

**FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2019**

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**TUESDAY, MAY 22, 2018**

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

The subcommittee met at 10:04 a.m., in room SD-138, Dirksen Senate Office Building, Hon. James Lankford (Chairman) presiding.

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

**DEPARTMENT OF THE TREASURY**

**STATEMENT OF HON. STEVEN T. MNUCHIN, SECRETARY**

**OPENING STATEMENT OF SENATOR JAMES LANKFORD**

Senator LANKFORD. Good morning. The subcommittee will come to order.

This is our second of our fiscal year 2019 budget hearings for agencies under the jurisdiction of the Financial Services and General Government Subcommittee.

Today we have with us the Secretary of the Treasury, Steve Mnuchin, and the Acting Commissioner of the Internal Revenue Service, David Kautter. Thank you for being here today.

We will do these in back-to-back panels.

The Treasury Department's budget request proposes a total funding of \$12.3 billion in 2019 for its operations and its bureaus. These offices execute important functions that promote our economic growth, combat illicit finance, safeguard our financial system, administer the Internal Revenue Code, and manage the Federal Government's fiscal operations.

One of the largest proposed increases is an additional \$17.2 million to the Office of Terrorism and Financial Intelligence. The Office of Terrorism and Financial Intelligence plays a critical role in our national security by developing and implementing our Government's strategies to combat terrorist financing.

I look forward to hearing how you will utilize the increase to target additional sanctions against terrorists, international narcotics traffickers, and those involved in the proliferation of weapons of mass destruction.

I also look forward to hearing how the memorandum of agreement between Treasury and OMB to create a new framework for reviewing tax regulations is being implemented.

I have long believed that IRS regulations should be held to the same rigorous standards as other agencies. While it is important that the IRS implements the Tax Cuts and Jobs Act expeditiously, it is also important that proposed tax regulations are thoroughly analyzed and impose the least possible burden of some costs.

The IRS requests a total of \$11.135 billion for its base operations and an additional \$362 million that would be provided through a program integrity cap adjustment. While the agency's previous request for a program integrity cap adjustment were not enacted, I look forward to discussing the agency's resource needs.

This funding is intended to administer the Nation's tax system, generate more than \$3 trillion in revenue to fund Government programs, protect billions of taxpayer records, and strengthen tax compliance.

Tax compliance in particular is critical. The Government Accountability Office has identified the enforcement of tax laws as a high risk area. In 2016, the IRS estimated that the average annual gross tax gap, the difference between taxes owed and taxes paid on time, was \$458 billion for tax years 2008 to 2010.

I look forward to hearing your strategy for closing the tax gap, and I stand ready to work with you on the solutions.

Thank you again for testifying today.

I now turn to my colleague, the Ranking Member, Senator Coons, for his opening statement.

#### STATEMENT OF SENATOR CHRISTOPHER A. COONS

Senator COONS. Thank you, Chairman Lankford, for convening this hearing. I appreciate the opportunity we have to work together on the diverse and important set of issues that come before the subcommittee and hope we can continue to find common ground and work well together.

I would like to welcome our witnesses, Treasury Secretary Mnuchin and IRS Acting Commissioner Kautter. Thank you for joining us this morning and for your service.

Today we are considering the budget for the Treasury Department, including the IRS. Treasury is central to our Government's stability and ongoing operations, helps sustain our country's fiscal health and protect our national security. You have a vital and wide-ranging job from collecting taxes and processing over \$3 trillion in Federal payments annually to prosecuting financial crimes here in the United States and identifying and stopping individuals that finance and promote terror abroad.

I am pleased you requested an increase in the Office of Terrorism and Financial Intelligence, which has the critical responsibility of enforcing sanctions. I do want to discuss the adequacy of resources for that office later in this hearing. I am concerned the very real and important work you are doing regarding North Korea and Iran do not limit your ability to enforce other sanctions around the world.

I am, however, disappointed your budget proposes to eliminate altogether grants to Community Development Financial Institu-

tions (CDFI) which support development and create jobs in underserved neighborhoods around our Nation. In fiscal year 2016 alone, CDFI program awardees originated more than \$5 billion in loans and investment, financed more than 12,000 businesses, the development of nearly 28,000 affordable housing units, and served nearly half a million individuals with financial literacy training.

I am also concerned about the overall adequacy of the IRS budget. No Government agency is more visible or has a greater personal impact on the American people than the Internal Revenue Service. The IRS collects the revenues that fund more than 95 percent of our Federal Government's operations, public services, and programs. And each year, more than 80,000 public servants at the IRS makes hundreds of millions of contacts with taxpayers and businesses. The IRS has endured years of freezes and budget cuts, and the proposal we are reviewing today would continue that trend by further cutting funds for both enforcement activities and taxpayer services.

My office frequently hears from Delawareans frustrated when their calls to the IRS go unanswered or it takes a long time to connect with an official at the IRS, especially those who are seeking information so that they can comply with their tax obligations voluntarily. I would imagine many other Senate offices hear from constituents with similar concerns. The solution to these concerns is to give the agency the resources it needs, not to slash the budget further in an effort to score points.

Like the Chairman, I am concerned about your strategy to close the tax gap and will be interested in hearing more about that today and to hearing more about why the Department and the IRS thinks it is a good idea to reduce its service delivery rates for taxpayers.

We have a great deal to discuss today and important ground to cover. I hope we will hear our witnesses' perspectives on what resources are essential to deliver the high quality services American taxpayers and companies deserve. I know Delawareans expect no less.

I welcome the opportunity to work with you on these important issues, Chairman Lankford, as the fiscal year 2019 process moves forward here in Appropriations. Thank you.

Senator LANKFORD. I want to recognize the Vice Chairman of the full committee for an opening statement as well.

#### STATEMENT OF SENATOR PATRICK J. LEAHY

Senator LEAHY. Thank you, Mr. Chairman. I note that both Senator Shelby and I are very anxious—and I know, Chairman Lankford and Senator Coons, you are too—to get all the appropriations bills through in regular order.

I am worried, Mr. Secretary—so I am going to have to leave to work on another one of the bills. But we have this tax bill, which some would praise, others would consider, as I do, a corporate tax giveaway. Corporate CEOs are happy with the result. Stock buybacks are booming, the most in the entirety of my life. JPMorgan Chase has estimated it could reach an all-time high this year.

But Vermonters feel that Washington has put the corporations ahead of their own interests, whether it is a relative pittance work-

ing families receive in relief. The amounts are low, and some polls show that more than half of Americans report not noticing the increase in their paychecks, or the rising health care premiums they face they feel is a bad deal. And on top of that, the tax cuts were put on the Nation's credit card. It is sort of like buying a war on a credit card. It means the deficits explode.

But also what they are finding is the IRS has been starved for resources. Senator Coons mentioned this, but in a rural State like Vermont, taxpayers that have questions or need assistance—they are left out in the cold. They do not have assistance. They do not have a place to get their questions answered. Now with the new law, many Vermonters are confused about how to navigate the tax system in light of the changes. I know the President promised we would do taxes on a postcard-sized tax return. Well, that is not the situation. That is not a promise that was kept. A typical Vermonter cannot afford armies of tax lawyers to help them. Millionaires, billionaires, corporations that benefit from the new tax law can. Now, they should have the right to call the IRS or visit a location in person to receive the assistance they need in a timely manner. That is not available.

And further troubling them is that millions of American taxpayers wonder whether their personal, sensitive information has been compromised in any one of the many data breaches, which never should have occurred. The loss of this data puts taxpayers at risk for fraud. And ironically, you are proposing cutting support for the IRS at a time when these data banks are even more vulnerable.

I am sorry we are in this. We are trying—Senator Shelby and I are—to have a bipartisan way of getting our appropriations bills through. I wish the same had been done on the tax bill. But the least we can do, now that it has been passed, is to make sure the average American taxpayer actually has the resources so they know how to navigate it. But your budget strains the IRS's already limited resources. It does not make it look like you are on the side of hardworking middle class Vermonters and Americans.

And then one last word on trade. Trade policy, Mr. Secretary, as you know, like tax policy is complicated. There are many stakeholders. There are many interests. There are many nuances. It cannot be negotiated on Twitter accounts. You cannot one day threaten billions of dollars in tariffs on Chinese products and then pull back on it the next day. You cannot accept promises to address intellectual property theft without meaningful commitments to back them up. We have a national security problem with the theft of our intellectual property by the Chinese and others. It is the envy of the world—our intellectual property. But it also means that they want to steal it, and you do not address that with 280 characters on Twitter.

So I will submit some questions for the record.

But, Mr. Chairman, I appreciate your moving forward, as others are in this subcommittee, to get our bills done.

Senator LANKFORD. Thank you, Senator Leahy.

Secretary Mnuchin, you are recognized. Obviously we have your written statement as well, and glad to be able to have that and pleased to be able receive your oral testimony now as well.

## SUMMARY STATEMENT OF HON. STEVEN T. MNUCHIN

Secretary MNUCHIN. Thank you very much.

Chairman Lankford, Ranking Member Coons, and Members of the subcommittee, it is good to be here with you today to discuss the President's budget and the priorities for the Treasury Department.

I would like to begin by thanking you for your support in the fiscal year 2018 omnibus for tax reform implementation and the Treasury's Office of Terrorism and Financial Intelligence (TFI). The Tax Cuts and Jobs Act is the most significant tax reform legislation since 1986. The resources appropriated will allow the IRS to update its systems to implement the new tax law and provide much needed guidance to taxpayers and businesses. The continued support for TFI's initiatives is critical as we as we continue our maximum pressure campaign on North Korea and support efforts to denuclearize the Korean Peninsula.

Additionally, funds for TFI are helping to advance the work of the Terrorist Financing Targeting Center (TFTC). The TFTC is a collaborative, multilateral effort with Saudi Arabia and the Gulf Cooperation Council to fight terrorism, counter Iran's malign influence, and isolate the Assad regime.

Turning to the President's 2019 budget, the administration's request reflects the priorities of protecting and strengthening America's financial system and national security. We have requested increased resources for TFI and the Financial Crimes Enforcement Network. Treasury is working aggressively to combat terrorist groups, transnational criminal enterprises, proliferators of weapons of mass destruction, human rights abusers, and other malign actors. Treasury will continue efforts to achieve a change in behavior by the North Korean regime and fully fund the TFTC in Saudi Arabia. These funds will also be used to implement the Countering America's Adversaries Through Sanctions Act, including funding for our Russia and Iran programs, to target illicit financial networks.

This budget also provides for Treasury-wide cybersecurity protections. As I have previously noted, protecting both Treasury and the global financial system from cyber attacks is critical to our Nation's financial stability. These attacks not only have the potential to affect financial markets and the broader economy. They also implicate our national security. In particular, I want to highlight the Cybersecurity Enhancement Account. This initiative makes proactive and strategic investments in enterprise-wide cybersecurity capabilities. These capabilities will ensure that Treasury is better prepared to defend against cyber attacks and respond appropriately when they occur.

Finally, as Chair of the Committee on Foreign Investment in the United States (CFIUS), I would like to highlight the ongoing collaborations between the administration and Members of this body to modernize the CFIUS review process. We are working together to protect technological advantages that are critical to our national security, while continuing to promote investment and economic growth.

The policies articulated in the President's budget will foster economic growth, set our country on a sound fiscal path in the long term, and carry out the administration's commitment to protect the national security of the United States.

Thank you very much.  
[The statement follows:]

PREPARED STATEMENT OF HON. STEVEN T. MNUCHIN

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Thank you very much.

Senator LANKFORD. Mr. Secretary, thank you.

I recognize myself for some brief opening questions. Then we will move to other Members quickly.

TERRORIST FINANCING TARGETING CENTER OPERATIONS

Tell me a little bit more about the Terrorist Financing Targeting Center in Saudi Arabia that you are standing up. What are the key goals that you want to have within the next 12 months as you target this financing, and when do you think it will be fully ready and operational?

Secretary MNUCHIN. Well, the key goals are to be able to share information that leads to combating terrorist financing activities and, in particular, make sure that we have coordinated sanctions, not only here but also throughout the Middle East. I think we have already seen this working. We have some people on the ground. We want to continue to staff that up on the ground. But I see this as a very significant achievement for us to be able to counter terrorist financing in the region.

Senator LANKFORD. Fast forward 12 months. How many people do you think are committed to this in the effort there in the region? And do you think it is fully operational by the end of 12 months?

Secretary MNUCHIN. I do think it will be fully operational. I think that we will have a significant number of people, I think something like 20 people on the ground from our standpoint and 10 to 20 from each of the additional countries. So something like 50 from them and 20 from us.

Senator LANKFORD. Do you see this as a model for dealing with counternarcotics and obviously the movement of money and illicit trafficking here in our hemisphere as well to be an effective model for what we are doing there on terrorist financing in Saudi Arabia and the region? Would that work in our region as well? And what would be different in how we handle counternarcotics work versus how we are handling counterterrorism work there?

Secretary MNUCHIN. Well, I think as you know, we fundamentally believe that sanctions are a critical tool in combating all different types of terrorist activities and can also be used to counter narcotics trafficking and other illicit activities.

We do see this as a model. I think in the region, it makes sense for us to have people on the ground working together. I think that we can use that same model here but do not necessarily need a physical presence.

Senator LANKFORD. I want to recognize the Ranking Member, Senator Coons.

Senator COONS. Thank you, Chairman Lankford.

Thank you, Secretary Mnuchin.

The President's fiscal year 2019 request for the Community Development Financial Institutes Fund eliminates all funding for grant programs, a cut of about \$236 million from the fiscal year 2018 enacted level. I just cannot understand why the administration is advancing these cuts. These are programs that have enjoyed strong bipartisan support the entire time I have served on this subcommittee. Applications for CDFIs are nearly four times what current resources can provide. CDFI investments generate \$12 in private capital in communities that badly need investment for every dollar in grants.

How do you justify or explain these proposed significant cuts to this important program?

Secretary MNUCHIN. Senator, first of all, I fully appreciate this does have bipartisan support, and to the extent you decide to fund it, I can assure you and commit that Treasury will continue to provide that function.

As it relates to the administration's decision to cut this, this was merely making difficult decisions and prioritizing spending.

Senator COONS. Well, if I could suggest a different difficult decision in prioritizing spending. Both taxpayer services and enforcement funding are significantly cut in this budget proposal. Taxpayer enforcement returns \$5 to the Treasury for every dollar spent on enforcement. I might suggest that is an area for greater investment rather than cutting a long-established bipartisan program that helps low-income communities.

#### TREASURY SANCTIONS

Let me move on to sanctions. I think also on a bipartisan basis, we have steadily increased our investment, but we also have a steadily growing range of sanctions around the world. And I think this is very important work that you are doing, and I look forward to supporting your work and hearing more about it that Senator Lankford was just asking about.

I am concerned, though, that Treasury's capacity to actually implement and enforce all the different sanctions around the world, including on the continent of Africa where there are sanctions against Burundi, South Sudan, Zimbabwe, the Central African Republic (CAR), and the Democratic Republic of the Congo (DRC) may be exceeded—may not be fully funded. Let me put it that way. We have heard Treasury may not be able to complete new congressionally mandated reports on Iran's sanctions because the limited staff are too busy monitoring and implementing existing sanctions. Is that correct, and do you think the 12 percent increase requested for the Office of Terrorism and Financial Assistance is sufficient?

Secretary MNUCHIN. Well, Senator, first of all, thank you very much. I am glad, as you appreciate, we are busier on sanctions throughout the world than we have ever been, and these are very important tools and I believe they are working very well in that process with our foreign policy and our national security issues.

As it relates to the Iran report, I can assure you that we will have those reports.

I think the increase is significant, but again, as you have outlined, these are areas that will have more and more demands and we will come back to you if we need additional resources once we staff up to these levels.

Senator COONS. I was concerned by the President's decision to withdraw from the Joint Comprehensive Plan of Action (JCPOA). Although I saw it as having real limitations and agreed with much of the initiatives proposed by Secretary Pompeo and the President to work with our European allies to strengthen our actions against Iran's unacceptable, aggressive behavior in the region, I did think we would be better off staying in the deal with our European allies.

Now that we are not just departed from the JCPOA, but Secretary Pompeo has announced intention to be far more aggressive, I am concerned. Do you think intend to sanction economic activity by some of our closest allies, Germany, the UK, France, or Korea, Japan, and others, in this context in order to try and re-escalate pressure on Iran?

Secretary MNUCHIN. Senator, as you are aware, the President has been saying for the last year he had very serious concerns about the Iran JCPOA. I can tell you I just got back from the region and there are significant concerns there as well about Iran's

bad behavior. The President is determined that Iran never has nuclear weapons, and I think that is an important issue for the region.

As it relates to the sanctions, as you are aware, the President—because he did not sign the certification, the Iran sanctions will go back in place, both the primary sanctions and the secondary sanctions. We have already communicated with our European partners both through Secretary Pompeo and myself that we will be enforcing the secondary sanctions.

Senator COONS. I will just say I am very concerned about how that will affect our relations. I agree with the broader objective of restraining, hopefully ending, Iran's aggressive and bad behavior, but the division with our allies at a critical moment concerns me.

Let me ask the last question. ZTE Corporation, a Chinese telecommunications giant, was subject to sanctions for violating our U.S. national sanctions on Iran and North Korea. FBI Director Wray just testified the FBI is deeply concerned about the threats foreign telecom companies pose to the security of U.S. networks. Sanctions are a critical tool. If we do not hold companies accountable for violating them, they become ineffective. Yet, the President tweeted I think last week that he and Xi Jinping are working hard together to make sure that ZTE is able to function and be vibrant.

Given the clear findings ZTE is guilty of violating U.S. sanctions against Iran and North Korea, why is the administration back-peddling to make it easier for a Chinese company to operate and compete with U.S. companies?

Secretary MNUCHIN. Senator, I would comment, as I have said recently. First of all, I do not think it is a function of back-peddling.

First, let me just comment on President Xi did ask President Trump look into this. This is not a surprise. President Trump often calls foreign leaders on business issues.

This is a Commerce Department enforcement issue, working with the Justice Department. The President has been very clear that this is up to the Commerce Department. Although I have participated in certain discussions, I can assure you that whatever the Commerce Department decides—the intel community has been part of the briefings, and we will make sure that we enforce national security issues. If there are any proposed changes on ZTE—the objective was not to put ZTE out of business. The objective was to make sure that they abide by our sanctions programs.

One proposal that the Commerce Department did was, obviously, limiting exports that create certain issues for our companies and our jobs. I cannot comment on what the Commerce Department is considering. But again, I can assure you anything that they consider will take into account the very important national security issues, and those will be addressed.

Senator COONS. Thank you. I certainly hope we will continue to rigorously enforce our sanctions against North Korea and Iran.

Senator LANKFORD. Senator Manchin.

Senator MANCHIN. Thank you, Mr. Chairman.

Secretary, thank you for being here.

In March, the administration announced the U.S. will place a 25 percent tariff on imported steel and a 10 percent tariff on imported

aluminum, which I have greatly supported. Historically trade deals have not been good for our State of West Virginia, and I appreciate the President taking a look at all these trade deals. And I support that very vigorously.

As a way of looking at these tariffs, I think I would want to know where you all stand on this as far as the tariffs on steel and aluminum with China, if that is still in place, if that tariff is going to go into force. And it seems like when it was first brought out, it was on like a blanket across all trade agreements and then brought back from those such as Canada, which we had surpluses with. Why would we have not just targeted China to begin with since we knew they are the bad actor?

Secretary MNUCHIN. Again, Senator, thank you very much.

First of all, as it relates to China, the steel and aluminum tariffs will remain in force. Those were not part of our discussions. We were merely focused on the proposed—

Senator MANCHIN. Those are not going to be touched at all.

Secretary MNUCHIN. Those are not being touched.

As it relates to other countries, I think, as you know, this was done under section 232 and addressing national security issues. And the President has instructed the Commerce Department and USTR to have discussions with other countries. As you know, in certain places, they have already gone into effect. In certain places, they are on hold pending discussions with those other countries and getting various assurances. But the President is very determined to make sure we protect the steel and aluminum industry here.

Senator MANCHIN. Senator Coons just mentioned about ZTE. We are very much concerned about ZTE. Last year, the U.S. imposed a \$1.19 billion penalty against ZTE, one of their big tech companies, and it was found to have violated U.S. sanctions by selling equipment to Iran and North Korea, which alerted us at a high level.

Last month, the Commerce Department decided to ban American companies from buying or selling the phone-maker's products for the next 7 years. And now we understand that might be undone, and I think that was the concern. I think you answered that by saying it would have to be a Commerce Department decision on that.

What is your own personal feelings on ZTE?

Secretary MNUCHIN. Again, just to comment on—because I have participated in listening in some of these discussions. I can assure you that the administration is absolutely determined to enforce sanctions and make sure there are very significant penalties for companies that violate sanctions, number one.

Number two, the administration is very well aware of the national security issues, and anything now or in the future will address national security issues. I have had the opportunity to be part of discussions with the intelligence community.

Number three, you know, kind of to the extent that the Commerce Department looks at alternative means, those will be subject to the enforcement and something that they are comfortable with.

Senator MANCHIN. Well, I would hope that you all would understand the security. If the U.S. were ever to go to war with China,

which I hope never, ever occurs and never even comes into the realm of talking about this, it is not far-fetched to believe that China could potentially disable American cell phones or take control of American networks.

I cannot understand in our trade deals how we allow them to come into our markets in ways we cannot get into their markets. That should be the simple adjustments to be made. If you are allowed to come into the markets, whether it be resources or our networks or our grid system, then we should be allowed to go into their markets. And for some reason, China gets a bye on this every time.

I would like to go to the CFIUS, if we could. As you are aware, I think it is important to keep an eye on foreign involvement in the U.S. economy. That is why I was an early supporter and cosponsor of the Foreign Investment Risk Review Modernization Act (FIRRMA). It really comes down to failure to address efforts by China to acquire U.S. technology. It has far-reaching costs over the long term. The Commission on the Theft of American Intellectual Property estimates that privacy theft and counterfeiting by China cost the U.S. economy between \$225 billion to around \$600 billion a year, and we are not even talking about the effects that it could have on our military's leadership around the globe.

So do you believe China is the U.S.'s greatest national economic threat?

Secretary MNUCHIN. Senator, first of all, I take my role at CFIUS very seriously. As you know, we have been quite aggressive in the use of these powers. I am also very much looking forward to the Senate. I believe they have a vote this morning on the FIRRMA legislation. It is something that the administration very much supports. We need to bring CFIUS into the modern age, and I think that is very important.

Senator MANCHIN. Well, do you believe that China is the United States' greatest economic threat? Do you see anybody else as a threat to our economy other than China?

Secretary MNUCHIN. Again, we carefully analyze all the different economic threats. I think, as you know, the President has been extremely focused on every discussion with every foreign leader on trade, and I believe he has a very strong position on trade and a very strong position on national security, which we have been enforcing.

Senator MANCHIN. Do you believe CFIUS reform legislation in the Senate now can protect the ownership of U.S. technology and infrastructure from transfers to countries like China?

Secretary MNUCHIN. I do indeed. On top of that, whatever we need to do, we will work to ensure that.

Senator MANCHIN. Thank you.

Senator LANKFORD. Senator Moran.

Senator MORAN. Mr. Chairman, thank you.

This is my first subcommittee meeting of this Financial Services and General Government Subcommittee (FSGG) with you as its Chairman, and I look forward to working with you.

Senator LANKFORD. A fairly familiar spot for you to be just over to the right here, though.

Senator MORAN. We will continue our close working relationship based upon geography and other features.

Mr. Secretary, thank you for joining us this morning.

I heard what Senator Coons asked you in regard to ZTE. I had a similar question. Reports from “The Wall Street Journal” is generally what I know about what the administration has announced in regard to ZTE. I also know from hearings, press reports, and conversations that our intelligence entities have testified and have indicated their concern from a national security point of view in regard to the company ZTE.

My question I think is perhaps similar to Senator Coons’. I was going to ask you to justify what appears to be a clear and present intelligence issue being resolved with at least what “The Wall Street Journal” reports as changes in our policies in regard to those sanctions.

My understanding is your answer would generally be this is a question for Secretary Ross. And decisions were made. You were in the room, as I understand it, but the details or the justification would be better coming from the Department of Commerce.

Secretary MNUCHIN. Well, again that is case. But I want to say very specifically—and there seems to be more interest in this issue than any enforcement issue I have seen in recent times. I can assure you that the administration is very focused on making sure that our sanctions regimes are enforced. That is number one.

Number two, any national security issues—I can assure you this administration is as much, if not more, focused on national security than anywhere else. That is why the President has taken very aggressive positions in all areas around the world in us using sanctions. So I can assure you that whatever changes or decisions that are made in Commerce will deal with the national security issues. The intelligence areas we have discussed and have reviewed. I would encourage anybody in a classified setting, if they are interested in understanding the security issues. But I can assure you the national security issues are being addressed, and that is of paramount importance to the President. This was not a quid pro quo or anything else. This was merely that President Xi asked President Trump to look into this, which he has done. Any changes to this will fully support the mandate of making sure that our sanctions and our technology are protected.

Senator MORAN. Mr. Secretary, thank you. I would assure you that in previous hearings and previous administrations, our interest, for example, in sanctions against Iran were visible and continuing. No different today. I want the United States to be protected, and one of the ways that we can do so is with our use of enforcement of our laws and the sanctions that come with them.

I want to turn to a more pedestrian issue. Mr. Secretary, there are, as I understand it, as of June 2017, more than 60 million U.S. savings bonds more than \$23 billion at the U.S. Treasury. They are matured and unredeemed debt. I have asked this question of your predecessor, Secretary Lew, without satisfaction.

But my question is related to the efforts by the Treasury Department to find the owners of those bonds and to remit them the money that they are due. The law indicates that and the past practice was that they would escheat to States and then States, in our

case the State treasurer's office, would begin the process of trying to pursue lost owners.

Seventeen States, in fact, have those laws in place, and they try to find the original owners. It was Treasury's longstanding policy that States would have to take title to the bonds through a valid State escheat process. However, in 2015, the Obama administration published a final rule that attempts to block States from taking title and to reunite and return those redeemed bonds to their owners. That was a complete reversal of Treasury Department policy of 60 years.

I wonder if your Treasury Department has a different policy and if you are taking any efforts to find the owners or to allow the process to take place in which the bonds escheat to the States?

Secretary MNUCHIN. Well, Senator, although I take great pride in knowing an awful lot of the details and the many aspects that the Treasury does, this is not one. But I promise you that I will look into this and make sure my staff addresses it. What you are suggesting is that our procedures do not make sense, and if that is the case, I can assure you we will look into it and address that.

Senator MORAN. I am suggesting that, and I think I had the same answer from Secretary Lew. So he did not know either. But I trust that you will follow up with an answer when I did not get—

Secretary MNUCHIN. You have my personal assurance that we will follow up with you.

Senator MORAN. Thank you very much, Secretary.

Senator LANKFORD. Senator Daines.

#### PROTECTING U.S. INTELLECTUAL PROPERTY AND TECHNOLOGY

Senator DAINES. Thank you, Mr. Chairman.

Secretary Mnuchin, thanks for coming up the hill.

I just recently returned from two trips to China over the last 6 weeks. I have crisscrossed the country. I have been in Shenzhen, Hangzhou, Beijing, Shanghai, and Shenyang. The threats regarding China are very real, as well as the significant opportunities. I spent 5 and a half years working in Guangzhou with Procter & Gamble, so I very much understand and see the balance and the understanding of the tremendous opportunities for American companies, for American farmers and ranchers, as well as the threats.

I think it is very important that we engage in these negotiations. We cannot just see this as a standard trade dispute with China. We must keep in mind China's long-term strategic approach and their long-term goal of becoming the world's superpower militarily and economically.

My question is, how will you seek to balance the importance of increasing U.S. exports in agriculture and energy in the immediate future, which I applaud, versus the longer-term threat of China's forced technology transfers, their military investments, their outright theft, and their incredibly fast developing innovation ecosystem?

Secretary MNUCHIN. Thank you.

Mr. Senator, I think as you are aware of, President Trump has been more aggressive than any previous President ever on dealing with the China trade issue. That is why we ended up with—pro-

posed \$150 billion of tariffs in a 301 report. It is because of those issues we have had a series of intense negotiations that are a framework. I can assure you that we are not looking at short-term gains. What we are looking at is creating opportunities for U.S. workers and U.S. companies to compete fairly there on a level playing field and to make sure that U.S. intellectual property and technology is protected. So that is absolutely the President's desire.

Senator DAINES. So I have been actively engaged for a long time and very specifically on the ground in China in areas of biotechnology, quantum computing, artificial intelligence, avionics.

A very specific question, Secretary Mnuchin. Will you reject any trade proposals with China that would loosen or weaken existing restrictions on the export or transfer of U.S. military technologies and the advanced dual-use technologies because of the military-civilian fusion there as they think about things over there, jet engines, semiconductors, or helicopter technologies?

Secretary MNUCHIN. I would say that export control items are absolutely not on the table for discussions. We would in no way look to loosen that, and quite the contrary, I think we are aggressively looking at whether it is through CFIUS, with FIRRMA, or other means—the President has instructed me to review protecting those technologies. I could assure you this President is very focused on, as I have said, protecting American technology.

Senator DAINES. You brought up CFIUS, Mr. Secretary. I am glad you did. I think it is clear that the time has past where the U.S. can be complacent when it comes to China. The very real threats they pose to our national security need to be addressed directly and in a strategic and very thoughtful manner.

As you chair the Committee on Foreign Investment in the United States, CFIUS, how can we best protect U.S. interests and our innovation while not unduly impeding foreign direct investment from our friends, as well as our allies?

Secretary MNUCHIN. Well, as I like to say, the United States is the most open environment for investment, and we want to keep it that way other than for national security issues. And the single most important thing is to pass the legislation that modernizes CFIUS, gives us the tools that we need. That is the first step and in my opinion the most important step for giving us tools. But I can assure you this administration is very focused, as I have said, on using CFIUS to the maximum amount available.

Senator DAINES. You have previously expressed some concerns that CFIUS does not currently cover joint ventures. I worked as part of a joint venture for 5 and a half years of a Fortune 25 company in China. I was engaged just recently on the ground there in China with some very high profile American joint ventures there in Shanghai.

Do you support legislation that would expand CFIUS jurisdiction to include joint ventures?

Secretary MNUCHIN. Yes. That may be one of the most important aspects of the new legislation.

Senator DAINES. Thank you, Mr. Secretary.

Senator LANKFORD. Senator Boozman.

Senator BOOZMAN. Thank you, Mr. Secretary. Thank you for being here.

## CYBERSECURITY

Secretary Mnuchin, as you mentioned in your testimony, cybersecurity is a huge concern as we continue to move into the world where everything is digital. Could you expand on the role of the Cybersecurity Enhancement Account and how it helps to prepare us in combating cybersecurity threats?

Secretary MNUCHIN. Yes, Senator. I think it is a very important source of funds. But I would also just comment that cybersecurity is extremely important between the IRS, which is constantly under attack and, as you know, needs to protect very important taxpayer information, as well as our role in making sure that the financial system is protected. I do believe—and the Acting Commissioner and I have discussed this—although we spent a lot of money on technology at the IRS, we have not spent enough. He and I are looking at a 5-year plan to address these issues. But one of my most important priorities is to make sure that we protect our financial system and the IRS against cyber intrusions.

Senator BOOZMAN. I know being on the subcommittee for a while, having gone through the challenges that IRS and OPM have faced, how do you change the culture. We can increase technology, but a lot of it is just the culture of thinking in a different way, in a secure way.

Secretary MNUCHIN. I think we have many, many important people at the IRS that understand this culture and that every day make sure that they protect it. The Commissioner and I are very focused on using technology at the IRS, as Senator Lankford talked about in the tax gap. In my mind, one of the biggest ways of shrinking the tax gap is through additional use of technology as opposed to just throwing money at enforcement. But I think the acting Commissioner and myself have spent a lot of time. We meet monthly with the IT people there, and that, for both of us, is a major priority across the Department.

Senator BOOZMAN. Very good.

Agriculture is one of the few areas where the U.S. actually runs a trade surplus, and it accounts for almost a third of Arkansas' overall economy. In many of Arkansas' small rural communities, in fact, much of Arkansas, it accounts for more like 90 percent of what is going on in the area's economy.

I have heard from many of my constituents that simply the uncertainty that we are going on through right now is causing significant problems as far as their plans and costing them market share. For Arkansas' largest row crop, soybeans, every third row is exported to China. However, just last week it was reported that almost 1 million tons of soybean exports have been canceled. With 95 percent of the world's consumers living outside of the United States, our farmers need markets to sell their products. There are other countries who are chomping at the bit to take our market share.

The University of Arkansas produced a report that noted if 25 percent retaliatory tariffs are placed on rice, corn, soybeans, and sorghum, Arkansas will see job losses over 4,400, and our State's value-added economy would be reduced by \$383 million.

And I know that you know all these things. You have been very good about visiting with Congress in small and big groups. You have been very, very available.

Can you talk just a little bit—and I know you are hearing this over and over again, but it truly is an important thing that is going on with our economy, with our farm community, not just our farm community but everything. And one of the great enemies that we have seen in the past, over regulation, we are getting somewhat better at now. But now we are creating this. Can you talk just a little bit about trade and what you see in the foreseeable future?

Secretary MNUCHIN. Yes. Thank you very much.

Let me just first comment on an overview that the President's economic plans are really beginning to kick in as a result of the tax cuts, regulatory relief, and trade.

I think for the first time we are now seeing many projections of 3 percent and higher GDP. I think that we could have a GDP number that surprises us on the up side this year very significantly. The number one issue is creating economic growth.

As part of that, our farmers are some of the most efficient in the world. This is a tremendous export for the United States. Whether it is the North American Free Trade Agreement (NAFTA) or whether it is China, our farmers have terrific opportunities not only to sell existing amounts, but they should be selling a lot more, and that was one of our specific discussions in China. But I can assure you the President is very focused on opportunities. Farmer income has gone down significantly, and we are looking to create better opportunities because as you said, these are great exports, and we need to make sure that there is certainty in long-term commitments for our farmers.

Senator BOOZMAN. Thank you very much.

Thank you, Mr. Chairman.

Senator LANKFORD. Mr. Secretary, let me do a quick second round with us as well to be able to clarify some additional questions that we may have.

The Office of Foreign Assets Control in March took on some of the Mexican heroin trafficking and then just earlier this month, there were countries and individuals in Venezuela and in Panama, that there were additional basically asset seizures and focus on trying to be able to deal with them and that trafficking coming in the United States.

Are there additional authorities that Treasury needs to be able to deal with the counternarcotics work in our hemisphere? There are about \$100 billion that is estimated to be moving from the United States just into Mexico in illicit trade and traffic. What other authorities do you need to be able to take that on that you do not have currently?

Secretary MNUCHIN. Thank you, Mr. Chairman. As you and I have discussed, this is a very big opportunity to stop the drug trafficking by following the money. I think we do have the authorities. We are working on putting together interagency groups to focus on this. We have used these sanctions successfully this year, and we will continue to do so. And we will work with our counterparts in Mexico and other countries to do that.

Senator LANKFORD. You have asked for some additional funding in that area. We think it is very reasonable to be able to have some additional emphasis based on what we are facing with the opioid crisis in the United States and such. We will want to be able to follow up in the year ahead to see how that is spent and what is done and the benefit of that to the United States in that additional investment.

Can I switch over to IRS? The IT investment. You and I have spoken as well. It seems like every year IRS comes back to us, asks for additional dollars and says we have a legacy system, so we need additional dollars for our IT to be able to improve that. That request has been out there about every 10 years in a row, and every year for 10 years or so, this Congress has given additional funds and targeted that area.

At what point do we get on top of that, and how does that actually happen that we finally catch the IRS up into the technology that is needed?

Secretary MNUCHIN. Thank you, Mr. Chairman.

Let me make just two comments.

The first is I would just highlight we do have a request to transfer money between Taxpayer Services and Enforcement into Operations Support. While the headline sounds like it does not make sense, as I have explained to you, the reason why we have that request is we run the entire technology budget through Operations Support. What will probably make more sense over time is to allocate the technology budget to Taxpayer Services and Enforcement and Operations. The money that we are requesting to transfer is to spend technology dollars on Taxpayer Services and Enforcement. I believe that is a much better long-term way of delivering taxpayer support and enforcement. That is issue number one.

Issue number two. I think you know we did have a technology problem this year on tax day. That is something that as far as I am concerned is completely unacceptable to have the IRS systems go down. As a result of that, as I have said, we are doing a complete review. I think that we have come back and always focused on the most pressing issues. But I am determined that we have a plan to bring the IRS into the modern age of technology. Right now, as I have said to you, we are looking at that seriously.

Senator LANKFORD. It is my understanding that there is in development a 5-year plan basically to be able to lay out how to be able to catch IRS up and what to be able to do with technology. Is that the current plan?

Secretary MNUCHIN. I have asked the Commissioner and the team to work on that. We meet every day with the Commissioner because he is busy on tax implementation. But this is a major focus that I have asked the Commissioner to work on and for us to make sure we come back and brief you on.

Senator LANKFORD. When do you think we would get that plan, at least the draft of it, to be able to see how—

Secretary MNUCHIN. I hope to, within the next 90 days, be able to come back and give you a preliminary update.

Senator LANKFORD. That would be helpful because, obviously, we need to be able to look at how we are going to allocate the funding

for that to be able to support that and to be able to have the completion.

The Committee on Foreign Investment that you are so incredibly engaged in, that has been such a conversation at this point of how we are going to handle that—do you have the funding that you need to be able to deal with that particular area? Because that is a growing threat for us. What do you need that you do not have that is additional to what you have requested?

Secretary MNUCHIN. We have asked for some additional funding under the current resources. But if FIRMA does pass, which we hope it does, we will need additional funding.

Senator LANKFORD. Do you have a good idea of what that will be for that additional funding?

Secretary MNUCHIN. I would rather privately come and brief you and the subcommittee Members on that since it is pending.

Senator LANKFORD. Senator Coons and I will look forward to that conversation then to be able to talk about where we are going long-term on those issues.

Obviously, there is a difference in funding needs because Treasury is now working with the Office of Information and Regulatory Affairs (OIRA) and to be able to work through the IRS. Do you have the funding that you need for the additional regulatory responsibilities and the answers to be able to get back to OIRA and that coordination back and forth. Is there an additional responsibility—that because of the additional responsibility, do you need additional funding in that area?

Secretary MNUCHIN. I believe we put in some additional requests for next year for that.

Senator LANKFORD. Okay. We will go through that as well.

You may be surprised that some community banks are coming and knocking on our door asking questions about interaction with Treasury and such. The Customer Due Diligence Rule is one of those issues that there has been some questions about. This is a long-term issue and has been discussed again for years.

What steps are being taken to allow community banks to be able to have their issues heard and to make sure that they are being heard and we are not running over the top of them, obviously. Large banks, community banks—very different staffing issues, and when you deal with the customer due diligence issue, that is very different for them.

Secretary MNUCHIN. Yes, I can appreciate that. On the one hand, we are trying to balance the important Bank Secrecy Act (BSA) requirements, as well as making sure that community banks can enforce these issues without being burdened by undue amount of costs. We have had the opportunity to meet with many of the community bank representatives, and we are working through those issues.

Senator LANKFORD. What do you think the timing is to try to resolve that to make sure that is fully resolved?

Secretary MNUCHIN. We will try to come back to you and give you an update within the next month on that.

Senator LANKFORD. That would be helpful.

One last question for me and I am going to recognize the Ranking Member as well for an additional set of questions.

The Judgment Fund has been an issue for awhile, just in basic transparency. That is an area that Congress has delegated out that responsibility years ago to make sure that there is not a continual vote every time that there needs to be a decision on it. But the Judgment Fund in recent days has been used—not in the last year, but in the last decade has been used for some rather creative ways.

How do we get greater transparency into how the Judgment Fund is actually used to make sure that Congress sees that it is actually being used in ways that it is intended?

Secretary MNUCHIN. Well, let me say I fully appreciate this issue. At Treasury, we are merely the fiscal agent on that fund. So like many other areas of the Government, we are responsible for the disbursement of the funds. But to the extent that the requests come in with the necessary authorization, we merely process it.

I would suggest that this is, again, an issue that perhaps we can come back to you on. Right now, the information that we collect is rather limited around the processing of those payments, and when we get the requests, we make sure that they are properly authorized. But we are not focused on the issue within our area of the reasons for the payments.

Senator LANKFORD. Senator Coons.

Senator COONS. Thank you for your clarification, Mr. Secretary, about a reallocation to Operations that in your view may end up supporting Taxpayer Services and Enforcement. I would welcome a little more detail on that.

Let me move to one of the consequences of the tax law that I am concerned about. According to the nonpartisan Tax Policy Center, charitable giving may fall by as much as \$13 billion per year because of changes in the tax law. Charities, as you well know, provide vital community services, education, health, and others. And given downward pressure on the State and local government spending in these areas as well, I am very concerned about what this might mean for our communities.

Are you concerned about a potential decrease in charitable giving? And would you support legislation that would allow individuals to claim the charitable deduction without having to itemize, the so-called universal charitable deduction?

Secretary MNUCHIN. Well, first, let me just say I think charitable contributions are an important part of communities and our society and are actually a very good and important alternative to government spending.

I think that the tax bill will encourage more charitable donations. One of the things we were very focused on is not putting a cap on charitable donations. There were people who proposed that. We did not support that.

I think what you are suggesting is that perhaps because of the simplification, that somehow or another it does not create the incentives. I am not sure I agree that will be the outcome. But this is something I would suggest if, over time, that indeed has the outcome, that we look at it and potentially address it. But I do not expect that in the short term.

Senator COONS. Well, I would welcome a chance to work with you if we, indeed, see an emerging significant drop in charitable giving.

As you may well know, buried in the tax code is a provision called the Master Limited Partnership (MLP) that has long been taken advantage of by the energy sector to build out infrastructure such as pipelines and create energy and infrastructure jobs. MLPs are taxed as a partnership, but ownership interests are traded like a corporate equity. But by statute, oddly, they can only be used by a narrow segment of energy, nonrenewable energy.

I have worked with a number of Republicans and Democrats—Senator Moran on this subcommittee is an early cosponsor—to broaden the number of uses to which MLPs can be put in the energy sector so we are not picking winners and losers. It has both bipartisan and bicameral support.

Are you familiar with MLPs and the benefits they provided to infrastructure in our energy sector? And do you think expanding MLPs to all forms of energy might be a wise way to expand infrastructure investment opportunities?

Secretary MNUCHIN. I am very familiar with MLPs and the role that they serve. I am less familiar with the issue, as you have suggested, about expanding them. But I will consult with our Office of Tax Policy and look at that and would be happy to review that with you.

Senator COONS. It is a conversation I have had with both of your predecessors who tended to oppose pass-through entities. I think we are in a different environment now, and I am hopeful that we might have a constructive conversation about it.

I share your hope that charitable giving does not go down, but I also wanted to raise a concern about deficits more broadly.

As a potential consequence of the tax bill, the chief economist of Goldman Sachs said yesterday that his projection is that the current deficit is \$825 billion. By 2021, it will go to \$1.25 trillion; by 2028, to \$2.05 trillion. All of this creating upward pressure on interest rates and I think potentially harming growth, which is the principal goal that you have identified.

Do you think at some point, if deficits and the national debt continue to grow, that we should reconsider some of the provisions of the tax bill?

Secretary MNUCHIN. I do not necessarily think we should reconsider certain provisions of the tax bill. I continue to think that if we hit our targets on GDP, that the tax bill will pay for itself.

But I do share your concerns about deficits overall. I think as it relates to the spending issue, the President was very focused on increases in military spending, and increases of non-military spending went along with that. I do think that deficits are something we do need to look at and address. But our primary goal right now is economic growth.

Senator COONS. Let me ask you a last question, if I might.

I was deeply concerned by recent reports that important financial information about Michael Cohen, President Trump's personal attorney, could not be located by law enforcement. A whistleblower from U.S. law enforcement said two suspicious activity reports on money paid to Mr. Cohen's account were missing.

Can you say that the Treasury Department did not remove, distort, or destroy any suspicious activity reports (SARS) related to Michael Cohen?

Secretary MNUCHIN. Mr. Senator, first of all, I very much appreciate you asking me this question because I think there has been misinformation on the press about this.

As we have recently said, let me first comment that I personally have not been involved in any of the procedures or anything associated with this. But I will also comment—we do have procedures where at the request of law enforcement agencies, we do have the ability to suppress important information, and for different law enforcement reasons, as you can appreciate, this is often done.

Now, let me also just be clear. I am not making any comments whether this was or was not done, as it relates to these specific SARs, but I do want to comment that the Financial Crimes Enforcement Network (FinCEN) does have a longstanding policy of accommodating the enforcement agencies on that.

I would also comment that our Inspector General is reviewing the issue of leaks. At least there is the appearance that some information may have gone out. I have seen articles that actually reference employees who claim they released information because they thought things that were suppressed. There is no excuse whatsoever for anybody who has access to these important systems to release information on an unauthorized basis, and I can assure you our Inspector General is reviewing these issues very carefully.

Senator COONS. If I might, Mr. Secretary, I appreciate that your IG has been directed to investigate leaks. Is the IG also investigating whether or not there has been any inappropriate interference with the SARs that are alleged to be inaccessible or missing?

Secretary MNUCHIN. Again, they are reviewing everything associated with the information of the SARs, both the technology issues, the issues around logging. Again, I can assure you that they are doing a thorough review because this system of SARs is absolutely critical to our entire FinCEN effort, and we need to make sure that it is in no way at risk.

Senator COONS. I am glad you are committed to the integrity of the Financial Crimes Enforcement Network and to hear that the Inspector General is looking at this broadly. And I would look forward to any follow-up from you on this. Thank you, Mr. Secretary.

Senator LANKFORD. Mr. Secretary, one quick question, as well as a follow-up on what Senator Coons was talking about also. It is a big concern for me, and that is the charitable giving side.

One of the challenges that we have had is getting up-to-date information. Often when we go back to IRS and say tell us the tracking on this, they will give us the information that may be 4 years old. With the charitable giving and that change, that is something we are going to have track pretty carefully to be able to see if that was a wise choice. There are, at this point, guesses on how that will happen, but it is all educated guesses as we go through the process of what that will mean for charitable giving in the days ahead.

How quickly do you think we can get accurate tax information at the end of this next year to be able to see what actually happened in charitable giving and the changes?

Secretary MNUCHIN. I think we will have some pretty good data so that we could begin to see the impacts of that.

Senator LANKFORD. Do you think that will take 18 months? Do you think that will take 6 months? How long do you think it will be before we get some good guesstimates?

Secretary MNUCHIN. I am going to have to confer with the Commissioner on that, but you are free to ask him that question.

Senator LANKFORD. We will follow up as well. It is just one of the things we will want to be able to look at. I would say from my perspective, I do not want to have to wait 3 years to be able to get the last year's information. If possible, to be able to get a rolling year-to-year comparison would help us.

Secretary MNUCHIN. I can assure you I do not want to wait for 3 years either, and we will get that to you.

Senator LANKFORD. It would be very helpful.

Secretary, thank you for being here. You have always been very open to answering questions. You have been available when we have asked you to be able to come in the office, even available by phone. So thank you from both of us and from our subcommittee to be able to walk through this. I appreciate you testifying before the subcommittee today.

At this point, we are going to have a brief pause here as we transition to our second panel with the Acting Commissioner David Kautter.

Thank you again, Mr. Secretary, for being here.

[Pause.]

Senator LANKFORD. Mr. Kautter, being the Commissioner of the IRS is an incredibly difficult task. Being the Acting Commissioner is even more difficult because you are always in flux and in transition. We appreciate you stepping up and being able to take the leadership and to be able to walk us through this. I look forward to receiving your testimony.

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## INTERNAL REVENUE SERVICE

### STATEMENT OF DAVID J. KAUTTER, ACTING COMMISSIONER

Mr. KAUTTER. Thank you, Mr. Chairman and Ranking Member Coons, and Members of the subcommittee. Thanks for the opportunity to discuss the IRS budget and current operations.

I want to begin by thanking Congress and especially this subcommittee for providing the IRS with an increase in funding for fiscal year 2018 in the omnibus budget bill. This funding will allow the IRS to continue delivering on critical priorities, including improving taxpayer service, updating our information technology infrastructure, increasing cybersecurity, and safeguarding taxpayer data.

I also want to express my appreciation for the additional \$320 million in funding to implement the Tax Cuts and Jobs Act and for the flexibility we were given to shift resources between accounts. Implementing the new tax law is a critical priority for the IRS this year and next. Our goal is to ensure taxpayers and tax professionals can understand and navigate the changes made by the new law.

Implementing tax reform is a huge undertaking. We estimate that the IRS will need to create or revise more than 400 tax forms, publications, and instructions. We will need to publish extensive

guidance, including regulations, notices, and frequently asked questions. And we will need to reprogram about 140 interrelated tax return processing systems to be ready for the 2019 filing season. So I am extremely grateful that we received this additional funding in the early stages of our work on the new tax law. It ensures we can start critical implementation activities on time, and knowing funding is available through next year allows us to let contracts appropriately and have the resources needed to test our processing systems in the first quarter of fiscal year 2019.

The broad scope of our efforts required us to begin implementation work almost as soon as the law was enacted last December. We worked on implementing the new tax law while we were administering the 2018 tax filing season. So far, we have issued over 70 pieces of public guidance and have drafted most of the revised tax forms we will need for 2018. We are finishing up the instructions for those forms and plan to release the forms and instructions for public comment over the summer.

Even with this challenge, I am pleased to report the filing season went well overall despite a system outage on April 17 that prevented the IRS from accepting electronically filed returns and some payments for about 11 hours. Later that day, we are able to bring our systems back up, and we subsequently received and processed 14 million electronic submissions. Within 24 hours of the onset of the outage, the IRS had fully recovered and was current in its processing.

For the filing season as a whole, IRS received a total of more than 139 million individual returns. We have issued more than 99 million refunds for more than \$275 billion. About 80 percent of returns filed so far have claimed a refund, with the average refund totaling approximately \$2,800, which is about the same as last year.

Looking ahead, the President's fiscal year 2019 budget requests an appropriation of \$11.497 billion for the IRS, which is \$11.135 billion in base resources, plus \$365 million provided through a program integrity cap adjustment. The President's budget submission seeks less costly ways of delivering taxpayer service and maintaining enforcement using technology, training, and internal efficiencies. The budget balances competing priorities and increases funding to operations support by 6.2 percent.

Dedicated funding is needed now to modernize IRS hardware and software so that we have the technology needed to run the day-to-day operations, transform the taxpayer experience, improve cybersecurity, and ensure we can continue to safeguard taxpayer data.

The IRS is subject to 2.5 million cyber attacks on average each day, 1 million of which are sophisticated attacks. Some of the attacks are referenced to acquire taxpayer data, and some are efforts to disrupt the functioning of the U.S. Government. Against this backdrop, it is important to realize that 59 percent of IRS hardware and 32 percent of its software is obsolete.

In regard to taxpayer service, we understand Congress' concern and are taking steps to improve service through a multi-channel approach.

It is important to underscore the fact that taxpayer service is funded not only by the Taxpayer Service Appropriations Account but also from the Operations Support Account. For example, funds from the Operations Support Account pay for the phones, computers, and office space for our Taxpayer Assistance Centers.

I would also note that the investments needed to improve IRS information technology that I mentioned a moment ago are critical to our efforts to improve taxpayer service. IT is the backbone for how we serve taxpayers today.

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

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

[The statement follows:]

PREPARED STATEMENT OF HON. DAVID J. KAUTTER

INTRODUCTION

Chairman Lankford, Ranking Member Coons and Members of the subcommittee, thank you for the opportunity to discuss the IRS's budget and current operations, including efforts to improve taxpayer service.

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

This piece of legislation was the first major tax reform legislation in more than 30 years. With hundreds of provisions intended to provide relief to American families and make America's businesses more competitive, the new law will require extensive work by the IRS in calendar years 2018 and 2019 to serve the needs of both taxpayers and tax professionals. We appreciate the additional \$320 million approved by Congress as part of the omnibus budget bill for fiscal year 2018. This funding enables the IRS to start critical implementation activities on time, and we transmitted updated implementation plans and cost estimates to Congress recently.

In addition, the IRS has been focused on implementing the tax-related provisions in the Bipartisan Budget Act enacted in early February. Retroactive extension of tax provisions requires the IRS to reprogram its tax return operating systems during the filing season, and by late February the IRS had completed system reprogramming for the three benefits most likely to be claimed on tax returns early in the tax filing season. Since then, the IRS has completed reprogramming its systems, and has updated the necessary forms and instructions, to accommodate the other extender provisions in the Budget Act.

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

The most visible service the IRS provides each year is delivery of a smooth tax filing season. I'm pleased to report that the 2018 filing season began on schedule on January 29 and went well overall, despite a system outage on April 17 that prevented the IRS from accepting electronically filed returns and some payments for

about 11 hours. Later that day we were able to bring our systems back up, and we subsequently received 14 million electronic submissions. Within 24 hours of the onset of the outage, the IRS had fully recovered and was current in its return processing. For the filing season as a whole, the IRS received more than 139.9 million individual returns through April 27. We have issued more than 99.5 million refunds for more than \$275.7 billion, with the average refund totaling approximately \$2,800. The average phone level of service (LOS) on our toll-free lines for the filing season was about 80 percent. During calendar year 2017, the IRS received more than 150 million individual income tax returns, 87 percent of which were filed electronically.

#### THE PRESIDENT'S FISCAL YEAR 2019 BUDGET

The President's fiscal year 2019 budget request of \$11.135 billion includes savings and reductions of \$24.5 million and more than 2,200 full-time equivalent equivalents (FTE) compared to the fiscal year 2018 enacted level (excluding the one-time funding of \$320 million provided for tax reform in the final bill).

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

#### *Taxpayer Services*

The President's budget request includes \$2.24 billion for taxpayer services. We will continue our investments in improving the use of online tools and offerings and modernizing the taxpayer experience. The IRS is mindful of the need to continually improve our efforts to ensure taxpayers can file their taxes as quickly and easily as possible. We will continue expanding opportunities for taxpayers and their representatives to complete service and compliance interactions through their preferred channel, be it online, over the phone, or in-person at one of the IRS's many Taxpayer Assistance Centers (TACs).

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

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

#### *Operations Support*

The President's budget request includes \$4.16 billion for operations support programs including rent, cyber and physical security, IT services for all IRS employees, and core tax processing and compliance systems. Within that total, \$2.29 billion is allocated for information services.

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

At the end of fiscal year 2017, more than 59 percent of IRS hardware was past its useful life compared to 64 percent at the end of fiscal year 2016, and 32 percent of software was two or more releases behind the most current commercially-available version. The fiscal year 2019 budget provides \$187.8 million to enable the IRS to implement critical hardware and software upgrades and reduce system outages and failures.

Sustained investments in IT are also required to improve cybersecurity and ensure the IRS can continue to safeguard taxpayer data. The IRS combats more than 1 million cyberattacks daily, and operates strong network perimeter defenses to

mitigate threats, detect vulnerabilities and monitor network security. The 2019 budget includes \$303.7 million for these critical activities.

#### *Enforcement*

The President's fiscal year 2019 budget includes \$4.63 billion for enforcement programs. In addition, the budget also includes a program integrity cap adjustment for improving the effectiveness and efficiency of the IRS's overall tax enforcement program.

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

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

#### *Business Systems Modernization*

The President's budget includes \$110 million for business systems modernization. To gain efficiencies, secure and protect data, and reduce the resources necessary to maintain existing systems, the IRS will continue efforts to modernize its systems. Our main initiatives in this area are: expanding the digital conversion of paper case files, automating repetitive manual processes, leveraging existing data to detect tax noncompliance earlier, and enabling a strong and secure systems platform for taxpayer-facing applications.

#### IMPLEMENTING THE NEW TAX LAW

Implementing the Tax Cuts and Jobs Act is one of the IRS's highest priorities. The IRS has established a Tax Reform Implementation Office, led by senior leadership, to ensure its successful administration. Our efforts to implement this new law began shortly after its enactment. For example, the IRS issued two important pieces of guidance related to the new law on December 29, 2017: notices that address amended section 965 of the Internal Revenue Code and the new section 1446(f). Subsequently, the IRS has issued additional guidance relating to section 965, including a set of Frequently Asked Questions that deal primarily with how to report the transition tax.

Additionally, the IRS and the Treasury Department have been working to update the income tax withholding process to take into account changes made by the new statute that affect virtually every taxpayer who receives a paycheck. In early January, we released updated withholding tables for 2018. In late February we released an updated version of our online Withholding Calculator on IRS.gov, which taxpayers can use to help them ensure the correct amount of tax is being withheld from their paychecks. At the same time, we released a revised Form W-4, Employee's Withholding Allowance Certificate, that more fully reflects the new law.

Additional published guidance on the new tax law will be provided as the Treasury Department and the IRS continue to analyze the law and its impact on tax administration. The 2017–2018 Priority Guidance Plan issued by the Treasury Department and the IRS includes projects related to the law, and updates to the plan are published periodically.

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

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

## LEGISLATIVE PROPOSALS IN THE PRESIDENT'S FISCAL YEAR 2019 BUDGET

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

*Program Integrity Cap*

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

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

*Streamlined Critical Pay Authority*

The IRS Restructuring and Reform Act of 1998 increased the IRS' ability to recruit and retain a small number of key executive-level staff by providing the agency with streamlined critical pay authority. This allowed the IRS, with approval from Treasury, to move quickly to hire well-qualified individuals to fill positions deemed critical to the agency's success, and that required expertise of an extremely high level in an administrative, technical or professional field. Executives hired under this authority included our former Chief Information Officer, a senior cybersecurity expert, our system architect, the director of our online systems development team and other senior IT executives. This authority expired at the end of fiscal year 2013. The last appointment made under Streamlined Critical Pay authority expired on September 29, 2017. Without this authority, the IRS continues to face challenges recruiting and retaining top-level talent, especially IT professionals who can help modernize our IT systems and protect taxpayer data from cyberattacks. The President's fiscal year 2019 budget request proposes reinstating this authority through fiscal year 2022.

*Correction Procedures for Specific Errors*

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

*Authority to Require Minimum Qualifications for Return Preparers*

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

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

Senator LANKFORD. Thank you very much for your statement and your preparation and the ongoing work there in that role.

Let me get right to a couple issues and we will try to clear this up and have an ongoing dialogue.

## IRS TECHNOLOGY

The first of which, let us talk about tax day and about filing, the 11-hour time period that there was the shutdown of the system. It is my understanding—though you had mentioned about 59 percent of the hardware is obsolete that is within our current system. My understanding is the particular piece of hardware that failed there was only a year and a half old at that point. Help us walk through the mechanics of what happened and how we are avoiding that for next year.

Mr. KAUTTER. Certainly. So you are correct, Senator. The equipment that failed is a year and a half old. It was what is called firmware, which is the software that actually runs the mainframe computer. These mainframes are in operation around the globe. This particular problem has only ever occurred once before. So it so happens that it happens on the last day of filing season. But we were able to quickly diagnose the problem. Within 12 hours of the problem having occurred, we had the systems back up and running. We did it on a planned basis where we started out small and then opened it up wider. Within 24 hours of the system problem, we had processed all the returns that were in the system and we were back up and running.

I think one of the lessons that we have learned, frankly, from this last episode is that probably during the peak of filing season, we need to keep our backup system up and running simultaneously with our mainframe systems.

Senator LANKFORD. This 5-year plan that is being discussed that the Secretary just mentioned—in the next 90 days, we will get some kind of update on that. How engaged are you in that process?

Mr. KAUTTER. I am very involved in it. In fact, it is hard for me to meet with the Secretary without him mentioning it. We are well along the road for developing that plan. We have got a pretty good outline of all the systems and the detail behind it. And right now, we are working on the cost of updating the systems in various stages.

But the IRS I think has done a fairly good job of strategically investing the technology dollars that it has. The hardware that runs the core filing system is up-to-date and current. The language that runs on those mainframes is not up-to-date and current. It is, frankly, a language from the 1960s. It is a solid language. It is stable. We can use it. But having the ability to use more modern language so the systems can be better integrated would be very beneficial to the IRS and efficient operating of the filing systems.

The other aspect. By using that old language, Mr. Chairman, the system is built block upon block. It is not an integrated system. So although we have got modern hardware, the software is really our Achilles heel. And I frankly personally, having been in the job 6 months and coming from the private sector, my sense is the best way to deal with this is going to be in a major, comprehensive way. I think dealing with it in an incremental approach is going to be highly inefficient and is not going to get the sort of efficiencies that you are looking for.

Senator LANKFORD. I would say when we hear “major, comprehensive way,” we typically hear outside contractor coming in,

charging us a fortune for their consulting services and doing a few things. We will want to be able to have an ongoing dialogue to be able to make sure that at the end of it, 3 years later, IRS is not coming back and saying we still have legacy systems. Millions were invested and most of it went to contractors rather than to actually solving the problem.

Mr. KAUTTER. I think that is fair. And I also think it is fair to say the IRS in the past has not done a particularly good job with respect to its technology dollars. The leadership team that is now in place in the IRS on the operations support side has been in place less than 2 years. The Deputy Commissioner has been in his job just a little over 2 years, and the eight primary deputies have all been in their jobs under 2 years. So I think it is a new team that is energetic, knowledgeable, and I hope and I believe will get a different result.

Senator LANKFORD. Let me ask you about the new tax regime and trying to be able to shift over to a new system. At this point, are you on schedule with the transition for the 2018 filing?

Mr. KAUTTER. Yes, sir. We have all the forms drafted. We are working on the instructions. They will be done within the next 2 weeks. The plan is for the forms and the instructions to be released over the summer for public comment. The publications that need to be amended are well in process of being amended and are on track.

The most time-consuming and expensive part of tax reform implementation is technology. For the \$397 million request we originally made, 73 percent of that is for technology. We have already started to develop the software to implement tax reform. The major piece that is left is guidance. We expect to have proposed regulations on most of the major pieces of the tax reform out by the fall. So we are on track. You could always do better. We could always move a little faster, but I think we are in pretty good shape.

Senator LANKFORD. It is my understanding there is a \$77 million request that is the second tranche. Is that a correct number?

Mr. KAUTTER. Yes, sir. That is correct.

Senator LANKFORD. Let me recognize the Ranking Member, Senator Coons.

Senator COONS. Thank you, Chairman Lankford.

Mr. Kautter, providing access to quality customer service helps American taxpayers understand their obligations so they can pay the right amount in a timely way. It is important to me that Delawareans, Americans are able to get the assistance they are seeking from the IRS so that they can, in good faith, pay the taxes they owe. For several years, for much of my time on this subcommittee, the IRS service level has, frankly, been awful and unacceptable. In 2015, only 38 percent of calls to the IRS were answered, and callers, American taxpayers, experienced an average waiting time of more than 30 minutes. Those service numbers have come back up significantly this year. Yet, as I understand your budget proposal, it is to make headcount cuts that will bring it back down. In fact, I think your goal for this coming year is, again, that 39 percent of calls to the IRS are answered. And that means if you reach that goal, the majority of American taxpayers calling with questions will never reach anyone to get an answer.

Why is that an acceptable goal for the IRS? And how do we return to a level of service experienced back in 2004 when the IRS answered 87 percent of phone calls and wait times averaged just 2 and a half minutes?

Mr. KAUTTER. Well, Senator, let me respond in two ways.

First of all, in putting together the budget, we had to make some choices between funding. And given the increasing number of cyber attacks, the sophistication of those attacks, and the age of some of the software and hardware that we have at the IRS, the decision was made to invest in operations support. Now, that is short term. It is not forever. And we talked about funding for technology to get the IRS up to speed. But it is just a hard choice that we had to make.

Second, with respect to level of service, if you look at the IRS response to telephone calls, you find a wide array of response between various phone lines that the IRS operates. The phone line for taxpayers calling to ask questions of the IRS, individual taxpayers—the level of service for that over the last filing season was 80 percent. And I do not mean to minimize the fact that other lines are not answered nearly as quickly. But with respect to that line, it is 80 percent.

Senator COONS. And given the hard choices you are referencing, do you expect it to continue to be 80 percent this coming filing season?

Mr. KAUTTER. Under the budget that has been submitted, it would be less than 80 percent.

Senator COONS. How much less than 80 percent?

Mr. KAUTTER. It would probably be in the 60–65 percent range.

Senator COONS. So about 40 percent of Americans who call looking for assistance, given a sweeping tax code reform, the biggest in 30 years, about 40 percent would not get an answer.

Mr. KAUTTER. I think that is a terrific question. So it is important to realize—

Senator COONS. It is. So let me just interrupt you there, if I might, because I asked the same question of the Secretary and I am expecting a better answer from you. I hear that you have got competing demands. You have got cyber attacks. You got aging IT equipment. One path is to cut service to American taxpayers. A better path would seem to me to to be invest in program integrity activities. If I understood your testimony right the tax gap, taxes that are owed but not paid, is about \$400 billion. If the IRS invested, I think you said, \$15 billion in program integrity over 10 years, it would recoup \$44 billion in additional revenue.

Mr. KAUTTER. Yes, sir.

Senator COONS. Well, so that is a roughly 3 and a half, 4 to 1 return on investment. You have got two options: lay people off and cut services so more Americans trying to seek taxpayer assistance are frustrated and confused, or invest in making sure the tax cheats actually pay their taxes. It seems to me there is an obvious alternative and much better choice.

The request from the IRS also requested a program integrity cap adjustment, which is sensible but something that the IRS has requested year after year after year. The Budget Committee has never provided appropriators with that adjustment. In fact, I do

not believe there is a Budget Committee vehicle that would even allow that this year.

So let me just suggest that perhaps a better approach is to request funding for program integrity activities—in other words, finding people who are cheating on their taxes—within your base budget request.

Could you please just share with me what you think the IRS should be spending on enforcement activities to maximize return on investment, and what are you doing in the current budget to reduce the tax gap?

Mr. KAUTTER. If you look at enforcement activity, it is down, over the last 10 years, 37 percent across the board, the number of audits. Part of the challenge is that, again given budget priorities, we are trying to decide between operations support and hardware and software.

But I would also say with respect to enforcement, the IRS is much more sophisticated today than it was 5 or 10 years ago in its use of technology and data analytics to identify taxpayers to audit. For example, an individual taxpayer making more than a million dollars a year is seven times more likely to be audited than a taxpayer under \$200,000 a year. With respect to taxpayer data that is submitted on information forms, the level of compliance is in the upper 90 percent range. Where we have our problems with the tax gap tends to be in the cash economy and with respect to activity that is not reported anywhere on a form that the IRS can find.

So I think enforcement is at a point where we need to start looking seriously about enhancing what we do. But I am not as concerned as some. I am concerned. I am not as concerned as some because I have seen what data analytics and technology can do in terms of identifying areas of noncompliance.

Senator COONS. Let me just make sure I have understood your testimony. Do I understand your testimony correctly that there is a significant tax gap, that auditing rates have been steadily declining over the past decade, and that significant improvements, increases in investment in tax enforcement, would bring a multiple rate of return for every additional dollar spent?

Mr. KAUTTER. It is true that—

Senator COONS. Then why on earth would we not do that?

Mr. KAUTTER. In a finite world, we have to make decisions between technology and—

Senator COONS. Door number one, generate more revenue. Door number two, frustrate American taxpayers by cutting services. It seems to me like an easy choice.

Mr. KAUTTER. Well, I think we will go back and take a look at what else we can in the enforcement area. Thank you.

Senator COONS. Let me ask one last question, if I might.

The National Taxpayer Advocate has endorsed an approach for years that would assign a single IRS account representative for tax-related identity theft and refund fraud victims. I noted that in your testimony the number of tax refund fraud victims dropped significantly over the past year from 400,000 in the previous year to 240,000 in calendar 2017. I just want to commend you and the folks at IRS on that improvement. That is still a quarter of a mil-

lion Americans facing the deeply frustrating experience of refund fraud.

What changes have you made to take into account this input from the Taxpayer Advocate, and how might we work together to make sure that the handling of tax refund fraud and identity theft is as streamlined and efficient as possible? These are some of the toughest constituent calls I get, people who are really upset.

Mr. KAUTTER. We are in the process of putting together a report on what we can do with respect to enhancing the identity theft area. We had great success. We are down 65 percent on the number of reported tax-related identity thefts over the last 2 years. I think the challenge is to get the number down to that point.

We have had to introduce a number of filters within the processing system. Some of those filters produce false positives. We end up holding up refunds longer than taxpayers would like. We are in the process of revisiting those filters and seeing what we can do to reduce the number of false positives.

I would also say, Senator Coons, prevention is part of the problem. With respect to helping taxpayers, once they are victims of identity theft, we have set up a separate identity theft victims assistance group, and they have had great success. About 75 percent of the victims have their problems resolved within 4 months. And again, we would like to get that down to a lower level. Our inventory is 5 percent of what it was 2 years ago.

Senator COONS. And is part of the actions that group is taking having a single point of contact for identity theft victims?

Mr. KAUTTER. It is. So what we have moved to is a small group concept, a team concept, for an individual taxpayer. We looked at providing sort of the one-on-one relationship, and our concern with that was that sometimes that one individual who is your point of contact within the IRS could have a large caseload. They could be on vacation. They could be out. So what we have moved to are small teams where the information can be exchanged easily and the taxpayer's account is sitting right there in front of that team. So I think that is a wonderful approach, and we are in favor of that.

Senator COONS. Well, thank you. I would appreciate the chance to have a longer dialogue with you about that, and I look forward to hearing about your reconsideration on enforcement investments. Thank you.

Mr. KAUTTER. Yes, sir.

Senator LANKFORD. Senator Van Hollen.

Senator VAN HOLLEN. Thank you, Mr. Chairman.

Welcome.

#### POTENTIAL IMPACT OF THE TAX BILL

Let me just first apologize for being late. I was just in a Banking Committee where we had a markup on a Committee on Foreign Investment in the United States (CFIUS) bill. And I am pleased that the committee adopted an amendment I offered on a bipartisan basis dealing with ZTE and Chinese telecommunications companies that have violated U.S. sanctions. I understand there was a lot of conversation about that here today. But in the Banking Committee on that bill—and the bill passed—there is now a provision that es-

essentially says that the President may not unilaterally change sanctions in place against a Chinese telecommunications company unless he certifies that the company has been in compliance with U.S. law for more than a year and that they are fully cooperating with the United States. So I was pleased to see bipartisan support for that.

So I have a couple of questions with respect to the tax law that passed. I understand you are double-hatted. Right? You are the Acting Commissioner of the IRS but also the Assistant Secretary that oversees tax policy at the Department. Right?

Mr. KAUTTER. Yes, sir.

Senator VAN HOLLEN. And I understand that the Secretary, Secretary Mnuchin, again claimed today that the tax bill that we just passed would pay for itself, meaning that it would not add to the debt. Is that a correct statement of what he said?

Mr. KAUTTER. Yes, sir.

Senator VAN HOLLEN. A simple question. At the time that the tax proposal was being put forward, Secretary Mnuchin said there were 100 analysts at the Secretary of the Treasury working on all the implications of this and that they were going to give us the analysis showing the impact on the debt. They were going to give us distribution analyses. All we ended up was getting a one-pager. In fact, I have got the one-pager here with me.

So my question is did the Department of the Treasury do an analysis showing what the impact of the tax bill would be on the debt?

Mr. KAUTTER. We had extensive analysis run as the bill was being considered, and I think it culminated in that one-page document that you are seeing.

Senator VAN HOLLEN. So that is it. So all that work culminated in a one-page analysis.

Mr. KAUTTER. There is a lot behind it and that is the summary.

Senator VAN HOLLEN. With all respect, Secretary, I mean the reality is that when the Joint Committee on Taxation does an analysis, they provide a document that shows how they got to their answer. So that is it. The one-pager is all that came out of that. Is that correct?

Mr. KAUTTER. To my knowledge, that is all that is being publicly released. Yes, sir.

Senator VAN HOLLEN. Is there analysis that has been done that is not publicly released that would show the impact on the debt?

Mr. KAUTTER. I do not know about the impact on the debt. I mean, we vigorously analyzed each provision, its impact, on various segments of the economy.

Senator VAN HOLLEN. But the Secretary is making claims about its impact on the debt, and so that is why I am focused on this issue because we have a full analysis that was recently presented to the Congress from the Congressional Budget Office that indicates that the debt would increase by close to \$2 trillion over the next 10 years. Have you had a chance to see that?

Mr. KAUTTER. Yes, sir.

Senator VAN HOLLEN. And do you have any reason to dispute their analysis?

Mr. KAUTTER. I think it is a reasonable analysis.

Senator VAN HOLLEN. I do too. And what is interesting is that when the Inspector General of the Department of the Treasury looked at some of these issues and asked one of the key people in the tax policy department, Mr. Mackey—are you familiar with Mr. Mackey?

Mr. KAUTTER. Yes, sir.

Senator VAN HOLLEN. I mean, he is a professional. Right?

Mr. KAUTTER. Yes, sir.

Senator VAN HOLLEN. They asked him about the previous JCT, Joint Committee on Taxation, analysis which showed that if you take into account the economic impact, you still have a trillion dollar addition to the debt. And that does not include, by the way, any additional interest on the debt.

And Mr. Mackey—when he was asked by the Inspector General about this, he said that the JCT estimates were, quote, widely considered to be reasonable. Unquote. Do you dispute that?

Mr. KAUTTER. I think they are reasonable. Yes, sir.

Senator VAN HOLLEN. Thank you.

Mr. KAUTTER. But I would say, Senator, once you move into predicting the future, there is a wide range of reasonable estimates that can be made. The Secretary, who I talk to daily, feels very strongly that the economic activity will create enough revenue for the tax bill to pay for itself. And I also believe that is within the range of reasonable estimates.

Senator VAN HOLLEN. Here is the issue. Feeling is one thing; analysis is another. Would you agree?

Mr. KAUTTER. Yes, sir.

Senator VAN HOLLEN. I mean, we would all love to say that whatever we are going to do is generate—why stop at 3 percent growth? Why not 4 or 5? But the reason you do analysis is to get your best estimate. Right?

Mr. KAUTTER. Yes.

Senator VAN HOLLEN. And as I understand what you are saying, the Treasury has not done that detailed estimate with respect to the debt, and yet the Secretary of the Treasury is making public comments very confidently predicting this thing is going to pay for itself when the CBO says it is going to add \$2 trillion to the debt and you—and I give you full credit—just said the CBO analysis is a good, reasonable analysis. So what are we supposed to believe?

Mr. KAUTTER. The analysis on the debt may have been made, Senator. I am just not aware of it at the Treasury Department.

Senator VAN HOLLEN. Well, if it has been made, I am going to ask you to make that available to the Congress because I think the American people are due whatever work product came out of an analysis of a tax bill. And so I would ask, Mr. Chairman, that if there is such an analysis, that the subcommittee request it from the administration.

Senator LANKFORD. I have no issue with that. Obviously, typically internal documents are internal to the executive branch and always have been. But if there is a document that we can get, we should.

Senator VAN HOLLEN. Well, this is just an analysis of the impact of the tax bill on the debt. I am not looking for any kind of work product information. And given that the Secretary continues to

make these statements, it would be interesting to discover what the basis of it is because most people believe that the CBO analysis was a reasonable one. So I appreciate that, Mr. Chairman, and thank you.

The last question I have. Did you do a distributional analysis at the Department of the Treasury?

Mr. KAUTTER. We have looked at distributions. Yes, sir.

Senator VAN HOLLEN. Because I did ask the Secretary about that in a Banking Committee hearing a little while ago. And I would also respectfully, Mr. Chairman, request the distribution analysis that was done by the Department of the Treasury.

Senator LANKFORD. I have no issue with that as well. Actually long-term on this—I appreciate your questions. Long-term is going to be over the next 2–3 years, as the actual numbers come in. The estimates at the beginning are one thing. Actually what occurs in the economy will be the real evidence as we roll out in the next couple of years.

Senator VAN HOLLEN. That is true. We all try to do analyses so that we can make the best decisions possible, given the information at hand. And I have seen the JCT estimate. I have seen the CBO estimate. I have seen the backup material for that. So it would be useful to have the backup material that the Secretary of Treasury is using. Thank you.

Senator LANKFORD. Thank you.

Senator DAINES.

Senator DAINES. Thank you, Mr. Chairman.

It is good to have you here, Mr. Kautter. Thank you for being here.

Obamacare violates the principles of Tribal sovereignty— it is a big issue for me back home in Montana for our Tribes—because it requires Indian Tribes to either provide health care coverage for their employees or face fines of \$2,000 per employee. These penalties would prove disastrous for our Tribes. The fines outstanding are seven-figure in nature. Their economies are already struggling. In many cases, Tribal governments would be forced to cut essential services to their people or lay off employees in a climate where jobs are already very scarce.

Last Congress, I offered some legislation that would exempt Tribal governments and tribally owned businesses and organizations from this severe standard. I am announcing right here and right now that I will be reintroducing that legislation again very soon.

Mr. Kautter, could you provide an update on where the IRS is in levying fines for noncompliance with the employer mandate?

Mr. KAUTTER. Yes, sir. At this point, the IRS has identified about 32,000 employers who may be subject to the penalty. We have issued 11,000 letters, just a little over 11,000 letters at this point. We have closed a little over 3,000 of those cases or letters. Of those 3,000, almost 82 percent have resulted in no change. It is basically the taxpayer filled out the form wrong. So we have had a high no-change rate. The amount of penalties assessed at this point is about \$83 million.

Senator DAINES. So thank you. I am impressed you have those numbers right there off the top of your head. I can tell you watch this very carefully.

But to confirm, the IRS is still working to exact those fines against Tribal governments, tribally owned businesses, and Tribal organizations in the same way that the IRS is going after other large employers. Is that correct?

Mr. KAUTTER. Yes, sir.

Senator DAINES. Do you know how many Native American governments, businesses, or Tribal organizations will be held liable for penalties under the employer mandate for tax years 2015 and 2016?

Mr. KAUTTER. No, Senator, I do not.

Senator DAINES. Would you be able to get that information to me after today's hearing?

Mr. KAUTTER. So you are looking for the number of—I will get the question from you.

Senator DAINES. Yes, the number of Native American governments, businesses, Tribal organizations that are held liable for penalties for 2015 and 2016.

Mr. KAUTTER. Yes, sir.

Senator DAINES. Thank you. And we will give the specifics as well on that just to be clear on it. Thank you for that.

I think it is important. And the purpose of that question and to get that data is so that we can better understand the scope of the employer mandate's negative impacts to Indian Tribes. And I look forward to leading the charge once again to prevent these negative impacts on our Tribes, and remedy would be the legislation I am proposing.

I want to shift gears and talk about freedom of speech. Mr. Kautter, as you may know, the previous Commissioner back in 2015 made statements questioning whether Schedule B forms for tax exempt organizations were necessary and also expressed concern about whether the confidentiality of the information can be kept. Recently we have seen tax-exempt organizations call for the Treasury and the IRS to suspend Schedule B forms for tax-exempt organizations in order to protect anonymous free speech.

Do you support this effort and will you act?

Mr. KAUTTER. Senator, I am actively involved with the Secretary looking at Schedule B, and I think for many organizations, there frankly is not a requirement. We do not need that information to administer the tax laws in a fair and equitable way. So let me work with the Secretary and get back to you. I know it is an issue of interest of his and it is an interest of mine, and I think we could do something with respect to Schedule B going forward.

Senator DAINES. Thank you. It was, I think, chilling for many of us who watched that unfold in the last administration, a fundamental First Amendment issue on freedom of speech and of expression. So I would appreciate your help in this effort.

Mr. KAUTTER. Yes, sir.

Senator DAINES. Thank you, Mr. Chairman.

Senator LANKFORD. Let me follow up on Senator Daines' question. It was one of the questions that I had as well.

Tell me what has changed in the exempt organization's portion of the IRS. There has been, obviously, a tremendous amount of attention focused on them over the last 8 years. What have you seen as a change in operation of what forms are required, the process,

the time period to be able to get answers back for all organizations regardless of the background? Tell me what has changed in the exempt organization's portion of the IRS.

Mr. KAUTTER. Sure. From my perspective, Mr. Chairman, the leadership of that division within the IRS has changed. The leadership has set a completely different tone than I think the tone that existed in that organization in the past. They are interested in fair and equitable administration of the law. I think your question earlier about how do you change the culture in the IRS, I think it is the same as any organization. It has to start at the top and it has to be driven through management and accountability.

I think that is what has happened to tax-exempt organizations. We continue to look at, as Senator Daines suggested changes in the forms and the filing that could be made that would allow us to continue to administer the tax law, reduce the regulatory burden on taxpayers, and assure that the laws are being complied with by tax-exempt organizations. So it is an area of great interest to me and, as I said, I think significant changes have been made and continue to be considered.

#### MINIMUM QUALIFICATIONS FOR RETURN PREPARERS

Senator LANKFORD. We will continue to be able to follow up on that in the days ahead as well.

You, in your written and then briefly in your oral testimony, had mentioned three requests that you have for additional legislation, one of them being authority to require minimum qualifications for return preparers. Let me ask the why on that, and I think I know the why, but I would like you to be able to clarify the why, and then let us talk about this business. It has been an ongoing conversation with IRS and Congress.

Mr. KAUTTER. Sure. I think two reasons. Accurate reporting by taxpayers is critical to the functioning of the tax system. Fifty-six percent of all returns prepared are prepared by a paid return preparer. There are about 650,000 paid tax return preparers. Sixty percent of those folks, about 400,000, have no professional credentials whatsoever. They are not CPAs, attorneys, or enrolled agents. The accuracy of those returns is not as high as it should be. That creates problems for the taxpayers who have used those individuals. It creates problems for the IRS. And requiring minimum competency and some annual education for someone who wants to be a paid tax return preparer seems to me to be a reasonable approach to help facilitate operation of the system.

Senator LANKFORD. So in previous dialogues that I have had with IRS leadership before, there is always the carrot and the stick conversation. Obviously, this was attempted before several years ago and then was ruled and was kicked out by the courts on those mandates, saying that there is not legislative support for that requirement. The question is, would the carrot work better on it? For instance, if you are a paid tax preparer, your returns come faster if you have already been through training. If you have not been through training, then your returns may take 2 months to come back, and you would have to be able to tell people as a tax preparer am I one that can get your return fast or am I one of those guys that can get your return, but it may be 2 months down the road

for it. Is there a way to be able to do that kind of prioritization saying those that are certified can do faster returns, those that are not certified do slower?

Mr. KAUTTER. An interesting approach, Mr. Chairman. I have not looked into that. In theory it is possible. We would have to gather some additional information to implement something like that. It does disadvantage those individuals who use return preparers who are not certified. And I guess different people would have different opinions on whether that is a good approach or not.

Senator LANKFORD. Well, typically if you are an individual doing a return, they are going to advertise, hey, we can get your return fast. You cannot say that if you cannot actually get the return fast. You are not actually certified to be able to do it. So the encouragement is, get the training, get the certification. Then you can help people actually get a faster return. If you do not get certified, then you are not.

Mr. KAUTTER. An interesting approach. And I would say in order to implement that approach, we would probably need some legislative authority to require the education of the return preparers and to implement that policy. But not having considered it, I would have to look into that.

Senator LANKFORD. Let us keep that ongoing conversation between us and our teams and see what may be needed because there may be some other ways to be able to deal with this.

#### IMPROPER PAYMENTS

This issue about improper payments. Obviously, this has come up over and over again on the issue about tax preparers that are, again, not qualified, that are putting out inconsistent information about improper payments. GAO has listed it as a high risk issue for years. The Inspector General has listed that as a major issue to be able to address.

Where are we right now on dealing with the issue of improper payments?

Mr. KAUTTER. This is an issue that has been looked at for years. It is very frustrating. If you look at the improper payments with respect to the earned income credit, the education credits, and the additional child tax credit, there are probably three broad sources of noncompliance. Let me divide it into two categories.

The legislation with respect to refundable credits is very complicated. It is some of the most complicated legislation in the Internal Revenue Code. And I say that as somebody who has been a tax practitioner for 40 years. The definition of who is a qualifying child, trying to identify the family income—many taxpayers misinterpret filing status, get head of household versus married, believe it or not. Our analysis is about 6 percent of the overpayments are attributable to the fact that the IRS does not have on hand the financial data to verify income of those individuals claiming the refundable credit.

Senator LANKFORD. Did you say 6 percent or 60 percent?

Mr. KAUTTER. Six.

Ninety-four percent of the problem, as we have analyzed it, comes from the complexity of the legislation, the definition of a qualifying child. Is someone a relative? How long do they live in

that household? And then second, the marital status. That is, in our analysis, 94 percent of the problem. And it is frustrating because I will sit here and tell you without changes in that legislation or invading people's lives, the IRS will continue to pay out \$20 billion to \$25 billion a year, year in and year out, in improper payments. I take no pride in saying that. It is in fact the way the system is structured.

Senator LANKFORD. Is that something that your team could make specific recommendations and say this is the area where, if we can clean this up, this will make an enormous difference?

Mr. KAUTTER. We have looked at it. We will make some recommendations. I do not know that we have got anything that will make an enormous difference unless we change some of the fundamentals of the statute.

Senator LANKFORD. Well, clearly that is something that Senator Coons and I do not handle here from our appropriations, but obviously, the Finance Committee does. And that type of language would need to be addressed in the authorizing statute. But that specific recommendation to be able to deal with a long-term issue is important, GAO has mentioned that year after year as a high risk. IRS continues to be able to say we need greater training typically for tax preparers because it is where they miss it. But if there are ways to be able to clean up the language and you have recommendations, we would be pleased to be able to pass those on.

Mr. KAUTTER. Yes, sir.

#### TAX LAW CHANGES

Senator LANKFORD. Let me ask about next year's tax filing. As you are going through and preparing forms, is there an estimate at this point of how many individuals—now, this is not just the business side but for the individual tax side—will have a simplified process of filing their taxes and what those forms might look like for Americans?

Mr. KAUTTER. We are right in the middle of trying to design the Form 1040 for next year, and I would hope within 2 weeks to 3 weeks we have got a pretty good idea of what that new design looks like. One thing for sure under the tax reform bill, the number of individuals itemizing on their returns will drop from about 35 percent of all taxpayers to 10 to 12 percent of all taxpayers. So that in and of itself will be a substantial simplification.

Senator LANKFORD. So as far as the 10 to 12 percent, those are still in the 1040 area. Are you anticipating the other 88 to 90 percent are on the 1040-EZ at that point?

Mr. KAUTTER. We are looking at the entire family of 1040 forms, including 1040-A and the 1040-EZ. And we are working on some concepts that might dramatically change the way that family of forms is structured.

Senator LANKFORD. Well, we will look forward to getting a chance to get a follow-up on that.

Senator Coons, do you have additional questions?

Senator COONS. Let me just ask one last question. Given that significant drop in the number of filers who will itemize, what is your expectation about the potential impact on charitable giving? I know you heard me ask the same question of Secretary Mnuchin.

Mr. KAUTTER. So I think it is a tough question. It is trying to predict the future. My sense is that most taxpayers—this is just personal, Senator—do not give because of the deduction. I think many give out of a sense of charity. I do think what you will see for a well-advised taxpayer, frankly, is bunching of charitable contributions. In other words, someone who gives a substantial amount and could bunch, say, 2 or 3 years of contributions in 1 year to get over the limit for being in the standard deduction—you will see more of that. I personally do not believe there will be a dramatic decline in charitable contributions. Can I prove it? I cannot.

Senator COONS. We have got lots of hopes and expectations about charitable giving, about deficits. I will say that across a number of subjects we have discussed today, what will be the impact of greater investment in enforcement? What will be the impact on the ability of taxpayers to get good customer service? How might we improve program integrity in terms of taxpayers using paid preparers, and what might we change? And then how might we reduce improper payments through some revisions to the relevant statute? All of these are things I look forward to working with the Chairman on. These are longstanding, vexing challenges. But as I emphasized before, I think the better path is investing in enforcement rather than cutting services at the highest level.

I appreciate the chance to have you before us today, and I look forward to continuing to work together.

Senator LANKFORD. Let me do one last comment. This is purely personal. I think it is a good learning technique for IRS just in general. I have an individual that we are doing casework for right now that is active deployed military. He has been frequently deployed, and his filing from 2015 was tagged as a possible identity theft. And he is told he has to go in person to a taxpayer assistance center to be able to go ahead and check in. He has been deployed over and over and over and over again. His power of attorney is not being accepted to be able to go in for him on his behalf.

If there are issues like that, then I would assume if we are working that case, that is probably true in other cases. That is something that we need to be able to evaluate for our folks that are forward deployed in the military and how they are going to interact with IRS and what that is going to look like to try to make it as simple as possible for them. They have fairly stressful days already, and to be able to deal with that would be one of the areas I would just flag for you to say we are dealing with that case currently. We are going to work it out. Our folks that have been the taxpayer advocates in Oklahoma that we work with have really been terrific folks and have been very, very responsive and have done a very good job of working with us on that. But this may be something that we are just not dealing with but a lot of other folks are as well.

Mr. KAUTTER. Well, thanks, Senator. I will take that back and make sure we do not have a systemic issue there.

Senator LANKFORD. That would be great.

Thank you again for your testimony today and for your participation and for the engagement on this issue and wearing two hats.

Your job is tough enough. Wearing two hats simultaneously makes it a little tougher on that.

ADDITIONAL COMMITTEE QUESTIONS

If there are no further questions on this, the hearing record will remain open until Thursday, May 31, for subcommittee Members to submit any statements or questions for the witness for the record.

[The following questions were not asked at the hearing, but were submitted to the Departments for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO HON. STEVEN T. MNUCHIN

QUESTIONS SUBMITTED BY SENATOR CHRIS VAN HOLLEN

*Question 1.* During the hearing, Mr. Kautter confirmed that the Treasury Department has performed its own distributional analysis of the recently enacted tax law (Public Law 115–97). When I asked whether the Treasury Department had done this distributional analysis, Mr. Kautter testified, “We have looked at distributions. Yes, sir.”

Renewing my request following your earlier testimony before the Senate Banking Committee on January 30, please provide the distributional analysis performed by the Treasury Department’s Office of Tax Analysis regarding the size of the average tax change for different income groups. At a minimum, this should include distributional tables showing the average tax change for each income group, expressed in dollar terms and as a percentage of after-tax income. And I would also appreciate any additional distributional analysis that the Office of Tax Analysis conducted regarding the new tax law.

If there is any reason that the Treasury Department is unable to disclose its distributional analysis of the new tax law, please describe the issue that is preventing the release of this information.

*Answer.* The Treasury Department regularly publishes analysis conducted by our Office of Tax Analysis (OTA). See attachment on the next page. Also available at: <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/Distribution-of-Income-by-Source-2019.pdf>.

ATTACHMENT

(Available at: <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/Distribution-of-Income-by-Source-2019.pdf>)

Distribution Table 2019 002  
Distribution of Income by Source  
(2019 Income Levels)

Adjusted Family Cash Income Decile <sup>1</sup>	Family Cash Income	Transfer Income	Labor Income	Positive Capital Income			Negative Capital Income <sup>2</sup>	Corporate Income Tax
				Total Positive Capital Income	Normal Capital Income	Supernormal Capital Income		
--- Billions of Dollars ---								
0 to 10 <sup>2</sup>	89.5	38.8	49.8	4.7	1.9	2.8	-3.7	0.4
10 to 20	297.0	120.2	170.6	10.1	4.4	5.7	-4.7	1.0
20 to 30	446.2	155.1	288.0	8.6	4.3	4.3	-6.8	1.5
30 to 40	595.1	170.0	419.4	13.7	7.8	5.9	-10.2	2.5
40 to 50	798.7	176.5	605.5	25.7	15.0	10.7	-13.1	4.1
50 to 60	1,066.9	193.8	826.6	52.0	32.8	19.2	-12.9	6.8
60 to 70	1,403.5	215.2	1,099.0	90.0	57.7	32.3	-13.0	10.5
70 to 80	1,860.8	204.9	1,513.4	138.0	89.5	48.5	-15.1	15.5
80 to 90	2,568.7	193.5	2,114.9	242.3	157.5	84.8	-17.4	25.1
90 to 100	7,337.3	208.2	4,534.3	2,186.6	1,229.8	956.8	-47.6	175.0
Total <sup>2</sup>	16,424.3	1,680.7	11,633.9	2,773.3	1,599.4	1,173.9	-181.5	243.0
90 to 95	1,807.9	93.9	1,460.0	228.8	147.0	81.8	-10.3	21.2
95 to 99	2,442.7	88.5	1,762.9	517.7	336.6	181.1	-15.2	39.3
99 to 99.9	1,608.4	23.0	892.2	563.4	309.7	253.7	-13.4	42.3
Top .1	1,478.2	2.8	419.2	876.7	436.5	440.2	-8.7	72.2
--- Percent Distribution of Income Across Deciles ---								
0 to 10 <sup>2</sup>	0.5	2.3	0.4	0.2	0.1	0.2	2.0	0.2
10 to 20	1.8	7.2	1.5	0.4	0.3	0.5	2.6	0.4
20 to 30	2.7	9.2	2.5	0.3	0.3	0.4	3.7	0.6
30 to 40	3.6	10.1	3.6	0.5	0.5	0.5	5.6	1.0
40 to 50	4.9	10.5	5.2	0.9	0.9	0.9	7.2	1.7
50 to 60	6.5	11.5	7.1	1.9	2.1	1.6	7.1	2.8
60 to 70	8.5	12.8	9.4	3.2	3.6	2.8	7.1	4.3
70 to 80	11.3	12.2	13.0	5.0	5.6	4.1	8.3	6.4
80 to 90	15.6	11.5	18.2	8.7	9.8	7.2	9.6	10.3
90 to 100	44.7	12.4	39.0	78.8	76.9	81.5	26.2	72.0
Total <sup>2</sup>	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
90 to 95	11.0	5.6	12.5	8.3	9.2	7.0	5.7	8.7
95 to 99	14.9	5.3	15.2	18.7	21.0	15.4	8.4	16.2
99 to 99.9	9.8	1.4	7.7	20.3	19.4	21.6	7.4	17.4
Top .1	9.0	0.2	3.6	31.6	27.3	37.5	4.8	29.7
--- Percent Distribution of Income Source Within Decile ---								
0 to 10 <sup>2</sup>	100.0	43.4	55.6	5.2	2.1	3.1	-4.1	0.4
10 to 20	100.0	40.5	57.5	3.4	1.5	1.9	-1.6	0.3
20 to 30	100.0	34.8	64.5	1.9	1.0	1.0	-1.5	0.3
30 to 40	100.0	28.6	70.5	2.3	1.3	1.0	-1.7	0.4
40 to 50	100.0	22.1	75.8	3.2	1.9	1.3	-1.6	0.5
50 to 60	100.0	18.2	77.5	4.9	3.1	1.8	-1.2	0.6
60 to 70	100.0	15.3	78.3	6.4	4.1	2.3	-0.9	0.7
70 to 80	100.0	11.0	81.3	7.4	4.8	2.6	-0.8	0.8
80 to 90	100.0	7.5	82.3	9.4	6.1	3.3	-0.7	1.0
90 to 100	100.0	2.8	61.8	29.8	16.8	13.0	-0.6	2.4
Total <sup>2</sup>	100.0	10.2	70.8	16.9	9.7	7.1	-1.1	1.5
90 to 95	100.0	5.2	80.8	12.7	8.1	4.5	-0.6	1.2
95 to 99	100.0	3.6	72.2	21.2	13.8	7.4	-0.6	1.6
99 to 99.9	100.0	1.4	55.5	35.0	19.3	15.8	-0.8	2.6
Top .1	100.0	0.2	28.4	59.3	29.5	29.8	-0.6	4.9

<sup>1</sup> Cash Income consists of wages and salaries, net income from a business or farm, taxable and tax-exempt interest, dividends, rental income, realized capital gains, unrealized gains at death, cash and near-cash transfers from the government, retirement benefits, and employer-provided health insurance (and other employer benefits). Employer contributions for payroll taxes and the federal corporate income tax are added to place cash on a pre-tax basis. Families are placed into deciles based on cash income adjusted for family size, by dividing income by the square root of family size.

<sup>2</sup> Families with negative incomes are excluded from the lowest income decile but included in the total line. Families with negative income have a significant share of negative capital income.

Note: Percentiles begin at family size-adjusted cash income of: \$9,319 for 10 to 20; \$15,931 for 20 to 30; \$21,925 for 30 to 40; \$29,391 for 40 to 50; \$39,251 for 50 to 60; \$51,389 for 60 to 70; \$66,094 for 70 to 80; \$86,481 for 80 to 90; \$123,716 for 90 to 95; \$172,205 for 95 to 99; \$399,008 for 99 to 99.9 and \$1,792,793 for Top .1.



*Question 2.* Mr. Mnuchin, ZTE reached a historic combined \$1.19 billion settlement with the U.S. Government and pled guilty to criminal charges, including obstruction of justice, and reached settlements with the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), the U.S. Department of Commerce's Bureau of Industry and Security (BIS), and the U.S. Department of Justice (DOJ), ending a long-running investigation into ZTE by the U.S. Government.

Part of ZTE's settlement with the U.S. Government was that ZTE also agreed to a 7-year suspended denial of export privileges, which could be activated if any aspect of the agreement was not met and/or if the company committed additional violations of the Export Administration Regulations (EAR). In fact, the Commerce Department released documents that featured flow charts on the best ways to circumvent American sanctions and provided step-by-step guidelines for setting up shell companies to circumvent U.S. export controls. It also released documents signed by ZTE executives, stating that the firm was exporting to "all five major embargoed countries—Iran, Sudan, North Korea, Syria and Cuba."

Last month, the Commerce Department activated its denial order of export privileges, denying ZTE's export privileges for 7 years. Then the President tweeted that he was going to put this enforcement action on the table as part of your trade negotiations with China. On May 25, the Commerce Department communicated to certain offices on Capitol Hill that the administration had reached a deal with ZTE that would allow the company to resume business with U.S. companies, subject to management changes and the payment of a fine.

*Question 2a.* Do you recall when OFAC assessed penalties on ZTE? Please state OFAC's charges against ZTE.

*Answer.* On March 7, 2017, ZTE executed a settlement agreement with OFAC whereby ZTE settled its potential civil liability for 251 apparent violations of the Iranian Transactions and Sanctions Regulations, 31 C.F.R. part 560 (ITSR) for \$100,871,266.

From on or about January 2010 to on or about March 2016, ZTE engaged in: (i) the exportation, sale, or supply, directly or indirectly, from the United States of goods to Iran or the Government of Iran; (ii) the re-exportation of controlled U.S.-origin goods subject to the Export Administration Regulations from a third-country with knowledge that the goods were intended specifically for Iran or the Government of Iran; and (iii) activity that evaded or avoided, attempted and/or conspired to violate, and/or caused violations of the prohibitions set forth in the ITSR. Specifically, ZTE appears to have engaged in 251 transactions in apparent violation of §§ 560.203, 560.204, and/or 560.205 of the ITSR. The total value of the transactions constituting the apparent violations was \$39,622,972.

*Question 2b.* Did ZTE fully comply with OFAC and Treasury officials during the investigation?

*Answer.* No, ZTE did not fully comply during the course of the investigation which ultimately led to the settlement concluded on March 7, 2017. In 2013, ZTE's highest-level leadership decided to surreptitiously resume its Iran-related business in 2013 while under investigation by the U.S. Government. ZTE continued its Iran-related business until March 2016, when the Department of Commerce added ZTE to the Entity List. Additionally, under the direction of its leadership, ZTE deleted evidence and provided the U.S. Government with altered information to hide the fact that it had resumed its unlawful business with Iran.

*Question 2c.* Did ZTE comply with OFAC's order after it reached its settlement? Please elaborate.

*Answer.* OFAC did not issue an order to ZTE but rather resolved its case via settlement agreement. The Department of Commerce issued two suspended denial orders against ZTE as part of its settlement agreements with the company. Questions regarding the suspended denial orders should be directed to the Department of Commerce, the agency that issued the orders.

*Question 2d.* Do you have evidence demonstrating a change in ZTE's behavior? If so, please provide that information. Do you have national security concerns about ZTE's access to the U.S. market?

*Answer.* Under the terms of the settlement agreement with OFAC, ZTE is required to maintain policies and procedures to minimize the risk of any recurrence of U.S. economic sanctions violations in the future. ZTE also confirmed in its agreement with OFAC that it had terminated the violative conduct described in the agreement.

Treasury does not speculate on possible sanctions violations or comment on possible or pending investigations. We constantly monitor for global activity that might undermine the integrity of our sanctions and trigger our authorities, and do not hesitate to pursue violative or sanctionable conduct when appropriate.

*Question 2e.* Did you ever recommend to the President to offer to China that you would reduce or lift penalties on ZTE as part of your ongoing trade negotiations with China for reasons unrelated to U.S. national security?

*Answer.* Any changes to Commerce Department penalties on ZTE will ensure the protection of the national security of the United States and the enforcement of U.S. sanctions programs. This is an enforcement issue, not a trade issue. We are committed to protecting American technology, American jobs, and our national security. Our goal is to protect America's interests without putting an entire company out of business and hurting innocent employees.

*Question 2f.* Did you ever recommend to the Secretary of Commerce that he reduce or lift the export controls on ZTE for reasons unrelated to U.S. national security?

*Answer.* Please see response to 2e.

*Question 2g.* Did the President consult with you about reducing or lifting these enforcement actions as part of your ongoing trade negotiations with China?

*Answer.* Please see response to 2e.

*Question 2h.* Did the President ask you or Secretary Ross to reduce or lift penalties on ZTE for reasons unrelated to U.S. national security?

*Answer.* Please see response to 2e.

*Question 2i.* Do you think it is appropriate to include large enforcement matters like the one we have with ZTE as part of trade negotiations with a foreign power?

*Answer.* Please see response to 2e.

*Question 2j.* Do you support lifting penalties on ZTE? Please explain your rationale.

*Answer.* ZTE settled its potential civil liability for 251 apparent violations of the ITSR for \$100,871,266. OFAC expects all apparent violators who enter into settlement agreements to fully comply with the terms of their agreements, including the payment of any agreed-to settlement amount. Treasury defers to other agencies with respect to any regulatory and law enforcement actions taken against ZTE.

*Question 2k.* What are the implications for other actors being investigated by Treasury for violations of sanctions or Bank Secrecy Act and Anti Money Laundering laws?

*Answer.* The ZTE settlement is OFAC's largest ever against a non-financial entity and sends a powerful message that Treasury will aggressively pursue any company that willfully violates U.S. economic sanctions laws and obstructs Federal investigations of such violations. This settlement is the result of close collaboration and coordination between multiple U.S. Government agencies and highlights the effectiveness of a whole-of-government approach to pursuing egregious violations of U.S. economic sanctions or export control laws. Other actors being investigated by Treasury are on notice that OFAC will continue to coordinate its efforts with other Federal agencies—including the U.S. Department of Justice and the U.S. Department of Commerce—in order to prevent sensitive or controlled U.S.-origin goods from being illegally shipped or exported to sanctioned countries or parties. Given the specific authorities under which the ZTE case was brought, this case is unlikely the implicate BSA/AML laws.

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QUESTIONS SUBMITTED TO HON. DAVID KAUTTER

QUESTIONS SUBMITTED BY SENATOR PATRICK J. LEAHY

*Question.* I have been very concerned about the budget cuts directed at the IRS over the last several years. The Trump administration's budget proposal for fiscal year 2019 would continue cuts to the IRS that will impact key taxpayer services at a time when many Americans are confused about their new obligations under the Republican tax cut legislation. The IRS also experienced an embarrassing technical failure on the last day taxpayers had to file their taxes, requiring an extension in the filing date. At the same time, IRS enforcement efforts have dropped and the sensitive information of American taxpayers is under constant attack.

How will further budget cuts, including reductions in taxpayer services (particularly in rural areas), improve the IRS experience for taxpayers in Vermont?

*Answer.* The IRS provides service through a variety of channels, which are funded through two different accounts. The Taxpayer Services account funds taxpayer services provided through toll-free phone lines, walk-in assistance at Taxpayer Assistance Centers, and correspondence. The Operations Support account funds the systems that support taxpayer services, a growing range of online taxpayer services, and web-based self-assistance tools. The 2019 budget includes funding for taxpayer services as well as the underlying systems and new tools and technology which en-

able taxpayers to conveniently and securely engage with us anytime and anyplace—similar to any other financial institution.

*Question.* Rural areas like Vermont have unique challenges when it comes to providing taxpayer services, which is why closing Taxpayer Assistance Centers (TACs) is so problematic. Attempting to replace in-person visits with online services doesn't help Vermonters who lack broadband service. Replacing these visits with phone calls only helps if the IRS sets a target response rate that aims to serve everyone who makes a call.

What consideration has the IRS given to the impact of TAC closures in rural areas that lack access to broadband?

*Answer.* We recognize that our obligation to serve all taxpayers requires the IRS to provide multiple ways to get assistance. The IRS is committed to finding ways to ensure all taxpayers have convenient and efficient service options. We will always provide service options that are alternatives to the Internet, including face-to-face and telephone service options. The IRS makes decisions about location and staffing of TACs after evaluating population covered, distance between the TACs, services most frequently requested in the area, cost, and availability of alternative services, including services through our trusted partners. Toll-free phone lines continue to be the number one choice for getting assistance with account and tax law questions. The IRS answered more than 21.4 million calls this fiscal year through July.

To continue providing face-to-face services outside of the traditional TAC model, the IRS has been exploring various options. For example, as of August 21, 2018, we have 38 partner cities that host the IRS Virtual Service Delivery technology. This technology enables taxpayers to receive assistance from TAC employees in another geographic area of the country via an IRS computer and high-resolution video. Thus, the IRS is able to maintain virtual face-to-face services without placing any technology demands on taxpayers. Additionally, the IRS partnered with the Social Security Administration (SSA) to pilot a program that co-locates IRS TAC employees within SSA office space. These collaborations provide additional service channels in geographic locations without a TAC.

Additionally, the IRS continues to look for innovative ways of providing taxpayer services for taxpayers without broadband. For example, the IRS redesigned IRS.gov, making it mobile friendly. This means the site will resize and adapt based on the screen size or the type of device used, including a smartphone or tablet. Taxpayers can now use IRS.gov on their mobile devices, without needing access to broadband. Another example is the IRS2Go App, which is the official IRS smartphone application compatible with Apple and Android mobile devices. Taxpayers don't need a computer or broadband to check their refund status, make a payment, find free tax preparation assistance, sign up for helpful tax tips, and more. IRS2Go is available in both English and Spanish. In addition, we offer 100 commonly used Instructions and Publications in eBook format. IRS eBooks for mobile devices are free and are provided in the ePub format.

*Question.* According to the Identity Theft Resource Center, there were a record-high 1,579 data breaches in 2017, compromising nearly 158 million Social Security numbers. The massive Equifax data breach impacted as many as 147.9 million Americans and exposed personally identifiable information that scammers can use to file fraudulent tax returns. It is clear that the number of data breaches is growing rather than shrinking.

What steps has the IRS taken to protect taxpayers in the wake of the Equifax data breach?

*Answer.* We have taken significant steps in recent years to strengthen our information technology systems to protect taxpayers against identity theft and refund fraud. As part of our Security Summit partnership with State tax administrators and the private sector tax community, we have added new protections for electronically engaging with the IRS, including greater authentication measures and fraud detection filters for verifying legitimate tax filers and detecting identity theft tax returns. These additional fraud detection filters and cross-checks make it harder for fraudsters to obtain fraudulent tax refunds, protecting taxpayers and revenue loss. We specifically designed these safety measures to work in the environment of large-scale data breaches, such as Equifax, where criminals obtained basic information such as names and Social Security numbers.

As it relates to the Equifax data breach specifically, we took immediate action to understand and evaluate the impact of the breach. Immediately upon notification, we conducted a comprehensive internal review and performed an on-site inspection at the Equifax facility. The on-site inspection confirmed that no IRS data was compromised. Additionally, in our continued efforts to combat cyber fraud and protect taxpayer data, we have seen no indications of tax fraud from information exposed

in the Equifax data breach. We will continue to actively and closely monitor the situation.

*Question.* Does the IRS budget request take into account the potential for future spikes in data breaches?

*Answer.* Yes. The 2019 budget includes a \$181 million initiative that would strengthen cyber security, provide higher levels of security for taxpayer data (improved identity assurance and authorization) and help maintain the currency of the agency's hardware and software, our most significant operating risk. Adequate funding for information technology operations is one of IRS's most critical needs.

*Question.* During the Obama administration, Republicans attacked the IRS for what they perceived as politicized behavior by its leadership. While I believe these attacks were overblown, there is no question that it is important to ensure that the IRS is independent from political concerns. You currently serve two roles in the Trump administration, including a policy role at the Treasury Department that may require you to take political considerations into account.

What assurances can you give this Committee that you are serving as Acting IRS Commissioner in a manner that is independent from political considerations?

*Answer.* I can assure you that as Acting IRS Commissioner, I am deeply committed to being independent in working to accomplish the mission of my organization, which is to provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

*Question.* Do you believe you can adequately shield IRS employees from political pressure given your dual role in the administration?

*Answer.* Yes. The IRS career employees provide high quality service to all American taxpayers on a fair and impartial basis, in an environment free of fear of retribution, retaliation or political pressure.

*Question.* Since becoming Acting IRS Commissioner, have you ever personally briefed or met with President Trump? If so, how many times?

*Answer.* I have not personally briefed President Trump in my role as Acting IRS Commissioner.

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QUESTION SUBMITTED BY SENATOR CHRIS VAN HOLLEN

*Question.* During the hearing, you testified that you were unaware of any detailed estimate performed by the Treasury Department for the impact of the new tax law on the debt, despite the Treasury Secretary's frequent claims that the tax law would pay for itself with economic growth. You further testified that, to your knowledge, the only analysis regarding this issue that has been "publicly released" was a one-page document that simply assumed higher economic growth without any analysis showing that the tax law would actually produce such growth. You later stated, however, that detailed analysis showing that the tax law would pay for itself may exist, but that you are, "just not aware of it at the Treasury Department."

If any detailed analysis exists to show how the new tax law will pay for itself with economic growth, at the Treasury Department or elsewhere, please provide that analysis.

*Answer.* For additional analysis on this topic from the administration, we would refer you to the detailed report published by the Council of Economic Advisors in October 2017 attached, and also *available at*: <https://www.whitehouse.gov/sites/whitehouse.gov/files/documents/Tax%20Reform%20and%20Wages.pdf>.

**ATTACHMENT**

(Available at: <https://www.whitehouse.gov/sites/whitehouse.gov/files/documents/Tax%20Reform%20and%20Wages.pdf>)



The Council of Economic Advisers  
October 2017



## Executive Summary

October 2017

Wage growth in America has stagnated. Over the past eight years, the real median wage in the U.S. rose by an average of six-tenths of a percent per year. But even as Americans' real wages stagnated, real corporate profits soared, increasing by an average of 11 percent per year. The relationship between corporate profits and worker compensation broke down in the late 1980s. Prior to 1990, worker wages rose by more than 1 percent for every 1 percent increase in corporate profits. From 1990-2016, the pass-through to workers was only 0.6 percent, and looking most recently, from 2008-2016, only 0.3 percent.<sup>1</sup> The profits of U.S. multinationals are still American profits, but, increasingly, the benefits of those profits do not accrue to U.S. workers.

The deteriorating relationship between wages of American workers and U.S. corporate profits reflects the state of international tax competition. The problem is not unique to America; countries around the world have responded to the international flow of capital by cutting their corporate tax rates to attract capital back from other countries. They have doubled down on such policies as they have seen business-friendly policies benefit workers.

This analysis from the Council of Economic Advisers reviews the evidence that has driven other developed countries to pursue the path of lower corporate tax rates and estimates how business tax reform in the Unified Framework for Fixing Our Broken Tax Code<sup>2</sup> (hereafter, the "Unified Framework") is expected to affect wages for American workers.

Reducing the statutory federal corporate tax rate from 35 to 20 percent would, the analysis below suggests, increase average household income in the United States by, very conservatively, \$4,000 annually. The increases recur each year, and the estimated total value of corporate tax reform for the average U.S. household is therefore substantially higher than \$4,000. Moreover, the broad range of results in the literature suggest that over a decade, this effect could be much larger.

These conclusions are driven by empirical patterns that are highly visible in the data, in addition to an extensive peer-reviewed research. While much of the academic literature predates the latest data, the covariation between the trajectory of inflation-adjusted wages

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<sup>1</sup> Results from a regression of total labor compensation in the U.S. on corporate profits from BEA data covering 1966-2016. A Wald test supremum trend break occurs in Q4 1989.

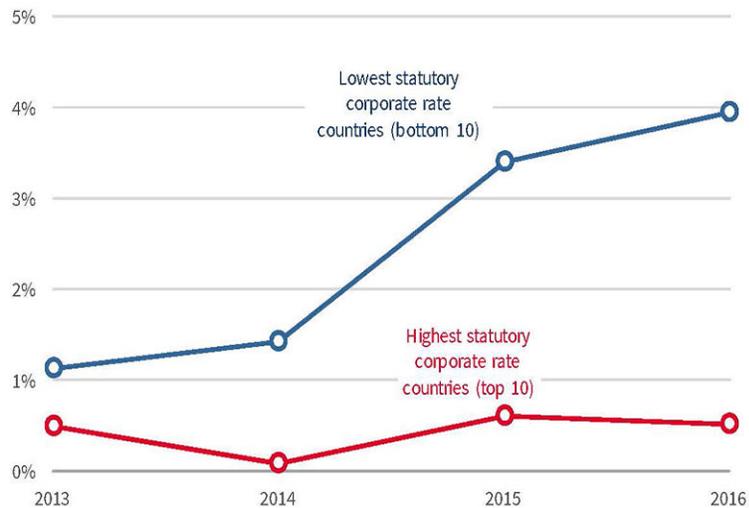
<sup>2</sup> U.S. Treasury (2017), also available at [https://waysandmeansforms.house.gov/uploadedfiles/tax\\_framework.pdf](https://waysandmeansforms.house.gov/uploadedfiles/tax_framework.pdf)

and statutory corporate tax rates (Federal and sub-Federal) between the most-taxed and least-taxed developed countries (OECD) over recent years, visible in Figure 1, is indicative of these papers' findings. Between 2012 and 2016, the 10 lowest corporate tax countries of the OECD had corporate tax rates 13.9 percentage points lower than the 10 highest corporate tax countries, about the same scale as the reduction currently under consideration in the U.S. The average wage growth in the low tax countries has been dramatically higher, as would have been predicted by a consumer of the academic literature, which looks at much longer time periods and explores the relationship with modern econometric techniques.

This sizable empirical literature measures the relationship between wages and corporate taxes, controlling for other variables that may affect wage growth across countries and over time. The literature suggests the relationship between corporate taxes and wages is more than observational and is econometrically robust. The remainder of this report explains the theory and the empirical regularities that relate lower business tax rates – such as those in the Unified Framework – to higher wages and uses these estimates to measure the likely wage effects of the business tax reforms of the Unified Framework.

**Figure 1. Wage Growth in Developed Countries:  
Lowest vs. Highest Corporate Tax Countries**

(Year-over-year change)



Note: Wage data show year-over-year percent changes in 2016 constant prices at 2016 USD PPPs. Wage growth measures are the unweighted average over the ten countries.

## 1. Introduction

An extensive literature on corporate tax policy documents that reducing the corporate tax rate results in increased capital formation and economic output. Effectively, reductions in the corporate tax rate incentivize corporations to pursue additional capital investments as their cost declines. Complementarities between labor and capital then imply that the demand for labor rises under capital deepening and labor becomes more productive.

Standard economic theory implies that the result of more productive and more sought-after labor is an increase in the price of labor, or worker wages. Indeed, considerable academic research indicates that this is the case; to summarize, the literature finds that worker wages are lower when corporate taxes are higher. Capital deepening, which brings additional returns to the owners of capital, brings returns to workers as well.

Although the wage effects for workers may theoretically differ across the skill distribution, recent research finds that corporate tax reductions serve to raise wages of both low- and high-skilled workers (Felix, 2007). Thus, reductions in the corporate tax rate may offer a potent solution to the tepid wage growth experienced by U.S. workers over the past several years.

We use a variety of estimates from the academic literature on corporate tax policy and wages to project the effects of a reduction in the statutory Federal corporate income tax rate from 35 percent to 20 percent. (We know of no literature on the relationship between worker wages and the introduction of immediate full expensing of capital investment excluding structures, although in theory this should further increase the productivity of labor and also increase the wages of workers.) Using conservative estimates from the academic literature on wages and corporate taxes, we estimate that corporate tax reductions of the Unified Framework, in their entirety, would in the medium term boost average U.S. household income annually in current dollars by at least \$4,000, conservatively. When we use the more optimistic estimates from the literature, wage boosts are over \$9,000 for the average U.S. household.

An additional potential benefit of corporate tax reform is its estimated effect on the behavior of U.S. firms holding profits overseas. The share of foreign-earned profits repatriated to the U.S. has declined over time along with the tax rates of OECD members and other countries, and in 2016, U.S. firms chose not to repatriate more than 70 percent of foreign-earned income. As a result, \$299 billion in U.S. corporate profits remained offshore in that year, unable to benefit U.S. workers. The volume of profits held by U.S. firms abroad has risen sharply in recent years. A lower rate would provide incentive for firms to move their income

and activity back to the U.S. These additional considerations magnify the potential impact of corporate tax reform for workers' wages.

## 2. Corporate Taxes and Worker Wages: Theory and Evidence

The productivity of workers in an economy depends, in part, on the flow of capital services enabling their production. Even in a closed economy, reductions in the corporate tax rates and the associated capital deepening may imply a higher marginal product of labor and higher wages. The ability of domestic U.S. firms to invest foreign profits overseas exacerbates the implications of corporate tax policy for domestic workers; an uncompetitive domestic corporate tax rate reduces the demand for U.S. workers by encouraging capital formation abroad. Indeed, when viewed in this way, the incidence of the corporate tax could theoretically fall entirely on U.S. workers, so long as workers are immobile and capital moves freely across borders.

How much of the corporate tax burden do workers bear? Empirical estimates differ but largely trend upward over time as estimates have caught up with the pace of global capital flows, whose rise substantially influences these calculations. An earlier literature argued that the incidence of corporate tax fell entirely on the owners of capital (Harberger, 1962). But Harberger's model was based on a closed economy with no ability for capital to move overseas, perhaps a reasonable contemporary assumption but less apt today.

A newer literature places the labor share of the corporate tax burden decidedly above zero based on model calibrations under various assumptions that account directly or indirectly for the fact that capital is much more mobile than labor. Arulpalapam et al (2012) find that workers pay nearly 50 percent of the tax, while Desai et al (2007) estimate a worker share of 45 to 75 percent. Gravelle and Smetters (2006) generate a rate of 21 percent when the rate of capital mobility across countries is moderate and 73 percent when capital can flow freely, evidence that the labor incidence is likely both dynamic and positively correlated with the rate of international capital transfers. A Congressional Budget Office (CBO) study (Randolph, 2006) finds that workers bear 70 percent of the corporate income tax burden in the baseline and 59 to 91 percent in alternative specifications. In a summary study, Jensen and Mathur (2011) argue for an assumption of greater than 50 percent. As a result of these more recent estimates, evaluators have upgraded their estimates of the worker incidence of corporate taxes. Intuitively, these estimates make sense because capital is far more mobile than labor. The idea that immobile factors bear a disproportionate share of taxes relative to mobile factors is almost as old as economics itself.

In addition to estimates of the incidence of the corporate tax, a recent empirical literature measures the relationship between corporate tax rates and worker wages directly. These estimates generally rely on cross-sectional differences in tax rates across states and countries, as well as within-country changes over time, to identify the impact of corporate tax rates on worker wages. The resulting elasticities of average wages with respect to corporate tax rates allow us to calculate the wage implications of the Unified Framework directly without making any additional revenue or capital return assumptions.

The measured elasticities of average wages to the top corporate tax rate range from -1.0 to -0.1 in these studies, implying that a 1 percent change in corporate tax rates reduce worker wages by as much as 1 percent and as little as 0.1 percent. A cross-country study by Hassett and Mathur (2006) based on 65 countries and 25 years of data finds that the elasticity of worker wages in manufacturing after five years with respect to the highest marginal tax rate in a country is as low as -1.0 in some specifications, although other sets of control variables increase the elasticity to -0.3.

Expanded analysis by Felix (2007) follows the Hassett and Mathur strategy, but incorporates additional control variables, including worker education levels. Felix settles on an elasticity of worker wages with respect to corporate income taxes of -0.4, at the high end of the Hassett and Mathur range. Felix's study is also able to analyze distributional effects, finding no difference in the effects of corporate taxes for low-, medium-, and high-skilled workers as proxied by education levels.

Felix (2009) estimates an elasticity of worker wages with respect to corporate income tax rates based on variation in the marginal tax rate across U.S. states. In this case, the elasticity is substantially lower; a 1 percentage point increase in the top marginal state corporate rate reduces gross wages by 0.14 to 0.36 percent over the entire period (1977-2005) and by up to 0.45 percent for the most recent period in her data (2000-2005). The estimates in Felix (2009) imply an elasticity of roughly -0.1 to -0.2. These rates, which may be higher than estimates based on cross-country variation due to the greater mobility of labor across states relative to countries, again confirm the idea that the mobility of a factor influences the extent to which it bears a tax.

In addition to estimating the incidence of the corporate tax, Desai et al (2007) also report estimates of worker wage effects of corporate tax rates. Whereas other papers mentioned above have used the country as the unit of analysis, the sample in this paper consists of individual U.S. employers along with their activities in 50 countries over 15 years. With these data, the authors measure both the changes in worker wages and changes in capital income associated with corporate income tax changes. The estimated labor burden of the corporate tax rate varies from 45 to 75 percent under various specifications in the paper. For a panel data

specification with country fixed effects, 57 percent of the burden of the corporate tax rate falls on labor. Applying the coefficient estimates to the U.S. corporate rate implies worker wages fall by approximately 0.3 percent for every 1 percent increase in the corporate tax rate.

### 3. Estimating the Effects of a 20 Percent Corporate Tax Rate

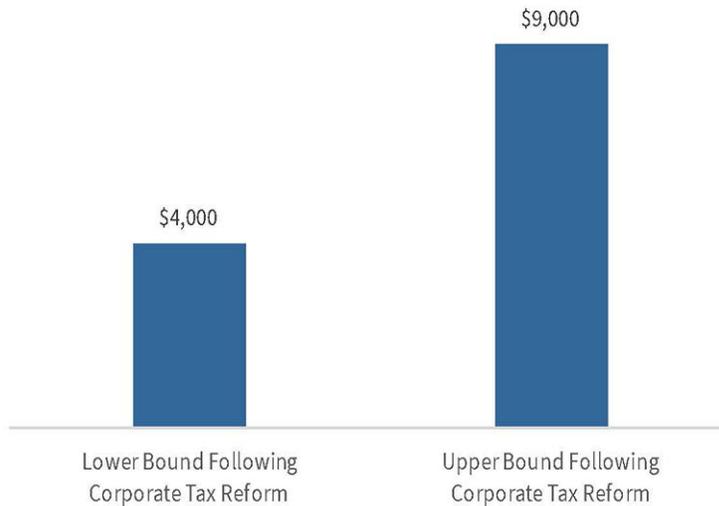
The reduced-form estimates of the elasticity of wages with respect to corporate tax rates discussed above suggest U.S. workers would experience substantial wage increases due to a reduction of the corporate tax rate from 35 to 20 percent. (Again, there is no simple way to measure the effects of full expensing on worker wages.) A conservative range of wage increases can be anchored by a lower bound based on cross-state estimation from 2000-2005 in Felix (2009) and an upper bound based on country panel results of Desai et al (2007), reflecting an elasticity of wages with respect to corporate taxes of -0.16 and -0.33, respectively. These wage effects are long-run outcomes and should be thought of as the recurring flow of income after the corporate tax changes have fully taken hold, since the identification relies on cross sectional variation in tax rates.

Using 2016 household income as the baseline, these effects translate into an increase in average household income from \$83,143 in 2016 to between \$87,520 and \$92,222, an increase of \$4,000 to \$9,000 in wage and salary income alone. (See Figure 2.) For households at the median, the effects would bring household income from \$59,039 in 2016 to between \$62,147 and \$65,486, for a boost of between \$3,000 and \$7,000.<sup>3</sup> These are the long-run, recurring values measured in 2016 dollars; households would receive these benefits each year once the changes in the corporate tax have been fully absorbed by the economy. As a result, the net present value (NPV) of these household income flows, the exact value of which depends on the speed at which reforms are adopted, will be substantially higher than the annual flow.

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<sup>3</sup> These estimates apply the wage growth implied by the papers' point estimates to wage and salary income only. On average, 78 percent of household income in 2016 was wage and salary income; another 11.5 percent was Social Security and other retirement, and 6.4 percent was self-employment income. The remaining 4.5 percent was comprised of various sources, including dividend and other investment income. Results from the Current Population Survey ASEC (2016) indicate households near the median income level have a similar share of wage and salary income.

**Figure 2. Estimated Increases in Average Household Income under the Corporate Tax Proposal of the Unified Framework (\$2016)**



Source: Census Current Population Survey; CEA calculations

Another way of looking at the benefits for U.S. households is to measure changes in the growth rate of real wages. For context, the growth rate of real worker wages in the U.S. has been decidedly slow for several years. In the 8-year span between 2008 and 2016, *median* real household income in the U.S. rose by 0.6 percent per year while the *average* household saw real increases of 1.1 percent per year. To measure the counterfactual rate of income growth without having to project counterfactual wage growth, we assume the income boosts in the previous paragraph (and in Figure 2) phased in over 8 years for a corporate tax reduction that was passed in 2008. This would imply a counterfactual rate of growth of 2.0 percent per year for the median household and 2.4 percent per year for the average household. This is a more than three-fold increase in annual wage growth for the median household and a more than two-fold increase for the average household.

These wage growth estimates are consistent with the evolution of wages in OECD countries. For developed countries, lower corporate tax rates correspond to higher rates of wage growth, as evidenced in Figure 1. Between 2012 and 2016, the average gap in annual wage growth between the highest and lowest corporate tax countries was 2.0 percent per year. At the same time, the difference in the average statutory corporate tax rate between these groups of countries was 14 percent, almost exactly the reduction in the corporate tax rate proposed in the Unified Framework. With additional wage growth of 2.0 percent per year, the

average U.S. household would earn more than \$4,000 in additional annual wage and salary income by Year 4 and \$9,000 in additional annual wage and salary income by Year 7.<sup>4</sup>

Finally, estimated household income gains from the Unified Framework are consistent with those provided by Auerbach et al (2017) and in Benzell et al (2017) in their evaluation of the House of Representatives' "Better Way" proposal, which also carries a corporate tax rate reduction to 20 percent. Estimated wage effects in these studies are on the order of 8 to 9 percent, implying average household income of more than \$5,100 annually above the baseline level. Thus, the impact suggested by the empirical literature is highly consistent with predictions of theoretical models, increasing our confidence that these effects are real.

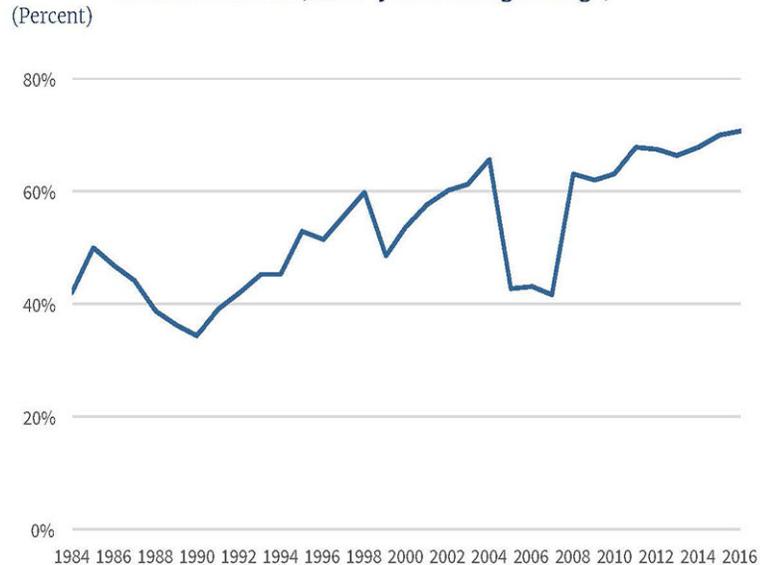
#### 4. The Impacts of Profit Shifting

One increasingly apparent implication of uncompetitive U.S. tax rates is the volume of activity large multinational U.S. firms attribute to foreign affiliates. Figure 3 shows how the share of U.S. multinational profits that appear to originate abroad has changed since 1984. Although there is some variation over time (the large dip in 2005 was due to a temporary tax holiday whereby firms were able to bring back earnings to the U.S. at a lower rate), the share exhibits an overall upward trend. In 1984, the three-year moving average was 42 percent of total foreign profits; by 2016, it had reached 70 percent.

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<sup>4</sup>OECD data extending back to 2000 tell a similar story; wage growth differences are 1.8 percent per year between the highest and lowest corporate tax countries between 2000 and 2016 and the average statutory corporate tax rate difference was 16 percent over this period.

**Figure 3. Percent of Overseas Profits of U.S.-Based Multinationals Invested Abroad (three-year moving average)**



Source: BEA International Data; CEA calculations

Firms' tendency to engage in profit shifting is highly responsive to tax rate differentials. Hines and Rice (1994), using aggregate country-level data from the Bureau of Economic Analysis, estimate a tax semi-elasticity of profit shifting of -2.25, indicating that a 1 percentage point increase in the statutory home corporate tax rate results in 2.25 percent higher profit shifting to lower-tax jurisdictions.<sup>5</sup> Applying Hines and Rice's (1994) findings to a statutory corporate rate reduction of 15 percentage points (from 35 to 20 percent) suggests that reduced profit shifting would result in more than \$140 billion of repatriated profit based on 2016 numbers. The assumption that U.S. workers would retain 30 percent of the 2016 profits of U.S. firms earned abroad and not currently repatriated implies a raise for the average U.S. household of up to 1 percent, depending on the share of profits repatriated. (See Kline et al 2017 for an example of workers capturing 29 percent of firm operating surplus.) The trajectory of foreign profits evidenced in Figure 3 indicates the value to U.S. workers of these profit shifts would increase in the future. Household income boosts from this channel may be additive to the

<sup>5</sup> Subsequent papers to Hines and Rice (1994) make use of firm level micro data and estimate smaller semi-elasticities. The consensus semi-elasticity estimate from these studies is 0.8 (see Dharmapala (2014) for a survey), or about one-third the size of the estimate from Hines and Rice. More recently, Clausing (2016) argues that the firm level approach "over controls" for too many firm specific factors and has advocated a return to the aggregate country level approach.

estimated \$4,000 in household income discussed in Section 3, as the empirical literature in Section 3 is largely based on countries and time periods with less foreign profit activity, and less existing capital parked overseas as taxes changed.

In general, profits earned abroad evidence the willingness of U.S. firms to invest in production and business operations overseas, at the expense of domestic investment. Reductions in the corporate rate create an opportunity for U.S. firms to increase domestic investment instead. Further, these multinationals are among the class of high-paying employers in the United States. As Krueger and Summers (1987) noted in the early literature on inter-industry wage differentials for seemingly similar workers, “[m]ore profitable industries tend to use some of their rents to hire better quality labor, and share some of their rents with their workers.” A more recent literature on intra-industry wage differentials confirms that rent-sharing remains a feature of the U.S. labor market (Barth et al, 2016; Card et al, 2016; Song et al, 2015). Successfully incentivizing these high-paying firms to perform more of their operations in the U.S. is again constructive for U.S. wage growth.

## 5. Conclusions

In the foregoing analysis, we have pointed to a range of empirical studies demonstrating that reductions in corporate tax rates have substantial effects on wages. By inducing higher capital investment, reductions in corporate tax rates increase the demand for workers and heighten their productivity. Using estimates from the taxes and wages literature, we calculate the change in worker wages resulting from corporate rate reductions espoused in the Unified Framework. Conservative estimates from the literature imply an increase in average household income of \$4,000 and more moderate estimates show increases of \$9,000. Put simply, capital deepening, which brings additional returns to the owners of capital, brings substantial returns to workers as well.

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October 2017

### **SUBCOMMITTEE RECESS**

The subcommittee hearing is hereby adjourned.  
[Whereupon, at 11:54 a.m., Tuesday, May 22, the subcommittee was recessed, to reconvene subject to the call of the Chair.]