protocol technology to hide their tracks and create false telephone numbers that show up on the victim's caller ID system. For example, the scammers may make it appear as though the calls are originating from Washington, DC, or elsewhere in the United States, when in fact they may be originating from a call center located in India.

The callers may even know the last four digits of the victim's SSN or other personal information about the victim. The caller claims that the intended victim owes the IRS taxes and that, if those taxes are not paid immediately, the victim will be arrested or charged in a lawsuit. Other threats for non-payment include the loss of a driver's license, deportation, or loss of a business license. They often leave "urgent" messages to return telephone calls and they often call the victim multiple times.

According to the victims we have interviewed, these scammers often demand that the victims immediately pay the money using Apple iTunes® gift cards, Target gift cards, prepaid debit cards, wire transfers, Western Union payments, or MoneyGram® payments in order to avoid being immediately arrested. They are typically warned that if they hang up, local police will come to their homes to arrest them immediately. Sometimes the scammers also send bogus IRS e-mails to support their claims that they work for the IRS. By the time the victims realize that they have been scammed, the funds are long gone.

TIGTA has made several arrests in connection with this scam and has numerous investigations underway. In July 2015, in one of the largest prosecutions on this scam that we have had to date, an individual pled guilty to organizing an impersonation

⁵⁰ Examples include interest income, rents, royalties, and certain gambling winnings.

⁵¹ TIGTA, Ref. No. 2017-IE-R004, *A More Focused Strategy Is Needed to Effectively Address Egregious Employment Tax Crimes* (March 2017).

⁵² TIGTA, Ref. No. 2017-40-038, *Case Selection Processes Result in Billions of Dollars in Potential Employer Underreported Tax Not Being Addressed* (July 2017).

⁵³ This includes Social Security tax, Medicare tax and Federal income tax.

ation scam ring. He was sentenced to over 14 years of incarceration and ordered to forfeit \$1 million. In October 2016, after an extensive 3-year investigation, TIGTA, the Department of Justice, and the Department of Homeland Security announced the indictment of 56 individuals and five call centers located in India.

In April 2017, 10 individuals were charged in an indictment with conspiracy to commit wire fraud in connection with this scam. The defendants traveled to 30 different States to collect money wired by unsuspecting taxpayers. Eight of the 10 individuals were arrested by TIGTA special agents and our law enforcement partners. Using approximately 80 different false identities, the defendants and their co-conspirators received monies totaling over \$8.8 million from more than 7,000 taxpayers.

Although the investigations and prosecutions have reduced the number of scam calls being placed by over 90 percent, we are still receiving reports that between 5,000 and 10,000 people are receiving calls each week. Fortunately, thanks to extensive public outreach efforts, some of which are described below, the vast majority of those called are now simply hanging up on the scammers.

In addition to the criminal prosecutions, to thwart scammers using robo-dialers, we have created and instituted an “Advise and Disrupt” strategy. The strategy involves cataloguing the telephone numbers that have been reported by intended victims. We then use our own automated call dialers to make calls to those telephone numbers to advise the scammers that their activity is criminal and to cease and desist their activity. Using this technique, we have placed more than 145,000 automated calls back to the scammers. We are also working with the telephone companies to have the scammers’ telephone numbers shut down as soon as possible. Of the 1,253 telephone numbers that have been reported by victims, we have successfully shut down 93 percent of them, some of them within one week of the numbers having been reported to us.

TIGTA is also publishing those scam-related telephone numbers on the Internet. This provides intended victims an additional tool to help them determine if the call is part of a scam. All they have to do is type the telephone number in any search engine, and the response will indicate whether the telephone number has been identified as part of the impersonation scam. These efforts are producing results; our data show that it now takes hundreds of calls to defraud one victim, whereas in the beginning of the scam it took only a double-digit number of attempts.

Further, TIGTA is engaged in public outreach efforts to educate taxpayers about the scam. These efforts include publishing press releases, granting television interviews, issuing public service announcements, and providing testimony to Congress. The criminals view this scam as they do many others; it is a crime of opportunity. Unfortunately, while we plan on arresting and prosecuting more individuals, the scam will not stop until people stop paying the scammers money. Our best chance at defeating this crime is to educate people so they do not become victims in the first place. Every innocent taxpayer we protect from this crime is a victory.

In 2015, a law was enacted that mandated the IRS’s use of private collection agencies (PCAs) to collect certain “inactive receivables.”⁵⁴ Certain inventories were specifically excluded from the definition of inactive receivables.⁵⁵ TIGTA initiated an audit soon after the enactment of the legislation to evaluate the IRS’s establishment of policies, procedures, and other infrastructure necessary to operate this program, as well as to assess the IRS’s efforts to mitigate risks to the program.⁵⁶ We have identified numerous concerns during our audit, including the IRS’s lack of commitment to assisting taxpayers who may be concerned that the PCAs calling them are actually part of an impersonation scam, as well as our concerns related to the IRS’s process for receiving taxpayer complaints about PCAs. In addition, TIGTA is planning a future audit related to the operations of the program, as well as a review evaluating the PCA contractors’ performance.

⁵⁴ Fixing America’s Surface Transportation Act, Public Law No. 114–94, Div. C, Title XXXII, § 32102, 129 Stat. 1312, 1733–36 (2015), codified in Internal Revenue Code (I.R.C.) Section (§) 6306. The term “inactive receivables” means: receivables removed from active inventory due to inability to locate the taxpayer; inventory in which one-third of the collection statute of limitations has expired; or assigned inventory in which more than 365 days have passed since contact with the taxpayer occurred.

⁵⁵ I.R.C. § 6306(d) excludes inventory that is: subject to a pending or active offer-in-compromise or installment agreement; is classified as an innocent spouse case; or involves a taxpayer identified as deceased, under the age of 18, in a designated combat zone, a victim of tax-related identity theft, is currently under examination, litigation, criminal investigation, or levy, or is currently subject to a proper exercise of a right of appeal.

⁵⁶ TIGTA, Audit No. 201630029, *Planning and Implementation of the IRS’s Private Debt Collection Program*, report scheduled for September 2017.

TIGTA provided the IRS with insight on how the widespread IRS impersonation scam might impact the Private Debt Collection program. Specifically, based on what TIGTA learned during its investigation of the impersonation scam, we provided the IRS with different ways it could consider notifying taxpayers about the program and that their accounts have been assigned to the PCAs. In addition, we have provided integrity and safety briefings to the PCAs' employees. TIGTA will closely monitor incoming impersonation complaints involving the PCAs, and we will work to take appropriate action and notify the IRS, the PCAs, and the public if we identify an impersonation scheme growing within the Private Debt Collection program.

TIGTA BUDGET REQUEST FOR FISCAL YEAR 2018

As requested by the subcommittee, I will now provide information on TIGTA's budget request for fiscal year 2018.

TIGTA's fiscal year 2018 proposed budget requests appropriated resources of \$161,113,000, approximately a 5 percent decrease from the fiscal year 2017 enacted budget. TIGTA will continue to focus on its mission of ensuring an effective and efficient tax administration system in this lean budget environment. The fiscal year 2018 budget resources requested include funding to support TIGTA's critical audit, investigative, and inspection and evaluation priorities, while still enabling it to maintain a culture that continually seeks to identify opportunities to achieve efficiencies and cost savings.

During fiscal year 2016, TIGTA's combined audit and investigative efforts recovered, protected, and identified monetary benefits totaling over \$15.1 billion, including cost savings, increased revenue, revenue protection,⁵⁷ and court-ordered settlements in criminal investigations, and affected approximately 1.1 million taxpayer accounts. Based on TIGTA's fiscal year 2016 budget of \$167 million, this represents a Return on Investment of \$90-to-\$1.

TIGTA's Audit Priorities

TIGTA's audit priorities focus on assessing key areas in which the IRS faces major risks, including the risk of unauthorized access to tax account information, identity-theft detection and prevention, customer service to taxpayers, the use of private debt collectors, and international tax compliance.

TIGTA will continue to provide oversight related to cybersecurity. The proliferation of data breaches reported in recent years and the types of information available on the Internet has compromised the effectiveness of controls used to authenticate individuals when they access their account information. Providing taxpayers with more avenues to obtain answers to their tax questions or access their own tax records online also creates more opportunities for exploitation by hackers and other fraudsters. TIGTA will evaluate the changes being considered for authenticating taxpayer access to their account information, the effectiveness of controls to mitigate external and internal threats to IRS systems, the security of data file transfers to third parties, and the effectiveness of controls to address cybersecurity incidents.

Stopping identity theft and refund fraud also continues to be a top priority for the IRS and for TIGTA in our oversight role. As identity-theft patterns are constantly evolving, the IRS needs to continuously adapt its detection and prevention processes. The risk for unauthorized access to tax accounts for the purpose of filing fraudulent tax returns will continue to grow as the IRS focuses its efforts on delivering taxpayers self-assisted interactive online tools. Tax account information obtained through unauthorized accesses, such as the Data Retrieval Tool breach, can be used to file fraudulent tax returns that more closely resemble a legitimate tax return, making it more difficult for the IRS to detect. TIGTA will continue to assess the IRS's efforts to detect refund fraud committed by identity thieves and authenticate individual taxpayers' identities at the time tax returns are filed and when services are provided.

Additionally, TIGTA will be auditing the IRS's implementation of the new legislative requirement to mandate the use of PCAs to collect inactive tax receivables. As mentioned previously, TIGTA has ongoing audit work to address the IRS's use of PCAs. Further, pursuant to I.R.C. § 306(j), TIGTA will also biannually provide an independent review of contractor performance.

International tax compliance also remains a significant area of concern. As the IRS noted in its most recent strategic plan, the evolution and proliferation of virtual commerce has expanded the exchange of goods, services, and currencies—real and virtual—across jurisdictions, further complicating tax administration. We will be

⁵⁷ Recommendations made by TIGTA to ensure the accuracy of the total tax, penalties, and interest paid to the Federal Government.

continuing to assess the IRS's compliance efforts in this area, including its use of the tools that the law provides to assist in its efforts. One of the most significant tools is the Foreign Account Tax Compliance Act,⁵⁸ which mandates reporting obligations for certain U.S. taxpayers with foreign accounts and also provides for the sharing of information between the U.S. and foreign financial institutions to ensure compliance with those obligations.

TIGTA's Investigative Priorities

TIGTA's investigative priorities include investigating allegations of serious misconduct and criminal activity by IRS employees; ensuring that IRS employees are safe and that IRS facilities, data, and infrastructure are secure and not impeded by threats of violence; and protecting the IRS against external attempts to corrupt or otherwise interfere with tax administration.

IRS employees are entrusted with the sensitive personal and financial information of taxpayers. It is particularly troubling when IRS employees misuse their positions in furtherance of identity theft and other fraud schemes. TIGTA will continue to process and investigate complaints from taxpayers, the Congress, and IRS employees and managers, as well as continue to use sophisticated data mining tools to proactively search for internal and external criminal activity. This includes proactively reviewing the activities of the 56,000 IRS employees who access taxpayer accounts for an indication of unauthorized accesses that may be part of a larger identity-theft fraud scheme.

Between fiscal years 2011 and 2016, TIGTA processed 14,095 threat-related complaints and conducted 7,067 investigations of threats made against IRS employees. TIGTA will continue to aggressively investigate individuals who threaten the safety and security of the IRS and its employees.

The recent large-scale cybersecurity incidents in which criminals were able to obtain the information of hundreds of thousands of taxpayers from IRS systems continue to be a major investigative focus for our investigators. We are in the midst of a multi-agency investigation into these incidents and we are, as able, sharing what we are learning from these investigations with the IRS. As mentioned earlier in my testimony, TIGTA has received almost 2 million reports from taxpayers claiming that they were contacted by individuals impersonating IRS employees in an effort to defraud them. TIGTA will continue to investigate these crimes against taxpayers and alert the public to this scam to ensure that taxpayers are not harmed by these criminals.

We at TIGTA take seriously our mandate to provide independent oversight of the IRS in its administration of our Nation's tax system. As such, we plan to provide continuing audit coverage of the IRS's efforts to operate efficiently and effectively and to investigate any instances of IRS employee misconduct or other threats to tax administration.

Chairwoman Capito, Ranking Member Coons, and Members of the subcommittee, thank you for the opportunity to share my views.

RURAL IN-PERSON TAXPAYER SERVICES

Senator CAPITO. Thank you both very much for your opening statement and I will begin the question portion. In your opening statement, Commissioner, you talked about taxpayer services and the ease at which to do an automated reply as opposed to a person replying to an individual request for assistance, how an auto—or how an online reply is much cheaper. Obviously, we know that. Senator Manchin and I are from a very rural State. We do have challenges on our broadband deployment, deep challenges to our access.

And, you know, I guess I would put a plug in for that person to person assistance still being a very vital part of taxpayer services. How do you view this and how do you balance it and what do you see for the future in terms of being able to maintain that personal assistance?

Mr. KOSKINEN. It is an important issue. As I have said, while we are trying to give taxpayers who would like to have an online ac-

⁵⁸Public Law No. 111–147, 124 Stat. 71 (2010).

count equivalent to what they have already with their banks or financial institutions, we are not like a bank or a financial institution. We cannot take a group of customers and say, "Well, let's forget about them. They do not provide enough revenue. They are difficult to deal with."

We have an obligation we happily accept to deal with every American to provide them communication opportunities in a way that they desire. We have tried to make it clear as we are moving people who want to be aligned with us in a digital environment, that what that does is not cause us to do away with call centers or taxpayer assistance centers. What it allows us to do is provide better services on the phone and in person for those people who need to be there, but also those people who want to be there or have to be there.

This last year we had almost 88 percent of people file electronically. That meant that we will receive 15 to 18 million paper returns. And if that is the easiest and most appropriate way for people to file, we are happy to have them do that. We recognize all of us know people who are either do not have the availability to the Internet or have really a great concern about using it and we are always willing and able to provide them those services.

So going forward I would just stress we will always have call services available. We will always have in person services available because what will happen is we will be able to provide those much better if, for instance, like Where's My Refund, the application, we had 300 million hits on it. Those used to be calls. They are no longer calls, so we can now deal more effectively with people.

Senator CAPITO. Let me just say that the taxpayer advocate and the assistance center that we have in Parkersburg, West Virginia, a lot of times we will get calls into our office asking for assistance and as soon as we call them they have been very responsive. And I just want to thank them, and you are the head of the ship there, so I want to thank them on my behalf for West Virginians because I have—they have really—I think they are sort of a hidden jewel in some ways. People do not know they are there and can be accessed as quickly, so we do know they are there and we appreciate they are there and I am sure we keep them very busy, so thank you for that.

INCREASES IN THE NUMBER OF FILED RETURNS

I did notice in the paper the other day a little paragraph that said more filings than ever had been filed at the IRS. Are you familiar with that statistic?

Mr. KOSKINEN. Well, the number of individual tax returns this year will be, we estimate, 152 million, so we are every year getting more returns. When you go back to the famous 2010 which I keep citing, since then we have 10 million more taxpayers. So part of our challenge is keeping up not only with technology, it is keeping up just with the increased volume.

Senator CAPITO. And, Inspector General, you talked a lot about cyber or security of data, and I shared a personal story with you on the way in about an issue on something that I was very familiar with. And you mentioned something to me I thought was really interesting, that the more the agency changes, the more the bad

actor can change ahead of it. Are you satisfied that the IRS is on the cutting edge of all of this or is it more of a reactive situation?

Mr. GEORGE. Well, the IRS has certainly made progress in this area and to its credit, we have not found a single instance in which the IRS's systems itself have been breached, so that is something that needs to be pointed out and lauded and credit given to the IRS.

That said, it is imperative that taxpayers have complete trust in the integrity or security of the information which they provide to the Internal Revenue Service. And to that end, there is still a major concern about the ability of the IRS to authenticate who it is that they are dealing with as it relates to tax information.

Now, authentication could be in the form of e-authentication. As the IRS progresses to more online types of activity, that presents a set of problems, but even prior to that if an individual because they either rifled through somebody's garbage or was able to convince someone in a different forum completely to provide name, Social Security Number, date of birth, they, in the past, have had the ability to gain information from the IRS or engage in transactions that they should not have or they should not be able to.

Now, in the context of the e-authentication, the IRS has learned through trial and error that they need to do more checking than just name, date of birth, Social Security Number. There have to be a multi factor way of gaining information to confirm that the person they are giving information to or ultimately giving refunds to is a person who deserves that information. So the bottom line is the more that the IRS does, great, but again, the bad guys are still very aggressive—

Senator CAPITO. Right.

Mr. GEORGE [continuing]. And there is an international problem.

Senator CAPITO. Right. Thank you.

Senator MANCHIN.

Senator MANCHIN. Inspector George, what is the greatest risk facing IRS today and what can Congress do to support the mitigation of these risks?

Mr. GEORGE. That is a massive area in which to address your question.

Senator MANCHIN. You have got about 30 seconds.

Mr. GEORGE. Oh, well, and I would then point to authentication now, sir. And, again, I do not need to repeat everything I have just said, but so—

Senator MANCHIN. Sure. I know that. That is the greatest risk?

Mr. GEORGE. That, in my view, yes.

Senator MANCHIN. Okay. And to Commissioner—

Mr. GEORGE. Oh, excuse me. I am sorry. With the addition of additional resources, sir. It is imperative that taxpayers be able to comply with their tax obligation. And if the tax code is too complicated or if they cannot get through to the IRS to try to get a simple question answered, they are less likely to comply than if the opposite were the case.

IRS USE OF MAIL TO COMMUNICATE WITH TAXPAYERS

Senator MANCHIN. Thank you. And, Commissioner, you know, Senator Capito just touched on it. In rural American, rural West

Virginia, sometimes broadband is not what it could be and should be and people are unfamiliar or not comfortable, elderly population. So I appreciate, you know, you all still understanding the importance of us receiving the mail and working through the traditional lines of communication.

Mr. KOSKINEN. No, I understand. Chairman, I grew up in Ashland, Kentucky, not far from you.

Senator MANCHIN. You are right across the river.

Mr. KOSKINEN. So those are people I understand and——

Senator MANCHIN. Well, however they are—well, it is still frustrating to many the way that we communicate by mail. Ten percent of our IRS notices do not reach their intended audience, which represents a total failure of communications at roughly twice the industry average. When a taxpayer receives a notice, it is often an indecipherable block of text using stock language and no visual or graphical clues as to what the taxpayer should do or why.

Moreover, ISR plans to address its high failure rate which involved moving to online communications are destined to be incomplete solutions at best because of what we just talked about.

Mr. KOSKINEN. Right.

Senator MANCHIN. So my recommendation, for what it would be worth to the IRS, is to learn from the best practices as used in industry. When we all get statements from credit card or our utilities, they use a colored modern, iconographic in a clear text because the credit card utility knows it is in the best interest for all of us for me to be able to understand the information. So does the IRS have plans to implement color and iconographic in order to make its notices more understandable to this population we just spoke about?

Mr. KOSKINEN. At this point, we are looking at—we have had a longstanding plain English goal, to have—when you get a letter from the IRS, be clear——

Senator MANCHIN. Make sense.

Mr. KOSKINEN [continuing]. Why you are getting the letter. We are not at the stage of going to color. Again, that is a resource issue as much as anything. We have an antiquated system. We have applications that——

Senator MANCHIN. Right.

Mr. KOSKINEN [continuing]. Were running when John F. Kennedy was President, but it is critical and I think your point is well taken that when people get a notice from us, it should not be unnecessarily confusing or unnecessarily frightening. It ought to say, “You are getting this letter for the following reason.” Our experience has been even when we are sending just an update notice to people that they have had a mistake and in the future they should ignore it. Whatever we say when even we say, “This is just for information,” people always call us. We expect that probably half the people who get any communication will call, and that is appropriate, but what is most important is for the letter to be clear, for the notice to be understandable by anyone.

Senator MANCHIN. What about the 10 percent that are not even receiving their notices by mail?

Mr. KOSKINEN. Well, our biggest problem is people move. It used to be that 20 percent of people moved every year. It has dropped

somewhat because people are less mobile than they used to be, but they will often leave a forwarding address for the post office, but we never quite get that notice. And so it is a problem, and especially when we are trying to provide information to taxpayers, knowing where they are and where they were last year is important to us.

TAX ADMINISTRATION IN THE GIG ECONOMY

Senator MANCHIN. My final question is going to be about the gig economy——

Mr. KOSKINEN. Yes.

Senator MANCHIN [continuing]. Because it is a whole other challenge. And where many people are freelance drivers with Uber or Lyft or freelance innkeepers with Airbnb, the nature of employment has drastically shifted, as we all know. In addition to the labor and benefits concerns this shift has created, we must also find a way to classify this type of work that both adjusted to growing portions of Americans engaging in this work and is appropriate for the workers themselves. So how does the Treasury and the IRS plan to ensure fair tax treatment for the incomes of those engaged in the new gig economy?

Mr. KOSKINEN. It is an important question. It is a growing area of the economy. Many of the people in that economy, whether they are in Airbnb, Uber, or Lyft, whatever it might be, do not realize they are in fact taxpayers and if you make money, you are supposed to pay taxes on it. So over a year ago we put up a special section of our website that said, you know, if you are in the gig economy here are obligations. Here is advice as to how you can in fact make sure you have good records, make sure that you are in fact meeting your obligations, and what you do not have to do.

One of the things worth looking at is whether for people who are regularly in that business even on an irregular basis, whether if they got a 1099 at the end of the year it would help them understand how much revenue they had and if they kept good records and we tried to help them with that, they would know what their expenses were and they would know what their tax obligation was. Most people want to be compliant, so part of our jobs is trying to help them understand what their tax obligations are and then try to make it as easy as we can for them to meet those obligations.

TAX COMPLIANCE IN THE DIGITAL ECONOMY

Senator MANCHIN. I know I am out of time here real quickly, but since it is just the two of us, maybe I can have some exception here. Finding some of these people, let us say that some of them just do not know, just do not understand. They have to get a business license usually, whether it be Airbnb. I am sure you have to have a business license to be an Uber driver, is that correct?

Mr. KOSKINEN. Well, I am not sure. It is a matter of State law. They have to have a driver's license obviously.

Senator MANCHIN. Right.

Mr. KOSKINEN. But we do not have control over whether they have a business license.

Senator MANCHIN. Do we know that from you alls—I am sure you are auditing Uber. You are going to hit the big boys, I would think.

Mr. KOSKINEN. Yeah. So, no, no. We obviously track that, but in terms of licensing, that is really a State and local issue as to what business license they have.

Senator MANCHIN. So, so——

Mr. KOSKINEN. If you are renting your house out, it is a question of what the local business license and requirements are.

Senator MANCHIN. But if I am renting it through Airbnb who you are going to be targeting because you know who they are——

Mr. KOSKINEN. Yes.

Senator MANCHIN [continuing]. Do you all not check in to find out how the people register? If I want to be a part of Airbnb and on their Internet, that I had to have a license, am I filing and?

Mr. KOSKINEN. No. We actually are happy to have you file whether you are properly licensed or not.

Senator MANCHIN. Oh, I know——

Mr. KOSKINEN. What our job is——

Senator MANCHIN [continuing]. That, but again, coming from a rural State, sometimes we would prefer not to.

Mr. KOSKINEN. I understand that. So that is again why one of our thoughts is with——

Senator MANCHIN. Can you catch me if I prefer not to?

Mr. KOSKINEN. With the coordinating bodies at Uber, the headquarters and that, if they provided 1099s to you, they would be providing 1099s to us as well. And having that third party information, we do have a reasonable number of people every year who are non-filers. And we know that because we get third party information. And with those people, we reach out to them. Sometimes we——

Senator MANCHIN. The only thing I would say to that is that when I was Governor of the State of West Virginia and we had budget constraints and we would have to adjust our budgets a little bit, I never would cut back on my auditing staff. I would always increase their budget because for every dollar I spent, I got \$100 in return. So I made sure that we were auditing and targeting and making sure those people——

Mr. KOSKINEN. Yes.

Senator MANCHIN [continuing]. Were paying. And the big guys are who you can hit who basically I have got to be connected in to them one way or another. And I am using the Uber or Lyft——

Mr. KOSKINEN. Right.

Senator MANCHIN [continuing]. Or Airbnb because——

Mr. KOSKINEN. It is one of my great concerns, and as I am leaving, I am trying to make sure everybody understands that concern at your point.

Senator MANCHIN. Well, continue to keep——

Mr. KOSKINEN. People want to be compliant.

Senator MANCHIN. Continue to keep helping us.

TAX COMPLIANCE RATES

Mr. KOSKINEN. Right. People want to be compliant, but part of the reason people are compliant is because they think the system is fair, fair in the sense that everybody is paying.

Senator MANCHIN. Sure.

Mr. KOSKINEN. To the extent that our audit rate drops from 1.2 to .5, we do not have the resources, in fact, to track the people who are trying not to be compliant. At some point, it is corrosive to compliance.

Mr. GEORGE. And I would just simply not too, add to what the Commissioner stated, Senator, we have had numbers that demonstrated that when income is reported by a third party via 1099 or other source, compliance rates are in the upper 90 percent, but when people operate on a cash only basis, the compliance rate falls dramatically, meaning 20 percent, around that area. So that is the key issue that we have raised.

Senator CAPITO. Thank you. Well, I thank you all for participating and preparing for this. I will have to say as a recipient of a letter from the IRS, we all recognize that black and white print and the little envelope, who it is from, and so I appreciate your service to the IRS and to this country. And if we do not meet again, I want to thank you for your service.

I appreciate hearing from the top officials at Treasury, IRS, and Inspector General's office and having the opportunity to explore a number of important issues. Today's discussion will be helpful as we look at the 2018 funding, so at this time I ask unanimous consent that a statement by the taxpayer advocate, Nina Olson, be included for the hearing record. Since I am the only one here, I will give myself unanimous consent.

[The statement follows:]

PREPARED STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE

Chairman Capito, Ranking Member Coons, and distinguished Members of this subcommittee:

Thank you for inviting me to submit this statement regarding the proposed budget of the Internal Revenue Service for fiscal year 2018.¹

The collection of revenue for the U.S. Government is a critical job, and the IRS has been forced to do it with substantially reduced resources in recent years. From fiscal year 2010 through fiscal year 2017, we estimate the IRS's budget has been reduced by nearly 20 percent on an inflation-adjusted basis.

The combination of reduced resources and more work has eroded the IRS's ability to serve taxpayers and promote voluntary compliance. The additional \$290 million in funding that Congress provided in fiscal year 2016 and fiscal year 2017 has been very helpful, and because of it, the IRS has done a much better job of answering taxpayer telephone calls than it did in fiscal year 2015. But taxpayer service is still not what it should be.

Partly because of resource constraints and partly because the IRS, like all large organizations, engages in long-term planning, the agency has developed a "Future State" plan that envisions how it will operate in 5 years and beyond. While I have previously expressed and continue to harbor concerns about aspects of the plan, I

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

commend the agency for the time and effort it has put into this planning, and I encourage a continuing dialogue about refining the plan so that it reflects the needs and preferences of U.S. taxpayers.

To improve taxpayer service, I recommend the IRS take the following steps:

1. Continue to expand its digital service offerings but simultaneously ensure that in-person and telephone services remain available for tens of millions of taxpayers who require or prefer to interact with the IRS in those ways.
2. Improve its telephone technology.
3. Answer a broader range of tax-law questions during the filing season—and throughout the year.
4. Improve the level of service on its “Installment Agreement/Balance Due” telephone line.
5. Establish a telephone line to answer questions about the eligibility and computational rules for the earned income tax credit (EITC).
6. Serve taxpayers without appointments at its Taxpayer Assistance Centers (TACs).
7. Expand outreach and education, particularly to small businesses, to improve tax compliance.
8. Assign at least one Appeals Officer and one Settlement Officer to every State.
9. Mail monthly bills to taxpayers who owe money, as private sector businesses routinely do.
10. Assign a single employee to work complex identity theft cases and correspondence examinations where a taxpayer calls the IRS or submits documentation.
11. Reduce the false positive rates produced by its identity theft and anti-fraud filters.

In the following pages, I will provide additional information regarding these recommendations. I believe the rationale for each one is strong and that most can be implemented immediately. In a few cases, however, it may be appropriate for the IRS to conduct a research study or pilot, in collaboration with the National Taxpayer Advocate, before moving to full implementation.

In addition, I recommend that the subcommittee continue to provide minimum funding levels in the Financial Services and General Government bill for the Tax Counseling for the Elderly (TCE) program, the Low Income Taxpayer Clinic (LITC) program, the Community Volunteer Income Tax Assistance (VITA) program, and the Taxpayer Advocate Service (TAS). In the case of the TCE, LITC, and Community VITA programs, a minimum funding level helps ensure that low income and elderly taxpayers receive the service and support they need when filing their tax returns and working with the IRS to resolve disputes. In the case of TAS, a minimum funding level helps ensure that TAS can fulfill its statutory mission as a “safety net” for taxpayers who are experiencing a “significant hardship”² and helps protect TAS’s independence in advocating for taxpayers both individually and systemically.³

I. The IRS Should Continue to Expand Its Digital Service Offerings But Simultaneously Ensure That In-Person and Telephone Services Remain Available for Taxpayers Who Require or Prefer to Interact with the IRS in Those Ways.

A central component of the IRS’s “Future State” plan is to migrate taxpayers away from interacting with the agency by phone or in person and toward interacting with the agency through online accounts. I believe online accounts are a beneficial addition to the IRS’s service offerings; in fact, I have advocated in the past that the IRS develop online accounts.⁴ However, online accounts should be viewed as a supplement to, not a replacement for, telephone and in-person assistance, as it is clear that many taxpayers either cannot utilize online accounts or do not feel comfortable using them for complex transactions.

During 2016, TAS undertook a series of steps to learn more about taxpayer needs and preferences. I myself traveled the country and held 12 Public Forums on Taxpayer Needs and Preferences.⁵ Together with Members of Congress, I heard directly

² See Internal Revenue Code (IRC) § 7811(a)(2) (defining the term “significant hardship”).

³ See IRC § 7803(c)(2)(A) (functions of TAS) and § 7803(c)(4) (independence of TAS).

⁴ See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, at 67–96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

⁵ See National Taxpayer Advocate 2015 Annual Report to Congress xv. National Taxpayer Advocate Public Forums were held in the following locations: Washington, District of Columbia (February 23, 2016); Glen Ellyn, Illinois (March 9, 2016 with Congressman Roskam); Bronx, New York (March 18, 2016 with Congressman Serrano); Hendersonville, North Carolina (April

from taxpayers and their representatives about the challenges they face in complying with the tax laws and dealing with the IRS.⁶ TAS also held focus groups consisting of tax return preparers and practitioners at the IRS Tax Forums.⁷ Additionally, TAS conducted a nationwide survey of U.S. taxpayers to hear directly what they need in the way of taxpayer service.⁸ Finally, my immediate staff identified significant research on topics that have relevance for tax administration, including approaches to voluntary compliance, worldwide taxpayer service, alternative dispute resolution, taxpayer rights, fraud detection, online accounts, and the impact of geographic presence and focus.⁹

Based on what we learned about taxpayer needs and preferences and in light of the IRS's data security protections, we believe taxpayer demand for telephone service and in-person service is not likely to diminish in the near future. First, many taxpayers have technology limitations. Approximately 33 million U.S. taxpayers have no broadband access,¹⁰ and taxpayers with Internet service connections slower than broadband will likely experience delays when attempting to access large files or complex web pages. Further, we estimate 14 million U.S. taxpayers have no Internet access at all.¹¹

Second, many taxpayers—even millennials with strong computer skills and access—do not feel comfortable using online accounts to handle complex matters. While these taxpayers readily use the Internet to download tax forms or seek out instructions, many report that they want to speak with an employee when dealing with account-specific matters, such as an audit or an identity-theft problem.

Third, the IRS has imposed stringent authentication requirements that taxpayers must satisfy when attempting to create online accounts. As a result, most taxpayers cannot establish an online account. As of July 22, 2017, of the nearly 2.2 million account registration attempts since the online account application launched, only about 22 percent were successful.¹² I am not suggesting that the IRS reduce its security protections. I believe protecting the security of taxpayer information is absolutely essential. However, the IRS must recognize that providing necessary security has implications for how many taxpayers will be able to access online accounts and how many will need to use other service channels, such as telephones or TACs.

For these reasons, I urge the IRS to continue to maintain high levels of service on its telephone lines and in its TACs. The IRS should not assume it can reduce these services—even over the long-term—unless and until it sees that taxpayers are willingly and comfortably migrating to online services and the demand for telephone and in-person assistance is diminishing. In my view, it is not clear this will happen. The tax law is complex, and the consequences of making a mistake on one's tax returns are considerable. Therefore, many taxpayers will continue to want to speak with an IRS employee, so they can ask follow-up questions and be certain they understand the answers.

By maintaining and strengthening the ability of taxpayers to obtain assistance by telephone and in person as well as online, the IRS would further the provision in the Taxpayer Bill of Rights that taxpayers have “The Right to Quality Service.”¹³

4, 2016 with Congressman Meadows); Harrisburg, Pennsylvania (April 8, 2016); Red Oak, Iowa (May 5, 2016 with Senator Grassley); Baltimore, Maryland (May 13, 2016 with Senator Cardin); Washington, District of Columbia (May 17, 2016); Parma, Ohio (August 16, 2016 with Congressman Renacci); Portland, Oregon (August 18, 2016); Los Angeles, California (August 22, 2016 with Congressman Becerra); and San Antonio, Texas (August 30, 2016 with Congressman Doggett).

⁶For information about, and full transcripts from, the National Taxpayer Advocate Public Forums, see <https://taxpayeradvocate.irs.gov/public-forums> (last visited April 25, 2017).

⁷TAS Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts About IRS's Proposed Future State* (October 2016), https://taxpayeradvocate.irs.gov/Media/Default/Documents/ResearchStudies/2016_TaxForum_FutureState_FocusGroup_Report.pdf.

⁸See National Taxpayer Advocate 2016 Annual Report to Congress, vol. 2, at 1–30 (Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*).

⁹These literature reviews are published in Volume 3 of the National Taxpayer Advocate's 2016 Annual Report to Congress.

¹⁰See National Taxpayer Advocate 2016 Annual Report to Congress, vol. 2, at 1–30 (Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*).

¹¹*Id.* TAS survey research also found that such vulnerable groups as the low income, seniors, and taxpayers with disabilities are less likely to have broadband access at home.

¹²IRS, Wage and Investment Division, Joint Operations Center (JOC), *Online Account External Launch Weekly Report* (week ending July 22, 2017).

¹³“The Right to Quality Service” is one of the ten rights included in the Taxpayer Bill of Rights that the IRS adopted in 2014 and that Congress cross-referenced in subsequent legislation. See IRS, Taxpayer Bill of Rights, <https://www.irs.gov/Taxpayer-Bill-of-Rights>; see also Con-

II. The IRS Should Improve Its Telephone Technology.

The IRS receives more than 100 million telephone calls every year, yet its telephone technology is old and prevents it from serving taxpayers efficiently. The IRS should conduct a study of best practices and technology in private industry call centers and then develop a plan to modernize its telephone operations.

One example of a technology improvement would be the addition of customer callback technology. Many private businesses and Federal agencies, including the Social Security Administration and the Department of Veterans Affairs, have deployed customer callback systems that allow callers to choose between waiting on hold and electing to receive a call back when their place in the telephone queue is reached.¹⁴ We believe a customer callback system would substantially improve the taxpayer experience at a reasonable cost.

In the President's fiscal year 2015 and fiscal year 2016 budgets, the IRS proposed this initiative and estimated it would cost about \$3.3 million.¹⁵ In November 2015, Commissioner Koskinen said that although the customer callback technology itself would cost about \$3.5 million, the IRS had determined its phone system would need to be upgraded at a cost of about \$45 million to allow the customer callback technology to run.¹⁶

Even if that is accurate, we think customer callback technology would be a prudent investment. For context, the IRS's fiscal year 2016 budget proposal requested about \$186 million to increase the Level of Service (LOS) on its toll-free lines to 80 percent.¹⁷ The significant majority of that funding would have paid for additional customer service representatives and other costs that recur annually. By contrast, the deployment of a customer callback system would essentially be a one-time cost, and it would permanently improve the IRS's LOS.

It should be emphasized that a high percentage of taxpayers who don't reach the IRS on their first attempt keep calling until they get through. The LOS during fiscal year 2016 averaged 53 percent, and those taxpayers who managed to reach an IRS telephone assistant had to wait an average of 18 minutes on hold.¹⁸

With customer callback technology, unsuccessful calls would be substantially reduced—as would hold times. Most taxpayers would only have to call the IRS once. Thus, this one-time cost would improve taxpayer service and substantially increase the LOS for years into the future.

In my view, customer callback would substantially strengthen the IRS's telephone operations, and there likely are other improvements the IRS can make. The IRS should develop a detailed plan to modernize its telephone operations.

By improving its telephone technology to better serve taxpayers, the IRS would further the provision in the Taxpayer Bill of Rights that taxpayers have “The Right to Quality Service.”

III. The IRS Should Answer a Broader Range of Tax-Law Questions During the Filing Season—and Throughout the Year.

When a government asks its citizens to pay over large portions of their income, it has a responsibility to make the process of doing so as simple and painless as possible. One way to do this is to answer questions about how to comply with the requirements of computing and paying taxes. Given the complexity of the Internal Revenue Code, U.S. taxpayers understandably have a lot of questions.

Beginning in 2014, largely citing funding limitations, the IRS sharply curtailed the scope of tax-law questions it would answer. It now answers only “basic” questions during the filing season. It does not answer tax-law questions at all after the filing season, including from the more than 15 million taxpayers who file their re-

solidated Appropriations Act, 2016, Public Law No. 114–113, Division Q, § 401 (2015) (codified at IRC § 7803(a)(3)).

¹⁴ See Government Accountability Office (GAO), GAO–17–140, *Financial Audit: IRS's fiscal years 2016 and 2015 Financial Statements* 116–117 (November 2016).

¹⁵ IRS, Congressional Justification for Appropriations accompanying the President's fiscal year 2015 budget at IRS–20 (2014); IRS, Congressional Justification for Appropriations accompanying the President's fiscal year 2016 budget at IRS–22 (2015).

¹⁶ See Lisa Rein, *IRS Customer Service Will Get Even Worse This Tax Filing Season*, *Tax Chief Warns*, Washington Post.com, November 3, 2015.

¹⁷ IRS, Congressional Justification for Appropriations accompanying the President's fiscal year 2016 budget at IRS–22 (2015).

¹⁸ IRS, JOC, *Snapshot Reports: Enterprise Snapshot—Accounts Management lines* (week ending September 30, 2016).

turns later in the year.¹⁹ This policy applies both on the IRS's telephone lines and in its TACs.

In my view, answering tax-law questions is a fundamental responsibility of a governmental tax agency, and the IRS's unwillingness to do more constitutes a breathtaking abdication of a core responsibility of tax administration.

By helping taxpayers comply with the tax laws by answering their basic and more complex tax-law questions throughout the year, the IRS would further the provisions in the Taxpayer Bill of Rights that taxpayers have "The Right to Quality Service" and "The Right to Be Informed."

IV. The IRS Should Improve the Level of Service on Its "Installment Agreement/Balance Due" Telephone Line.

Among the IRS's many telephone lines, one important one is the "Installment Agreement/Balance Due" line. During the 2017 filing season, the IRS received about 2.7 million calls on this line. For the most part, these calls come from taxpayers who are seeking to make payment arrangements—the sort of calls most private businesses would pick up in a heartbeat. Yet the IRS answered only 40 percent of these calls, and the average wait time among taxpayers who got through was a staggering 47 minutes.

The IRS's performance on this telephone line deteriorated markedly as compared with the 2016 filing season. In 2016, the IRS answered 76 percent of these calls, and the wait time was 11 minutes. Thus, the percentage of calls the IRS answered from taxpayers seeking to make payment arrangements on this line during the 2017 filing season dropped nearly in half as compared with last year, and wait times were more than four-fold.²⁰

The poor service on this and certain other telephone lines is largely budget-driven. The additional funding the IRS has received over the last 2 years to improve telephone service has been helpful but limited, and the IRS has used that funding primarily to improve service on its core filing season telephone lines. Still, both to improve both taxpayer service and revenue collection, the IRS must do a much better job of answering telephone calls from taxpayers who owe money and are seeking information to enter into payment arrangements.

By promptly answering telephone calls from taxpayers seeking to pay their debts through installment agreements, the IRS would further the provisions in the Taxpayer Bill of Rights that taxpayers have "The Right to Quality Service," "The Right to Privacy," and "The Right to a Fair and Just Tax System."

V. The IRS Should Establish a Telephone Line to Answer Questions About the Eligibility and Computational Rules for the Earned Income Tax Credit.

The earned income tax credit (EITC) is one of the Government's largest means-tested, anti-poverty programs. For tax year 2015, more than 27 million taxpayers claimed nearly \$67 billion in EITC benefits.

However, the EITC is plagued by an improper payments rate of about 24 percent. While some improper payments are due to intentional overclaims, others are due to lack of knowledge about the law or how to compute the correct amount. The EITC eligibility rules are complex, and about one-third of taxpayers who claim it each year did not claim it in the prior year, which means they need to learn the eligibility rules for the first time or refresh their understanding if they qualified previously.

The IRS devotes considerable resources toward reducing EITC improper payments. For example, it audits taxpayers claiming the EITC at about twice the rate of other taxpayers, even though these taxpayers are disproportionately low income.²¹ The IRS could better serve taxpayers and improve EITC compliance if it establishes a telephone line to answer EITC questions that is staffed by employees knowledgeable about EITC eligibility requirements and related rules.

By establishing a telephone line to answer questions about the EITC, the IRS would further the provisions in the Taxpayer Bill of Rights that taxpayers have "The Right to Quality Service," "The Right to Be Informed," "The Right to Pay No

¹⁹ During 2016, the IRS received nearly 137 million tax returns by April 22 and nearly 153 million by December 30, indicating that nearly 16 million returns were received after the filing deadline. See IRS Filing Season Statistics (weeks ending April 22, 2016, and December 30, 2016).

²⁰ IRS, JOC, *Snapshot Reports: Product Line Detail, Installment Agreement/Balance Due* (week ending April 22, 2017).

²¹ See IRS, *2016 Data Book* 23 (Table 9a).

More Than the Correct Amount of Tax,” and “The Right to a Fair and Just Tax System.”

VI. The IRS Should Serve Taxpayers Without Appointments at Its Taxpayer Assistance Centers.

The IRS operates nearly 400 Taxpayer Assistance Centers (TACs). In the past, the IRS has served more than five million taxpayers each year in the TACs, and it provided a wide range of services, such as assisting with tax return preparation and answering tax-law questions. Historically, the TACs were known as “walk-in” sites. But this year, the IRS has flipped its traditional approach toward serving taxpayers on its head, requiring that taxpayers schedule appointments in advance to receive service.²²

The IRS says that taxpayers are visiting the TACs less frequently because when they call for appointments, telephone assistants are often able to address their questions, obviating the need to visit. To some degree, that is undoubtedly true. But many taxpayers with tax problems still want to talk with an IRS employee face-to-face. If the IRS’s current trend continues, taxpayers soon may not have that opportunity. The IRS has already reduced the number of TACs from 401 to 376 since 2011.²³ In addition, 22 TACs have no staff, while 95 have only one employee,²⁴ and the IRS is considering closing a significant number of additional TACs through fiscal year 2018. Because of its new “appointment only” policy, the IRS is projecting that the number of taxpayers visiting a TAC will decline from about 5.6 million in fiscal year 2015 to 3.5 million this year.²⁵

I am concerned that the IRS will cite the reduced number of taxpayers served in the TACs as “evidence” of reduced taxpayer demand and then close more TACs, when in fact a key driver of the reduced number of taxpayers seeking services are the obstacles the IRS has created to obtaining service.

This has happened before. On several occasions, the IRS has made important services less accessible to taxpayers and then cited the (predictable) decline in usage as a basis for making further reductions or eliminating the services altogether. For example, the IRS prepared nearly 500,000 tax returns for taxpayers in fiscal year 2004.²⁶ Over time, it placed significant limitations on the number and type of returns employees could prepare, and it began to require advance appointments. As a result of making the service harder to obtain, the IRS prepared substantially fewer returns over time, reaching a low of about 125,000 during the 2013 filing season. The IRS then eliminated the service, citing low usage.

The same is true with answering tax-law questions in the TACs. The Government Accountability Office has reported the number of tax-law questions answered by the IRS during the filing season alone dropped from 795,000 in 2004 to 110,000 in 2013.²⁷ There is no evidence that taxpayers had fewer questions. Rather, the IRS reduced TAC staffing and reduced the scope of questions it was willing to answer, and wait times became unreasonably long. As it became harder and harder to obtain answers to tax-law questions, taxpayers became deterred from asking them. The IRS’s decision to restrict employees from answering tax-law questions in 2014 was based partly on this “reduced demand.”

The IRS should not take this approach to reduce TAC assistance. Taxpayers often travel long distances to get to a TAC, not knowing that advance appointments are required. Many are senior citizens. Turning these taxpayers away or requiring them to come back at a later date to receive service can cause tremendous inconvenience and frustration.

²² In response to complaints from TAS and others, the IRS has given TAC managers the discretion to make exceptions to the policy. But the general rule continues to require advance appointments.

²³ In 2011, the IRS operated 401 TACs. IRS response to TAS information request (December 23, 2014). As of December 31, 2016, the IRS operated 376 TACs, a reduction of six percent. IRS response to TAS fact check (December 20, 2016).

²⁴ IRS response to TAS fact check (December 20, 2016).

²⁵ IRS Wage & Investment Division, *Business Performance Review* 7 (February 9, 2017).

²⁶ See National Taxpayer Advocate 2014 Annual Report to Congress 3, 21 (Most Serious Problem: *Taxpayer Service: Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*) (and GAO data cited therein).

²⁷ GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (December 2013); GAO, GAO-07-27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (November 2006) (supplemented with more precise IRS data provided to TAS by the IRS Wage & Investment Division for 2004 through 2006).

I previously recommended that the IRS allow taxpayers to schedule appointments, and I am glad it is doing so. I realize that at times scheduled appointments will limit the IRS's ability to assist others. But the IRS should change its policies to direct the TACs to assist walk-in taxpayers to the maximum extent possible. All TACs currently have a large sign on their front doors declaring "APPOINTMENT ONLY." This is a negative message to send to taxpayers seeking assistance to comply with their tax obligations and have traveled sometimes long distances to obtain that assistance. How much better it would be if that sign instead read, "APPOINTMENTS RECOMMENDED BUT WALK-INS WELCOME."

By assisting all taxpayers who visit Taxpayer Assistance Centers for help, the IRS would further the provision in the Taxpayer Bill of Rights that taxpayers have "The Right to Quality Service" and "The Right to Be Informed."

VII. The IRS Should Expand Outreach and Education, Particularly to Small Businesses, to Improve Tax Compliance.

As a result of the IRS Restructuring and Reform Act of 1998,²⁸ the IRS created units of employees to conduct outreach and education to individual and small business taxpayers. The rationale is, in essence, that "an ounce of prevention is worth a pound of cure"—i.e., educating taxpayers about tax requirements in a pre-filing environment will improve return accuracy and reduce the need for (more costly) post-filing audits and other compliance actions. Pre-filing outreach and education is particularly important for small businesses, which often need to learn and comply with complex rules that individual taxpayers do not encounter, such as rules governing eligible business expenses, equipment depreciation, and employment taxes. Yet the IRS has whittled down these outreach units to the point where they are barely functional.

The IRS dedicates only 365 employees to conduct outreach and education to the nearly 125 million Wage and Investment taxpayers (i.e., taxpayers who are classified as "employees") and only 98 employees to conduct outreach and education to the roughly 62 million Small Business and Self-Employed taxpayers (i.e., taxpayers who are self-employed or own small businesses). In fact, 14 States have no IRS liaisons to small business taxpayers at all.²⁹ By contrast, even after the workforce reductions of the last few years, the IRS has more than 8,800 revenue agents (who conduct field audit activities) and more than 3,000 revenue officers (who conduct field collection activities).³⁰ Having at least one employee with a post of duty in each State and responsible for the field outreach and education activities in that State would ensure such activities are geared to the economy, businesses, geography, and culture of that State.

The IRS should do more to educate taxpayers about tax requirements in a pre-filing environment both because it is the right thing to do and because it likely will reduce the need for more expensive compliance activities in a post-filing environment.

By expanding outreach and education, the IRS would further the provision in the Taxpayer Bill of Rights that taxpayers have "The Right to Be Informed."

VIII. The IRS Should Assign At Least One Appeals Officer and One Settlement Officer to Every State.

Congress has long recognized that "all taxpayers should enjoy convenient access to Appeals, regardless of their locality."³¹ As a result, Congress required the IRS, among other things, to "ensure that an appeals officer is regularly available within each State."³² Yet today, the IRS reports that 12 States do not have either an Appeals Officer or a Settlement Officer.³³ That should change.

²⁸ Public Law No. 105–206, 112 Stat. 685 (1998).

²⁹ The 14 States are Alaska, Delaware, Hawaii, Kentucky, Mississippi, Montana, North Dakota, Nebraska, New Hampshire, South Dakota, Vermont, West Virginia, Wisconsin, and Wyoming. There also is no liaison in the District of Columbia. IRS response to TAS fact check (Dec. 15, 2016); IRS Human Resources Reporting Center, *Report of Small Business/Self-Employed (SB/SE) Job Series 0526, Stakeholder Liaison Field Employees as of the week ending October 1, 2016* (December 1, 2016).

³⁰ IRS response to TAS fact check (December 16, 2016).

³¹ S. Rep. No. 105–174, at 92 (1998).

³² Internal Revenue Service Restructuring and Reform Act, Public Law No. 105–206, Title III, Subtitle E, § 3465(b), 112 Stat. 685, 768 (1998).

³³ An Appeals Officer conducts hearings when a taxpayer challenges an IRS audit determination. A Settlement Officer conducts collection due process (CDP) hearings. It is important that

The IRS has suggested in the past that requiring an Appeals Officer and a Settlement Officer in each State would be costly. We do not agree. Placing at least one Appeals Officer and one Settlement Officer in each State would not require more Appeals personnel. It would simply require the IRS to relocate a small number of Appeals personnel currently posted in large IRS campuses to States with no Appeals Officers or Settlement Officers, which can be accomplished through attrition hiring.

The IRS has also suggested that virtual conferences or circuit riding is sufficient. We do not agree with those contentions, either. In many cases, it would be impossible for an Appeals Officer to judge the credibility of a witness without an in-person conference, and “circuit riding” does not happen often, requiring taxpayers to wait months, or even a year or more, to obtain a face-to-face hearing. Moreover, while virtual conferences may be suitable in many situations, having an Appeals Officer and a Settlement Officer reside in a State would ensure the particular conditions, economy, and culture of the State are understood, which can be relevant to a taxpayer’s tax situation and ability to pay.

By placing an Appeals Officer in each State, the District of Columbia, and Puerto Rico, the IRS would comply with the congressional directive and further the provisions in the Taxpayer Bill of Rights that taxpayers have “The Right to Challenge the IRS’s Position and Be Heard,” “The Right to Appeal an IRS Decision in an Independent Forum,” and “The Right to a Fair and Just Tax System.”

IX. The IRS Should Mail Monthly Bills to Taxpayers Who Owe Money, as Private Sector Businesses Routinely Do.

Most businesses, particularly large businesses, send bills at least monthly to customers who owe debts. The IRS does not. After sending taxpayers four notices, the IRS largely disappears. By statute, the IRS is required to send taxpayers an annual statement,³⁴ but that is often all it does unless and until it chooses to work the case or assigns it to a private collection agency, which often does not happen for several years. Moreover, when a tax debt is sent to a private collection agency, up to 50 percent of the taxes collected are diverted from the public treasury to the private collection agency and the IRS. Conversely, when the IRS receives payments in response to an IRS notice, 100 percent of the taxes remitted go to the public fisc.

As a general matter, the first few bills a creditor sends generate more revenue than later bills. But later bills still generate revenue. (If businesses didn’t benefit from sending monthly bills, they would stop sending them.) For example, an individual who loses his job may experience financial hardship and fail to pay creditors for a period of time but then begin to pay off his debts when he obtains a new job. If he is receiving monthly bills from most creditors but has not heard from the IRS in nearly a year, the IRS’s “invisibility” is likely to mean he will prioritize paying off others creditors who are consistently making their presence known.

Government agencies frequently speak about adopting “best practices” from the private sector. Sending monthly bills to debtors is one “best practice” the IRS should adopt now.

By mailing monthly bills to taxpayers with tax debts, the IRS would further the provision in the Taxpayer Bill of Rights that taxpayers have “The Right to Be Informed.”

X. The IRS Should Assign a Single Employee to Work Complex Identity Theft Cases and Correspondence Examinations Where a Taxpayer Calls the IRS or Submits Documentation.

When a taxpayer is audited in person, a single IRS employee typically works with the taxpayer from start to finish. If the taxpayer has questions or needs to provide follow-up information, he knows whom to call. The employee is familiar with the taxpayer’s case, so the taxpayer does not need to start from scratch in every conversation. In addition, the employee is responsible for the timely and accurate resolution of the case.

When a taxpayer experiences an identity-theft problem or is subject to a correspondence audit (and about three-quarters of all individual audits were conducted via correspondence in fiscal year 2016), the IRS generally does not assign a single employee to work the case. In many cases, the taxpayer will not need to speak with an employee. But in other cases, the taxpayer may call several times—perhaps to

both Appeals Officers and Settlement Officers be available for face-to-face hearings and understand local economic conditions.

³⁴See IRC § 7524.

ask additional questions, to provide requested documentation, or to check on the status of his case.

I believe the IRS should assign a single employee to work a case when either (i) the taxpayer has an identity theft problem that involves more than one issue or more than one tax year or (ii) the taxpayer calls in response to a correspondence examination notice or submits documentation. If subsequent telephone calls are required, the taxpayer should be given the opportunity to speak directly with that employee whenever possible, and if the employee is not available, the taxpayer should be given the option of either leaving a message for the employee for a call-back or speaking with another available assistor.

Assigning cases to specific employees where a taxpayer calls or submits documentation should improve the taxpayer experience and improve case resolution.

By allowing taxpayers who have experienced identity theft or are undergoing correspondence audits to work with a single IRS employee, the IRS would further the provision in the Taxpayer Bill of Rights that taxpayers have “The Right to Quality Service” and “The Right to a Fair and Just Tax System.”

XI. The IRS Should Reduce the False Positive Rates Produced by Its Identity Theft and Anti-Fraud Filters.

The IRS has made considerable progress in combating stolen identity refund fraud, and it deserves credit for doing so. However, the filters it uses to identify suspicious returns have high false positive rates. Notably, the filters used in the Taxpayer Protection Program, the primary set of filters for identity theft cases, had a false positive rate of 53 percent in 2016, and so far in 2017, the rate has risen to 60 percent as of July 5. That means the majority of returns stopped by the filters have turned out to be legitimate.

High false positive rates can impose a significant burden on taxpayers whose returns are frozen. The significant majority of taxpayers receive refunds, and the average refund amount in 2016 was \$2,860.³⁵ When the IRS stops a return due to suspicion of identity theft, it often requires the taxpayer to prove his or her identity, and that process can take several months. Thus, in addition to the time taxpayers must spend proving their identities and the frustration they experience in having to do so, they must wait extended periods of time to receive their refunds. For some taxpayers, this delay can cause a financial hardship.

In using filters to combat identity theft, the IRS must balance the twin goals of blocking as many illegitimate returns as possible and minimizing the number of legitimate returns it stops. The IRS has made major strides in blocking bad returns, but it can and should do a better job of refining its filters to stop fewer valid returns. In the National Taxpayer Advocate’s 2016 Annual Report to Congress, we published a “Literature Review” of the various approaches taken to minimize false positive rates in government, the military, and business. We also made several recommendations to reduce the false positive rates produced by the IRS’s filters, but the IRS has not agreed to adopt them.

I recommend the IRS undertake a study before the 2018 filing season, in conjunction with my office, to identify best practices to reduce false positive rates and describe what steps it will take toward that end. This report should be shared with this Committee.

By reducing the false positive rates in its identity theft and anti-fraud filters, the IRS would further the provision in the Taxpayer Bill of Rights that taxpayers have “The Right to a Fair and Just Tax System.”

ADDITIONAL COMMITTEE QUESTIONS

Senator CAPITO. If there are no further questions, the hearing record will remain open until August—Wednesday, August 2, at noon for subsequent questions from the subcommittee Members who can submit statements and questions to the witnesses for the record.

[The following questions were not asked at the hearing, but were submitted to the Department of the Treasury and the Internal Revenue Service for response subsequent to the hearing:]

³⁵ See IRS, *2016 Filing Season Statistics* (week ending December 30, 2016).

QUESTIONS SUBMITTED TO HON. STEVEN T. MNUCHIN

QUESTIONS SUBMITTED BY SENATOR SHELLEY MOORE CAPITO

Question. Mr. Secretary, as you know, the National Association of Insurance Commissioners (NAIC) will consider in August 2017 a proposal to require a new, additional Risk Based Capital charge for all types of insurance, on top of the existing State Risk Based Capital formulas. Does the Treasury Department have a position on this proposal, and has it been conveyed to global regulators and the NAIC?

Answer. Treasury does not currently have a view regarding the additional operational risk charge that was added to the NAIC Risk Based Capital formula by the Capital Adequacy (E) Task Force at the 2016 NAIC Spring National Meeting. Treasury is reviewing the additional operational risk charge. Treasury, through the Federal Insurance Office, continues to engage with stakeholders, including State insurance regulators and the NAIC in order to further evaluate this issue and to ensure appropriate coordination and consultation.

Question. Does the Department of Treasury believe that new Risk Based Capital requirements are necessary, especially considering the unique nature of U.S. health insurance markets? If so, can you provide a report to the Committee detailing this evidence?

Answer. Treasury does not currently have a view regarding the additional operational risk charge that was added to the NAIC Risk Based Capital formula by the Capital Adequacy (E) Task Force at the 2016 NAIC Spring National Meeting. Treasury is reviewing the additional operational risk charge. Treasury, through the Federal Insurance Office, continues to engage with stakeholders, including the State insurance regulators and the NAIC, to evaluate the issue and to ensure appropriate coordination and consultation.

Question. Is the Department of Treasury aware of any justification for this new, additional risk charge, since the current Risk Based Capital calculations consider all elements of risk such as underwriting?

Answer. Treasury does not currently have a view regarding the additional operational risk charge that was added to the NAIC Risk Based Capital formula. At this time, Treasury would refer you to the NAIC's public justification for the operational risk charge, available at http://www.naic.org/documents/cmte_e_capad_2016_13_0.pdf. An August 2017 NAIC newsletter summarizing the operational risk charge and its status is available at: http://www.naic.org/documents/cmte_e_capad_hrbc_1708.pdf.

Question. Will the Department of Treasury ask the NAIC how operational risk has been quantified under this proposal, and specifically what methodology and data was utilized? Did the NAIC use comparisons from other countries with vastly different healthcare systems to arrive at its conclusions?

Answer. Treasury, through the Federal Insurance Office, continues to engage with stakeholders, including the State insurance regulators and the NAIC, to assess the issue and to ensure appropriate coordination and consultation.

Question. Similarly, will the Department of Treasury ask the NAIC if they accounted for the fundamental differences in the health insurance business compared to other insurance markets such as life and property and casualty?

Answer. Treasury, through the Federal Insurance Office, will continue to engage with stakeholders, including the State insurance regulators and the NAIC, to assess the issue and to ensure appropriate coordination and consultation.

Question. Will the Department of Treasury ask the NAIC to examine the effects on the business of health insurance from this proposal before it is considered in August 2017, in order to avoid disruption in America's health benefits markets?

Answer. Treasury, through the Federal Insurance Office, will continue to engage with stakeholders, including the State insurance regulators and the NAIC, to assess the issue and to ensure appropriate coordination and consultation.

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER A. COONS

OFR AND FSOC

Question. One of the "core principles" established in President Trump's Executive order on regulating the financial system is "to foster economic growth and vibrant financial markets through more rigorous analysis on risk and market failures"—yet the budget proposes a 25 percent cut for the very entity that was established to conduct that research, the Office of Financial Research. Similarly, the Treasury report submitted in response to that Executive order calls for an expansion in the role of

the Financial Stability Oversight Council (FSOC) to better coordinate financial regulators, but the budget cuts its funding by 8 percent.

What is your vision for the roles of FSOC and OFR, and how does this budget support their mission for financial stability in the US economy?

Answer. The estimates for the Financial Stability Oversight Council (FSOC) and the Office of Financial Research (OFR) included in the President's 2018 budget are consistent with accomplishing the important missions of both entities in an efficient and effective manner. In Treasury's June 2017 review of the regulatory framework for the depository sector, Treasury recommended that Congress expand FSOC's authority to play a larger role in the coordination and direction of regulatory and supervisory policies. This can include giving it the authority to appoint a lead regulator on any issue on which multiple agencies may have conflicting and overlapping regulatory jurisdiction. Treasury also recommended that Congress reform the structure and mission of the OFR to improve its effectiveness and to ensure greater accountability. The current Director of OFR has announced he will be stepping down by the end of 2017. Treasury has appointed an interim head of OFR to manage OFR until a new Director is nominated and confirmed by the Senate.

CYBERSECURITY

Question. As you explained in your testimony, one of your top priorities is cybersecurity, but the budget proposes a 43 percent reduction for the new cybersecurity enhancement initiative.

Do you believe the budget is requesting sufficient funds for this important purpose?

Answer. Yes. The Cybersecurity Enhancement Account (CEA) for fiscal year 2018 is funded at the President's budget request level of \$27 million, which is in addition to the \$47 million in multi-year money we received in fiscal year 2017. This funding was not enacted until May of 2017. Treasury is in the process of implementing a targeted set of strategic investments to improve its cyber defenses using these new resources. The large majority of the requested fiscal year 2018 funding is for operations and maintenance of the strategic investments initiated in fiscal year 2017.

Question. What is Treasury's role in improving cybersecurity across the financial sector, and what more can Treasury do on this issue?

Answer. Treasury's work through its Office of Critical Infrastructure Protection and Compliance Policy depends on partnerships with various stakeholders, including private sector institutions and industry groups, and other government entities to enhance the security and resilience of the U.S. financial services sector.

Treasury works closely with the Department of Homeland Security, law enforcement, Federal and State financial regulators through the Financial and Banking Information Infrastructure Committee (FBIIC), and the private sector to reduce cybersecurity risk to the financial sector. This work includes, for example, sharing cybersecurity information, enhancing the baseline cybersecurity protections, and supporting incident response and recovery efforts.

FBIIC serves as a venue for coordinating approaches among agencies with different statutory authorities, and Treasury believes that FBIIC should be the focal point to drive domestic regulatory harmonization efforts. Within FBIIC, Treasury has supported efforts to promote the National Institute of Standards and Technology (NIST) Cybersecurity Framework as a common lexicon for regulatory agencies to incorporate into their supervisory efforts; to expand and complete efforts to map existing regulatory guidance to reflect and incorporate appropriate elements of the Framework; and to advance work as to whether cybersecurity examinations could be further coordinated.

Internationally, Treasury has also encouraged further collaboration and partnership through the G-7 Cyber Experts Group in the financial area.

Treasury is dedicated to working with the private sector and regulators and coordinating with other government agencies to improve the cybersecurity posture of the financial sector.

DEBT CEILING

Question. As you know, the United States reached the debt limit in March and is now using extraordinary measures to avoid default.

Do you agree that allowing the Government to default on its debts is a terrible idea that would have significant consequences for our markets and economy?

Answer. Honoring our outstanding debt is critical. Failing to meet the Government's obligations could jeopardize the U.S. credit rating and have serious ramifications for the U.S. economy as a whole.

Question. Do you agree that even the threat of a default has the potential to have costly implications for the U.S. Government and undermines our credibility?

Answer. Recent debt limit impasses have drawn increased scrutiny from market participants as the date approaches when extraordinary measures are projected to be exhausted. Some market participants avoid holding Treasury securities (including collateral) with maturity or interest payment dates within close proximity to such projected dates. Additionally, a debt limit impasse can necessitate that Treasury draw down its operating cash balance to below prudent levels, leaving Treasury with increased risk exposure to a loss of market access.

Question. As Treasury Secretary, do you think it is good fiscal stewardship to be engaging in a pattern where every year or 18 months Congress manufactures a debt-ceiling showdown that leads to questions about whether we'll pay our debts?

Answer. We need to issue debt to pay for the expenditures that Congress has already authorized. Congress should address its concerns during the annual budget and appropriations process, not after it has already authorized expenditures.

Question. What are you doing to ensure that the limit is lifted as soon as possible?

Answer. Throughout the most recent debt limit impasse, I worked with Members of Congress on both sides of the aisle to ensure that the debt ceiling was raised in a timely manner. On September 8, 2017, the President signed into law Public Law 115-56, which suspended the statutory debt limit through December 8, 2017. This will continue to be a priority, and I will continue to reach out to Members as needed to address any debt limit impasses that may occur in the future.

TAX REFORM

Question. Since I first arrived in the Senate in 2010, I have strongly supported tax reform that lowers rates, supports innovation, and simplifies the code. Most of my colleagues share this view as well. President Trump continues to advocate for tax reform, however much like healthcare reform, I'm concerned that this may be another attempt to make major policy changes without bipartisan engagement.

Will you commit to work with Democrats to develop and advance a tax reform package that is bipartisan?

Answer. I have long said that the administration's hope is for the tax reform process to be bipartisan. I am committed to continuing to work with Congress and other stakeholders to accomplish the administration's priority of creating a tax system that is fair, simple, and efficient and that puts Americans back to work and puts America first.

Question. Would you support advancing reform through regular order (rather than reconciliation)? I stand ready to work with you, President Trump, and my Republican colleagues to advance bipartisan tax reform.

Answer. Tax reform has been my number one priority since I was appointed to serve as Secretary of the Treasury. This is the most important issue for the American economy. I am committed to using whatever means necessary to reform our tax system so that it better serves and supports the American people.

FISCAL SERVICE & WASTEFUL PAYMENTS

Question. Through Treasury's Fiscal Service, the department issues payments and collects debt for nearly all other Federal agencies—processing millions of dollars every day. Treasury has the ability to reduce costs across the Federal Government by improving these payment and collection systems, to reduce wasteful, improper payments and catch fraud before it happens. In fact, Treasury's Do Not Pay Center identified and prevented over \$25 million in improper payments. Yet, the budget proposes to eliminate funding for these types of investments in the Fiscal Service, including addressing specific weaknesses identified in the financial audit and known critical system weaknesses.

Are you concerned that eliminating these small investments now could result in greater costs in future years?

Answer. From October 2014 through June 2017, the Do Not Pay Business Center (DNP) has assisted agencies in identifying or stopping \$116 million in improper payments. Of this amount, almost \$59 million was identified or stopped during fiscal year 2016.

Treasury is confident that it can continue to address improper payments at the funding level in the President's 2018 budget. Instead of additional funding, DNP could be a more effective tool in addressing improper payments if Treasury has explicit legislative authority to obtain additional data sources. For example, Treasury, working with the Office of Management and Budget and the Social Security Administration, has sought explicit legislative authority to acquire and use for DNP the Social Security Administration's full death file to prevent, identify, or recover im-

proper payments. This data source contains at least 10 percent more death records than the public Death Master File to which Treasury currently has access. An amendment to the Social Security Act to allow Treasury to use the full death file for DNP would improve the timely detection and prevention of payments to deceased individuals. Treasury has also sought explicit authority to acquire access to the Department of Health and Human Services' (HHS) National Directory of New Hires for DNP. This HHS data source would increase the efficiency and effectiveness of DNP efforts to prevent and detect improper payments in means-tested programs.

Question. What do you believe is Treasury's responsibility over the payments it makes for other Federal agencies?

Answer. Treasury's Bureau of the Fiscal Service (Fiscal Service) is responsible for the centralized disbursement of almost 87 percent of the Federal Government's payments to businesses, government entities, and individuals throughout the world. In fiscal year 2016, the Fiscal Service disbursed more than 1.2 billion payments, on behalf of Federal agencies. These disbursements totaling \$3.3 trillion included Social Security, Veterans' benefits, and income tax refunds to more than 100 million people, vendor and loan payments supporting businesses; grant monies; and State funding for critical infrastructure projects and State-administered programs.

The Fiscal Service has established a robust set of internal controls and data-centric electronic tests throughout the payment lifecycle. The Fiscal Service controls and provides financial integrity to the Federal payment process, including through its support of the DNP Program, which helps agencies identify, prevent, and recover improper payments, as well as through its post-payment activities, such as reconciliation, accounting, claims activities, and the support of law enforcement actions against criminals who have defrauded the Government. Fiscal Service employs various techniques to protect the payment system from direct deposit enrollment fraud and identity theft fraud, preventing fraudsters from misdirecting Social Security, Veterans', and other benefit payments.

In fiscal year 2016, Treasury processed 6 million "exceptions" to the payment process so that monies erroneously paid to deceased individuals were recovered; payee claims of non-receipt were processed; stale uncashed checks were cancelled; misdirected electronic payments were returned; and checks returned in the mail were properly safeguarded with the funds redirected to the correct payee address or held safely in the U.S. Treasury. In addition, Fiscal Service supports inspectors general, Federal prosecutors, and State and local law enforcement agencies in the investigation and prosecution of criminals engaged in fraud related to the Treasury payment system. In fiscal year 2016, this collaboration resulted in 107 arrests, 83 convictions, and \$24 million recovered through fines, restitution, and seizures.

IRS REPORTING REQUIREMENTS

Question. In November 2016, the IRS issued Internal Revenue Notice 2016-66. There have been numerous complaints that this notice imposes burdensome and duplicative information reporting requirements on 831(b) Captives, their owners and, in some cases, even their service providers.

Will Treasury commit to carefully reexamine the requirements imposed by this Notice, including meeting with small and medium-sized businesses that are impacted by new reporting requirements to understand their concerns?

Answer. The IRS issued Notice 2016-66 late last year to identify certain micro-captive transactions as transactions of interest because they have the potential for tax avoidance or evasion. As you note, the notice requires disclosure from participants in the identified transactions and their material advisors. These disclosures allow the IRS to gather information to determine which transactions are or have the potential to be abusive tax avoidance transactions. We have begun to evaluate the information we have received in these disclosures to determine what steps are appropriate as we work toward addressing potential tax abuse in this area.

To minimize the burden of the disclosure requirements, we carefully crafted the objective criteria in Section 2 of Notice 2016-66, which describes the micro-captive transactions that are subject to disclosure. Specifically, we require disclosure only if an insured entity or a related party owns at least 20 percent of an electing section 831(b) captive insurance company, and the captive insurance company either has a loss ratio of less than 70 percent for the most recent 5-year period or makes the captive insurance company's capital available to the insured entity or a related party.

We requested comments from the public about the notice and received 27 comments and six congressional inquiries, including this question. In addition, we met with those who requested meetings and responded to telephone calls regarding the

notice. Subsequently, the United States Tax Court issued its first decision on a micro-captive transaction challenged by the IRS (*Avrahami v. Commissioner*, 149 T.C. No. 7, filed August 21, 2017), concluding that the entity purported by the taxpayers to be a micro-captive insurance company was not an insurance company and that payments made to that entity did not qualify as insurance premiums. We will continue to evaluate the disclosures received and developments in this area.

QUESTIONS SUBMITTED BY SENATOR JOE MANCHIN, III

CFIUS

Question. I appreciate the Trump administration's commitment to the security of our Nation. However, there are many facets that comprise the security of a nation.

You have under your oversight, the Committee on Foreign Investment in the United States (CFIUS). As you know, this Committee examines the national security implications of certain foreign investment transactions. This usually involves critical infrastructure, proximity to national security assets, or sensitive trade secrets.

The Committee looks at various factors when determining if a transaction is passable, however they are somewhat constrained by law from doing what is necessary to complete their mission. For example, though CFIUS may review any foreign investment, CFIUS reviews are largely initiated on a voluntary basis by the foreign company.

In addition, they are constrained by making decisions purely on the basis of "national security." I would argue that the economic security of our Nation is critical as well.

Do you think that these constraints are troubling, or do you think the existing structure of CFIUS is adequate to ensure that the national security of the United States is protected from troubling foreign investment, especially from an adversary?

Answer. CFIUS is a robust process to address potential national security risks arising from foreign acquisitions of U.S. businesses. The statute already provides CFIUS with broad authority to determine whether transactions pose a national security risk, including whether the economic effects of a transaction pose a national security risk. Maintaining CFIUS' nexus to national security is critical; expanding CFIUS beyond national security could dilute the effectiveness of CFIUS in addressing national security risks.

While the CFIUS process is voluntary, the Committee is not solely dependent upon parties to a transaction voluntarily notifying transactions to CFIUS. The CFIUS statute allows the Committee to unilaterally initiate a review of any covered transaction. CFIUS agencies monitor mergers and acquisitions activity to identify transactions that have not been voluntarily notified to CFIUS and consider whether the transactions may present national security considerations that warrant CFIUS review.

However, there are certain steps that can be taken to enhance CFIUS' ability to address national security concerns posed by certain types of transactions. For example, CFIUS should have the ability to review certain additional types of joint ventures that could raise national security concerns. We are prepared to work with Congress to ensure that CFIUS has the necessary and appropriate tools to address these concerns.

FOLLOWING THE OPIOID MONEY

Question. As you know, West Virginia has been reeling from the opioid and heroin epidemic for a number of years. I have been working with FDA, NIH, DEA, CDC, and DOJ to ensure that they are making combatting opioids, especially in rural underserved areas, a priority in their programs and plans.

The Congress has allocated a lot of money to treatment and criminal justice, but I believe we also need to be focused on cash flow that supports the distribution and trafficking of the illegal uses of opioids and heroin.

We need your help to cut off the supply and financing of these drug operations.

What is Treasury doing to track the money that is flowing through the economy as a result of these illicit opioid and heroin sales? Has the Financial Crimes Enforcement Network (FinCEN) been involved or well positioned to play a role in this effort?

Answer. Financial Crimes Enforcement Network (FinCEN) has exploited keywords, typologies, and known trafficking networks to analyze and expand upon fintech-related financial flows in Bank Secrecy Act data. FinCEN is leveraging known precursor providers and opioid traffickers to identify trafficking networks,

characterize trends and behavior patterns, and pinpoint nodes of vulnerability. We are identifying the typical cost/payment structure of fentanyl-associated transactions and what sets these transactions apart from the trafficking of other drugs. FinCEN is paying particular attention to financial flows between regions in the United States, China, Mexico, and the Dominican Republic. FinCEN has also identified potential drug traffickers marketing overtly and covertly online. These traffickers deal in virtual currencies and online payment methods and falsely label illicit drugs as “research chemicals” in an attempt to avoid detection. FinCEN shares the results of its analysis with interagency and international counterparts.

Question. Are you working with the DEA and DOJ to track illicit financing of the drug trade?

Answer. The Department of the Treasury’s Office of Terrorism and Financial Intelligence works closely with both DEA and DOJ to track illicit financing of the drug trade of both domestic and international organizations. For example, the Office of Foreign Assets Control (OFAC) works closely with DEA and DOJ to implement the Foreign Narcotics Kingpin Designation Act and administer other authorities. OFAC, DOJ, and DEA conduct joint investigations, which have allowed OFAC sanctions investigators to build designation packages and DEA special agents to carry out criminal cases simultaneously. These joint investigations uncover foreign individuals and entities engaged in the laundering or investment of drug proceeds. These discoveries in turn can lead to OFAC sanctions, DOJ criminal cases, and further joint investigations into other entities and individuals. In one instance in 2015, the DEA Denver Field Division and the U.S. Attorney’s Office for the District of Colorado charged Mexican heroin trafficker Jose Luis Ruelas Torres with running a Continuing Criminal Enterprise, along with related narcotics trafficking and money laundering offenses. OFAC subsequently worked with DEA Denver agents, which led to the May 2017 identification of Ruelas Torres and his criminal organization as Tier I Kingpins along with a network of key criminal associates. These collaborative investigative efforts allow for the U.S. Government to not only target U.S.-based drug trafficking activities but also use financial sanctions to disrupt the efforts by foreign drug traffickers to invest their drug proceeds and use their investments to fund future drug shipments.

Additionally, FinCEN assists in large-scale DEA investigations through a number of initiatives, including detailing an analyst to DEA’s Special Operations Division. The collaboration provides assistance in large-scale DEA investigations and fosters strategic and tactical information exchange. For instance, FinCEN provides bulk data access to the Organized Crime Drug Enforcement Task Force Fusion Center, and has convened public-private information sharing meetings regarding information requests made pursuant to Section 314(a) of the USA PATRIOT Act in support of DEA money laundering investigations. FinCEN also provides training to DEA analysts and agents regarding illicit finance. To further facilitate close FinCEN–DEA collaboration, the DEA Headquarters/Financial Operations Section has assigned a full-time detailee to both the FinCEN and OFAC portfolios to support these efforts as well as counter-illicit finance, counter-narcotics, and other mission areas of mutual concern.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS (CDFIS)

Question. In my State of West Virginia, community development financial institutions (CDFIs) are critical in filling a large need that just isn’t met in many rural areas. For example, Woodlands Community Lenders (WCL) in Elkins, West Virginia has leveraged in both public and private financing at a 10:1 ratio. Since Woodlands Community Lenders’ inception in 2013, they have financed over 50 new and expanding small businesses, leveraging in a total of \$4.6 million in outside investment, supporting over 100 jobs in our 3-county region.

WCL provides loans, business development services, and finance packaging for small businesses that are otherwise “unbankable.” WCL takes an alternative approach to assessing and mitigating risk, allowing it to support small business development in ways that traditional lenders often cannot.

The administration’s budget zeroes out the CDFI Financial Assistance Program.

Question. If these programs are eliminated, what do you believe the will be on rural areas utilizing this program?

Answer. The budget eliminates discretionary grant funding for the CDFI Fund to reflect the administration’s priority to support fiscal responsibility and to focus resources on activities that promote national security and public safety. However, the budget provides funding for the CDFI Fund to continue to operate the non-grant programs, which provide support for CDFIs and other community organizations

lending and investing in economically-distressed communities across the country, including those in rural areas.

The Budget also proposes to extend the Bond Guarantee Program to allow \$500 million in new guarantees in fiscal year 2018. This program provides capital to CDFIs, at no cost to the taxpayer.

Question. How will Treasury ensure that the critical capital injections needed to support the transitioning economies in West Virginia continue?

Answer. I will work with the team at Treasury to be sure that all CDFI Fund programs are operating consistent with all applicable laws, rules, and administration policies.

Question. Has Treasury explored any special initiatives or technical assistance programs to build capacity of CDFIs serving coal communities?

Answer. Treasury would be happy to work with your office to preserve access to low-cost capital in coal-impacted communities.

CYBERSECURITY

Question. Recent estimates have found the cost of criminal data breaches will cost global businesses \$8 trillion over the next 5 years. I continue to believe that a comprehensive approach to cybersecurity best practices is necessary to properly work towards preventing, detecting, and responding to cyberattacks.

I applaud efforts to centralize cybersecurity leadership within Treasury to work collaboratively and transparently to protect critical financial infrastructure. While cyberattacks have grown exponentially, I am concerned that investments made in cybersecurity capabilities will not keep up with the threat.

Beyond threat sharing, how can you work with small, rural institutions to implement best practices and make these investments in cybersecurity where necessary?

Answer. I cannot emphasize enough the importance of a public-private partnership when it comes to our Nation's cybersecurity, especially because the private sector owns and operates the bulk of the critical infrastructure that Treasury and others in Government seek to help protect. It is also critically important to highlight that Treasury's cybersecurity mission is designed to support not just large financial institutions, but also the smaller financial sector companies that are the primary interface with the financial system for millions of Americans.

Treasury works on a regular basis to assist all financial sector companies large and small by encouraging the use of baseline protections, assisting with response and recovery activities, and facilitating information sharing. Treasury does this work in close partnership with the Department of Homeland Security, the Federal Bureau of Investigation, financial regulators, and industry groups such as the Financial Sector Information Sharing and Analysis Center.

A great example of this work is the Hamilton Exercise Program. Over the past 2 years, Treasury has carried out regional cybersecurity exercises focused specifically on smaller financial sector companies. These exercises are an opportunity for firms to practice incident response procedures, share and refine good practices, and develop stronger connections with similar firms in their communities. This program, and others like it, benefits smaller firms, which are a key component of our financial sector.

STATE SMALL BUSINESS CREDIT INITIATIVE

Question. West Virginia found great success with the State Small Business Credit Initiative (SSBCI) program created under the 2010 Jobs Act. New companies were able to launch and existing companies were able to expand. Those activities created jobs, helped to retain jobs and fostered private investment.

The \$13 million West Virginia received created and/or retained almost 1,000 jobs and fostered over \$90 million in private investment. WV's success was not the only successful State in the program. West Virginia and other States in Appalachia have not seen the economic recovery that other parts of the country have seen. The SSBCI program allows these struggling States to help diversify their economies, grow jobs and foster entrepreneurship. However, the President's budget eliminated this program for fiscal year 2018.

Given the success seen by West Virginia and other States that lack access to business capital, would it be beneficial to continue to fund programs such as SSBCI?

Answer. The SSBCI was created by the Small Business Jobs Act of 2010 to support State-level small business financing programs to improve access to capital in the wake of the Great Recession. As set forth in the original statute, Treasury's administration of SSBCI ended in September 2017. SSBCI funds will remain with the States to be recycled to support more small businesses over time.

MARKETPLACE FAIRNESS

Question. I believe that restoring fairness in the tax system is one of the most important things we can do to set this Nation on a strong financial path, improve our economy, and get people back to work. Businesses, no matter how they sell their goods, should compete on a level playing field.

Over the last 25 years, brick-and-mortar businesses in West Virginia and around the United States have found it increasingly difficult to compete against out-of-state online retailers who offer lower prices because they can avoid charging sales tax. This imbalance is unfair to the hard-working small business owners who support our communities and create good, local jobs.

Products ordered online are delivered to your door using the airports, roads, and bridges often funded by State tax dollars.

Do you believe brick-and-mortar retailers in West Virginia should be the only businesses funding State infrastructure, while their out-of-state competitors take advantage of that infrastructure to put them out of business?

Answer. Fairness and equity are important principles in evaluating tax reform proposals, along with simplicity and the impact of the proposal on economic efficiency and growth.

QUESTIONS SUBMITTED TO HON. JOHN KOSKINEN

QUESTIONS SUBMITTED BY SENATOR THAD COCHRAN

Question. Commissioner Koskinen, in your opening statement you mentioned that the Internal Revenue Service (IRS) is gradually transitioning towards online services to assist citizens. Many of my constituents do not have access to computers or broadband service, especially in rural areas of Mississippi. What is the IRS doing to ensure taxpayers are not adversely affected by the IRS's focus on online services? Please provide the Committee with data from the previous three fiscal years about the number of in person and phone interactions the IRS has conducted with taxpayers. Additionally, what is the average wait time for taxpayers to reach an IRS employee through in person visits or phone interactions? Does the IRS plan to transition to online services only? If so, please provide a timeline and details of such plan.

Answer. As we improve the online experience, we understand the responsibility we have to serve the needs of all taxpayers, whatever their age, income, or preferred method of communication. Although our research tells us that taxpayers increasingly prefer to interact with the IRS through digital channels, we recognize there will always be taxpayers who do not have access to digital services, or who simply prefer not to conduct their transactions with the IRS online.

Consequently, we remain committed to providing the services these taxpayers need. While we will continue to offer more web-based services, taxpayers will still be able to call our toll-free lines, write to us, or obtain in-person assistance, if that is how they want to interact with the IRS. In fact, we believe that providing more online services for those who want them will free valuable resources to allow us to further improve service on our other channels—phone, in person, and correspondence, particularly for those taxpayers with more complex issues.

The tables below provide the metrics requested for the previous three fiscal years.

WAGE AND INVESTMENT PHONES

	Fiscal Year 2014	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2017 through July
Average Wait Time	19 min	30 min	17 min	8 min
Total number of Calls Answered (assistor and automated).	63.9 million	55.7 million	63.8 million	47.3 million

TAXPAYER ASSISTANCE CENTERS

	Fiscal Year 2014	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2017 through July
Total Number of Face-to-Face Contacts.	5.5 million	5.4 million	4.4 million	2.8 million
Percent of customers waiting 30 minutes or less**.	75%	68%	73%	94%

** Beginning in 2015, we started offering service by appointment at a small number of Taxpayer Assistance Centers (TACs). In fiscal year 2017, all IRS TACs offered service by appointment.

Question. Commissioner, the understaffing and closure of Taxpayer Assistance Centers (TAC) has been a cause of concern for this Committee. In fiscal year 2017, this Committee directed the IRS to hold public forums and notify the Senate and House Committees on Appropriations before closing a TAC. Will you share with the Committee what the IRS is doing to analyze the impact of closing a TAC? Describe how the agency determines the impact in rural areas. What metrics is the IRS using when deciding to close a TAC? Describe the process that the IRS uses to notify communities of TAC closures.

Answer. To best use our resources and to meet the demand for services in our Taxpayer Assistance Centers (TACs), in 2015 we started offering service by appointment in a small number of locations. We received favorable taxpayer response, and expanded the pilot. In fiscal year 2017, all of our TACs offered service by appointment. As each traditional TAC location comes under review, we compile data to determine the most efficient methods to meet taxpayer face-to-face service needs. For example, we have a service strategy that considers items such as the services most requested by taxpayers at the TAC location, available staffing, proximity of the next closest TAC, availability of a partner to provide virtual assistance, availability of Voluntary Income Tax Assistance and Tax Counseling for the Elderly locations, and local demographic information.

If the IRS makes a tentative determination to change the method of providing service (either through moving the TAC location or changing from one service-delivery method to another—such as to virtual assistance provided by a community partner), we will invite taxpayers in the community to provide input in the decision-making process. Should the data and preliminary public comments suggest that face-to-face service is no longer required through any service channel, we would schedule a formal public hearing to obtain further public comment. We would follow the public hearing process with a report to oversight agencies, as requested in previous and current committee reports.

We routinely review locations to promote more efficient use of the Government's real estate assets and to comply with Executive Orders, OMB directives, Federal Acquisition Regulations administered by the General Services Administration, and congressional mandates regarding real estate. This review includes evaluating small, mid-size, and large posts-of-duty with a high percentage of vacant workstations, a high number of field-based employees, and space reduction projects initiated because of lease expirations, relocations, review of training space needs, and other reasons. During these reviews, we analyze taxpayer access to face-to-face service in the community and determine how to effectively meet taxpayer needs and preferences for service.

Question. Commissioner, I am pleased to hear that the number of tax-related identity theft has declined in the past 2 years. The Taxpayer Advocate Service has recommended that constituents with multiple identity theft issues be assigned one point of contact at the IRS to assist them until the resolution of their case. What is the IRS doing to help simplify assisting taxpayers affected by identity theft? Has the IRS taken this proposal into consideration? When does the agency plan to implement this proposal?

Answer. Our work on identity theft (IDT) and refund fraud touches nearly every part of the organization. Helping victims and reducing the time it takes to resolve cases is a top priority for the IRS.

During 2015, the IRS centralized IDT victim assistance policy, oversight, and campus case work into a new Identity Theft Victim Assistance (IDTVA) organization within the Wage and Investment (W&I) Division. IDTVA can work IDT cases from beginning to end, providing an improved taxpayer experience.

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, but for more complex

cases, resolution can take up to 180 days. This timeframe is substantially less than a few years ago, when cases could take over 300 days to resolve. While this change marks a significant improvement, we continue to look for ways to shorten this time and ease the burden IDT places on these taxpayers.

Whenever possible, the same employee processes multiple claims (often for multiple years) from the same taxpayer, to make sure there is consistent processing. In January 2015, the IRS developed automation to associate IDT documentation with existing IDT cases/category codes. In April 2016, we expanded the programming to include the association of documentation with new categories of work resulting from the centralization effort under the IDTVA organization.

Centralization of IDTVA work significantly affected our ability to resolve those cases more quickly. Since implementation, we resolve those cases in less than 120 days 75 percent of the time, compared to 34 percent prior to implementation.

Our toll-free hotline for IDT victims helps taxpayers reach a trained IDT specialist any time during business hours, without having to rely on the availability of a single IRS employee. Customer service representatives staffing this specialty line can review the taxpayer's case file and respond to the IDT victim's call. While we believe this approach provides the best possible experience for the victim, we are aware that sometimes the customer service representative cannot respond to the IDT victim's call. For these instances, beginning on August 1, 2017, we implemented a process for IDT victims to have direct contact with the employee working their IDT cases. The customer service representative will provide the IDT victim with a different toll-free number to call to directly contact the employee working his or her case. If the employee is unavailable to answer the IDT victim's call, the victim can leave a message for the employee, and the employee will return the victim's call within five business days. In addition, we expanded procedures to provide a single point of contact when a victim's case spans multiple years.

QUESTION SUBMITTED BY SENATOR JOHN BOOZMAN

Question. Commissioner Koskinen, I would like to discuss taxpayer services. There have been reports citing a continuing decline in the level of service that IRS provides to taxpayers, especially those who are victims of stolen identity refund fraud. Additionally, we have heard of increasing wait times for taxpayers contacting IRS, and a rise in the use of “courtesy disconnects”—hanging up on a customer after an excessive wait time. What has your office done to remedy this, and going forward, what plans does your office have to improve on customer service and taxpayer assistance?

Answer. We have had many notable achievements for 2017 in terms of improving the level of service provided to taxpayers on the calls the Wage and Investment (W&I) Division handles. Congress specifically appropriated additional funding to help the IRS improve customer level of service (LOS). This additional funding, along with effective planning and monitoring, allowed W&I toll-free phone operations to deliver a filing season telephone LOS of over 79 percent—the highest telephone LOS since 2007. This change is an increase over the 72.1 percent achieved in this same timeframe in 2016. The 2017 fiscal year LOS is at 76.7 percent through the beginning of August, a substantial improvement over the 53.4 percent in 2016. We are on pace to have the best fiscal year LOS in 10 years.

In the IDT 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, but for more complex cases, resolution can take up to 180 days. This timeframe is substantially less than a few years ago, when cases could take over 300 days to resolve. In addition, we continually improve our efforts to stop fraudulent refunds from being paid. For example, we have improved the filters that help us spot suspicious returns before we process them. The number of people reporting to the IRS that they were victims of IDT declined from 698,700 in calendar year (CY) 2015 to 376,500 in CY 2016—a 46 percent drop. This downward trend has continued into 2017.

	Taxpayer Assistance Toll-Free Line Fiscal Year LOS	Taxpayer Assistance Toll-Free Line Filing Season LOS
Fiscal Year 2007	82.08%	83.46%
Fiscal Year 2008	52.81%	77.41%
Fiscal Year 2009	70.02%	63.97%
Fiscal Year 2010	74.04%	75.28%
Fiscal Year 2011	70.07%	74.64%

	Taxpayer Assistance Toll-Free Line Fiscal Year LOS	Taxpayer Assistance Toll-Free Line Filing Season LOS
Fiscal Year 2012	67.55%	68.31%
Fiscal Year 2013	60.50%	70.12%
Fiscal Year 2014	64.39%	70.88%
Fiscal Year 2015	38.10%	37.28%
Fiscal Year 2016	53.43%	72.11%
Fiscal Year 2017		79.12%

Through April, filing season (FS) average speed of answer (ASA) (wait time) was 6½ minutes on the taxpayer assistance toll-free line. This wait compared to 11 minutes in FS 2016 and 23 minutes in FS 2015, and reflects a decrease of 16½ minutes. During this same period, disconnects (calls terminated due to a lack of system or assistor resources) were 834,000 compared to 1.3 million in FS 2016 and 8.8 million in FS 2015, a 90 percent (almost 8 million) decrease. Call volume was also a factor in delivering a higher LOS. By implementing robust communication and outreach strategies for filing season initiatives, the IRS successfully brought awareness to taxpayers and partners about key changes and programs, and equipped them to take any action needed timely. These efforts greatly diminished expected inquiries from taxpayers, media, and oversight resulting in reduced impact on operations and demand on customer service.

The IRS also provides telephone assistance to other groups of taxpayers, such as to taxpayers responding to a notice received in the mail. Those phone lines may provide a different level of service than the toll-free assistance line and reflect our resource challenges.

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER A. COONS

ELECTRONIC TAX RETURN FILING—BUSINESS RETURNS

Question. Over the past decade, the rate for electronic filing of individual tax returns grew exponentially from 54 percent in 2006 to 86.4 percent in 2016. In the recent 2017 filing season, 90 percent of individual returns were submitted electronically. In contrast, in 2016, only 50 percent of the nearly 30 million business returns were electronically filed. The IRS fiscal year 2018 budget justification indicates that the business e-filing target will increase to 51 percent for fiscal year 2017 and to 52 percent for fiscal year 2018.

- Can you elaborate on this phenomenon and explain what the IRS is presently doing or planning to do to improve the e-filing rate for business returns?
- Is there a rational basis for not setting more ambitious targets as an incentive to achieve a higher rate?
- Are there any particular advantages for a business taxpayer to file electronically?

Answer. Our greatest challenge to achieving e-file increases in business returns is the employment tax series (Form 94x). This family of forms represents the greatest overall volume of business forms, and therefore the greatest opportunity to increase overall e-filing of business returns. During the past seven filing seasons, the Form 94x series e-file rate has consistently seen the slowest or close-to-slowest growth of all major return types. In 2015, the IRS released a Federal Register request for comments on ways to increase the electronic filing of employment tax returns. The digital signature process was highlighted in the responses received as a key barrier to increasing e-file rates across these returns. We are evaluating the development of a Form 94x online signature preparer identification number (PIN). After removing this key barrier, we will pursue a means to offer free or low cost 94x e-file solutions with the goal of driving greater e-filing of this high-volume family of forms.

We process e-file returns faster and with fewer errors. For taxpayers, this means quicker refunds and less contact with the IRS. IRS e-file provides proof of receipt within 24 hours of sending returns to the IRS. Individuals and businesses can e-file balance due returns and schedule an electronic funds transfer (EFT) from their account for any date.

IMPACTS OF PROPOSED CUTS—DIMINISHED SERVICES FOR TAXPAYERS

Question. The Trump budget request for the IRS of \$10.975 billion is expected to take a toll on the ability of the IRS to respond to taxpayers' telephone calls. In the budget justification materials submitted to Congress, the IRS states that the resources made available in 2016 supported a 53.4 percent Level of Service (with a 72 percent level during filing season which included a seasonal workforce). For 2017, a target LOS of 64 percent is specified, with the most recent filing season achieving a 79 percent service level. But the IRS then projects a 39 percent target for 2018, even with a planned infusion of \$58 million in user fees to augment appropriated dollars.

- Commissioner Koskinen, providing access to quality customer service helps taxpayers understand their obligations so they can pay the right amount on time. It is important for me that hard working Delawareans are able to readily obtain assistance they need to act in good faith and pay the taxes they owe. That's why the 2018 service target of 39 percent deeply concerns me, particularly given that the IRS has, to its credit, made significant strides to turn around an abysmal level of service recorded for 2015, when only 38 percent of 100 million calls were answered and experienced an average waiting time of 30 minutes?
- Do you think it is acceptable to provide a level of service where as many as 6 of 10 callers will not likely be able to connect to an account representative or will be forced to spend inordinate amounts of time waiting on hold? As Commissioner, what do you consider to be an "acceptable" level of service for taxpayers calling on the toll-free phones?
- Is it conceivable that the IRS could ever achieve the level of service experienced in 2004 when the IRS answered 87 percent of phone calls with an assistant and waiting times averaged just 2.5 minutes?
- What amount of funding would the IRS require in fiscal year 2018 in order to sustain this year's results where there's a 64 percent general target and a 79 percent service level during the filing season?

Answer. I consider an acceptable level of service (LOS) to be approximately 70 percent or above. Delivering a LOS much higher than 80 percent can result in inefficiencies as our call site assistants could wait extended periods of time for the next call. Funding for Taxpayer Services is just one of many variables that influence the LOS. Call volume, often driven by external events such as the enactment of tax legislation, and the availability and reliability of IRS technology infrastructure, are other major factors the IRS would have to consider before committing to new targets.

COMBATING TAX SCAMS AND IDENTITY THIEVES

Question. In recent years, thousands of people have lost millions of dollars and their personal information to tax scams and fake IRS communication. Scammers use the regular mail, telephone, fax or email to set up their victims and regularly alter their tactics to perpetrate crimes in new ways. Even tax professionals are being targeted by identity thieves. On July 11, the IRS announced a new "Don't Take the Bait" awareness campaign aimed at tax professionals who may be vulnerable to sophisticated spear-phishing cybercrimes.

- What resources is the IRS devoting to fighting tax scams? Have successful prosecutions of scammers provided any measurable deterrent effect?

Answer. We have devoted significant resources to fighting tax scams and our work has had a measurable effect. The prosecutions by India and the United States resulted in a measurable drop in calls by scammers. Initially, the number of calls reported to TIGTA dropped from 40,000 a week to 1,000 a week. Unfortunately, the number of calls reported to TIGTA is creeping back up to 7,000 a week, indicating that we still have a problem.

The Criminal Investigation (CI) Division, specifically, continues to devote significant resources in the battle against Tax Related ID Theft. In fiscal year 2017, as of July 31, CI has dedicated 13.9 percent of its direct investigative time to this effort representing over 295,000 investigative hours. During that time, CI initiated over 300 new investigations and over 450 identity thieves were sentenced. Additionally, CI has worked with partners within the IRS Security Summit to focus outreach efforts addressing the emerging schemes targeting tax professionals and payroll service providers. Examples of these efforts include generating a YouTube video warning tax professionals of the need to maintain an Information Security Plan, delivering presentations at regional and national conferences, and working with private sector entities within the tax eco-system to enhance information security. CI also works closely with IRS operating divisions to ensure data losses involving tax preparers

and payroll service providers receive enhanced screening for ID Theft. As of August 17, 2017, CI forwarded information on over 431 incidents involving data losses that affected 372,776 taxpayers.

CI has noticed a downward trend in the street level crime. However, it has seen an increase in sophisticated and complex computer intrusions, spear phishing, and remote accesses takeovers that resulted in high consistency Stolen Identity Refund Fraud. As a result, IRS CI will continue to provide RICS (Return Integrity & Compliance Services) with updated information and personal identifying information for revenue protection.

Question. What additional measures would help the IRS to better detect fraud and halt refund fraud schemes in their tracks?

Answer. Several additional measures would help us to better detect fraud and halt refund fraud schemes. Combating the sophisticated criminals committing identity theft is a never-ending process that requires significant resources. Over the last several years, we have made steady progress against identity theft thanks to the collaborative efforts of the Security Summit. This strong, unique partnership between the public and private sectors has allowed us to coordinate efforts on many different levels and put in place many new and productive safeguards. These efforts to date have significantly affected the tax ecosystem. We continue to devote significant time and attention to this challenge and are committed to doing all that we can to prevent the payment of fraudulent refunds, pursue the perpetrators, and assist the victims.

While the PATH Act provisions are assisting us in effectively administering refundable credits, we need further statutory authority. Currently, the IRS lacks statutory authority to address, at the time of filing, claims in excess of lifetime limits and the lack of required documentation. Instead, we must address these errors through audits, which takes longer and requires more resources. Granting the IRS the authority to correct such errors at filing (correctable error authority) would increase our ability to address more of the improper claims and errors we identify and decrease improper payments of refundable credits. We requested this additional authority in the 2018 budget.

In addition, since paid tax preparers prepare more than half of the returns filed for refundable credits, requiring them to meet minimum competency standards, through testing and continuing education, would help promote high quality services from paid tax preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system. This requirement would benefit all taxpayers, including those claiming refundable credits. We requested this additional authority in the administration's 2018 budget.

Question. Is the IRS working in conjunction with other Federal agencies, such as the Federal Trade Commission and the U.S. Postal Service, to alert consumers?

Answer. We conducted an extensive consumer education effort on tax scams and schemes for several years, making it a key part of filing season information for taxpayers, as well as a central component of communications work in the Security Summit effort. The Summit, a joint project between the IRS, State tax agencies, and the private-sector tax industry, has highlighted Identity Theft (IDT) and tax scams in joint communications since 2015. This outreach effort has included working with numerous private-sector partners as well as Government agencies, including the Federal Trade Commission (FTC). We have actively participated for several years with the FTC's identity theft efforts, participating in panels, issuing joint communications, and sharing information on their respective websites. For example, the IRS participated in FTC IDT awareness weeks in January 2016 and 2017. Similar communications efforts have been made with dozens of State tax agencies participating in the Security Summit.

Question. To what extent is IRS working with paid preparers and the software industry to leverage their resources and share information about emerging threats? What are your expectations of the recently launched "Don't Take the Bait" campaign?

Answer. We chartered the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center (IDTTRF-ISAC) in December 2016 and began pilot operations at the start of this filing season on January 23, 2017. The IDTTRF-ISAC is a natural result of our Security Summit activities, which began in 2015 to look holistically at the tax refund IDT problem across the lifecycle of a tax return. The purpose of the IDTTRF-ISAC is to share IDT tax refund fraud information, data, and related analysis with public and private entities to detect, prevent, and deter IDT tax refund fraud. As of late April 2017, the IDTTRF-ISAC has 36 member organizations from State departments of revenue and tax software and tax preparation industries. The two primary capabilities being piloted this year are: sharing of tax eco-

system alerts and analyzing leads generated by the tax software and tax preparation industry, as well as other member data.

Tax ecosystem alerts are akin to a neighborhood listserv for the tax ecosystem. Members report and share tax ecosystem threats they encounter so that others can protect themselves against the same or similar threat. Past threats have included employer W-2 breaches, compromised return preparers, new schemes, and dark web chatter about system vulnerabilities. Because of Security Summit workgroup efforts, we are preventing more identity theft this year than last year, we are detecting fewer fraudulent refund claims, and fewer people are reporting that they have become tax-related identity theft victims. The IRS continues to prevent more fraudulent refunds at the door, which has a cascading effect on individuals reporting they've become victims of identity theft. The number of people reporting to the IRS that they were victims of IDT declined from 698,700 in calendar year (CY) 2015 to 376,500 in CY 2016—a 46 percent drop. This downward trend has continued into 2017.

We have also worked with State and industry participants to implement a Rapid Response team for the efficient communication of emerging threats. These alerts are shared with partners and in the ISAC functionality.

We designed the “Don’t Take the Bait” campaign to warn tax professionals to beware of spear phishing emails, a common tactic cybercriminals use to target practitioners. The expectation is that practitioners would become more aware of the types of cyber security threats facing their businesses and clients. This awareness should also lead to the establishment or improvement of cybersecurity plans to protect taxpayers and the IRS from the loss of critical personally identifiable information. We have been pleased at the significant media coverage thus far to our weekly releases warning against various threats to the public, tax preparers, and businesses.

IMPROVING SERVICES FOR TAX REFUND FRAUD VICTIMS

Question. For several years, the National Taxpayer Advocate has endorsed an approach that would assign a single designated IRS account representative to tax-related identity theft and refund fraud victims to help navigate the case through the process from intake through disposition and maintain control of the taxpayer’s case. This would improve the current scheme whereby an already frustrated victim has to often speak with multiple different assistants and frequently has to re-explain or resubmit their cases.

- What consideration is the IRS giving to the National Taxpayer Advocate’s proposal to assign a designated IRS account representative to victims of tax refund fraud for consistent service from intake to disposition? Why is such an approach not feasible or preferable?
- What other steps has the IRS taken to improve the handling of tax refund fraud and identity theft and with what results?
- What more should be done to assist victims?

Answer. Our work on IDT and refund fraud touches nearly every part of the organization. Helping victims and reducing the time it takes to resolve cases is a top priority for the IRS.

During 2015, the IRS centralized IDT victim assistance policy, oversight, and campus case work into a new Identity Theft Victim Assistance (IDTVA) organization within the W&I Division. IDTVA can work IDT cases from beginning to end, providing an improved taxpayer experience.

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, but for more complex cases, resolution can take up to 180 days. This timeframe is substantially less than a few years ago, when cases could take over 300 days to resolve. While this change marks a significant improvement, we continue to look for ways to shorten this time and ease the burden IDT places on these taxpayers.

Whenever possible, the same employee processes multiple claims (often for multiple years) from the same taxpayer to make sure there is consistent processing. In January 2015, the IRS developed automation to associate IDT documentation with existing IDT cases/category codes. In April 2016, we expanded the programming to include the association of documentation with new categories of work resulting from the centralization effort under the IDTVA organization.

Centralization of IDTVA work enabled full capabilities to use the Correspondence Imaging System in handling the IDT cases with current or past compliance activity. This change has significantly affected our ability to resolve those cases more quickly. Since implementation, we resolve those cases in fewer than 120 days 75 percent of the time, compared to 34 percent prior to implementation.

Our toll-free hotline for IDT victims helps taxpayers reach a trained IDT specialist any time during business hours, without having to rely on the availability of a single IRS employee. Customer service representatives staffing this specialty line can review the taxpayer's case file and respond to the IDT victim's call. While we believe this approach provides the best possible experience for the victim, we are aware that sometimes the customer service representative cannot respond to the IDT victim's call. For these instances, beginning on August 1, 2017, we implemented a process for IDT victims to have direct contact with the employee working their IDT cases. The customer service representative will provide the IDT victim with a different toll-free number to call the employee working his or her case directly. If the employee is unavailable to answer the IDT victim's call, the victim can leave a message for the employee, and the employee will return the victim's call within 5 business days. In addition, we expanded procedures to achieve a single point of contact when a victim's case spans multiple years.

RESTORING IRS STREAMLINED CRITICAL PAY AUTHORITY

Question. As part of the 1998 restructuring of the IRS, Congress authorized some unique special personnel flexibilities to help the IRS recruit and retain highly skilled employees with specialized expertise. "Streamlined critical pay authority" permits the IRS to bring in up to 40 uniquely qualified experts for 4 year appointments to revitalize and enhance the IRS workforce. The original authority had a 10 year sunset and was renewed in the fiscal year 2008 FSGG bill for 5 additional years, but has now lapsed as of September 30, 2013. The President's fiscal year 2018 budget seeks language to reinstate the authority.

- I understand that other than addressing funding requirements, one of the IRS's top priorities for the fiscal year 2018 appropriations cycle is the reinstatement of streamlined critical pay authority. How has the IRS used streamlined critical pay authority and what have been the primary benefits?
- What types of positions has this authority enabled the IRS to fill?
- What are the ramifications if this now-expired authority is not renewed?

Answer. Since its inception under the Restructuring and Reform Act of 1998 (RRA '98), the IRS has found the Streamlined Critical Pay (SCP) authority to be an enormously valuable tool in recruiting top tier talent from private industry. The tool has been particularly valuable in recruiting for positions in the Information Technology (IT) organization where external talent has contributed greatly to our keeping pace with the technological advances needed to provide world class service to the American taxpayer. We have used the authority to recruit individuals with specific expertise in sensitive, high-level initiative areas such as:

- IT Engineering
- IT Architecture
- Cybersecurity
- Online/Web Services

In addition to being a useful tool in Information Technology, the hiring authority has also been invaluable in helping to fill positions in sophisticated and complex areas of international taxation, risk management, and data analytics. Because the IRS has not been able to approve new SCP appointments since the authority expired on September 30, 2013, we have lost all SCP appointees through either appointment expiration or separation.

The incumbents were sitting in technical, highly-specialized positions where internal successors with the requisite skills to fill the position are not readily available to backfill behind the SCP appointee. Reinstating the SCP authority would allow us to recruit and hire other highly-specialized executives for critical positions to help deliver our mission and achieve modernization. To remain with the IRS absent SCP authority, SCP appointees would have to competitively apply to an open Senior Executive Service (SES) vacancy announcement and obtain SES certification from the Office of Personnel Management (OPM) prior to the end of their appointment. This process can take upwards of 6 months to complete. To bring their salary in line with the pay cap limitations set under the Executive Schedule, SCP appointees would incur a significant pay cut to their annual rate of basic pay by 20 to 30 percent. Due to each appointee's high-level of expertise and technical abilities within his or her related fields, each will be more than capable of obtaining salaries and compensation packages far exceeding IRS's capabilities in the private sector.

The SCP authority allowed the IRS to hire top-caliber executives under an abbreviated timeline. Once a candidate has accepted an SCP position, IRS can bring the individual on-board within four to 6 weeks. This includes time to complete the required background and tax checks, as well as allowing the individual to provide suf-

ficient notice to his/her current employer. In rare cases, due to the critical nature of the position, IRS on-boarded a SCP appointee in as few as 2 weeks.

This streamlined hiring capability was crucial in recruiting highly-skilled professionals. Particularly in the information technology and cybersecurity fields, the demand for top recruits can be so aggressive that a speedy hiring process, along with a competitive compensation offer, can be the difference between hiring a “game changing” executive and losing one to a competitor in either the public or private sector. Additionally, the SCP authority allows the Commissioner to set pay up to, but not exceeding, the Vice President’s salary. This flexibility allows the IRS to attract candidates we would normally not be able to reach due to the pay limitations under the Executive Schedule.

We used the SCP authority for 171 appointments between October 1, 1998, and September 30, 2013, when the authority expired. The IRS has three SCP executives on-board; the last of whose term will expire on September 29, 2017. Since SCP was extended in 2008, the number of SCP positions has ranged between three (as of August 17, 2017) and 30 (March 2010).

IRS MANAGEMENT AND PERFORMANCE CHALLENGES FOR FISCAL YEAR 2017

Question. Each year, the Treasury Inspector General for Tax Administration (TIGTA) evaluates IRS programs, operations, and management functions to identify the areas of highest vulnerabilities to the Nation’s tax system. On October 6, 2016, TIGTA issued its assessment enumerating the top 10 management challenges for 2017. The number one priority challenge TIGTA cited is security over taxpayer data and protection of IRS resources.

TIGTA reported that while the IRS recognizes the growing challenge it faces in establishing effective authentication processes and procedures, the IRS has not established a service-wide approach to managing its authentication needs. Consequently, the level of authentication the IRS uses for its various services is not consistent. TIGTA emphasized that while the IRS is evaluating potential improvements to existing authentication methods to prevent identity theft, the IRS is not developing overall strategies to enhance authentication methods across IRS functions and programs.

—Mr. Koskinen, what are your perspectives on TIGTA’s identification of the most challenging management concerns facing the IRS?

Answer. Each year, TIGTA identifies the IRS’s major management and performance challenges based on the findings and results of prior audit work and other analyses. TIGTA then designs and delivers an audit plan with audit work focused in each of the top 10 areas. In fiscal year 2017, TIGTA reported IRS top management and performance challenges, in order of priority, as:

1. Security Over Taxpayer Data and Protection of IRS Resources
2. Identity Theft and Impersonation Fraud
3. Implementing the Affordable Care Act and Other Tax Law Changes
4. Improving Tax Compliance
5. Reducing Fraudulent Claims and Improper Payments
6. Improving Tax Systems and Expanding Online Services
7. Providing Quality Taxpayer Service Operations
8. Impact of Global Economy on Tax Administration
9. Protecting Taxpayer Rights
10. Achieving Program Efficiencies and Cost Savings

TIGTA included identity theft as a new challenge in fiscal year 2017, removing human capital from the list. We certainly agree these areas represent important challenges and opportunities for the IRS.

TIGTA’s Fiscal Year 2017 Annual Audit Plan contained 168 new or in-process audits focused on these 10 challenges. Leadership and management enterprise-wide are actively engaged throughout the audit process and appreciate our auditors’ objective reviews of IRS programs and processes. We carefully consider all reported findings and recommendations.

I personally appreciate TIGTA’s insightful and continued attention to the most challenging concerns the IRS faces, and consider TIGTA a partner in helping the IRS achieve its mission.

Question. How does the IRS under your leadership integrate the findings and recommendations for corrective action suggested by GAO and TIGTA audits into strategic management decisionmaking and budget planning processes?

Answer. As mentioned above, we carefully consider all reported findings and recommendations by TIGTA and the Government Accountability Office (GAO). We must ensure we use our budget and resources to address the most significant

vulnerabilities identified. Since 2015, the GAO has provided a list of its Priority Recommendations, asking us to focus on the recommendations it cited as having the highest priority.

Responsible officials at the management and executive level must assess whether taking corrective action in the finding area is mission-critical and if funding is available. If funding is not available when management is responding to the reported findings, a business unit may place a recommendation on hold and leadership may periodically assess its status throughout the budget cycle. As of August 15, we have 219 outstanding corrective actions in our inventory, with another 18 on hold. More than 100 new corrective actions will be added to our inventory as fiscal year 2017 audit activity concludes.

IRS REPORTING REQUIREMENTS

Question. In November 2016, the IRS issued Internal Revenue Notice 2016-66. There have been numerous complaints that this notice imposes burdensome and duplicative information reporting requirements on 831(b) Captives, their owners and, in some cases, even their service providers.

—Will the IRS commit to carefully reexamine the requirements imposed by this Notice, including meeting with small and medium-sized businesses that are impacted by new reporting requirements to understand their concerns?

Answer. We issued Notice 2016-66 late last year to identify certain micro-captive transactions as transactions of interest because they have the potential for tax avoidance or evasion. As you note, the notice requires disclosure from participants in the identified transactions and their material advisors. These disclosures allow the IRS to gather information to determine which transactions are or have the potential to be abusive tax avoidance transactions. We have begun to evaluate the information we have received in these disclosures to determine what steps are appropriate as we work toward addressing potential tax abuse in this area.

To minimize the burden of the disclosure requirements, we carefully crafted the objective criteria in Section 2 of Notice 2016-66, which describes the micro-captive transactions that are subject to disclosure. Specifically, we require disclosure only if an insured entity or a related party owns at least 20 percent of an electing section 831(b) captive insurance company, and for the most recent five-year period the captive insurance company either has liabilities less than 70 percent of its premiums earned or has made its capital available to the insured entity or a related party.

We requested comments from the public about the notice and received 28 comments and 6 congressional inquiries, including this Question for the Record. In addition, we met with those who requested meetings and responded to telephone calls regarding the notice. Subsequently, the United States Tax Court issued its first decision on a micro-captive transaction challenged by the IRS (*Avrahami v. Commissioner*, 149 T.C. No. 7, filed August 21, 2017), concluding that the entity purported by the taxpayers to be a micro-captive insurance company was not an insurance company and holding that payments made to that entity did not qualify as insurance premiums. We will continue to evaluate the disclosures received and developments in this area.

QUESTIONS SUBMITTED BY SENATOR JOE MANCHIN, III

MODIFICATION OF TAX DOCUMENTS

Question. Commissioner Koskinen, IRS taxpayer notices are the primary mode by which the IRS communicates with taxpayers. As you often say, in an effort to prevent phone scams involving people impersonating IRS officials “If you are surprised to be hearing from us, you aren’t hearing from us.”

However, the way that IRS communicates with taxpayers by mail is frustrating to many. Ten percent of IRS notices don’t reach their intended audience, which represents a total failure of communications at roughly twice the industry average. When a taxpayer receives a notice, it is often an indecipherable block of text using stock language and no visual or graphical clues as to what the taxpayer should do or why.

Moreover, IRS plans to address its high failure rate, which involve moving to online communications, are destined to be incomplete solutions at best.

My recommendation would be for IRS to learn from the best practices at use in industry. When I get a statement for a credit card or utility, it uses color, modern iconography, and clear text because that credit card or utility knows that it is in their interest and my interest for me to be able to understand the information that is being conveyed.

—When will IRS implement color and graphics in order to make its notices more understandable?

Answer. I agree that we need to ensure that our communications with taxpayers are as clear as possible. We began to revise notices in 2010 to comply with the Plain Writing Act of 2010. Since 2010, we have reviewed all new and revised notices for compliance with the Plain Writing Act on a continuing basis. Our goal is to create notices that are clear, concise, and well-organized and that follow best practices. We do not have the color printers necessary to produce color notices. We need to conduct more in-depth analysis of the requirements necessary to determine a full implementation schedule and cost.

Question. What is IRS doing to reduce its undeliverable mail problem?

Answer. Over the past several years, we have implemented several mailing best practices to reduce undeliverable mail. To obtain the most current valid address, we run a series of address update routines. Following industry best practices, we use commercial address hygiene software approved by the United States Postal Service (USPS) that validates each address. We also consult the USPS National Change of Address (NCOA) dataset so our records are updated to reflect the most current address available. In 2013, we began using USPS Full Service Intelligent Mail barcodes that provide the ability for enhanced tracking and improved address quality. We are also exploring several other address initiatives, including providing a secure method for taxpayers to change their addresses online.

We have improved since 2010 when TIGTA issued its report about undeliverable mail. The report stated that IRS fiscal year 2009 undeliverable mail volume was 19.5 million (201 million mailed). The fiscal year 2016 undelivered mail volume was 16.3 million (215 million mailed). The current fiscal year 2017 IRS deliverability of mail rate is 92.6 percent. This rate is lower than the industry average. Most undeliverable mail is caused by a taxpayer moving and not providing a forwarding address or providing a bad, uncorrectable address.

TAX-PAYER ASSISTANCE

Question. Commission Koskinen, as you mention in your testimony, there's no question that the efficient operation of the Internal Revenue Service is integral to the functioning of our Government. Plain and simple, our Government needs revenue to work.

For many citizens, especially those in rural areas like West Virginia, the Internal Revenue Service has, in fact, become less of a service. As the IRS continues to find ways to cut costs, access to paper forms and assistance has continually been reduced. Furthermore, the switch to offering online services may be favorable for some—but only for people who have broadband access and feel comfortable using the Internet. Unfortunately, this is not the case for many West Virginians.

Many West Virginians simply want to pay what taxes they owe and comply to the best of their ability. It just makes sense that the IRS would want to help people comply before they need to file so that we don't waste resources on the back end through enforcement measures and cause our citizens unnecessary headaches.

—In the budget justification, a cut of \$153 million is proposed to the office of Taxpayer Services. How does this funding reduction contribute to improving the service aspect of the Internal Revenue Service?

Answer. We provide service through a variety of channels, including toll-free service, walk-in assistance, correspondence, and a growing range of online self-assistance tools funded by the Operations Support account, not from the Taxpayer Services account. We support the Administration's efforts to reform the Federal Government and deliver services in the most efficient manner possible. Funds are provided to help us update our out-of-date IT infrastructure. We are committed to providing services that will satisfy taxpayer needs by taking advantage of the latest tools and technology aimed at transforming the entire taxpayer experience. We continue to develop ways to provide our services so taxpayers can conveniently and securely engage us at the time and place of their choosing.

To do that, we need to continue to invest in new information technology and services. Reducing funding in Taxpayer Services may affect level of service on the phones and in-person interaction, depending on the volume of interactions. However, investing in our online capabilities will improve our ability to provide our services as more and more taxpayers choose to interact with us online in a secure, virtual environment in the same manner they do with other financial institutions. The more often taxpayers successfully obtain the information and help they need by visiting IRS.gov and using our online tools, instead of calling or visiting, allows for greater capacity to help those taxpayers who prefer or need to interact with us on the phone or in person.

QUESTIONS SUBMITTED TO HON. J. RUSSELL GEORGE

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER A. COONS

IMPLICATIONS OF FUNDING CUTS

Question. In your fiscal year 2018 budget request, you seek \$161.113 million in appropriated funds. This proposed level represents a cut of \$8.521 million (5 percent) below the \$169.6 million in current year resources, and would appear to necessitate a significant reduction in TIGTA's workforce.

Can you describe the implications of this funding level on staffing of critical TIGTA audits and investigations?

Answer. Nearly 75 percent of TIGTA's budget supports labor and benefit expenses so that a cut in the fiscal year 2018 budget requires a reduction in labor costs and Full-Time Equivalents. Staffing for both the Office of Audit and the Office of Investigations will be reduced resulting in a decreased number of investigations and audits. TIGTA's Office of Investigations will be limited in its ability to respond to every allegation of Internal Revenue Service (IRS) employee misconduct and it will extend the amount of time it takes to investigate all of the allegations received by TIGTA. The budget cut will also affect TIGTA's ability to conduct investigations and audits of the IRS's electronic taxpayer data sharing programs. This is critically important as international criminals continue to target and exploit the IRS's data systems. TIGTA's Office of Audit will have a higher percentage of staff devoted to mandated audits versus high-risk audits.

Question. With less resources, could TIGTA expect to experience a decline in the high-risk audits currently conducted that have had quantifiable positive outcomes such as cost savings, revenue protection, and taxpayer privacy and security benefits?

Answer. Yes, with less resources, the Office of Audit will initiate less audits in areas such as information security, international tax compliance, and identity theft. Additional resources would allow TIGTA to more fully support critical audit priorities.

Question. In fiscal year 2016, TIGTA realized several laudable accomplishments including \$14.6 billion in increased or protected revenue, \$40.8 million in cost savings; and \$487 million through significant investigative work, for a commendable return on investment of \$90 for every \$1 invested. Do you believe a funding cut could adversely impact TIGTA's ability to sustain those successes?

Answer. Yes. With less resources, the Office of Audit will initiate less audits in high-risk areas identified through our risk-based strategic planning. A reduction in the number of audits would adversely impact the amount of financial benefits resulting from the Office of Audit's work. Similar to the Office of Audit, the budget cut will reduce the number and complexity of TIGTA's investigations, especially in the IRS's automated environment where the majority of high-level criminal exploitations are occurring.

SAFEGUARDING TAXPAYER INFORMATION

Question. Like Inspectors General in other Federal departments and agencies, TIGTA issues an annual report regarding the top management challenges facing agencies. In TIGTA's top management challenges report of October 6, 2016, protecting the confidentiality of taxpayer information by the IRS was identified as the #1 priority concern for fiscal 2017.

Why do you consider protecting the confidentiality of taxpayer information by the IRS to be the most critical challenge and what recommendations do you have for responding to this challenge?

Answer. The threat landscape has become more prominent than ever. Bad actors are relentless and persistent in their pursuit of monetary gain. Recent cyber events against the IRS have illustrated that these bad actors are continually seeking new ways to attack and exploit IRS systems and processes in order to steal tax information for the purpose of identity theft and filing for fraudulent tax refunds. From the IRS Get Transcript incident to the FAFSA IRS Data Retrieval Tool incident, we have witnessed where the IRS closed one systemic weakness only to find that these criminals discovered another means to pilfer tax information from the IRS. Our investigations and audits have also identified significant internal threats to protecting the confidentiality of taxpayer information.

For these reasons, we believe protecting the confidentiality of taxpayer information remains the top management challenge for the IRS. To assist the IRS in meeting its fiduciary responsibility to protect taxpayer data, we perform an array of

cybersecurity audits and investigations of the IRS and make recommendations so the IRS can improve its security posture.

Our audits have assessed the IRS's ability to protect its systems and data from external threat. For example, we have conducted audits of the Get Transcript online application and electronic authentication platforms and made recommendations to develop a Service-wide strategy that establishes consistent oversight of all authentication needs across IRS functions and programs, ensures that the level of authentication risk for all current and future online applications accurately reflects the risk, and ensures that the authentication processes meet Government Information Security Standards. In just one of our investigations involving the Get Transcript exploitation, TIGTA's agents and analysts were able to identify and cause freezes on tax accounts that could have resulted in over \$168 million dollars in fraudulent IRS tax refunds.

In addition to external threats, the IRS must ensure its systems and data are protected against internal threats. These threats may appear in the form of malicious insiders or disgruntled employees who seek to misuse their access privileges for personal gain. These threats may also come in the form of employees who unintentionally or accidentally do something that may create a security weakness that may be exploited by others or unnecessarily expose data to unauthorized access and/or disclosure.

For example, TIGTA audits of various internal systems have highlighted the following problems: users have been given more access privileges than their job requires; systems have not been updated with security patches on a timely basis, and high-risk security vulnerabilities have not been mitigated as required. OI's data analysis techniques are instrumental in identifying IRS employees who access taxpayer records without authorization, then use the information for illegal activities. In one recent investigation, TIGTA identified an IRS employee who accessed the IRS data of thousands of names, dates of birth, and Social Security Numbers from IRS data systems and then filed hundreds of fraudulent returns that claimed over \$550,000 in fraudulent tax refunds. The IRS employee worked with two co-conspirators to cash the refunds. As a result of TIGTA's investigation, the former employee was sentenced to serve over 9 years in Federal prison and was ordered to pay over \$438,000 in restitution.

Question. Do you believe the IRS is doing enough to address deficiencies in the security and effectiveness of authentication methods for access to information systems?

Answer. Our audits have found that the IRS has performed well at protecting its perimeter network against cyberattacks. In that regard, we believe the IRS is doing enough to ensure hackers are not successful in their attempts to directly attack the IRS's Internet-facing applications. However, the IRS must make significant gains in its deployment of audit trails for all of its data systems to enable TIGTA and the IRS to identify IRS employees who abuse their access authority in order to steal or improperly manipulate taxpayer data (i.e., prevent insider threats). In addition, other audits have shown that much work needs to be done to strengthen the IRS's internal security posture.

In regards to the effectiveness of authentication methods for access to information systems, we have found that the IRS continues to take steps in response to TIGTA's recommendations to provide more secure authentication, including the implementation of two-factor authentication, and strengthening application and network controls. However, as noted, we remain concerned about the IRS's logging and monitoring capabilities over all connections to IRS online services. We currently have two audits in process that will provide updated progress and assessments on authentication controls to online services: Review of the Online Transcript Delivery System and Electronic Authentication to IRS Online Services. Both audit reports are expected to be issued in October 2017.

CONCLUSION OF HEARINGS

Senator CAPITO. Again, I thank you all and this subcommittee is hereby adjourned.

[Whereupon, at 11:35 a.m., Wednesday, July 26, the hearings were concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]