AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

TAX RETURN FILING SEASON, INTERNAL REVENUE SERVICE OPERATIONS, FISCAL YEAR 2009 BUDGET PROPOSALS, AND THE IRS NATIONAL TAXPAYER ADVOCATES ANNUAL REPORT

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MARCH 13, 2008

Serial No. 110–75

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

49–992 WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON WAYS AND MEANS

CHARLES B. RANGEL, New York, *Chairman*

FORTNEY PETE STARK, California
SANDER M. LEVIN, Michigan
JIM McDERMOTT, Washington
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
MICHAEL R. McNULTY, New York
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California
LLOYD DOGGETT, Texas
EARL POMEROY, North Dakota
STEPHANIE TUBBS JONES, Ohio
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
RAHM EMANUEL, Illinois
EARL BLUMENAUER, Oregon
RON KIND, Wisconsin
BILL PASCRELL JR., New Jersey
SHELLEY BERKLEY, Nevada
JOSEPH CROWLEY, New York
CHRIS VAN HOLLEN, Maryland
KENDRICK MEEK, Florida
ALLYSON Y. SCHWARTZ, Pennsylvania
ARTUR DAVIS, Alabama

JIM McCRERY, Louisiana
WALLY HERGER, California
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
SAM JOHNSON, Texas
PHIL ENGLISH, Pennsylvania
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri
RON LEWIS, Kentucky
KEVIN BRADY, Texas
THOMAS M. REYNOLDS, New York
PAUL RYAN, Wisconsin
ERIC CANTOR, Virginia
JOHN LINDER, Georgia
DEVIN NUNES, California
PAT TIBERI, Ohio
JON PORTER, Nevada

Janice Mays, *Chief Counsel and Staff Director*
Brett Loper, *Minority Staff Director*

SUBCOMMITTEE ON OVERSIGHT

JOHN LEWIS, Georgia, *Chairman*

JOHN S. TANNER, Tennessee
RICHARD E. NEAL, Massachusetts
XAVIER BECERRA, California
STEPHANIE TUBBS JONES, Ohio
RON KIND, Wisconsin
BILL PASCRELL JR., New Jersey
JOSEPH CROWLEY, New York

JIM RAMSTAD, Minnesota
ERIC CANTOR, Virginia
JOHN LINDER, Georgia
DEVIN NUNES, California
PAT TIBERI, Ohio

Pursuant to clause 2(e)(4) of Rule XI of the Rules of the House, public hearing records of the Committee on Ways and Means are also, published in electronic form. **The printed hearing record remains the official version.** Because electronic submissions are used to prepare both printed and electronic versions of the hearing record, the process of converting between various electronic formats may introduce unintentional errors or omissions. Such occurrences are inherent in the current publication process and should diminish as the process is further refined.

CONTENTS

	Page
Advisory of March 5, 2008, announcing the hearing	2

WITNESSES

Linda Stiff, Acting Commissioner, Internal Revenue Service	6
Nina E. Olson, National Taxpayer Advocate, Internal Revenue Service	30

SUBMISSIONS FOR THE RECORD

Benson S. Goldstein, Statement	100
Colleen M. Kelley, Statement	106
Gerald E. Scorse, Statement	112
IRS Oversight Board, Statement	113

TAX RETURN FILING SEASON, INTERNAL REVENUE SERVICE OPERATIONS, FISCAL YEAR 2009 BUDGET PROPOSALS, AND THE IRS NATIONAL TAXPAYER ADVOCATES ANNUAL REPORT

THURSDAY, MARCH 13, 2008

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

The Subcommittee met, pursuant to notice, at 10:10 a.m., in room 1100, Longworth House Office Building, Hon. John Lewis (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
March 06, 2008
OV–7

CONTACT: (202) 225–5522

Lewis Announces a Hearing on the Tax Return Filing Season, Internal Revenue Service Operations, Fiscal Year 2009 Budget Proposals, and the IRS National Taxpayer Advocate's Annual Report

House Ways and Means Oversight Subcommittee Chairman John Lewis (D–GA) today announced that the Subcommittee on Oversight will hold a hearing on the 2008 tax return filing season, IRS operations, the fiscal year 2009 budget proposals, and the National Taxpayer Advocate's Annual Report. **The hearing will take place on Thursday, March 13, 2008, at 10:00 a.m., in the main Committee hearing room, 1100 Longworth House Office Building.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Acting Commissioner Linda Stiff, Internal Revenue Service, and Nina E. Olson, National Taxpayer Advocate, have been invited to testify. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

In 2007, the Internal Revenue Service ("IRS") collected $2.7 trillion in taxes and processed nearly 250 million tax returns, including 140 million individual income tax returns. The Subcommittee will discuss the current tax return filing season with a focus on taxpayer service and assistance, earned income tax credit outreach, and the status of economic stimulus payments.

The Subcommittee also will review IRS operations not related to the filing season. Specifically, the Subcommittee will look at examination rates, collection activities, the tax gap, electronic filing, and protection of taxpayer information. In July 2007, the IRS established a new office to focus on data protection and identity theft, including phishing schemes and online fraud. The Subcommittee will discuss activities of this office to notify and assist potential victims of identity theft and data loss incidents.

As part of its consideration of IRS operations, the Subcommittee will discuss the Administration's fiscal year 2009 proposed budget for the IRS of $11.4 billion, an increase of 4.3 percent over the fiscal year 2008 level. The Subcommittee will examine the Administration's priorities with respect to taxpayer services, enforcement, operations support, and business systems modernization. Further, the Subcommittee will consider the Administration's compliance initiatives and budget proposals to close the tax gap.

Finally, the position of National Taxpayer Advocate was established by the 1996 Taxpayer Bill of Rights (Public Law 104–168). The purpose of the Taxpayer Advocate is to provide an independent system to address taxpayer problems not resolved by normal channels and to propose changes in the administrative practices of the IRS. The Taxpayer Advocate must submit a report each year to the House Committee on Ways and Means and the Senate Committee on Finance. The National

Taxpayer Advocate will highlight key issues and recommendations from the December 2007 Report to Congress.

In announcing the hearing, Chairman Lewis said, **"The IRS must enforce our tax laws, but it also needs to make taxpayer service a priority so that we maximize the numbers of taxpayers who voluntarily comply with our tax laws. The Congress must ensure that the IRS operates efficiently and fairly for all Americans."**

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, http://waysandmeans.house.gov/, select "110th Congress" from the menu entitled, "Committee Hearings" (http://waysandmeans.house.gov/Hearings.asp?congress=18). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You MUST REPLY to the email and ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Thursday, March 27, 2008**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

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

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

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

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

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

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

Chairman LEWIS. Good morning. The hearing of the Subcommittee will come to order.

Today the Subcommittee on Oversight is holding its annual hearing on IRS operations.

This morning we will examine the current tax return filing season, the IRS budget, and Taxpayer Advocates Annual Report.

We're very pleased to have Linda Stiff, the IRS Acting Commissioner, and Nina Olson, the National Taxpayer Advocate appear before this Subcommittee. I welcome you both.

I look forward to hearing your views about what needs to be done to serve the needs of taxpayers, and to improve taxpayer compliance.

I have reviewed the administration's proposed budget, and many of us this morning would like to discuss whether it strikes the right balance between taxpayer service and enforcement.

We have a tax gap of more than $345 billion. We need to explore ways to increase compliance by taxpayers. The Subcommittee on Oversight values the views of the witnesses and we want to ensure the fairness of our tax system.

I would like to commend the IRS on the work done this filing season. I know your workload has increased this year as you prepare to get tax rebates into the hands of people who are suffering.

Many people who don't normally file a tax return will have to file a tax return this year in order to receive their tax rebate checks. These people will need help in filing their returns, and I know you will help.

I have followed your plans to educate taxpayers about the tax rebate checks. I am hopeful that the IRS will make sure that all taxpayers who are eligible for this benefit receive the service they need to complete and file their returns.

Finally, I do not know how much longer you will be serving as Acting Commissioner, Madam Commissioner of the IRS, Ms. Stiff, so I would like to take this chance to thank you for all of your good work, on behalf of Members of this Committee, on behalf of the Congress and the American people. It has been a pleasure to work with you, and you are always welcome back.

Chairman LEWIS. I am pleased to recognize the distinguished Ranking Member, my dear friend, Mr. Ramstad, for his opening statement.

[The prepared statement of Chairman Lewis follows:]

Opening Statement of Congressman John Lewis (D-GA)
Subcommittee on Oversight Hearing on
the Tax Return Filing Season, Internal Revenue Service
Operations, Fiscal Year 2009 Budget Proposals, and the
IRS National Taxpayer Advocate's Annual Report
March 13, 2008

Today, the Subcommittee on Oversight is holding its annual hearing on IRS operations. We will examine the current tax return filing season, the IRS budget, and the Taxpayer Advocate's Annual Report.

We are very pleased to have the IRS Acting Commissioner and the National Taxpayer Advocate appear before the Subcommittee. I look forward to hearing their views about what needs to be done to serve the needs of taxpayers and to improve tax compliance.

I have reviewed the Administration's proposed budget, and I want to discuss whether it strikes the proper balance between taxpayer service and enforcement. We value the views of the witnesses and want to ensure the fairness of our tax system.

I would like to commend the IRS on the work done this filing season. I am sure that you have spent a great deal of time handling the tax filing season and educating taxpayers about the tax rebate checks. I am hopeful that the IRS will make sure that all taxpayers who are eligible for this benefit receive the services they need to complete and file returns.

Finally, I do not know how much longer you will be serving as Acting Commissioner of the IRS, Ms. Stiff. So, I would like to take this chance to thank you, on behalf of the Congress. It has been a pleasure to work with you, and you are always welcome back.

Thank you.

Mr. RAMSTAD. Thank you, Mr. Chairman. Thank you for your leadership of this Subcommittee and for calling this important hearing today.

I certainly appreciate seeing the Acting Commissioner, as well as the taxpayer advocate, and appreciate the fact that you're doing, both of you, tough jobs, very well, from everything I can ascertain.

The IRS certainly has its work cut out for you and your colleagues at the service, commissioner. The filing season, I know, is very different from previous years, with two special challenges—the late passage of the AMT patch and the enactment of the economic stimulus legislation.

I know that both added greatly to your workload on top of what was already going to be a busy filing statement, and that's—filing season—and that's an understatement, I know.

The IRS, when I look at the magnitude of your mission, it's really staggering to this mere mortal, when you think that you're going to be processing more than $2.5 trillion in tax receipts and pay hundreds of billions of dollars in refunds to more than 110 million taxpayers. You obviously have a big assignment ahead of you.

Of course, once the filing season is over, then the service will calculate, process, and mail more than $100 billion worth of stimulus payments as required by the Stimulus Act.

The reason for mentioning the magnitude of your mission is, I think you'll agree that the IRS, I think everyone will agree, must balance service with enforcement, and I hope to hear today that the impact of foregoing collection revenue is not serious, is not—that we're not foregoing too much in collection revenues in lieu of using employees in the service function.

But I just want to say finally that I'm still concerned about the tax gap. I'm glad the President's budget proposes several initiatives to close that gap and additional resources toward IRS enforcement efforts.

I remember last year's hearing on the filing season and the IRS, we had this discussion, as well as several other hearings, and I know that that was asked for by the service, that is, more resources toward enforcement, and those will hopefully be forthcoming.

So, thank you again for being here today. Thank you again for the jobs that you both do. I certainly look forward to your testimony.

I yield back.

Chairman LEWIS. Thank you, Mr. Ramstad.

Now, we will hear from our witnesses. I ask that you limit your testimony to 10 minutes. Without objection, your entire statement will be included in the record.

It is now my pleasure to introduce the Acting Commissioner of the Internal Revenue Service, Linda Stiff.

Welcome.

STATEMENT OF LINDA STIFF, ACTING COMMISSIONER, INTERNAL REVENUE SERVICE

Ms. STIFF. Good morning, Chairman Lewis, Ranking Member Ramstad, and Members of the Subcommittee. Thank you for the opportunity to be here today.

My name is Linda Stiff, and I have served as the Acting Commissioner of the IRS since last September. I am a career IRS employee, having started as a revenue agent more than 27 years ago.

— My written statement provides information on a number of IRS programs and activities, and I will be happy to respond to questions about any of those. However, in the brief time I have today, I would like to mention three key areas that I think are of interest to the Subcommittee.

First, allow me to update you on the progress we have made on the economic stimulus program enacted by Congress in early February.

Through extraordinary planning efforts and the dedication of the IRS work force, we are poised to deliver not only the filing season but to distribute stimulus checks just as soon as we complete the current filing season.

We expect the first checks to be deposited electronically in taxpayer bank accounts in the first week of May, and for the first checks to be mailed to taxpayers who did not choose the direct deposit option in the second week of May.

We are making every effort to keep taxpayers informed about the stimulus payments. We have posted a special section on IRS.gov designed to answer questions and provide updated information.

This month, we are sending letters to all taxpayers reminding them that they must file a 2007 tax return in order to be eligible for a stimulus payment.

In late March, we will send a special mailing to recipients of Social Security and Veterans Affairs benefits, because those benefits are generally non-taxable and those recipients may not ordinarily be required to file a tax return.

We are reaching out to the Department of Veterans Affairs, the Social Security Administration, and private groups, such as AARP, to ask that they assist us in reaching those who may be eligible for the stimulus payment but who may not be otherwise required to file a 2007 return.

To assist those individuals, we have created a sample Form 1040–A, with information on how to fill out just a few lines that will enable eligible people to receive the stimulus payment.

The second major point I wish to touch on is the current filing season.

We are positioned to deliver yet another successful tax filing season. We are on target to process more than 140 million individual tax returns and issue more than $225 billion in tax refunds in the coming weeks.

I am pleased to report that, based on early results, the number of returns filed electronically is once again higher than at the same point a year ago; the number of taxpayers using Free File is also on the rise, up almost 12 percent compared to the same point in time last year.

I am also pleased to say that we were able to reprogram our systems to accommodate the AMT patch that was enacted late last year, and we were able to do that far quicker than I could have ever imagined.

That is a credit to the hard work of a number of IRS employees who worked nights, weekends, and even holidays.

As a result, we were able to allow most AMT-impacted taxpayers to begin filing in January and all others by February 11th.

At the IRS, the most fundamental premise of our compliance efforts involves balancing taxpayer service with our enforcement programs. Last year, we provided services to more than 332 million taxpayers. That was an increase of 10 percent year over year.

We have leveraged technology, improved processes, and enhanced work force training to not only increase our service capacity but to significantly increase the quality of the service to ranges in excess of the 90 percentile.

This was accomplished across the many service channels that we provided at the IRS.

We saw an 11-percent increase in visits to IRS.gov for tax return information.

On Web services, an application where you and your constituents can go online and track the status of your refund with the ″Where's My Refund″ feature, we served more than 32 million taxpayers accessing that last year. That was a 30-percent increase over the prior year.

Through our automated self-assist telephone services and telephone assistors, we served 500,000 more taxpayers than we did the prior year.

We served 1 million additional taxpayers through our field assistance sites and community-based volunteer efforts.

I am pleased to report to you today that we are positioned to deliver these services again this year in a quality manner during the current filing season.

The third topic I want to touch on is the President's 2009 Budget request for the IRS. This year's request is an increase of $469 million over the budget approved last year.

Guided by the IRS Tax Gap strategy, this increase will enable the IRS to strengthen enforcement programs to address compliance by small businesses, the self-employed, and large corporations.

It will allow us to expand our ongoing research of filing, payment, and reporting compliance levels.

This budget request will allow us to expand our efforts to identify and address issues relating to globalization and offshore activities.

Additionally, the funding will allow the IRS to expand our document matching programs and to implement the legislative proposals to reduce the tax gap, submitted as a part of that budget.

We are confident at the IRS that we can do this while maintaining a strong taxpayer service program that will allow us to continue making progress in implementing the Taxpayer Assistance Blueprint.

In closing, I would also like to share with you the continuing progress being made in modernizing IRS systems.

CADE, the replacement to the Masterfile system, is processing almost a quarter of the returns filed thus far this year.

This means that those accounts are being settled in a 24-hour cycle, comparable to other private sector best practices.

Refunds for returns processed in CADE are delivered to taxpayers an average of 4 days sooner than those not. Early releases to the replacement system for accounts management have been on time and delivered functionality as promised.

We have improved our management and governance to ensure these successes and are well-positioned to deliver new modernized capabilities in the coming years.

Thank you again for the opportunity to appear before you this morning, and I am happy to respond to any questions you may have.

[The prepared statement of Linda Stiff follows:]

WRITTEN TESTIMONY OF
LINDA STIFF
ACTING COMMISSIONER OF
INTERNAL REVENUE
BEFORE THE
HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
ON
THE 2008 FILING SEASON
MARCH 13, 2008

Introduction

Chairman Lewis, Ranking Member Ramstad, and members of the Subcommittee, thank you for the opportunity to testify today on the 2008 Income Tax Filing Season. I would also like to update you on IRS operations, the progress we have made in the areas of taxpayer service and enforcement, our FY 2009 budget request, our latest efforts to improve voluntary compliance and reduce the tax gap, and the status of economic stimulus payments under the recently enacted economic stimulus program.

Overview

The IRS and its employees represent the face of U.S. government to more American citizens than any other government agency. We administer America's tax laws and collect over 96 percent of the revenues that fund the federal government each year.

The IRS strategic plan goals are:

- Improve *Taxpayer Service* – Help people understand their tax obligations, making it easier for them to comply with their obligations under the tax law.

- *Enhance Enforcement of the Tax Law* – Ensure taxpayers meet their tax obligations, so that when Americans pay their taxes, they can be confident their neighbors and competitors are also doing the same; and

- *Modernize the IRS through its People, Processes and Technology* – Strategically manage resources, associated business processes, and technology systems to meet service and enforcement strategic goals effectively and efficiently.

The FY 2009 IRS proposed budget, which I will discuss in detail later in my testimony, supports those strategic goals by retaining the critical balance between taxpayer service and compliance and enforcement.

2008 Filing Season

The biggest challenge we faced at the end of 2007, as we approached the 2008 Filing Season, was the uncertain status of legislation to address the situation of an additional 25 million taxpayers who otherwise would have become subject to the alternative minimum tax (AMT).

On October 30, 2007, Chairman Rangel, Ranking Member McCrery along with their counterparts on the Senate Finance Committee, sent me a letter assuring the IRS that Congress intended to enact AMT relief (the AMT patch) in a manner acceptable to the House of Representatives, the Senate, and the President. This letter was very helpful because it allowed IRS to move forward on certain planning and design aspects of implementing the AMT relief legislation, shortening the implementation process by a number of weeks.

However, as we advised at the time, we have key systems that can only accommodate one programming option without introducing excessive risk to the filing season. As a result, we were only able to proceed so far without actual legislation being enacted. When the President signed the AMT relief law on December 26, 2007, we immediately began the detailed reprogramming of systems to accommodate the new law. Our employees worked diligently to modify systems to implement the changes in a relatively short time period. My thanks go out to all of those dedicated IRS employees who worked nearly around the clock to enable us to implement this AMT relief legislation in record time.

Given their efforts we were able to begin the filing season on schedule for most taxpayers, but the processing of filed returns for approximately 13.5 million taxpayers that file one of five forms associated with the AMT legislation was delayed. These taxpayers had to wait until February 11 before having their filed return processed. Fortunately, due to historic filing patterns, most of these taxpayers do not regularly file until after February 11.

The other challenge facing us this filing season is the implementation of the economic stimulus program enacted by Congress in early February, specifically the planning for the distribution of the stimulus checks to eligible recipients throughout the country this spring. We will begin immediately after the close of the filing season to distribute those checks with the expectation that the first checks will be sent electronically the first week of May with the first paper checks being mailed by the second week.

To deliver the stimulus payments, we must program our systems to calculate the appropriate amount for each taxpayer based on their 2007 returns and then distribute the checks, through Treasury's Financial Management Service, based on the preferences expressed on that return by direct deposit or by paper check.

However, there are a significant number of economic stimulus recipients that typically do not have an income tax filing requirement. This would include retirees or those who have

minimal income and are thus not required to file. But in order to receive the stimulus payment, the recipient must file a tax return for 2007. To reach these recipients and educate them requires an extensive outreach program that includes the IRS coordinating with the Social Security Administration and Department of Veterans Affairs, along with private groups such as the AARP.

The chairman of the IRS Oversight Board recently put into words the attitude we are taking during this filing season. According to Paul Cherecwich, "Implementing the stimulus plan is a large and complex undertaking, and the IRS is devoting a lot of effort into the program. More management attention on the stimulus program stretches the IRS thin in other areas, but executing the filing season and stimulus program flawlessly is the IRS' highest priority at the moment."

Despite the challenges presented by the late enactment of the AMT patch and the implementation of the economic stimulus payments, I am proud to report that thus far the filing season has gone very well. Allow me first to give an update on some of the numbers we are looking at approximately one month from the due date for individual tax returns.

Numbers Thus Far

We expect to process nearly 140 million individual tax returns in 2008, and we anticipate continued growth in the number of those that are e-filed. In the 2007 filing season, almost 60 percent of all income tax returns were e-filed. We fully expect to exceed that number this year. As of March 1, we have received nearly 44 million tax returns electronically, an increase of 6.3 percent compared to the number of returns that were e-filed during the same period last year.

This increase in e-filing is being driven by people preparing their own returns using their personal computers. The total number of self-prepared returns that are e-filed is up by almost 15 percent compared to the number of self-prepared returns filed during the same period a year ago. Over 14 million returns have been e-filed by people from their personal computers, up from over 12.2 million for the same period a year ago.

Overall, 78 percent of the 55.7 million returns filed through March 1 have been e-filed. Encouraging e-filing is good for both the taxpayer and for the IRS. Taxpayers who use e-file can generally have their tax refund deposited directly into their bank account in two weeks or less. That is about half the time it takes us to process a paper return. For the IRS the error-reject rate for e-filed returns is significantly lower than that for paper returns.

More people are choosing to have their tax refunds deposited directly into their bank account than ever before. So far this year, we have directly deposited over 37.7 million refunds, or 81 percent of all refunds issued this tax filing season.

People are also visiting our web site – IRS.gov – in record numbers. We have recorded almost 82.6 million visits to our site this year, up over 11 percent from 74.1 million for the same period a year ago. The millions of taxpayers that have visited IRS.gov have benefited from many of the services that are available through the web site. We have made it easier for taxpayers to get answers to many of their tax questions online. The web site:

- Allows taxpayers to obtain information on the economic stimulus rebate program;
- Assists the taxpayer in determining whether he or she qualifies for the Earned Income Tax Credit (EITC);
- Assists the taxpayer in determining whether he or she is subject to the Alternative Minimum Tax (AMT);
- Allows more than 70 percent of taxpayers the option to file their tax returns at no cost through the Free File program;
- Allows taxpayers who are expecting refunds to track the status via the "Where's My Refund?" feature; and
- Allows a taxpayer to calculate the amount of their deduction for state and local sales taxes.

As of March 1, we have received over 55.7 million returns, an increase of 3.17 percent over the same period as last year. We have issued 46.5 million refunds so far this year, for a total of $122.7 billion. The average refund thus far is $2,637, approximately $59 more than last year. In addition, over 19.1 million taxpayers have tracked their refund on IRS.gov, up 20.7 percent over last year.

As of March 1, our Taxpayer Assistance Centers (TACs) are reporting over one million taxpayers assisted. Our telephone assistors have answered almost 7.4 million calls, and 10.8 million callers received automated services.

Free File

Over 2.5 million people have utilized Free File as of March 1, up over 12 percent compared to the number of taxpayers that used Free File during the same period a year ago. This year anyone with adjusted gross income of $54,000 or less is eligible for Free File, which includes 97 million taxpayers. The number of Free File returns compared to the prior year has been steadily increasing, and we expect to meet or exceed 2007 totals by the end of the filing season. One reason for this increase is that we have committed resources to market and promote the Free File program.

In the 2006 filing season an indicator was included for the first time on Free File returns, which allowed the IRS to identify those taxpayers using Free File. As a result, we obtained important information such as customer satisfaction and demographic data that had never before been available.

VITA/TCE Sites and Other Community Partnerships

The use of tax return preparation alternatives, such as volunteer assistance at Volunteer Income Tax Assistance (VITA) sites and Tax Counseling for the Elderly sites (TCEs), has steadily increased over the years. In 2007, over 2.6 million returns were prepared by volunteers. As of March 1, volunteer return preparation is up 10.6 percent compared to the number of volunteer returns filed by during the same period a year ago. Volunteer e-filing is also up slightly, by 2.1 percent over the same period in the last tax filing season. This is reflective of continuing growth in existing community coalitions and partnerships.

We have also made a concerted attempt to expand outreach to taxpayers, particularly those taxpayers who may be eligible for the EITC. For example, we sponsored EITC Awareness Day on January 31st, in an effort to partner with our community coalitions and partnerships to reach as many EITC-eligible taxpayers as possible and urge them to claim the credit. Over 125 coalitions and partners hosted local news conferences and issued more than 100 press releases highlighting EITC Awareness Day this year.

A Commitment to Service, Enforcement and Modernization

In FY 2007, we continued making improvements in our service and enforcement programs as well as having significant successes in our IT modernization program.

Taxpayer Service

According to most of our taxpayer service metrics, we continued to see improvement in FY 2007. The numbers in our telephone services, electronic filing, and IRS.gov access have all increased. This is demonstrated by the following FY 2007 business results:

- More taxpayers chose to file electronically in 2007 than during the prior year, with 57 percent of individual tax filers choosing to e-file in 2007, up from 54 percent in 2006.

- More people visited the IRS website – IRS.gov. The IRS website was accessed more than 215 million times in 2007, up 10 percent from the same period in 2006.

- The IRS helped more taxpayers find out about their refunds through the agency's internet-based system 'Where's My Refund?' The system was accessed 32.1 million times during 2007, up 30 percent from last year's usage of 24.7 million.

- The IRS provided a high level of service for taxpayers seeking traditional phone-based or in person assistance. In FY 2007, the IRS customer assistance call

centers answered 33.2 million assistor telephone calls and 21.1 million automated calls. We maintained an 82.1-percent level of service on the telephone with an accuracy rate of 91.2 percent on tax law questions.

- The agency maintained a 94-percent customer satisfaction rating for its toll-free telephone service.

- Outreach and educational services were enhanced through partnerships between the IRS and public organizations. Through its 11,922 Volunteer Income Tax Assistance and Tax Counseling for the Elderly sites, the IRS provided free tax assistance to the elderly, disabled, and limited English proficient individuals and families. Over 76,000 volunteers filed 2.63 million returns. Additionally, the IRS established 6 new clinics in rural areas to help low-income taxpayers meet their tax obligations.

- The IRS successfully implemented the Telephone Excise Tax Refund (TETR), a one-time payment available on federal income tax returns to refund previously collected long distance telephone taxes. Successful delivery of the integrated TETR approach enabled the filing of nearly 98 million individual and business tax returns in 2006, claiming approximately $5.48 billion in telephone excise tax refunds. Some individual and business returns for 2006 are continuing to be filed claiming TETR refunds. In addition, the IRS prevented more than $538 million in potential erroneous refunds with the aid of a return selection tool created specifically to catch questionable TETR requests.

- The IRS also introduced a split refund capability, which allowed taxpayers to direct deposit their refund into as many as three financial accounts.

Another development in our taxpayer service program is the Taxpayer Assistance Blueprint (TAB). This collaborative effort of the IRS, the IRS Oversight Board, and the National Taxpayer Advocate began in July, 2005 in response to a Congressional mandate to develop a five-year plan that outlines the steps we should take to improve taxpayer services.

TAB represents a significant milestone in a decade-long history of service enhancements by the IRS. During this period taxpayer satisfaction with IRS services has grown significantly, due in large part to the strength of our commitment to continual improvements. Increases in electronic filing and on-line service transactions, high levels of toll-free access and accuracy, extensive stakeholder engagement, and increasingly diversified efforts to reach taxpayers through local partners and community coalitions have all led to better taxpayer understanding and participation in the tax system.

Several notable accomplishments in FY 2008 include:

- Established the Taxpayer Services Program Management Office and Services Committee to provide senior executive coordination and governance to TAB implementation;

- Implemented an Estimated Wait Time announcement to inform taxpayers about their expected wait time in the telephone queue prior to reaching a customer service representative;

- Implemented Spanish "Where's My Refund," which adds refund status to the Spanish web page on IRS.gov that mirrors English-based refund information;

- Launched an electronically searchable Publication 17, Your Federal Income Tax on IRS.gov;

- Enhanced training for volunteers in the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs; and

- Released tax publications in new languages, including Chinese, Russian, Korean, and Vietnamese.

Expanding Enforcement Efforts

The most prominent measure of our success in improving compliance is the increase in enforcement revenue, which has risen from $33.8 billion in FY 2001 to $59.2 billion in FY 2007, an increase of 75 percent. This represents a 5.6 to 1 return on investment for all IRS activities in FY 2007 from enforcement revenue alone.

In FY 2007, both the levels of individual returns examined and coverage rates have risen substantially. We conducted nearly 1.4 million examinations of individual tax returns in FY 2007, an 8 percent increase over FY 2006. This is over three-quarters more than were conducted in FY 2001, and reflects a steady and sustained increase since that time. Similarly, the audit coverage rate has risen from 0.6 percent in FY 2001 to 1 percent in FY 2007. This increase was achieved without a significant increase in resources as compared to the previous fiscal year.

While the growth in examinations of individual returns is visible in all income categories, it is most visible in examinations of individuals with incomes over $1 million. Audits of these individuals increased from 17,015 during FY 2006 to 31,382 during FY 2007, an increase of 84 percent. One out of 11 individuals with incomes of $1 million or more faced an audit in 2007. Their coverage rate has risen from 5 percent in FY 2004 to 9.25 percent in FY 2007.

In the business arena, the IRS has continued efforts to review more returns of flow-through entities – partnerships and S Corporations. Our business statistics reflect that we have placed more emphasis in the growing area of these flow-through returns. While large corporate audits are down slightly, we have increased our focus on mid-market corporations – those with assets between $10 million and $50 million.

The IRS enforcement budget in FY 2007 was similar to the budget in FY 2006, and in times of flat budgets, the agency cannot increase activity across the board but must address the areas where there is growth and potential risk.

- Audits of S Corporations increased to 17,681 during FY 2007, up 26 percent from the prior year's total of 13,984.
- Audits of partnerships increased to 12,195 during FY 2007, up almost 25 percent from the prior year's total of 9,777.
- Audits of mid-size corporations increased to 4,473, up 6 percent from last year's total of 4,218.
- Audits of businesses in general rose to 59,516, an increase of almost 14 percent from the prior year's total of 52,223.
- Although the audits of large corporations dipped slightly in FY 2007 to 9,644 audits, the number of audits is up 14 percent from the FY 2002 level.

Finally, examinations of tax-exempt organizations have also risen. In FY 2001 5,342 tax-exempt organization examinations were closed. This number rose to 7,580 in FY 2007.

Delivering Modernization

The IRS' Business Systems Modernization (BSM) program continues to improve its delivery performance, meeting schedule and cost estimates for the vast majority of releases over the past three years, and delivering significant business value. Over the past six months, the IRS has had a number of notable accomplishments in its modernization efforts:

1. **Customer Accounts Data Engine (CADE). CADE Release 3.2** was delivered on time (January 14, 2008) for this filing season and is doing well in production. In fact, as of the end of February, CADE had processed 12.7 million returns, which is more than 25 percent of all individual returns filed to date for this year. CADE not only stores the taxpayer data on a modernized data base, but also settles daily (akin to a modern banking institution), which enables CADE to process refunds on average four days faster than the IRS master file. In addition, the updated account information is immediately available for our customer service personnel, unlike the master file, which is only updated on a weekly basis.

2. **Account Management Services (AMS)**. AMS is a strategic program designed to deliver improved support and functionality to IRS employees by bridging the gap between modernization initiatives like CADE and existing legacy systems. AMS enables authorized users to access, validate, and update taxpayer accounts on demand.

AMS Release 1.1 provides on-line address change capability for CADE accounts. The first release of AMS accomplished an historic achievement for IRS when it delivered the capability to update authoritative account data on a daily cycle to 33,539 IRS customer service representatives. Release 1.1 was deployed on time and on budget in October 2007, and through February 25, 2008, has completed over 365,000 address changes.

AMS Release 1.2 provides improved customer support with new inventory and workflow functionalities to automate the assignment, research, resolution, and closure for entity and account transcripts and transition from a paper-based manual process to an automated on-line process. Release 1.2A pilot was deployed on February 18, 2008.

3. **Modernized e-File (MeF).** MeF is the IRS' designated e-File platform (electronic filing system) for the future and provides e-Filing capability for large corporations, small businesses, partnerships, and non-profit organizations. MeF benefits both taxpayers and the IRS by enabling taxpayers to file all of their tax forms electronically, eliminating the need for IRS personnel to match paper documents to electronic returns. Additionally, the enhancements embedded within MeF allow more robust error checking and data validation before returns are processed, reducing the number of returns that need manual intervention and correction.

   MeF to date has accepted over 4 million tax returns. The first five weeks of CY 2008 MeF accepted over 61,000 returns, a 112-percent increase over the same period in CY 2007. MeF Release 5 went into production as planned in January 2008 and provides the ability to file electronically Form 1120F (tax returns for foreign corporations) and Form 990N (so called electronic postcard for small tax exempt organizations to meet their filing requirement). The next major release, Release 6, is scheduled for deployment in August 2009, and will begin the transition of Form 1040 returns from the IRS legacy e-filing system to MeF.

The recent successes of BSM are due to the maturation of many key management processes resulting in better management of its IT investments and better performance in delivering its modernized systems. Much of this improvement is attributable to IRS' enhanced IT governance process and its IT Modernization Vision and Strategy (MV&S), which have enabled the IRS to use its resources more effectively by working closer with the business to match IT investments to business needs; delivering smaller, incremental system releases; and leveraging existing systems where appropriate.

President's FY 2009 Budget Funds Taxpayer Service and Enforcement

The President's FY 2009 Budget request for the IRS supports not only our five-year strategic plan, but also the tax compliance strategies addressed in *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance* sent to Congress last summer and the IRS *Taxpayer Assistance Blueprint,* which I discussed earlier in my statement.

These documents underscore the IRS' commitment to provide quality service to taxpayers while enforcing America's tax laws in a balanced manner.

The President's FY 2009 Budget request supports improving compliance by funding activities that promote better tax administration and compliance with the tax laws. The President's FY 2009 Budget request for the enforcement program is $7,487,209,000, an increase of $489,983,000, or 7 percent, over the FY 2008 enacted level. The Administration proposes to include these enforcement increases as a Budget Enforcement Act program integrity cap adjustment. The enforcement program is funded from the Enforcement appropriation and part of the IRS' Operations Support appropriation.

Budget Request

For FY 2009, the President is requesting a total of $11,361,509,000 for IRS activities. This is a $469,125,000 increase, or an increase of 4.3 percent, over the FY 2008 enacted level.

The overall IRS budget is broken down into the following five areas:

- Taxpayer Services – The FY 2009 requested level for this area is $2,150,000,000. This is the same as the FY 2008 enacted level. Included in this area are the following activities:
    - Pre-Filing Taxpayer Assistance and Education ($617,326,000) – This budget activity funds services to assist with tax return preparation, including tax law interpretation, publication production, and advocate services.
    - Filing and Account Services ($1,532,674,000) – This budget activity funds programs that provide filing and account services to taxpayers, process paper and electronically submitted tax returns, issue refunds, and maintain taxpayer accounts.
- Enforcement – The FY 2009 request is $5,117,267,000. This is an increase of 7.1 percent from the FY 2008 enacted level. As mentioned earlier, the Operations Support budget provides an additional $2.3 billion to support enforcement activities. Included in the specific enforcement area are the following activities:
    - Investigations ($603,466,000) – This budget activity funds the criminal investigations programs that explore potential criminal violations of the internal revenue tax laws, enforce criminal statutes relating to these violations, and recommend prosecution as warranted.
    - Exam and Collections ($4,363,826,000) – This budget activity funds programs that enforce the tax laws and compliance through examination and collection programs that ensure proper payment and tax reporting. The budget activity also supports appeals and litigation activities associated with exam and collection.

- Regulatory ($149,975,000) – This budget activity funds the development and printing of published IRS guidance materials; interpretation of tax laws; advice on general legal servicing, ruling and agreements; enforcement of regulatory rules, laws, and approved business practices; and supporting taxpayers in the areas of pre-filing agreements, determination letters, and advance pricing agreements. The Office of Professional Responsibility is also funded within this budget activity.

- Operations Support – The FY 2009 request is $3,856,172,000. This is an increase of 4.8 percent from the FY 2008 enacted level. Included in this area are the following activities:

  - Infrastructure ($883,325,000) – This budget activity funds administrative services related to space and housing, rent and space alterations, building services, maintenance, guard services, and non-Automated Data Processing (ADP) equipment.

  - Shared Services and Support ($1,243,703,000) – This budget activity funds policy and management, IRS-wide support for research, strategic planning, communications and liaison, finance, human resources, and equal employment opportunity and diversity services and programs. It also funds printing and postage, business systems planning, security, corporate training, legal services, procurement, and specific employee benefits programs.

  - Information Services ($1,729,144,000) – This budget activity funds staffing, equipment, and related costs to manage, maintain, and operate the information systems critical to the support of tax administration programs.

- Business Systems Modernization – The FY 2009 request is $222,664,000. This is a reduction of 16.6 percent from the FY 2008 enacted level. This appropriation funds the planning and capital asset acquisition of information technology to modernize the IRS business systems, including labor and related contractual costs.

- Health Insurance Tax Credit Tax Administration. The FY 2009 request for this program is $15,406,000. This is an increase of 1.1 percent from the FY 2008 enacted level. This appropriation funds costs to administer a refundable tax credit for health insurance to qualified individuals, which was enacted as part of the Trade Adjustment Assistance Reform Act of 2002.

The justification for the requests in each of these areas is discussed in detail below.

Adjustments from FY 2008 Levels to Help Reduce the Tax Gap

The IRS total requested funding increase for FY 2009 is $469,125,000. This increase will go to improving voluntary compliance and reducing the tax gap. These investments fund increased front-line enforcement efforts, enhanced research, and implementation of

legislative proposals to improve compliance. By FY 2011, these investments are projected to increase annual enforcement revenue by $2.0 billion. In addition, the legislative proposals included in the FY 2008 Budget to improve tax compliance are estimated to generate $36 billion over the next ten years.

Specific increases to improve voluntary compliance include:

- Reduce the Tax Gap for Small Business and the Self Employed (+$168,498,000 / +1,608 FTE) – This enforcement initiative will increase enforcement efforts to improve compliance among small business and self-employed taxpayers by: increasing audits of high-income returns, increasing audits involving flow-through entities, implementing voluntary tip agreements, increasing document-matching audits, and collecting unpaid taxes from filed and non-filed tax returns. This request will generate $981 million in additional annual enforcement revenue once new hires reach full potential in FY 2011.

- Reduce the Tax Gap for Large Businesses (+$69,488,000 / +519 FTE) – This enforcement initiative will increase examination coverage of large and mid-size corporations, including multi-national businesses, foreign residents, and smaller corporations with significant international activity. It will also enable the IRS to use existing systems further to capture other electronic data through scanning and imaging. The initiative will allow the IRS to address risks arising from the rapid increase in globalization, and the related increase in foreign business activity and multi-national transactions where the potential for non-compliance is significant. Funding of this request will generate $544 million in additional annual enforcement revenue once the new hires reach full potential in FY 2011.

- Improve Tax Gap Estimates, Measurement, and Detection of Non-Compliance (+$51,058,000 / +393 FTE) – This enforcement initiative will support and expand ongoing research studies, including the National Research Program, of filing, payment, and reporting compliance to provide a comprehensive picture of the overall taxpayer compliance level. Research allows the IRS to target better specific areas of noncompliance, improve voluntary compliance, and allocate resources more effectively to reduce the tax gap. Improved research data will also refine workload selection models reducing audits of compliant taxpayers. The audits associated with these studies will generate $16 million in additional annual enforcement revenue once the new hires reach full potential in FY 2011 and the research they provide will help us achieve the high rate of return (5.6 to 1 in FY 2007) that we receive from our enforcement programs.

- Increase Reporting Compliance of U.S. Taxpayers with Offshore Activity (+$13,697,000 / +124 FTE) – This enforcement initiative will address domestic taxpayer offshore activities. Abusive tax schemes, reporting of flow-through income, and high-income individuals are prime channels or candidates for tax avoidance. This initiative will focus on uncovering offshore credit cards, disguised corporate ownership, and brokering activities in order to identify

individual taxpayers who are involved in offshore arrangements that facilitate noncompliance. Funding of this request will generate $102 million in additional annual enforcement revenue once the new hires reach full potential in FY 2011.

- Expand Document Matching (+$35,060,000/+413 FTE) – This enforcement initiative will increase coverage within the Automated Underreporter (AUR) program. This program matches third-party information returns (e.g., Form W-2 and Form 1099 income reports) against income claimed on tax returns. When potential underreporting is discovered taxpayers are contacted to resolve the issue. This request will produce $359 million in additional annual enforcement revenue once the new hires reach full potential in FY 2011.

- Implement Legislative Proposals to Improve Compliance (+$23,045,000 /0 FTE) – While the IRS continues to address compliance by improving customer service and using traditional methods of enforcement, the FY 2009 Budget also includes several legislative proposals that would provide additional enforcement tools to improve compliance, if enacted. It is estimated that these proposals will generate $36 billion in revenue over ten years. The proposals would expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties. This enforcement initiative includes funding for purchasing software and making modifications to the IRS IT systems necessary to implement the proposals. The specific legislative proposals are listed later in my testimony.

Other Adjustments from FY 2008 Levels

Other significant adjustments to the FY 2009 Budget proposal, relative to the FY 2008 appropriated levels, includes the following:

- Adjustments Necessary to Maintain Current Levels (+$264,985,000 / 0 FTE) – Funds are requested for: FY 2009 cost of the January 2008 pay increase of $57,854,000; proposed January 2009 pay raise of $152,303,000; and non-labor related items such as contracts, travel, supplies, equipment and GSA rent adjustments of $54,828,000.

- Efficiency savings that include the following:

    - Efficiency Savings (-$71,356,000 / -769 FTE) – The IRS continues to improve the efficiency of all of its programs. The Budget reflects efficiency savings in the Enforcement and Operations Support accounts. Enhancements of technology; improved workload selection models; on-going management productivity and efficiency improvements; and streamlining, centralizing, and consolidating work processes and programs will lead to operational efficiencies resulting in significant savings in FY 2009.

- Increase e-File savings (-$10,300,000 / -207 FTE) – This program decrease is a result of savings from increased electronic filing (e-File), which is projected to lead to 4.2 million fewer returns filed on paper (3.5 million individual and 0.7 million business) in FY 2009. This budget request proposes to reinvest these savings to cover the costs of Increase Efficiency through Submission Processing Consolidations and Address Correspondence Inventory.

- Non-Recur Savings (-$12,593,000 / 0 FTE) – This reflects non-recurring, one-time costs associated with the IRS FY 2008 initiatives, such as new hire training, background investigations, and acquisition of telecommunications equipment, computers, and printers.

- Program Decreases

  - Taxpayer Assistance Centers and Outreach (-$31,200,000 / -99 FTE) – Additional resources were provided in FY 2008 for increasing outreach and education activities. Many of these investments are long-term, nonrecurring investments that will benefit taxpayers for many years, including enhancements to the website and expansion of facilitated self-assistance terminals in the Taxpayer Assistance Centers. In FY 2009, the IRS will continue to work to implement other taxpayer assistance improvements detailed in the Taxpayer Assistance Blueprint (TAB).

  - Taxpayer Advocate Service (-$7,711,000 /-25 FTE) – Additional Taxpayer Advocate Service (TAS) funds were provided in FY 2008 to expand TAS case processing activities. In FY 2009, these activities will be restored to levels in line with resources for other taxpayer service programs. The IRS does request $2.7 million in additional TAS funding to support the FY 2009 enforcement initiatives.

  - Volunteer Income Tax Assistance Grants Program (-$8,000,000 / 0 FTE) – Funds provided in FY 2008 included $8,000,000 for a new Volunteer Income Tax Assistance (VITA) matching grant demonstration program for tax return preparation assistance. This funding is available until September 30, 2009. Given the ramp-up time to establish the grant application and approval process, these grants will be issued for the 2009 filing season.

  - Business Systems Modernization (BSM) (-$45,780,000 / -25 FTE) – The FY 2009 proposed level of $222,664,000 will allow continued progress on key modernization projects including the Customer Account Data Engine (CADE), Accounts Management Services (AMS), and Modernized e-File (MeF).

Specific Legislative Proposals

The President's FY 2009 Budget includes a number of legislative proposals intended to improve tax compliance while minimizing the burden on compliant taxpayers as much as possible. If enacted, it is estimated that these proposals will generate an additional $36 billion over the next ten years (see the Treasury Blue Book, available on the Treasury Department web site, for more information). The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

- *Expand information reporting* – Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific information reporting proposals would:

  1) Require information reporting on payments to corporations;
  2) Require basis reporting on security sales;
  3) Require information reporting on merchant payment card reimbursements;
  4) Require a certified Taxpayer Identification Number (TIN) from contractors;
  5) Require increased information reporting on certain government payments;
  6) Increase information return penalties; and
  7) Improve the foreign trust reporting penalty.

- *Improve compliance by businesses* – Improving compliance by businesses of all sizes is important. Specific proposals to improve compliance by businesses would:

  1) Require electronic filing by certain large organizations; and
  2) Implement standards clarifying when employee leasing companies can be held liable for their clients' Federal employment taxes.

- *Strengthen tax administration* – The IRS has taken a number of steps under existing law to improve compliance. These efforts would be enhanced by specific tax administration proposals that would:

  1) Expand IRS access to information in the National Directory of New Hires for tax administration purposes;
  2) Permit disclosure of prison tax scams;
  3) Make repeated willful failure to file a tax return a felony;
  4) Facilitate tax compliance with local jurisdictions;
  5) Extend statutes of limitations where state tax adjustments affect federal tax liability; and
  6) Improve the investigative disclosure statute.

- *Expand penalties* – Penalties play an important role in discouraging intentional non-compliance. A specific proposal to expand penalties would impose a penalty on failure to comply with electronic filing requirements.

Improve Tax Administration and Other Miscellaneous Proposals

The Administration has put forward additional proposals relating to IRS administrative reforms. Five of these proposals are highlighted below:

- The first proposal modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations.

- The second proposal allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities.

- The third proposal eliminates the requirement that the IRS Chief Counsel provide an opinion for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding $50,000. This proposal requires that the Secretary of Treasury establish standards to determine when an opinion is appropriate.

- The fourth proposal extends the IRS authority to use the proceeds received from undercover operations through December 31, 2012. The IRS was authorized to use proceeds it received from undercover operations to offset necessary and reasonable expenses incurred in such operations. The IRS authority to use proceeds from undercover operations expired on December 31, 2007.

- The fifth proposal equalizes penalty standards between tax return preparers and taxpayers, reducing unnecessary conflicts of interest between them. The standard applicable to tax return preparers for disclosed positions would be "reasonable basis," but for certain reportable transactions with a significant purpose of tax avoidance, the existing standard would persist, i.e., the preparer should have a reasonable belief that the position, more likely than not, would be sustained on the merits.

Other IRS Programs

There are two other programs that I know are of great interest to the Subcommittee, but are not directly related to the filing season, on which I would like to update you.

Private Debt Collection

Since 2006, the IRS has had in place a program to utilize private debt collectors to collect certain tax debts from delinquent taxpayers. The program was authorized by the

American Jobs Creation Act of 2004. The first cases were assigned to private collectors in September 2006, only after IRS screened potential contractors and then trained them on taxpayer rights and IRS procedures.

Since its inception through late January 2008, we have placed cases involving over 90,000 entities. These 90,000 entities involve nearly 158,000 cases or modules, totaling $848 million. We have received full payments from over 10,000 taxpayers and approved installment agreements with another 4,600.

We have received actual payments of $43.5 million. We have paid out commissions of $7.3 million leaving net receipts of $36.2 million.

For the period April 1, 2007 through January 31, 2008, the taxpayer satisfaction score with these collection activities is 95 percent. We have a Regulatory and Procedural Accuracy rate of 98.8 percent, a timeliness score of 99.3 percent and a professionalism score of 99.9 percent. The program is on target with our revised economic projections and is recovering more money each year than the IRS spends to run the program. And, according to those revised projections, we expect the program to fully recover the "sunk costs" that were used to get the program up and running in FY 2010. We have 95 instances of reported contract concerns, which is about one-tenth of one percent of the entities placed and of those, we have validated 5 cases in which penalties have been imposed.

We listened carefully to some of the criticisms expressed at the hearing last May and have tried to make improvements to address some of those recommendations. For example, we now provide the latest taxpayer phone number that we have to the private collection agent (PCA) to increase the likelihood that they will reach the correct taxpayer. We have also given the contractor the date of birth of the taxpayer as an additional authentication point. In addition, we have revised the letter to those taxpayers indicating they have received a previous IRS or PCA letter but who refuse to authenticate. The new letter advises that refusal to authenticate will result in the case being returned to the IRS.

PCAs can now also disclose to the taxpayer the reason for the call. They can say they are calling on behalf of the IRS when they believe they are talking to the taxpayer. They can also leave voicemail message saying they are calling on behalf of the IRS if they believe they have reached the correct taxpayer. Finally, PCAs have been given increased flexibility in authenticating the taxpayers social security number (SSN). Now if the taxpayer is reluctant to give their full SSN, the PCA can authenticate the taxpayer by using any four digits of the SSN, not just the last four digits.

We believe these improvements will increase the likelihood that we reach the correct taxpayer and that the taxpayer is more likely to understand the nature of the call.

Identity Theft

Combating identity theft is a major priority for the IRS. We continue to look for opportunities to make our efforts more effective and efficient in the areas of identity-theft awareness, prevention, detection, and prosecution.

To strengthen our enterprise-wide approach to identity theft, IRS established the Privacy, Information Protection, and Data Security (PIPDS) office in July 2007. PIPDS is led by a Senior Executive who reports directly to the Deputy Commissioner for Operations Support, which enables the office to reach across all IRS organizations and ensure that proper attention and discipline are given to the issues of privacy, identity theft, and data security.

We created the Identity Theft and Incident Management (ITIM) office within PIPDS to continue implementing the IRS identity-theft strategy and coordinate efforts within the IRS to provide assistance and consistent treatment to taxpayers who are victims of identity theft.

The IRS is also updating our identity-theft strategy to reflect the implementation of several recommendations outlined in the President's Identity Theft Task Force report for preventing and deterring identity theft. We have initiated efforts targeted at decreasing the unnecessary use of Social Security Numbers (SSN), implementing data security guidelines and rules, responding to data losses, and where appropriate, collaborating with law enforcement agencies to identify and prosecute identity theft associated with criminal tax and money-laundering violations affecting tax administration.

The IRS generally encounters two primary types of identity theft that relate to tax administration: (1) the misreporting of income and (2) the filing of questionable tax returns generally claiming a refund.

- **Misreporting of Income –** This type of identity theft involves an individual using another person's name and SSN to obtain employment. Because income earned is reported to the IRS by the employer, it will appear to the IRS that the lawful taxpayer did not report all income on his or her tax return. These cases are primarily resolved by the Compliance function through the Automated Underreporter (AUR) program. The AUR program matches information reported on information returns (e.g., Form W-2 and Form 1099) submitted by third parties, such as banks, employers, and other payers against the information submitted by taxpayers on their individual income tax returns. The IRS has updated its AUR process to provide assistance to victims whose identities have been stolen for employment purposes. If the taxpayer provides the necessary documentation on an identity-theft claim, the income in question will not result in an additional assessment, and the IRS can close the case.

- **Questionable Tax Returns –** This second type of identity theft involves an individual using another person's SSN to file a tax return in order to obtain a tax refund. These cases are primarily resolved by the Criminal Investigation division (CI), the investigative law-enforcement arm of the IRS, and Accounts

> Management function within our Wage and Investment division. Because duplicate returns filed with a single SSN do not always involve identity theft, the IRS first tries to determine whether there is another reason for the duplicate filing, such as IRS transcription errors, a single taxpayer filing multiple returns for the same year to correct mistakes, or transposition errors by the taxpayer (the most common cause). If this is not the case, employees in Accounts Management make every effort to locate a correct SSN for the taxpayers and resolve the duplicate filing situation before contacting the taxpayers. If Accounts Management is unable to resolve the issue definitively through research and contact with the taxpayers, the common number is "scrambled" and both taxpayers are assigned a temporary number (IRSN) to file future tax returns pursuant to IRS "Scrambled SSN" procedures.

While the IRS recognizes that there is more work to be done to improve the policies, processes, and procedures for assisting identity theft victims, we have taken significant steps in the past few years to develop a more consistent, more efficient, and less burdensome manner for handling identity theft cases. Additionally, we are expanding the IRS identity-theft strategy to address recommendations from the President's 2007 Identity Theft Task Force. We look forward to continuing to work with taxpayers, stakeholders, and the National Taxpayer Advocate in order to identify, develop, and implement additional improvements in this important area of tax administration.

Summary

The FY 2009 Budget request includes significant increases for IRS enforcement efforts. Fully funding that request will help us make progress in improving voluntary compliance. Based on our analysis covering the most recent 11 years of collection experience, we estimate that every dollar we have spent on enforcement has generated a direct return, on average, of four dollars in increased revenue to the U.S. Treasury. This return can be expected to occur when the full productive benefit of the investment is realized. In FY 2007, the return on our enforcement programs rose to 5.6 to 1.

We also believe that dollars spent on taxpayer service have a positive impact on voluntary compliance. Research has shown us that the complexity of the U.S. tax code is an important factor in the ability of many taxpayers to remain compliant with tax laws. Even sophisticated taxpayers can make honest mistakes on their tax returns.

Accordingly, helping taxpayers understand their obligations under the tax law is a critical part of improving voluntary compliance. To this end, the IRS remains committed to a balanced program assisting taxpayers in both understanding the tax law and remitting the proper amount of tax.

In addition, the President's FY 2009 Budget contains a number of legislative proposals that provide additional tools for the IRS to enforce the existing tax law. Perhaps the most critical of these tools is greater third-party reporting.

An analysis of the data from the National Research Program of TY 2001 individual income tax returns leads to one very obvious conclusion. Compliance is much higher in those areas where there is third-party reporting. For example, only 1.2 percent of wages reported on Forms W-2 are underreported. This compares to a 53.9 percent underreporting rate for income subject to little or no third-party reporting. Congress' continued support of third-party reporting requirements will help the IRS fulfill its mission and reduce the tax gap.

The FY 2009 Budget request asks Congress to expand information reporting to include additional sources of income and make other statutory changes to improve compliance. These legislative proposals are intended to improve tax compliance with minimum taxpayer burden. When implemented, it is estimated that these proposals will generate $36 billion over ten years.

Finally, full funding of the budget request will enable the IRS to improve our research and our understanding of what drives taxpayer compliance. Despite all of our progress, there is still much we do not know about the drivers and the overall size of the tax gap. Although the updated estimates provided by the NRP study are more accurate than our previous estimates, and more accurate than the estimates made at various times by others using more indirect methods, they have some significant limitations. These estimates are useful for understanding the general areas and levels of noncompliance and the scope of the problem, but they are far from precise or timely measurements.

I appreciate the opportunity to testify this morning, and I will be happy to respond to any questions that Members of the Committee may have.

Chairman LEWIS. Madam Commissioner, thank you very much for your testimony.

Ms. Olson, before we recognize you, we may have to interrupt your testimony. At 10:30, we would pause for a moment of silence with our colleagues on the House floor in memory of our military service people.

Now, it's my pleasure to introduce the National Taxpayer Advocate, Nina Olson.

STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE

Ms. OLSON. Chairman Lewis, Ranking Member Ramstad, and Members of the Subcommittee, thank you for inviting me to testify today.

At the outset, I would like to say that the IRS has done an admirable job during this filing season, given all the challenges it is facing.

What with late year tax law changes and the recently authorized economic stimulus payments, the IRS not only must process payments to over 130 million taxpayers who currently file income tax returns, but it also must identify and process returns from and payments to more than 20 million persons who have no filing requirement.

The IRS has managed to turn on a dime and deliver this filing season without significant glitches, an extraordinary achievement.

I must note, however, that now that the IRS has demonstrated its ability to change processes virtually overnight, I fully expect it to adopt and implement some of the recommendations from my annual report to Congress in the same timeframe. I will address some of these issues in my following remarks.

First, in my 2007 annual report to Congress, I mark the 10th anniversary of the IRS Restructuring and Reform Act 1998 by recommending that Congress address taxpayer rights again, by creating a true Taxpayer Bill of Rights that incorporates a clear statement of taxpayer rights and a clear statement of taxpayer responsibilities.

Second, I note in my report that identity theft is the number one consumer complaint in the United States, far outpacing all others.

Misuse of another person's Social Security number or identity generally occurs in tax administration in two contexts: first, the filing of a false return to obtain a fraudulent refund; and second, the theft and use of another person's Social Security number, or SSN, to obtain employment.

Regardless of motive, identity theft results in serious consequences for the innocent taxpayer. Such consequences may include the delay or denial of refunds, the assessment of tax debts resulting from income reflected on the fraudulent filer's return, and the requirement for victims to prove their identity to the IRS year after year.

The IRS has a duty to these taxpayers to expeditiously determine the true owner of the SSN, to restore the integrity of the affected taxpayer's account, and certainly not to exacerbate the victim's injury.

The IRS does not know how many taxpayers are impacted by identity theft. Until recently, the Taxpayer Advocate Service was the only IRS function tracking identity theft cases.

Stolen identity cases within TAS have increased by 644 percent from fiscal year 2004 to fiscal year 2007, from 447 cases to 3,327 cases.

My employees now report that they are receiving calls from senior citizens who filed for the economic stimulus payment after not filing for years only to find that someone else had been using their SSN on tax returns.

I applaud the IRS for taking some proactive measures to assist victims of identity theft. For example, the IRS recently implemented a tracking system through which an indicator will be placed on an identity theft victim's account once he or she has provided verification of identity theft.

Unfortunately, the IRS has not issued central guidance to its employees about how to apply the indicator, thereby allowing each function to create its own procedures. Moreover, the IRS has no coordinated approach to address an identity theft victim's issues from start to finish.

I have recommended that the IRS develop a dedicated centralized unit to handle all identity theft cases, and a centralized internal revenue manual to house all identity theft procedures. A centralized unit will be able to identify all trends and systemic problems and can serve as a central contact point for discussions with the Social Security Administration to improve processing.

My third issue involves elderly or disabled persons who receive in-home personal and household care under state and local government health and welfare programs. Under current law, the home care service recipients in these programs are often treated as common law employers of the caretakers. As such, they are personally responsible for reporting, filing, and paying the employment taxes on their caretaker's wages. These tasks may be difficult for an elderly or disabled person.

As a result, government entities often contract with a variety of third parties to handle these tax responsibilities.

One common arrangement is for the government to hire an intermediary service organization, or ISO. However, these ISOs or other third parties sometimes fail to meet these employment tax obligations.

When that happens, the elderly and disabled home care service recipients, as the common law employers, remain liable for the tax, interest, and penalties. Such liabilities can result in severe hardship.

Placing employment tax reporting and payment obligations on elderly and disabled taxpayers who need government assistance for in-home care defies logic and does not reflect good tax administration.

In my written testimony, I make several administrative recommendations in this area, but I believe the simplest and most elegant solution is to amend the Code to provide that a home care service worker is the statutory employee of the administrator of the program's funding, be it states, localities, their agencies, or ISOs.

By designating these workers as statutory employees, the proposal is neutral as to whether the administrator must treat the home care service worker as a common law employee for purposes of other employee or retirement benefits, thereby addressing some administrators' concerns.

Next, in my annual reports to Congress and in prior testimony, I have expressed significant concerns about the many aspects of private debt collection initiative.

Today, I will focus on the revenue projections and return on investment.

The private debt collection program, or PDC, generates about $23 million a year in gross revenue.

After subtracting out the direct costs of the program, $7.65 million, and commissions payable to the collection agencies, about $4.6 million, the annual net revenue of the PDC program is about $11 million, which translates to a return on investment, or ROI, of about 1.45 to 1.

If we instead allocated the $7.65 million to the IRS automated collection system function, the ROI would be much greater. Even using the IRS' conservative ROI estimate of 13 to 1 for ACS, an expenditure of $7.65 million would produce gross revenue of $99.45 million and net revenue after costs of $91.8 million.

Very simply, the PDC program will cost the government more than $81 million in foregone revenue this year, and the cost is likely to reach nearly half a billion dollars over the next 6 years.

Since the purpose of the PDC program was to raise revenue, the fact that it is costing the government at least $80 million a year destroys whatever thin rationale might remain for its existence. It is time for this program to end.

My next issue involves the low-income taxpayer clinic program, which Congress funded in 1998 after hearing testimony about the problems that low-income and English as a second language taxpayers encounter in obtaining representation and in learning about their rights and responsibilities as taxpayers.

The importance of LITCs is underscored by a recent study by my office showing that taxpayers who are represented in earned income tax credit audits were almost twice as likely as unrepresented taxpayers to retain all their EITC.

Despite this program's demonstrated results, IRS employees who talk with taxpayers often are reluctant to refer taxpayers to LITCs. Although IRS employees can direct taxpayers to the LITC Web site, or Publication 4134, the list of LITCs, or read a list of clinic names and phone numbers in the taxpayers' areas, there is doubt as to whether they can refer a taxpayer to a specific LITC.

Many low-income taxpayers lack access to the Internet, or cannot wait to receive a publication by mail before they get help. In light of the vital role that representation can play in the outcome of a taxpayer's audit, I urge you to consider legislation expressly authorizing IRS employees to refer low-income taxpayers who do not have representation to specific LITCs in their locales.

Finally, for several years, I have highlighted problems with the IRS' delivery of face-to-face taxpayer service in the taxpayer assistance centers, or TACs.

I am pleased that the IRS is now reversing its trend in recent years of limiting the types of services in the TACs. Nevertheless, many challenges remain.

In 2001, the IRS committed to opening 118 new TACs over the next 8 years. None of these TACs were opened. Today, TAC offices adequately serve only 60 percent of the U.S. population and only 55 percent of TACs are open for 36 to 40 hours per week. During the last 3 years, the IRS reduced TAC staffing by 9 percent leaving most TAC offices with staffing shortages.

Although the IRS is now hiring seasonal workers to ease the staffing crunch, it should make a firm commitment to providing a permanent and sufficient level of staffing. Moreover, the IRS must conduct appropriate research to determine the taxpayer service needs by geographic and demographic factors in order to identify the most appropriate number and placement of TACs.

Moreover, the IRS is still downplaying its role in tax preparation, which is a core service for the tax administrator. For example, the IRS has declared returns involving cancelation of debt income out of scope for both the TACs and volunteer preparation sites, even though these subjects are highly likely to impact the very taxpayers who are eligible for TAC services, whether because of credit card forgiveness or home foreclosures. Thus, these low-income taxpayers have no alternative but to pay for return preparation, something they personally cannot afford to do.

Thank you for this opportunity to testify today.

[The prepared statement of Nina E. Olson follows:]

Written Statement of

Nina E. Olson
National Taxpayer Advocate

Before the

Subcommittee on Oversight

Committee on Ways and Means
U.S. House of Representatives

Hearing on

The 2008 Tax Return Filing Season,
IRS Operations, FY 2009 Budget Proposals, and
The National Taxpayer Advocate's 2007 Annual Report to Congress

March 13, 2008

TABLE OF CONTENTS

I. The Time Is Ripe for a Taxpayer Bill of Rights 1

II. Identity Theft Is an Increasing Area of Concern to Taxpayers and to Tax Administration, and the IRS Must Do More to Assist Taxpayers Who Are Victims of Identity Theft 4

III. The Procedures Taxpayers Must Follow to Exclude Canceled Debts from Gross Income Are Confusing, and as a Result, Many Taxpayers May Be Paying Tax They Do Not Owe 9

IV. Elderly and Disabled Taxpayers Who Need In-Home Care Are Sometimes Liable for Unpaid Employment Taxes on Amounts the Government Pays to Their Caretakers 12

V. The IRS Should Take a Stronger Oversight Role in the Electronic Filing Arena 16

VI. The Treasury Department and Congress Should Modify the Rules Governing the Use and Disclosure of Return Information by Preparers ... 21

VII. The Private Debt Collection Initiative Will Cost the Federal Government at Least $81 Million in Foregone Revenue Annually and Should Be Terminated 23

VIII. To Reduce the Tax Gap, the IRS Should Place More Emphasis on Combating Noncompliance in the Cash Economy 24

IX. EITC Audits Present a Significant and Excessive Challenge for Taxpayers and Cause Taxpayers with Representation to Fare Better Than Unrepresented Taxpayers 26

X. Congress Should Amend IRC § 7526 to Authorize IRS Employees to Refer Taxpayers to Low Income Taxpayer Clinics 28

XI. IRS Service Delivery at Taxpayer Assistance Centers Is Improving but Still Requires Additional Resources and Effort 30

Chairman Lewis, Ranking Member Ramstad, and distinguished Members of the Subcommittee:

Thank you for inviting me to testify today to discuss the Internal Revenue Service's 2008 filing season and other issues presented in the 2007 National Taxpayer Advocate's Annual Report to Congress.[1] At the outset, I would like to say that the IRS has done an admirable job during this filing season, given all the challenges it is facing. As I noted in my Annual Report, late-year tax-law changes impact both taxpayers and the IRS, and the uncertainty surrounding such changes increases the risk that problems will arise with basic service delivery and return processing.[2] These challenges increase when the IRS must devote substantial resources during the filing season to a major new initiative, such as preparing to pay out the recently authorized economic stimulus rebates. To deliver these rebates, the IRS not only must process payments to the over 130 million taxpayers who currently file income tax returns, but it also must identify and process returns from and payments to more than 20.5 million persons who have no filing requirement.[3] All of these exigencies divert the IRS from other important work, yet the fact that the IRS has managed to turn on a dime and deliver this filing season without significant glitches is a testament to the extraordinary people who work at the IRS.

Moreover, now that the IRS has demonstrated its ability to change processes virtually overnight, I fully expect it to adopt and implement some of the recommendations I made in my Annual Report to Congress in the same time frame! I will address some of these issues below.

I. The Time Is Ripe for a Taxpayer Bill of Rights[4]

Before I address administrative challenges facing the IRS, I will briefly discuss one legislative recommendation I proposed in my recent report. On July 22nd of this year, we will be marking the tenth anniversary of the Internal Revenue Service

---

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

[2] *See* National Taxpayer Advocate 2007 Annual Report to Congress 3-12 (Most Serious Problem: The Impact of Late-Year Tax-Law Changes on Taxpayers).

[3] Approximately 20.5 million persons received Social Security or Veterans benefits and are therefore likely to qualify for stimulus rebates but did not file tax returns in 2006. IRS News Release, *Special Economic Stimulus Payment Packages Go to Social Security, Veterans Recipients*, IRS-2008-37 (Mar. 10, 2008). There is also an unknown number of low income taxpayers who ordinarily would not have a filing requirement but will have to file this year to receive a rebate.

[4] *See* National Taxpayer Advocate 2007 Annual Report to Congress 478-489 (Taxpayer Bill of Rights and *De Minimis* "Apology" Payments).

Restructuring and Reform Act of 1998 (RRA 98), a landmark piece of legislation that established many significant protections for taxpayers in their dealings with the IRS. Over the last ten years, there have been many changes in the tax world – including a new batch of tax shelters, increasing identity theft, a greater ability to electronically track financial transactions, a large increase in the number of returns filed electronically, and an increased emphasis on tax law enforcement. Despite all of these changes, there has been no significant legislation in the taxpayer rights or tax procedure arena over the last ten years.

In my 2007 Annual Report to Congress, I recommend that Congress address taxpayer rights by creating a true "Taxpayer Bill of Rights" (TBOR). Modeled after the U.S. Constitution's Bill of Rights, this TBOR would serve as a clear statement of the social contract between the government and its taxpayers – that taxpayers agree to report and pay the taxes they owe and the government agrees to provide the service and oversight necessary to ensure that taxpayers can and will file and pay their taxes. I believe it is in the best interest of taxpayers and tax administration for this unspoken agreement to be explicitly articulated in a formal Taxpayer Bill of Rights, which should incorporate a clear statement of taxpayer rights as well as a statement of taxpayer obligations. I propose the following:

TAXPAYER BILL OF RIGHTS

Taxpayer Rights

1. The Right to Be Informed (including access to adequate legal and procedural guidance and information about taxpayer rights);
2. The Right to Be Assisted;
3. The Right to Be Heard;
4. The Right to Pay No More Than the Correct Amount of Tax;
5. The Right of Appeal (both administrative and judicial);
6. The Right to Certainty (including clear guidance, periods of limitations, no second exam, and closing agreements);
7. The Right to Privacy (including due process considerations, least intrusive enforcement actions, and search and seizure protections);
8. The Right to Confidentiality;
9. The Right to Representation;
10. The Right to a Fair and Just Tax System (including offers-in-compromise, appropriate abatements, access to the Taxpayer Advocate Service, and symbolic apology or other compensation for IRS errors).

Taxpayer Obligations

1. The Obligation to Be Honest;
2. The Obligation to Be Cooperative;
3. The Obligation to Provide Accurate Information and Documents on Time;
4. The Obligation to Keep Appropriate Records;
5. The Obligation to Pay Taxes on Time.

I am hopeful that legislation to enact a Taxpayer Bill of Rights can also serve as a vehicle for more comprehensive taxpayer rights and tax procedure legislation that fills some of the gaps identified since the passage of RRA 98. In recent years, the tax-writing committees have made efforts to pass such legislation. In 2003, the Ways and Means Committee reported and the full House approved the Taxpayer Protection and IRS Accountability Act,[5] and in 2004, the Finance Committee and the full Senate approved the Tax Administration Good Government Act.[6] However, no conference committee was formed, and the bills were never enacted. In 2006, the Senate Finance Committee tried again, approving a significant taxpayer rights and tax administrative package as part of the Telephone Excise Tax Repeal Act, but it was not considered by the full Senate.[7]

The passage of time has only increased the need for such legislation. Among the proposals I believe should be included are the following:

- Protect the more than 60 percent of taxpayers who rely on paid tax preparers by imposing minimum standards of competence. At present, anyone can prepare federal tax returns; there are no standards at all. Preparers should be required to pass a basic competency test and take periodic Continuing Professional Education courses. Greater accuracy in return preparation will benefit both taxpayers and the IRS.
- Increase electronic filing by allowing taxpayers to prepare and file their returns electronically without having to pay a fee to private vendors. The IRS should make an e-filing template available and develop a direct filing portal. A direct filing portal will not only attract taxpayers concerned about costs but will also reassure taxpayers who have data security concerns about routing their personal tax information through third-party vendors.

[5] H.R. 1528, 108th Cong. (2003).

[6] S. 882, 108th Cong. (2004).

[7] S. 1321, 109th Cong. (2006).

- Protect low income taxpayers by regulating refund anticipation loans (RALs), especially by prohibiting cross-collection agreements.
- Reduce the burdens on partners in partnerships by advancing the initial partnership return filing deadline from April 15 to March 15. At present, partnerships generally cannot prepare Schedules K-1 on which they report each partner's income and other tax attributes until they finish preparing the full partnership return, and hundreds of thousands of partners receive their K-1s on or after April 15, requiring them to file for extensions.
- Protect low income senior citizens by exempting Social Security payments from levies or by requiring the IRS to develop and utilize an effective screen so that levies are not automatically imposed on taxpayers who are likely to suffer economic hardship.
- Simplify the "kiddie tax" computation rules.

This is not a comprehensive list of proposals that I believe should be adopted, but it represents a good start in combination with proposals included in prior legislation approved by the Ways and Means and Finance committees. I urge the Ways and Means Committee to take up the Taxpayer Bill of Rights this year.

II. Identity Theft Is an Increasing Area of Concern to Taxpayers and to Tax Administration, and the IRS Must Do More to Assist Taxpayers Who Are Victims of Identity Theft[8]

Identity theft is the number one consumer complaint in the United States, far outpacing all others.[9] Identity theft impacts tax administration when an individual intentionally uses the Social Security number (SSN) of another person to file a false tax return or fraudulently obtain employment. Misuse of another person's SSN or identity generally occurs in tax administration in two contexts: (1) the filing of a false return to obtain a fraudulent refund ("refund fraud") or (2) the theft and use of another person's SSN to obtain employment ("employment-related fraud").

In refund fraud, the perpetrator files early in the filing season using the personal information of the innocent taxpayer and before the lawful owner of the SSN has an opportunity to file. Typically, a perpetrator will use false Forms W-2 reflecting phantom wages and withholding credits, thus forming the basis of a fraudulent claim for a refund. To secure the fraudulent refund, the perpetrator typically will direct the IRS to transmit the refund electronically to a bank account under his or her control.

---

[8] *See* National Taxpayer Advocate 2007 Annual Report to Congress 96-115 (Most Serious Problem: Identity Theft Procedures).

[9] In 2007, the Federal Trade Commission (FTC) received 258,427 complaints of identity theft. The next closest complaint was shop-at-home catalog sales with 62,811 complaints. *See* FTC website, http://www.ftc.gov/opa/2008/02/fraud.pdf.

When the identity theft victim later attempts to file his or her tax return, the IRS flags it as a "duplicate" return and freezes the refund. Although the IRS is required to notify a taxpayer when a refund claim is denied, the IRS does not systemically notify a taxpayer when a refund claim is frozen in identity theft cases, despite the fact that a refund freeze can have the same economic effect as a refund denial. In my 2007 Annual Report to Congress, I recommended that the IRS consider issuing a "soft notice" to the second filer informing the taxpayer that the refund has been frozen as a result of a duplicate filing.[10] This puts the second filer on notice that a potential identity theft has occurred and allows the taxpayer to take steps to protect himself or herself. In addition, the IRS should consider whether to send a notice to the first filer, as in some cases it is not clear which filer is the victim and which filer is the perpetrator.

In employment-related fraud, persons without the necessary legal status to obtain employment in the United States unlawfully use another person's SSN to appear work eligible. The employer of the undocumented worker will file a Form W-2 reflecting the worker's wages, which IRS data systems will attribute to the rightful SSN owner. The IRS will assess a balance due unless the lawful owner of the SSN acts to halt the erroneous assessment.

Regardless of the motive, identity theft results in serious consequences for the innocent taxpayer. Such consequences may include (1) the delay or denial of refunds, (2) the assessment of tax debts resulting from income reflected on the fraudulent filer's return, and (3) the requirement for victims to prove their identity to the IRS year after year. The IRS has a duty to these taxpayers to expeditiously determine the true owner of the SSN and restore the integrity of the affected taxpayer's account.

We applaud the IRS for taking some proactive measures to assist victims of identity theft. For example, the IRS recently implemented a tracking system through which an indicator will be placed on an identity theft victim's account once he or she has provided verification of identity theft. I am very pleased with this positive development, as my office has long advocated such a tracking system.[11]

However, the IRS needs to take a much more taxpayer-centric approach to identity theft with respect to the identity theft indicator. For example, the IRS has no central guidance about how to apply the indicator, allowing each operating division and function to create its own procedures and guidance. Thus, an identity theft victim's account may be handled differently depending on which part of the IRS he or she contacts.

I am also concerned that the IRS does not know how many taxpayers are impacted by identity theft. As noted earlier, the IRS prior to FY 2008 had no method to systemically identify taxpayers whose SSNs were compromised. Although the IRS

---

[10] *See* National Taxpayer Advocate 2007 Annual Report to Congress 98, 115.

[11] *See* National Taxpayer Advocate 2005 Annual Report to Congress 191.

issues temporary numbers to some identity theft victims, it cannot distinguish those taxpayers from other taxpayers to whom it issues similar temporary numbers. My personal belief is that the IRS has many more cases of identity theft on its hands than it is estimating. For example, my employees report that they are now receiving calls from seniors who filed for the economic stimulus payment after not filing for years, only to find that someone else had been using their SSN on tax returns.

In talking with my local taxpayer advocates and case advocates, I often hear that there is a lack of adequate procedures available to IRS employees to address the relatively new crime of identity theft. In some respects, the IRS tries to fit a round peg into a square hole when addressing identity theft issues by using so-called "mixed entity" procedures[12] and "scrambled SSN" procedures,[13] which were initially designed to address very different circumstances. As a result, there are significant gaps in the IRS's Internal Revenue Manual into which identity theft victims fall.

For example, we are currently working a case where an individual with no filing requirement came to TAS because current IRS procedures address multiple filing situations only. The falsified income information on the fraudulent return was transmitted to the Social Security Administration, which promptly discontinued the Social Security disability benefits of the victim because it recorded the wages reported on Form W-2 under her name and therefore believed she was now working. The IRS does not have adequate procedures to address situations where the identity theft victim does not have a filing requirement, so the taxpayer was referred to TAS.

Another example that illustrates the inadequacy of current IRS procedures is the use of IRS Numbers, or "IRSNs." Under its scrambled SSN procedures, the IRS assigns a temporary tax identification number, called an IRSN, to victims of identity theft.[14] In FY 2005, the IRS assigned IRSNs to over 77,000 taxpayers. The IRS

---

[12] The IRS uses "mixed entity" procedures when it knows which of the multiple SSN users is the rightful owner. Under mixed entity procedures, the IRS assigns a temporary IRS number (IRSN) to taxpayer(s) wrongfully using the SSN, while the rightful SSN owner can continue using the SSN. The IRS then separates out the income attributable to the fraudulent filer from the innocent taxpayer's account, transferring the disputed income to the IRSN. *See* IRM 21.6.2.4.3 (Oct. 1, 2007).

[13] The IRS uses "scrambled SSN" procedures when it cannot determine the true owner of the SSN. In this situation, it assigns IRSNs to both (or all, if more than two) taxpayers who used the common SSN. The IRS instructs taxpayers who are assigned IRSNs to discontinue using their SSN. Letter 239C advises taxpayers:

> You should use the Internal Revenue Service Number (IRSN) for federal income tax purposes until we can verify your social security number (SSN). Your IRSN is only a temporary number. We cannot allow you credits such as the Earned Income Tax Credit, etc., unless you have a valid taxpayer identification number. However, you should file your return on time and claim any credits.

See IRM 21.6.2.4.4 (Oct. 1, 2007).

[14] However, identity theft victims are not the sole recipients of IRSNs. For example, in mixed entity cases, perpetrators of identity theft are assigned IRSNs. *See* IRM 21.6.2.4.3.1 (Oct. 1, 2007).

sends a letter (Letter 239C) to identity theft victims instructing them to use this temporary number to file tax returns while the IRS and the Social Security Administration (SSA) seek to determine the rightful owner of the SSN in question, a process that has historically taken over two years.[15] In the meantime, identity theft victims who file a return using an IRSN (per IRS instruction) will be denied personal exemptions and credits (such as the child tax credit and the earned income tax credit) because the IRS does not consider an IRSN to be a valid tax identification number. For example, if the SSN of a five-year-old child shows up on a Form W-2 reporting wages from a full-time job, it should be fairly clear that the five-year-old child did not earn those wages and should be treated as the victim rather than the perpetrator. Because of IRS processing requirements, however, that child may be instructed to use an IRSN instead of a SSN when he is claimed as a dependent on his parents' return. Now, in addition to having to straighten out the serious problem of identity theft, the child's parents –through no fault of their own – may be ineligible for the dependency exemption, child tax credit, and earned income tax credit with respect to the child until the IRS and SSA reach a formal decision about the true holder of the SSN.

This harm is compounded under the provisions of the recently enacted Economic Stimulus Act of 2008.[16] The Act provides that any return that does not include an SSN – whether for a primary or secondary taxpayer or a dependent – will be ineligible for the economic stimulus payment.[17] Thus, taxpayers who already are victims of identity theft are further victimized by IRS processes. These taxpayers in fact have an SSN. It is simply IRS's and SSA's cumbersome processes that are causing these taxpayers to wait for and possibly lose up to two years' worth of dependency exemptions, child tax credits, and earned income tax credits – and now economic stimulus payments as well.

I have proposed that the IRS search its records to identify identity theft victims that were required by the IRS to use IRSNs on their returns, contact these taxpayers, and assist them in filing amended returns that would list both their SSNs and their IRSNs, so they will be able to receive the tax benefits to which they are entitled. Since the taxpayer will also list the IRSN, the IRS will still be able to process the return. If these taxpayers are to receive their economic stimulus payments this year, however, the IRS must act quickly. At the very least, it can instruct these taxpayers to claim the payment on their 2008 income tax returns.

Another concern is that, although the IRS's Automated Underreporter, Automated Collection System, Criminal Investigation, Examination, and Accounts Management functions all work identity theft cases, there is no coordinated effort to address an

---

[15] The IRS states that the average scrambled SSN case currently takes approximately ten months to resolve. This is a substantial reduction from prior periods and is attributed to recently implemented process improvements made by the IRS in collaboration with the Social Security Administration. *See* National Taxpayer Advocate 2007 Annual Report to Congress 110.

[16] Pub. L. No. 110-185, 122 Stat. 613 (2008).

[17] Economic Stimulus Act of 2008, Pub. L. No. 110-185, 122 Stat. 613 (2008).

identity theft victim's issues from start to finish.[18] As a result, my organization has had to devote our limited resources to resolving identity theft issues. Stolen identity cases within TAS have increased by 644 percent from FY 2004 to FY 2007.[19]

In my 2007 report to Congress, I recommended that the IRS develop a dedicated, centralized unit to handle all identity theft cases and a centralized IRM to house all identity theft procedures.[20] A centralized unit will be able to identify trends and systemic problems, and can serve as a central contact point for discussions with SSA to improve processing. I am personally seeking agreement from the IRS leadership to work with me and my staff to develop such a unit and IRM.

I also recommended that the IRS develop a form that taxpayers can file when they believe they have been victims of identity theft. The creation of such a form would have two benefits. First, it would allow the IRS to better track identity theft cases. The IRS has already begun to place an indicator on an identity theft victim's account, but this form would contain much more information about the victim's circumstances. Second, the instructions on the form should explain which steps the IRS will take and which steps the taxpayer should take to restore the integrity of the taxpayer's account (*i.e.*, obtaining an FTC affidavit).

In the meantime, we have been collaborating with the IRS Office of Privacy, Information Protection, and Data Security on a pilot program to work online refund fraud crime cases. This group is charged with developing processes to assist two types of identity theft victim groups: (1) victims of refund crimes; and (2) victims of online fraud or phishing schemes. The working group will propose a new notification process and a new account maintenance process.

---

[18] In fact, the IRS estimated that there are 17 entry points at which an identity theft case can come into the system. *See* IRS, *Identity Theft Program Current State* (July 20, 2007).

[19] The table below shows the increase in TAS Stolen Identity cases (primary issue code 425) from FY 2004 to FY 2007.

	FY 2004	**FY 2005**	**FY 2006**	**FY 2007**
Stolen Identity	447	922	2,486	3,327

Taxpayer Advocate Management Information System, FY 2004, FY 2005, FY 2006 and FY 2007. TAS began tracking Stolen Identity cases in March 2004; the annual total for 2004 is a 12-month estimate based on an actual nine-month count of 335 cases.

[20] *See* National Taxpayer Advocate 2007 Annual Report to Congress 115.

III. The Procedures Taxpayers Must Follow to Exclude Canceled Debts from Gross Income Are Confusing, and as a Result, Many Taxpayers May Be Paying Tax They Do Not Owe[21]

Taxpayers who default on their mortgages, taxpayers whose liabilities exceed their assets, and taxpayers whose debts are discharged in bankruptcy are in most cases exempt from the general rule that canceled debts are taxable.[22] In fact, the exemption for taxpayers who default on mortgages secured by their principal residences was enacted just this past December to protect the hundreds of thousands of taxpayers who have lost or are likely to lose their homes to foreclosure in the subprime mortgage crunch.[23]

Significantly, however, none of the exceptions applies automatically. In order to exclude the amount of a canceled debt from taxable income, a taxpayer must file Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)*. If a taxpayer fails to file Form 982, the IRS's document-matching system generally will treat the amount of the canceled debt (which is reported by the lender on Form 1099-C) as unreported by the taxpayer and will issue a notice proposing additional tax. Once this notice is issued, the taxpayer at best will have to spend time understanding and responding to the notice to avoid a tax assessment. At worst, the taxpayer will not respond or will not respond adequately, and the IRS will assess tax that the taxpayer does not owe.

Taxpayers receive about two million Forms 1099-C annually reporting cancellation of debt income.[24] At least among electronically filed returns, it appears that *fewer than one percent* of taxpayers with cancellation of debt income file Form 982 claiming entitlement to exclude the amount of the canceled debt from taxable income.[25]

---

[21] *See* National Taxpayer Advocate 2007 Annual Report to Congress 13-34 (Most Serious Problem: Tax Consequences of Cancellation of Debt Income).

[22] IRC § 108(a)(1). Canceled debts are also excluded from gross income where a debt is qualified farm indebtedness and, in the case of a taxpayer other than a C corporation, where the discharged debt is qualified real property business indebtedness.

[23] Mortgage Forgiveness Debt Relief Act, Pub. L. No. 110-142, § 2 (2007). The exclusion applies to the extent that the principal balance of the loan does not exceed $2 million, the home is the taxpayer's principal residence, and the debt is canceled in 2007, 2008, or 2009.

[24] IRS Document 6961, Table 2 (showing that the IRS received 1,942,694 Forms 1099-C in 2006 and projects it will receive 2,058,600 Forms 1099-C in 2007).

[25] For Tax Year 2005, the IRS received 495,495 electronically filed returns from taxpayers who had cancellation of debt income reported on a Form 1099-C. IRS Compliance Data Warehouse, Information Returns Master File and Individual Returns Transaction File (Tax Year 2005). By comparison, the IRS received only 4,571 electronically filed Forms 982 for that time period. IRS E-File Reports (Processing Year 2006). Note that the number of electronically filed returns actually was greater than 495,495 because our data search only reflects Forms 1099-C issued to taxpayers listed with the primary taxpayer identifying number (TIN) on a tax return. It does not reflect cases where a spouse or a person whose TIN was listed as other than the primary TIN received a 1099-C.

I spent 27 years preparing tax returns and representing taxpayers before I joined the government, and I do not for a minute believe that only one percent of taxpayers with canceled debts qualify for an exclusion. Taxpayers who default on their debts are generally experiencing significant financial problems, and almost by definition, their liabilities are high relative to their assets. A taxpayer whose liabilities exceed his or her assets is insolvent and may exclude cancellation of debt income to the extent of the insolvency. If taxpayers understood the definition of insolvency and knew how to compute and report it, I am convinced that a very high percentage of taxpayers would be eligible to exclude their canceled debts from income. I am therefore deeply concerned that tens of thousands of taxpayers who qualify for the insolvency exclusion are not claiming it. And now, with the recently enacted exception for canceled home mortgage indebtedness, I am concerned that even more taxpayers entitled to claim an exclusion will fail to do it.

The confusion in this area stems largely from the complexity of the law, but the IRS has devoted surprisingly little effort to explaining the rules clearly to taxpayers. Consider the following obstacles that taxpayers face:

- The instructions to Form 1040 imply that canceled debts are always taxable by listing them under the heading of "Examples of income to report on line 21" and making no mention of exceptions or of Form 982.

- Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)*, is intended to be used by both business taxpayers and nonbusiness taxpayers. The form is extraordinarily complex. For business taxpayers, the IRS estimates that the time required to complete the form is 10 hours and 43 minutes. While it should take non-business taxpayers considerably less time, they still must navigate requests on the form to list such things as "qualified farm indebtedness," "qualified real property business indebtedness," "real property described in section 1221(a)(1)," "depreciable real property," "depreciable property," "net operating loss," "general business credit carryover," "minimum tax credit," "net capital loss," "nondepreciable and depreciable property," "passive activity loss and credit carryovers," and "foreign tax credit carryover to or from the year of the discharge."

- Nonrecourse debts (meaning debts on which the lender can do no more than repossess the property that secures a loan if the borrower defaults) do not give rise to taxable income at all. Yet this is not explained in IRS instructions, and Forms 1099-C issued by lenders do not specify whether a canceled debt is recourse or nonrecourse. Therefore, a taxpayer who receives a Form 1099-C may unnecessarily report a canceled nonrecourse

---

Note, too, that the data excludes returns filed on paper, which represent slightly less than half of all individual income tax returns filed. We could not determine how many Forms 982 were submitted with paper-filed returns.

debt as income and, if he fails to do so, the IRS likely will seek to collect tax on the canceled nonrecourse debt because it has no way to know whether the debt is recourse or not.

- Because of the complexity of the subject, the IRS has designated the tax treatment of canceled debts as "out of scope" for purposes of answering taxpayer questions at its Taxpayer Assistance Centers.

- Although IRS Taxpayer Assistance Centers generally prepare returns for low income taxpayers who seek assistance, the IRS has designated the tax treatment of canceled debts as "out of scope" for purposes of preparing tax returns as well.

- The IRS has designated the tax treatment of canceled debts as "out of scope" for purposes of return preparation at Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites.

- The IRS currently has no publication that comprehensively explains the taxation and reporting of canceled debts.

- One of the most common bases to exclude a canceled debt from income is insolvency of the taxpayer. However, many taxpayers do not know what the term "insolvency" means, much less how it is computed. The IRS provides very little guidance for taxpayers regarding the meaning of the term or its computation.

- The IRS has posted a series of questions and answers on its website about canceled debts that states: "Insolvency can be fairly complex to determine and the assistance of a tax professional is recommended if you believe you qualify for this exception."[26] However, a taxpayer who is insolvent – meaning that his liabilities are greater than his assets – probably cannot afford to pay a tax professional, and the IRS has essentially blocked taxpayer access to free return preparation assistance by declaring canceled debt issues to be "out of scope" at its Taxpayer Assistance Centers and at VITA and TCE sites.

- In cases involving homes, cars, boats or other property, the amount of debt cancellation varies depending on the fair market value the lender assigns to the property. Valuing a home or car is not an exact science, and there are times where a taxpayer may disagree with the value a lender assigns. Yet in contrast to other Forms 1099, the IRS does not require issuers of Form 1099-C to list a telephone number. As a result, taxpayers may not be able to contact their lenders with questions or requests for correction.

---

[26] *See* IRS website, Questions and Answers on Home Foreclosure and Debt Cancellation, http://www.irs.gov/newsroom/article/0,,id=174034,00.html (last visited Mar. 7, 2008).

To its credit, the IRS has been working with my office to address some of these problems. It has revised the Form 982 instructions to make them somewhat clearer for nonbusiness taxpayers, it has agreed to issue a publication on the treatment of canceled debts that a member of my staff is now drafting, and it has posted a series of questions and answers on the IRS.gov website explaining the new home mortgage exclusion. However, I believe that more needs to be done, and I remain concerned that many taxpayers who are entitled to exclude canceled debts from income are either failing to file Form 982 to properly exclude canceled debts or are receiving proposed assessments from the IRS and failing to respond because they do not understand how to approach the issue.

I recently recorded a podcast intended to educate taxpayers about cancellation of debt income and its exclusions. My office will also be issuing a plain language "consumer tax tips" brochure on this issue, and we are working with Low Income Taxpayer Clinics (LITCs) to get taxpayers the help they need if disputes arise in connection with cancellation of debt income. Moreover, I made 11 specific recommendations in my recent Annual Report to Congress to address this problem, and I hope the IRS will do more to implement them on an expedited basis.

IV. Elderly and Disabled Taxpayers Who Need In-Home Care Are Sometimes Liable for Unpaid Employment Taxes on Amounts the Government Pays to Their Caretakers[27]

State and local government agencies administer a variety of health and welfare programs that provide assistance with personal care and household chores to individuals eligible to receive in-home support services.[28] Under current law, the home care service recipients in these programs are often treated as the common law employers of those who care for them.[29] As such, they are personally responsible for reporting, filing, and paying the employment taxes on their caretaker's wages.

Because participants in these programs are elderly and disabled, it is often difficult for them to correctly determine whether they are the caretaker's common law

---

[27] *See* National Taxpayer Advocate 2007 Annual Report to Congress 355-373 (Most Serious Problem: Employment Tax Treatment of Home Care Service Recipients) and 556-557 (Legislative Recommendation: Home Care Service Workers).

[28] In 2003, nearly 2.6 million individuals received home and community-based services paid for by the government. *See* Kaiser Commission on Medicaid and the Uninsured, *Medicaid 1915(c) Home and Community-Based Service Programs: Data Update* (December 2006); *see also* Office of Inspector General, Department of Health and Human Services, *States' Requirements for Medicaid-Funded Personal Care Attendants*, OEI-07-05-00250 (revised Dec. 2006).

[29] IRC § 3401(d) generally defines "employer" as "the person for whom an individual performs or performed any services, of whatever nature, as the employee of such person, except that if the person for whom the individual performs or performed the services does not have control of the payment of wages for such services, the term "employer" means the person having control of the payment of such wages." The common law rules apply for determining whether an employer-employee relationship exists. *See* IRC § 3121(d)(2); *see also* Rev. Rul. 87-41, 1987-1 C.B. 296.

employer (which involves applying complex and sophisticated employment tax rules and regulations).[30] Even if they determine that they are the employer, these elderly and disabled service recipients may not be able to comply with the complicated tax payment and reporting requirements applicable to employers. As a result, government entities often contract with a variety of third parties to file, report, and pay employment taxes on the caretaker's wages.[31]

One common arrangement is for the government to hire an intermediary service organization (ISO).[32] However, these ISOs or other third parties sometimes fail to properly file, report, and pay employment taxes.[33] In such cases, the elderly and disabled home care service recipients – as the common law employers – remain liable for the tax, interest, and penalties. Such liabilities can result in severe hardship.[34]

IRS computer programming errors have exacerbated these problems, even in cases where an ISO has properly complied with all employment tax obligations. Prior to January 2007, IRS systems could not link the service recipients' Social Security numbers (SSNs) to the ISO's Employer Identification Number (EIN). As a result, the IRS erroneously initiated inappropriate collection activity against thousands of

---

[30] The determination of who is liable for withholding, paying, and reporting employment taxes begins with the identification of who is the common law employer. IRC § 3121(d)(2). Generally, this determination is based on all facts and circumstances, taking into consideration whether the employer has the right to direct and control the method and means by which an employee performs the services. *See generally* IRC §§ 3401(d) and 3121(d)(2); Treas. Reg. §§ 31.3121(d)-1 and 31.3401(c)-1. In 1987, the IRS published a 20-factor test for use as an analytical tool in determining whether an employer-employee relationship exists based on an examination of court decisions and rulings concerning indicia of common-law employment. *See* Rev. Rul. 87-41, 1987-1 C.B. 296.

[31] *See generally* IRC § 3504; Treas. Reg. § 31.3504; Rev. Proc. 70-6, 1970-1 C.B. 420; Notice 2003-70, 2003-2 C.B. 916 (state and local governmental agents); and Rev. Proc. 2007-38, 2007-1 C.B. 1442. *See also* National Taxpayer Advocate 2007 Annual Report to Congress 339, Table 1.22.1, Third Party Arrangements (illustrating the range of responsibilities, required forms and authorizations, potential tax liability of the third party payer and the client employer, and the current regulatory authority or absence of authority associated with the use of each type of third party payers).

[32] An ISO may act as a designated agent under IRC § 3504. Generally, IRC § 3504 allows employers to designate agents to act on their behalf to perform duties such as payment of employee wages and company payroll taxes. Under IRC § 3504, all provisions of law (including penalties) applicable in respect of employers apply to the designee and remain applicable to the employer. *See* IRC § 3504; Treas. Reg. § 31.3504-1; Rev. Proc. 70-6, 1970-1 C.B. 420; and Notice 2003-70, 2003-2 C.B. 916 (state and local governmental agents).

[33] The IRS currently regulates only designated IRC § 3504 agents and reporting agents. *See* Rev. Proc. 70-6, 1970-1 C.B. 420; Notice 2003-70, 2003-2 C.B. 916 (state and local governmental agents); and Rev. Proc. 2007-38, 2007-1 C.B. 1442. Neither the Internal Revenue Code nor Treasury Regulations require such agents to be bonded.

[34] The IRS has filed notices of federal tax lien, issued levies on elderly and disabled individuals' personal bank accounts, and levied their monthly Social Security benefits even though many elderly and disabled taxpayers depend on these funds to pay rent and buy food and medicine.

elderly and disabled service recipients.[35] TAS and the IRS provided relief to many of these individuals.[36] However, IRS computer systems still cannot identify existing employer/third-party payer relationships established prior to 2007.[37] Unfortunately, home care service recipients and their designated agents may continue to experience significant burden.[38]

Placing employment tax reporting and payment obligations on elderly and disabled taxpayers who need government assistance for in-home care defies logic and does not reflect good tax administration. If we do place these obligations on the elderly and disabled, we need to take additional steps to minimize the burdens they create. Both Congress and the IRS can do more in this regard.

What Can the IRS Do to Address the Problem?

The IRS should take the following actions to help elderly and disabled home care service recipients and their agents better understand their employment tax responsibilities and minimize the impact on elderly and disabled individuals of the failure of third parties to fulfill them:

- Issue a policy statement to indefinitely suspend assessment and collection of employment tax from elderly and disabled service recipients resulting from ISO defaults, while actively pursuing collection of the unpaid employment tax liability from the ISOs that are jointly and severally liable under IRC § 3504;
- Develop tools, such as flow charts, that can be used to analyze relevant facts and circumstances attributable to the service provider-service

[35] In addition, the IRS was unable to identify the specific home care service recipients included in the aggregate returns filed by ISOs on behalf of multiple clients. SB/SE response to TAS research request (Oct. 25, 2007).

[36] In FY 2006 and FY 2007, TAS and the IRS identified over 25,000 elderly and disabled taxpayers potentially subject to collection activity. TAS worked closely with various IRS Collection and Customer Service functions (Automated Collection System, Federal Payment Levy Program, and Accounts Management) to resolve the myriad account issues. The TAS Office of Systemic Advocacy initiated three immediate interventions and an advocacy project. Local TAS offices in Pittsburgh and St. Louis resolved more than 300 individual cases.

[37] The IRS implemented a programming change to prevent taxpayers from receiving erroneous Form 941, *Employer's Quarterly Federal Tax Return*, tax delinquency notices. However, this change applies only to taxpayers and agents who filed Form 2678, *Employer's Appointment of Agent*, after January 1, 2007. Taxpayers and agents could still be subject to inappropriate collection activity for prior years.

[38] In 2006 and 2007, the IRS Collection function, TAS, and the Office of Taxpayer Burden Reduction identified and successfully adjusted accounts impacted by 29 vendors in three states representing nearly 23,000 home care service recipients. However, TAS continues to work with over 20 vendors in one state that represent more than 9,000 home care service recipients. The Small Business/Self Employed Operating Division advised TAS that it no longer has the resources to resolve the remaining cases. Many elderly and disabled service recipients are still subject to inappropriate collection actions including levies against their Social Security benefits.

recipient relationships and determine whether an employer-employee relationship exists in a given case;

- Develop additional outreach and educational materials for the home health care industry;
- Simplify IRS processes for state and local agencies managing welfare-funded home care programs for home care service recipients;
- Develop uniform and mandatory third party application and filing guidelines for use by IRS campuses across the country; and
- Implement appropriate computer programming that can currently determine whether the correct amount of tax is reported and paid by the ISO on behalf of the home care service recipients and link the accounts of the service recipients and the ISOs for relationships established prior to January 1, 2007.

What Can Congress Do to Address the Problem?

As I recommended in 2001,[39] Congress should:

- Amend IRC § 3121(d)(3) to provide that a home care service worker is the statutory employee of the administrator of the home care service worker funding (defined as states, localities, their agencies, or ISOs, regardless of the original funding source).[40]

---

[39] *See* National Taxpayer Advocate 2001 Annual Report to Congress 193. In 2001, I raised concerns about the disparate tax treatment of home care service workers and the classification of service recipients as common law employers. I proposed a legislative change to shift the liability for employment taxes from the service recipients, who are generally considered common law employers under current law, to the administrators of home care service recipient funding, including (but not limited to) states, state agencies, or ISOs, regardless of the original source of funding. In 2002, Senator Jeff Bingaman introduced legislation to clarify that any home care service worker is an employee of the administrator of home-based service worker program funding. S. 2129, 107th Cong. (2002).

[40] By designating these workers as statutory employees, the proposal shifts responsibility for withholding, reporting, and paying required employment taxes for home care service workers from the service recipients to the funding administrators without making a determination that a worker is a common law employee of the administrator. Thus, the proposal is neutral as to whether the administrator must treat the home care service worker as a common law employee for the purposes of employee or retirement benefits.

V. The IRS Should Take a Stronger Oversight Role in the Electronic Filing Arena[41]

While the IRS has made impressive progress in increasing the rate of electronic filing, it is still far from reaching the congressionally mandated goal of 80 percent.[42] During the 2007 filing season, almost 57 percent of all individual returns were filed electronically.[43] Considering the significant benefits e-filing affords both the IRS and taxpayers, it is time to revisit the agency's policies surrounding this program. As the tax administrator, the IRS has the authority to determine the policies and criteria that entities must meet to participate in the e-file program. In important respects, however, it appears that the IRS has relinquished control of the electronic filing program to private industry. The IRS should urgently assess what is in the best interests of taxpayers and the agency itself, and then develop plans to meet these objectives.

To Fully Realize the Benefits of e-File, the IRS Should Enable All Taxpayers to Prepare Their Returns and File Directly with the IRS without Charge

The IRS has an incentive to increase the rate of electronic filing to the highest level possible. Electronic filing of tax returns brings benefits to both taxpayers and the IRS.[44] From a taxpayer perspective, e-filing improves accuracy by eliminating the risk of IRS transcription errors, pre-screens returns to ensure that certain common errors are fixed before returns are accepted, and speeds the delivery of refunds. From an IRS perspective, e-filing eliminates the need for data transcribers to input return data manually (which could allow the IRS to shift resources to other areas), allows the IRS to capture return data electronically, and enables the IRS to process and review returns more quickly.[45]

---

[41] *See* National Taxpayer Advocate 2004 Annual Report to Congress 89-109 (Most Serious Problem: Electronic Return Preparation and Filing) and 471-477 (Legislative Recommendation: Free Electronic Filing for All Taxpayers); *see also* National Taxpayer Advocate 2007 Annual Report to Congress 83-95 (Most Serious Problem: The Use and Disclosure of Tax Return Information by Preparers to Facilitate the Marketing of Refund Anticipation Loans and Other Products with High Abuse Potential) and 547-548 (Legislative Recommendation: Authorize Treasury to Issue Guidance Specific to Internal Revenue Code Section 6713 Regarding the Use and Disclosure of Tax Return Information by Preparers); National Taxpayer Advocate 2006 Annual Report to Congress 197-221 (Most Serious Problem: Oversight of Unenrolled Preparers); and National Taxpayer Advocate 2005 Annual Report to Congress 162-179 (Most Serious Problem: Refund Anticipation Loans: Oversight of the Industry, Cross-Collection Techniques, and Payment Alternatives).

[42] The IRS Restructuring and Reform Act of 1998 directed the IRS to set a goal of having 80 percent of all returns filed electronically by 2007. *See* Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685 (1998). The 80 percent e-filing goal was not achieved by 2007. However, we believe Congress should reiterate its commitment to requiring the IRS increase the e-filing rate as quickly as possible.

[43] IRS News Release, *IRS E-File Opens for 2008 Filing Season for Most Taxpayers,* IR-2008-5 (Jan. 10, 2008).

[44] *See* S. Rep. No. 105-174, at 39-40 (1998).

[45] *See* IRS Fact Sheet, *2008 IRS E-File,* FS-2008-4 (Jan. 2008).

During the 2007 filing season, approximately 25 percent of all individual returns processed by the IRS through June 2007 were prepared using software yet mailed in rather than submitted electronically.[46] These taxpayers could have easily e-filed their returns once they were prepared using computer software, but for some reason the taxpayers chose to file paper returns, which requires the IRS to devote additional resources to enter the tax return data manually and, in turn, creates a risk of transcription error. The IRS needs to research and address the reasons behind this type of filing behavior. If the IRS successfully converts a significant portion of these taxpayers to electronic filing, it would come close to, and perhaps surpass, the 80 percent e-filing goal.

I have strongly advocated for years that the IRS place a basic, fill-in template on its website to permit taxpayers to self-prepare their tax returns and file directly with the IRS for free.[47] There is no reason why taxpayers should be required to pay transaction fees in order to file their returns electronically. A free template and direct filing portal would address some taxpayers' cost and security concerns and would result in a greater number of e-filed tax returns. For those taxpayers who are comfortable preparing their returns without assistance, the government should provide the means for them to do so without charge. For those taxpayers who do not find a basic template sufficient and would prefer to avail themselves of the additional benefits of a sophisticated software program, they will remain free to purchase one.

Despite the IRS's efforts, some taxpayers still will not e-file. For those cases, the IRS should develop 2-D bar code technology, which would provide taxpayers and the IRS with many of the same benefits as electronic filing.[48] It is my understanding that the IRS has already incorporated this technology into other functions.

Recent, highly publicized phishing schemes confirm the need for the IRS to develop a free fill-in template and direct filing portal. During the 2007 filing season, for example, an Internet tax scam lured taxpayers into entering confidential tax return information on sites masquerading as Free File sites, and these taxpayers became victims of identity theft.[49] It is understandable that some potential Free File users fall victim to scams, especially when taxpayers wishing to prepare their returns pursuant to an IRS sanctioned program visit the official IRS website only to be

---

[46] IRS Electronic Tax Administration, Partial Tax Year 2006 / Processing Year 2007 Database, Ad Hoc 344 Results.

[47] *See, e.g.,* National Taxpayer Advocate 2004 Annual Report to Congress 471-477.

[48] To utilize 2-D bar code technology, a taxpayer or preparer uses software to complete the return. Once printed, the return has a horizontal and vertical bar code containing tax return information. The IRS scans the return, captures the data, decodes it and processes the return as if it had been sent electronically.

[49] *See* IRS News Release, *Late Tax Scam Discovered; Free File Users Reminded to Use IRS.gov*, IR-2007-87 (April 13, 2007). The IRS is also aware of several phishing schemes during the 2008 filing season. *See* IRS News Release, *IRS Warns of New E-Mail and Telephone Scams Using the IRS Name; Advance Payment Scams Starting*, IR-2008-11 (Jan. 30, 2008).

directed to one of 19 potentially unfamiliar commercial websites. All taxpayers should have the option to prepare and file their federal income tax returns on a website that is clearly sanctioned by the IRS without having to understand the dynamics between the commercial website and the federal government.[50]

The IRS Needs to Assert Control over its e-File Policies so that They Serve the Best Interests of Taxpayers and Tax Administration

Currently, the IRS relies completely on private industry to develop and update tax return preparation and filing software. Furthermore, when the industry encounters a problem or determines that a certain software programming update is not feasible or cost-effective, taxpayers and the IRS are left to deal with the downstream consequences.

An example of the IRS's reliance on the e-file industry can be illustrated by a recent issue involving the economic stimulus package. Eligibility for a 2008 economic stimulus rebate is based on information reported on an individual's 2007 filed income tax return. Therefore, low income taxpayers who are not typically required to file a return pursuant to IRC § 6012(a) will need to file a 2007 return in order to receive the stimulus rebate. However, the IRS e-file systems are not programmed to accept returns reporting zero adjusted gross income (AGI). To address this limitation, the IRS quickly developed a solution that permits eligible individuals to enter $1 in AGI, without the threat of compliance-related consequences, for the sole purpose of effectuating the electronic filing of the return.[51] Yet this solution requires a certain amount of cooperation among commercial software providers due to the requisite prompts the software would need to provide the user.

The IRS has a small degree of control over Free File participants' products, but it cannot force Free File or any other software vendors to make last-minute programming changes of this nature. As of March 10, 2008, the IRS Free File webpage indicated that only five of the 19 Free File participants had accommodated the $1 work-around solution, having reprogrammed their software to alert taxpayers to this issue and directing affected taxpayers to print out step-by-step instructions to report the $1 AGI item.[52] While the IRS Free File page will seek to guide affected taxpayers to use those products that support the $1 work-around, we are concerned about the level of confusion that inevitably will ensue when taxpayers without a sophisticated understanding of these issues seek to navigate the Free File site. We are also concerned about the confusion and frustration that taxpayers who do not use the Free File site will encounter when they unwittingly purchase software products that do not support the $1 work-around.

---

[50] Free File is accessible through the official IRS website, but not all taxpayers are eligible to use the program. For the 2008 filing season, 70 percent of individual taxpayers are eligible for IRS Free File. Taxpayers must have adjusted gross income of $54,000 or less to be eligible. *See* IRS Fact Sheet, *2008 IRS E-File,* FS-2008-4 (Jan. 2008).

[51] *See* IRS Notice 2008-28, 2008-10 I.R.B. 546; Rev. Proc. 2008-21, 2008 WL 556742.

[52] *See* http://www.irs.gov/efile/lists/0,,id=179739,00.html (last visited Mar. 10, 2008).

The economic stimulus package as well as other late-year tax legislation presented potentially unprecedented challenges for all parties involved. The IRS was called upon to make mid-filing season systems programming changes on a dime and managed to resolve the issues in a timely manner. At the same time, many software companies struggled to reprogram their products to accommodate the changes required by all of the late legislation. The rationale for the government's initial decision to enter into Free File and refrain from providing e-filing products itself was largely that the private sector is more innovative, nimbler, and better able to serve taxpayer needs than the IRS. However, the IRS has demonstrated this year that it *also* has the ability to rise to the occasion and meet enormous challenges on a moment's notice.

The 2007 filing season provided an additional example of the IRS's reactive role in the e-file arena and the resulting impact on tax administration. Taxpayers using Intuit Inc. tax return preparation and filing software products (Lacerte, ProSeries, and TurboTax) during the 2007 filing season experienced filing problems at the eleventh hour. Specifically, a significant number of taxpayers attempting to file returns through Intuit were unable to do so on April 17th (the standard April 15th deadline was extended because of a weekend and holiday) because of a slowdown in the company's electronic filing server. As a result, the IRS granted these taxpayers a two-day filing extension and agreed not to impose late-filing penalties. While the IRS and Intuit worked quickly to minimize the impact on these taxpayers, many of them experienced unnecessary frustration and anxiety. It would be understandable if some of the affected taxpayers revert back to paper filing in 2008 after such a negative experience with the e-file process in 2007.[53]

Finally, it has come to my attention that a nonprofit-operated free return preparation and filing product faced initial opposition to its request for a listing as a Free File program participant or, alternatively, as an IRS e-file partner on the IRS official website. The program I-CAN! E-FILE is run by the Legal Aid Society of Orange County, California (LASOC), which also happens to operate a Low Income Taxpayer Clinic (LITC).[54] Denying a listing on the IRS website placed I-CAN! E-FILE in a difficult position and potentially harmed taxpayers who stand to benefit from the product, since the IRS has actively warned taxpayers about phishing schemes and informed them that the only real way to avoid becoming a victim of a

---

[53] Intuit Press Release, *Intuit Apologizes to Lacerte, ProSeries and TurboTax Customers* (Apr. 19, 2007).

[54] I-CAN! E-FILE can be used to prepare and file federal and state returns of low income taxpayers who lived and worked in one of the following states: California, Michigan, New York, Pennsylvania or Montana. The program can also add the Permanent Fund Dividend to federal returns of Alaska residents. For the 2006 tax year, the program returned more than $18,370,000 in tax refunds to 13,438 low-income taxpayers. Letter from Robert J. Cohen, Executive Director, Legal Aid Society of Orange County, to David R. Williams, Director, Electronic Tax Administration and Refundable Credits (Jan. 18, 2008) (on file with the Taxpayer Advocate Service); Letter from Robert J. Cohen, Executive Director, Legal Aid Society of Orange County, to Tim Hugo, Free File Alliance (Aug. 3, 2007) (on file with the Taxpayer Advocate Service). For more information about this product, see http://www.icanefile.org.

potential scam is to access an e-file product through the official IRS website. Free File denied LASOC membership on two grounds: (1) membership is limited to commercial software companies, and (2) the Alliance developed its software using federal funds received through the Legal Services Corporation, a nonprofit corporation, and through the LITC grant program (which the organization vigorously disputes).[55] The IRS initially stated that the LASOC product cannot be listed as an IRS e-file partner if the corresponding description advertises both free preparation and free filing services.[56]

When a seemingly reputable program run by a nonprofit organization has trouble obtaining a listing on the IRS website as either a Free File participant or an e-file partner merely because it is run by a nonprofit organization and wants to advertise free preparation *and* filing services in its listing description, I am concerned that the IRS's electronic filing policies have gone astray.[57] These determinations are presumably made to further the IRS e-file program, yet they do not reflect the best interests of taxpayers and do not seem to be grounded in any legitimate tax administration purpose.

I believe that the IRS should take a more proactive role in the electronic filing arena by setting the policies and standards for participation in the IRS e-file program. Such policies and procedures should align with the needs of both taxpayers and tax administration. All high quality return preparation and filing products should have equal access to the market, reflect the latest tax law changes, and be compatible with filing season peaks in demand as well as IRS's computer and processing needs. Unless the IRS takes corrective action, the IRS remains in a reactive position at the whim of private industry and is forced to devote scarce resources to address the downstream consequences of potentially avoidable problems.

---

[55] E-mail from Robert J. Cohen, Executive Director, Legal Aid Society of Orange County, to Taxpayer Advocate Service (Feb. 29, 2008) (on file with the Taxpayer Advocate Service).

[56] Letter from Robert J. Cohen, Executive Director, Legal Aid Society of Orange County, to David R. Williams, Director, Electronic Tax Administration and Refundable Credits (Jan. 18, 2008) (on file with the Taxpayer Advocate Service); e-mail from Robert J. Cohen, Executive Director, Legal Aid Society of Orange County, to Taxpayer Advocate Service (Mar. 5, 2008).

[57] It should be noted that exempt organizations electronically file Form 990-N, or e-postcards, for free through the Urban Institute. *See* http://epostcard.form990.org. In addition, the Urban Institute is listed as a Form 990 e-file partner with a description clearly identifying free e-file and free preparation services at http://www.irs.gov/efile/lists/0,,id=119598,00.html.

VI. The Treasury Department and Congress Should Modify the Rules Governing the Use and Disclosure of Return Information by Preparers[58]

On January 3, 2008, Treasury and the IRS issued an advance notice of proposed rulemaking (ANPR) describing rules under consideration by the Treasury Department and the IRS to restrict the marketing of refund anticipation loans (RALs), refund anticipation checks (RACs), audit insurance, and other substantially similar products or services in connection with the preparation of a tax return. The ANPR would amend the regulations under IRC § 7216.[59]

The ANPR identified two major concerns regarding certain products and services marketed by preparers during the tax return preparation and filing process. The first concern relates to the financial incentive tax preparers have to take improper tax return positions to inappropriately inflate refund claims.[60] The second concern relates to the exploitation of unsophisticated taxpayers, which was raised by commentators in response to an earlier notice of proposed rulemaking under IRC § 7216.[61]

I share the concerns raised by Treasury and the IRS in the ANPR. In general, taxpayers should be able to control the use and disclosure of their own tax information. However, there are situations where consumer protection or tax administration concerns warrant the restriction of taxpayers' use and disclosure of that information. This restriction is particularly warranted where there is a need to protect unsophisticated taxpayers from exploitation. Restriction is further warranted to protect the public fisc by limiting opportunities for return preparers to profit from inappropriately inflating tax refunds.[62]

---

[58] *See* National Taxpayer Advocate 2007 Annual Report to Congress 83-95 (Most Serious Problem: The Use and Disclosure of Tax Return Information by Preparers to Facilitate the Marketing of Refund Anticipation Loans and Other Products with High Abuse Potential) and 547-548 (Legislative Recommendation: Authorize Treasury to Issue Guidance Specific to Internal Revenue Code Section 6713 Regarding the Use and Disclosure of Tax Return Information by Preparers).

[59] REG-136596-07, 2008 I.R.B. (Jan. 28, 2008) (all written and electronic comments are due by April 7, 2008). Section 7216 of the Internal Revenue Code generally prohibits tax preparers from using or disclosing tax return information they obtain from their clients for any purpose other than preparing a tax return. IRC § 7216 also authorizes the Treasury Department to issue regulations permitting certain uses or disclosures. Under the current regulations, tax return preparers use the tax preparation process to sell a variety of products to their clients.

[60] The ANPR also identified a concern that the marketing of RALs creates an incentive for preparers to comply less than fully with due diligence requirements designed to ensure the accuracy of EITC claims.

[61] Department of the Treasury, Notice of Proposed Rulemaking, Guidance Necessary to Facilitate Electronic Tax Administration – Updating of Section 7216 Regulations, 70 Fed. Reg. 72,954, REG-137243-02, RIN-1545-BA96 (Dec. 8, 2005).

[62] For a more detailed discussion of the National Taxpayer Advocate's concerns, see National Taxpayer Advocate 2007 Annual Report to Congress 83-95.

With the existing statutory framework of IRC § 7216, Treasury has the discretion to restrict the ability of preparers to obtain taxpayer consent to either use or disclose tax return information in the marketing of RALs, audit protection, and similar products. The statute contains a broad prohibition against the use and disclosure of tax return information by preparers. Because the consent-based exceptions to the general rule are a regulatory creation, Treasury and the IRS have the responsibility to look to the best interests of tax administration as well as protect taxpayers against exploitation. However, the IRS has failed to conduct meaningful research on this subject despite numerous and significant concerns expressed by members of Congress, stakeholders, and the Office of the Taxpayer Advocate.[63]

Accordingly, I believe the IRS should conduct research in conjunction with the Office of the Taxpayer Advocate to determine the impact certain commercial products have on tax compliance and taxpayer exploitation. Further, I recommend that the Treasury and the IRS, after careful review of findings from the aforementioned research and public comments, amend Treasury Regulation § 301.7216-3 as set forth in the ANPR.

Finally, my 2007 Annual Report includes an additional legislative recommendation to permit the Secretary to issue guidance specific to IRC § 6713. Internal Revenue Code § 6713 is the civil counterpart to the criminal penalty applicable to tax return preparers under IRC § 7216. Like IRC § 7216, IRC § 6713 provides a broad prohibition against the use and disclosure of tax return information. However, the current statutory framework seemingly requires that exceptions be made either to both the criminal and civil statutes, or to neither. Treasury is understandably reluctant to subject preparers to criminal sanctions except for egregious conduct, so it has used its regulatory authority to carve out broad exceptions from the general prohibition against the use or disclosure of tax return information set forth in IRC § 7216. I believe that taxpayer protections would be stronger if Treasury is given the flexibility to promulgate regulations applicable only to the civil penalty without concern that the criminal penalty would also apply.[64]

---

[63] For a detailed list of documents raising concerns related to these issues, see National Taxpayer Advocate 2007 Annual Report to Congress 85 n.7.

[64] National Taxpayer Advocate 2007 Annual Report to Congress 547-548.

VII. The Private Debt Collection Initiative Will Cost the Federal Government at Least $81 Million in Foregone Revenue Annually and Should Be Terminated[65]

In my Annual Reports to Congress and in prior testimony, I have expressed significant concerns about many aspects of the private debt collection (PDC) initiative, including concerns about potential taxpayer rights violations, concerns that the procedures private collection agencies (PCAs) use are less transparent to the public – and to congressional oversight – than IRS procedures, and concerns that the so-called "simple" cases on which the program was initially promoted do not exist in significant numbers.

Today, I will focus on the revenue projections. Very simply, the program will cost the government more than $81 million in foregone revenue this year, and the cost is likely to reach nearly a half billion dollars over the next six years. I explain below how I arrive at this conclusion.

The IRS projects that it will use $7.65 million in appropriated funds in FY 2008 to administer the PDC program, and it anticipates relatively steady-state costs in future years.[66] At the same time, the IRS projects that the program will generate gross revenue averaging about $23 million this year and next year,[67] and it is unlikely that gross revenue will increase in future years unless significant changes to the nature of the program are made. By these calculations, the annual net revenue the program can be expected to generate after subtracting out the direct costs of the program ($7.65 million) and commissions payable to the PCAs (about $4.60 million) comes to about $11 million. Thus, an annual IRS expenditure of $7.65 million will result in annual net revenue of about $11 million, which translates to about a 1.45:1 net return on investment (ROI).[68]

If the PDC program did not exist and the IRS instead allocated $7.65 million in appropriated funds to its Automated Collection System (ACS) function, the ROI would be vastly greater. IRS data shows that the average ROI for the ACS program is about 20:1, which would mean that an expenditure of $7.65 million would

---

[65] *See* National Taxpayer Advocate 2007 Annual Report to Congress 411-431 (Status Update: Private Debt Collection); National Taxpayer Advocate 2006 Annual Report to Congress 34-61 (Most Serious Problem: True Costs and Benefits of Private Debt Collection) and 458-462 (Legislative Recommendation: Repeal Private Debt Collection Provisions); *IRS Private Debt Collection: Hearing Before the H. Comm. on Ways and Means,* 110th Cong. (May 23, 2007) (statement of Nina E. Olson, National Taxpayer Advocate).

[66] E-mail from Director, PDC Program Office, to TAS Attorney Advisor (Feb. 29, 2008).

[67] *Id.*

[68] In fact, the data I have cited actually overstate the likely ROI because the IRS's cost estimates are not comprehensive (*e.g.,* they do not include the time that Taxpayer Advocate Service case advocates spend assisting taxpayers who request our help with PDC cases or the time senior IRS executives must devote to studying, monitoring, and answering continual questions about the program) and the IRS's revenue estimates include funds that the IRS collects on the basis of its initial letter – before the PCAs make any contact with the taxpayers.

generate annual revenue of $153 million.[69] In testimony before the Ways and Means Committee last May, Acting IRS Commissioner Kevin Brown placed the ACS ROI somewhat lower, stating in response to a question that it is about 13:1.[70] Even accepting the lower figure for this purpose, a 13:1 ROI on an expenditure of $7.65 million would produce gross revenue of $99.45 million and net revenue (after subtracting the $7.65 million expenditure) of $91.8 million.

Thus, the IRS's expenditure of $7.65 million in appropriated funds is generating about $11 million in net revenue when applied to the PDC program but should generate at least $91.8 million if applied to its ACS collection function. In other words, the opportunity cost of spending $7.65 million of appropriated funds on the PDC program each year is $81 million, and possibly much more.

Since the purpose of the PDC program was to raise revenue, the fact that it is costing the government $81 million or more each year destroys whatever thin rationale might remain for its existence. I believe it is time to end the PDC program.

VIII. To Reduce the Tax Gap, the IRS Should Place More Emphasis on Combating Noncompliance in the Cash Economy[71]

As you know, the gross "tax gap" – the amount of tax that is not voluntarily and timely reported and paid – stood at an estimated $345 billion in 2001 and remains a serious problem.[72] Households that comply with their tax obligations effectively pay a "surtax" averaging about $2,680 per year to subsidize noncompliance by others.[73] Where taxable payments are reported to the IRS by third parties, taxpayers

---

[69] We have computed the fully loaded cost of an average ACS employee at slightly less than $75,000 (assuming GS-8, step 5). The current average dollars collected by an ACS employee per year is about $1.53 million. That translates to a return-on-investment on the average ACS employee of about 20:1.

[70] *IRS Private Debt Collection: Hearing Before the H. Comm. on Ways and Means,* 110th Cong. (May 23, 2007) (testimony of Kevin M. Brown, Acting Commissioner of Internal Revenue).

[71] *See* National Taxpayer Advocate 2007 Annual Report to Congress 35-65 (Most Serious Problem: The Cash Economy), 490-502 (Legislative Recommendation: Measures to Address Noncompliance in the Cash Economy), and vol. 2, at 1-43 (Research Study: A Comprehensive Strategy for Addressing the Cash Economy).

[72] The gross tax gap is the amount of tax that is imposed by law for a given tax year, but not voluntarily and timely paid. The net tax gap is the portion of the gross tax gap that remains uncollected after taking into account late payments and IRS enforcement actions for a given tax year. The 2004 IRS National Research Program study estimated the 2001 gross tax gap at $345 billion and the net tax gap at $290 billion. IRS, *Tax Gap Map for Year 2001* (Feb. 2007), *available at* http://www.irs.gov/pub/irs-utl/tax_gap_update_070212.pdf. These figures do not include unpaid tax on income from illegal activities.

[73] If we divide the estimated 2001 net tax gap of $290 billion by the estimated 108,209,000 U.S. households in 2001, we see that each household was effectively assessed an average "surtax" of about $2,680 to subsidize noncompliance. *See* U.S. Census Bureau, Population Division (data as of Mar. 2001).

generally report well over 90 percent of their income.[74] By contrast, where taxable payments are not reported to the IRS by third parties, reporting compliance drops below 50 percent.[75] Therefore, it should come as no surprise that underreported income from the "cash economy" – taxable income from legal activities that is not subject to information reporting or withholding – is probably the single largest component of the tax gap, likely accounting for over $100 billion per year.[76]

Noncompliance in the cash economy merits special attention because the IRS's traditional enforcement tools such as document matching and audits are less effective when there is no third party reporting, and also because it is growing. According to one study, the percentage of all income subject to third party information reporting fell from 91.3 percent in 1980 to 81.6 percent in 2000.[77] The IRS's filing projections suggest that the cash economy and the amount of unreported income may continue to grow.[78]

In my 2007 Annual Report to Congress, I proposed a comprehensive strategy to address the cash economy portion of the tax gap that consisted of 15 administrative recommendations and seven legislative recommendations. As a threshold matter, I believe the IRS should establish a Cash Economy Program Office. The office would have responsibility for coordinating efforts to improve compliance in the cash economy. At present, there is no single unit or executive within the IRS with responsibility for ensuring that enforcement, research, and educational activities aimed at the cash economy are implemented in a coordinated fashion. The IRS uses a coordinated approach to address certain other issues – an example being the EITC Program Office – and I believe a program office would help the IRS address the cash economy as well. Such an office would bring accountability to the effort because it could measure its success based on the impact of IRS initiatives on compliance by cash economy participants.[79] Absent a strategic, coordinated

---

[74] *See* IRS News Release, *IRS Updates Tax Gap Estimates,* IR-2006-28 (Feb. 14, 2006) (accompanying charts), *available at* http://www.irs.gov/newsroom/article/0,,id=154496,00.html.

[75] *See id.*

[76] *See* IRS News Release, *IRS Updates Tax Gap Estimates,* IR-2006-28 (Feb. 14, 2006) (accompanying charts), *available at* http://www.irs.gov/newsroom/article/0,,id=154496,00.html. Underreporting makes up about 83 percent of the tax gap ($285 billion of the $345 billion gap). Underreporting of business income by individuals – from sole proprietors, rents and royalties, and pass-through entities – accounted for about $109 billion. *Id.* Associated underreporting of self-employment taxes by unincorporated businesses accounts for another $39 billion. *Id.*

[77] Kim Bloomquist, *Trends as Changes in Variance: The Case of Tax Noncompliance*, presented at the 2003 IRS Research Conference (June 2003) (citing growth in capital gains, partnership, and small business income).

[78] The IRS expects the number of individual returns from small business or self-employed taxpayers to grow by about 33 percent between 2006 and 2014, while the number of individual returns from other taxpayers is expected to decline by about two percent over the same period. IRS Office of Research, Research, Analysis and Statistics, Document 6292, Fiscal Year Return Projections for the United States, 2007-2014 (Sept. 2007), *available at* http://www.irs.gov/pub/irs-soi/d6292.pdf.

[79] The Treasury Inspector General for Tax Administration and the Government Accountability Office both generally agree that measures that promote accountability would help the IRS reduce the tax

approach, the IRS is less likely to make progress in reducing noncompliance in the cash economy.

My other recommendations fall into four broad categories: (1) making compliance easier, (2) increasing income visibility and the productivity of audits, (3) increasing the focus on preparers, and (4) identifying areas where additional research is needed to help the IRS understand how it can efficiently improve voluntary compliance.

IX. EITC Audits Present a Significant and Excessive Challenge for Taxpayers and Cause Taxpayers with Representation to Fare Better Than Unrepresented Taxpayers[80]

Earned Income Tax Credit (EITC) audits demonstrate some of the problems that can arise when an examination initiative does not take into account the particular characteristics of the subject population. The EITC audit process puts a heavy burden on taxpayers who may be ill-equipped to correctly navigate the audit process, suggesting that the IRS may frequently reach the wrong conclusion concerning EITC eligibility.[81] TAS Research conducted a study exploring two key facets of the IRS EITC audit process:

- Barriers faced by taxpayers undergoing an audit; and
- The impact the presence or absence of representation has on audit outcomes.[82]

TAS Research identified potential barriers through targeted interviews with Low Income Taxpayer Clinic (LITC) attorneys and from tax preparer feedback at focus groups conducted by TAS during the IRS Tax Forums. Subsequently, Wage & Investment Research and TAS Research jointly administered a survey to a representative sample of audited taxpayers to quantify the prevalence of these barriers.

---

gap. *See, e.g.*, Government Accountability Office, GAO-06-208T, *Multiple Strategies, Better Compliance Data, and Long-Term Goals Are Needed to Improve Taxpayer Compliance* (Oct. 26, 2005); Written Statement of Russell George, Treasury Inspector General for Tax Administration, *Hearing Before the Senate Committee on Appropriations Subcommittee on Transportation, Treasury, the Judiciary, Housing and Urban Development, and Related Agencies on the Internal Revenue Service's Fiscal Year 2006 Budget Request* (Apr. 7, 2005).

[80] *See* National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2, at 94-117 (Research Study: IRS Earned Income Credit Audits – A Challenge to Taxpayers).

[81] Attributes of EITC filers include: less likely to speak English, less education, and lower income levels. *See* Playing by the Rules, but Losing the Game – America's Working Poor, Urban Institute (http://www.urban.org/publications/410404.html). These attributes suggest that EITC taxpayers may be less likely to understand IRS correspondence and less able to afford representation (*i.e.*, power of attorney) with the IRS.

[82] *See* National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2, at 94-117 (Research Study: Earned Income Credit Audits – A Challenge to Taxpayers).

Survey results show that the correspondence audit process causes taxpayers to experience significant barriers in communicating with the IRS and in providing the documentation requested.

Communication with the IRS was problematic. More than 70 percent of the survey respondents stated that the IRS's audit notification letter was hard to understand, and only about half of the respondents said they thought they knew what they needed to do to answer IRS questions. Nearly three-quarters of EITC audited taxpayers personally called or visited the IRS in response to the IRS audit notification letter, mostly due to communication issues. Perhaps most notably, *more than 25 percent of the respondents did not even realize their tax return was being audited*. Overall, more than 70 percent of respondents wanted to communicate with the IRS about their audit in a manner other than correspondence.

Taxpayers also experienced problems attempting to identify and provide the documentation requested by the IRS:

- More than half of the respondents reported difficulties obtaining requested documents;
- Nearly 40 percent of respondents who indicated they sent in all the requested documentation were asked for the same documentation again;
- 19 percent were asked to provide additional information (different from the original request);
- Over 40 percent of respondents reported waiting more than 30 days for the IRS to acknowledge receiving the requested documentation, and
- An additional 10 percent reported that the IRS never acknowledged receipt of the documentation.

The barriers in the audit process likely help to explain the findings in the second part of this study, which showed that taxpayers who are represented during an EITC audit fare significantly better than their unrepresented counterparts.

To conduct the study, TAS Research analyzed results for all taxpayers whose tax year 2004 returns were audited. TAS found that taxpayers who used representatives were much more likely to be found eligible for the EITC:

- Nearly twice as many represented taxpayers were found eligible for EITC after audit as those without representation,[83] and

[83] Among taxpayers with representation, 47.6 percent retained at least some EITC compared with 27.4 percent of unrepresented taxpayers.

- Representatives with more training were better able to successfully represent their clients – 46 percent of those using CPAs retained their claimed EITC, as compared with 39 percent of those who used unenrolled preparers.

Represented taxpayers also retained more EITC and owed less additional tax than those who were not represented during the audit:

- More than 40 percent of represented taxpayers retained all the EITC they claimed;
- Less than 25 percent of unrepresented taxpayers retained all the EITC they claimed;
- 41 percent of unrepresented taxpayers ended up owing additional tax, while
- Only 23 percent of represented taxpayers were found to owe additional tax.

The barriers faced by taxpayers during EITC audits and the gap in audit outcomes between represented and unrepresented taxpayers have important ramifications for the administration of EITC compliance. At a minimum, they suggest that corrective actions are necessary for the IRS to consistently reach the right conclusion on EITC eligibility.

X. Congress Should Amend IRC § 7526 to Authorize IRS Employees to Refer Taxpayers to Low Income Taxpayer Clinics[84]

In 1998, Congress created a grant program to fund Low Income Taxpayer Clinics (LITCs) after hearing testimony about the problems that low income and English as a second language (ESL) taxpayers encounter in obtaining access to representation and in learning about their rights and responsibilities as taxpayers.[85] The TAS study (described above) showing the significant impact that representation has on the outcome of audits, particularly Earned Income Tax Credit examinations, underscores the importance of the LITC program.[86]

However, IRS employees who talk with taxpayers are limited in their ability to refer taxpayers to LITCs. The Supplemental Standards of Ethical Conduct for Employees of the Department of the Treasury prohibit IRS employees from

---

[84] *See* National Taxpayer Advocate 2007 Annual Report to Congress 551-553 (Legislative Recommendation: Referrals to Low Income Taxpayer Clinics).

[85] *IRS Restructuring: Hearing Before the Senate Finance Committee*, Statement of Nina E. Olson, Director of the Community Tax Law Project, 105th Cong. (Feb. 5, 1998); *Taxpayer Rights Proposals: Hearing Before the House Ways and Means Committee*, Statement of Nina E. Olson, Director of the Community Tax Law Project, 105th Cong. (Sept. 26, 1997).

[86] For additional information, *see* National Taxpayer Advocate 2007 Annual Report to Congress 222-241 (Most Serious Problem: EITC Examinations and the Impact of Taxpayer Representation) and vol. 2, at 94-117 (Research Study: IRS Earned Income Credit Audits – A Challenge to Taxpayers).

recommending or referring taxpayers to specific attorneys or accountants.[87] Further, the Office of Government Ethics (OGE) Standards of Ethical Conduct for Employees of the Executive Branch prohibit employees, including IRS employees, from endorsing any product, service or enterprise.[88]

Based on both the OGE Standards and the Treasury Standards, the IRS's Deputy Ethics Official (DEO) has advised that, although the Treasury Standards appear to apply only to recommendations or referrals of attorneys or law firms, tax clinics are "similar enough to law firms, such that they fall within the prohibitions of the OGE Standards and the Treasury Standards."[89] According to the DEO, tax clinics are similar to law firms in that they have a fiduciary duty to taxpayers, provide legal advice, and represent taxpayers in court.[90] IRS employees can read the names and phone numbers of the clinics located in a taxpayer's geographic area but cannot refer a taxpayer to a specific LITC. The DEO advised that IRS employees may provide a taxpayer with the contact information for a particular LITC only if the taxpayer specifically asks.

LITCs are federally funded organizations that are subject to substantial monitoring by the Taxpayer Advocate Service and the Treasury Inspector General for Tax Administration (TIGTA).[91] LITCs include (1) clinical programs at accredited law, business, or accounting schools in which students represent taxpayers in controversies before the IRS and (2) IRC § 501(c) organizations exempt from tax under IRC § 501(a) that either directly represent taxpayers or refer taxpayers to qualified representatives. By virtue of their congressional authorization, the type of work they engage in, and the population they are designed to serve, I believe that LITCs can be sufficiently distinguished from law and accounting firms to entitle them to different treatment on the issue of taxpayer referrals.

Without the ability to refer low income taxpayers to specific clinics, the IRS cannot help these taxpayers find the assistance they need. Although IRS employees can

---

[87] "Employees of the IRS shall not recommend, refer or suggest, specifically or by implication, any attorney, accountant, or firm of attorneys or accountants to any person in connection with any official business which involves or may involve the IRS." 5 C.F.R. § 3101.106(a).

[88] *See* 5 C.F.R. § 2635.702(c)(1) and 5 C.F.R. § 2635.101(b)(8).

[89] GLS-0779-00 (May 16, 2000).

[90] *Id.*

[91] Treasury Inspector General for Tax Administration, Ref. No. 2006-10-093, *Confirmation of Tax Compliance Issues Among Low Income Taxpayer Clinics* (Sept. 18, 2006); Treasury Inspector General for Tax Administration, Ref. No. 2005-10-129, *Progress Has Been Made but Further Improvements Are Needed in the Administration of the Low Income Taxpayer Clinic Grant Program* (Sept. 21, 2005); Treasury Inspector General for Tax Administration, Ref. No. 2003-40-125, *Improvements Are Needed in the Oversight and Administration of the Low-Income Taxpayer Clinic Program* (May 29, 2003); Treasury Inspector General for Tax Administration, Ref. No. 2002-10-085, *Increased Monitoring of the Low-Income Taxpayer Clinics Is Needed to Ensure Compliance with the Grant Terms and Conditions* (May 10, 2002).

direct taxpayers to the LITC website[92] or Publication 4134, Low Income Taxpayer Clinic List, these are not always the most effective options for putting taxpayers in touch with those who may be able to help them.[93] In light of the vital role that representation can play in the outcome of a taxpayer's audit, I urge you to consider legislation to authorize IRS employees to refer taxpayers to LITCs without restriction.

As a separate matter, I will soon be writing a letter to the heads of state bar associations, CPA societies, and other professional associations to urge their members to volunteer with LITCs in their area. In that way, I am hopeful that we can expand the number of taxpayers the LITCs are able to serve.

XI. IRS Service Delivery at Taxpayer Assistance Centers Is Improving but Still Requires Additional Resources and Effort[94]

For several years I have highlighted problems with the IRS's delivery of face-to-face taxpayer service in the Taxpayer Assistance Centers (TACs).[95] Partially in response to those concerns, Congress in 2006 directed the IRS to prepare a Taxpayer Assistance Blueprint (TAB), which was released last April.[96] The TAB

---

[92] http://www.irs.gov/advocate/article/0,,id=106991,00.html.

[93] Internal Revenue Service, *The 2007 Taxpayer Assistance Blueprint Phase 2,* at 37-39 (Apr. 2007) (discussing barriers to website use); National Taxpayer Advocate 2006 Annual Report to Congress vol. 2, at 10-13 (discussing taxpayer unwillingness to use the Internet and barriers to usage). *See also* National Taxpayer Advocate 2006 Annual Report to Congress 333-354, 355-375 (discussing issues related to limited English proficiency, English and a second language, and low income taxpayers).

[94] *See* National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: Service at Taxpayer Assistance Centers).

[95] *See* National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: Service at Taxpayer Assistance Centers), *see also* National Taxpayer Advocate 2006 Annual Report to Congress xi-xiv (Taxpayer Assistance Blueprint: The National Taxpayer Advocate's Perspective); National Taxpayer Advocate 2005 Annual Report to Congress 2-24 (Most Serious Problem: Trends in Taxpayer Service); National Taxpayer Advocate 2004 Annual Report to Congress 8-66 (Most Serious Problem: Customer Service in a Complex and Changing Tax Environment).

[96] H. Rep. No. 109-307, at 209 (2005). The Senate Committee Report provides further detail on the content of the five-year plan, directing the IRS to:

> … undertake a comprehensive review of its current portfolio of taxpayer services and develop a 5-year plan that outlines the services it should provide to improve services for taxpayers. This plan should detail how it [IRS] plans to meet the service needs on a geographic basis (by State and major metropolitan area), including any proposals to realign existing resources to improve taxpayer access to services, and address how the plan will improve taxpayer service based on reliable data on taxpayer service needs. As part of this review, the Committee strongly urges the IRS to use innovative approaches to taxpayer services, such as virtual technology and mobile units. The IRS also should expand efforts to partner with State and local governments and private entities to improve taxpayer services.

S. Rep. No. 109-109, at 134 (2005).

was intended to serve as a strategic plan for taxpayer service and lead to the development of taxpayer-centric, research-based models to help the IRS make decisions about taxpayer service and the delivery of face-to-face service. Because of the TAB and my own office's research, we know more than ever about taxpayer needs and preferences, and their willingness to try new methods of service delivery.[97]

The IRS has certainly recommitted to delivering quality taxpayer service and begun reversing its trend in recent years of limiting the types of services and methods of delivery. I applaud the IRS for creating a Service Committee – the counterpart to the Enforcement Committee – which enables the entire senior leadership of the IRS to consider and coordinate taxpayer service initiatives. The IRS currently is undertaking many initiatives to assist taxpayers in claiming economic stimulus payments, including keeping TACs open on more Saturdays. I am also pleased that IRS management has indicated a willingness to consider reinstating Problem Solving Days and taking a geographic approach to determining which topics to designate as "out-of-scope" (*e.g.,* the IRS should not treat farm-related questions as "out-of-scope" in TACs in areas where there is a significant amount of farming activity). The IRS has also recently relaxed its stringent and illogical rules about providing taxpayers with copies of their tax return transcript at the TACs.[98]

However, there is still much to be done in the taxpayer service area. In my 2007 Annual Report to Congress, I identified several other problems that limit the usefulness of the TACs, including the insufficient number and staffing of TACs and the significant conditions for obtaining return preparation assistance that have the effect of deterring taxpayers from seeking service.

The Location and Number of TACs May Not Be Adequate

In 2001, the IRS committed to opening *118 new TACs* in the following seven to eight years.[99] Unfortunately, none of these new TACs was opened, and the IRS even initiated an unsuccessful effort to close 68 TACs.[100] The TAB concluded that TAC offices were adequately serving only 60 percent of the United States population.[101] In order to make better decisions about the location, number, and staffing of TACs, the IRS developed a decision tool about TAC operations, but that

---

[97] *See* National Taxpayer Advocate 2006 Report to Congress, vol. 2 (Research Study: Study of Taxpayer Needs, Preferences, and Willingness to Use IRS Services).

[98] Previously the IRS required taxpayers to obtain transcripts of their accounts through the toll-free number, which would mail a transcript within 7 to 10 days. Taxpayers could only obtain transcripts at TACs in "emergency" situations. It was TAS's experience that the TACs almost never acknowledged an emergency situation. In fact, since that policy was in place, TAS transcript cases have increased sharply. The IRS's more liberal transcript policy should result in fewer TAS cases in this area.

[99] National Taxpayer Advocate 2001 Annual Report to Congress 49.

[100] IRS News Release, *IRS to Create Efficiencies with Taxpayer Assistance Centers*, IR-2005-63 (Jun. 27, 2005).

[101] Internal Revenue Service, *Taxpayer Assistance Blueprint: Phase 2* at 116 (Apr. 17, 2007).

tool only includes the present TAC locations. It is not clear whether the IRS will use this program to consider adding TAC locations, even though TAB research demonstrates that TAC coverage across the United States is insufficient. Thus, we recommend that the IRS conduct additional research of population segments to determine the volume, scope, and type of service that taxpayers require by geographical location, and utilize its TAC decision tool to identify the most appropriate number and placement of TACs.

TAC Staffing and the Availability of Services Is Inadequate to Meet Taxpayer Needs

Only 55 percent of TACs are open for 36 to 40 hours per week, and during the last three years, the IRS reduced TAC staffing by nine percent, leaving most TAC offices with staffing shortages. Although the IRS is now hiring seasonal workers to ease the staffing crunch, I believe the IRS should make a firm commitment to providing TACs with the level of staffing necessary to meet taxpayer needs.

The IRS Should Embrace its Fundamental Tax Administration Responsibility to Offer Tax Return Preparation to Needy Taxpayers

I am concerned that the IRS imposes too many barriers and limitations on tax preparation. I am pleased that the IRS heeded our earlier criticism and has changed its position on requiring taxpayers to visit a TAC twice in order to obtain return preparation services – once to make the appointment and once to have the return prepared. However, the IRS continues to downplay its role in tax preparation.

To my mind, tax preparation is a core service for the tax administrator. It cannot look to the nonprofit sector alone to meet the needs of the tens of millions of low income taxpayers, including many elderly taxpayers, who cannot afford to pay a return preparer. Yet the IRS continues to straddle the line – it prepares enough returns to allow it to claim it is providing the service but makes it very difficult in some cases for taxpayers to obtain assistance. As noted above, for example, the IRS has declared returns involving cancellation of debt income out-of-scope both for the TACs *and* volunteer preparation sites, even though those subjects are highly likely to impact the very taxpayers who are eligible for TAC services (whether because of credit card debt forgiveness or home foreclosures). Thus, these low income taxpayers have no alternative but to pay for return preparation, something they generally cannot afford to do.

It is not just individual taxpayers who suffer from this restriction of preparation services in the TACs. Today, organizations exempt from tax under IRC § 501(c)(3) are required to file an e-postcard annually if their gross receipts are normally $25,000 or less, providing the IRS with basic contact information and informing the IRS whether the organization is still a going concern.[102] Failure to file for three

[102] IRC § 6033(i).

consecutive years will result in automatic revocation of the organization's exempt status.[103]

Approximately half of exempt organizations have all-volunteer staffs and another third have fewer than ten employees.[104] These smaller nonprofits frequently lack professional tax guidance and rely on their volunteers to deal with the IRS.[105] Thus, while the e-postcard may appear to be an innocuous filing requirement, it is entirely possible that a volunteer treasurer for an all-volunteer exempt organization may need assistance but cannot afford to pay for that assistance. The TACs have agreed to assist exempt organizations with filing the e-postcard on the condition that the IRS not publicize the availability of this assistance. Thus, the only way a small exempt organization will know whether the IRS will help it is if it happens to visit a TAC on its own initiative. This "we will provide you service but we won't tell you about it" approach falls well short of the level of service the public has a right to expect from its government.

[103] IRC § 6033(j).

[104] IRS, TE/GE FY 2005 Strategic Assessment 3 (Feb. 2, 2005).

[105] IRS, TE/GE FY 2005 Strategic Assessment 3 (Feb. 2, 2005).

Chairman LEWIS. Thank you very much, Ms. Olson, for your testimony.

Let me say to Members of the Committee and to our two witnesses and to all of you in the audience, now we will join our colleagues on the floor of the House by observing a moment of silence in honor of our troops.

[A moment of silence was observed.]

Chairman LEWIS. Madam Commissioner, Ms. Olson reports that seniors filing for the rebate checks are finding that someone else has been using their Social Security number on tax returns. There are also tax rebate scams that target the elderly.

What can the IRS do to protect seniors? What happens to these seniors? Do they receive a rebate check?

Ms. STIFF. The identity theft issue that I think all of us are facing individually and that has become a concern for other financial sector private/public agencies, is certainly a growing area.

I think in Nina's testimony and in our documents she says that it's the number one consumer complaint that's registered with the Federal Trade Commission.

We at the IRS take identity theft very seriously. We have procedures and processes in place when we identify it.

We encounter two forms of identity theft as tax administrators.

One is where someone uses your SSN to file a fraudulent return to get a refund. In another instance, someone is using your SSN to get employment and then the IRS receives a 1099 or a W–2 showing income that doesn't belong to you.

In each of those instances, the taxpayers whose identities are stolen become subject to notices, potential bills, and to having to work with us to establish, verify, and validate both their identity and their address.

In the past 6 months, we have established an entire organization whose sole mission is to help us find ways to strengthen our ability to help taxpayers who are victims of identity theft from a tax administration standpoint.

We have simplified the documentation that's required and provided taxpayers with the option to fax documentation.

I think that what we're finding with stimulus, though not in any great number of instances except several Nina has run into already is where people haven't had a filing requirement for years.

If you're someone who is prone to stealing another individual's SSN that makes a good target, because such individual is not filing, the ability to be caught and identified as doing something criminal is probably somewhat reduced.

So as we're finding these situations, we're trying to deal with them on an individual basis. We're reaching out. We've told those seniors to contact us.

We have procedures in place both in the Tax Advocate Service and on the IRS side that will enable us to work with those seniors to ensure that we get their identities verified in our database and that they do indeed receive their stimulus payments.

Chairman LEWIS. Madam Commissioner, have the rebate checks affected taxpayer service this filing season?

Let me just ask, before you respond, why did the IRS shift collection employees to answer the telephone?

It's my understanding that the GAO estimates that the foregoing revenue from shifting the collection employees to answer the phone would be $681 million.

Ms. STIFF. Let me provide some context for what we're facing as an agency.

When the stimulus laws were enacted and we said we would be able to get the stimulus checks in play in May, I think everyone was of a like mind that sooner was better than later, if the goal was to stimulate the economy.

Then we're faced with dealing with taxpayers regarding economic stimulus checks, at the same time that we're dealing with taxpayers who are trying to file their tax returns.

Let me just context that.

134 million individual returns that we'll process between now and the end of April; $225 billion in refund checks that we want to issue to 100 million taxpayers.

In any given year, during filing season, we hear from about 60 million of those taxpayers on our phone lines, seeking assistance, either through the self-assisted automated phone lines or a personal assistor to help them navigate the tax system.

Now, we've got 135 million taxpayers plus maybe 20 million Social Security recipients and Veterans' Affairs benefits recipients who are expecting stimulus payments.

From the time Congress enacted the stimulus provision, up until as recently as yesterday, we have been receiving 50,000-plus calls from taxpayers on a daily basis wanting to talk about other stimulus, and we can only imagine those numbers increasing the closer it gets to May 2nd.

So, now we've got the convergence of trying to handle the increased stimulus calls at the same time that we're answering refund calls.

We believed it was important, still believe that it's important that a senior citizen, a recipient of Veterans' Affairs benefits, or any other taxpayer for that matter, should be able to call us and get a question answered so they can do what they need to do to receive their stimulus payment.

In order to expand our ability to answer telephones for those taxpayers in this compressed timeframe that we're all dealing with, we looked to our Automated Collection System, our telephone collection operation, because that operation operates on the same phone lines that our customer service does, and we're able to switch them over on an hour-to-hour basis to supplement our toll-free tax assistance to taxpayers.

So, we worked with the Taxpayer Advocate and we worked with our compliance operations, and we made a decision to train our ACS assistors to provide that assistance if needed.

We're monitoring hour-by-hour, day-by-day, and only supplementing as the traffic demands it.

The estimate you have is the top end. If we needed all of those people to answer calls every hour of the day, it would be up to a $600 million loss on the collections side.

But thus far, we have been on the low side of the demand. We're only having to migrate people over on occasion, as opposed to all day long.

So, we're actually hoping that the impact on the lost revenues will be significantly less, but I think, more importantly, it's imperative that taxpayers trying to file their returns or get their stimulus payments get the answers to the questions that they have so that they can get those checks in May and June.

That was the basis of our thinking.

Chairman LEWIS. Thank you very much, Madam Commissioner.

Ms. Olson, just one question for you.

Could you tell Members of the Committee why it is so important that the IRS be allowed to refer low-income, including EITC taxpayers, for assistance to low-income tax clinics? Why is that so important?

Ms. OLSON. Well, as you know, the low-income taxpayer clinics provide representation to taxpayers in controversies.

We did a study that showed that low-income taxpayers who are audited by the IRS for earned income credit, that in those exams, if they are represented, they are nearly twice as likely to get the earned income tax credit and get almost twice as much earned income tax credit than unrepresented taxpayers.

So, it's clear that representation helps these taxpayers navigate our audit procedures.

We feel it's very important for taxpayers, when they are low-income, and they may not be able to navigate the IRS, they may speak different languages as their primary language, that getting representation really assists them in getting the right answer from the IRS, rather than a default answer that is not the correct answer.

So, the IRS employees who have the taxpayer on the phone, we really want them to be able to say, ″You live in this area, and there is a low-income taxpayer clinic that serves this area, and they have language capabilities, they have translators that can speak your language, so let me give you the phone number of this, the intake number for that clinic."

We just think that that will improve tax administration overall, and get the right answer for these taxpayers.

Right now, a lot of times, they're getting an answer in an audit or a collection issue because—that's the wrong answer—because they just don't know the right things to give us in terms of information.

Chairman LEWIS. Thank you very much, Ms. Olson.

We have one non-Subcommittee Member, Mr. Pomeroy, who is a Member of the full Committee, and we welcome him here this morning to participate in the questioning.

Now, it is my pleasure to turn to Ranking Member Ramstad for his questions.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Chairman, at the request of Mr. Johnson, who had to leave the hearing, I would ask unanimous consent that Mr. Johnson's questions be submitted, of these two witnesses, be submitted for the record.

Chairman LEWIS. Without objection.

[The information follows:]

SAM JOHNSON
THIRD DISTRICT, TEXAS

1211 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-4303
(202) 225-4201

www.samjohnson.house.gov

2929 NORTH CENTRAL EXPRESSWAY
SUITE 240
RICHARDSON, TX 75080
(972) 470-0592

Congress of the United States
House of Representatives
Washington, DC 20515–4303

COMMITTEES:
WAYS AND MEANS

RANKING MEMBER:
SUBCOMMITTEE ON SOCIAL SECURITY

DEPUTY WHIP

COMMISSIONER:
U.S.–RUSSIAN JOINT COMMISSION ON POW/MIAs

REGENT:
SMITHSONIAN INSTITUTION

Questions for the Record
Ways & Means Subcommittee on Oversight
March 13, 2008

SAM JOHNSON
Member of Congress

Ms. Olsen last year I asked you about a problem that I'm going to ask you about again this year – it has to do with the interaction of the Alternative Minimum Tax and Incentive Stock Options. In 2006, I worked with a bipartisan group to get some relief enacted into law so that people can get back prepaid taxes on phantom income. I understand that in the last couple of weeks some people have started to get checks from the IRS as refunds of these prepaid taxes.

The law didn't fix the entire problem for everyone and I've been working with Mr. Van Hollen on H.R.3861 to finish the job. In the last couple of weeks, the Senate has been working in a bipartisan way to address the problem – Senator Grassley just cosponsored Senator Kerry's bill. I believe that this show of bipartisanship is a good indicator that we will finish the job this year.

The problem is that the IRS is poised to evict some more people from their homes as a result of this tax nightmare, just as we are about to fix the problem. I am asking you as Taxpayer Advocate to work with IRS enforcement agents to forestall any more evictions for the rest of the year. Had there been some report language with the 2006 tax bill, when we first addressed this problem, I believe it would have directed the Service to be more humane in its approach to enforcement.

Congress is going to address this problem and it just doesn't make any sense to evict more people out of homes over this mess.

Ms Olsen and Commissioner Stiff, my other question concerns a bill I introduced H.R.5450, the MOBILE Cell Phone Act. This bill would eliminate the requirement that employees keep a detailed log sheet to account for the calls they make on the cell phone their employer gives to them for work purposes. This was a law put into place in 1989, when cell phones were the size of a shoe and the batteries for the required a suitcase to carry. Clearly time and technology have marched on and cell phones are simply an extension of the business day and place to anytime and anywhere. Cell phone contracts are often written with unlimited minutes so the employer is not even paying for specific air time.

But apparently this issue came up on audit and the IRS decided that they could play "gottcha". Rather than someone having an "aha moment" and asking whether this still made any sense for American productivity to keep call log sheets, the IRS decided to issue audit guidelines on how to enforce it. It is my understanding that tax exempt organizations and state and local governments were among the first targets of the IRS. I know that the IRS has been threatening social workers with having to pay personal income tax on the value of the cell phone service they use if they cannot produce detailed call sheet logs. Don't you think that Social workers should better spend their limited time checking in on neglected and abused kids rather than cell phone paperwork for the IRS?

I know the Office of the Assistant Secretary for tax has been trying to mitigate this mess through a regulatory project, but why didn't either someone at the IRS or someone with the Taxpayer Advocate take an ounce of common sense and ask whether it even makes sense to have this law on the books?

Mr. RAMSTAD. Commissioner Stiff, Ms. Olson raised the issue of the IRS' private collection program, the PCA program, for collecting delinquent tax debts.

Your predecessors have testified before this Committee that even if the IRS were given more resources to hire enforcement employees, it wouldn't be used to collect the type of debt currently being collected by the PCA program.

Instead, IRS employees, according to your predecessors, would be used for more complex, higher priority cases.

Is this still the case?

Ms. STIFF. Yes, it is.

Mr. RAMSTAD. Then it seems to me there's not really a choice between using IRS employees and using private collection agencies to collect this debt.

Isn't the real choice whether we use private collection agencies or let these tax debts go uncollected?

Ms. STIFF. Well, I think, to respond to that, and maybe to clarify to what Nina included in her testimony, is that the cost that the IRS incurs to support the PCAs is not a choice of $7 million to spend on this or on that.

The PCA work is paying for itself on an annual basis. The cost to start the program will be recovered in late 2010.

What we're doing is, through the PCA program, collecting thus far I think roughly $43 million that, as you pointed out, otherwise wouldn't be collected, because the competition isn't—it's not a choice, they're not mutually exclusive.

Mr. RAMSTAD. So, do you concur then with the finding of the—of our own non-partisan Joint Committee on Taxation, which believes that IRS employees would not be used to collect this debt, and therefore if we terminate the PCA program, it would reduce tax revenues by, again, according to the Joint Committee on Taxation, it would reduce tax revenues by over $1 billion during the next 10 years?

Ms. STIFF. I can't confirm their projection there, but we would lose what it is that we're getting each year, and the Treasury, the FISC is getting 50 percent of what's collected.

Mr. RAMSTAD. Do you have those numbers?

Ms. STIFF. I can get it to you back. I'll have to follow up.

Mr. RAMSTAD. Very well.

I certainly hope we don't take a step backward in our efforts to close the tax gap by eliminating a program that's obviously working and has, according to the surveys that we all saw, has enormous taxpayer satisfaction ratings, certainly ratings infinitesimally higher than this body, which is unfortunate. I don't say that in a humorous vein at all.

So, would you care to respond, Ms. Olson?

Ms. OLSON. Thank you, sir.

In point of fact, the IRS has a test underway right now that is testing what would happen if we used IRS employees to collect this very debt, because my contention is that for less money, we would be more productive with the same cases.

It's just the IRS' policy call that they don't want to use its employees to collect this debt, which I do not support that call.

Second, the IRS is running out of cases to send to the PCAs, and as I speak right now, the IRS is looking at other cases that the IRS is working right now, preparer penalty cases, ACS, actual cases in ACS inventory that they want to ship out to the private debt collection agencies, which are not the cases upon which the Congress authorized this program. Congress was told that the PCAs would only get easy cases.

Finally, in terms of the tax gap, our projections show, and these are the actual numbers from the IRS' private debt collection program, that the net revenue from the PCA program is only about $11 million a year.

We have a $345 billion annual tax gap, and when you do the chart that shows the 345 billion and then the 11 million, the 11 million is a blip on the—it doesn't even show up as a blip on the radar screen.

So, I just remain completely unconvinced that this program is worth the expenditure of the resources and the risk that we have in sending taxpayer information into the hands of parties other than IRS employees.

Mr. RAMSTAD. Well, certainly, in response, the Joint Committee on Taxation disagrees with your assertions.

They believe that terminating the program would reduce tax revenues by over $1 billion in the next 10 years. So there's obviously a disagreement there.

I think we—I just hope we don't eliminate a program that, in my judgment, everything I've seen, all the—in trying to look at it objectively, all the evidence points to the fact that it's working.

So anyway, I just hope we continue to collect those revenues, and I hope they do total over $1 billion over the next 10 years, because we need to do everything possible to close the tax gap.

With that, Mr. Chairman, I'll yield back.

Chairman LEWIS. Thank you.

I want all of the Members to be aware that we're going to be operating under the Gibbons Rule, so no one would think I'm not being conscious and peaceful and nonviolent. Okay?

[Laughter.]

Chairman LEWIS. Mr. Tanner is now recognized for his questions.

Mr. TANNER. Thank you, Mr. Chairman. I'm glad you're gong to be peaceful and nonviolent, since I'm sitting next to you.

[Laughter.]

Mr. TANNER. Madam Secretary, we'll be voting on the budget resolution later today, I assume, and we have, the blue dogs have endorsed the budget, and section 401 provides some additional money for tax compliance, what my friend, Mr. Ramstad, was saying with respect to the tax gap.

I'm told that it could be as much as 13 percent of the budget, or about $350 billion a year.

Considering the fact that we are borrowing in all of our names from foreign sources over $500 million a day, primarily going to wartime expenditures of 10 to 23 billion dollars a month in Iraq, I think it becomes a matter of patriotism for people to pay what they legally and fairly owe under the law.

I guess people have been grumbling about paying taxes since the 18th century, and certainly I'm not immune to that. We all pay whatever it is we legally and equitably and fairly owe.

I would be curious. In that budget resolution, there's an additional appropriation of $490 million for this purpose of tax compliance.

Do you have, if we can make this happen, plans, and if so, could you give us an idea of what they might be?

Ms. STIFF. The budget request that you have before you, as I outlined in my opening statement, will allow us to expand our compliance efforts and our enforcement programs in a number of areas.

We have a Tax Gap Report, we have a Taxpayer Service Blueprint, and we have a Modernization Vision and Strategy.

Those documents guide our investments, whether they are in enforcement services or technology. With any additional funding, we would guide those investments by the priorities that are outlined in those documents.

But we're focused on reducing non-compliance in the small business arena, and among large corporations and high-wealth individuals, and particularly as a result of globalization, we are looking at offshore transactions.

I can tell you that, for every dollar invested in IRS enforcement programs, we get on average a 5 to 1 return on investment.

Mr. TANNER. I appreciate you mentioning the offshore business.

We tried to do something with that with respect to paying for the AMT fix, as you know, and were unsuccessful. Maybe you'll have more success than we did.

Thank you very much.

Chairman LEWIS. Now we turn to Mr. Linder for questions.

Mr. LINDER. Thank you, Mr. Chairman.

Madam Commissioner, welcome. Ms. Olson, welcome.

With all these phone calls you're getting from 60 million people looking for help on their tax returns, how many are getting an accurate response?

Ms. STIFF. We've undertaken significant efforts in recent years to improve the accuracy of our responses.

Last year, and again this year, the quality, meaning the accuracy and the timeliness of the responses, is in the 90 percentiles, both on the phones and at walk-in sites.

That's a significantly improved number than where we were even 3 years ago.

Mr. LINDER. Five or 6 years ago, you were at 50 percent.

Ms. STIFF. Like I said, we've had all hands on deck, a number of efforts, both leveraging technology, training, and working with our employees and our customers to get those numbers up into the 90 percentiles.

Mr. LINDER. How much are you spending to reach out to people with respect to the stimulus?

Ms. STIFF. Well, I think the appropriation that Congress enacted for stimulus for IRS was about $202 million, and I don't know that I have the exact number on outreach.

I suspect that it's probably almost 50 percent of that total appropriation.

Mr. LINDER. Wasn't the first letter about $43 million?

Ms. STIFF. Yes, sir, it was.

Mr. LINDER. Okay. Of the $100 billion in underreporting by businesses, how much of that is small business?

Ms. STIFF. Well, our research data shows us—it's quite interesting, and you've probably heard the statistic before—it says that where we have information reporting, we have about a 95 percent-plus compliance rate with what happens on the tax returns.

On small businesses, particularly where they're not subject to third party information reporting, we're getting about 53 cents on the dollar.

Mr. LINDER. What is the compliance rate of the big box companies? The Wal-Marts, the Sam's, the——

Ms. STIFF. Well, our tax gap data in the corporate arena has not been refreshed as currently as the other numbers that I just gave you, but I think the estimates of corporate noncompliance are north of $30 billion annually.

Mr. LINDER. You have about 200 million filers now, isn't that about right?

Ms. STIFF. About 140 million individual filers——

Mr. LINDER. But then you have business filers. That's about 200, isn't it?

Ms. STIFF. Mm-hmm.

Mr. LINDER. Would you have better compliance if you had 40 million filers instead of 200 million filers?

The way you're arguing here argues for a pure consumption tax as opposed to an income tax, where you could reduce the number of filers from 200 million to 40 million, you'd have big box companies collecting 50 percent of all the revenues, you'd have 3.6 percent of all the companies in America collecting 87 percent of all the revenues.

If they were honest, you'd have a better collection rate than the IRS currently has.

Ms. STIFF. I certainly couldn't weigh in on that probably one way or the other with my lack of experience.

I know that that's a discussion that appears every time we talk about tax reform, and probably one that will continue.

Mr. LINDER. Do you, as an agency, pay any attention or have any policy staff looking into more efficient collection systems?

Ms. STIFF. More efficient collection system?

Mr. LINDER. Systems, yeah.

Ms. STIFF. I'm not sure what you mean by that.

We are constantly looking at improving our collection of delinquent taxes and taxes due, but from a policy perspective of looking at the broader tax system, I think that Treasury's Office of Tax Policy undertakes that work.

Mr. LINDER. Thank you for your help. Thank you.

Chairman LEWIS. Now we turn to Mr. Neal for questions.

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

Welcome, to our panelists.

Commissioner Stiff, a number of us have become concerned that one prominent defense contractor, KBR, has been able to skirt payroll tax liability for American workers in Iraq via an offshore subsidiary.

Can you tell the Committee whether the IRS was ever contacted by any official at the Defense Department alerting you to the fact that the company and its workers would not be making payroll tax payments?

Ms. STIFF. Sir, I'm unable to comment on any specific case.

Let me say that we're certainly familiar with the issues surrounding that case. We understand that employment taxes is an area where we have to stay vigilant to improve compliance.

We've increased our employment tax programs, enforcement efforts, and audits significantly in the last 24 months. We continue to do that.

The issues in the case you raised clearly reflect the changing world, with globalization, and more and more workers doing business in foreign countries, and how transactions are structured and the legality of those transactions, and certainly we continue to, as I said be vigilant in trying to stay on top of those emerging issues.

Mr. NEAL. I appreciate the second part of your answer, but my response to that would be, we will have a bill for Iraq of more than $1 trillion, by conservative estimates, and so the follow-up question would go like this:

In a similar vein, has the IRS opined in any fashion as to whether U.S. citizen workers of these war contractors are employees or independent contractors for income and employment tax purposes?

Ms. STIFF. We wouldn't have opined, broadly speaking.

We have a 20-factor test that we use to determine if someone is an independent contractor versus an employee, and it's a case-by-case determination, taxpayer-by-taxpayer decision when you look at it, and it's a complex area, because even when one makes those determinations, you have to step back and look at the application, if appropriate, of section 530 in the Tax Code.

Mr. NEAL. But would you consider off shoring, in these instances here, to be a tax avoidance scheme?

Ms. STIFF. I don't, without the specific facts and circumstances of an individual case, and I couldn't say, broadly speaking, that it's tax avoidance.

Mr. NEAL. Well, a sign on the side of the building with no employees inside——

Ms. STIFF. Not in and of itself would I say that's tax evasion. I would have to look at the——

Mr. NEAL. I didn't say evasion, I said avoidance.

Ms. STIFF. Avoidance.

I don't even know that that would suggest that there's avoidance in and of itself.

I'd have to look at the facts and circumstances and the legality that governed what was reported on the tax return versus what was not reported.

Mr. NEAL. A more specific question.

A constituent company, which has recently been bought by a Canadian entity, asked me if I understood the reporting and filing requirements for visiting executives.

I didn't, but now that I do, I have some questions about their utilization and effectiveness.

Apparently, once an executive exceeds $3,000 in U.S.-sourced earnings, he or she must file a Form 1040 non-resident form.

For some visiting executives, a week or two of meetings here in New York, Boston, or L.A. would trigger that threshold.

I wonder if you could tell the Committee what the compliance rate is.

Do you believe that all foreigners visiting the U.S. on business which exceed this threshold are filing with the IRS, and if so are these filings useful for the IRS office in your efforts to close the tax gap?

Ms. STIFF. Let me take the latter first.

The filings are definitely useful. We were receiving roughly 650,000 a year, plus or minus a few, in each of the last 3 years.

What I can't tell you sitting here today is what the compliance rate is, because I don't know the universe that should be filing. We're undertaking research to look at that.

As I mentioned earlier, as we see globalization, and we see more and more work done cross-border, these issues are taking on a greater life than perhaps they had in other decades.

So we are looking at that.

Mr. NEAL. Would you judge this to be a priority for enforcement?

Ms. STIFF. It's a priority.

Particularly, we've redone our international focus this past year, and our priorities, and this is certainly one of the ones that's being worked while we sit here today.

Mr. NEAL. As to determine whether or not it's worthwhile?

Ms. STIFF. I don't know the answer to that yet, because I don't know what the compliance levels are.

We're going to have to incur some cost and research to determine whether this is a significant issue or if most people are indeed complying.

Mr. NEAL. Might I suggest that, given the irony of your respective responses to the two questions I raised, that having a sign on a building that indicates that it's an address when it really is not is probably more of a priority in terms of enforcement than the idea of a visiting executive who is here for a week at a time, and the enthusiasm with which we demonstrate our pursuit of those revenues is something that the Committee, along the IRS, needs to examine.

Ms. STIFF. Well, and let me assure you that we recognize the issues, particularly in the employment tax arena.

We've tripled our efforts there in the last 24 months. It's on our radar screen.

Mr. NEAL. Thank you.

Chairman LEWIS. Thank you very much.

Now, we recognize Mr. Kind for his questions.

Mr. KIND. Thank you, Mr. Chairman.

Ms. Olson, thank you for your testimony here today.

Ms. Stiff, let me start with you, and I want to follow up with something that Mr. Lindner just touched upon briefly with you, and that's the IRS notification letters that are going out in regards to the tax rebates.

When I started, you know, reading these articles that appeared in the paper over the last week or so, my reaction was kind of similar to everyone else who I think was looking at this.

You know, $42 million for the first notification letter going out this month, just how necessary is this, and doesn't this strike you as an incredible waste of taxpayer dollars?

I certainly understand the need to do some outreach with those who would qualify for the rebate checks that normally wouldn't have to file a return, because all this is based on tax filings.

But we're talking about the vast majority of Americans receiving the rebate checks are those who have always filed returns, they're going to file a return this time.

Isn't there a way that the IRS can do a better job of targeting and still save taxpayer dollars, rather than a blanket notification procedure?

It's my understanding, in reading the IRS letter that's going out this month, is it's not just one notification, but everyone is going to be receiving a second notification after eligibility has been determined already, and it just seems to be incredible redundancy and an unnecessary expenditure of tax dollars.

As you indicate in your testimony, you've established your own Web site with information.

Most of us have already established a Web site with information about the tax rebates and who would qualify. I know my office is doing some outreach in the District, too, to help people if they have questions.

I think there are better ways, and more efficient ways for us to get the notice out there, but without just a blanket dual notification system for something that they don't even have to react to. They just file a return and this stuff goes out automatically.

Could you help me with this a little bit?

Ms. STIFF. Sure. Those are fair questions.

Considering all of the discussions that we had as we crafted our strategy for informing and educating taxpayers as to the stimulus, let me just share with you what drove our decision.

I'm never one to say there's not a better way to do anything, because I'm confident there is, and we'll find it.

But at the time that we made this decision, what we were looking at is the scenario that I described earlier.

This stimulus payment is overlapping with the filing season. We have 60 million calls coming in, and now we've got 135,050,000 calls already before any notice has gone out, of taxpayers calling every day.

Then we look back to our experience. In 2001, we did rebates. Mind you, that was identical to the situation you just described. There was no Social Security, no VA recipients. It was taxpayers who filed and knew they would receive a stimulus payment.

We got 27 million calls in June and July, which caused our system to crash and be shut down. We weren't able to answer anyone's calls for a period of time.

Recognizing what happened in 2001, and that we were now going to overlay the same economic stimulus of facts in an April–May timeframe—when we're at the peak of our filing season—with an added 20 million potential non-filers trying to get in, we made the decision. We were very fortunate that the Congress supported that decision in the appropriation, that was a risk too great to take, and that by mailing this notice to taxpayers, if we could somehow give

them enough information that they didn't feel the need to call, that we were going to be ahead of the game.

The second notice is one for recordkeeping requirements, and it's to individual taxpayers, specifying what the amount of their rebate was, how it was calculated, so that they'll have that for subsequent year recordation.

But had it not been——

Mr. KIND. Why would they need that? Because the rebate is not going to be taxed in the——

Ms. STIFF. Many of them won't get their full rebate this year, and you provided a true-up the following year. They'll need that information for their recordkeeping. I think most taxpayers want that.

So that was the convergence of facts, and like I said, maybe a good call or a bad call, but we felt it was the prudent call, given the risk and the prior experience that we had.

Mr. KIND. Maybe I'm just underestimating the power of free money out there, and what that does to people——

Ms. STIFF. Yes.

Mr. KIND [continuing]. In motivating them to make phone calls and that, but it just seems to be incredible overlap, and if the 42 million applies for the March mailings, I assume it's also going to apply for the subsequent mailing that's going to go out, the second one.

Ms. STIFF. I think it's approximately the same.

Mr. KIND. Is that right?

Ms. STIFF. I think it's a little less the second time around.

Mr. KIND. Well, if you're going to go ahead do this, was there any thought given to including a paragraph about identity theft in it?

Because as Ms. Olson, you know, testified, this could be a very major issue that's going to arise with these rebate checks, and identity theft, there's simple steps that taxpayers can take in order to protect themselves from this.

Ms. STIFF. I think that's an excellent suggestion, and I only wish I had thought of it or we had done it on the front end.

I don't think, when we were planning the mailings that we were moving in real-time, but were instead just trying to be responsive to getting the checks out in May. I'm not sure that we scoped the identity theft as something that we needed to put in that letter.

But what we are doing now is working with the Taxpayer Advocate, working with AARP, working with every newspaper, and public service announcements, to get the message out.

Mr. KIND. Well, I see my time has expired, and I may follow up with your office in regards to that, but one other issue, and I'll follow up because I don't have time, is the slow turnaround time as far as the AMT fix, and whether we've got a problem with the computer system at the IRS.

Why can't we get something changed quicker than what we encountered?

I know we fixed it late last year, but there was a lot of concern that, with the late date, this was going to slow down the whole AMT calculation.

Ms. STIFF. Are you wanting me to respond——

Mr. KIND. No, no——

Ms. STIFF [continuing]. Come back on the record?

Mr. KIND [continuing]. No. If there's a second round, if I'm still here, I may ask about that.

Thank you.

Ms. STIFF. Thank you.

Mr. KIND. Thank you, Mr. Chairman.

Chairman LEWIS. Thank you very much.

Now we turn to Mr. Tiberi for his questions.

Mr. TIBERI. Thank you, Mr. Chairman. Thank you for having this hearing today.

A couple questions of Ms. Olson.

We have in the United States today an online system, a Free File system, and my understanding is that at this point in time, this year, it is up 14 percent, yet some have advocated getting rid of that system and going to a system where the IRS does all filing online, self-administered.

I believe you're an advocate of doing that. I'd like your comments on that.

At the same time, the system in Britain, which today is administered by the British government, the online system completely, is looking at going to the American system of having a Free File online system for taxpayers, as well. In America, that's for taxpayers whose AGI is under about $54,000 a year.

My question to you is, why should we eliminate a system that appears to be working?

Ms. OLSON. Well, I would first challenge the statement that it appears to be working, with all due respect, but let me try to describe my thinking about electronic tax returns.

I believe that the government has a responsibility to develop a free portal for electronic filing for all taxpayers, so that no taxpayer has to pay $14.95 or $19.95, or whatever it is, just for the act of electronic filing.

That's silly. They'll spend 42 cents to use a stamp rather than pay $14.95, myself included.

I also believe that the IRS, the government, should provide the electronic equivalent of a paper 1040 and what is available in paper that the government publishes in electronic format.

So, I envision, you know, a 1040 with fill-in blanks and math, because people make math errors when they do it on paper, and for each line, you would click on the line to get linked to the instructions, not spiffy things that all the software has, but instructions, and if in the instructions we refer to an IRS publication, then we link to that publication.

These are all things that taxpayers can have on paper on their desks in front of them if they go to that trouble.

Then, taxpayers who are not happy with that, as I think many taxpayers would like the bells and whistles that the other software programs have and the links to their bookkeeping software, and all that, then they can go out and purchase those other products.

I think that where the government goes awry with the Free File alliance is first of all, it's a closed shop. Free File gets to decide who gets to be in that alliance.

So, just this past filing season, we had a non-profit program that had developed an excellent, very modest, but right to the point program for free e-filing, and free tax preparation, and was used by thousands of taxpayers, and they petitioned Free File to be part of the Free File alliance, and Free File alliance decided no, they couldn't be part of that alliance, and I don't really understand their rationale.

We also have found that listing all of these programs on Free File, it's not clear what they offer up front.

Taxpayers get part of the way through, and find out that what they need is not part of that program, and they have to purchase that from the program in order to get the full capability. For example, a Schedule C. Some of the programs do not allow, you know, listing more dependency exemptions than a certain number, so if you have X number of kids, you know, you can't include them.

That's very confusing to the taxpayers, and I think you see that in the low numbers of taxpayers are using on the Free File alliance. Even though Free File had a 14-percent increase this year, they had a decline last year, and the numbers have been in the 3 million to 4 million usage, when you have 130 million taxpayers.

Mr. TIBERI. Thank you.

Let me ask you one other question, because my time is expiring.

Ms. OLSON. Sorry.

Mr. TIBERI. The issue that the Chairman talked about earlier at the very beginning, about seniors being targeted, I had heard that actually, with respect to the EITC, with respect to the refund, the rebate coming up, that some predators are going after people, saying, "I'll take a percentage of your return, I'll give you some of it up front if you can sign it over to me, your refund to me or your tax rebate to me."

Is there anything that this Committee can do or this Congress can do to stop that from happening, or that the IRS can do?

Ms. OLSON. I don't know how you stop it.

That is pure fraud, and there—you know, wherever there's money involved, there are going to be people messing with that.

But the IRS has a very good, you know, publicity campaign about these schemes and scams, as we see them, and certainly criminal investigation is trying to monitor these schemes and scams to the extent that we can find them, and they're doing a very good job, in my opinion.

I would also suggest that, you know, we can get you information about these scams so you can put them into your newsletters and on your Web sites, because—and as you're talking to the press, the more awareness that the public has about not buying into these things—they come in as e-mails, and you click on them, and it looks legitimate.

Mr. TIBERI. Thank you. Thank you, Mr. Chairman.

Chairman LEWIS. Thank you very much.

Now we turn to Mr. Pascrell for his questioning.

Mr. PASCRELL. Thank you, Mr. Chairman.

I want to thank the commissioner. I want to thank Ms. Olson for being here today, always astute.

Commissioner, in September of 2006, the IRS began turning over thousands of taxpayer files, which include private and sensitive taxpayer information, to private sector debt collectors.

Under the IRS plan——

[Interruption to the proceedings.]

Mr. PASCRELL. Isn't that great? Isn't that wonderful? It's like a Greek chorus.

Under the IRS plan, the private collection agencies are allowed to keep up to 24 percent of what they collect, depending on the size of the case.

But in testimony before Congress, IRS officials have repeatedly acknowledged that using private collection companies to collect Federal taxes is more expensive than having IRS do the work itself.

According to the IRS, the return on investment from using IRS employees to collect these taxes is 13 to 1, while the ROI for the TCAs is just 3 to 1.

In addition, according to the IRS, after commission payments to the PCAs totaling more than $5.5 million, the net revenue generated by private collectors for 2007 was just $20 million.

Today, after spending $71 million in startup and ongoing maintenance costs through the end of fiscal year 2007, the IRS private tax collection program has lost $50 million.

Now, given the drastic disparity in the return on investment between the private contractors and the IRS employees, and the dismal performance of private collectors to date, do you believe it makes sense for the IRS to continue to pay private collectors almost 25 cents for every dollar collected on the easiest cases in which IRS employees could collect much more cost effectively?

Do you believe we should continue with that practice?

Ms. STIFF. Sir, private collection agencies are self-funded.

I'm not faced with $7 million on the table, and a choice of whether to spend it for PCAs or for IRS employees.

There's not $7 million. PCAs are self-funded through their collection processes.

I think that we've been very candid in saying that IRS employees would have a higher return on investment for $7 million that comes from the PCA program, but the choice has never been one or the other.

Mr. PASCRELL. Well, why should there even be a choice, then, if that is the record? Why don't we simply support, provide the resources, and have enough of IRS employees to do the job?

If we're not getting the return that we expect or we can get from the public employees, why in God's name are we continuing this process?

Ms. STIFF. Well, I think that's a question——

Mr. PASCRELL. Educate me.

Ms. STIFF [continuing]. That's a question to be debated here, in that our job is to administer this program as effectively, as efficiently——-

Mr. PASCRELL. Madam Commissioner, the debate is not that, because every IRS person that's come before us has never, ever contradicted those numbers which I provided in the basis of my question.

Are you debating——

Ms. STIFF. No, I'm not debating the numbers. What I'm saying——

Mr. PASCRELL. Okay, if we're not debating the numbers, then why are we continuing the practice?

Ms. STIFF. This is a collection tool that the Congress authorized the IRS to use, and it is bringing in $20 million.

Mr. PASCRELL. This is ideologically driven, there's no two ways about it.

This process should be ended and ended immediately. It is a waste of taxpayers' money. I believe that it is wrong to continue.

My second question is this:

Since 1995, the total number of IRS employees has been cut by more than 27,000.

Do you believe these staffing reductions have hampered the service efforts to close the tax gap? What's your opinion?

Ms. STIFF. Since 2000, we have achieved double digit improvements in our productivity, and we've gotten our audit coverage up to where it was through technology, better management, and better training.

We saw dollars collected through the tax system last year—as a direct result of IRS intervention—increase to almost $60 billion, from 33 billion in 2003, record numbers.

So, I think that we're using the resources that were given in a way that is producing the end result in the return at a higher rate than we've ever seen before.

Mr. PASCRELL. Yet the amount of—the number of people and the amount owed to the government which we're not collecting has risen substantially, substantially, since we've lost 27,000 employees.

Thank you, Mr. Chairman. I yield back.

Chairman LEWIS. Thank you very much.

Mr. Crowley is recognized for his questions.

Mr. CROWLEY. Thank you, Mr. Chairman, and thank you for this hearing today.

I want to also thank both Ms. Stiff as well as Ms. Olson for being here today and for their testimony.

Ms. Stiff, let me just, before I ask my question to both of you, let me just make a quick statement that pertains to Mr. Tiberi's statement before about this rebate, and those unscrupulous individuals out there who may take advantage of those who may be eligible for this.

I would just want to also suggest that those nationally known tax preparers that are out there, and I will not name any specific one, but this is a great opportunity, I think, for them to show some kindness, as well as build some good public relations, and particularly as it pertains to those individuals who do not have to file four taxes, but under these circumstances, need to in order to avail themselves of the rebate—I'm talking specifically of Social Security recipients as well as disabled veterans.

It's been brought to my attention that some of those preparers, if not all are charging at least $35 to file on behalf of those individuals.

For some of them, that is about 10 percent or more of the rebate that they will be receiving.

I think, taking into consideration those individuals, the level of income is negligible for some of them, this is really something that they need to get every penny possible out of, so I would ask those, as an act of good will to those individuals, to take that into consideration and not charge for this simple filing.

Let me, Ms. Stiff, then go to you first.

My question pertains to a recommendation in the President's fiscal year 2009 Blue Book regarding their recommendation to conform penalty standards between preparers and taxpayers.

Does the IRS agree with this proposal to conform the penalty standards for tax preparers and for taxpayers, for taxpayers?

Ms. STIFF. Yes, we do.

The disparity that exists today presents unique challenges and problems both for the taxpayer and for the practitioner.

Mr. CROWLEY. Thank you very much for your response.

Ms. STIFF. Thank you.

Mr. CROWLEY. Ms. Olson, for you, I understand that your annual report, which is too heavy to lift up and show to everyone here today, and I want to thank you for it, you do great work, you also have stated concerns with the current, quote, ″more likely than not," end quote, standard.

So, do you also support the administration's position on this issue, and if so, why?

Ms. OLSON. Yes. First let me note my report does come in a CD ROM, which is lighter.

[Laughter.]

Ms. OLSON. We'll be glad to get you one.

Yes, we do support that those two standards, that the preparer and the taxpayer standard be made congruent. It brings about all sorts of screwiness, for lack of a better word, in the relationship.

Mr. CROWLEY. Thank you very much.

I don't have much time, so I'm going to try to bring this to a concise point here on this particular question, as it pertains to the AMT patch and the discussion that took place prior to our passage of a 1-year fix.

The IRS had noticed that Congress was attempting to fix this before we left, and before time ran out, ever so moving back the deadline period by which IRS needed to know what the intention of Congress was going to be so they can prepare for the change in your schedule and your ability to react to the AMT fix.

Is there any way that the IRS, knowing that, having a good faith or good sense that the Congress is going to act to intercede on behalf of those individuals who are faced with AMT, knowing that we were going to somehow divert that, any way to prepare prior to our actually taking legislative action, so as to not be caught off-guard or offhand, and can we not have a way in which we can start that? If Congress fails to act, shame on us, but if Congress doesn't fail to act and then it falls into your lap, who is the same on at that point?

Is there any way in which we can work in a more cooperative way?

By the way, you have been incredible cooperative in creating an atmosphere between the Committee and the IRS.

Is there any way we can broaden that out now to kind of have a fuller cooperation, not having that threat over our head by the White House, not having that threat that if we don't act now we can't get it done, knowing that we're going to do something?

Ms. STIFF. The answer has to be yes. I think there's always an opportunity to work more closely together.

I do need to thank you, because we actually were able to get some preplanning underway, because of the letter that you gave us that provided some specificity as to what to expect.

I think the challenge is, and is going to continue to be, that the tax system is so large, there are so many systems, that I don't know that the taxpayers, you or us, would want to incur the cost to allow that tax system to be programmed multiple, multiple ways for any eventuality, but I think there has to be a way to narrow down what the choices are going to look like, and get ahead of it a little bit.

Mr. CROWLEY. I appreciate that.

So, no—you don't necessarily need legislation to pass in order to act?

Ms. STIFF. I don't want to say that, because we actually do need legislation to be able to fully act.

Mr. CROWLEY. Understood.

Ms. STIFF. Okay.

Mr. CROWLEY. But to prepare, you don't need, right?

Well, thank you. Thank you for your

Ms. OLSON. Sir, if I might

Mr. CROWLEY. Yes, please.

Ms. OLSON [continuing]. Add something, in my annual report, I recommend that one thing that Treasury and the IRS could do to move the ball rolling faster is to provide during the year, early in the year, a list to Congress, to the two tax writing Committees, of the expiring provisions, and then an estimate of the impact that the expiration would have, plus the drop-dead date, when do we need to have a real action by, so that folks who really care about these issues can use that information to move things along accordingly.

Mr. CROWLEY. Thank you very much.

Chairman LEWIS. Now, we turn to Ms. Tubbs Jones for her questions.

Ms. TUBBS JONES. Thank you, Mr. Chairman, and Ms. Olson and Ms. Stiff.

My question is directed to Ms. Stiff.

I'm a former Cuyohoga County prosecutor, and we contracted with the Child Support Enforcement Agency to do work on behalf of child support.

There's been a recent ruling with regard to access to IRS information to county governments to lawyering, and in essence, the Department of Child and Family Services has been in conversation with the IRS about the sharing of this Federal tax information, and I would like to have my tax counsel follow up your office about our ability to access.

You know, you create what's called, I think it's a GDF process, to limit access of this information, so it doesn't go out of those who are supposed to have it.

As a result of that, there is some conversation as to whether or not prosecutors or attorneys that you can contract to access this information.

It's a big deal for 20 counties in the state of Ohio. Child support enforcement is a big deal.

I just want to be able to have my tax counsel follow up with your folks and see if we can continue this conversation and work that out.

Ms. STIFF. Will do.

Ms. TUBBS JONES. Thank you very much, Mr. Chairman. I appreciate it. All the people in Ohio will be real happy.

Chairman LEWIS. Thank you very much.

The Committee hearing will recess for about 10 minutes, and we will return.

Is that okay?

Ms. STIFF. Yes, sir.

Chairman LEWIS. Thank you very much.

[Recess.]

Chairman LEWIS. Thank you very much for being patient. Now, the hearing will resume.

Ms. Olson, you noted that over 32,000 elderly have received an employment tax notice for workers caring for them in their home. Some have had their Social Security payment levied. Should this be happening?

Ms. OLSON. No.

Chairman LEWIS. Would a change in the statute resolve this unbelievable problem?

Ms. OLSON. Yes.

The problem is arising from the fact that the recipients of the home health care are considered employers under the common law rules that Commissioner Stiff talked about earlier, the 20-factor test, and what that means is, even if the state, for example, takes on the payment or the reporting obligations, the recipient of the care is still on the hook if something goes wrong.

By making these workers the statutory employees of the entity who administers the funding, rather than the elderly person receiving the services, you basically make that entity responsible for all the reporting and paying and filing obligations, and if something goes wrong, we're looking to the entity, whether it's the state or an intermediate service organization or a local agency, we're looking to them to make amends and make the corrections and take the collections, and the recipient of the care is protected from levies for these employment taxes.

Chairman LEWIS. Thank you.

Ms. OLSON. You're welcome.

Chairman LEWIS. Mr. Pomeroy, my friend, welcome back. You are now recognized for your questions.

Mr. POMEROY. Thank you, Mr. Chairman, and Mr. Ranking Member.

As a former Ranking Member of this Subcommittee, I care deeply about the work, and appreciate being allowed to participate, even though I'm not on the Subcommittee this Congress.

I well remember the leadership Rob Portman used to provide on this Subcommittee.

He really would get into the weeds of how the IRS got this enormous responsibility, this charge, and whether it continued to have the resources that it needed.

I've got so many questions, and not much time. I would just—one of the things we discussed during those years was the computer, this vast investment in the computer that—it was the computer project that was deeply frustrating.

I mean, among other things, I think one of the takeaways I remember is, I guess to this contracting out business again, we were so dependent upon our consultants, we didn't have internal staff capable of really driving and guiding the project and evaluating the quality of work that consultants were bringing us, really ultimately resulting in a cost of tens of millions, maybe hundreds of millions of dollars extra, and an awful lot of delay.

How is that old computer project coming, and how is your internal capacity to deal with it?

Ms. STIFF. I am very pleased to report to you that, over the last 4 years, I think we've turned the corner on the project and on the management, even more importantly.

I think earlier this week, or maybe later this week, but sometime this week, GAO is going to issue their first positive report on the modernization project. I'm with you. I'll believe it when I've got it in my hands.

But we have significantly improved our management and our governance, and as a result, we are, year in/year out,—÷this year being our most successful—producing new functionality, and delivering it on time, on schedule, and under cost.

I mentioned earlier, and I don't know if you were here, but our CADE system, the one that's replacing the master file, this filing season, as we sit here today, is processing almost 25 percent of the individual returns filed, and for those returns, we're able to settle those account balances in 24 hours, like you would experience with your bank or any other financial segment.

So, we're seeing—the list is long of the progress, but just an example, and I honestly feel very comfortable saying——

Mr. POMEROY [continuing]. That report, and I'm delighted by what you've said.

To the extent, you know, when you get in this business, oversight business, no news is good news sometimes. We hadn't heard much about this for a while.

I'm very pleased that that's the affirmative activity taking place underneath it.

Nina, you mentioned something during your testimony that concerns me a lot. I've had some problems with this Free File alliance.

To me, it has—we have given them an unbelievable, thoroughly endorsed, moneymaking opportunity, and at the same time, what was expected to be delivered by Free File has not really ever reached anywhere near the numbers that they're talking about,

and the 14-percent growth this time off of a diminished base from 2006 this isn't anywhere near the expectation that we had.

I'm very concerned by your report that they wouldn't allow a very credible product prepared by a nonprofit in, which I expect compared very cost-competitively with other products available by other Free File members. Is that correct?

Ms. OLSON. Well, yes, for the service, the things that it offers, it is very competitive, just from looking at it, plus it is free electronic filing and free cost, and so——

Mr. POMEROY. Ms. Stiff, I mean—sorry to interrupt, I see my time dwindling quickly -I think the service has responded to a number of the questions this Subcommittee on Oversight has raised over the years about Free File, and you've got some standards on products, and things that you didn't used to have. That's good.

How about noncompetitive behavior of this private partnership that is our public-private partner?

Obviously, noncompetitive behavior by Free File alliance is certainly repugnant to me, and I expect it would be to the service. Is that correct?

Ms. STIFF. Yes, sir. What we're doing in response to the concerns, which emerge each year, take a different form, and morph from this to that, is, we've——

Mr. POMEROY. By the way, I might just say, in business, if you got a partner, it's always something. It's just always something. You don't have much of a partner.

So I really think that Free File, in terms of having such little policing of its membership, where they're always trying to look at some other low route way to make a buck, in exploitation of this relationship with the service, they're certainly not getting the job done, in my opinion.

I would like to think Free File is a best practice, its policing, uplifting effect, and it certainly has not been my view of their work so far.

Ms. STIFF. Well, I think that they are serving the needs of millions of taxpayers each year, but I think more importantly, what we're doing now, which will actually, I think, further this debate and decisionmaking on a forward-going basis, is that we are conducting an advanced e-file study, because as you know, you have an expectation that we're going to get to 80 percent of all returns being e-filed at some point, and so we are bringing in internally, an independent third party to help us assess what are the best ways to advance our e-file goals.

That's going to include looking at direct file options. That's going to include looking at Free File and what its providing. It's going to include looking at 2D bar coding options.

The list of what we're going to cover in that study should get at all of the issues that are raised——

Mr. POMEROY. Frankly, will you be looking at a service developed product to be available free?

Ms. STIFF. We're going to be exploring that option, as well.

Mr. POMEROY. As you do that work, I know—I'm glad you're going to do that work, I look forward to seeing it.

Just to close back on this allegation of, or I won't say allegation, because it happened in fact, the appearance of anti-competitive activity in Free File alliance to keep out a lower-cost product from the offerings allowed by alliance members, as the service gets its answers, I would very much like the report, and——

Ms. STIFF. We will follow up with you.

We did make an intervention when that came to our attention, and I believe that partner is currently being listed.

Mr. POMEROY. Is that correct?

Ms. OLSON. Not on Free File. Not on Free File.

It's listed on the IRS' site that lists partners, but it is not allowed on that site to tell that it is both free filing and free preparation, so the fullness of what it offers taxpayers is not being advertised on that site——

Mr. POMEROY. So, we have an entity that wants to offer free filing——

Ms. OLSON. It's a nonprofit.

Mr. POMEROY [continuing]. By a nonprofit, and the service has not made that information publicly available on the Web site. Why would that be?

Ms. STIFF. I think it's available on the Web site.

Ms. OLSON. It's not. It's on the list.

It's on the list, but it is not allowed under the rules of that Web site to say that it is both free e-filing and free preparation software.

It can only say one of those two things, like, "This is free e-filing," and then taxpayers don't know that they don't have to pay to do the preparation, or it can say, "free preparation," but they don't know that it's free e-filing.

Those are the rules of that site. That's the listing that it's got up there.

It was not allowed to be listed on the Free File alliance, become a member of the Free File alliance, which the IRS is actively publicizing as "Go here for free electronic filing and preparation."

Mr. POMEROY. I know I'm out of time, Mr. Chairman, but I would just say that, as this relationship matures, as products become available, broadly, cheaply, I think it does not behoove the IRS anymore to basically safeguard the profit opportunities for Free File partners.

I saw the service playing that role, when suddenly they allowed, by service action, a maximum of something like 57,000 or whatever the amount is for a taxpayer using Free File.

Before it was unlimited. It was the service that put a cap in, and basically to enhance the profit opportunity for Free File Members.

Now, this, if there's activity taking place among the Free File alliance, basically keeping out lower-cost alternatives in any way, and the service is countenancing this activity, I just think that's so wrong, and I would hope that that's corrected.

I would also hope the information, as much information as possible about this lower-cost alternative would be available to the taxpayers.

Thank you, Mr. Chairman, for allowing me to——

Chairman LEWIS. Thank you very much.

Now we turn to Mr. Becerra for a question. Welcome, my friend.

Mr. BECERRA. Thank you, Mr. Chairman.

Mr. Chairman, I hope we continue to do these types of hearings.

I think it's so important to have the administrator, to have the tax advocate, the commissioner and the tax advocate here to help us make sure that the American public understands what is being done in terms of taxes and how they can avail themselves of whatever services are available.

No one wants to be hounded by the IRS, and most people, fortunately, in this country, do the right thing, and so I think it's very important to these oversight hearings, and especially because of this rebate, that most Americans qualify for.

I think Ms. Stiff is correct in trying to point out that folks need to get this information, and I thank you.

I hope that the IRS is able to do as much as possible to explain to all Americans, including those Americans who weren't planning to file a tax return this year, that they should consider it, because they may have a rebate coming, even if they weren't planning to file for any type of income tax refund, or if they didn't think they owed any taxes.

I'd like to focus on a couple of things, and forgive me. I'm suffering from what I think half of the universe is suffering from——

Ms. STIFF. Me, too.

Mr. BECERRA [continuing]. Yes, this cold.

Tax preparers—and Ms. Olson, let me ask you, this, going directly to some of your testimony.

In some of your testimony, you mentioned that there is a need for a legislative proposal to do, among other things, to protect the more than 60 percent of taxpayers who rely on paid tax preparers by imposing minimum standards of competence.

At present, anyone who can Federal tax—I'm sorry.

"At present, anyone can prepare Federal tax return. There are no standards at all." That's a quote from your testimony.

Should tax preparers register with the Treasury so that we know who is involved in the preparation of tax returns?

Ms. OLSON. Absolutely.

The tax return is the entry point to the tax system, and we have so many people going to preparers, and there are so many more programs, just because of software being available, who have no training in tax, who can just buy a package off the shelf, and prepare returns.

Although the packages are wonderful, you know, they don't replace knowledge of the Tax Code if you are preparing a return for a fee.

Mr. BECERRA. So, give me some recommendations. What would you recommend we do to ensure that all preparers are competent?

Ms. OLSON. Well, certainly many preparers, the attorneys, the CPAs, the enrolled agents, are already subject to licensing and testing, some kind of testing regime, and usually continuing education requirements.

So, what we're worried about are what we call the unenrolled preparers, and those folks need to be registered with the IRS. We need to know about them.

We need to have an entrance examination for them to just test their basic level of competency, that they understand the basic concepts of tax.

I know that some folks have said that this might be costly, but we have an estimate from the group that runs the California preparer regulation system that they have, and they have estimated that they can do all of the testing, all of the tracking of registration, et cetera, for about $35 per preparer, which would be a fee we would pass on to those preparers, so it would be paid for by the preparers themselves.

Mr. BECERRA. Do you think Treasury is capable of managing a system that requires some type of competence of these preparers?

Ms. OLSON. I think that—I have thought the Treasury was, we were capable of doing that since I proposed it in 2002.

Mr. BECERRA. Thank you.

Now, Ms. Olson, I suspect that your workload has increased recently as a result of the downturn in the economy, more folks trying to figure out what they do, more modest-income folks who can't afford to go to a professional tax preparer.

How many people did you contact, or had contact with your office in, say, 2007?

Ms. OLSON. We had about 248,000 cases, and about—the growing issues in our cases are in enforcement issues, because the IRS is ramping up enforcement, and then as the economy turns down, people have more economic, you know, economic pressures on them, and they're not able to deal with paying their tax obligations.

Mr. BECERRA. Are you expecting to have as many or perhaps more contacts for 2008?

Ms. OLSON. We are expecting more contacts in 2008, and already seeing that.

Mr. BECERRA. Ms. Stiff, is there value in the Tax Advocate's Office from the perspective of the IRS?

Ms. STIFF. Absolutely.

Mr. BECERRA. Give me a sense.

My understanding is that the administration's budget proposal would decrease funding for the Taxpayer Advocate Services to a level that's about $8 million below what they got last year.

Is that something the IRS is supporting?

Ms. STIFF. Let me give you some context with that number, because taken out of context, you get a different sense for it.

From the year 2007 to the year 2009, the taxpayer advocate budget will experience a 9-percent increase. Okay?

Mr. BECERRA. You're not suggesting that they go the money and didn't use it well?

Ms. STIFF. No, no, no, sir. I'm just trying to put some perspective

Mr. BECERRA. Okay.

Ms. STIFF. They had a 9-percent increase in a 2-year period, while the rest of the IRS budget increased 7 percent.

Mr. BECERRA. I understand.

But now let me ask Ms. Olson, with that 9-percent increase, were you able to adequately handle all the contacts that were made to your office?

Ms. OLSON. My—not really.

My employees are at the highest case per—highest case inventory per case advocate that we have ever been in the history of the Taxpayer Advocate Service.

Mr. BECERRA. I would presume that chances are, Ms. Olson could probably use a 90-percent increase in her budget, and she'd still find that people are coming, simply because, as you and I know, it's become very expensive to get good professional advice, and more and more, people are finding that they can't afford it.

You know, you buy the new washing machine that you need to clean your kids' clothes, or you get a professional tax preparer, and sometimes I think washing clothes beats out the tax preparer.

But I understand that you have constraints. You have to live with what the administration provides you to fund all the operations within IRS, including the taxpayer advocate.

But wouldn't it be pound foolish for us to diminish the resources that the taxpayer advocate has to make sure that people, first, voluntarily comply with their obligation to file a tax return, but two, to do it correctly, so that you don't have to then use all your personnel later on to make corrections to someone who is making modest income, who just happened to make an innocent error?

Ms. STIFF. Sir, I agree that the Taxpayer Advocate provides a valuable service, but as the Acting Commissioner, balancing all of the enforcement and service needs, I think it's equally important that we provide equivalent levels of services across the board so that the cases don't end up at the Taxpayer Advocate's Office.

So, it's trying to maintain balance.

Mr. BECERRA. Yeah. I know that most of us would hate to have to sit in your seat to try to respond to some of those questions, because you do have to balance all the obligations you have with the moneys that you're given.

I would just hope that, in the process of budgeting, you all, not so much you all, but Office of Management and Budget, the White House, would not be pennywise and end up being not just pound foolish, but foolish with all those taxpayers who are already burdened, but are still willing to voluntarily comply with their obligation to file a tax return.

I think it would just be such a sin for us to send a message to Americans who have very modest income that we don't care to have them comply with something that most of us don't wish to have to do, and that is pay our taxes.

I was shocked when I learned that the President's budget called for an $8 million cut to the Taxpayer Advocate's Office.

Mr. Chairman, I know my time has expired, so I'll just say one last thing and won't ask a question.

The taxpayer assistance centers that you have, same thing.

To not ramp up those centers where, for the money that we pay as taxpayers to fund that program within IRS that gives assistance to, again, people who are voluntarily trying to comply with their tax requirements, to not have those offices open long enough so that people who work long hours can take part or participate in those programs that you make available, to get good advice so they don't have to then pay someone else a pretty big fee to do something very simple, which someone in your office, if you had the resources and the staffing, could answer, I just—that's what gives us

a bad name, both as government and as the IRS, when we seem to make it more difficult for people to do voluntarily what they know they must do.

I just think that if you move toward doing these things, it has such a great return—the Taxpayer Advocate's Office, the taxpayer assistance centers, the low-income tax centers—you know, we would get much greater response from the American people that we're really trying to be helpful, not just take their money.

I thank the Chairman and I thank the two witnesses for their time.

Chairman LEWIS. Thank you very much.

At this time, I would like to thank the IRS, the Acting Commissioner and the National Taxpayer Advocate, for their time, and your wonderful and helpful and meaningful testimony.

The Subcommittee and all of the Members, all of us, appreciate your views.

Is there any other business to come before the Subcommittee?

[No response.]

Chairman LEWIS. There being no further business, this hearing is now adjourned.

[Whereupon, at 12:10 p.m., the hearing was adjourned.]

[Questions for the record follow:]

Questions from Mr. Johnson

SAM JOHNSON
THIRD DISTRICT, TEXAS

1211 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–4303
(202) 225-4201

www.samjohnson.house.gov

2929 NORTH CENTRAL EXPRESSWAY
SUITE 340
RICHARDSON, TX 75080
(972) 470-0592

Congress of the United States
House of Representatives
Washington, DC 20515–4303

COMMITTEES:
WAYS AND MEANS
RANKING MEMBER:
SUBCOMMITTEE ON SOCIAL SECURITY
DEPUTY WHIP
COMMISSIONER:
U.S.–RUSSIAN JOINT COMMISSION ON POW/MIAs
REGENT:
SMITHSONIAN INSTITUTION

Questions for the Record
Ways & Means Subcommittee on Oversight
March 13, 2008

SAM JOHNSON
Member of Congress

Ms. Olsen last year I asked you about a problem that I'm going to ask you about again this year – it has to do with the interaction of the Alternative Minimum Tax and Incentive Stock Options. In 2006, I worked with a bipartisan group to get some relief enacted into law so that people can get back prepaid taxes on phantom income. I understand that in the last couple of weeks some people have started to get checks from the IRS as refunds of these prepaid taxes.

The law didn't fix the entire problem for everyone and I've been working with Mr. Van Hollen on H.R.3861 to finish the job. In the last couple of weeks, the Senate has been working in a bipartisan way to address the problem – Senator Grassley just cosponsored Senator Kerry's bill. I believe that this show of bipartisanship is a good indicator that we will finish the job this year.

The problem is that the IRS is poised to evict some more people from their homes as a result of this tax nightmare, just as we are about to fix the problem. I am asking you as Taxpayer Advocate to work with IRS enforcement agents to forestall any more evictions for the rest of the year. Had there been some report language with the 2006 tax bill, when we first addressed this problem, I believe it would have directed the Service to be more humane in its approach to enforcement.

Congress is going to address this problem and it just doesn't make any sense to evict more people out of homes over this mess.

Ms Olsen and Commissioner Stiff, my other question concerns a bill I introduced H.R.5450, the MOBILE Cell Phone Act. This bill would eliminate the requirement that employees keep a detailed log sheet to account for the calls they make on the cell phone their employer gives to them for work purposes. This was a law put into place in 1989, when cell phones were the size of a shoe and the batteries for the required a suitcase to carry. Clearly time and technology have marched on and cell phones are simply an extension of the business day and place to anytime and anywhere. Cell phone contracts are often written with unlimited minutes so the employer is not even paying for specific air time.

But apparently this issue came up on audit and the IRS decided that they could play "gottcha". Rather than someone having an "aha moment" and asking whether this still made any sense for American productivity to keep call log sheets, the IRS decided to issue audit guidelines on how to enforce it. It is my understanding that tax exempt organizations and state and local governments were among the first targets of the IRS. I know that the IRS has been threatening social workers with having to pay personal income tax on the value of the cell phone service they use if they cannot produce detailed call sheet logs. Don't you think that Social workers should better spend their limited time checking in on neglected and abused kids rather than cell phone paperwork for the IRS?

I know the Office of the Assistant Secretary for tax has been trying to mitigate this mess through a regulatory project, but why didn't either someone at the IRS or someone with the Taxpayer Advocate take an ounce of common sense and ask whether it even makes sense to have this law on the books?

Questions from Mr. Cantor

ERIC CANTOR
7TH DISTRICT, VIRGINIA

CHIEF DEPUTY REPUBLICAN WHIP

COMMITTEE:
WAYS AND MEANS

SUBCOMMITTEES:
SELECT REVENUE MEASURES
OVERSIGHT

Congress of the United States
House of Representatives
Washington, DC 20515–4607

WASHINGTON OFFICE:
329 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-2815
FAX: (202) 225-0011

RICHMOND OFFICE:
4201 DOMINION BOULEVARD, SUITE 110
GLEN ALLEN, VA 23060
(804) 747-4073
1-800-439-3793
FAX: (804) 747-6308

CULPEPER OFFICE:
703 MADISON ROAD, SUITE 207
CULPEPER, VA 22701
(540) 825-8930
FAX: (540) 825-8964

http://cantor.house.gov

Congressman Eric Cantor

Questions for the Acting IRS Commissioner Linda Stiff

1. I understand that Free File returns have greatly increased, perhaps on the order of 14% year-to-date. Do you believe the program reforms and improvements have increased public confidence and usage of the program?

2. The IRS research denotes a 98% customer satisfaction rating for the Free File program; to what do you attribute this obvious success?

3. Given the success of the Free File program, has the IRS made any efforts to educate the public about its availability and what is the plan to assure public awareness of this program going forward?

4. It has been estimated that if IRS were to terminate Free File and replace it with an IRS WebPortal it would cost at least $400 million to build, and $ 100 million a year to operate possibly reaching $1 billion in its first 5 years of operation.

   a. Would the IRS contract to create this program be sole-sourced awarded or would it be open for competition?
   b. Currently the Free File program is free to both the Government and the taxpayers, what programs would the IRS have to cut to make the funds available to operate such a program?

5. The British government provides free tax services online for its citizens at a cost of hundreds of millions of pounds. In addition, the government launched a major national advertising campaign including television advertisements. Despite these efforts, their government run electronic filing rate is half of what it is here in the United States and is plagued with security problems and system failures. The British Parliament did an extensive study last summer which included a suggested

change to the U.S. system. I know IRS has been under pressure to shift over to the British model here, but given their failures, would you still ponder such a move?

The Free File Enhancement Act, which I introduced with my colleague Zoe Lofgren, has been co-sponsored by 70 bipartisan Members of the House and half the Members of the Ways and Means Committee. This expansion would not only allow eligible taxpayers access to free tax software, but would also allow taxpayers to directly e-file their returns. provide a forms-based tax preparation system that taxpayers could e-file directly. This expansion would have no cost to IRS, and it would be free to American taxpayers. Some argue that my legislation is not necessary since the IRS currently has the ability to require such an expansion. Does the IRS currently have the ability to require an expansion of the Free File Alliance to provide e-filing for eligible taxpayers? and if so, why hasn't the IRS done so?

[Submissions for the Record follow:]

Statement of Benson S. Goldstein

The American Institute of Certified Public Accountants thanks the House Ways and Means Subcommittee on Oversight for the opportunity to submit this statement for the record of the public hearing on the 2008 tax return filing season, IRS operations, the Administration's fiscal year 2009 budget proposals, and the National Taxpayer Advocate's 2007 Annual Report to Congress, held on March 13, 2008.

The AICPA is the national, professional organization of certified public accountants comprised of approximately 350,000 members. Our members advise clients on federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses. It is from this broad perspective that we offer our comments today.

GENERAL COMMENTS ON THE FILING SEASON

We are pleased to report that the 2008 filing season is generally progressing without any significant problems. The AICPA has received a few reports by CPAs about difficulties taxpayers have experienced as a result of enactment of the Alternative Minimum Tax "patch" in late 2007. These scattered reports of difficulties stem from the resultant delays in IRS's release of certain forms, which caused processing delays (through February 11, 2008) for the returns of about 13.5 million taxpayers.

Our members are receiving a moderate number of questions from clients regarding the economic stimulus program enacted in February 2008, a cash payment from the government to about 130 million households starting in May. While some taxpayers may be confused by the eligibility rules for the stimulus payments, we believe the IRS is generally doing a very commendable job in terms of publicity for the program and getting the necessary guidance out to the public.

The AICPA appreciates that the Treasury and IRS promptly issued Notice 2008–32 in February 2008 following the January 16, 2008 U.S. Supreme Court decision in *Knight v. CIR.*[1] The notice, in providing interim guidance for 2007 tax returns, does not require trustees to determine the portion of a bundled fee that is subject to the 2-percent floor under Internal Revenue Code Section 67 for tax years prior to 2008. We note the certainty, clarity and helpfulness of the guidance for taxpayers and practitioners who are in the process of preparing 2007 tax returns. We also appreciate that the IRS and Treasury have opened a new three month comment period with respect to prop. reg. section 1.67–4, which was issued prior to the Supreme Court ruling.

Our additional comments focus on a number of issues impacting on IRS operations and tax administration; specifically: (1) the Form 1065, Schedule K–1 due date; (2) IRS's e-file strategy; (3) the tax gap and stakeholder outreach; (4) the National Taxpayer Advocate; (5) the section 6694 preparer penalty; (6) tax strategy patents; (7) federal regulation of tax return preparers; and (8) the section 7216 regulations.

- **FORM 1065, SCHEDULE K–1 DUE DATE**

One of the most significant filing season problems of recent years involves the receipt of "last minute" Form 1065, Schedules K–1, a problem that has perplexed taxpayers whose returns (Forms 1040, 1065, 1120 and 1120S) must include Schedule K–1 information. While the AICPA believes that this issue might be addressed ultimately and more completely through legislative changes, we believe a simple regulatory change would quickly assist a significant percentage of taxpayers presently burdened by the late receipt of Schedules K–1. Accordingly, we recommend changing temp. reg. section 1.6081–2T, the automatic extension of time to file certain returns by partnerships; a temporary regulation that expires on November 4, 2008.

Under temp. reg. section 1.6081–2T, partnerships are generally allowed an automatic six month extension of time (from April 15 to October 15 for calendar year partnerships) to file Form 1065, *U.S. Partnership Return of Income*, or Form 8804, *Annual Return for Partnership Withholding Tax*, as long as the partnership submits the appropriate form for extension. This regulation has, unfortunately, contributed to the problem of a large number of calendar year partnerships completing and sending Schedules K–1 to taxpayers just prior to or after the due dates of the partners' tax returns. Receiving Schedules K–1 on October 13 or 14 makes it very difficult for tax preparers and taxpayers to complete their returns by October 15, in

[1] *Knight v. CIR,* S.Ct. Docket No. 06–1286 (January 16, 2008).

the case of an individual or other partnership tax return, and impossible for corporate returns (both S and C) which have an extended due date of September 15.

We have had discussions with the Service regarding a regulation project to: (1) address the difficulties taxpayers face when receiving delayed Schedules K–1 and (2) move the extended due date for partnership returns from October 15 to September 15, thus providing a maximum extension of five months.

- **IRS's e-file strategy**

The AICPA appreciates: (1) the benefits electronic filing offers to tax administration and taxpayers; and (2) the successes the IRS has had with its electronic tax filing (e-filing) program during recent filing seasons, successes due in large part to the Service's vigorous efforts to gain the input and involvement of affected parties.

The IRS closely collaborated with the AICPA during the 2006 and 2007 filing seasons on the Service's rollout of the mandatory large corporate and exempt organizations e-file programs on the MeF platform; and also with respect to its rollout during the 2007 filing season of the large partnership e-file program on the MeF platform. With respect to these e-file programs, the AICPA played a proactive role in surfacing issues and solutions that ultimately contributed to the success of e-file. We plan to continuing working closely with the Service to meet its expectations for these programs for the 2008 filing season; and with respect to its future rollout of the Form 1040 MeF program.[2]

We support using the AICPA/IRS collaborative model for e-file for other customer outreach initiatives involving the Service, especially from the perspective of encouraging voluntary compliance. In general, we wholeheartedly support efforts by the Service to reach out to the AICPA and other stakeholders as much in advance as possible prior to the Service's implementation date for a new program. By doing this the IRS will receive constructive feedback about the pending new program, input that will likely improve the program upon implementation; and such stakeholder outreach is likely to garner a higher degree of stakeholder "buy-in" or support for the program.

- **the Tax gap and stakeholder outreach**

The AICPA supports the suggestion by National Taxpayer Advocate Nina Olson that the IRS place a significant effort on understanding the tax gap and the non-compliance rates associated with small business taxpayers. According to IRS statistics, non-compliance by small business is the single largest component of the tax gap, representing about 44 percent of the gross federal tax gap of $345 billion.[3]

While we support the concept of increased enforcement to address the tax gap, we recognize (like the National Taxpayer Advocate) that the IRS should increase its focus on educating small businesses as opposed to solely relying on its enforcement apparatus. In Ms. Olson's 2006 report to Congress, she suggests increasing the scope and reach to the small business community of the Small Business/Self-Employed Division's Communication, Liaison, and Disclosure (CLD) function. We support an increase in resources for CLD, as well as enhancement of CLD's educational component.

CLD is doing a very commendable job in serving the small business and tax professional communities in terms of its stakeholder outreach efforts despite the reduction in staff and resources that took place a few years ago. We do believe a further commitment to programs like the Service's Small Business Tax Workshops and its online resources such as the Small Business and Self-Employed Online Classroom, Small Business Resource Guide, and the Virtual Small Business Tax Forum are positive endeavors. In order to enhance further development of these types of products, it would be helpful for the SB/SE Division to study the market penetration and use of these programs by small firms.

The AICPA does recognize that the Service heavily relies on irs.gov and the Internet to accomplish much of its "customer outreach" to small business. We appreciate the Service's understanding that a substantial majority of small businesses rely on CPAs and other tax professionals to prepare their tax returns and provide professional advice. For this reason, the Service heavily utilizes the AICPA and other professional associations to assist the government in its outreach efforts to the business community on key tax administration issues.

---

[2] See IRS Modernized e-File Form 1040 Status Report, dated January 2008, as provided by the IRS to the AICPA and posted to aicpa.org at URL: http://tax.aicpa.org/NR/rdonlyres/8F52D6AA-A50D-466D-BD91-2C62C73FB8BD/0/1040_MeF_Overview_AICPA_012008.ppt

[3] See the National Taxpayer Advocate's 2006 Annual Report to Congress, December 31, 2006, page 174.

- **NATIONAL TAXPAYER ADVOCATE**

From our perspective, the National Taxpayer Advocate is one of the best customer service oriented programs within the IRS. We find the two yearly reports issued by the National Taxpayer Advocate to be excellent compendiums of systemic problems and evolving trends within the tax administration and tax policy implementation arenas.[4] We note that the Advocate's 2007 Annual Report to Congress: (1) raises concerns about the potential conflicts of interest that could occur between preparers and their clients due to the higher standards of conduct put in place by last year's modifications in IRC section 6694; and (2) recommends enactment of legislation to ban tax strategy patents.[5] The section 6694 preparer penalty and tax strategy patent issues are described in more detail below.

In addition to systemic advocacy, the Taxpayer Advocate's office performs a vital function by providing taxpayers with an independent channel for resolving individual tax problems. The Advocate assists taxpayers by reviewing requests for assistance with respect to enforcement related cases involving "significant hardship," and where appropriate, helps craft solutions to relieve such hardship.

- **Section 6694 Preparer Penalty**

The AICPA strongly supports H.R. 4318, legislation introduced by Representative Joseph Crowley, with Representative Jim Ramstad joining as an original cosponsor. H.R. 4318 is designed to reverse the negative impact of a tax provision enacted into law as part of the U.S. Troop, Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act of 2007 ("the Act"). This provision—passed last year without hearings or public comment—increased the tax return reporting standards applicable to tax return preparers under section 6694 for undisclosed items, from the "realistic possibility of success" standard to the "more likely than not" standard. As under prior law, if that reporting standard cannot be satisfied and the preparer wants protection from the possible imposition of an understatement penalty, a disclosure of the item on the return is necessary.

The 2007 law raises the tax return reporting standard for preparers above the reporting standard for taxpayers (which is "substantial authority"), creating the potential for conflicts of interest between preparers and their clients (as pointed out by the National Taxpayer Advocate above). It also creates the potential for the IRS being overwhelmed by excessive disclosures filed for routine items, thus defeating the purpose of the IRS disclosure system.

Representative Crowley's bill, H.R. 4318, would restore the role of CPAs as advocates for taxpayers by equalizing the tax return reporting standards for preparers and taxpayers at the substantial authority level. In introducing the legislation, Representative Crowley stated "The legislation ends the potential conflict between the tax preparer and the taxpayer, and it will reduce the paperwork backlog that prevents taxpayers from claiming deductions or credits." Enactment of H.R. 4318 would restore a commonsense approach and perspective to section 6694. Treasury also supports a similar position, as noted in the Blue Book regarding the Administration's fiscal year 2009 revenue proposals.

- **STRATEGY Patents**

To date, at least 65 patents for tax strategies have been granted and 107 patent applications for tax planning methods are pending. Patents for tax planning methods have already been granted in a variety of areas, including the use of financial products, charitable giving, estate and gift tax, pension plans, tax-deferred exchanges, and deferred compensation. One patent granted is for the process of computing and disclosing the federal income tax consequences involved in the conversion from a standard Individual Retirement Account (IRA) to a Roth IRA. We expect many more tax planning method patents to be issued, directly targeting average taxpayers in a host of areas, including: (1) income tax minimization; (2) alternative minimum tax (AMT) minimization; and (3) income tax itemized deduction maximization.

The AICPA Position

Patents for tax planning methods undermine the integrity, fairness, and administration of the tax system and are contrary to sound public policy. Consistent with this perspective, we believe patents granted for tax planning methods:

---

[4] See "The National Taxpayer Advocate's Fiscal Year 2007 Objectives to Congress," July 19, 2007; and the "National Taxpayer Advocate, 2007 Annual Report to Congress," December 31, 2007.

[5] See the "National Taxpayer Advocate, 2007 Annual Report to Congress," December 31, 2007, Volume 1, pages 140–160 and 512–524.

- Limit the ability of taxpayers to fully utilize interpretations of tax law intended by Congress;
- May cause some taxpayers to pay more tax than Congress intended and may cause other taxpayers to pay more tax than others similarly situated;
- Complicate the provision of tax advice by professionals;
- Hinder compliance by taxpayers; and
- Mislead taxpayers into believing that a patented strategy is valid under the tax law.

AICPA Legislative Recommendations

AICPA supports S. 2369, as introduced in the Senate; and H.R. 1908, the Patent Reform Act of 2007, as passed by the House of Representatives, which (among other provisions) prohibits the granting of tax planning method patents. Both bills would generally exempt tax preparation software, with the intended effect of not impacting the development and sale of products like TurboTax and TaxCut.

The AICPA also supports H.R. 2365, introduced by Representatives Rick Boucher, Bob Goodlatte, and Steve Chabot. The legislation still allows the patenting of tax strategy patents. However, it provides immunity from patent infringement liability for taxpayers and tax practitioners. H.R. 2365 exempts tax preparation software, just like the bills described in the preceding paragraph.

- **Federal Regulation of Tax Returns Preparers**

This section provides the AICPA's comments on the federal regulation of tax return preparers. In drafting these comments, we recognize that Senator Jeff Bingaman introduced legislation last year (S. 1219, the Taxpayer Protection and Assistance Act of 2007) that specifically addresses some of these issues. When this section refers to the "preparer registration proposal," we are referring to the general concept of the regulation of tax return preparers, and at other times, we will specifically refer to S. 1219.

The AICPA Commitment to Professional Ethics

The AICPA strongly supports the implementation of high professional standards for tax practitioners; and for this reason, we are sympathetic to the underlying reasons driving support for the federal regulation of tax return preparers. Our longstanding track record regarding high professional standards for CPAs, includes the AICPA Code of Professional Conduct and our enforceable Statements on Standards for Tax Services. These standards provide meaningful guidance to CPA members in performing their professional responsibilities.

While the AICPA strongly supports initiatives designed to ensure high professional standards among tax professionals, we are not convinced that Congressional proposals calling for the regulation of unlicensed tax practitioners will accomplish the stated objectives advanced by the proponents of such proposals. We believe that there is a need to better understand the nature of the problem before coming to any particular conclusions as to the best solution.

The AICPA also notes that the preparer registration legislation is being promoted at a time when the government is reviewing the current regulatory framework governing tax return preparer penalties, their interrelationship to taxpayer penalties, and the regulations governing practice before the IRS (i.e., Circular 230).[6] Treasury's call for a review of the regulatory regime governing preparer penalties is consistent with our concern that the preparer registration legislation warrants further evaluation.

Addressing EITC and Refund Anticipation Loan Problems

Legislation to regulate preparers has generally been proposed by members of Congress as a partial response to: (1) the high error rate associated with Earned Income Tax Credit (EITC) claims; and (2) consumer protection concerns associated with refund anticipation loans.

We share the concerns regarding the high error rate associated with EITC claims and with the proliferation of high-interest, short-term refund anticipation loans (RALs). According to the Treasury Inspector General, an IRS study of 1999 tax returns suggests that—out of the $31 billion in EITC claims by taxpayers that year—

[6] See IRS Notice 2008–13 regarding "Guidance Under the Preparer Penalty Provisions of the Small Business and Work Opportunity Act of 2007."

between 27 and 32 percent of those claims were erroneous.[7] With respect to the RALs, many commercial preparers aggressively encourage the use of RALs by low income taxpayers, often misleading these taxpayers about the true cost of such loans. These concerns have resulted in the introduction of bills such as S. 1219. Among other provisions, S. 1219 provides for the regulation of what the bill refers to as "federal tax return preparers" and "refund anticipation loan facilitators."

Before seriously considering legislation to regulate tax return preparers, the AICPA recommends Congress consider proposals that narrowly focus on solutions to address issues associated with the EITC program and the consumer protection issues surrounding refund anticipation loans. By creating solutions targeted to the specific problems associated with the EITC and RALs programs, we believe such proposals may result in more tangible increases in compliance than a preparer registration proposal might alone yield.

The AICPA also believes the IRS currently has at its disposal tools that, if utilized and enforced, would achieve: (1) immediate reductions in fraudulent return preparation; and (2) long-run compliance improvements with respect to unregulated tax preparers. Any introduction of a new preparer regulation regime is premature and could potentially take years to see any possible rewards.

Enforcement through Existing Regulatory Authority

The AICPA believes the Service already has sufficient authority to regulate federal tax return preparers without the need for new legislation. First, the IRS has authority to regulate tax preparers through the penalty authority under current law. The Internal Revenue Code permits the Service to assess (among others) penalties for the understatement of a taxpayer's liability (section 6694); the failure to furnish a copy or to sign the return (section 6695); the promotion of abusive tax shelters and gross valuation overstatements (section 6700); the aiding and abetting of the understatement of tax liability (section 6701); and actions to enjoin certain conduct by preparers or promoters (sections 7407 and 7408).

The government also regulates practitioners through the IRS's Office of Professional Responsibility (OPR). OPR enforces Circular 230 which governs the practice by certified public accountants (CPAs), attorneys, and enrolled agents (EA) before the Service. OPR has the authority to discipline these Circular 230 practitioners through disbarment and other sanctions. One of the largest sources of referrals to OPR is through information referrals from IRS compliance personnel.[8]

While unlicensed preparers are not subject to Circular 230, they are subject to a number of civil penalties, including the section 6694 understatement of taxpayer's liability penalty. We believe the recent modifications to section 6694, including the marked increase in the dollar amount of the penalty from $250 to a level of $1,000 or more—should provide the Service with significant authority to regulate "unethical" or incompetent unlicensed preparers.

Public Awareness Campaign

The AICPA strongly supports the Service's annual news release of tips advising taxpayers how to choose a competent paid federal income tax return preparer. This publicity campaign receives wide coverage by U.S. newspapers and media outlets. It is an excellent foundation for any further efforts by the Service to educate the public about unethical and incompetent practices by preparers. The Service's current media plan is crafted in a very positive way; it provides general tips on picking a competent preparer without putting itself in the difficult and likely un-winnable position of choosing sides between preparers who are not regulated by Circular 230, as well as the differing constituencies currently regulated under Circular 230 (i.e., CPAs, attorneys, and enrolled agents).

Electronic Return Originator Application Process

The AICPA recommends that Congress and the IRS review the current electronic return originator (ERO) application process. The ERO process significantly overlaps and may even duplicate any "limited" registration process to address unregulated tax return preparers. Under the current ERO application process, the IRS conducts a background check of principals and responsible officials affiliated with a tax re-

[7] Testimony of J. Russell George, Treasury Inspector General for Tax Administration, Hearing on IRS's Fiscal 2006 Budget Request; Senate Committee on Appropriations, Subcommittee on Transportation, Treasury, the Judiciary, Housing, and Urban Development, and Related Agencies, April 7, 2005.

[8] The Internal Revenue Manual (IRM) requires IRS to refer all practitioners subject to section 6694 penalties to OPR.

turn preparer's firm. This background check includes: (1) an FBI criminal background review; (2) a credit history check; and (3) an IRS records check with respect to the preparer and the firm's adherence to tax return and tax payment compliance requirements, including a review of any prior non-compliance under the IRS e-file program.

In its September 2007 report on the ERO program, the Treasury Inspector General for Tax Administration (TIGTA) points out that certain inadequacies exist within the current IRS procedures for screening and monitoring EROs and that such inadequacies increase the risk to the public and to the Federal Government for potential losses due to unscrupulous e-file providers. The AICPA supports the implementation of new procedures with respect to EROs in order to mitigate any risks to the public and government; however, we believe the enactment of a wholly new tax return regulation regime (one that shares common administrative features to the current ERO program) will *not* likely reduce the risks associated with unscrupulous tax preparers. Instead, we believe it would be far more constructive (and resource efficient) to improve on and build onto the current ERO program, as opposed to implementing a largely duplicative regulatory-required administrative machine.[9]

Exception for CPAs, Attorney

The AICPA continues to support language contained in S. 1219 that would require the IRS to, within one year of enactment, prescribe regulations that will regulate compensated return preparers not otherwise regulated under *31 USC 330* (the enabling legislation upon which Circular 230 is issued). Since they are already regulated by Circular 230, CPAs, attorneys, and EAs should be exempt from any new regulation regime imposed on currently unlicensed preparers. Previously proposed legislation has properly recognized that CPAs, attorneys, and EAs are already subject to regulation and professional standards imposed upon them by state boards of accountancy, state bars, court systems, and Circular 230, and we recommend that any proposal continue to include such exemption.

- **Section 7216 Regulations**

The AICPA Tax Division has formed a task force to review the impact of TD 9375, final regulations released by Treasury and the IRS in January 2008, involving the disclosure and use of tax return information by tax return preparers under Internal Revenue Code section 7216. According to Treasury and the IRS, the regulations are designed to "strengthen taxpayers' ability to control their tax return by requiring that tax return preparers give specific information—to allow taxpayers to make knowing, informed, and voluntary decisions over the disclosure or use of their tax information by their preparer." The new (final) regulations have been issued as a follow-up to proposed regulations the Service released about two years ago.

In our public comments dated March 8, 2006, the AICPA raised three primary concerns about the scope of the proposed regulations. First, we raised a concern about the extent to which the regulations fashioned "an entirely new consent regime for any return preparation activities involving parties located outside the borders of the United States. Second, our 2006 comments suggested that a civil penalty is a more practical mechanism for regulating a practitioner's everyday disclosure and use of taxpayer information, as opposed to reliance on a criminal statute like IRC section 7216.

Our third concern, as expressed in our 2006 comments, involves tax preparation for U.S multinationals, non-U.S. multinationals, and U.S. Citizens (expatriates) located overseas. It is very typical for a tax professional located in the U.S. to consult with a tax professional located overseas in order to complete a business' tax return or an expatriate's Form 1040 tax return. A tax preparer should generally not be required to obtain consent from the taxpayer because the taxpayer anticipates that their tax information will be disclosed outside the United States. In this context, we stated we believe that adopting the current AICPA professional ethics rules regarding a member's responsibilities when outsourcing services to third-party service providers are a far more preferable way of dealing with professional services offered by accountants and attorneys across borders.

Some of the major tenets or provisions of the TD 9375 (the final regulations) are as follows:

---

[9] The Treasury Inspector General for Tax Administration Report on "Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program," Reference No. 2007–40–176, September 19, 2007.

- Within appropriate limits and safeguards, the regulations validate that the taxpayer continues to maintain the ability and the right to direct a preparer to disclose most tax return information as the taxpayer sees fit.
- The regulations clarify that return preparers may disclose return information to the IRS for any purpose.
- The disclosure of tax return information to a preparer located outside the U.S. is generally a permissible disclosure if the taxpayer consents to such disclosure. However, a preparer located inside U.S. is not permitted to obtain consent to disclose a taxpayer's Social Security Number to a preparer located outside the U.S. Instead, the U.S. based preparer must redact or otherwise mask the taxpayer's SSN before the return information can be disclosed to the overseas preparer. While we are still evaluating this provision, our initial assessment suggests that this provision will likely prove extremely problematic to the many firms and practitioners who have well established expatriate practices. As it currently stands, this provision has the potential of injecting additional cost, complexity and increased security risks that actually run contrary to what we expect was the public policy motivation behind the original "redaction" proposal.
- With respect to large corporations and other "large taxpayers," tax return preparers are permitted to obtain the taxpayer's consent for the disclosure or use of return information through the use of an engagement letter.
- The Service has released Rev. Proc. 2008–12, which generally complements TD 9375 by providing guidance regarding the content of certain consents to disclose and use tax return information.

Anticipating that the regulations could dramatically impact the office operations and procedures of tax return preparers, Treasury and IRS have established a January 1, 2009 effective date for the regulations, providing preparers one year to make any necessary changes in their professional practices. The AICPA is currently reviewing the final regulations to assess the impact on the tax return preparation practices of CPAs, and expects to meet with Treasury and IRS to obtain clarification of the scope of some of the provisions of the regulations.

The section 7216 regulations will also cause the AICPA to assess the impact of these tax regulations on the AICPA's current professional ethics rules, particularly with respect to the outsourcing of tax return information to a location outside the U.S. The current AICPA rules, including Rules 102, 201, 202, and 301 of the Code of Professional Conduct, generally provide that prior to sharing confidential client information (such as a tax return) with a third-party service provider, the AICPA member must inform the client, preferably in writing, that he or she may be using a third-party service provider when providing professional services to the client. In contrast to the AICPA professional ethics rules, Rev. Proc. 2008–12 provides for a specific written consent (which must be signed by the client) before tax return information can be transmitted to the third-party service provider.

Treasury and the IRS have also released a notice of proposed rulemaking (REG–136596–07) in January 2008, requesting comments on whether a tax return preparer should effectively be prohibited from obtaining consent for the disclosure or use of tax return information in the solicitation of refund anticipation loans (RALs) for taxpayers. The AICPA is currently reviewing this proposed rule, particularly in light of the perceived usurious nature of RALs, and the potential negative impacts that RALs may have on promoting tax compliance.

The AICPA will keep the Subcommittee on Oversight informed about the impact of the recently released (final) section 7216 regulations on tax preparation.

Thank you for the opportunity to share these views with you.

Statement of Colleen M. Kelley

Chairman Lewis, Ranking Member Ramstad, and distinguished members of the Subcommittee, I would like to thank you for allowing me to provide comments on the Administration's FY '09 budget request for the Internal Revenue Service (IRS). As President of the National Treasury Employees Union (NTEU), I have the honor of representing over 150,000 federal workers in 31 agencies, including the men and women at the IRS.

IRS FY '09 Budget Request

Mr. Chairman, the IRS and its employees represent the face of U.S. government to more American citizens than any other government agency. The IRS is responsible for helping all of America's taxpayers understand and meet their tax respon-

sibilities and collects 96 percent of the revenues that fund the Federal Government. Without an adequate budget, the IRS cannot expect to continue providing taxpayers with top quality service and will be hampered in its effort to enhance taxpayer compliance and close the tax gap.

And while acknowledging that IRS employees continue to provide world class customer service and are as efficient as ever in collecting taxes and enforcing tax law, the Administration continues to put forth insufficient and unrealistic budget requests that fail to allow the service to meet its customer service and enforcement challenges.

Insufficient funding from Congress is not the problem. Over the past seven years, Congress has been supportive of IRS's efforts to improve service to taxpayers and increase enforcement staff and IRS has succeeded at the former. However, despite budgets that were almost fully funded, IRS enforcement staff is still down far below 1995 levels.

The decline in IRS personnel, particularly enforcement staff can be attributed to unrealistic budget requests which since 2003 have contemplated internally generated savings or "efficiency savings" to help fund proposed increased staffing for enforcement. For FY '09, the budget request identifies "efficiency savings" of more than $94 million at the cost of almost 976 FTEs. If, as sometimes has been the case in previous years, IRS fails to realize all expected savings then the funds available for new enforcement personnel spending would be further reduced.

And although it's widely recognized that additional funding for enforcement provides a great return on the investment, the IRS has repeatedly told Congress that the IRS does not need any additional funding above the President' budget request.

Employee productivity is not the issue. Despite the significant decline in enforcement staff over the past ten years, enforcement revenue has increased significantly reaching $59.2 billion in 2007, up from $48.7 billion in 2006 and an increase of $46 billion since 2000. The $59.2 billion in collections in 2007 represents a 5.6 to 1 return on investment for all IRS activities.

Yet, between 1995 and 2007, the total number of employees has shrunk from 114,064 to 86,638. Even more alarming is that during that period, revenue officers and revenue agents—two groups critical to reducing the tax gap—have shrunk by 33 and 20 percent respectively. Revenue officers went from 8,139 to 5,468 and revenue agents fell from 16,078 to 13,026. These drastic cuts have come at a time when the IRS workload has increased dramatically. According to IRS's own annual reports and data, taxpayers filed 114.6 million returns in 1995. After a steady annual climb, eleven years later, the Service saw 134.4 million returns filed. In addition, between 1997 and 2007, the number of individual tax returns with $100,000 in reported income, which are generally more complex returns, increased by 103 percent.

Unfortunately, instead of recognizing that the dramatic cuts to the IRS workforce are straining the ability of IRS employees to handle the increasing workload, the IRS has continued to reduce its workforce. Further exacerbating the dire staffing situation at the Service is the aging of the IRS workforce. Approximately 4,000 of its employees are retiring annually presenting the Service with the difficult challenge of replacing a large portion of its workforce each year and the institutional knowledge they take with them. These retirements of some of the Services' most experienced personnel will only further stress the current IRS workforce already straining under a rising workload.

Amazingly, IRS efforts to reduce the overall workforce have targeted some of the Service's most productive employees. These include the recent re-organization of the Estate and Gift Tax Program which sought the elimination of 157 of the agency's 345 estate and gift tax attorneys—almost half of the agency's estate tax lawyers—who audit some of the wealthiest Americans. The Service pursued this drastic course of action despite internal data showing that estate and gift attorneys are among the most productive enforcement personnel at the IRS, collecting $2,200 in taxes for each hour of work. It is difficult to understand why the IRS sought the elimination of key workforce positions in an area that could produce significant revenue to the general treasury.

In addition, the Service continues to move forward with its plan to close five of its ten paper tax return submission facilities by 2011. The IRS originally sought the closings of the five paper return submission centers due to the rise in the use of electronic filing (e-filing) and in order to comply with the IRS Restructuring and Reform Act of 1998 (RRA 98) which established a goal for the IRS to have 80 percent of Federal tax and information returns filed electronically by 2007. But the IRS recently reported that in 2007 just 57 percent of Federal tax returns were filed electronically and has previously acknowledged that it is getting harder to convert additional taxpayers to e-filing as those might convert most readily have already done so.

The continued slow migration of taxpayers to e-filing recently caused the IRS Oversight Board to call on Congress to extend the 80 percent deadline to 2012 in their recent report to Congress on e-filing.

In addition, while the IRS has stated that it will receive millions of dollars in cost savings as a result of the paper submission consolidation effort, an August 2007 report by the Treasury Inspector General for Tax Administration (TIGTA) found that the agency's business decision to consolidate sites did not even include a cost-benefit analysis *(TIGTA Report Number: 2007–40–165)*. Furthermore, the report found that the IRS had not adequately updated or monitored financial information on the personnel costs of consolidations and had included savings not attributable to site consolidation in some of its analyses. What is most disturbing is that while the IRS acknowledged some of the assumptions used to determine the consolidation plan may have changed, they refused to complete a cost-benefit analysis to determine if the existing plan is optimal or if alternatives need to be considered.

Mr. Chairman, while overall use of e-filing may be on the rise, it is clear that the number of taxpayers opting to use this type of return is not increasing as rapidly as the IRS had originally projected. Combined with the fact that the IRS consolidation strategy rests on an incomplete business plan which did not include any type of cost-benefit analysis, NTEU believes that the IRS should immediately postpone further site consolidations until a comprehensive cost-benefit analysis can be completed to ensure that the existing plan is optimal in terms of cost savings and benefits.

It is clear that drastic reductions in some of the agency's most productive tax law enforcement employees directly contradict the Service's stated enforcement priority to discourage and deter non-compliance. In addition, we believe these staffing cuts have greatly undermined agency efforts to close the tax gap which the IRS recently estimated at $345 billion. As Nina Olson, the National Taxpayer Advocate noted, this amounts to a per-taxpayer "surtax" of some $2,000 per year to subsidize non-compliance. And while the agency has made small inroads and the overall compliance rate through the voluntary compliance system remains high, much more can and should be done. NTEU believes that in order to close the tax gap and handle a rising workload, the IRS needs additional employees on the frontlines of tax compliance and customer service. In addition, we believe Congress should establish a dedicated funding stream to provide adequate resources for those employees.

NTEU Staffing Proposal

In order to address the staffing shortage at the IRS, NTEU believes the workforce should be gradually increased to its pre-1996 levels. Specifically, we support a 3 percent annual net increase in staffing (roughly 2,600 positions per year) over a five-year period to gradually rebuild the depleted IRS workforce to its pre-1996 levels from its current level of 86,638. Because it takes time and careful management to hire, train, and deploy qualified professional staff, consistent but modest annual increases are necessary. A similar idea was proposed by former IRS Commissioner Charles Rossotti in a 2002 report to the IRS Oversight Board. In the report, Rossotti quantified the workload gap in non-compliance, that is, the number of cases that should have been, but could not be acted upon because of resource limitations. Rossotti pointed out that in the area of known tax debts, assigning additional employees to collection work could bring in roughly $30 for every $1 spent. The Rossotti report recognized the importance of increased IRS staffing noting that due to the continued growth in IRS' workload (averaging about 1.5 to 2.0 percent per year) and the large accumulated increase in work that should be done but could not be, even aggressive productivity growth could not possibly close the compliance gap. Rossotti also recognized that for this approach to work, the budget must provide for a net increase in staffing on a sustained yearly basis and not take a "one time approach."

Adding staff to handle an increasing workload at the IRS is not a new concept. In its 2001 budget request, IRS asked for funding for the Staffing Tax Administration for Balance and Equity program (STABLE), an initiative aimed at restoring IRS staffing to mid-1990s levels and strengthening the Service's tax compliance and customer service functions. The STABLE initiative envisioned hiring nearly 4,000 new employees to help increase compliance and improve customer service. The proposal sought to boost staff in Field Offices, where IRS employees provide direct, in-person service to taxpayers, and Service Center/Call Sites, where service is typically provided via telephone and correspondence. Hiring requirements for the Field Offices was to be determined based on projected workload in the office's geographic area, and existing staff capabilities. Conversely, Service Center/Call Site workload would be planned on a nationwide basis due to the nature of the work, and staffing

allocations based upon physical space and local labor market conditions around the center in question.

Although such a staffing initiative would require a substantial financial commitment, the potential for increasing revenues, enhancing compliance and shrinking the tax gap makes it very sound budget policy. One option for funding a new staffing initiative would be to allow the IRS to hire personnel off-budget, or outside of the ordinary budget process. This is not unprecedented. In fact, Congress took exactly the same approach to funding in 1994 when Congress provided funding for the Administration's IRS Tax Compliance Initiative which sought the addition of 5,000 compliance positions for the IRS. The initiative was expected to generate in excess of $9 billion in new revenue over five years while spending only about $2 billion during the same period. Because of the initiative's potential to dramatically increase federal revenue, spending for the positions was not considered in calculating appropriations that must come within annual caps.

A second option for providing funding to hire additional IRS personnel outside the ordinary budget process could be to allow IRS to retain a small portion of the revenue it collects. The statute that gives the IRS the authority to use private collection companies to collect taxes allows 25 percent of collected revenue to be returned to the companies as payment, thereby circumventing the appropriations process altogether. Clearly, there is nothing magical about revenues collected by private collection companies. If those revenues can be dedicated directly to contract payments, there is no reason some small portion of other revenues collected by the IRS could not be dedicated to funding additional staff positions to strengthen enforcement.

While NTEU agrees with IRS' stated goal of enhancing tax compliance and enforcement, we don't agree with the approach of sacrificing taxpayer service in order to pay for additional compliance efforts. That is why we were disappointed to see that the President's proposed budget calls for a $31 million cut in funding for Taxpayer Assistance Center (TACs) at a cost of 262 FTEs. NTEU believes providing quality services to taxpayers is an important part of any overall strategy to improve compliance and that reducing the number of employees dedicated to assisting taxpayers meet their obligations will only hurt those efforts. It is clear that IRS employees are continuing to provide quality customer service to American taxpayers. 2007 year end data from the IRS shows that IRS' customer assistance centers met the 82 percent level of service goal, with an accuracy rate of 91 percent for tax law questions. And while these numbers show that employees providing taxpayer services are helping taxpayers understand and meet their tax responsibilities, more can and should be done.

Mr. Chairman, in order to continue to make improvements in taxpayer services while handling a growing workload and increasing collections, it is imperative to reverse the severe cuts in IRS staffing levels and begin providing adequate resources to meet these challenges. With the future workload only expected to continue to rise, the IRS will be under a great deal of pressure to improve customer service standards while simultaneously enforcing the nation's tax laws. NTEU strongly believes that providing additional staffing resources would permit IRS to meet the rising workload level, stabilize and strengthen tax compliance and customer service programs and allow the Service to address the tax gap in a serious and meaningful way.

Private Tax Collection

Mr. Chairman, as stated previously, if provided the necessary resources, IRS employees have the expertise and knowledge to ensure taxpayers are complying with their tax obligations. That is why NTEU continues to strongly oppose the Administration's private tax collection program. NTEU believes this misguided proposal is a waste of taxpayer's dollars, invites overly aggressive collection techniques, jeopardizes the financial privacy of American taxpayers and may ultimately serve to undermine efforts to close the tax gap.

NTEU strongly believes the collection of taxes is an inherently governmental function that should be restricted to properly trained and proficient IRS personnel. When supported with the tools and resources they need to do their jobs, there is no one who is more reliable and who can do the work of the IRS better than IRS employees.

As you know, in September 2006, the IRS began turning over delinquent taxpayer accounts to private collection agencies (PCAs) who are permitted to keep up to 24 percent of the money they collect. NTEU strongly believes the collection of taxes is an inherently governmental function that should be restricted to properly trained and proficient IRS personnel.

NTEU believes this misguided proposal is a waste of taxpayer's dollars, invites overly aggressive collection techniques, jeopardizes the financial privacy of American taxpayers and may ultimately serve to undermine efforts to close the tax gap.

While supporters of the program and IRS officials claim that the use of private collectors is a sensible and cost efficient way to help collect delinquent taxes, recent data from the IRS makes clear that the program is not working. According to the IRS, in FY '07, the PCAs brought in just $31 million in gross revenue, far below their original projections of up to $65 million. After deducting commission payments to the PCAs, the true net revenue from PCA (non-IRS) collection activity was just $20 million. Therefore, after spending $71 million in start up and ongoing maintenance costs through the end of FY '07, the IRS private tax collection program lost $50 million.

According to the National Taxpayer Advocate's 2007 Annual Report to Congress, the dismal performance of the private collectors resulted in the IRS revising its original ten-year projection for the program. The report notes that as recently as last May, the IRS projected the program would bring in between $1.5 and $2.2 billion in gross revenue (before commissions) over the next ten years. To meet this projection the IRS would need to average $185 million per year. The PCA initiative only collected $31 million in gross revenue for FY 2007 and is projected to collect only $23 million to $30 million for FY 2008.

NTEU also believes that sky high commission payments to the private contractors for work on the easiest to collect cases is unjustified and unnecessary. Under current contracts, private collection firms are eligible to retain 21% to 24% of what they collect. The legislation authorizing the program actually allows PCAs to retain up to 25% of amounts collected. These commission rates were never put up for competition. Before the initial bid solicitations went out, the IRS set commission rates at 21 to 24 percent of the revenue collected by contractors, denying bidders an opportunity to make offers on terms that would have resulted in the IRS getting a greater share of the collected revenue. Consequently, one of the companies that lost its bid for a contract filed a protest with GAO and noted in its bid protest that "offerors were given no credit for proposing lower fees than the 'target' percentages recommended by the IRS."

The problem of excessive commission rates was recently addressed by Congress in legislation overhauling the Department of Education's student loan program, which the IRS has consistently held up as a model for the IRS private collection program. Amid *charges that student aid lenders have engaged in abusive and potentially illegal collection tactics including* charging excessively high collection fees, coercing consumers into payment plans they could not afford and *misrepresenting themselves as Department of Education employees, the House and Senate approved H.R. 2669, the "Higher Education Access Act of 2007," which lowers from 23 percent to 16 percent the amount of recovered money that private guaranty agencies contracted by the government can retain on defaulted loans.*

Mr. Chairman, in addition to being fiscally unsound, the idea of allowing PCAs to collect tax debt on a commission basis also flies in the face of the tenets of the IRS Restructuring and Reform Act of 1998 (RRA 98) which specifically prevents employees or supervisors at the IRS from being evaluated on the amount of collections they bring in. But now, the IRS has agreed to pay PCAs out of their tax collection proceeds, which will clearly encourage overly aggressive tax collection techniques, the exact dynamic the 1998 law sought to avoid.

The fear that allowing PCAs to collect tax debt on a commission basis would lead to contractor abuse was realized when the IRS recently confirmed that that the agency had received more than five dozen taxpayer complaints against the PCAs, including violations of the taxpayer privacy laws under Code section 6103. At least one of those complaints was confirmed by an IRS Complaint Panel to be a serious violation of law. In addition, penalties totaling $10,000 have been imposed by the IRS on the PCAs for taxpayer violations. In one instance, private collectors made 150 calls to the elderly parents of a taxpayer after the collection agency was notified he was no longer at that address. And one of the three private contractors was dropped by the IRS for dubious practices despite the Service's previous assurance that its oversight would prevent abuse.

Mr. Chairman, NTEU is not alone in our opposition to the private tax collection program. Opposition to the IRS tax debt collection program has also been voiced by a growing number of major public interest groups, tax experts, two former IRS Commissioners as well as the National Taxpayer Advocacy Panel, whose members are appointed by the Internal Revenue Service (IRS) and the Treasury Department. In addition, the National Taxpayer Advocate, an independent official within the IRS previously identified the IRS private tax collection initiative as one of the most serious problems facing taxpayers and recently renewed her prior call for Congress to

immediately repeal the IRS' authority to outsource tax collection work to private debt collectors.

Opposition to the program has also been growing within Congress. Since granting IRS the authority to use PCAs in the American Jobs Creation Act of 2004, the House of Representatives, with bi-partisan support, has twice passed language prohibiting the IRS from moving forward with its private collection initiative. In addition, last session, the House overwhelmingly approved two separate tax bills (H.R. 3056, the "Tax Collection Responsibility Act of 2007" & H.R. 3996, the "Temporary Tax Relief Act of 2007") that contain language that would repeal IRS' authority to use private debt collectors to pursue tax debts.

In the Senate, stand alone legislation (S. 335) introduced by Senator Byron Dorgan (D–ND) that would force the IRS to immediately and permanently suspend its plan to outsource part of its tax debt collection responsibilities to PCAs and prohibit the use of any IRS funds for that purpose has 24 co-sponsors.

Mr. Chairman, instead of rushing to privatize tax collection functions which jeopardizes taxpayer information, reduces potential revenue for the Federal Government and undermines efforts to close the tax gap, NTEU believes the IRS should increase compliance staffing levels at the agency to ensure that the collection of taxes is restricted to properly trained and proficient IRS personnel.

While proponents of the program have argued that the IRS does not currently have the infrastructure or technological capabilities to work the type of cases being turned over to the private companies, the facts say otherwise. The IRS already has a significant collection infrastructure with thousands of trained employees, including fourteen Automated Collection System (ACS) sites which allow the IRS to contact taxpayers by telephone and collect delinquent taxes.

The ACS function is a critical Collection operation, collecting nearly $1.49 million per employee per year. The IRS itself has analogized the use of private collectors to the ACS, where IRS collection representatives interact with taxpayers on the telephone. But unlike the private collectors, ACS personnel are able to analyze financial statement information, research assets, enter into installment agreements, make currently not collectible determinations, and can take lien and/or levy enforcement actions. ACS employees also receive training that is far more comprehensive and rigorous than that of the private collectors. In addition, these employees undergo mandatory annual training on topics such as confidentiality and privacy of taxpayer information, ethics awareness, taxpayer rights and computer security.

Unfortunately, inadequate staffing at ACS sites has prevented the IRS from using its current systems to proactively contact taxpayers by telephone to resolve delinquent accounts. The need for the IRS to expand ACS' use of outbound calls has been recognized by IRS management and at least two recent internal IRS study groups have recommended making more outbound calls as a way to make the ACS operation more effective and efficient.

The IRS requested $7.35 million to run the private collection program in FY '08. We believe this $7.35 million could fund roughly 98 additional ACS employees that could return more than $146 million to the Treasury annually. By comparison, the IRS is now projecting the PCAs to bring in between just $23 million to $30 million in gross revenue in FY '08, far less than its original estimate of $88 million.

NTEU believes that increasing the number of ACS personnel would allow the IRS to maximize its ability to proactively resolve delinquent accounts by contacting taxpayers directly. This would also help ensure that the high level of customer service to those taxpayers who call the ACS seeking account resolution is preserved. The IRS has acknowledged that ACS employees are already performing admirably noting that in 2006, ACS customer service and quality ranged between 89.5 to 99.5 percent *(pg. 54—IRS response to Olson '06 Report to Congress)*. These exceptional ratings are all the more impressive when you consider ACS employees generally work on much more complex and often contentious cases than those being worked by the private collectors and that the total number of cases worked by ACS employees dwarfs those worked by the private collectors.

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

Conclusion

It is indisputable that the IRS workforce is getting mixed signals regarding its value to the mission of the Service and the level of workforce investment the Service is willing to make. Without a doubt, the frontline employees are committed to working with management to increase efficiency and customer satisfaction.

But NTEU believes that until the Administration begins proposing realistic budget requests for the Service, reverses drastic staffing cuts that have targeted some of the IRS' most productive employees and ceases its' reliance on outside contractors to handle inherently governmental activities such as the collection of taxes, the agency's ability to fulfill its tax enforcement and customer service missions will be severely challenged.

Statement of Gerald E. Scorse

Honorable Chairman Lewis and other members of the Subcommittee:

In the United States in 2008, the federal income tax on the wages of average Americans is higher than the tax on long-term capital gains.

It seems to me inequitable on its face to tax earned income (wages) at a higher rate than unearned income (capital gains). In addition, the standard rationale for this preferential tax treatment is demonstrably *false*; propaganda is its only reason for being.

The following article addresses this tax inequity. The article will also remind the Subcommittee of President Ronald Reagan's Tax Reform Act of 1986, and how it addressed the very same issue.

I think you'll be interested.

Tax Policy Loves Investors, Squeezes Wage Earners

Over the last ten years, nobody has gotten more love from Washington than investors. It's time to stop and ask if the love is misplaced.

Investor-love settled in on the Potomac in 1997, when President Clinton cut the tax on long-term capital gains from 28% to 20%. In 2003, President Bush kept the love coming from the GOP side. He took another 5% off the capital gains rate and slashed the levy on corporate dividends as well.

All this love has worked splendidly for the loved. The tax on long-term gains and qualified dividends has been driven down to 15%. That's a 70-year low, and it's less than the rate on the wages of average Americans. As the multi-billionaire Warren Buffett abashedly confessed, the secretaries in his office now pay taxes at a higher rate than he does.

Buffett was quickly called out for coming up short on investor-love. Maria Bartiromo, an anchor on the business channel CNBC, labeled his remark "misleading".

Misleading? Hardly, compared to the claim that buyers of stocks drive the U.S. economy by growing jobs and new businesses. If so, investor-love might be deserved. Let's look in on the market and analyze what takes place.

Billions of shares change hands daily on the major exchanges. On any given day, only a minute fraction of those shares grows anything. Days can pass without a bona fide investment; the sounds you hear are aftermarket noise and the closing bell.

In short, "investors" do not grow jobs (except in the financial sector). The seed money that nourishes start-ups and expansions comes from a tiny subset of real investors; the rest of us merely place our bets at the tables down on Wall Street.

What's the problem with investor-love? First, Warren Buffett has it right: it's wrong for income from work to be taxed at a higher rate than income from wealth. Second, investor-love has no reason for being; it's a tax policy shaped by propaganda.

Lawmakers might better follow the policy shaped by Ronald Reagan.

Reagan's 1981 tax cuts tilted toward the wealthy and made him a supply-side icon. But Reagan could also be fair, and fairness would permeate his last fiscal legacy. In the landmark Tax Reform Act of 1986, nearly three years in the drafting, Reagan again cut marginal rates but raised taxes sharply on investors.

The reform ended preferential tax treatment of capital gains. The tax rate on long-term gains leapt from 20% to 28%, nearly double the current levy. Higher-income taxpayers could pay as much as 31% on their gains.

Reagan hailed the bill as "the dream of America's fair-share tax plan." He also called it "the best job creation program ever to come out of the Congress"; hyperbole, but evidence that he expected no growth falloff from higher capital gains taxes. The

new 28% rate held until '97, when a GOP-controlled Congress and a Democratic president fell under the spell of investor-love.

Republican presidential candidate John McCain stays miles away from the fact that Reagan equalized taxes on income from wages and income from wealth. But Barack Obama (and John Edwards, before dropping out) have pointed to it with relish.

In their bones they know what's fair, just like The Gipper did.

Statement of IRS Oversight Board

The IRS Oversight Board thanks Chairman Lewis and Ranking Member Ramstad for the opportunity to submit its views on the Internal Revenue Service's operations and its FY2009 budget. Created as part of the IRS Restructuring and Reform Act of 1998 (RRA 98), the Oversight Board's responsibilities include overseeing the IRS in its administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws. The Board is also responsible for ensuring that the IRS' organization and operations allow the agency to carry out its mission. To this end, the Board was given specific responsibilities for reviewing and approving annual budgets and strategic plans.

Given the mission of the Board to provide governance over the IRS, it is most appropriate for the Board to focus its comments on the progress that IRS operations have made since the passage of RRA 98, the strategic challenges which the IRS still faces, and its recommendations for the IRS' FY2009 budget.

IRS Operations and Challenges

It is now almost a decade since the enactment of the IRS Restructuring and Reform Act of 1998 and the IRS Oversight Board is pleased to report that the IRS has made steady progress in meeting the letter and spirit of that landmark legislation.

Over the past nine years, the IRS has reorganized and modernized itself to think strategically and operate with a customer-centric focus. It is becoming a performance-driven, results-oriented organization that provides taxpayers with quality service through a variety of channels, including Internet, telephone, and in-person.

It is doing a better and more efficient job of enforcing the tax laws and collecting the taxes owed the Federal Government. The IRS has improved its ability to interact with taxpayers electronically and is now delivering benefits to all types of taxpayers. For example, the IRS can now accept electronically many types of returns including all the major tax forms and offers more Internet-based self-serve options than ever before.

The Oversight Board praises the IRS for this improvement. The IRS has demonstrated to its skeptics that it can change for the better. However, it still faces many challenges and must not become complacent. The existence of an annual $290 billion net tax gap, the difference between what is legally owed and what is actually paid, is a stark reminder that improvements in tax administration are still needed.

The IRS should not settle for good performance—it must set its sights on great performance. In the Board's view, taking that important step will require increased management focus and potential "breakout" performances in four key areas: (1) customer service, (2) enforcement, (3) human capital, and (4) information technology.

To take customer service to the next level, the IRS must do more than respond to taxpayer inquires. It must understand taxpayers' needs better through new research and implement education and outreach services tailored to the needs of specific groups of taxpayers. Great service requires that the IRS proactively provide taxpayers with information that helps them easily understand their tax obligations, provides more self-service applications, simplifies information sharing, and facilitates electronic filing. On a limited basis, the IRS has demonstrated that it can form community partnerships that perform effective outreach to taxpayers, such as the Volunteers in Tax Assistance (VITA) program. Such programs should be expanded.

Through modern electronic tax administration (ETA) services, the IRS can provide more opportunities for taxpayers and tax professionals to interact quickly, efficiently and accurately with the IRS. Great service will entail a broader use of secure electronic interactions over the Internet between taxpayers, practitioners and the IRS, such as account management and issue resolution, than is offered today. These capabilities are much along the lines of what large financial institutions already offer their customers.

The IRS must apply the results of its research program to increase the effectiveness and efficiency of its enforcement activity. In selecting taxpayers for audits, the IRS should have a high degree of confidence that an audit is necessary. High no-change rates for audits place unnecessary burdens on taxpayers and waste IRS re-

sources. The Oversight Board expects that the IRS will use the results of the National Research Program (NRP) to focus its audit programs where they will be the most effective. Collection cases must also be worked as effectively as possible, with cases assigned to different treatment streams based on the optimum assignment of resources for the expected return and impact on compliance.

Today, enforcement is a major part of the IRS' mission but does not dwarf customer service as it did in the early—to mid-1990s. In this regard, the IRS is to be commended for doing a better job enforcing the Tax Code in a manner consistent with RRA 98's safeguards. As customer service improved, more resources were appropriately shifted to support enforcement activities. Key performance measures for enforcement, such as audits of individuals with higher incomes are up and enforcement revenues have increased, while taxpayer service measures such as level of service have remained stable.

Through its annual taxpayer attitude survey, the Board has also found that 94 percent of taxpayers believe it is every American's civic duty to pay their fair share of taxes. Around 86 percent cite personal integrity as a principal factor influencing whether they report and pay their taxes honestly, while only 54 percent of taxpayers indicate they are influenced by fear of an audit.

The Board encourages the IRS to find ways to leverage this strong support for voluntary tax compliance and personal integrity and reinforce the message that tax compliance is a "social norm," much like obeying laws against shoplifting or drunk driving. The Board is particularly concerned that this message be reinforced with America's young people. Previous surveys have shown they are more willing to accept cheating "a little here or there" on their taxes.

Another area that must be addressed for the IRS to achieve great performance is workforce development. Employees are the IRS' greatest asset but the aging of the workforce represents an enormous challenge; approximately 4,000 of its employees are retiring annually. Many of them possess unique skills and institutional knowledge that are not captured when they leave, and the IRS has found it difficult to recruit a sufficient number of skilled employees to replace them.

The IRS must devote more attention to the total career development of its workforce, from hiring to retiring. It should emphasize career development throughout the entire "work life" of employees. It should recruit more like the private sector and employ proven "best practices" to improve employee recruitment, retention, training, and succession planning. Employees should have clearly defined career development opportunities throughout their employment.

More progress must also be made in the IRS' efforts to modernize its information technology (IT). The IRS has made slow but steady progress in replacing its antiquated IT systems. The most noticeable improvements to taxpayers include electronic filing of tax returns and Internet self-service tools such as "Where's my Refund?", "***Dónde está mi reembolso?***", and Practitioner e-Services. Infrastructure improvements have also allowed the IRS to improve toll-free telephone level of service through more effective call routing. However, IRS performance is still hampered by archaic IT systems used for central record-keeping that update taxpayer account information on a weekly instead of a daily basis.

The IRS will not be able to achieve great performance until it can update its central records on a daily basis, much like any other modern financial institution. Such a capability is needed to modernize both its customer service and enforcement functions. Daily updating of records will provide current information to taxpayers, tax professionals, and IRS employees, improve IRS efficiency, and reduce taxpayer burden.

It is critical that the IRS make real progress each year to reach its three strategic goals. However, it is also vitally important that specific quantitative measures for these long-term goals be set to follow the IRS' performance in key areas. In March 2007, the Oversight Board approved five long-term measures with target values and requested the IRS to identify an additional set of measures for employee engagement and customer satisfaction, along with a measure to assess progress in modernizing its technology systems. The Board is pleased to see the IRS make progress in measuring the achievement of its strategic goals.

FY2009 IRS Budget Recommendations

One of the IRS Oversight Board's most important statutory responsibilities is to ensure that the IRS' budget request supports the agency's annual and long-term strategic plans. A budget request is more than a mechanism for appropriating funding; it's also a plan and a commitment. Not only does a proposed budget request funding, it also describes the activities the IRS will perform, how those activities align with the long-range strategic plan, and identifies measures to evaluate the ex-

pected results. A performance budget is more than money, it's a performance management tool, and properly used, enhances the ability of the IRS to meet its short-term performance targets and the agency's three strategic plan goals: (1) improve customer service; (2) enhance enforcement of the tax law; and (3) modernize the IRS through its people, processes and technology.

Achieving these three strategic goals will enable the IRS to address the most serious problem facing tax administration today—reducing the tax gap, the difference between what taxpayers should be paying and what they actually pay in a timely manner. The size of the tax gap is significant, with the IRS' most recent estimates placing it at approximately $290 billion (net) annually, based on 2001 tax returns. The imperative for closing the tax gap has never been greater. An annual net tax gap of $290 billion averages to about $2,200 per individual tax return, an enormous burden for the average taxpayer, and one that should not be tolerated by honest taxpayers. It is far too large to be dismissed lightly—it imposes a large burden on all taxpayers and undermines respect for tax administration.

The IRS Oversight Board recommends an IRS FY2009 budget of $11.737 billion, an increase of $845 million over the enacted FY2008 amount of $10.892 billion, as summarized in Table 1.

Table 1: IRS Oversight Board's Recommended FY2009 IRS Budget

(all dollars in millions)

FY2008 Enacted Appropriation	$10,892.38
Base Adjustments	$262.62
Savings/Reinvestments	($61.65)
FY2008 Base Budget	$11,093.35
Initiatives	
Enforcement	
Reduce the Tax Gap for Small Business/Self-Employed	$120.7
Increase Reporting Compliance of Domestic Taxpayers with Offshore Activity	$16.4
Reduce the Tax Gap for Large Businesses	$52.0
Expand Federal Payment Levy Program	$17.3
Reduce Tax Fraud	$72.2
Enhance Financial Investigations of Narcotics Trafficking Organizations	$24.0
Enhance BSA Compliance Program	$3.4
Address Complexity through Up-Front Guidance, Education, and Correction Opportunities	$8.9
Expand Examination of Tax Exempt Organizations	$28.6
Increase Tax Court Litigation	$5.8
Implement New Procedural Tax Court Requirements	$3.4
Improve Tax Gap Estimates, Measurement, and Detection of Non-Compliance	$11.1
Increase Monitoring of Preparers	$2.5
Total Enforcement	$366.3
Taxpayer Services	Dollars (M)

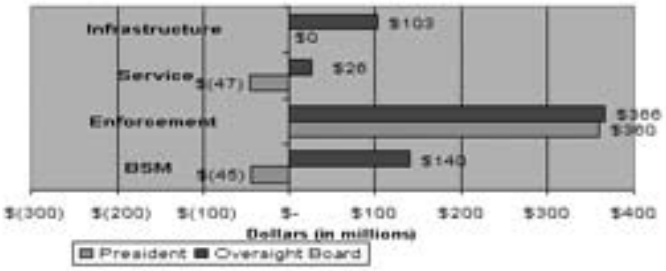
Maintain Processing of Critical Pension Plan Returns	$6.3
Research Taxpayer Burden, Complexity, and Compliance	$10.0
Expand Volunteer Income Tax Assistance and Low Income Tax Clinics	$10.0
Total Service	$26.3
Infrastructure/IT	Dollars (M)
Enhance IT Security	$16.7
Enhance Contingency Planning and Disaster Recovery	$8.7
Implement Security Auditing	$6.8
Redesign Form 990 for Tax Exempt Organizations	$23.5
Preserve Quality IT Workforce in Applications Development	$36.8
Build Alternate Power Supply for the Computing Centers	$11.0
Infrastructure/IT Initiatives Subtotal	$103.5
Business Systems Modernization (BSM)	$142.4
HITCA	$5.50
Total Initiatives	$644.00
FY2009 Budget Request	$11,737.35
FY2009 Request Increase over FY2008 Base	$844.97
FY2009 President's Request for IRS	$11,361.51
Increase Over President's Budget Request	$375.8

The recommended budget takes a long-term view of IRS needs. Despite the severity of the tax gap, the Board believes such a view is both warranted and needed. In submitting its FY2009 budget recommendations to the Treasury Department in June 2007, the Board identified increased funding for Business Systems Modernization (BSM), security, infrastructure, and research as high priorities. These initiatives offer the best opportunity to reduce the tax gap in the long term.

By following this approach, the Board's recommended budget maintains balance at its core: enforcement, taxpayer service, business systems modernization, and employee development must be adequately funded for the IRS to succeed in *all* parts of its mission and to ensure the long—term health of our tax administration system.

The Board's recommended IRS budget compares to the President's request of $11.361 billion, an increase of $469 million over the FY2008 enacted appropriation. Although the two budgets are within 3.3 percent, they take different approaches to funding priority program initiatives at the margin. The Board recommends a total of $644 million in program initiatives, spread among four areas: enforcement, taxpayer service, infrastructure and IT, and BSM. The President's budget requests a nearly identical amount of funding for enforcement initiatives as the Board, but cuts taxpayer service and BSM funds, and includes no program initiatives for infrastructure and IT. Figure 2 shows the differences in graphic form.

Figure 2. Program Initiative Funding



Although both budgets have as a core objective the reduction of the tax gap, the Board recommends funding initiatives across the full range of IRS functions and taxpayer segments. In contrast, the President's budget has as its central focus a short-term effort to build up IRS revenue-producing enforcement staffing at a time when the IRS is hard-pressed to replace the high number of experienced employees who are retiring. Increased staffing is important, but the Oversight Board believes the IRS cannot "audit its way out of the tax gap," and should avoid the temptation to close the tax gap with large staffing increases in revenue-producing functions that cannot be absorbed effectively. The Board believes its recommended budget avoids this problem by focusing on ways to make the IRS more efficient in the long term, and putting more resources into technology, infrastructure, and service as well as enforcement.

Because reducing the tax gap is of critical importance, the Board has identified a subset of its recommended initiatives as having the highest priority. These initiatives are generally infrastructure and research intensive and will have the greatest effect on reducing the tax gap in the long term, and are identified in Table 2.

Table 2. IRS Oversight Board Highest Priority Initiatives

Technology/Infrastructure	Dollars (in millions)
Fund Business Systems Modernization in Line with Current Strategy	$141.0
Enhance IT Security	$16.7
Enhance Contingency Planning and Disaster Recovery	$8.7
Implement Security Auditing	$6.8
Preserve quality IT workforce in applications development	$36.8
Build alternate power supply for computing center	$11.0
Technology/Infrastructure Subtotal	$221.2
Enforcement	
Improve tax gap estimates, measurement, and detection of non-compliance	$11.1
Taxpayer Service	
Research Taxpayer Burden, Complexity, and Compliance	$10.0
Total Highest Priority Initiatives	$242.3

None of these initiatives, except the enforcement initiative for improving tax gap estimates, are funded in the President's budget. Moreover, as shown in Figure 2, the BSM program and taxpayer service programs undergo reductions of $45 million and $47 million, respectively. The Board recommends that the appropriated IRS FY2009 budget closely follow the priorities and balance reflected in this statement.

The following sections discuss the Board's budget recommendations in the context of each of the IRS' strategic goals.

Strategic Goal 1—Improve Taxpayer Service

IRS customer service has made consistent gains since FY2002. For example, Toll-Free Tax Law Accuracy and Accounts Accuracy are at 91 percent and 93 percent respectively in FY2007, as compared to 84.4 percent and 90 percent five years ago. Of particular note, overall customer satisfaction with IRS Toll-Free Service has held steady at 94 percent for four consecutive years. Such stability is most welcome and a good indicator that best practices have taken root.

As a result, a more pressing challenge is to deliver more extensive electronic self-assistance tools and to perform research that identifies innovative ways to expand taxpayer education and outreach to all taxpayer segments, especially those who are now under served.

To a large degree, many of the IRS' customer service activities are designed to respond to taxpayer inquiries. Examples include toll-free telephone service and Taxpayer Assistance Centers. Overall, the IRS has done a good job fielding and answering questions, whether via toll-free telephone, the Internet, or in person at Taxpayer Assistance Centers.

The IRS expends considerably fewer resources on education and outreach services. A broader approach to customer service would entail giving taxpayers access to self-service applications so they could "pull" specific information on accounts or tax law, and "pushing" answers, information and updates to taxpayers, practitioners and other affected parties as the need for such information became apparent. Lastly, the IRS must seize opportunities to provide innovative outreach, education and community partnerships. For example, given limited resources and elimination of programs such as TeleFile, the IRS must also work to broaden and strengthen partnerships, such as Volunteers in Tax Assistance (VITA).

To take customer service to the next level, the IRS must better understand the taxpayers they serve. The IRS must conduct more insightful research, and based on this analysis, develop services better tailored to the specific needs of particular taxpayer segments. By better understanding taxpayers, the IRS can focus both its service and enforcement efforts to increase compliance through targeted pre-filing, filing, and post-filing efforts. The IRS must find out what kind of information and assistance taxpayers need and the most effective ways of delivering that information to them.

In the last two years, the IRS has put considerable effort into developing the Taxpayer Assistance Blueprint (TAB), which establishes a five-year plan for delivering service to taxpayers. This vision entails a much broader use of electronic interactions between taxpayers, practitioners and the IRS, such as account management and the ability to resolve taxpayer issues securely over the Internet. The TAB describes an IRS that is an "interactive and fully integrated, online tax administration Agency" with the capability "for any exchange or transaction that occurs face-to-face, over the phone, or in writing to be completed electronically." These types of services are much along the lines of what customers of large financial institutions already experience today but are still for the most part unavailable to taxpayers.

The vision of great customer service is clear, but to go from good to great the IRS must execute the five-year strategic plan articulated in the TAB to improve service beyond what is familiar and available today.

The Oversight Board disagrees with the President's program reductions for taxpayer service and recommends that the following three initiatives be funded for a total of $26.3 million:

- Maintain Processing of Critical Pension Plan Returns ($6.3 million)
- Research Taxpayer Burden, Complexity, and Compliance ($10 million)
- Expand Volunteer Income Tax Assistance and Low Income Tax Clinics ($10 million)

The first initiative supports customer service by providing funds to maintain processing of essential pension plan return information while transitioning to a new mandated electronic filing system "EFAST2" in 2010. It also enables processing of residual returns that are IRS-only forms and not part of the mandated EFAST2 system (Form 5500EZ and Schedule SSA filings).

The second initiative provides funding to enhance understanding of the interaction between taxpayer burden, complexity of the tax law and process, and taxpayer compliance. This research will help improve understanding of these inter-relationships, in keeping with strategies put forth in the Taxpayer Assistance Blueprint (TAB) and the Department of the Treasury report, *A Comprehensive Strategy for Reducing the Tax Gap*.

The third initiative provides funding to enhance two programs to improve service delivery to two taxpayer segments with specifically identified needs: the growing number of elderly and the ethnically diverse. These taxpayer segments face unique challenges in meeting their tax obligations because of limited access to or inability to use all of the channels offered for service delivery. Additional resources will enhance the IRS's volunteer return preparation and other services provided by the Volunteer Income Tax Assistance (VITA) and the Low Income Tax Clinic programs with emphasis on both targeted taxpayer segments. Such services help created a more fair and just tax system.

Strategic Goal 2—Enhance Enforcement of the Tax Law

Increases in IRS enforcement activity intended to produce gains in direct revenue collection must be balanced with a broad view of the tax gap. The Board recognizes that increased enforcement activity over the past five years has produced noticeable results—enforcement revenue has increased from $34.1 billion in FY2002 to $59.2 billion in FY2007, a gain of nearly 74 percent. The IRS estimates that it can produce more than a four-to-one return on every dollar invested in additional enforcement resources, a fact that the Board believes warrants the appropriation of additional enforcement funding.

However, while the Board applauds the increases in enforcement activity and revenue, it also recognizes that the IRS cannot "audit its way out" of the tax gap. There is wide belief, as evidenced by the Board's recommendations for reducing the tax gap and the aforementioned Treasury Department's tax gap strategy, *A Comprehensive Strategy for Reducing the Tax Gap*, that an integrated set of comprehensive actions is needed. Even a large infusion of resources for more enforcement personnel—something highly unlikely—would not eliminate the tax gap. There are many reasons for taxpayer non-compliance. Only a balanced program that promotes voluntary compliance across a broad continuum of taxpayers, from education and service for those who want to comply, to enforcement and even criminal prosecutions for those who refuse to comply, can be effective.

Table 3 below compares the Board's and President's enforcement initiatives. Although very close in dollars, the President's initiatives place more emphasis on enforcement resources that can be shown to produce revenue in the short term. The Board takes a broader view of enforcement, and recommends program increases in such areas as expanded collection of proper taxes from recipients of federal payments, investigation of tax-related criminal activity, Bank Secrecy Act compliance, tax exempt organization examination, more published guidance for Tax Exempt taxpayers, additional litigation staff, and tax preparer monitoring.

Table 3. Comparison of Enforcement Initiatives for Board's and President's Budgets

Oversight Board's Budget Enforcement Initiatives	Dollars (M)	President's Budget Enforcement Initiatives	Dollars (M)
Reduce the Tax Gap for Small Business/Self-Employed	$120.7	Reduce the Tax Gap for Small Business/Self-Employed	$168.50
Increase Reporting Compliance of Domestic Taxpayers with Offshore Activity	$16.4	Improve Reporting Compliance of U.S. Taxpayers with Offshore Activity	$13.70
Reduce the Tax Gap for Large Businesses	$52.0	Reduce the Tax Gap for Large Business	$69.49
Expand Federal Payment Levy Program	$17.3		
Reduce Tax Fraud	$72.2		

Oversight Board's Budget Enforcement Initiatives	Dollars (M)	President's Budget Enforcement Initiatives	Dollars (M)
Enhance Financial Investigations of Narcotics Trafficking Organizations	$24.0		
Enhance BSA Compliance Program	$3.4		
Address Complexity through Up-Front Guidance, Education, and Correction Opportunities	$8.9		
Expand Examination of Tax Exempt Organizations	$28.6		
Increase Tax Court Litigation	$5.8		
Implement New Procedural Tax Court Requirements	$3.4		
Improve Tax Gap Estimates, Measurement, and Detection of Non-Compliance	$11.1	Improve Tax Gap Estimates, Measurement, and Detection of Non-Compliance	$51.06
Increase Monitoring of Preparers	$2.5		
		Expand Document Matching	$35.06
		Implement Legislative Proposals to Improve Compliance	$23.05
Total Enforcement	$366.3		$360.85

Additional enforcement resources produce a positive return on investment and result in short-term benefits, so the benefits of increased enforcement are apparent. However, increases in enforcement resources must also be balanced with more systemic long-range actions that improve voluntary compliance, and priorities must be considered as budget resources are limited. The Oversight Board considers technology modernization and research a higher priority than additional enforcement resources, in recognition of the long-term impact that technology modernization and research have on the IRS' ability to work more efficiently to reduce the tax gap and to be better able to focus both its service and enforcement resources optimally.

Another factor that must be considered is the degree to which additional staffing can be absorbed into various IRS organizational units. Figure 3 depicts the distribution of new hires in major IRS organizations that are required by the President's and Board's budget. The Board believes its budget strikes a more balanced posture across all IRS organizational units and expands enforcement resources for a range of activities that are important elements of IRS enforcement, although they do not generate revenue directly, such as examination of tax exempt organization reporting, regulation of pension plans, and criminal investigation of tax fraud and abusive tax shelters. These activities are all part of a balanced, enforcement program that has as a goal the promotion of voluntary compliance among all taxpayer segments.

To better understand the organizational implications of the Small Business/Self-Employed (SB/SE) and Large and Mid-Sized Business (LMSB) divisions' hiring requirements inherent in both budgets, the Board examined hiring requirements during FY2009 for the SB/SE and LMSB divisions. Table 4 shows the number of Mission Critical Occupation (MCO) employees projected to be on-rolls as of September 30, 2008, as well as the hiring requirements contained in both budgets. The Board has used a rule of thumb that 15 percent new hires is a reasonable limit on the amount of new employees that can be effectively accommodated into an organization in a year. It had concerns with the hiring implications of its own budget on SB/SE, but thought this risk could be mitigated. The President's budget would increase the percentage of new hires in SB/SE to over 23 percent of its employees in FY2009, and over 16 percent for LMSB.

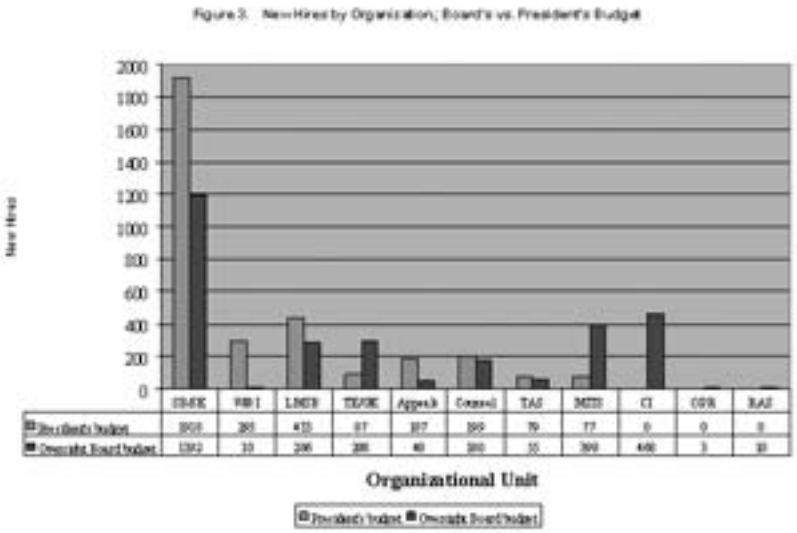


Table 4. SB/SE and LMSB Hiring Requirements in the Board's and President's FY2009 Budgets

Operating Unit Mission Critical Occupations	Projected on rolls as of 9/30/2008	Projected Attrition Hires in FY2009	Projected New Hires in FY2009 to Meet Budget Request	Total Attrition Hires and New Hires	Percent of Hires to total MCO population
Oversight Board Budget					
SB/SE	19,394	2,612	1,177	3,789	19.5%
LMSB	5,126	403	273	676	13.2%
President's Budget					
SB/SE	19,394	2,612	1,918	4530	23.4%
LMSB	5,126	403	433	836	16.3%

As in FY2006 through FY2008, the Administration proposes to include its requested enforcement increases as a Budget Enforcement Act program integrity cap adjustment. The Oversight Board's recommended enforcement initiatives would also qualify for such treatment, should Congress decide to make such an adjustment.

Strategic Goal 3—Modernize the IRS Through its People, Processes and Technology

The most effective strategy for reducing the tax gap in the long term is to provide the IRS with modern technology that enables it to operate at a high performance level. The Board has no doubts that a high performing organization with high service, quality, and satisfaction levels also minimizes taxpayer burden. Under such conditions, service and enforcement activities are prompt, efficient, and correct.

The Board has identified program initiatives for IT and infrastructure activities that are funded under the BSM and Operations Support accounts. These initiatives will further modernize the IRS core IT systems used for tax administration, upgrade its infrastructure, and improve its security posture.

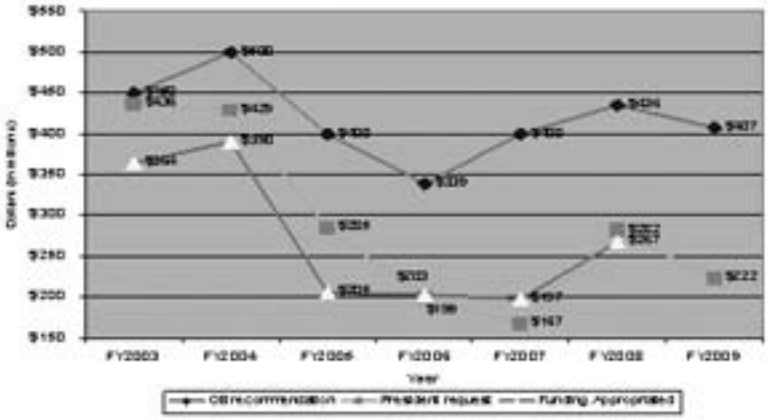
Business Systems Modernization Program Initiative

Tax administration is a knowledge-intensive activity and the IRS depends heavily on information technology (IT) to leverage the knowledge and perform its mission. The IRS has made slow but steady progress in replacing its antiquated IT systems. The most noticeable improvements to taxpayers have been increased use of electronic products and services to interact with the IRS. However, the IRS' performance is still hampered by archaic IT systems used for central record-keeping that update taxpayer account information on a weekly instead of a daily basis.

The Oversight Board has long advocated that the BSM program be funded at a higher level so progress could be made more quickly. Admittedly the program experienced a series of cost and schedule overruns during its first several years, and the result has been to slow down the funding stream to levels that dictate only modest progress can be made in modernizing the core IRS master files and account management systems. Because of its long-term effect on reducing the tax gap, the Board considers increasing BSM funding so that the pace of IT modernization can be increased as having the highest priority.

Figure 4 compares the BSM budget recommended by the Oversight Board, the amount requested by the President, and the BSM funding appropriated by Congress for fiscal years 2003 to 2008. BSM funding needs to be restored to the levels realized in FY2003 and FY2004 to make progress faster. Had the Board's funding recommendations been followed, the IRS would be closer to the day when it could update its central records on a daily basis.

Figure 4. BSM Funding FY2003 to FY2008



Note: FY2008 and FY2009 amounts contain $45.2 and $56.9 million of labor costs not contained in prior years.

Table 5. Application of FY2009 BSM Funding to Projects in the IRS Oversight Board and President's Budgets

	Dollars (M)				
		Oversight Board		President	
Project Activities	FY2008	FY2009	Increase over FY2008	FY2009	Increase over FY2008
Customer Account Data Engine	$58.5	$80.0	$21.5	$58.8	$0.3

	Dollars (M)				
		Oversight Board		President	
Project Activities	FY2008	FY2009	Increase over FY2008	FY2009	Increase over FY2008
Accounts Management Services	$29.0	$47.4	$18.4	$26.2	($2.8)
Modernized e-File	$55.8	$25.0	($30.8)		
Common Services Project	$0.0	$16.0	$16.0	$0.0	$0.0
Integrated Financial System	$0.0	$73.0	$73.0	$0.0	$0.0
Core Infrastructure; Architecture Integration & Management; and Management Reserve	$78.6	$98.1	$19.5	$69.3	($9.3)
Subtotal Capital Investments	$221.8	$350.6	$128.8	$179.3	($42.6)
BSM Labor	$45.2	$56.7	$11.5	$43.4	($1.8)
BSM Program Total	$267.1	407.3	$140.2	$222.7	($44.4)

Note: BSM program excludes $1.2 M of corporate costs in Operations Support.

The Board believes that when implemented, modernized IT systems will literally save taxpayers billions of dollars in burden reduction and make the IRS much more efficient. For example, replacement of the Individual Master File by the Customer Account Data Engine (CADE) will allow the IRS to update the tax accounts for individuals on a daily basis, instead of its current weekly update process. The Oversight Board expects that a rapid refund from the IRS of three to five days will reduce the number of Refund Anticipation Loans (RALs). The National Consumer Law Center and Consumer Federation of American estimate that approximately 12 million American taxpayers spent an unnecessary $1.6 billion on RALs in 2004 (the latest year for which data is available) to obtain their refund monies faster by two weeks. Moreover, daily updating of account records will give IRS employees and taxpayers access to the most current taxpayer account data, eliminating the problems associated with having various data bases with less than current status. The Oversight Board expects that daily posting of account information will improve the IRS' analysis capability and greatly reduce the burdens associated with the account resolution process.

The Modernized e-File system not only makes it easier for taxpayers to file tax returns with the IRS, it reduces the human resources needed to receive and process tax returns and eliminates the error-prone transcription process. For corporate filers, it helps the LMSB division improve currency and cycle time in working large corporate tax cases. When implemented for individual tax returns, it will make the electronic filing process even simpler than it is today with the current legacy electronic filing system.

The Integrated Financial System (IFS) will provide necessary improvements to the system the IRS uses to manage its financial resources, clearly a must for any agency, especially one that is responsible for managing taxpayers' accounts as well as its own appropriated resources. The IFS upgrade is needed to ensure that the IRS remains in compliance with federal accounting and other financial management requirements. The additional funding for the IFS initiative will enable the IRS to add procurement and asset management modules to the existing IFS application and integrate related business processes with core accounting and financial management operations. The funding will also provide for the subsequent transfer of IFS to a Shared Service Center and thereby maintain its longer term viability.

The Board believes that funding for the BSM program should be accelerated, not slowed down. Failure to fund the IRS BSM program at higher levels, in the view of the Board, is a case of being penny-wise and pound foolish.

Information Technology/Infrastructure Program Initiatives

The IRS must be held to the highest standards for security and data integrity while increasing its engagement in the electronic world in which most taxpayers already live. Meeting this dual challenge of high security and a high degree of electronic interaction with taxpayers demands that the IRS have a modern information systems and infrastructure.

The Board recommends six program initiatives for a total of $103 million that will improve the IRS' operations by allowing it to make critical improvements to its technology and personnel infrastructure. By comparison, the President's budget contains no initiatives for IRS infrastructure.

Three of the initiatives, totaling $32.2 million, enhance the IRS' security posture as the way the IRS does business continues to evolve and security threats seem to increase on a daily basis. Data security has taken on an expanded meaning in a post 9/11 world. Terrorists from around the globe are actively working to exploit weaknesses in government IT security systems with the intent of producing both great physical and economic harm. Disrupting IRS returns processing and stealing sensitive information could wreak havoc on the economy and financial markets. The IRS cannot be complacent with respect to security, and the Board recommends the following security initiatives:

- Enhance IT Security ($16.7 million)
- Enhance Contingency Planning and Disaster Recovery ($8.7 million)
- Implement Security Auditing ($6.8 million)

The first initiative enables the IRS to further implement key IT security and privacy safeguards to assure the integrity of sensitive taxpayer and employee data and supporting infrastructure processes. Protecting taxpayer data is paramount. The second initiative is to enhance the IRS enterprise-wide contingency planning and disaster recovery capabilities to support critical business systems. Any unavailability of critical IRS business systems poses an unacceptably high risk to the nation's security. The third initiative, Security Auditing, will allow the IRS to more effectively monitor key networks and systems to identify any unauthorized activities.

The remaining three initiatives, for a total of $71.3 million, allow the IRS to improve other elements of its infrastructure. They are:

- Redesign Form 990 for Tax Exempt Organizations ($23.5 million)
- Preserve Quality IT Workforce in Applications Development ($36.8 million)
- Build Alternate Power Supply for the Computing Centers ($11.0 million)

The first initiative, the only one that is not considered high priority, is recommended because it brings new efficiencies to tax filing for a segment of taxpayers who are frequently ignored because their tax returns do not produce revenue—tax exempt organizations. The Form 990 tax return is difficult to complete for tax exempt organizations to complete and for reviewers to comprehend. Worse, it fails to provide the IRS with sufficient information to detect and analyze compliance trends in the sector and target enforcement actions as needed.

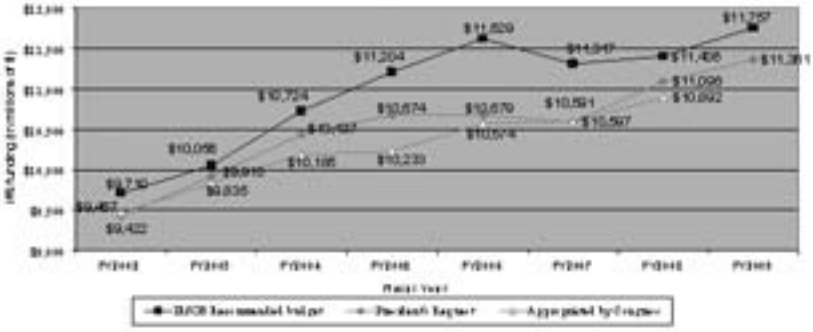
The second initiative will give the IRS better tools to retain its IT workforce by mitigating intellectual and experiential loss through a series of supporting strategies such as workforce re-tooling, succession planning, and retention. The third initiative provides alternate power supply for three of the IRS's computing centers. Currently there is but a single power supply facility at each of the computing centers. An alternate power supply capability at each of the three computing centers would ensure the continuous operation of, and continuous access to, tax processing systems at the computing centers during unplanned emergencies and planned power supply tests, and avoid the revenue loss and overtime expense associated with the current process that requires total shut down periods.

Investing in IRS is a Good Business Decision Supported by the Public

In spite of recommendations made by the IRS Oversight Board, the IRS has not been funded at the most effective levels to achieve its strategic objectives. Figure 5 illustrates funding recommendations made by the Board since its inception, the President's budget request during this same time frame, and the funding appropriated by Congress. One of the principal reasons for this so-called "resource gap" is the budget process which treats the IRS the same as it does all other discretionary spending requests. It does not credit the IRS with bringing in 95 percent

of all the revenue to fund the Federal Government, nor does it recognize the previously discussed four-to-one return on every dollar invested in tax enforcement.

Figure 5. IRS Funding History FY2002-2009



The Oversight Board has urged previously Congress to view funding of the IRS as an investment.[1] Other members of the tax administration community, such as the National Taxpayer Advocate and the National Treasury Employees Union, have made similar recommendations.[2]

There are a number of approaches that Congress could take to achieve this result, such as funding the IRS outside of budget caps, and the Board believes that the implementation of such a change is best left for Congress to decide. The Board would be remiss, however, if it didn't point out providing additional funds to the IRS has been consistently supported by nearly two out of three members of the public. In its annual Taxpayer Attitude Survey, the Board has asked taxpayers whether they support additional funding for the IRS. The results for 2005 through 2007 are shown in Table 6.

Table 6. Results of Taxpayer Attitude Survey on IRS Funding

Survey Question 11	Percent Completely Agree			Percent Mostly Agree		
	2007	2006	2005	2007	2006	2005
The IRS should receive extra funding to enforce tax laws and ensure taxpayers pay what they owe	24	24	20	40	39	43
The IRS should receive extra funding so it can assist more taxpayers over the phone and in person	21	24	22	42	42	44

The Board believes such strong support indicates the public understands the need for effective tax administration and realizes that, ultimately, it pays for itself.

Conclusion

Approving a budget is not just about money; it's also about choices. The Board believes its budget recommendations, if implemented, will put the IRS on an effective long-term path to achieving the IRS strategic goals, improving voluntary compliance, and reducing the tax gap.

[1] IRS Oversight Board reports, *FY2006 IRS Budget Recommendations/Special Report, FY2007 IRS Budget Recommendations/Special Report, and FY2008 IRS Budget Recommendations/Special Report.*

[2] NTA, 2006 Report to Congress, Section 2, p. 445, and Statement of Colleen M. Kelley, President, National Treasury Employees Union, Testimony Before the House Committee on Ways and Means, May 23, 2007.

Although the Board's recommended budget is $375 million more than the President's request, there are some important decisions that must be made with respect to priorities and balance. The Congress must not only decide the amounts to be appropriated, but must also choose whether it wants to pursue short-term growth in enforcement activity over a more balanced path that stresses the benefits of long-term investments in technology, infrastructure, service, and research.

○