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TAX FILING SEASON: IMPROVING THE TAXPAYER EXPERIENCE

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

APRIL 26, 2012

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

80–396—PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
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TAX FILING SEASON: IMPROVING THE TAXPAYER EXPERIENCE

THURSDAY, APRIL 26, 2012

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

The hearing was convened, pursuant to notice, at 10:09 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Wyden, Cardin, and Hatch.

Also present: Democratic Staff: Russ Sullivan, Staff Director; Neil Pinney, Detailee; Amanda Bartmann, Detailee; Andrea Chapman, Detailee; Ann Cammack, Tax Counsel; and David Burt, Detailee. Republican Staff: Chris Campbell, Staff Director; Mark Prater, Deputy Chief of Staff and Chief Tax Counsel; and Jim Lyons, Tax Counsel.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

Albert Einstein once said, "The hardest thing in the world to understand is the income tax."

Last week, taxpayers in Montana and across the country filed their annual returns. I am sure many of them had the same thought that Einstein expressed. We need to simplify the code. Reforming and simplifying the code will make filing taxes easier for Americans and reduce uncertainty.

Today we will look at ways we can improve the taxpayer experience and consider how to deal with the 132 provisions that frequently expire and create uncertainty. We will look at how to effectively use technology to improve communication between the taxpayers and the IRS.

We know the great majority of taxpayers follow the law, and more than 80 percent of taxes are paid on time. This voluntary compliance shows that most people are doing their part every April.

But improving the taxpayer experience and creating certainty can push that rate even higher. More people voluntarily complying with our tax laws will reduce the United States' annual $450 billion tax gap. Reducing this gap between taxes paid and those legally owed helps ensure the burden will not be passed on to the law-abiding Americans who do pay their taxes.

However, issues with our current system make this difficult. Frequent and last-minute changes to the code and complex procedures

create uncertainty and confusion. Too many Americans can tell you what a nightmare going through an audit or appealing a decision with the IRS can be. Taxpayers become discouraged when they cannot understand what they owe or why they owe it.

One IRS process that is particularly hard on taxpayers is the correspondence audit. This audit is done through letters rather than face-to-face meetings. Often these are simple audits that could easily be resolved through a short conversation, but instead they are drawn out over months or even years.

Taxpayers often cannot reach anyone at the IRS to talk to, and, if they ever do, the IRS representative is often unfamiliar with their case and none of their submitted documents has been considered.

Correspondence audits are just one glaring example. There are others. One is staffing. IRS staffing is a major concern. In my hometown of Helena, MT, the Helena IRS walk-in center is only open part-time with temporary staff. When people travel across a State as large as Montana to reach an IRS official, they should be able to receive help during normal business hours.

We cannot forget that filing taxes is one of the most direct relationships many Americans have with their government. The IRS needs to make compliance easier on taxpayers and needs to make the process more simple. IRS must explore innovations and new technologies to use resources efficiently. Private industry has successfully incorporated technology to make things easier. IRS needs to do the same.

As we consider tax reform, we have an opportunity—indeed, an obligation—to improve the taxpayer experience. Through tax reform, we can reduce the compliance burden. We can make things easier for folks every April.

So let us reform the code to give taxpayers more certainty and more predictability. Let us make it easier for taxpayers to work with IRS to resolve issues more quickly and correctly. Let us take the right steps to improve the taxpayer experience.

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

The CHAIRMAN. I might say to all those here, I am going to have to leave. Senator Cardin will take over and chair this hearing. And we are going to be shuffling back and forth a little bit. Senator Hatch is going to come a little later. There is just a lot going on right now. One for me is the Ag conference and looking at a farm bill.

It is not meant to be disrespectful of all of you witnesses. We are still listening, taking testimony, asking questions, and doing the very best we can. So please bear with us.

Our first witness is Mr. Jim White, Director of Tax Issues at the U.S. Government Accountability Office. Thank you, Mr. White.

Second, Mr. Troy Lewis, vice president at Heritage Bank in Saint George, UT and owner of Lewis and Associates, an accounting firm in Saint George.

Next, Beth Tucker, the Deputy Commissioner for Operations Support for the Internal Revenue Service. Thank you, Ms. Tucker.

And finally, Ms. Teresa Thompson. Ms. Thompson is the Local Taxpayer Advocate for Montana. Thank you very much, Ms. Thompson, for coming out here.

Our customary practice is for witness statements to be automatically submitted for the record and each of you to speak about 5 minutes.

We will start with Mr. White. Unfortunately, I have to leave and, as I said, Senator Cardin will take over until Senator Hatch comes. And we will work it out.

Thanks very much.

Why don't you proceed, Mr. White?

STATEMENT OF JAMES WHITE, DIRECTOR, TAX ISSUES, GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC

Mr. WHITE. Chairman Baucus, Senator Cardin, Ranking Member Hatch, and members of the committee, I am pleased to be here to discuss improving the taxpayer experience and voluntary compliance.

As you know, the U.S. tax system depends heavily on taxpayers calculating their tax liability, filing a return, and paying what they owe on time without intervention from the IRS. This is often referred to as voluntary compliance.

Voluntary compliance is influenced by a number of factors, including, one, the quality of IRS's assistance, such as its telephone help line and website; two, knowledge that IRS's enforcement programs are effective and that noncompliance will not go undetected; and three, a belief that the tax system is fair and enforced on all—that is, that one's friends, neighbors and business competitors are paying their fair share.

In addition, voluntary compliance is affected by third parties who assist taxpayers, including paid tax return preparers, tax preparation software companies, volunteer tax assistance sites run by private organizations, and third parties such as employers or banks that provide year-end summary information about income or expenses.

The taxpayer experience also depends on how IRS deals with taxpayers who do not voluntarily comply, either intentionally or unintentionally.

I now want to summarize how IRS is doing at providing assistance to taxpayers. In a nutshell, IRS's service is not what it should be. Taxpayers who want to speak to an IRS telephone assistor actually got through at a rate of 68 percent so far this year, a drop of 7 points from last year and well below the 82 percent rate in 2007. Wait time to speak to an assistor this year has averaged 16 minutes. At the same time, IRS is falling further behind in processing paper correspondence from taxpayers.

Given the tight budget environment and increasing demands being made of IRS, how can the taxpayer experience be improved? Innovation has to be part of the answer, including more self-service tools. The goal here should not be simply to shift taxpayers away from expensive live assistance. The goal should be to improve service by, for example, making it faster.

One example is checking the status of amended returns. Taxpayers must now wait to talk to a live assistor. Automated assistance might be faster.

IRS is working on an Internet strategy costing hundreds of millions of dollars, and we have made several recommendations to make it more specific, such as estimating costs and benefits and laying out a time frame for implementing the strategy.

Expanded information reporting. Information reporting can make it easier for taxpayers to comply and reduce the need for burdensome audits. Two suggestions we made for additional information reporting cover payments for services that businesses make to incorporated contractors and payments for services made by owners of rental real estate.

Better leveraging third parties. About 90 percent of tax returns are now prepared by paid preparers or tax preparation software, intermediaries between IRS and taxpayers. Using data collected on preparers as part of the new regulatory regime, IRS should be able to better identify problem preparers and take remedial actions, such as education or enforcement. The same point applies to tax software.

Modernized information systems. IRS has made great strides developing its capacity to manage IT acquisition and development, but it needs to implement the next two phases of CADE 2, its modernized taxpayer account database.

Pre-refund compliance checks. This is part of the Commissioner's vision for the future of IRS. More verification before issuing refunds could benefit taxpayers by catching errors before interest and penalties accrue. It could also reduce the need to resort to expensive and burdensome processes for trying to collect money after it has gone out the door.

Tax code simplification. In addition to the frustration of figuring out tax liabilities and the need for complicated financial recordkeeping, tax complexity affects taxpayers in other ways. A surprising number overpay. Some make bad financial decisions. For example, in our work on higher education assistance, we found taxpayers selecting the wrong program from the perspective of their own finances.

In addition, the stability of the tax code matters. Changes to the tax laws introduce opportunities for new errors by taxpayers. We have reported in the past how IRS's telephone volume is driven, in part, by taxpayer questions about tax law changes.

In summary, taxpayer service will not be improved by doing more of the same. It will require innovation and a variety of approaches.

Mr. Chairman and Ranking Member, that completes my statement. I would be happy to answer questions.

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

Senator HATCH [presiding]. Thank you.

Let us go to you, Mr. Lewis.

STATEMENT OF TROY LEWIS, LEWIS AND ASSOCIATES, CPAs, LLC, DRAPER, UT

Mr. LEWIS. Chairman Baucus, Ranking Member Hatch, and members of the Senate Finance Committee, I am honored and very

appreciative of this opportunity to address you on today's topic of improving the taxpayer experience.

My written testimony contains one basic recurring theme. The lessons learned from the 2011 filing season suggest that there are things that can be done to improve the taxpayer experience. With the correct leadership, focus, and effort, the taxpayer experience can be improved.

In my written testimony, I suggest, among other things, that the taxpayer experience can be improved by and through, one, meaningful tax reform; two, simplification of the existing laws; three, the IRS improving the correspondence audit process; and four, suspending the 1099–B matching program of IRS with respect to reported tax basis for the 2011 tax year.

One, meaningful tax reform. In the long term, the taxpayer experience will be improved by reforming the tax code. Whether I am teaching a class or tax planning for a client, I often ask myself if the tax code of today really achieves the objectives that former President Ronald Reagan laid out back in 1984, the last time that the Congress set out to recodify and modify the existing tax laws, and that being that the United States tax code and system needed to be fair, encourage growth, and be simple.

To be honest, at times, it is hard for me to see each one of those elements in our current tax code. Most of these terms are relatively defined. This individual relativism makes the process of reforming the code painful and spirited.

In order to make serious progress and reform the code, it will take a major undertaking by all parties involved. And let me add my voice to the process by saying such effort is worth the end result.

Two, simplification of our existing tax laws. In the short term, while Congress studies how to reform the tax system, I would suggest that there are progressive steps that can be considered to improve the taxpayer experience. Chief among those would be to simplify the tax law.

One of the few ways I suggest this could be accomplished is by resolving some of the uncertainty of the tax laws attributable to the so-called tax extenders. I cannot with any surety tax plan for a client today with respect to the 2012 tax year regarding issues such as the purchase of new equipment or the ability to generate a research and experimentation credit because the laws for these items expired at the end of last year. And I cannot predict whether or not those are going to be retroactively made effective back to the start of 2012 so that there is no lapse in coverage.

The uncertainty associated with this annual list of extenders weakens the taxpayers' confidence. This uncertainty also causes inaction on the part of the taxpayer. The law today is clear, but the possibility of a potential law change tomorrow that would impact behavior already undertaken earlier this year is paralyzing.

Three, correspondent audit process. In my written testimony, I discuss the need for improvement in the IRS correspondent examination process. As less budget dollars are allocated to the office and field audit examination process by IRS, the pressure to conduct more audits through the correspondence process will increase.

I suggest in my written testimony steps that should be considered to better this program. The program can be refined and significantly improved with the proper leadership and guidance.

Four, 1099–B matching suspension. During 2011, the Form 1099–B reporting was modified such that brokers were required for the first time to report to taxpayers the cost basis of sold securities of newly acquired assets. In addition, the reporting entity was also required for the first time to segregate each transaction into categories based upon certain criteria.

It is very possible now that instead of an individual reporting all their stock transactions on one Schedule D, instead they would have to initially report such transactions on six different Form 8949s that would then be summarized into one Schedule D, a new process.

As I provided in my written testimony, during the 2011 tax year, CPAs and other tax professionals have reported challenges and problems with the information being reported to the taxpayers on these Form 1099–Bs. I suggest that the IRS consider standardizing the 1099–B form, as well as suspending matching of the tax basis amounts for 2011 so that the known and yet unknown issues can be resolved without unduly burdening taxpayers.

In conclusion, I am grateful to the committee for holding these hearings. I believe improving the taxpayer experience is critical to establishing confidence in the tax system and administration.

Again, thank you for the opportunity to provide both written and verbal testimony to this committee.

Chairman Baucus, Ranking Member Hatch, and members of the committee, this completes my prepared statement, and I would be pleased to respond to any questions that you may have at this time.

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

Senator HATCH. Thank you, Mr. Lewis. We are proud to have you here from Utah and appreciate your testimony very much.

Ms. Tucker, we will turn to you.

STATEMENT OF BETH TUCKER, DEPUTY COMMISSIONER, OPERATIONS SUPPORT, INTERNAL REVENUE SERVICE, WASHINGTON, DC

Ms. TUCKER. Chairman Baucus, Ranking Member Hatch, and members of the committee, thank you for the opportunity to testify on the 2012 filing season and the IRS's efforts to improve the taxpayer experience.

We strongly believe that it is important to provide quality customer service not only during the filing season, but throughout the year and in the post-filing season environment, as well. We also recognize that one size does not fit all when it comes to serving taxpayers and improving their experience with the IRS. We have a highly diverse customer base, and we must meet taxpayers' different needs when and where they want it, ranging from smart phone apps online to self-service applications to traditional service channels.

Improving the taxpayer experience also means helping taxpayers get it right from the start. And with 9 out of 10 taxpayers using a paid return preparer or commercial software, our return preparer

program can do just that. By ensuring a basic level of competency and rooting out unscrupulous preparers, it can help taxpayers avoid potentially costly problems down the road.

Tax software has also become popular because it guides taxpayers through the filing process, prompting them to report income, reminding them of benefits, and helping them avoid errors.

Mr. Chairman, let me turn to the 2012 filing season, which is winding down and going smoothly. As of April 14, 2012, the IRS received over 109 million individual returns. We have issued more than 86 million refunds for a total of $237 billion, with the average refund being approximately $2,700, about the same as last year.

Of note, the individual e-file rate continues to trend upward this year, a very positive development, while paper returns continue to fall. In a challenging budget environment like we face at IRS, the cost savings are substantial. It costs IRS $0.15 to process an electronic return versus $3.50 for a paper return.

Irs.gov also remains the favorite source of information for millions of taxpayers. As of April 14, 2012, there were over 225 million visits, a 22-percent increase over the same period last year.

We are also offering on *irs.gov* helpful interactive tax tools, such as "where is my refund," the earned income tax credit assistant, interactive tax assistant, and the "Get Free Tax Help Act."

Under the leadership of Commissioner Shulman, we are continually working to improve the services we provide taxpayers. One of the most important achievements in this area occurred earlier this year. It was largely invisible to taxpayers, but will be providing meaningful and tangible benefits to them and our tax system for years to come.

I am speaking of the standup of our new customer account data engine, also known as CADE 2, that will allow the IRS to go from weekly batch processing to daily processing for the first time in 60 years.

CADE 2 addresses the multitude of issues that historically created challenges and problems in the tax system. It will provide more up-to-date information at the fingertips of our customer service representatives that will enable them to faster resolve taxpayer account issues and account adjustments, both of which will greatly help taxpayers, as well as the IRS.

CADE 2 will also correct one of the biggest problems we have. A taxpayer calls about a payment he or she has made, but our representatives cannot tell whether it has been posted or not. That will change because of the daily processing that CADE 2 affords. CADE 2 will also eliminate structural technology problems that could lead to time lag problems, such as when notices are sent to taxpayers.

The CADE 2 database will also allow the IRS to consider offering a wider range of web-based self-initiated service solutions that could fundamentally change the way that taxpayers interact with the Internal Revenue Service and also provide for greater operational efficiencies.

A good example is the electronic transcript delivery system on *irs.gov* that we plan to launch later this year. This initiative will enable a taxpayer to securely send a transcript to an authorized

third party. As a result, taxpayers will gain access to their tax records with greater efficiency and decreased burden.

As I mentioned in my opening statement, we are providing a variety of service channels to meet different and evolving taxpayer needs in a balanced fashion. One innovative program in particular I wanted to mention is virtual service delivery, which has great potential to improve the taxpayer experience.

Currently located in 13 sites, it uses video communication technology to deliver a number of services to taxpayers—such as assistance with letters, notices, tax law, procedural questions—and allows taxpayers to seek different service delivery options outside of the traditional brick-and-mortar IRS facility.

Mr. Chairman, Ranking Member Hatch, this concludes my oral testimony. I would be happy to answer any questions you may have.

[The prepared statement of Ms. Tucker appears in the appendix.]

Senator HATCH. Thank you so much.

Ms. Thompson, we will turn to you now.

STATEMENT OF TERESA THOMPSON, LOCAL TAXPAYER ADVOCATE FOR MONTANA, TAXPAYER ADVOCATE SERVICE, HELENA, MT

Ms. THOMPSON. Chairman Baucus, Ranking Member Hatch, and members of the Senate Finance Committee, thank you for inviting me to testify today regarding filing season 2012 and the assistance the Taxpayer Advocate Service provides in Montana.

This filing season has seen challenges in both Montana and the country as a whole. I will highlight five points from my written testimony that deserve emphasis.

First, although Montana may not be as populated as other States, its individuals should be afforded all services provided by their Federal Government. The IRS must be available to them. Taxpayers should be able to reach an IRS employee by telephone or by visiting a walk-in office when they have questions or other concerns about Federal income taxes.

Unfortunately, many taxpayers cannot get through on the IRS toll-free lines or cannot visit walk-in sites because they are not open. For example, the Helena walk-in office, it is open only on limited days and for limited hours.

So taxpayers call our office as the only available alternative. But, because of budget constraints, my office is not even staffed with a secretary to answer phone calls. Unless staffing levels improve, my staff and I will continue to be drawn away from the taxpayers who need our help the most—those assigned to the Taxpayer Advocate Service.

I would also like to point out that the IRS does not have an appeals officer or a settlement officer in Montana and numerous other States. Taxpayers should be afforded access to these officers locally. Their knowledge of local economic issues relevant to taxpayer cases is important to ensure fair and impartial hearings.

Second, Montana would be the perfect place for piloting 2-way video conferencing with taxpayers because of its geographic size and weather conditions at various times during the year. IRS problems do not always happen when there is good weather in Mon-

tana. People cannot travel to Helena to visit my office or travel to any of the walk-in offices throughout the State when road conditions are dangerous. And getting through on the toll-free number is always a gamble.

Why not harness technology that is already available and provide top-notch service to our taxpayers by utilizing 2-way video conferencing? Two-way video conferencing would be an effective way of delivering government services to a diverse population and could alleviate taxpayer frustration and confusion.

Third, identity theft is a national epidemic, and, when the theft has tax consequences that cause economic harm to taxpayers, they often seek help from the Taxpayer Advocate Service. The IRS should prioritize assistance to victims of tax-related identity theft. A crime has been committed, and, as such, the victims should be made whole as soon as possible.

This requires dedication of resources and strategic casework planning both on the front end to catch the identity theft before the refund is issued, and on the back end when the damage has already been done and the taxpayer needs to be made whole. Unfortunately, budget shortfalls resulting in staffing cutbacks have hindered these efforts.

Fourth, correspondence audits can be confusing and impersonal. Documentation sent in by taxpayers or their representatives to verify items on tax returns are sometimes never associated with the case.

What happens to this mail? The responsibility for a correspondence audit should be given to a single IRS auditor who will work the case from beginning to end, as we do in the Taxpayer Advocate Service. The auditor should contact the taxpayer by telephone or through 2-way video conferencing when that is available.

Correspondence audits should be limited to returns with specific, clear-cut issues, and are not well-suited to complicated issues like business expenses.

Fifth, there are seven federally recognized Native American tribes in Montana. These tribes have a unique legal status which should not be overlooked when Congress writes legislation for income, expenses, and credits.

At times, TAS casework reflects this legislative omission. When a Native American child adopted from a reservation does not meet qualifications for the adoption credit, as currently spelled out in the Internal Revenue Code, my opinion is that a part of this country has been overlooked.

I am honored to be here today and would be happy to answer your questions.

[The prepared statement of Ms. Thompson appears in the appendix.]

Senator HATCH. Thank you so much. We really appreciate the testimony of each of you and look forward to asking you some questions.

Maybe I can just make my opening remarks at this point, and then we will go into questions. I will probably turn to you first. How is that? I think that is appropriate.

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

Senator HATCH. Though you would not know it from the fiscal policies being advanced by President Obama, this Nation faces a real crisis in just a few months. What some have called "taxmageddon" is rapidly approaching.

Unless Congress acts appropriately come January 1, 2013, Americans will be hit with the largest tax increase in history. Now, this record-breaking tax increase will hit every American who pays income taxes. Small business owners will face a top marginal rate hike of 17 percent.

The number of farmers and small businesses that will face a death tax will grow exponentially. Do not forget, the alternative minimum tax patch has already expired, leaving 26 million middle-income families and individuals paying $92 billion in stealth taxes in just 8 months. In fact, those 26 million families and individuals are required by law to have already made their first estimated tax payments this year.

The rate of tax on dividends will nearly triple from 15 percent to 43.4 percent. Now, the President has actually proposed this massive dividend tax increase in the latest version of his annual tax-and-spend budget that is still supported by exactly nobody. And the rate of tax on capital gains will increase by 59 percent from 15 percent to 23.8 percent.

Now, these tax increases are ones for the record book, and Congress should have already prevented them from occurring. They are ticking time bombs, in my opinion, for families, individuals, and the American economy. Instead, the Senate continues to dawdle on the non-starter provisions like the Buffett tax. That so-called deficit reduction proposal is so backwards that it actually loses $793 billion over the next 10 years if it is implemented in the way proposed by President Obama in his most recent budget. That is, if the Buffett tax replaces the AMT, as President Obama says it should, we actually increase the deficit by $793 billion over the next 10 years alone.

Unfortunately, some view the expiration of such a large part of our tax code at the end of the year as a bonanza for bigger government. Deploying the tired rhetoric of class warfare, they welcome these tax increases, which will finance even higher government spending.

But make no mistake about it. This impulse to increase taxes at all costs risks a recession. Congress should come together and act to prevent this historic tax increase that is hanging over the nation's head like the Sword of Damocles. Doing so would greatly improve the taxpayer experience by giving taxpayers more predictability and allowing the IRS to put out more complete and timely guidance for taxpayers, points that some of you have made.

With respect to the IRS's performance when it comes to the tax filing experience, I will say that one thing that stands out is its stated goal of answering 61 percent of phone calls from taxpayers. Now, I have heard of setting the bar low so that it is easy to exceed expectations, but 61 percent of phone calls answered is simply not good enough. It would earn a student a D-minus, at best, and that is probably grade inflation.

On this issue, I would give the IRS a failing grade, and I suspect that the nearly 40 percent of taxpayers whose calls go unanswered would probably agree. It is a real problem to us.

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

Senator HATCH. I would like to extend, like I say, a special welcome to Mr. Troy Lewis, who comes from Utah and has a wide array of experience with taxes. He is an adjunct professor at Brigham Young University. He owns his own CPA firm and is vice president of Heritage Bank in Saint George, UT. He spent the majority of his career at a large accounting firm in Salt Lake City.

So I want to thank you all for coming this morning. It means a great deal that we could have your expertise in this area. And this is one of the hearings that we have been having with regard to tax matters, and I want to personally pay tribute to our chairman for being willing to go through so many hearings on the tax situation that we are all so concerned about.

Let me turn to the distinguished Senator from Delaware——

Senator CARDIN. Maryland

Senator HATCH. Maryland.

Senator CARDIN. But a University of Pittsburgh graduate.

Senator HATCH. A University of Pittsburgh graduate. I did not realize that you had that great experience until you came to the Senate.

Senator CARDIN. Senator Hatch, thank you very much.

Senator HATCH. I am sorry to mess up your State. I apologize.

Senator CARDIN. Do not mess up our State. It is a great State.

Senator HATCH. It is.

Senator CARDIN. Let me thank Senator Hatch and thank all of our witnesses here for their testimony and for your work.

I want to go back, I guess, a little over a decade ago when we had the commission that looked into the IRS. Then-Congressman Portman was one of the leaders. He needed a partner in the House of Representatives to advance those proposals. So I joined him, and we were able to get some significant reforms done in the IRS.

As Ms. Tucker knows, I have recently been out to visit with our IRS employees to thank them. I think they are doing an incredible job. They are being asked to do more with less under very stressful conditions, and I think they are doing their best, and we are very proud of their public service.

So I want to start off with the fact that I think we have some very dedicated people who are working to collect taxes, which is never a popular thing to do, but an extremely important role for our society.

But the recommendation about a decade ago was to modernize the IRS with technology and to instill more consumer function to the IRS so that it would be more consumer-friendly, based upon the recognition that voluntary compliance dictated that type of a model.

So, back when we started looking at this, I would say the telephone connection rate was well below what it is today, and we brought it up to levels that we thought were where it should be, and now we are falling back in the wrong direction.

So that is a major concern to me, and I think it should be a major concern to this committee and our country. And I expect that a good part of this has been the budget and failure to provide the type of support for this agency.

It is not only the number of personnel. It is also the equipment and the technology and all of the above. And I think we need to get back to that if we are going to be able to, again, meet the needs of our consumers.

I think, Ms. Thompson, your point about offices not being open during normal business hours, that is unacceptable. That is unacceptable. And the connection rate of in the 60s is unacceptable. We need to have that in the 90s.

So I think we need to refocus again on making the IRS a more consumer-friendly group, but do not expect it to perform miracles as Congress cuts the budgets. Now, some of you have mentioned, properly, and so has Senator Hatch, that Congress could do a lot of things to help you. We could simplify the tax code. We could do tax reform. We could pass some of the information issues that, Mr. White, you pointed out.

All of that, I think, would be helpful, but I think a critical part is to give the type of support to the IRS that it needs. And the interesting point is, all of the scorekeepers here tell us that if we made the resources available, IRS would collect more money.

So, from the point of view of helping our budget deficit, we are shortchanging our budget deficit by what we are doing on the support for the IRS.

I want to ask a specific question on ID theft. Ms. Thompson, you raised that issue. And I have had a couple cases in my office of taxpayers who have had their identification stolen and fraudulent efforts to get refunds using an ID of someone else. In one or two of these cases that I have looked at personally, the individual taxpayer was not notified until many months later.

Ms. Tucker, I just really want to know. I understand you have to do certain investigations. I know you have to confirm what happens. In these cases, what normally happens is someone has filed a fraudulent return in an effort to get a refund using someone else's identity. Then the real taxpayer files their tax return. So you look at the two and you say something is not right here.

But should it take months before the victim of the identity theft is notified?

Ms. TUCKER. First of all, Senator Cardin, thank you so much for the kind words you expressed to the IRS workforce. You are absolutely right. The 97,000 men and women of IRS are doing their best every day for our taxpayers and to ensure that we have a quality tax administration system.

As we have talked about before, identity theft is one of the most vexing and complex tax situations that we are seeing right now at IRS. Unfortunately, these fraudsters, the perpetrators, they come in, they file a tax return, as you indicated. That is the first return in. We then subsequently receive a return from the legitimate taxpayer or even potentially another return from another fraudulent taxpayer.

And so then we have to go about the process of doing the validation of, are you really who you say you are? And that takes time.

We have dramatically increased our staff who are working identity theft. In fact, by the end of this calendar year, we will increase our staffing 5 times over. We will have roughly 2,500 folks going at this work.

But, unfortunately, it is complex. It takes time.

Senator CARDIN. That is an incredible number. And we know it is the fastest-growing—I think it is the fastest-growing crime in America. At least the last time I checked, it was the fastest-growing crime in America. And it is pervasive in so many different areas.

IRS returns is certainly just one of many areas in which people's identities have been compromised and they themselves have been compromised. I would just urge you to do everything you possibly can to inform the victim at the earliest possible stage. Now, we have taken steps, when computer information has been compromised, to make sure those who are potential victims of identity theft are notified at the earliest possible moment.

I think you need to be able to at least identify that someone's identity has been compromised and let him or her know about it at an early stage so that they are aware of it.

And I understand you would like to have all the information in place before you go forward, but I can tell you, the anxiety of knowing that you have been victimized, and knowing that it was done 6 months ago and you are just finding out about it, adds to the trauma.

Thank you, Senator Hatch.

Senator HATCH. Thank you, Senator Cardin. Sorry about your State. I still have not gotten awake, I think. [Laughter.]

I have enjoyed your testimony, every one of you, and, frankly, you have brought some pretty important points out.

Let me just say this. Let me ask you this question. And I am concerned about the 61 percent, Ms. Thompson. I am concerned about that. And there is an average wait time, I think, of around 19 minutes.

It is a tough job you have. So I am the last to try to find major fault with it. But it would be better if we could somehow figure out how to do that. And then again, we are not doing our job up here well enough for you, either, as far as I am concerned.

Let me just ask this question. Levels of taxpayer service have already decreased at the IRS. If the health spending law is implemented—we are talking about Obamacare, or the Affordable Care Act, whichever you care to choose—but, if the health spending law is implemented, the IRS would be forced to deal with administering tax credits that are given to 23 million people who are newly enrolled in the health exchanges by, I think, 2019. In addition, 3.9 million people will be subject to the individual mandate penalty, according to CBO's April 22, 2010 analysis, and the IRS is the agency responsible for administering that penalty.

Therefore, will not levels of taxpayer service decline even further as the IRS resources for taxpayer services are diverted to deal with the health spending law?

How do you handle that problem? It is not one of your own choosing, I know.

Ms. TUCKER. Let me first talk about our overall level of customer service. So, the 61-percent figure that folks have talked about today, that was our projected level of service based on our budget allocation.

So I think that we have talked about this with the committee before. IRS resources were down by roughly 5,000 employees at this point in the filing season this year. Of that 5,000, roughly 2,000 employees were down in the taxpayer service area.

So, as we have started this filing season, based on our available resources, based on our available budget, we projected a level of service of 61 percent. Now, the good news—trying to be the eternal optimist—our level of service coming out of this point in the filing season is actually 67.5 percent, and that increase, we believe, is due to a couple of things.

Number one, all of the other automated tools that we have introduced. As I mentioned earlier, the taxpayers coming to *irs.gov* have significantly increased this year. We have more folks using the automated phones assistor application. We have more people using our interactive tax assistors. We have more folks using the mobile app to check information.

So we actually have achieved a better level of service on our phones than we had anticipated based upon our funding situation, just like any other program. The IRS worked to implement the tax provision associated with the Affordable Care Act. We will take those provisions just like we do any other new tax law change, and we will work that into our available budget, staffing, and resources.

The other thing that we are doing is—to your point earlier about how we have to continue to focus on the customer experience—so much of the work that we are doing right now on the technology front is really going to change the way that IRS is able to interact with taxpayers, not only with increased online services and online applications, but things like my colleague from Montana talked about: the increased use of things like virtual assistors.

So at IRS, it is always a balancing act, and we come to work every day trying to do our very best for the taxpayers based on our available funding and staffing.

Senator HATCH. I appreciate that.

Let me just ask a question for the whole panel, and we will start with you. And that question is this. If you were given the power to change one thing about our tax system to improve American taxpayers' experience with paying taxes, what one thing would each of you change? Start with you.

Mr. WHITE. If it is literally one thing, I think it would have to be the complexity of the tax code. That would have the biggest impact. Now, that is a tax policy change.

On the administrative side, if I was limited to tax administration, then I think the change that needs to be made is in terms of innovation, the problems that have been discussed so far, taxpayers being able to get through on the phones or dealing with ID theft.

There are long-term options there that hold out a lot of potential for solving some of those problems. Trying to deal with them through traditional methods—just getting better at answering the telephone or dealing with ID theft cases given current technology

and current information available to IRS—is not going to be very effective. It is going to take a long time for taxpayers to be notified.

So, if we can think in more innovative ways—and IRS, I give them credit, is looking at some different approaches. Being able to match tax returns to W–2s before issuing refunds would go a long way to preventing ID theft from being successful in terms of committing tax fraud. Thinking about how to leverage the tax preparation community and tax preparation software to answer taxpayers' questions and head off the need for them to call IRS in the first place would solve some of the telephone call problem at IRS.

Some people need to call IRS, and only an IRS assistor can help them. But a fair number of the calls to IRS do not have to be answered today by a live assistor.

Senator HATCH. Thank you, Director White. We appreciate the work you do, and your whole organization.

Mr. Lewis?

Mr. LEWIS. Thank you. Limited to one item, I would have to say tax reform/tax simplification. The whole process of the tax filing is a unique business relationship because, in the private industry, for instance, in my accounting firm, if I was unresponsive, if I did not pick up the phone, if I did not answer questions timely, if I chose not to provide accurate information, eventually the client would just move on and go somewhere else.

Unfortunately for the taxpayers, one thing is certain—next year they are going to be dealing with the same folks. There is really not a brand X that you can choose. So that is one point.

The other point I think I would make would be that the code today is so complicated that I think the average American really does not even have a sense of what they owe. They completely rely on what the software tells them or what their paid preparer tells them.

If you were to ask someone, "Just how much money do you think you are going to owe this next year," their only sense would be, "What I owed last year." It would just be a relative comparison. But they really do not have a good feel of how taxes impact them.

And when they get so far removed, I think you lose confidence in the system. If there was more of a direct—if it was simple enough that they felt a direct correlation between what they did and what they owed, I think that would increase and improve the taxpayer experience.

Senator HATCH. Thank you.

Yes?

Ms. TUCKER. I will sound like a broken record, but it is the simplification issue, as my colleagues on the panel have stated. We know that our ability to clearly communicate with the taxpaying public about their obligations to file and pay is made much easier the less burden that there is in interpreting the tax law, the regulations, the guidelines. So anything that drives simplification, we believe is better for our taxpayer.

I guess the other thing, if today is our wish list day of what we think would help us, in particular, at IRS, I think we are very, very concerned about the uncertainty for the remainder of this tax year.

Believe it or not, we just wrapped up filing season last week, but our staff is already busy working, planning for the next filing sea-

son. And that includes not only programming our computer systems, revising our forms, preparing our publications, and, as Commissioner Shulman stated during some recent testimony, we are very, very concerned about the adverse implications we could have going into the next filing season if we do not have certainty on the expiring provisions or new provisions that could be enacted.

Senator HATCH. I have a very high opinion of Mr. Shulman and you. We would really appreciate if you would weigh in really heavily on what changes ought to be made and what kind of language should be used. You are great experts.

We will go to you, Ms. Thompson.

Ms. THOMPSON. Well, I am sorry, I am going to have to make it 4-for-4. Tax simplification is my long-term desire or wish for this country. It has gotten to where people call, they do not understand. They just do not understand the complexity of what is going on with their tax returns.

I do not even want to repeat everything they said, because I agree with everything my co-panelists have said. In the short-term, we have to deal with this identity theft. If you will notice, in my written testimony, the Taxpayer Advocate Service cases not only in Montana, but in the country, are skyrocketing from the ID theft, and there are sad cases of these people coming in who need these refunds—the correct people coming in. We have not had any uncorrect people yet come to us, but that could happen, I suppose.

But the correct people have come to us and are desperate for their refunds. They are expecting the refunds that they get or that are due them, and when they find out someone else has filed under their numbers, they are devastated.

It is a very personal crime that is being committed against them, and we do our best in the Taxpayer Advocate Service to get them their refund as soon as possible.

But those are my two wishes.

Senator HATCH. I appreciate that.

Senator Cardin, I have to leave, so I am going to turn this over.

Senator CARDIN. Let me turn it over to Senator Wyden.

Senator HATCH. I am sorry. I did not see Senator Wyden.

Senator WYDEN [presiding]. Thank you, Senator Cardin and Senator Hatch.

It has been a great panel. I have been out in the tax reform precincts for almost a decade now. It really started with Rahm Emanuel, who was then on the House Ways and Means Committee and had been trying to build a bipartisan coalition for tax reform, and then Senator Gregg joined the cause, and then, of course, he retired, and now I have been partnering with Senator Coats, the Republican Senator from Indiana.

And, as I listened to the points that the four of you made, I think you give us, particularly at this critical time when, with the expiring provisions of the Bush tax cuts, people are talking about what is next, you really give us the foundation that we have been trying to build for the last decade for tax reform, and I want to go over just kind of one key part of it.

It seems to me all of you are, in effect, articulating the position that a simpler tax code that makes it easier to comply and harder to cheat is going to be better for the vast majority of Americans

and businesses. And by reducing the tax gap, that is also going to help us close the Nation's deficit.

That is a winning proposition. And I want to see if I can—particularly with you, Ms. Thompson, and you, Mr. Lewis, not to insult our Washington witnesses, but to kind of hear from particularly out in our part of the country, the west, their thoughts on one other key kind of subject, and that is, the longer you look at this, the more convinced you become that the heart of the complexity problem, this myriad array of incomprehensible provisions in the tax code, involves a relatively small number of people, the people who tend to be well-off financially and, over the years, have had lobbyists and various kinds of experts try to—and they have been extremely successful—try to advance provisions in the tax law that will promote their interests. And that is their right. That is what we do in a free country.

I am wondering about your thoughts about the idea that, if we get rid of these provisions, these ones that are extraordinarily complicated and tend to benefit a relatively small number of people, will not the whole country be better off because we will be able to address those broader goals that you identified, reduce cheating, close the trade gap, and also be fair to them, because that was done, for example, in 1986, where everybody felt that they were given an opportunity to get at it?

So my question—and maybe we can start with you, Mr. Lewis—do you share this view that the lion's share of these special interest tax breaks, tax expenditures, go to a relatively small number of people and that the whole country can benefit by going after those kinds of breaks to broaden the base and hold down rates for everybody and achieve the goals that you have been talking about?

Mr. LEWIS. Thank you for your question. The question of how big should the base be is one that we have debated here for several years. The question of complexity is a separate component.

So let us deal first with the base. I think Ann Landers had the basic quote attributed to her that said, "One doesn't know how much to be grateful for something until you have to pay taxes on it," the concept being that, if you have some skin in the game, you have some substance and you have a connection.

I think there is a lot of truth in that. Even if it is something—I mean, more than 50 percent of the U.S. households pay no Federal income tax. That is a disconnect. It is sort of a—it is a disincentive. You do not pay, you do not have any vested interest, and there is that debate we can have.

But as far as the base itself, I see a wider base being a positive. As far as the complexity issue, you are correct: a lot of the provisions are specialized. There are several provisions, though, that we have in today's tax code which I would suggest offer complexity for the average American; for instance, education. This last semester that I taught a taxation class, I had to teach them that there were five, six different potential ways that you could deal with expenses you paid to go to college.

That is complex for people. They want, "Do I get a credit?" Well, yes, but it depends on which credit, and it depends on if they have ever been convicted of a felony for drug possession. Was it a mis-

demeanor? All right, then. There are all these little exceptions to the rules, and that gets to be burdensome, I think.

Retirement plans. You will see in my written testimony, there are a lot of different retirement plans. I think we can simplify a lot of those type provisions, which would give that mass reduction. It would give some stability to the system, and it would take out a lot of the complexity.

As far as specific provisions, yes, a lot of the provisions that you referenced do tend to take on a very unique single class, and I think we can do a lot in that regard to limit the complexity by targeting those.

Senator WYDEN. And how about you, Ms. Thompson? It is a question of the lion's share of the benefits from most of these special interest tax breaks going to a relatively small number of people and, by rooting those out, we get a simpler system and one that, in my view, is going to do more to encourage growth for the country.

Ms. THOMPSON. Well, I am going to make a political statement, but in general, the——

Senator WYDEN. We have never had any political statements here. [Laughter.]

Ms. THOMPSON. The Taxpayer Advocate Service tries to stick to the tax administration, and we avoid commenting on tax policy like rich versus poor.

Senator WYDEN. This is not a rich versus poor issue. This is a question of, when I take out the $1 trillion worth of tax expenditures, they seem to go to a small number of these special interests. And then I hear you all tell me about complexity, and I say, would it not make for a simpler system to, in effect, root those out and ensure fairness for everybody, not hurting any one class, but ensuring fairness for everybody?

Ms. THOMPSON. Well, I am sure it would. But to Mr. Lewis's point, even the basic credits—of education credit, pension, IRAs—there is so much complexity. Even in the earned income tax credit now, it is complex—if you are related this way, if you are not related that way.

I mean, there is just complexity even at the lower levels that, personally, I think, should and could be simplified for people filing their tax returns.

Senator WYDEN. Well, you are surely right about that. We saw, for example, in the economic recovery legislation, the extra relief that was provided to those people, and our friends at the IRS can recall all the problems that middle-income and low middle-income people had signing up for that. They could not figure out how to do it.

Again, it comes back to the argument for tax reform. I would say to members here on this committee, I would say, here we are having debates about the Recovery Act. Most Americans had no idea that there were any tax provisions in that, and they said, "Oh, this is just another big kind of spending bill," because the system, as you have outlined, is so big and so complicated.

Even when there is a tax break for somebody, people cannot figure it out, and they cannot figure out how to get it, which is what we saw in the Recovery Act.

Let me just ask one last question, if I might, for you, Mr. Lewis. You make another good point with respect to the problems that the small businesses have in terms of being overwhelmed by tax law changes at the end of a year.

My sense is that this year, this is going to be particularly acute. In other words, the warning lights that you and Ms. Thompson have talked about in the past with respect to the end of the year, this is going to be an even greater problem at the end of this year, because the Congress will be faced with a lame duck end of these provisions and the like.

What is your assessment of how bad this problem is going to be for small businesses at the end of this year with so much on the schedule to expire?

Mr. LEWIS. Thank you for the question. There are two aspects of the extenders. There is the taxpayer reaction, the taxpayers who will actually go out and do something about the tax laws. There is the administration aspect as well. So let us deal with it first. It is paralyzing. Today, Mr. Wyden, if you were my client, if you came to me and you said, "My estimated tax payment was due a couple weeks ago for the first quarter," I really could not tell you what that is going to be.

I can tell you, historically, that the Congress has typically gone back and retroactively made all these things applicable, but I cannot tell you whether that is going to occur or not. As you mentioned, with the political environment, with the potential push for some summer legislation, but, quite frankly, in an election year and everything else, I fear that it will come down to the end of the year.

Does it have an impact? Absolutely, because today, for instance, even in a normal year, without the extenders, the depreciation that you are going to receive on a purchase of a fixed asset, you will not really know what that number is until you know several other components: what is my income for the year, what are my other asset purchases going to be today, and, more importantly, what are they going to be in the last quarter of the year?

I mean, there are all these other tax rules. But on top of that, if you are going to insert, "Well, they might raise the section 179 limitation, they may put back more than 50-percent bonus," I think that businesses are keenly aware of the uncertainty, and it paralyzes.

I do not know that they do anything counter, but they do not do anything pro.

Administratively, if I may——

Senator WYDEN. Go ahead.

Mr. LEWIS. Administratively, I think you then have to say, what is that going to do in terms of the IRS, and Ms. Tucker could answer that. But my sense is, yes, this is a big one. All these other ones have just sort of—we have had a little bit here, maybe 10 provisions, but now with the expiration and the sunsetting of the 10-years-ago so-called Bush tax cuts and the patch that we did for the estate tax and all of these things, they have all sort of just been pushed to this year. It is a culmination, and it does worry me.

Senator WYDEN. I think that is a very thoughtful answer, and that was really the question that I was trying to get at.

I think there is no doubt that, generally, when the Congress is looking at a lame duck session, small businesses, in particular, are saying to themselves, "Oh, my goodness, what are they going to think up now?"

What you have done, though, is addressed the question I was most interested in. I think all of those concerns—the lack of certainty, the lack of predictability, what is coming at the end of the year—are going to be multiplied several times over during this kind of November–December period with the prospect of a lame duck session.

You all have been a great panel, and we are going to have to have you in the tax reform debate.

Mr. Chairman, you have given me a lot of time, and I thank you.

Senator CARDIN [presiding]. I thank Senator Wyden for his comments. I think we all share the concern of the uncertainty and what is going to happen come tax planning, whether it is by the IRS or by individuals or businesses, how they go about doing it for the next tax season.

I just want to ask one additional question, Ms. Tucker, as it relates to identity theft. I think Ms. Thompson raised this also, with the number of people who are being victimized, as to what the IRS is doing proactively to help minimize identity theft. And let me just give you one example.

I have seen instructions in this tax season that all documents that you send to the IRS should include your identification number, your Social Security number, including the remittance checks.

I would hope that the IRS is taking proactive steps to tell those who give advice to tax filers to only use the last four numbers and not to use the entire identification number. Are you doing things like that to try to minimize the risk of identity theft?

Ms. TUCKER. Let me address where we are seeing the source of the identity theft. We are very cognizant that the folks who are coming into IRS victimized by identity theft, that their Social Security number or their identity has not been compromised through the filing process.

So in other words, these perpetrators are getting the Social Security number, they are getting the identifying information outside of the tax system.

They are just using the tax system as a way to come in and get——

Senator CARDIN. Let me just clarify. When you write a tax remittance check and you put your Social Security number on it, it is very possible that the integrity is maintained through the entire system while IRS has it in custody.

Ms. TUCKER. Yes.

Senator CARDIN. But that check goes other places, and there may not be the same degree of integrity as it goes through the banking system or as it goes through wherever else those checks end up.

My question is pretty direct. There should be no need for you to have the full identification number on a remittance check or other documents where you are just trying to make sure you are attaching it to the right document.

Would not the last four numbers satisfy that? And do you have direct instructions to tell people who are responsible for giving ad-

vice to taxpayers not to include the full number on such a document?

Ms. TUCKER. So a couple of things that we are doing. You are probably aware that a lot of the taxpayer notices that we mail out, in the past, typically did have the full Social Security number on it. And we have initiated a whole host of notice improvement initiatives where we are using bar coding, scanning only the last four digits. Simply because of that reason, the less identifying information that is circulating around, obviously, the better for all taxpayers.

With regard to the question about the identifying information on the actual payment check, we will need to go back and look into that for you.

I know a lot of it has been to make sure, especially with paper returns, as they come in to a large processing center, a lot of times, the checks are split from the return for us to get that deposit in in a timely manner. And so for us to properly credit that payment to your account, we would need to know the Social Security number to get that process through.

But let me go back and look at that and come back to you.

Senator CARDIN. I would appreciate that. I remember looking at some of the internal procedures here in the U.S. Congress where they used our identification numbers—certainly in health claims—where they used our Social Security numbers, and it was amazing how many times it was not necessary.

You are only as strong as your weakest link, and the more people who have access to Social Security numbers, the more vulnerable we are.

So I would hope that the IRS, which is now having to employ 2,500 people to deal with identity theft, would take a very proactive role to show best practices for the best possible security we have and not put full Social Security numbers on documents that are handled by individuals outside the IRS. A remittance check gets handled outside the IRS.

So I would hope you would be able to give explicit instructions to those who help prepare returns that they should not be putting the full Social Security number on a remittance check, because I do think that makes us all more vulnerable to identity theft.

Ms. TUCKER. Let us go back and look at this issue.

Senator CARDIN. I would appreciate that.

Once again, let me thank all of our witnesses. I found this hearing to be very instructive. We have the message about simplicity, we have the message about tax reform, and we also, I think, understand the importance of our constituents having convenient service, accurate service, to be able to comply with the tax code.

I think most individuals really do want to voluntarily comply, but, with the complexity and the uncertainty and the lack of getting information, it makes it difficult for that, in fact, to be at the level that we expect it to be.

With that, the hearing will stand adjourned.

[Whereupon, at 11:19 a.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Hearing Statement of Senator Max Baucus (D-Mont.)
On Improving the Taxpayer Experience
As prepared for delivery

Albert Einstein once said, "The hardest thing in the world to understand is the income tax."

Last week, taxpayers in Montana and across the country filed their annual tax returns. I'm sure many of them had the same thought Einstein expressed.

We need to simplify the tax code. Reforming and simplifying the code will make filing taxes easier for Americans, and it will reduce uncertainty.

Today we'll look at the ways we can improve the taxpayer experience. We will consider how to deal with the 132 tax provisions that frequently expire and create uncertainty for taxpayers. And we will look at how to effectively use technology and improve communication between taxpayers and the IRS.

We know that the great majority of taxpayers follow the law. More than eighty percent of taxes are paid on time. This voluntary compliance rate shows that most folks are doing their part every April, but improving the taxpayer experience and creating certainty can push that rate even higher.

More folks voluntarily complying with our tax laws will reduce the United States' annual $450 billion tax gap. Reducing this gap between taxes paid and those legally owed helps ensure the burden won't be passed on to the law-abiding Americans who do pay their taxes. However, issues with our current system make this difficult.

Frequent and last-minute changes to the tax code and complex IRS procedures create uncertainty and confusion. And too many Americans can tell you what a nightmare going through an audit or appealing a decision with the IRS can be. Taxpayers become discouraged when they can't understand what they owe or why they owe it.

One IRS process that's particularly hard on taxpayers is the correspondence audit. This audit is done through letters, rather than face-to-face meetings. Often, these are simple audits that could easily be resolved through a short conversation. But instead, they are drawn out over months or even years.

Taxpayers often cannot reach anyone at the IRS to talk to during the process. And if they ever do, the IRS representative is often unfamiliar with their case and none of their submitted documents have been considered.

Correspondence audits are just one glaring example. The problem points to larger issues taxpayers have when trying to work with the IRS.

IRS staffing is another area of concern. In my hometown, the Helena IRS walk-in center is only open part-time with temporary staff. When folks travel across a state as big as Montana to reach an IRS office, they should be able to receive help during normal business hours.

We know budgets are tight, and we have to make tough choices about what we can afford. But we can't forget that filing taxes is one of the most direct relationships many Americans have with their government.

The IRS needs to make compliance easier on taxpayers, and we need to make the process simpler.

The IRS must explore innovations and new technology to use resources efficiently. Private industry has successfully incorporated technology to make things easier for customers. The IRS needs to do the same.

As we consider tax reform, we have an opportunity – and an obligation – to improve the taxpayer experience. Through tax reform, we can reduce the compliance burden on taxpayers. We can make things easier for folks every April.

So let us reform the tax code to give taxpayers certainty and predictability. Let us make it easier for taxpayers to work with the IRS to resolve issues quickly and correctly. And let us take the right steps to improve the taxpayer experience.

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STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER U.S. SENATE COMMITTEE ON FINANCE HEARING OF APRIL 26, 2012 TAX FILING SEASON: IMPROVING THE TAXPAYER EXPERIENCE

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining ways to improve the tax filing experience for American taxpayers:

Though you would not know it from the fiscal policies being advanced by President Obama, this nation faces a real crisis in just a few months. What some have called taxmaggedon is rapidly approaching. Unless Congress acts, come January 1, 2013 Americans will be hit with the largest tax increase in history.

This record-breaking tax increase will hit every American that pays income taxes. Small business owners will face a top marginal tax rate hike of 17 percent.

The number of farmers and small businesses that will face the death tax will grow exponentially.

Don't forget, the alternative minimum tax patch has already expired, leaving 26 million middle-income families and individuals paying $92 billion in stealth taxes in just 8 months. In fact, those 26 million families and individuals are required by law to have already made their first estimated tax payments this year.

The rate of tax on dividends will nearly triple, from 15 percent to 43.4 percent. The President has actually proposed this massive dividend tax-increase in the latest version of his annual tax-and-spend budget that is still supported by exactly nobody.

And the rate of tax on capital gains will increase by 59 percent, from 15 percent to 23.8 percent.

These tax increases are ones for the record book, and Congress should have already prevented them from occurring. They are a ticking time bomb for families, individuals, and the American economy.

Instead, the Senate continues to dawdle on non-starter proposals, like the Buffett Tax. That so-called deficit reduction proposal is so backwards, that it actually loses $793 billion over the next ten years if it is implemented in the way proposed by President Obama in his most recent budget. That is, if the Buffett Tax replaces the AMT as President Obama says it should, we actually increase the deficit by $793 billion over the next ten years alone.

Unfortunately, some view the expiration of such a large part of our tax code at the end of the year as a bonanza for big government. Deploying the tired rhetoric of class warfare, they welcome these tax increases, which will finance every higher government spending.

But make no mistake about it. This impulse to increase taxes at all costs risks a recession. Congress should come together and act to prevent this historic tax increase that is hanging over the nation's head like the Sword of Damocles. Doing so would greatly improve the taxpayer experience by giving taxpayers more predictability and allowing the IRS to put out more complete and timely guidance for taxpayers.

With respect to the IRS's performance when it comes to the tax filing experience, I will say that one thing that stands out is its stated goal of answering 61 percent of phone calls from taxpayers. I have heard of setting the bar low so that it's easy to exceed expectations, but 61 percent of phone calls answered is simply not good enough. It would earn a student a D-minus at best, and that is probably grade inflation.

On this issue, I would give the IRS a failing grade, and I suspect that the nearly 40 percent of taxpayers whose calls go unanswered would agree.

And I would like to extend a special welcome to Mr. Troy Lewis who comes from Utah and has a wide array of experience with taxes. He is an adjunct professor at Brigham Young University, owns his own CPA firm, is a Vice President at Heritage Bank in Saint George, Utah, and spent the majority of his career at a large accounting firm in Salt Lake City. I want to thank you all for coming here this morning.

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TESTIMONY OF TROY K. LEWIS, CPA
BEFORE THE SENATE FINANCE COMMITTEE
U.S. SENATE
HEARING ON
TAX FILING SEASON: IMPROVING THE TAXPAYER EXPERIENCE
April 26, 2012

Chairman Baucus, Ranking Member Hatch, and members of the Senate Finance Committee ("Committee"); I appreciate this opportunity to address the topic of improving the taxpayer experience. My name is Troy Lewis. I am a Certified Public Accountant ("CPA") and Vice President with Heritage Bank a small community bank in St. George, Utah. I am also the sole proprietor of a small CPA firm, Lewis & Associates, CPAs, LLC based in Draper, Utah, as well as an adjunct professor of accounting and taxation at Brigham Young University in Provo, Utah. I also currently serve as a member of the American Institute of Certified Public Accountants' Tax Executive Committee. My testimony today is based primarily on my experience in performing tax-related work for small businesses, individuals and other tax professionals through my current role with Heritage Bank, my current CPA firm practice, my service on the AICPA's Tax Executive Committee, as well as my previous professional positions with national accounting firms.

I believe the taxpayer experience can be improved through Congressional oversight and action, administrative actions and guidance as well as overall improved communication. In this context, my comments focus on the following areas of concern and opportunity for improvement: (1) tax reform; (2) correspondence examinations; (3) due dates; and (4) basis reporting.

1. TAX REFORM

The Internal Revenue Code ("Code"), Treasury Regulations, and other administrative pronouncements impose too many compliance and filing burdens on small businesses. Accordingly, to improve the taxpayer experience, tax reform should encompass simplification proposals designed to alleviate the complexity and burdens placed on small businesses. Many small businesses are organized as entities other than C corporations. Tax reform therefore cannot merely involve changes to corporate tax rates or other tax provisions targeting C corporations if the desired impact is to help all small businesses overcome the burdens and complexities of tax compliance. These improvements must target other key areas.

There are a number of areas in the Code that impose substantial burdens on small businesses and individuals, including "pass-through entities" such as partnerships and S corporations. Simplification is needed in areas such as depreciation, the Alternative Minimum Tax ("AMT"), certain partnership tax provisions, education deductions and credits, retirement plans and small business provisions that exclude non-corporate entities. A key point that would also significantly improve the taxpayer experience would be minimizing the overall uncertainty throughout the Code and expanding provisions intended to help small businesses and individuals specifically focusing on non-corporate entities.

Depreciation

Depreciation is an area that should be simplified in order to improve the taxpayer experience.[1] The depreciation methods required by the Code are different than those used for financial accounting. There are differences in depreciation methods between financial and tax accounting methods based primarily upon the different conventions, recovery period and different rules based upon when the asset was purchased. In recent years, there have also been provisions added to provide for "bonus" depreciation and increased recovery amounts under Code Section 179. An asset bought during 2012 might have several different calculated basis recovery amounts depending upon whether or not it was purchased new, when it was purchased, the amount of taxable income of the taxpayer for the tax year and the amount and the timing of other assets that will be purchased by the taxpayer during the year. Taxpayers therefore don't know what to expect in terms of basis recovery on an asset purchased in January 2012 until at least December 2012. This delay produces uncertainty and distrust in the tax system. Planning for the net cash flow from the purchase of an asset in such a case is difficult at best.

There are several depreciation "books" often maintained by a business on the same exact assets. It is not uncommon to find depreciation records being maintained for financial accounting, regular tax, AMT and then depending upon the states in which the business operates a whole new set of tax books using state specific modified rules. In the end, the purpose of the depreciation rules is to provide a consistent approach for the recovery of cost basis for assets used in a trade or business. However, because of the various depreciation books required to be maintained, the whole area of depreciation has led to excessive complexities. The taxpayer's experience will be improved if Congress will work to modify the depreciation process so that the redundancy of multiple calculations to calculate the cost basis for the same asset potentially six or seven different ways (if multiple states are involved) is reduced.

In recent years, Congress has acted in some limited form to reduce such complexity by increasing the Code Section 179 limits and expanding the definition of qualified Section 179 property to include qualified leasehold property. Such action did reduce the administrative burdens placed on small business. I commend Congress for such actions. The small business owner needs more of this type of solution in the future to reduce complexity.

Depreciation rules should be simplified to provide for a more basic approach with fewer alternative methods which would serve to not only reduce confusion and unintended consequences but also to permit taxpayers to better plan for their capital needs in the future.

Alternative Minimum Tax

Small businesses, including those operating as pass-through entities, are increasingly more vulnerable to being subject to AMT. The AMT was created to ensure that all taxpayers pay a

[1] See *Background and Present Law Relating to Cost Recovery and Domestic Production Activities* prepared by the Staff of the Joint Committee on Taxation for a Public Hearing before the Senate Committee on Finance on March 6, 2012, JCX-19-12.

minimum amount of tax on their economic income regardless of the regular income tax laws. The AMT is one of the tax law's most complex and least understood components.[2]

As you know, the AMT is a separate and distinct tax regime from the "regular" income tax that requires the taxpayer to make a second, but parallel computation of their taxable income. This second parallel system is applicable to not only large businesses but also small businesses operating in various entity forms.

Small businesses must maintain complicated annual records to be used in computing the AMT as well as any resulting credits that may be utilized in the future to reduce the taxpayer's regular tax liability. This second calculation often produces complications and unforeseen adjustments that produce unanticipated results for small business owners. The calculation related to the AMT credit alone can be difficult as the taxpayer is forced to separate AMT differences between adjustment and preference items and to recalculate the AMT for a given year to determine the extent the AMT is as a result of any one particular item.

The number of taxpayers facing potential AMT liability is expanding significantly. Middle-class taxpayers with basic itemized deductions can be subject to the AMT for no other set of reasons other than the fact that they pay real estate taxes on their home, pay income taxes to a state and have several dependent children.

Today, Congress continues to extend the AMT exemption amount or the so-called AMT patch on a year by year basis in order to provide individual taxpayer inflation–adjusted relief from the AMT. This process produces annual uncertainty for middle-class taxpayers. The number of taxpayers currently paying some amount of AMT is at a historical high. Without the added annual AMT patch the amount of impacted middle-class taxpayers would clearly rise significantly.

Due to the increasing AMT complexity, the AMT's impact on unintended taxpayers, and AMT compliance problems, I suggest Congress strongly consider repealing the individual AMT altogether. However, I recognize that simply eliminating the AMT would generate a large loss of tax revenue that would accompany such a move. AMT repeal is perhaps best accomplished as part of an entire Code reformation project. In the end, eliminating the AMT in exchange for modifying and simplifying some existing regular tax provisions will work to simplify the Code and to therefore increase the confidence in the tax system by many middle-class taxpayers.

While the objectives of the AMT are well known and perhaps supportable, it is my opinion that the burdens on small businesses and individuals can be reduced without unduly compromising revenue generation objectives.

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[2] See *Present Law and Background Relating to the Individual Alternative Minimum Tax* prepared by the Staff of the Joint Committee on Taxation for a Public Hearing before the Senate Committee on Finance on June 27, 2007, JCX-38-07.

Certain Partnership Tax Provisions

Partnership tax rules are among some of the most complex in the Code. Yet because of the federal tax law's flexibility in utilizing partnerships, these partnership entities still remain a very popular choose among small businesses today. Many small businesses are organized in such a way as to permit them to be taxed as partnerships.

However, the tax implications of various transactions for partners in a partnership are often very different from shareholders in C or S corporations, or even sole proprietorships. The result is that there can be inequality of taxation outcomes strictly based upon entity type even when there appears to be very little policy reason for such a distinction.

Today there exist two particular partnership related issues that are in need of improvement:

First, in most cases, a partner in a partnership is not allowed to receive a W-2 for the services he or she may provide to a partnership during the year but rather such earnings are taxed as self-employed compensation through allocations of earnings. This treatment is inconsistent with how a similarly-situated shareholder would be taxed related to their performing services for an S or C corporation. In the end, the same amount of payroll taxes will have been paid to the government but because of the entity differences, the partner/owner is treated differently. This particular payroll issue has caused tremendous confusion and misinformation within the tax preparer community. Compliance with and respect for the laws governing this partner/self-employment tax issue is at a low point. This portion of the law remains somewhat unsettled based partially upon Congressional action and inaction[3] and the IRS current stance.[4] As a result, there is a wide degree of interpretation of the law based primarily upon the lack of Congressional action. I would urge Congress to act to resolve this discrepancy. My sense is that the Social Security Trust Fund is collecting far less in taxes than it ought to collect in this area simply because the law has not been made clear enough to taxpayers and their tax advisors. Resolving this issue will also not only stabilize the payroll collection for partners but it could also potentially resolve for the need for unnecessary controversy between taxpayers and the IRS. Most importantly, allowing W-2 treatment for services would also enhance the taxpayer experience in that there would be certainty.

Second, partners that participate in the trade or business of their respective partnerships should be assessed self-employment taxes based upon the fair value of their services. Likewise, partners should be allowed to separate a return on their invested capital from their distributive share attributable to their service. Congress should consider adopting legislation that would permit such separations in interest so that the amount of self-employment income assessed to each partner would be more certain. By adopting legislation that permits such a distinction, Congress would help to resolve present-day confusion and misinformation in this area as well as provide for a more uniform and predictable outcome between entity types.

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[3] See Section 935 of the Taxpayer Relief Act of 1997

[4] Proposed Treasury Regulation Section 1.1402(a)-2

Education Deductions and Credits

By my last count there are currently two income tax credits, four income tax deductions and two different and distinct types of educational savings plans designed to accomplish and encourage taxpayers towards the same basic goal: that of encouraging Americans to seek out higher education. Each one of these ideals is fundamentally sound in its approach. Each serves a purpose. Over time these various provisions has been adopted on a year by year approach. Looking back, it is very easy to see why we have collected such an eclectic group of common-minded provisions. But each different provision has its own separate limitations, phase-outs, maximum and minimums, and overall applicability requirements. This multi-choice experience confuses taxpayers and their advisors and often can lead to different "best" answers on a year by year basis based upon a taxpayer's individual situation.

In my view, the time has now come to simplify and reduce such provisions. We don't need all of these different provisions to motivate and encourage the citizens of this country to seek out higher education. I urge Congress to combine and merge several of these provisions such that the number of available choices for taxpayers will be limited to a brief conversation with their tax advisor instead of today's process of making various assumptions to predict the "right" potential educational option for a taxpayer.

Numerous Retirement Plans

There are too many options for retirement plans that businesses need to consider before deciding which is appropriate for them. These options include a SEP, SIMPLE, SARSEP, 401(k), profit sharing plan, defined benefit plan, money purchase plan, ESOP, SIMPLE 401(k), Solo 401(k), among others.[5] Some plans are only available to employers with a certain number of employees while other plans require mandatory contributions and higher administrative burdens. Some of the administrative burdens would include annual return filing, discrimination testing, etc. To determine which plan is right for their business, owners must often consider their cash flows, projected profitability, anticipated growth of the work force, and expectations by their employees and co-owners. What plan type is right for a small business owner might change from year to year based upon the operational changes of the business.

It appears that the diversity of plans came about because of Congress' intent to create plans for small business owners that were easier to manage, allowed for more flexibility in funding, and created choices for different sized entities. Over the years, however, as new and existing plans have been added, modified, adjusted, expanded and limited, the complexity associated with the general good intent of the provisions has risen dramatically. We are now at a point where the choices can be overwhelming and many are too complex or costly for the small business owner to be able to benefit. I urge Congress to act to phase out and merge several of these plans into just a few simple choices whereby Americans and their employers would receive more encouragement to save for retirement in a tax-deferred, simple and uncomplicated manner. The status-quo is too unnecessarily complicated.

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[5] See *Present Law and Background Relating to the Tax Treatment of Retirement Savings*, Prepared by the Staff of the Joint Committee on Taxation, for a Public Hearing before the Senate Finance Committee on September 15, 2011.

Small Business Provisions that Exclude Non-Corporate Entities

Some tax provisions that have been passed by Congress are applicable only to businesses operated in C corporation form. For example, laws designed to allow a certain percent of gain recognized on the sale of the certain stock of a business under Code Section 1202 or a potential deferral from the sale of a business under Code Section 1045 (Qualified Small Business Stock) are applicable only to businesses and their owners operating in C Corporation form. There appears to be little policy reason why such benefits could not be extended to businesses operated for instance, in partnership form.

Under Code Section 118, C corporations are allowed to receive contributions to their capital on a tax-free basis from non-owners under certain limited situations. This provision is often utilized to allow municipalities to partially fund community improvement projects with for-profit entities in a way that does not needlessly generate taxable income to the for-profit entity. However, Code Section 118 does not apply to businesses organized and conducted as partnerships. A large percent of new businesses being formed today are done so as federal taxable partnerships. Thus, a contribution from the local municipality to an entity to construct the same local improvement project might be taxable as gross income to one taxpayer operated as a partnership and non-taxable to the taxpayer operating as a C corporation. When two similarly situated taxpayers in the same business find themselves in a very different tax positions relative to a contract with a municipality for no reason other than entity choice, taxpayer confidence in the taxing system, and their sense of fairness, is weakened.

As future modifications to the Code are made or as new provisions are added, I would urge Congress to include in the dialog the concept of entity choice and current business practices. I believe that a recognition that many small businesses today are formed in the pass-through entity form will lead Congress to design incentives and Code modifications to better allow the majority of new businesses to take full advantage of well intentioned Congressional changes.

Uncertainty of Tax Law

Although the IRS attempts to educate taxpayers regarding new tax laws, which are passed after the tax year has commenced, taxpayers are often unable to or often fail to take full advantage of the intended benefits. Even in today's electronic communication age, business owners often find themselves unaware of tax law changes until after the close of the year when they meet with their tax professional to prepare their income tax return. Thus, most tax motivating provisions in the Code which involve immediate applicability and are effective for only a short period of time often go unnoticed and unappreciated by many taxpayers. This failure of the taxpayer to be notified is a shortcoming of the system, and, in my view, substantially reduces the effectiveness of the laws which Congress has enacted for various short-term objectives.

In 1788 in the *Federalist 62*, James Madison wrote:

> In another point of view, great injury results from an unstable government. The want of confidence in the public councils damps every useful undertaking, the success and profit

> of which may depend on a continuance of existing arrangements. What prudent merchant will hazard his fortunes in any new branch of commerce when he knows not but that his plans may be rendered unlawful before they can be executed? What farmer or manufacturer will lay himself out for the encouragement given to any particular cultivation or establishment, when he can have no assurance that his preparatory labors and advances will not render him a victim to an inconstant government? In a word, no great improvement or laudable enterprise can go forward which requires the auspices of a steady system of national policy.

During the last few years there has been a fair amount of tax legislation designed to stimulate the economy. Small businesses can be overwhelmed by the barrage of changes to the tax laws and regulations which occur late in the tax year and leave many taxpayers with neither the time nor the ability to evaluate properly the impact of the changes on their businesses. For example, during 2011, a taxpayer, needed to choose the correct and most beneficial depreciation method from a menu of choices, which necessitated cumbersome alternative computations. Taxpayers buying new equipment in 2011 had to evaluate their cost basis recovery options by potentially selecting one of several ways to recover the cost of the equipment with each having its own set of qualifications, criteria for applicability and speed of recovery. All of these computations related to the same basic objective: basis recovery of the purchase of an asset.

Actions regarding the use of temporary provisions have also created uncertainty. While some measures, such as those designed for economic stimulus, may be appropriate for temporary and sporadic use, temporary tax provisions, including many incentive provisions, have become far too common.[6] The uncertainty associated with this annual list of extenders weakens the confidence in the tax system by the taxpayer.

These somewhat frequent changes to the Code also work to lessen the confidence of the general public in the United States taxation system overall. The initial First-Time Homebuyer Credit is an example of a stimulus concept that was somewhat well received initially but in the end may have been tarnished somewhat by the very taxpayers that availed themselves of the tax credit. The home builder and real estate community did a reasonable job of educating the general public of this provision. In Heritage Bank's lending area we saw some increased buying activity as a result of this credit. The credit provided first time homebuyers with an income tax credit in the year of the initial purchase of their residence with the mandate that such tax benefit be recaptured back into subsequent succeeding tax returns over the next fifteen years. Then after the applicability of the initial credit expired, an extension/modification of the income tax credit was provided that not only raised the amount of the potential credit but also waived the recapture of any of the prior credit benefit. Thus, two first-time homebuyers living side by side separated only by a few months in the closing of their respective homes found themselves in completely different tax situations. Make no mistake that the first homeowner that availed themselves on the initial credit received exactly what they bargained for but such cannot hide the fact that once the first buyer realized that but for a few months their situation was far less favorable to that of their neighbor, the first buyer was disappointed and their level of reliance and trust in the tax system was shaken.

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[6] See *List of Expiring Federal Tax Provisions 2011-2012*, Prepared by the Staff of the Joint Committee on Taxation, January 6, 2012, JCX-1-12.

In the course I taught at BYU this past winter, one of the most difficult subjects to teach was that of the self-employment tax; not because of technical difficulty but rather due to uncertainty. In mid February 2012, I was asked by a student, after teaching the self-employment tax law as it applied to 2011, to explain how the self-employment tax was to be calculated for 2012. I explained that I could only accurately predict what the law would provide through the end of February 2012 as the 2% employee portion of the payroll reduction may or may not be extended for the entire 2012 tax year like we had just seen in 2011. The student asked how a small business owner could possibly plan or prepare for the 2012 tax year then not knowing what law would be effective in six months let alone in two weeks. For that question, I had no good answer.

Although there are often good reasons which may argue for a quick change in the Code and/or for a short-term stimulus provisions, I would submit that such changes often will have significant unintended consequences. As part of the tax reform movement, I would urge the Congress to have a bias to minimizing provisions that are either short-lived or retroactive. By doing so, I believe that Congress will enhance the confidence of taxpayers in the United States taxation system and further provide a definitive course that will allow taxpayers to adequately plan for their future while improving the taxpayer experience.

2. CORRESPONDENCE EXAMINATIONS

According to the IRS Oversight Board, correspondence examinations have grown from 72 percent of all IRS examinations in fiscal year 2001 to 78 percent in fiscal year 2010[7]. Of even further significance, these statistics are even more startling when taking into account that correspondence audits amounted to 54 percent of all examinations in fiscal year 2000.[8] Further, according to a 2009 report by National Taxpayer Advocate Nina Olson, "IRS employees spent an average of only 1.6 hours in 'direct time' on each correspondence examination in FY 2008, as compared to 8.5 hours on each office examination, and 46.4 hours on each field examination."[9]

The IRS Oversight Board's stated goal of developing the correspondence examination into a more efficient and taxpayer friendly method of examination is commendable. However, the program as it exists today is in need of improvement.

Improvements for the Correspondence Examination Program

I have spoken with a number of CPAs in my local community about the problems taxpayers have faced with correspondence examinations. These CPAs have raised concerns about: (1) the excessive time it takes the IRS to resolve a taxpayer's case; (2) the great difficulties taxpayers face when trying to contact the IRS to obtain information regarding the status of their correspondence audit case; (3) the numerous telephone inquiry calls taxpayers or their tax representative make to the IRS which go unreturned; and (4) the IRS employees routinely closing cases without having reviewed correspondence submitted by the taxpayer. The IRS will

[7] IRS Oversight Board letter, dated January 11, 2012, to Edward Karl, AICPA Vice President-Taxation.
[8] National Taxpayer Advocate 2009 Annual Report to Congress, December 31, 2009, Volume 1, page 158.
[9] Ibid, page 158.

need to continue to address these kinds of issues in order to reduce taxpayer's burdens related to correspondence audits.

IRS delays in the posting or proper handling of correspondence mailed by a taxpayer to the IRS stands out as a huge concern of CPAs about the correspondence examination program. This is consistent with a February 2011 report of the Treasury Inspector General for Tax Administration (TIGTA).[10] According to the report, the IRS indicated to the IRS Oversight Board in 2009 that it would target three areas for improvements regarding its correspondence audit program, including mail processing. The TIGTA report discusses a "judgmental sample" of 24 default cases after receiving concerns that IRS employees were not following proper procedures in handling taxpayer correspondence. In 17 of these cases, it was concluded that IRS staff did not consider the taxpayers' correspondence prior to closure of the cases. Moreover, in 10 of these 17 cases, the taxpayers' correspondence was not input into the IRS's computer system within the required time period, resulting in the IRS employees involved with the correspondence audit program not being aware that correspondence had been received prior to closure of the cases.

The 2011 TIGTA report mentions that the Wage & Investment Division (W&I) began piloting a centralized model for processing incoming mail at the Austin Compliance Site in February 2010. This pilot provided for the centralization of all mail processing and it included flexibility in planning and staffing. The TIGTA report states that the IRS planned on implementing this model at all W&I and Small Business/Self-Employed compliance sites by June 2011. I recommend that the Senate Finance Committee obtain updated information from the IRS regarding how these new centralized mail processing procedures are presently working.

Unfortunately, based on the informal reactions of other CPAs, no discernible improvements in the handling of taxpayer correspondence mailed to the IRS in response to a correspondence examination have been seen. Thus, to the extent problems continue with mail processing, even with these new centralized procedures in place, I recommend that the managers of IRS employees become more involved with resolving issues with respect to correspondence audit cases more than 6 months old.

With respect to faster account resolution, I suggest that the IRS explore the potential for expanding its e-Services suite of web-based products to handle correspondence submitted by a tax professional on a taxpayer's behalf. Currently, certain tax professionals with proper authorization may use e-Services for disclosure authorization, electronic account resolution, and transcript delivery. If e-Services could be expanded to effectively act as a "portal" for correspondence submitted on the taxpayer's behalf, I believe significant opportunities might be created for resolving correspondence examinations more timely, including the prospects that the correspondence submitted through e-Services might be electronically date-stamped as to its submission date.

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[10] See Treasury Inspector General for Tax Administration Report on "Progress Has Been Made to Re-Engineer the Examination Program, but Additional Improvements Are Needed to Reduce Taxpayer Burden, February 18, 2011.

Correspondence Examinations and Taxpayer Rights

In addition to its February 2011 report, TIGTA has released a number of reports raising concerns about the correspondence examination program and taxpayer burden. Similarly, in her 2011 report to Congress, National Taxpayer Advocate Nina Olson raises significant concerns about the IRS's ability to respond to telephone calls and correspondence from taxpayers.[11] I join CPAs and other tax professionals who support TIGTA's and the National Taxpayer Advocate's concerns about the linkage between improving taxpayer service and the ability of the IRS to properly address taxpayer rights. The IRS has made positive strides by improving its telephone customer service lines and the handling of taxpayer correspondence, but obviously further improvements are warranted.

As part of a correspondence examination, taxpayers are often requested to substantiate specific tax deductions like miscellaneous itemized deductions, state and local income taxes, and real estate taxes. However, it appears that the IRS may be making this substantiation request to a large number of taxpayers who happen to be in an alternative minimum tax position, where these types of deductions have no impact on the taxpayer's ultimate tax liability. The net result is a "no-change" audit for the taxpayer and a waste of IRS resources. I suggest that the IRS create an additional "filter" for its correspondence audit selection process to remove these types of cases from the IRS's active case file. My last correspondence audit involved a request to substantiate miscellaneous itemized deductions. Knowing that such amounts were fully supportable and being unable to contact anyone at the IRS to explain why such efforts on my part would be wasted, I simply advised my client to comply rather than to risk a default judgment. Had additional filters been in place or had a dedicated person at the IRS been available for consultation, the increased time, fees and effort could have been minimized and/or avoided. I see signs of progress in the process with the recognition that there is more work to be done.

3. <u>DUE DATES</u>

I would like to highlight S. 845, the Tax Return Due Date Simplification and Modernization Act of 2011, introduced by Senator Michael Enzi and co-sponsored by Senator Olympia Snowe. While many of the original and extended due dates for important tax and information returns have been in place for years, S. 845 recognizes that compelling reasons now exist for changes in these due dates. This proposed legislation has also received the support of the American Institute of Certified Public Accountants and its Tax Executive Committee.[12]

The interconnectedness of business entities and those who own them now demand a more logical flow of information between parties. Tax returns no longer serve only as a means for taxpayers to self-report and pay their tax liability to the government. Taxpayers, as part of their tax compliance process, equally rely upon the return information of others to properly report their own tax liability to the government. Individuals, S corporations, C corporations, trusts and other partnerships may all invest in or operate partnerships and, if they do, require Schedules K-1 (Form 1065) before completing their returns. S. 845 highlights that the current two-step due-date

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[11] National Taxpayer Advocate 2011 Annual Report to Congress, December 31, 2011, Volume One, op. cit., page 9.

[12] Letter to The Senate Finance Committee and House Committee on Ways & Means dated October 8, 2010 by Patricia Thompson.

system for most major returns does not reflect a logical flow of information between or among parties; and thus, the legislation acknowledges that change in the current due date structure is imperative.

Historically, calendar-year C and S corporations have been required to file their tax returns by March 15th (with an extension, to September 15th) while individuals, trusts and partnerships have been required to file by April 15th (with an extension to October 15th). Since January 1997, when the "check-the-box[13]" regulations became effective and "eligible" entities found it easy to file as partnerships, the formation of new limited liability companies, limited liability partnerships and similar state law entities (collectively, LLEs) increased exponentially resulting in a dramatic increase in the number of partnership returns being filed. Understandably, the number of individuals and entities, including S and C corporations, trusts and estates *that invest in LLEs and other federal tax partnerships* has grown significantly causing a dramatic increase in the number of taxpayers that rely on information from partnerships and other pass-through entities in determining taxable income.

The use of tiered partnership structures has also increased in recent years -- and with it, the complexity of tax compliance -- by vehicles such as hedge funds, master limited partnerships, business trusts, series LLCs and private equity funds to address nontax issues such as litigation and other risks and to facilitate increasingly complex financial transactions. Further, the increased complexity of the Code and other tax laws has resulted in the need for significantly greater information gathering and analysis. In this new environment, practitioners and taxpayers often find that the current ordering of tax return due dates for partner (i.e., individual, C corporation, S corporation, trust, or other partnership) and partnership make the timely filing of complete and accurate returns difficult, if not impossible to meet. In far too many cases, it has become impossible for the ultimate owner of a partnership interest to obtain the information needed to prepare tax returns on a timely basis. Increasingly complex partnership transactions and reporting requirements have added to return preparation time as additional analysis time is needed to ensure accuracy.

Thus, S. 845 strives to address these problems and improve the prospects for the timely filing of the tax returns of partners, returns that are often not prepared by the same individual or firm that prepared the partnership's return. I encourage Congress to pass this legislation and help modernize the tax return due dates and to correct the mismatch of information flow that persists in the system today. By doing so, Congress will continue to improve the taxpayer experience.

4. **BASIS REPORTING**

The IRS views information reporting as a great opportunity for increasing compliance by taxpayers. Unfortunately, it can also result in an increase in burden for taxpayers. It is in this context that many CPAs are concerned about the issue of basis reporting. I have been hearing from many CPAs about the challenges they faced with respect to the just completed filing season. One of the biggest challenges involved the Forms 1099-B taxpayers are receiving from brokerage firms regarding the "covered" and "uncovered" securities sales taxpayers made during 2011. While brokers were generally required to mail the Forms 1099-B to taxpayers by February

[13] See Treasury Reg. §§301.7701-1 through 301.7701-3.

15 to ensure timely filing of a taxpayer's return, it seems like many brokers have had great difficulties in compiling and reporting the information correctly to taxpayers on a timely basis. It is my understanding that this situation has resulted in major financial institutions having requested extensions of the February 15 transmittal due date to taxpayers.

CPAs are also reporting that wide divergences exist in the format brokerage firms are following with respect to reporting information on Form 1099-B. It almost seems as though nobody's Form 1099-B is the same from broker to broker. For example, one CPA's client has reported that his Form 1099-B actually lists trades that never took place, or it lists amounts for securities trades that are not correct. For other clients, I have heard reports that some brokerage houses have inadvertently reported certain securities sales as "covered" when they should have reported as "uncovered" and vice versa. I have observed inconsistent reporting in my own practice.

Another aspect of this dilemma involves the reporting complexities of Schedule D and Form 8949 which the IRS has adopted for reporting securities sales on 2011 tax returns. The IRS appears interested in entering into a dialogue with CPAs and other tax professionals regarding the complexities with basis reporting. Some possible solutions to the complexities involved with basis reporting include (among others): (1) standardization of the way brokers report securities sales and basis on Form 1099-B; and (2) a suggestion that the IRS forgo "matching" of basis information for purposes of 2011 tax returns.

The 2011 tax year was the initial year that would require credit and merchant card-paying companies to issue tax filing reports to the merchants that they paid related to credit card transactions. Thus, each major credit card company was required to report to each merchant the amount of money that was paid to the merchant, above certain levels, related to credit card processing payments. The stated intent of the reporting requirement was to increase the tax reporting accuracy from businesses related to credit card payments received. These payments are reported on the new 1099-K form.

However, in late December 2011, the IRS, after listening to various constituents and internally reviewing the known weaknesses in the initial filing season of the 1099-K, opted to still require the filing of the forms but to delay enforcement of compliance as long as there was real intent by the reporting parties to comply with the filing obligations. Common thought among the practioner community has been that the IRS will not be attempting to match these 1099-Ks to tax filings until the short-comings in the reporting system can be resolved. I would strongly recommend that the IRS be encouraged to do the same thing related to the new 1099-B reporting system. This forgoing of the match will permit the additional issues to be resolved prior to needless correspondent type audits being conducted to match against misreported 1099-B information.

Again, thank you for this opportunity to present my views and I wish you well in your efforts to improve the taxpayer experience.

WRITTEN STATEMENT OF

TERESA THOMPSON

LOCAL TAXPAYER ADVOCATE
MONTANA

HEARING ON

FILING SEASON 2012

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

APRIL 26, 2012

Chairman Baucus, Ranking Member Hatch, and distinguished Members of the Finance Committee:

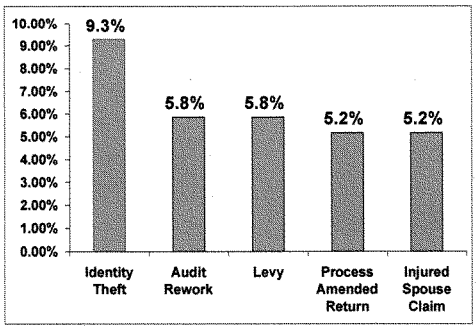
Thank you for inviting me to testify about the issues my office faced during the 2012 tax filing season and the assistance we provide to taxpayers located in Montana. I am the Local Taxpayer Advocate (LTA) for the state of Montana. My office is in Helena, the state capital, where I have a staff of four extremely dedicated advocates to help me serve the taxpayers in Montana.

There are over 70 Local Taxpayer Advocates like myself around the nation, with at least one in every state, the District of Columbia, and Puerto Rico. We are all part of the Taxpayer Advocate Service (TAS), which is an independent organization within the IRS. We report to the National Taxpayer Advocate (NTA), who in turn is charged with submitting independent reports directly to the Senate Finance and House Ways and Means Committees.

TAS acts as a safety net for taxpayers. Our goal is to help taxpayers resolve problems with the IRS that they cannot resolve by themselves. Sometimes taxpayers need our help because the IRS is administering the tax law in a way that creates or aggravates a financial difficulty, emergency, or hardship. In those cases, we compel the IRS to move faster than it normally does. Sometimes taxpayers need our help because their cases involve unique facts and the IRS is taking a "one-size-fits-all" approach that does not resolve their problems. In other situations, the taxpayer has tried to resolve the problem through normal channels with the IRS, but the process has simply broken down, making resolution impossible without our help.

The chart below shows the top five issues we have received in the Montana TAS office through the first half of fiscal year (FY) 2012.

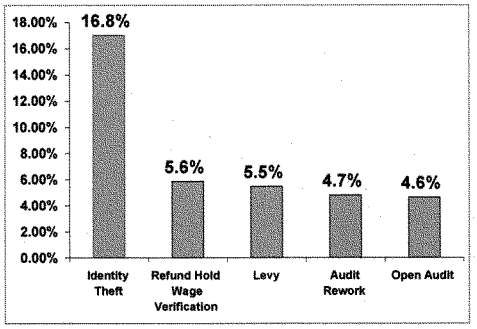
Chart 1: Top five TAS issues in Montana, based on percentage of new case receipts from Oct. 1, 2011 thru Mar. 31, 2012*



*Source: Taxpayer Advocate Management Information System (TAMIS) database.

The following chart shows the top five issues in TAS nationwide through the first half of FY 2012. As you can see, although my office is relatively small, the cases we receive from Montana taxpayers mirror the problems of other taxpayers across the country, particularly in identity theft, levy issues, and reworking closed audits.

Chart 2: Top Five TAS Issues nationwide, based on percentage of new case receipts from Oct. 1, 2011 thru Mar. 31, 2012*



*Source: TAMIS database

Local Taxpayer Advocates, like myself, serve as a bridge between the bureaucratic and legal complexity of the IRS and the individual, business, and nonprofit taxpayers who sometimes become entangled in that complexity. We advocate within the IRS for the taxpayers who need our services. In fact, at TAS we call ourselves "Your Voice at the IRS."

In my testimony today, I will make the following points:

1. Budget and staff reductions at IRS toll-free sites and walk-in offices are making voluntary compliance by Montana taxpayers more difficult.

2. The introduction of Virtual Service Delivery (VSD) with two-way video conferencing between TAS and Montana citizens could make it easier for taxpayers in states like Montana to voluntarily comply with the tax law.

3. The dramatic increase in tax-related identity theft cases in the last few years is harming Montana taxpayers, whether or not they are victims of tax-related identity theft themselves.

4. IRS correspondence audits are frustrating, time-consuming, and ineffective for many Montana taxpayers.

5. Congress should always consider the unique status of Indian Tribal Governments when drafting new federal tax legislation.

6. The Low Income Taxpayer Clinic in Montana helps disadvantaged taxpayers meet their federal tax obligations and protect their rights

I. Budget and staff reductions at IRS toll-free sites and walk-in offices are making voluntary compliance by Montana taxpayers more difficult.

The TAS office in Montana has experienced staffing cutbacks in FY 2012, as have other TAS offices, and the IRS as a whole. For example, my office has not had a secretary to answer the phone during the entire filing season.

a. The IRS does not do a good job of answering its phones.

As I mentioned previously, mine is the only TAS office for the entire state of Montana. As you can imagine, we hear from a wide variety of taxpayers. For instance, taxpayers and their representatives call us if they cannot reach an IRS toll-free site because the lines are too busy. We also hear from taxpayers who live too far away from an IRS Taxpayer Assistance Center (TAC), *i.e.*, a walk-in office, to visit personally. Sometimes, we hear from taxpayers who just want a "live person" to help them because they cannot navigate through the IRS phone system.

In January, February and March, the phone logs in my office show that we answered 717 calls that were not related to cases we were currently working for taxpayers in TAS. We provided direction to these taxpayers or answered their questions whenever possible. I personally answered about 80 percent of the 717 calls that were not related to cases. I patiently listened to the callers' frustration about the complexity of the tax code and their inability to reach IRS personnel to answer their questions.

b. TAS taxpayers suffer when taxpayers cannot reach the IRS.

The time my staff and I spend on the phone with these taxpayers takes us away from the taxpayers who really need our help. These are the taxpayers whose cases we have accepted into TAS because their problems have reached the point where they need our advocates to resolve them.

We assign an employee, called a Case Advocate, who takes personal responsibility for the taxpayer's problem until it is fixed. I am privileged to have three such employees working for me in Helena, plus an employee called an Intake Advocate who screens taxpayers for entry into TAS. My staff consists of the most efficient, hard-working group of people I have ever had the pleasure to

work with in my 38 years with the IRS. I am proud to say that they are a microcosm of TAS employees throughout the country.

However, when the IRS cannot answer its phones or staff its walk-in offices, my staff and I are frequently pulled away from the very people who have been assigned to us because their problems are so serious. The majority of taxpayers assigned to my office are Montana residents, so when the IRS cannot answer its phones or staff its walk-in offices, Montana residents with the most serious problems pay the price.

As a remedy, I would suggest the following:

- The IRS needs to answer its toll-free phone numbers so confused and frustrated taxpayers get the help they need; and
- The tax code should be simplified so any taxpayer can understand his or her tax obligation and not wonder how it came to be.

c. There is no IRS Appeals Officer in Montana.

The IRS has no Appeals Officers in Montana and nine other states, plus Puerto Rico, and has no Settlement Officers in Montana and fourteen other states.[1] This means that when taxpayers or their representatives need a face-to-face meeting with an Appeals Officer, an Appeals "circuit rider" must arrange to travel to Montana to meet with them. It would seem appropriate to have an Appeals presence in Montana to afford taxpayers the right to an Appeals hearing with someone familiar with local tax issues. As noted in the National Taxpayer Advocate's 2009 Annual Report to Congress, the Office of Appeals should provide a convenient conference opportunity for taxpayers upon their request.[2]

d. The IRS walk-in site in Helena operates part-time and has no permanent staff.

My TAS office is located in the federal building in Helena, which also houses the IRS TAC office. What I want to share with you is this rather amazing fact: The TAC office in Helena, the capital of Montana, has no permanent staff. IRS employees from other offices in Montana rotate into and out of the Helena office. Further, during this filing season, the TAC office in Helena has been closed on Mondays and Fridays and is open for about five hours per day on Tuesdays and

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[1] According to recent data, ten states do not have Appeals Officers. They are Alaska, Arkansas, Idaho, Kansas, Montana, New Mexico, North Dakota, Rhode Island, Vermont, and Wyoming. In addition, 15 states do not have Settlement Officers. They are Alaska, Arkansas, Delaware, Hawaii, Idaho, Iowa, Kansas, Maine, Montana, North Dakota, Rhode Island, South Dakota, Vermont, West Virginia, and Wyoming. Appeals Officers handle appeals involving assessment issues, such as audit assessments and refund claims. Settlement Officers handle appeals involving tax collection issues. See IRS, Human Resources Reporting Center, *Organizational Location Reports* (Apr. 7, 2012).

[2] National Taxpayer Advocate 2009 Annual Report to Congress 346-350.

Thursdays. Wednesday is the only day of the week that the TAC office in the state capital is open all day.

In addition, the TAC office in Helena does not prepare tax returns for taxpayers, unless they meet certain income and complexity criteria. The office used to prepare returns with less stringent restrictions, but no longer does so. Many of the taxpayers who call my office have been affected by the reduction in hours and service at the TAC, especially by the lack of help preparing returns during filing season.

II. The introduction of Virtual Service Delivery (VSD) with two-way video conferencing between TAS and Montana citizens could make it easier for taxpayers in states like Montana to voluntarily comply with the tax law.

a. *VSD makes sense for Montana taxpayers.*

Virtual Service Delivery provides a two-way videoconferencing environment in which taxpayers and the IRS can interact face-to-face. Having a VSD site, or sites, available for taxpayers to request TAS assistance and provide documentation to help us work their cases would be a big asset for a geographically vast state like Montana. This system would give TAS and the IRS a cost-effective method of resolving the time-sensitive taxpayer issues that come in daily to the Helena TAS office from all over the state. Taxpayers in remote areas such as the towns of Havre, Miles City, Glendive, and the Fort Peck Indian Reservation would benefit from the use of two-way videoconferencing technology. The IRS and TAS are piloting virtual services in a limited number of offices nationwide and hope to expand the program soon. My employees and I look forward to being able to offer these services to taxpayers throughout Montana.

b. *VSD makes sense for the IRS, especially when it conducts correspondence audits.*

The virtual service concept could be especially valuable in helping resolve problems with the IRS's correspondence audits. The IRS conducts these audits by mail, fax, and telephone, with the taxpayer and auditor never meeting in person. Using two-way videoconferencing, a taxpayer could easily supply documentation for items questioned on a tax return and the auditor could complete the audit quickly. This would reduce the expensive downstream costs associated with unsuccessful repeat contacts, audit reconsideration, and appeal requests. It would also reduce the need for taxpayers to contact my office for help because they were unable to communicate directly with IRS auditors.

In a recent blog post, National Taxpayer Advocate Nina Olson sums this up by saying

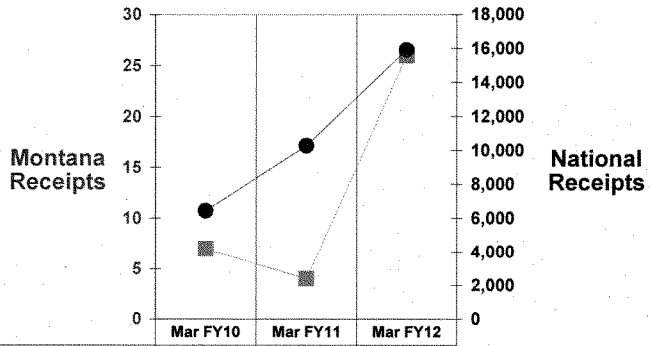
> And wouldn't we want to be sure that our exam processes are designed to elicit the correct result, and are at least flexible enough to consider different ways of proving a taxpayer's tax return position? After all, taxpayers are a very diverse group. Shouldn't a tax agency be able to accommodate its taxpayers' diverse abilities to read, communicate orally, obtain documentation, and explain themselves?[3]

How better to do that than by using technology to communicate in person with taxpayers who don't happen to live near an IRS office?

III. The dramatic increase in tax-related identity theft cases in the last few years is harming Montana taxpayers, whether or not they are victims of tax-related identity theft themselves.

During the 2012 filing season, Montana TAS cases have reflected trends that exist in TAS nationwide, as well as in the IRS as a whole. In particular, Montana has experienced an increase in refund-related identity theft cases. As the chart below illustrates, the upward trend in identity theft receipts in Montana is following the national trend upwards, simply on a smaller scale.

Chart 3: Identity Theft Cases Received in the First Six Months of FY10, FY11, and FY12 (October 1 through March 31 for each fiscal year)*



	Mar FY10	Mar FY11	Mar FY12
Montana ID Theft Receipts	7	4	27
National ID Theft Receipts	6,427	10,272	15,921

Source: Business Performance Management System.

[3] *Virtual Face-to-Face Audits: A Prescription for Curing the IRS's Ailing Correspondence Examination Process*, NTA Blog, April 4, 2012, available at www.TaxpayerAdvocate.irs.gov/blog.

In my office alone, we have six Montana taxpayers whose identities we believe were involved in a single scheme that resulted in returns being filed in the eastern part of the country under their stolen Social Security numbers. These taxpayers experienced financial hardships as a result. We have been working with the IRS to issue their legitimate refunds to them and correct the damage from the scheme.

Some taxpayers filing legitimate returns are also caught up in the IRS's system of detecting identity theft. The IRS uses electronic filters that are intended to screen out fraudulent refund returns, but also sometimes stop legitimate refunds from being issued. When that happens, these taxpayers often come to my office with financial emergencies because they were depending on the refund to make ends meet. We act immediately in such cases to help them prove their returns are legitimate, so the IRS can issue their refund.

From my viewpoint, I would suggest the following:

- The IRS needs to put more resources into assisting taxpayers experiencing significant tax problems caused by identity theft; and
- At the same time, the IRS needs to continue improving its fraud detection filters for identity theft, to avoid harming innocent taxpayers. This is a tall order for an agency experiencing staffing cutbacks.

IV. IRS correspondence audits are frustrating, time-consuming, and ineffective for many Montana taxpayers.

a. *The outcome of correspondence audits is biased in favor of the IRS because the IRS communicates with taxpayers impersonally.*

In recent years, the IRS has expanded the use of correspondence audits. In these audits, the IRS communicates with the taxpayer by mail. The taxpayer never sees the auditor in person. The taxpayer can attempt to call the audit unit assigned his case, but will often reach different people every time he calls and frequently receive a different answer with each call.

The Montana TAS office continues to receive correspondence audit cases that exhibit taxpayer frustration and lack of communication by the IRS throughout the audit process. When a taxpayer or taxpayer representative tries to contact the IRS during a correspondence audit, they are unlikely to reach a "live" body and often must leave a message that may not be returned. If taxpayers do reach an IRS employee on a call and can discuss their case, they will probably not reach the same person the next time they call.

The case advocates in my office regularly hear from taxpayers who want "one IRS auditor" to work with on their case, which is how we handle casework in TAS. The IRS should begin assigning cases to audit employees who will work

the case from beginning to end, contact the taxpayer by telephone if necessary, and receive any mailed documentation needed to resolve the case.

b. *The IRS misplaces or loses taxpayer correspondence during correspondence audits.*

Taxpayers undergoing a correspondence audit have come to the Montana TAS office advising us they have sent information to the IRS multiple times and have never received any acknowledgment. What happens to this mail? Taxpayers and their representatives are frustrated by having to send large amounts of records to IRS campuses, sometimes more than once and at significant cost, with no acknowledgement or acceptance by the IRS. If one person were assigned to a case, that person would be more likely to receive the mail and associate it with the case. Taxpayers subjected to other types of IRS audits, such as office or field audits, are each given one auditor who handles their case. I do not believe that this is too much to ask in a correspondence audit.

c. *The IRS is expanding correspondence audits to inappropriate tax returns.*

The IRS is expanding its use of correspondence audits to returns that do not have specific, clear-cut issues. One such issue that the Montana TAS office has increasingly seen is correspondence audits of employee business expenses. The volume of documentation required to verify employee business expenses is often immense and can include mileage logs, motel receipts, automobile expenses, employer reimbursement statements, and much more. Further, the interpretation of the documentation in these audits frequently requires the auditor to make subtle distinctions between what is allowable and what is not. The type and volume of documentation, plus the nuanced interpretations required, do not lend themselves to a correspondence audit, in which the taxpayer never has an opportunity to clarify disputed items in person. These types of audits require trained auditors capable of discussing issues and the basis for determinations with taxpayers and representatives..

Based on the TAS cases in Montana, I would suggest the following remedies:

- The IRS should conduct additional training in areas such as employee business expenses; and
- The IRS should encourage its correspondence auditors to be reasonable and employ sound judgment.

V. Congress should always consider the unique status of Indian Tribal Governments when drafting new federal tax legislation.

Indian Tribal Governments have a unique status in federal tax law. They "are 'semi-sovereign' entities, or 'distinct, independent political communities' within the

borders of the state in which they reside."[4] This fact is sometimes overlooked when legislation for credits and deductions is written.

A recent case in the Montana TAS office provides an example of this situation. The adoption credit found in Internal Revenue Code (IRC) § 36C allows for an adoption of a "special needs" child as defined in IRC § 36C(d)(3). A "special needs child" is a child who is difficult to place for adoption because of a certain factor or condition, such as the child's ethnic background, age, membership in a minority or sibling group, or medical condition. Under the Code, only *States* are allowed to certify that the special needs requirements in the Code have been met for a specific child. Another part of the Code, Section 7871, explains when an Indian Tribal Government may be treated as a State for tax purposes. Unfortunately, Section 7871 of the Code does not provide that an Indian Tribal Government is a State for the purposes of certifying a special needs child.

This means that taxpayers adopting special needs children directly from tribal reservations, without any involvement by a State, can be denied the adoption credit because they do not have a certification from a State. In some instances, the adopting parents need the adoption credit urgently. Our office had just one of these cases this past filing season.

Native American family structure, which can consist of multiple generations living together in one household, affects eligibility for credits and deductions, such as the EITC, Child Tax Credit, and dependency exemptions. This is another issue we find in our casework in Montana. Tribal governments are unique, require guidance separate and apart from other entities, and should always be considered when federal tax legislation is written.

VI. The Low Income Taxpayer Clinic in Montana helps disadvantaged taxpayers meet their federal tax obligations and protect their rights.

TAS provides an additional safety net for some taxpayers through its administration of the Low Income Taxpayer Clinic (LITC) matching grant program. LITCs provide representation on behalf of low-income taxpayers in disputes with the IRS and educate taxpayers for whom English is a second language about their rights and responsibilities as U.S. taxpayers. The IRS awards matching grants to these organizations on the condition that they provide services to taxpayers for free or for a nominal fee.

In Montana, the LITC at Montana Legal Services Association (MLS) uses *pro bono* attorneys located across the state to assist low-income taxpayers. MLS conducts outreach on tax issues to Native Americans, migrant farm workers, veterans, senior citizens, and other low-income individuals and families. The clinic conducts outreach on reservations and through churches, senior centers, community groups, government agencies, and other social service providers.

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[4] IRM 4.86.1.5(3), *Tribal Sovereignty Overview* (Jan. 1, 2003).

MLS and other LITCs located in rural areas face their own challenges in assisting taxpayers. First, it is difficult to reach and serve taxpayers across a wide geographic area. Many low income taxpayers in rural areas are isolated — geographically, culturally, and technologically. They may have limited education, literacy, or job skills. They may lack access to reliable transportation, telephone, or internet services. Yet, these taxpayers still need help with a variety of tax problems, such as proving eligibility for the Earned Income Tax Credit , obtaining Innocent Spouse relief, or successfully negotiating an offer in compromise. In addition, it is often difficult to find attorneys in remote areas who are willing and able to represent low income taxpayers on a *pro bono* basis. Consequently, LITC staff members provide mentorship, supervision, and training to participating attorneys about the unique tax issues that confront low income individuals.

VII. Conclusion

My office faces many of the same challenges as other small offices in TAS nationwide. However, we also face the unique challenge of serving the public in a state the size of Montana.

We must have adequate staffing to deliver vital services to Montana taxpayers in TAS, but my staffing concerns extend beyond TAS, to the IRS personnel in TAC offices and the Appeals officers who are not located in Montana. The services these offices provide are essential in promoting voluntary compliance. TAS may not be the first call taxpayers make if there are appropriate alternatives.

Publicizing our services throughout the state can be difficult. Providing easy and fast access to TAS and the IRS by VSD two-way videoconferencing, especially in correspondence audits, would help us overcome this geographic barrier. The increasing use of correspondence audits by the IRS, especially in inappropriate situations such as employee business expense audits, will continue to generate TAS cases that reflect confusion and frustration by taxpayers and inaccurate decisions by the IRS. The IRS must take steps to improve its communication and assistance to taxpayers in the correspondence audit process.

With the continued rise in identity theft throughout our nation, I expect my office will continue to receive more identity theft cases. Finally, as an advocate for all of the taxpayers in Montana, I ask you to consider Indian Tribal Governments and Native Americans whenever new tax legislation is considered.

Thank you for giving me this opportunity to testify.

Senate Finance Committee Hearing
"Tax Filing Season: Improving the Taxpayer Experience"
April 26, 2012
Responses to Questions for Ms. Teresa Thompson

Questions from Senator Orrin Hatch

1. Levels of taxpayer service have already decreased at the IRS. If the health spending law is implemented, the IRS would be forced to deal with administering tax credits that are given to 23 million people who are newly enrolled in the health exchanges by 2019.

   In addition, 3.9 million people will be subject to the individual mandate penalty according to CBO's April 22, 2010 analysis, and the IRS is the agency responsible for administering that penalty.

   Therefore, won't levels of taxpayer service decline even further as IRS resources for taxpayer service are diverted to deal with the health spending law?

The IRS does its best to implement new laws and programs that Congress directs it to administer. Implementation of the health insurance law would undoubtedly mean more work for the IRS. Its ability to implement the law with accuracy and minimal taxpayer burden will depend significantly on resources. If the IRS is given sufficient resources, it should be able to do the job. If the IRS is not given sufficient resources, it will struggle both in performing its traditional tax-collection responsibilities and in administering the new law. Either way, the IRS will continue to do its best to fulfill the tasks Congress assigns it with the resources provided.

2. The IRS has certainly seen benefits from technological advances. However, I want to know what technology would be helpful for the IRS to use, but is either not being used or is being underutilized? And why isn't that technology being utilized, or fully utilized?

Virtual Service Delivery (VSD) through the use of two-way videoconferencing is a technological advance that has the potential to significantly benefit taxpayers and tax administration. This technology could be made available for all types of IRS contacts and would be a cost-effective method for resolving time-sensitive issues that come in daily to the IRS. VSD is currently being used by the IRS in limited locations throughout the country. VSD is underutilized because of funding limitations. To chronicle the benefits of this technology will require expansion to additional sites, like Montana, which will require additional funding. As the Local Taxpayer Advocate for a rural state where travel time to an IRS office is often measured in hours and hundreds of miles, I believe developing and deploying technology that allows taxpayers to communicate directly with IRS personnel would greatly improve taxpayer service and has the potential to enhance tax compliance as well.

WRITTEN TESTIMONY
OF
BETH TUCKER
DEPUTY COMMISSIONER
OPERATIONS SUPPORT
INTERNAL REVENUE SERVICE
BEFORE
SENATE FINANCE COMMITTEE
"TAX FILING SEASON: IMPROVING THE TAXPAYER EXPERIENCE"
APRIL 26, 2012

INTRODUCTION AND SUMMARY

Chairman Baucus, Ranking Member Hatch, and Members of the Senate Finance Committee, thank you for this opportunity to testify on the 2012 tax filing season and the IRS's progress on some key programs.

The 2012 filing season is winding down and is going smoothly. As of March 31, 2012, the IRS received over 91 million individual returns. We have issued more than 75 million refunds for a total of $213 billion, as compared to 75 million refunds for a total of $220 billion over the same time period in 2011. The average dollar refund was approximately $3,000, about the same as last year. During the same time period, the IRS directly deposited 62 million refunds to taxpayers, as compared to 61 million last year – a nearly two percentage point increase. The number of savings bonds being requested by taxpayers owed a refund is up by 16 percent and the dollar value of those bonds requested is up by 57 percent, to more than $11 million.

Of note, the IRS e-file program continues to grow. This year the individual e-file rate continues to trend upward – a very positive development – while returns filed on paper continue to fall. Later in my testimony, I provide more statistics and information on the filing season.

Mr. Chairman, the IRS is vital both to the functioning of government and keeping our nation and economy strong. In FY 2011, the IRS collected $2.415 trillion in taxes, representing 92 percent of Federal Government receipts. The IRS processed more than 144.7 million individual returns during the 2011 filing season and issued almost 110 million refunds totaling $345 billion that traditionally help boost consumer spending and savings.

The IRS is also proud of its record over the past few years as we have made tangible progress on a number of strategic initiatives while carrying out our core duties, such as delivering a smooth filing season in 2011 – in spite of the late passage of legislation. The following are some of the more prominent programs and initiatives, including certain core programs that demonstrate how targeted investments can deliver real value to taxpayers and our nation. Gains in customer service can be found in the Filing Season section of my testimony.

CADE2 Launch

I want to highlight first a major milestone for the IRS and our tax system that occurred earlier this year – the successful stand-up of CADE2 (Customer Account Data Engine). Since the 1960s, the IRS has performed its core account processing, which includes basic taxpayer information such as current account balance, outstanding amounts due, and any recent payments, on a weekly basis.

I am pleased to report that in January 2012, the IRS successfully migrated from a weekly processing cycle to daily processing. CADE2 was a multi-year, incredibly complex undertaking, which went to the heart of systems that process trillions of dollars in tax revenue. Again, this is a major milestone for the IRS.

Our state-of-the-art database will become the sole authority source of individual taxpayer account data and will replace the legacy master file tapes. And of note, when we converted master file data from the legacy tapes to the new database, the financial information going back to the 1960s balanced to the penny.

CADE 2 addresses a multitude of issues that have historically created challenges and problems in the tax system. It will provide more up-to-date information at the fingertips of our customer service representatives that will enable faster resolution of taxpayer account issues and account adjustments – both of which will greatly help taxpayers and the IRS.

And CADE2 will correct one of the biggest problems we have when a taxpayer calls about a payment he or she made, but our representative cannot tell whether it has been posted or not. It will also eliminate structural technology problems that could lead to time-lag problems, such as when notices are sent to taxpayers.

Practitioners will see quicker updates to web-based applications, and faster taxpayer notices. The CADE2 database will also allow IRS to consider offering a wider range of web-based, self-initiated service solutions that could fundamentally change the way taxpayers interact with the IRS and potentially provide greater operational efficiencies.

In addition, CADE2 supports sophisticated, next-generation service and compliance systems, which will improve overall compliance through better taxpayer information, enhanced workload selection and advanced decision analytics.

Return Preparer Program

The Return Preparer Program is one of the most important initiatives the IRS has undertaken in recent memory. Our goal is to leverage preparers' expertise and commitment to quality service to improve the integrity of the tax system.

Boiled down to its essence, the program will ensure a basic level of competency for return preparers while enabling us to focus on addressing those who produce low-quality

returns or who are downright unscrupulous. First, we had to identify all preparers and have them register.

Since September 2010, almost 840,000 individuals have registered and obtained a Preparer Tax Identification Number, or PTIN, and are now in our tax professional database. And we are learning some interesting facts about not only the size, but the nature of the tax preparer community. For example, over 60 percent of PTIN holders are not attorneys, CPAs, or enrolled agents and, prior to this effort, were not required to demonstrate competency or meet any set of consistent standards.

Once PTIN registration was in place, we began the next phase of the program aimed at ensuring a minimal level of competency for all return preparers. In November 2011, we launched a new competency test for certain tax return preparers who prepare Form 1040 returns but who are not attorneys, CPAs, or enrolled agents, or supervised by one of them in a firm. These individuals also have a new requirement to complete 15 hours of continuing education each year from IRS-approved providers.

Let me add also that from the beginning we planned to exempt CPAs, attorneys, and enrolled agents from the testing and continuing education requirements as they already have more stringent testing and education requirements.

As we've set up the registration, testing and continuing education components of our return preparer initiative, it is also important that we focus on finding unscrupulous preparers who damage the good name of honest return preparers and undermine the overall tax system; therefore, we are developing a comprehensive strategy to focus on preparer enforcement and compliance.

Our compliance efforts will be focused on places of highest risk – where the vast majority of preparers who play by the rules should want us to focus.

We will also continue to conduct undercover shopping visits to return preparers suspected of engaging in fraud, and we will continue to work closely with the Department of Justice to pursue civil or criminal action against unscrupulous return preparers.

Budget Trends

Over the last several years, the IRS budget requests have reflected strategic investments in the IRS that serve to reduce the deficit, along with substantial efficiency and other targeted reductions that reflect our commitment to effective stewardship of the resources that we are given.

These savings and efficiencies reflect an across-the-board commitment to finding better and more efficient ways to administer the tax system. They come from a variety of sources, including reductions in outside contracts, training and all but case-related travel.

However, even with these efficiencies, the IRS would not have been able to meet the level of budget reduction enacted for FY 2012 without substantially reducing our workforce. The IRS had already instituted an agency-wide hiring freeze and has only been replacing attrition on an exception basis. Attrition savings were not sufficient to meet the 2012 levels, though, so the IRS resorted to voluntary incentives designed to accelerate retirements of those who were retirement-eligible, or close to eligible. As of March 5, 2012, these incentives – known as Voluntary Separation Incentive Payments (VSIPs) – were given to approximately 1,000 workers. As a result of these measures, the IRS has approximately 5,000 fewer staff on the payroll this filing season compared to last year. Of the 5,000, approximately 3,000 were associated with enforcement activities, with the balance of the reduction principally coming from taxpayer service functions.

Enforcement

Turning to enforcement, the IRS continues to run robust compliance programs. We continue to have appropriate and balanced audit coverage rates across taxpayers and to innovate in our collection programs. Through our Offshore Voluntary Disclosure Programs, we have collected more than $4.4 billion to date from those hiding money overseas, and that number will grow as the IRS processes the 2011 cases.

In FY 2011, IRS compliance activities returned $55.2 billion to the Treasury as a result of our examination and collection programs. While the direct revenues brought in by IRS activities are important, the indirect effects are far more substantial and important. A strong and fair enforcement program serves to support over $2 trillion that is paid on a timely basis every year without the need for direct enforcement measures.

It should be underscored that IRS enforcement revenues do not include billions of dollars in attempted refund fraud that is stopped by IRS up-front fraud detection programs. Overall, IRS identified and prevented the issuance of over $14 billion in fraudulent refunds in 2011. Identity theft is a subset of this overall refund fraud. Moreover, this filing season, we have expanded our work on several fraud filters which catch not only identity theft but other fraud. In this area we have stopped roughly as much so far this filing season as we stopped last calendar year.

In short, despite a quickly evolving taxpayer base and unprecedented demands on IRS resources, the IRS continues to deliver for the American people.

People

The IRS' workforce is our greatest asset. Three years ago, Commissioner Shulman embarked on a campaign to make the IRS the best place to work in the Federal Government. This past November, the Partnership for Public Service released the results of the 2011 Best Places to Work in Federal Government survey. The IRS ranking improved yet again, moving over a two-year period from a ranking of 127 to a ranking of 65 out of the 240 participating agencies. And, we are now ranked third out of 15 large agencies (those with over 20,000 employees) in the employee engagement index from the survey.

In addition, our own employee engagement index – which measures the degree of employees' motivation, commitment and involvement in the mission of the organization – and the job satisfaction index both remained stable compared with last year. In other words, we saw no erosion of the substantial gains we had made over the past few years.

The fact that our survey results showed that our employees remain engaged, motivated and committed, regardless of the external environment, is a testament to the professionalism and deep commitment to service woven into the culture of the IRS.

THE 2012 FILING SEASON & TAXPAYER SERVICE

Mr. Chairman, although the budget reduction for FY 2012 has had an impact, there is much of which to be proud this filing season. Let me stress that providing quality taxpayer service throughout the year, but especially during the filing season, is important if we are to help taxpayers get it right from the start and avoid making unintentional errors.

Assisting taxpayers with their questions before they file their returns prevents inadvertent noncompliance and reduces burdensome post-filing notices and other interactions with the IRS.

The IRS continues to provide taxpayers with quality customer service and different service channels and products. We recognize that we must never stop innovating to meet the service needs of an increasingly diverse taxpayer base and must serve taxpayers when and where they need it.

Our broad portfolio of customer service channels run the gamut from traditional walk-in sites for those who need to see an IRS representative face-to-face, to toll-free automated and assistor telephone service, and web-based applications and social media. All make it easier for taxpayers to file and pay their taxes.

Providing high-quality customer service also means assisting taxpayers who are facing tough economic times. For example, in March we announced a major expansion of our "Fresh Start" initiative to help struggling taxpayers by taking steps to provide new penalty relief to the unemployed and making Installment Agreements available to more people. Under the new Fresh Start provisions, part of a broader effort started at the IRS in 2008, certain taxpayers who have been unemployed for 30 days or longer will be able to avoid failure-to-pay penalties. In addition, the IRS is doubling the dollar threshold for taxpayers eligible for Installment Agreements to help more people qualify for the program.

We received an important sign of the progress the IRS is making on customer service: every year, the American Customer Satisfaction Index survey is conducted and for 2011, the survey of taxpayers showed satisfaction with our services reaching 73 on a scale of 100 among all individual tax filers. That score is a three-point jump from a year earlier

and our highest score since we began participating in the survey that began in 1994. Satisfaction among people who filed electronically came in even higher at 78. This is a tremendous step in the right direction and one that we will build upon in the future.

Submission Processing, Refunds and E-filing

Mr. Chairman, let me turn to the 2012 filing season. As of March 31, 2012, the IRS received over 91 million individual returns. Overall individual filing is up two percent compared to the same time period last year.

The IRS e-file program continues to grow. This year the individual e-file rate is trending higher than last year – a very positive development. On the other hand, paper returns are dropping.

For FY 2011, it cost only 15 cents to process an e-filed return – a fraction of the $3.55 it takes to process a paper return. And with e-file, taxpayers get their refund faster, with fewer data processing errors that can lead to problems later in the process.

Indeed, taxpayers filing electronically can get their refunds as soon as 10 to 21 days upon acknowledgement of receipt by the IRS. This compares favorably with the six week average time frame for processing a paper tax return.

I would be remiss if I did not acknowledge that in the first few weeks of the tax filing season, we experienced some delays in processing a subset of e-filed returns. These were temporary issues that affected a subset of taxpayers who filed in late January and early February, and the issues were resolved by mid-February. And, even with the delays, the IRS was generally delivering refunds in our normal 10 to 21 day time frame. I recognize that this group of taxpayers encountered delays this filing season and we regret any inconveniences.

It bears mentioning that the overall average refund timeline remained steady in FY 2012 when compared to FY 2011. In other words, the delays were isolated to early issues in the filing season, and after that IRS was processing tax returns according to normal refund timelines.

At the same time, combating refund fraud, including identity theft, can also affect the time frame of delivering a refund. As previously noted, we are continually improving our screens and filters to help us identify and block fraudulent returns. For most taxpayers, these measures do not impact refund timelines. However, it can add time to processing for some. There is clearly a delicate balance here.

We cannot manually inspect 100 million refunds to ensure all are correct – nor is there any justification for doing so. The IRS has a dual mission when it comes to refunds, particularly when they are generated in whole or in part by tax credits. Refundable and other tax credits are provided to achieve important policy goals, such as relieving poverty or boosting the economy.

The IRS must deliver refunds in the intended timeframe, while ensuring that appropriate controls are in place to minimize errors and fraud. We must balance the need to make payments in a timely manner with the need to ensure that claims are proper and taxpayer rights are protected.

Toll-Free Telephone Performance

High quality toll-free telephone service – both assistor and automated – is an extremely important tool in answering taxpayer questions, helping them navigate an extremely complex tax code and making voluntary compliance easier.

For the current filing season through March 31, 2012, IRS telephone assistors answered 11 million calls as compared to 13 million calls over the same period last year. Due to budget constraints, fewer resources are available to staff our toll-free operations. As of March 31, 2012, Assistor Level of Service stood at 68 percent versus 75 percent in 2011. This is largely a result of reduced budget resources provided in the FY 2012 budget as enacted, which means fewer assistors available to answer taxpayer phone calls.

Taxpayers also completed 36 million automated calls – a one-third increase over last year's 27 million calls, reflecting in part a growing taxpayer appetite for quality self-serve options and the time savings of not having to wait for a live assistor.

Accuracy rates for both customer tax law and account questions remain in the 90-plus percentile with minimal change over last filing season's levels.

Website Usage and New Media

IRS.gov continues to be the favorite source of information for millions of taxpayers. As of March 31, 2012, there were over 200 million visits to IRS.gov – a 26 percent increase over the same time period last year. Use of the "Where's My Refund" electronic tracking tool continued to post double-digit yearly gains. IRS.gov/Español offers many of the same services and information in Spanish.

Taxpayers can also use electronic tools, such as the Earned Income Tax Credit (EITC) Assistant, to determine if they qualify for the refundable tax credit and a withholding calculator to help them determine the right amount of tax to withhold from their paychecks.

The Interactive Tax Assistant (ITA) is an expanded resource this filing season that provides consistent answers to a limited number of tax law questions using a probe and response process. The ITA will guide taxpayers to accurate answers that are not readily addressed through simple Frequently Asked Questions.

In FY 2011, the IRS received a Compuware Gomez "Best of the Web" award, which recognized IRS.gov as one of the best websites in government for performance and quality and first in consistency.

The IRS is also increasingly communicating with taxpayers who may not get their information from traditional sources, such as newspapers and broadcast and cable news. By employing social and new media, such as YouTube, Twitter and even iTunes, we are able to reach these taxpayers with important service and compliance messages. Last year, the IRS also unveiled IRS2Go, its first smartphone application that lets taxpayers check on the status of their tax refund and obtain helpful tax information. This new smartphone application reflects our ongoing commitment to modernizing the agency and engaging taxpayers where and when they want.

For example, during the week of February 10-17, 2012, our YouTube Video "When Will I Get My Refund?" had more than 254,000 views. Our "tweet" and subsequent "re-tweets" on the "Dirty Dozen" tax schemes reached almost 28,000 people. The IRS Video in English is currently the 4th most viewed Federal Government YouTube channel with nearly three million total views.

Virtual Service Delivery

In October 2011, the IRS began testing the use of video communication technology to deliver services to taxpayers. This technology is located in 10 of the 400 Taxpayer Assistance Centers, two IRS partner sites in Prescott, Arizona and Bellefonte, Pennsylvania, and one in Tampa, Florida serving taxpayers seeking assistance from the National Taxpayer Advocate. Taxpayers will find many of the typical services available at an IRS office, such as assistance with letters and notices, tax law and procedural questions, and case advocate appointments. Services are limited to those that do not involve the exchange of paper, such as accepting payments or tax returns. In May, two additional sites will give taxpayers using the services of the Low Income Tax Clinics access to Appeals Officers.

These pilots provide the IRS an opportunity to (1) seek service delivery alternatives outside IRS facilities; (2) improve the utilization of resources (3) optimize staffing and balance workload, and (4) increase access to face-to-face service where currently not available.

Taxpayers participating in the pilot will visit an IRS office, and walk up to a high definition videoconference monitor that is connected to an employee in another location. The taxpayer and IRS employee will be able to see and talk to one another live, face-to-face while the employee provides assistance. The high resolution equipment facilitates document (driver's license, passport or IRS notice) viewing by holding in front of the camera.

As of mid-March, the IRS has served over 8,000 taxpayers using video conferencing. So far, taxpayers that have used the technology are satisfied with an 87 percent overall

satisfaction rate and 92 percent of taxpayers indicating they would use the technology in a future visit.

Taxpayer Assistance Centers (TACs)

As of March 24, 2012, approximately two million taxpayers were served at TACs. In addition to IRS help, community organizations partner with the IRS on services such as tax preparation and counseling. For example, Volunteer Income Tax Assistance (VITA) programs assist people who earned $50,000 or less, and Tax Counseling for the Elderly programs assist individuals age 60 and over with their 2012 income tax return preparation and electronic filing. Many of these sites have Saturday hours while others offer assistance at various times during the week. Over two and a half million taxpayers have been served by volunteer return preparation through April 1, 2012.

On January 28, 2012, the IRS launched on IRS.gov a locater tool called "Get Free Tax Help." The easy-to-use locater tool helps taxpayers find VITA sites, where free tax return preparation assistance is available. The locater tool provides the opportunity to enter a Zip Code and a range (in miles) from that zip code, and then allows the taxpayer to select a list of the closest available VITA sites. Taxpayers will be able to browse further details about the VITA site, including address, contact information, hours of operations, and languages supported. In addition, taxpayers can easily get directions to the VITA site by using the integrated Google Maps feature. To date, more than 115,000 visitors have accessed the tool from IRS.gov. This tool replaces 52 pages of content on the website.

Limited English Proficiency (LEP)

Today, the IRS offers language services to LEP taxpayers, thereby affording them the same access to Federal benefits and services as English speakers. We now have more than 2,300 bilingual employees who provide services to LEP taxpayers; a Spanish language web site; and a Multilingual Gateway that provides information in Chinese, Vietnamese, Korean and Russian. A telephone interpreter service is also available in more than 170 languages, and more than 600 tax products have been translated into languages such as Spanish, Chinese, Vietnamese, Russian and Korean.

CONCLUSION

In conclusion, let me thank you again, Mr. Chairman and the Committee for this opportunity to discuss the 2012 filing season and the progress on some of our strategic initiatives. The IRS continues to make improvements, innovate and better serve taxpayers – even in a difficult budget environment. This is a great tribute to our employees and management. I would be happy to answer any questions.

Senate Finance Committee Hearing
"Tax Filing Season: Improving the Taxpayer Experience"
April 26, 2012
Questions for Ms. Beth Tucker

Questions from Senator Orrin Hatch

Levels of taxpayer service have already decreased at the IRS. If the health spending law is implemented, the IRS would be forced to deal with administering tax credits that are given to 23 million people that are newly enrolled in the health exchanges by 2019.

In addition, 3.9 million people will be subject to the individual mandate penalty according to CBO's April 22, 2010 analysis, and the IRS is the agency responsible for administering that penalty.

Therefore, won't levels of taxpayer service decline even further as IRS resources for taxpayer service are diverted to deal with the health spending law?

Answer: The IRS is constantly balancing the need to implement the laws on the books, provide services to taxpayers, follow up on potential non-compliance, and invest for the future in information technology and workforce development. To answer your specific question, the Administration's budget request includes the funding needed for the IRS to administer the nation's tax laws.

2. The IRS has certainly seen benefits from technological advances. However, I want to know what technology would be helpful for the IRS to use, but is either not being used or is being underutilized? And why isn't that technology being utilized, or fully utilized?

Answer: Over the long run, the IRS will benefit from using technologies to enable electronic interactions with taxpayers. While we continue to develop our technology capabilities to support these interactions, we also must be careful to ensure that we are able to properly authenticate the identity of the taxpayers with whom we interact. The IRS has initiatives underway to explore these issues and potential solutions. The Administration's 2013 budget request includes funding to strategically invest in state-of-the-art technologies, such as online taxpayer services, that will enhance the taxpayer experience while helping the IRS to cope with increasing service demands in a cost-effective manner.

Additionally, the IRS continues to develop the CADE 2 program to build capabilities for other systems to use data for enhanced queries and data analytics resulting in more timely decision making for compliance activities. Finally, a new technology referred to as

Massively Parallel Processing may offer new opportunities to speed processing and matching of large volumes of data to improve the IRS's ability to detect, resolve, and prevent non-compliance.

Question from Senator John Kerry

Ms. Tucker, you may be familiar with the recent D.C. district court decision invalidating the long-distance telephone tax refund program and remanding the issue back to the IRS to develop a better remedy. I am troubled by the small percentage of poor individuals, senior citizens and small businesses who never filed for tax refunds. Could you tell us how the IRS plans to proceed on this to ensure more people and businesses receive refunds?

Answer: To date, the IRS has made more than 100 million refunds of overcollected telephone excise tax, totaling more than $5.8 billion. Nonetheless, there are many individuals and businesses who never requested a refund of the telephone excise tax. But the Service's ability to ensure that more people and businesses receive refunds is limited because it is dependent on taxpayers coming forward to identify themselves and the amounts of tax that they had paid to the telecommunication companies. The IRS has no information regarding either the identity of the telephone customers who originally paid the tax to telecommunication companies or of the amount paid by each customer. The telecommunication companies were unable to assist the IRS by providing this information.

From the outset of the program, the IRS recognized one impediment to taxpayers obtaining refunds was the difficulty in determining the amount of tax they had paid and provided safe harbor amounts that individual taxpayers could receive without making any attempt to document their actual taxes paid. For businesses, the IRS provided an estimation procedure based on the last month of telecommunication bills for which the tax had been collected. The IRS engaged in an extensive communication strategy to encourage taxpayers to come forward and request their refunds.

At our request, TIGTA studied why small business taxpayers had not come forward to request refunds of the telephone excise tax. The study concluded that the primary reason was that small businesses believed that the likely refund amounts did not justify the work and expense involved in preparing the refund requests. TIGTA Audit Report 2008-30-175 *The Telephone Excise Tax Refund Was Not Claimed on Business Tax Returns Primarily Because of the Perceived Work and Expense Involved to Do So*. No similar study was prepared with respect to individuals, but we believe that many chose not to file requests simply because the amount of the refund ($30-$60 safe harbor amounts) did not justify the effort of completing a tax return for those without any other filing obligation.

The recent district court opinion does not directly bear on the reasons for taxpayer lack of participation in the refund program. The appellate court held that the IRS' decision, announced in Notice 2006-50, that it would not process telephone excise tax refunds

claims that were submitted on Forms 843, the form specified in Treasury Regulations, affected a taxpayer right. (The IRS required taxpayers to request excise tax refunds using their 2006 income tax returns.) As such, the court held the Notice was substantive within the meaning of the Administrative Procedure Act and should only have been promulgated after notice and comment. The district court implemented the appellate mandate by invalidating Notice 2006-50 prospectively.

The IRS will now process claims for refund submitted on Forms 843, but we do not believe this will result in an appreciably greater number of refund requests being submitted. Whether an income tax return or a Form 843 is used, a taxpayer must still either use one of the permitted estimation methods or establish the actual amount of taxes paid. Nearly six years have now passed since the last amount of excise tax on long distance service was collected. Records of taxes paid are undoubtedly even less available now than in 2006, so the difficulty in substantiating a refund amount must be greater.

The IRS recently issued Announcement 2012-16 to remind taxpayers to submit requests for refunds of telephone excise taxes by July 27, 2012.

United States Government Accountability Office

GAO

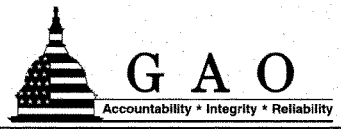
Testimony
Before the Committee on Finance,
U.S. Senate

For Release on Delivery
Expected at 10:00 a.m. EDT
Thursday, April 26, 2012

INTERNAL REVENUE SERVICE

Opportunities to Improve the Taxpayer Experience and Voluntary Compliance

Statement of James R. White, Director
Strategic Issues



GAO-12-652T

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Accountability * Integrity * Reliability
Highlights

Highlights of GAO-12-652T, a testimony before the Committee on Finance, U.S. Senate

April 26, 2012

INTERNAL REVENUE SERVICE

Opportunities to Improve the Taxpayer Experience and Voluntary Compliance

Why GAO Did This Study

The U.S. tax system depends on taxpayers calculating their tax liability, filing their tax return, and paying what they owe on time—what is often referred to as voluntary compliance. Voluntary compliance depends on a number of factors, including the quality of IRS's assistance to taxpayers, knowledge that its enforcement programs are effective, and a belief that the tax system is fair and other people are paying their share of taxes. Voluntary compliance is also influenced by other parties, including paid tax return preparers, tax software companies, and information return filers (employers, financial institutions, and others who report income or expense information about taxpayers to IRS). For this testimony, GAO was asked to (1) evaluate the current state of IRS's performance and its effect on the taxpayer experience, and (2) identify opportunities to improve the taxpayer experience and voluntary compliance. This testimony is based on prior GAO reports and recommendations. Additionally, GAO analyzed IRS data in delivering selected taxpayer services in recent years.

What GAO Recommends

GAO has made numerous prior recommendations that could help improve the taxpayer experience. Congress and IRS have acted on some recommendations, while others are reflected in the strategies presented in this testimony.

View GAO-12-652T. For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

What GAO Found

The Internal Revenue Service (IRS) has made improvements in processing tax returns, and electronic filing (e-filing), which provides benefits to taxpayers including faster refunds, continues to increase. However, as the following table shows, IRS's performance in providing service over the phone and responding to paper correspondence has declined in recent years. For 2012, as with previous years, IRS officials attribute the lower performance to other funding priorities.

IRS's Performance for Telephone Service and Paper Correspondence, Fiscal Years 2007 through 2013

	2007	2008	2009	2010	2011	2012 planned	2013 planned
Percentage of callers seeking and receiving live assistance	82.1	52.8	70	74	70.1	61.0	63.0
Average wait time for callers (in minutes)	4.4	10.4	8.8	10.8	13.0	18.8	18.8
Percentage of paper correspondence not resolved within 45 days	17	23	25	27	35	n/a	n/a

Legend: n/a = not applicable.

Sources: IRS Oversight Board, IRS's Congressional Budget Justification, and GAO Reports.

Following are among the opportunities to improve the taxpayer experience and increase voluntary compliance that GAO identifies in this testimony:

- **IRS can provide more self-service tools to give taxpayers better access to information.** IRS can create an automated telephone line for amended returns (a source of high call volume) and complete an online services strategy that provides justification for adding new self-service tools online.
- **Better leveraging of third parties could provide taxpayers with other avenues to receive service.** Paid preparers and tax software providers combine to prepare about 90 percent of tax returns. IRS is making progress implementing new regulation of paid preparers. As it develops better data, IRS should be able to test strategies for improving the quality of tax return preparation by paid preparers. Similarly, IRS may also be able to leverage tax software companies.
- **Expanded information reporting could reduce taxpayer burden and improve accuracy.** Expanded information reporting, such as the recent requirements for banks and others to report businesses' credit card receipts to IRS, can reduce taxpayers' record keeping and give IRS another tool.
- **Implementing modernized systems should provide faster refunds and account updates.** Modernized systems should allow IRS to conduct more accurate and faster compliance checks, which benefits taxpayers by detecting errors before interest and penalties accrue.
- **Expanding pre-refund compliance checks could result in more efficient error correction.** Expanding such checks could reduce the burden of audits on taxpayers and their costs to IRS.
- **Reducing tax complexity could ease taxpayer burden and make it easier to comply.** Simplifying the tax code could reduce unintentional errors and make intentional tax evasion easier to detect.

Chairman Baucus, Ranking Member Hatch, and Members of the Committee:

Thank you for the invitation to be here today to discuss how to improve the taxpayer experience.

The U.S. tax system depends on taxpayers calculating their tax liability, filing their tax return, and paying what they owe on time. The taxpayer experience is at its best when taxpayers are able to fulfill these responsibilities independently without intervention from the Internal Revenue Service (IRS). This is often referred to as voluntary compliance. Some of the obvious influences on taxpayers' willingness and ability to voluntarily comply include the quality of IRS's service to taxpayers, knowledge that IRS's compliance checks and collection programs are effective, and the belief that the tax system is fair and that others are paying their share of taxes. Perhaps less obvious is the role of third parties, including paid tax return preparers, tax software companies, and information return filers (employers, financial institutions, and others who report income or expense information about taxpayers to IRS) in influencing voluntary compliance.

The taxpayer experience also depends on how IRS deals with taxpayers who fail to voluntarily comply by helping taxpayers correct unintentional errors, and identifying and pursuing taxpayers who intentionally try to evade taxes.

Maximizing voluntary compliance is especially important today given the nation's large structural budget deficits and the size of the tax gap. Earlier this year, IRS estimated the gross tax gap—the difference between taxes owed and taxes paid on time—at $450 billion for tax year 2006. IRS estimated that it would eventually collect $65 billion of this through enforcement actions and late payments, leaving a net tax gap of $385 billion.

My statement today focuses on two areas: (1) evaluating the current state of IRS's performance and its effect on the taxpayer experience, and (2) identifying opportunities to improve the taxpayer experience and voluntary compliance. To address these objectives, we reviewed and summarized prior GAO reports and recommendations. Additionally, we obtained and analyzed IRS data in delivering selected taxpayer services in recent years. We discussed newly reported information in this statement with IRS officials. Additional information on the scope and methodology of underlying work is available in published products, referenced throughout

this statement. We conducted our work in April 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Taxpayers Have Benefitted from Improved Processing, but IRS's Service to Taxpayers Has Declined

Taxpayers' experience depends heavily on IRS's performance during the tax filing season, roughly mid-January through mid-April.[1] During this period, millions of taxpayers who are trying to fulfill their tax obligations contact IRS over the phone, face-to-face, and via the Internet to obtain answers to tax law questions and information about their tax accounts. This period is also when IRS processes the bulk of the approximate 140 million returns it will receive, runs initial compliance screens, and issues over 100 million refunds. In recent years, IRS has improved its returns processing but has seen its taxpayer service performance deteriorate.

Increased Electronic Filing Contributes to Greater Return Accuracy and Faster Processing

For years we have reported that electronic filing (e-filing) has many benefits for taxpayers, such as higher accuracy rates and faster refunds compared to filing on paper. So far in 2012, the percentage of e-filed returns has increased by 1.9 percentage points to 88.8 percent since about the same time last year (a 2.2 percent increase), as table 1 shows. Since the same time in 2007, the percentage of e-filed returns has increased from 72.3 percent to 88.8 percent. This year, IRS may meet its long-held goal of having 80 percent of individual tax returns e-filed. However, the overall e-file percentage is likely to decline as the tax filing season ends since IRS typically receives more returns filed on paper later in the filing season. In addition, IRS is in the midst of a multi-phase modernization project, known to as the Customer Account Data Engine (CADE) 2, which will fundamentally change how it processes returns. With CADE 2, IRS also expects to be able to issue refunds in 4 business days for direct deposit and 6 business days for paper checks after IRS processes the return and posts the return data to the taxpayer's account.

[1]The filing season year is the year in which the taxpayer files the tax return, usually the year after a taxpayer has earned income on which tax is due (which is referred to as the tax year).

Table 1: Processing Data for January 1 through Mid-April, 2007 through 2012

	2007	2008	2009	2010	2011	2012	Percentage change from 2011 to 2012
Number of individual tax returns processed (in thousands)	105,159	114,737	112,612	107,158	107,401	105,668	-1.6
Electronic (in thousands)	76,034	84,935	89,268	88,330	93,306	93,846	0.6
Paper (in thousands)	29,125	29,801	23,344	18,828	14,094	11,822	-16.1
Percentage electronically filed[a]	72.3	74.0	79.3	82.4	86.9	88.8	2.2
Number of refunds issued (in thousands)	88,168	89,898	93,438	88,676	88,157	86,078	-2.4
Amount of refunds (dollars in millions)	$203,022	$214,264	$250,635	$257,324	$252,596	$237,750	-5.9
Average refund amount	$2,303	$2,383	$2,682	$2,902	$2,865	$2,762	-3.6

Source: GAO analysis of IRS return processing data.

Notes: Data are from January 1 of each year through April 20, 2007; April 18, 2008; April 17, 2009; April 16, 2010; April 15, 2011; and April 13, 2012. Some figures and totals may vary slightly due to rounding.

[a]The percentage of returns filed electronically early in the filing season is likely to decline before the filing season is over. Taxpayers filed about 78 percent of all individual returns electronically in 2011.

Early in the 2012 filing season, IRS experienced two processing problems that delayed refunds to millions of taxpayers, and reported the problems had been resolved by mid-February. We summarized these problems in an interim report on the 2012 filing season.[2]

Taxpayer Service Has Declined

Providing good taxpayer service is important because, without it, taxpayers may not be able to obtain necessary and accurate information they need to comply with tax laws. In addition, more and more, taxpayers are relying on IRS's website to obtain information and execute transactions, making it important that IRS have a modern website. However, as we have reported, IRS has experienced declines in performance in selected taxpayer service areas, most notably with respect to providing live telephone assistance and timely responses to

[2]GAO, *Internal Revenue Service: Interim Results of 2012 Tax Filing Season and Summary of the Fiscal Year 2013 Budget Request*, GAO-12-566 (Washington, D.C.: Mar. 20 2012).

taxpayers' correspondence.[3] When taxpayers do not get timely responses from IRS to paper correspondence or have access to information online, they call IRS, correspond again, or seek face-to-face assistance—all of which are costly to IRS and burdensome to the taxpayer. Table 2 shows the declines in telephone service and paper correspondence and the goals for 2012 and 2013. Additional performance data is shown in appendix I.

Table 2: IRS's Performance for Telephone Service and Overage Paper Correspondence, Fiscal Years 2007 through 2013

Performance measure (in percent)	2007	2008	2009	2010	2011	2012 planned	2013 planned
Assistor calls							
Percentage of callers seeking live assistance who receive it	82.1	52.8	70	74	70.1	61.0	63.0
Average wait time (in minutes)	4.4	10.4	8.8	10.8	13.0	18.8	18.8
Overage paper correspondence (in percent)[a]	17	23	25	27	35	n/a	n/a

Legend: n/a = not applicable.

Sources: 2009 and 2010 IRS Oversight Board Annual Reports to Congress, the fiscal year 2013 Congressional Justification for IRS and GAO reports.

[a]IRS generally considers paper correspondence that is not resolved within 45 days to be overage. IRS does not have a performance measure for taxpayer correspondence that includes providing timely service to taxpayers, which we recommended in 2010. See, GAO, *2010 Tax Filing: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others*, GAO-11-111 (Washington, D.C.: Dec. 16, 2010).

So far in the 2012 filing season, as the following examples illustrate, declines in taxpayer service have continued (further information on telephone service trends is in appendix II).

- The level of telephone service (taxpayers seeking and receiving live telephone assistance) is about 68 percent so far during the 2012 tax filing season, down about 7 percentage points from 2011. This represents a significant decline from fiscal year 2007 level, when the level of service was 82 percent.
- The average wait time to talk with an assistor increased to about 16 minutes (from 9.5 minutes in 2011). In fiscal year 2007, the average wait time was just under 5 minutes.

[3]See GAO-12-566; and *2011 Tax Filing: Processing Gains, but Taxpayer Assistance Could Be Enhanced by More Self-Service Tools*, GAO-12-176 (Washington, D.C.: Dec. 15, 2011).

IRS has also lowered its telephone service and average wait time goals (meaning it expects wait times to be longer) for fiscal year 2012. IRS's goal for the

- level of telephone service is 61 percent, down from 71 percent in fiscal year 2011 and 82 percent in fiscal year 2007; and
- average wait time to speak to an assistor is 18.8 minutes, an increase from 11.6 minutes in fiscal year 2011 and 4.3 minutes in fiscal year 2007.

For 2012, as with previous filing seasons, IRS attributes the lower performance and goals to other funding priorities. For information on how IRS sets goals, see our recent report.[4]

Opportunities Exist to Improve the Taxpayer Experience and Voluntary Compliance

To improve the taxpayer experience and voluntary compliance, IRS has a range of options. Some of its options could provide taxpayers with better information to accurately fulfill their tax obligations. Other options would allow IRS to take enforcement actions sooner and with less burden on taxpayers. Simplifying the tax code could reduce unintentional errors and make intentional tax evasion harder.

IRS Can Provide More Self-Service Tools to Give Taxpayers Better Access to Information

The recent declines in telephone service and increases in overage paper correspondence highlight the need to offer more self-service tools to taxpayers, particularly through IRS's automated telephone lines and website. Better self-service has the potential to reduce the demand to speak to live assistors, a relatively high-cost service, and reduce wait time for taxpayers. To improve the taxpayer experience and help taxpayers meet their obligations voluntarily, we recently recommended and IRS agreed to:

- create an automated telephone line for taxpayers seeking information on the status of an amended return, a source of high call volume;[5]

[4]GAO-12-176.

[5]GAO-12-176.

- develop an online locator tool listing volunteer tax preparation sites—IRS introduced an enhanced volunteer site locator tool in 2012;[6] and
- complete an Internet strategy that provides a justification for online self-service tools as IRS expands its capacity to introduce such tools.[7]

In addition to actions we recommended, IRS is also studying ways to better communicate with taxpayers and determine which self-service tools would be the most beneficial to taxpayers. According to IRS officials, the study should be completed later this year. Identifying more efficient ways to provide service also benefits IRS because it is able to make better use of scarce resources.

Better Leveraging of Third Parties Could Provide Taxpayers With Other Avenues to Receive Service

Paid Preparer Regulations

As intermediaries between taxpayers and IRS, paid preparers prepare about 60 percent of all tax returns filed and they play a critical role in answering taxpayers' questions and filing tax returns. Based in part on our reports and recommendations, IRS is implementing new regulations for paid preparers, such as registration, competency testing and continuing education requirements.[8] IRS's goals for the preparer regulation program include leveraging relationships with paid preparers and improving the accuracy of the returns they prepare. We recently reported that IRS plans to develop a comprehensive database containing information on paid preparers and the tax returns they prepare.[9] IRS plans to use information from this database to test which strategies are

[6]GAO, *Tax Administration: Opportunities Exist for IRS to Enhance Taxpayer Service and Enforcement for the 2010 Filing Season*, GAO-09-1026 (Washington, D.C.: Sept. 23, 2009).

[7]GAO-12-176.

[8]GAO, *Tax Preparer Regulation: IRS Needs a Documented Framework to Achieve Goal of Improving Taxpayer Compliance*, GAO-11-336 (Washington, D.C.: Mar. 31, 2011).

[9]GAO-11-336.

most effective for improving the quality of tax returns prepared by different types of paid preparers. Likewise, IRS has discussed how to measure the effect of the requirements such as requiring continuing education and testing on tax return accuracy. It will take years to implement the approach as it will likely evolve over time and become more detailed.

Tax Preparation Software

Tax preparation software is another critical part of tax administration. Almost 30 percent of taxpayers use such software to prepare their returns and, in the process, understand their tax obligations, learn about tax law changes, and get questions answered. Many also electronically file through their software provider. Consequently, tax software companies are another important intermediary between taxpayers and IRS. We have reported that IRS has made considerable progress in working with tax software companies to provide, for example, clearer information about why an e-filed return was not accepted, require additional information on returns to allow for IRS to better identify the software used, and enhance security requirements for e-filing.[10] To illustrate the potential for leveraging tax software companies to improve taxpayer compliance, 4 years ago we recommended and IRS agreed to expand outreach efforts to external stakeholders and include software companies as part of an effort to reduce common types of misreporting related to rental real estate.[11] In another report, we discussed the value of research to better understand how tax software influences compliance.[12]

Volunteer Sites

IRS has volunteer partners, often nonprofit organizations or universities, that staff over 12,000 volunteer sites. Volunteers at these sites prepare several million tax returns for traditionally underserved taxpayers, including the elderly, low-income, disabled, and those with limited English proficiency. In recent reports we have made recommendations about estimating of the effectiveness of targeting underserved populations at such sites and making it easier for taxpayers to find the locations of

[10]See GAO-12-176; GAO-11-111; GAO, *Tax Administration: Many Taxpayers Rely on Tax Software and IRS Needs to Assess Associated Risks*, GAO-09-297 (Washington, D.C.: Feb. 25, 2009).

[11]GAO, *Tax Gap: Actions That Could Improve Rental Real Estate Reporting Compliance*, GAO-08-956 (Washington, D.C.: Aug. 28, 2008).

[12]GAO-09-297.

nearby sites.[13] As is the case with paid preparers, IRS has an opportunity to work with these volunteer partners to help improve assistance to taxpayers with the goal of improving compliance.

Expanded Information Reporting Could Reduce Taxpayer Burden and Improve Accuracy

Information reporting is a proven tool that reduces tax evasion, reduces taxpayer burden, and helps taxpayers voluntarily comply. This is, in part, because taxpayers have more accurate information to complete their returns and do not have to keep records themselves. In addition, IRS research shows that when taxpayers know that IRS is receiving data from third parties, they are more likely to correctly report the income or expenses to IRS. As part of its recent update of its tax gap estimates, IRS estimated that income subject to substantial information reporting, such as pension, dividend, interest, unemployment, and Social Security income, was misreported at an 8 percent rate compared to a 56 percent misreporting rate for income with little or no information reporting, such as sole proprietor, rent, and royalty income.

Several major new information requirements have recently taken effect, based at least, in part, on our work and recommendations.

- Brokers are required to report their clients' basis for securities sales, starting in 2012.[14]
- Banks and other third parties are required to report businesses' credit card and similar receipts, starting in 2011.[15]
- Under the Foreign Account Tax Compliance Act, starting in 2014, U.S. financial institutions and other entities are required to withhold a portion of certain payments made to foreign financial institutions that

[13]See GAO-12-176; and GAO, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Compliance Should Be Evaluated*, GAO-08-38 (Washington, D.C.: Nov. 15, 2007).

[14]GAO, *Capital Gains Tax Gap: Requiring Brokers to Report Securities Cost Basis Would Improve Compliance if Related Challenges Are Addressed*, GAO-06-603 (Washington, D.C.: June 13, 2006).

[15]GAO, *Tax Administration: Costs and Uses of Third-Party Information Returns*, GAO-08-266 (Washington, D.C.: Nov. 20, 2007).

have not entered into an agreement with IRS to report details on U.S. account holders to IRS.[16]

As these three sets of information reporting requirements have only recently taken effect, it is too soon to tell the impact they are having on taxpayer compliance.

We have made recommendations or suggested possible legislative changes in several other areas in which IRS could benefit from additional information reporting. They include the following:

- *Service payments made by landlords.* Taxpayers who rent out real estate are required to report to IRS expense payments for certain services, such as payments for property repairs, only if their rental activity is considered a trade or business. However, the law does not clearly spell out how to determine when rental real estate activity is considered a trade or business.[17]

- *Service payments to corporations.* Currently, businesses must report to IRS payments for services they make to unincorporated persons or businesses, but payments to corporations generally do not have to be reported.[18]

Broader requirements for these two forms of information reporting, covering goods in addition to services, were enacted into law in 2010, but later repealed. We believe the more narrow extensions of information reporting to include services, but not goods, remain important options for improving compliance.

Additionally, we have identified existing information reporting requirements that could be enhanced. Examples include the following:

[16]GAO, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified*, GAO-12-403 (Washington, D.C.: Feb 28, 2012).

[17]GAO-08-956.

[18]GAO, *Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements*, GAO-09-238 (Washington, D.C.: Jan. 28, 2009).

- *Mortgage interest and rental real estate.* We recommended requiring information return providers to report the address of a property securing a mortgage, mortgage balances, and an indicator of whether the mortgage is for a current year refinancing when filing mortgage interest statements (Form 1098) could help taxpayers comply with and IRS enforce rules associated with the mortgage interest deduction.[19] We have reported that collecting the address of the secured property on Form 1098 would help taxpayers better understand and IRS better enforce requirements for reporting income from rental real estate.[20]

- *Higher education expenses.* Eligible educational institutions are currently required to report information on qualified tuition and related expenses for higher education so that taxpayers can determine the amount of educational tax benefits they can claim.[21] However, the reporting does not always separate eligible from ineligible expenses. We recommended revising the information reporting form could improve the usefulness of reported information.[22]

Identifying additional third-party reporting opportunities is challenging. Considerations include whether third parties exist that have accurate information available in a timely manner, the burden of reporting, and whether IRS can enforce the reporting requirement. We have noted, for example, that the reason there is little third-party reporting on sole proprietor expenses is because of the difficulty of identifying third parties that could report on expense like the business use of cars.

Implementing Modernized Systems Should Provide for Faster Refunds and Account Updates

Modernized systems should better position IRS to conduct more accurate and faster compliance checks, which benefits taxpayers by detecting errors before interest and penalties accrue. In addition, modernized systems should result in more up-to-date account information, faster refunds, and other benefits, such as clearer notices so that taxpayers can

[19]GAO, *Home Mortgage Interest Deduction: Despite Challenges Presented by Complex Tax Rules, IRS Could Enhance Enforcement and Guidance*, GAO-09-769 (Washington, D.C.: July, 29, 2009).

[20]GAO-08-956.

[21]26 U.S.C. § 6050S.

[22]GAO-10-225.

better understand why a return was not accepted by IRS. Two new, modernized systems IRS is implementing include the following:

- **Customer Account Data Engine (CADE) 2.** For the 2012 filing season, IRS implemented the first of three phases to introduce modernized tax return processing systems. Specifically, IRS introduced a modernized taxpayer account database, called CADE 2, and moved the processing of individual taxpayer accounts from a weekly to a daily processing cycle. IRS expects that completing this first phase will provide taxpayers with benefits such as faster refunds and notices and updated account information. IRS initially expected to implement phase two of CADE 2 implementation by 2014. However, IRS reported that it did not receive funding in fiscal year 2011 that would have allowed it to meet the 2014 time frame.

- **Modernized e-File (MeF).** IRS is in the final stages of retiring its legacy e-file system, which preparers and others use to transmit e-filed returns to IRS, and replacing it with MeF. Early in the 2012 filing season, IRS experienced problems transferring data from MeF to other IRS systems. IRS officials said that they solved the problem in early February. IRS officials recently reiterated their intention to turn off the legacy e-file in October 2012 as planned. However, more recently, IRS processing officials told us they would reevaluate the situation after the 2012 filing season.[23] MeF's benefits include allowing taxpayers to provide additional documentation via portable document files (PDF), as opposed to filing on paper. In addition, MeF should generate clearer notices to taxpayers when a return is rejected by IRS compared to the legacy e-file system.

Expanding Pre-Refund Compliance Checks Could Result in More Efficient Error Correction

The Commissioner of Internal Revenue has talked about a long-term vision to increase pre-refund compliance checks before refunds are sent to taxpayers.[24] As previously noted, early error correction can benefit taxpayers by preventing interest and penalties from accumulating. In one example, IRS is exploring a process where third parties would send information returns to IRS earlier so they could be matched against taxpayers' returns when the taxpayer files the return as opposed to the

[23]GAO-12-566.

[24]GAO-12-176.

current requirement that some information returns go to taxpayers before being sent to IRS. The intent is to allow IRS to match those information returns to tax returns during the filing season rather than after refunds have been issued.

Another option for expanding pre-refund compliance checks is additional math error authority (MEA) that Congress would need to grant IRS through statute. MEA allows IRS to correct calculation errors and check for obvious noncompliance, such as claims above income and credit limits. Despite its name, MEA encompasses much more than simple arithmetic errors. It also includes, for instance, identifying incorrect Social Security numbers or missing forms. The errors being corrected can either be in the taxpayers' favor or result in additional tax being owed.

MEA is less intrusive and burdensome to taxpayers than audits and reduces costs to IRS. It also generally allows taxpayers who make errors on their returns to receive refunds faster than if they are audited. This is due, in part, to the fact that IRS does not have to follow its standard deficiency procedures when using MEA—it must only notify the taxpayer that the assessment has been made and provide an explanation of the error. Taxpayers have 60 days after the notice is sent to request an abatement.

Although IRS has MEA to correct certain errors on a case-by-case basis, it does not have broad authority to do so. In 2010, we suggested that Congress consider broadening IRS's MEA with appropriate safeguards against the misuse of that authority.[25] In the absence of broader MEA, we have identified specific cases where IRS could benefit from additional MEA that have yet to be enacted. These include authority to:

- use prior years' tax return information to ensure that taxpayers do not improperly claim credits or deductions in excess of applicable lifetime limits,[26]

[25]GAO, *Recovery Act: IRS Quickly Implemented Tax Provisions, but Reporting and Enforcement Improvements Are Needed*, GAO-10-349 (Washington, D.C.: Feb. 10, 2010).

[26]GAO, *2011 Tax Filing: IRS Dealt with Challenges to Date but Needs Additional Authority to Verify Compliance*, GAO-11-481 (Washington, D.C.: Mar. 28, 2011).

- use prior years' tax return information to automatically verify taxpayers' compliance with the number of years the Hope credit can be claimed,[27] and

- identify and correct returns with ineligible (1) individual retirement account (IRA) "catch-up" contributions and (2) contributions to traditional IRAs from taxpayers over age 70½.[28]

In 2009, Congress enacted our suggestion that IRS use MEA to ensure that taxpayers do not improperly claim the First-Time Homebuyer Credit in multiple years, which we estimate resulted in savings of about $95 million.[29]

Reducing Tax Code Complexity Could Ease Taxpayer Burden and Make It Easier to Comply

Tax code complexity can make it difficult for taxpayers to voluntarily comply. Efforts to simplify or reform the tax code may help reduce burdensome record keeping requirements for taxpayers and make it easier for individuals and businesses to understand and voluntarily comply with their tax obligations. For example, eliminating or combining tax expenditures, such as exemptions, deductions, and credits, could help taxpayers reduce unintentional errors and limit opportunities for tax evasion.

Frequent changes in the tax code also reduce its stability, making tax planning more difficult and increasing uncertainty about future tax liabilities. Limiting the frequency of changes to the tax code could also help reduce calls to IRS with questions about the changes. We have reported that IRS annually receives millions of calls about tax law changes.[30]

Reducing complexity in the tax code could take a variety of forms, ranging from comprehensive tax reform to a more incremental approach focusing on specific tax provisions. Policymakers may find it useful to compare any

[27]GAO-10-225. The American Opportunity Tax Credit modified the Hope Tax Credit from tax year 2009 through 2012.The Hope Tax Credit is scheduled to be reinstated in 2013.

[28]GAO, *Tax Administration: IRS's 2008 Filing Season Generally Successful Despite Challenges, although IRS Could Expand Enforcement during Returns Processing*, GAO-09-146 (Washington, D.C.: Dec. 12, 2009).

[29]GAO-11-481 and GAO-09-1026.

[30]GAO-11-111.

proposed changes to the tax code based on a set of widely accepted criteria for assessing alternative tax proposals. These criteria include the equity, or fairness, of the tax system; the economic efficiency, or neutrality, of the system; and the simplicity, transparency, and administrability of the system. These criteria can sometimes conflict, and the weight one places on each criterion will vary among individuals. Our publication *Understanding the Tax Reform Debate: Background, Criteria, & Questions* may be useful in guiding policymakers as they consider tax reform proposals.[31]

In closing, improving the taxpayer experience and increasing voluntary compliance will not be achieved through a single solution. Because voluntary compliance is influenced by so many factors, multiple approaches, such as those listed here, will be needed.

Chairman Baucus, Ranking Member Hatch, and Members of the Committee, this completes my prepared statement. I would be happy to respond to any questions you and Members of the Committee may have at this time.

Contacts and Acknowledgments

For further information regarding this testimony, please contact James R. White, Director, Strategic Issues, at (202) 512-9110 or whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this statement include Joanna Stamatiades, Assistant Director; LaKeshia Allen; David Fox; Tom Gilbert; Kirsten Lauber; Sabrina Streagle, and Weifei Zheng.

[31]GAO, *Understanding the Tax Reform Debate: Background, Criteria, & Questions*, GAO-05-1009SP (Washington, D.C.: September 2005).

Appendix I: Selected Internal Revenue Service (IRS) Taxpayer Service Performance Data, Fiscal Years 2007 through 2013

As shown in table 3, in recent years, the level of access to telephone assistors has declined and average wait time has increased. In addition, the volume of overage correspondence has steadily increased. On a positive note, tax law and account accuracy remains high.

Table 3: Selected IRS Taxpayer Service Performance Data, Fiscal Years 2007 Through 2013

Performance measure (in percent)	2007	2008	2009	2010	2011	2012 planned	2013 planned
Assistor calls							
Percentage of callers seeking and receiving live assistance	82.1	52.8	70	74	70.1	61.0	63.0
Average wait time (in minutes)	4.4	10.4	8.8	10.8	13.0	18.8	18.8
Tax law accuracy[a]	91.2	91.2	92.9	92.7	93.4	92.7	92.7
Account accuracy[a]	93.4	93.7	94.9	95.7	96.0	95.0	95.0
Overage paper Correspondence[b] (in percent)	17	23	25	27	35	n/a	n/a

Legend: n/a = not applicable.

Sources: 2009 and 2010 IRS Oversight Board Annual Reports to Congress and the fiscal year 2013 Congressional Justification for IRS, and previous GAO reports.

[a]Customer accuracy measures how often customers receive correct answers or solutions to their inquiry from a live IRS assistor. Tax law accuracy refers to callers asking questions about specific tax laws while account accuracy refers to callers asking questions about their individual accounts.

[b]IRS generally considers paper correspondence that is not resolved within 45 days to be overage. IRS does not have a performance measure for taxpayer correspondence that includes providing timely service to taxpayers, which we recommended in 2010. See, GAO, *2010 Tax Filing: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others*, GAO-11-111 (Washington, D.C.: Dec. 16, 2010).

Appendix II: Internal Revenue Service (IRS) Telephone Performance Data, January 1 through Early April, 2008 through 2012

As shown in table 4, access to IRS assistors has declined over the last few years. IRS officials attribute the higher-than-planned level of service so far this year to a slight decline in the demand for live assistance. At the same time, the number of automated calls has significantly increased which IRS officials attributed in part to taxpayers calling about refunds, and requesting transcripts (i.e., a copy of their tax return information).

Table 4: IRS Telephone Performance Data, January 1 through Early April, 2008 through 2012

Call volume (in millions)		2007	2008	2009	2010	2011	2012	Percentage change from 2011 to 2012
Total calls to IRS		36.5	40.6	52.4	51.9	56.8	68.2	20.1
Automated calls answered		16.0	17.1	19.6	24.3	28.3	37.7	33.2
Assistor answered calls		12.3	13.4	14.9	13.8	13.9	11.4	-18.0
Abandoned, busies, and disconnects		8.2	10.1	17.9	13.8	14.6	19.0	30.1
Performance								
Level of service—percentage of callers seeking live assistance who receive it	Fiscal year goal[a]	82.0	82.0[b]	77.0[c]	71.0	71.0	61.0	—[d]
	Actual to date	84.1	79.9	64.3	75.7	75.1	68.1	—[d]
Average wait time (in minutes)	Fiscal year goal[a]	4.3	4.5	10.4	11.6	11.6	18.8	62.1
	Actual to date	3.9	5.7	8.8	9.5	9.5	15.8	66.3

Source: GAO analysis of IRS data.

Note: Data are cumulative for IRS from January 1 of each year to April 7, 2007, April 5, 2008; April 4, 2009; April 10, 2010; April 9, 2011; and April 7, 2012.

[a]The goal listed is for the entire fiscal year, not just the period from January 1 through early April.

[b]IRS revised its original fiscal year goal of 82.0 percent down to 74.0 percent because of high call volume caused by economic stimulus-related calls.

[c]IRS revised its original fiscal year goal of 77.0 percent down to 70.0 percent because of high call volume from taxpayers requesting electronic filing authentication information and asking stimulus-related questions.

[d]The difference is 10 percentage points between fiscal year 2011 and 2012 for the goal and 7.0 percentage points for actual performance between 2011 and 2012.

Senate Finance Committee Hearing
"Tax Filing Season: Improving the Taxpayer Experience"
April 26, 2012
Questions for Mr. James White

Questions from Senator Orrin Hatch

1. **Levels of taxpayer service have already decreased at the IRS. If the health spending law is implemented, the IRS would be forced to deal with administering tax credits that are given to 23 million people that are newly enrolled in the health exchanges by 2019.**

   In addition, 3.9 million people will be subject to the individual mandate penalty according to CBO's April 22, 2010 analysis, and the IRS is the agency responsible for administering that penalty.

   Therefore, won't levels of taxpayer service decline even further as IRS resources for taxpayer service are diverted to deal with the health spending law?

   Answer

   The Affordable Care Act and other recent tax law changes, including the Foreign Account Tax Compliance Act and requirements for information reporting on (1) basis for securities and (2) credit card payments, are contributing to an increase in IRS's workload. IRS's ability to provide high quality service to taxpayers depends on a variety of factors, including effectively managing these workload increases and its success in offering service through a variety of channels. For example, by providing more self-service options on its website or over the phone, IRS may be able to reduce the demand to speak to live assistors over the phones (a high cost service) and the amount of time taxpayers must wait to talk to an assistor (taxpayers are waiting an average of about 16.5 minutes to talk to an assistor so far this fiscal year). In addition, effectively leveraging paid preparers and tax software providers can help ensure taxpayers have access to needed services. Other actions, such as conducting automated pre-refund compliance checks and further expanding information reporting, could also reduce the need for audits and make additional resources available for other purposes.[1]

2. **The IRS has certainly seen benefits from technological advances. However, I want to know what technology would be helpful for the IRS to use, but is either not being used or is being underutilized? And why isn't that technology being utilized, or fully utilized?**

[1]See GAO-06-603, GAO-08-266, GAO-12-176, GAO-12-403, and GAO-12-566.

Answer

In recent years, IRS has made use of new technology to provide better service to taxpayers and is currently upgrading several key return processing systems. However, opportunities exist for IRS to make better use of technology. For example, we have reported on the following areas in which IRS can better leverage technology:

- *Online Services.* IRS is investing hundreds of millions of dollars in providing new online services. However, taxpayers currently lack access to basic online services, such as accessing their individual accounts. In 2011, we recommended that IRS develop an online services strategy and use its capabilities to redirect taxpayers who would otherwise call IRS to use the web. IRS agreed with our recommendation and has since begun taking steps expand its strategy for providing online services. Doing so could provide more efficient service, decrease costs to IRS, and speed transactions for taxpayers in comparison to IRS's current capabilities.[2]
- *Return Processing.* We reported earlier that IRS may meet its goal of 80% electronic filing of individual returns for the first time in 2012. Leveraging technology to improve returns processing reduces costs and allows IRS to deliver refunds more accurately and faster. For example, IRS is implementing its Customer Account Data Engine (CADE) 2 database, but still must finish the final two implementation phases in the coming years. In addition, IRS is replacing its legacy electronic filing system with the Modernized e-File system.[3]
- *Prerefund Compliance Checks.* Prerefund checks allow IRS to prevent erroneous payments, which results in savings to IRS and can benefit taxpayers who underestimate their refund amounts. IRS plans to replace its legacy Electronic Fraud Detection System (EFDS) with a new system called the Return Review Program (RRP) in the coming years. IRS reports that RRP will speed up compliance reviews resulting in faster detection of errors and quicker processing of returns without errors.[4]
- *Matching to private databases.* Technology improvements at IRS should allow it to make better use of third party data to improve taxpayer compliance. These data can be combined with existing IRS data to improve taxpayer compliance and the accuracy of IRS data.[5]

Question from Senator John Kerry

1. **Mr. White, I understand that you were involved several years ago in evaluating the success of the IRS's long distance telephone tax refund program during the 2006 filing season. The GAO report, as I recall, found that less than 2 percent of the 10 –**

[2] See GAO-12-176.
[3] See GAO-11-168 and GAO-12-176.
[4] See GAO-12-176.
[5] See GAO-10-950.

30 million people who do not file income tax forms requested tax refunds. Similarly, GAO found that less than 2 percent of businesses filed for refunds.

As evidenced by this hearing, we are all interested in simplifying the tax filing process and ensuring that taxpayers understand their rights and responsibilities. It looks like the IRS did not accomplish that goal when it implemented the telephone excise tax refund program, since only about 2/3 of tax filers requested a refund, and more troubling, less than 2 percent of non-filers requested a refund.

You are probably aware that litigation over this failure has continued since then. I have a constituent who is a lead plaintiff in this case. Just a couple of weeks ago, the plaintiffs succeeded in having the old notice invalidated and the issue was remanded back to the IRS for a better remedy. What suggestions would you make to the IRS to guide them in structuring a better refund program that will reach non-filers, small businesses and tax-exempt organizations, few of whom received their refunds?

Answer

The federal district court for the District of Columbia has prospectively vacated Notice 2006-50, the notice which provided for how IRS would administer the refunds for the telephone excise taxes improperly collected between February 2003 and August 2006. Under the court order, IRS will have to issue a new notice, either using notice and comment or claiming good cause not to do so under the Administrative Procedure Act.

However, more generally, in our written statement for the April 26, 2012 hearing GAO identified opportunities for IRS that would potentially improve the taxpayer experience and help ensure taxpayers eligible to claim certain provisions do so. For example, IRS can

- develop self-service tools to help taxpayers identify whether they are eligible for certain provisions;
- leverage paid tax return preparers to ensure that eligible taxpayers claim benefits to which they are entitled;
- provide necessary and accurate information on its website for taxpayers to comply with tax laws; and
- use third party data to identify taxpayers that are both eligible or ineligible for tax benefits.

In addition, Congress could take steps to simplify the tax code so that taxpayers have a better understanding of the tax benefits they are eligible to claim on their tax returns.

COMMUNICATIONS

H&R BLOCK®

April 19, 2012

Senate Committee on Finance
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RE: Tax Filing Season: Improving the Taxpayer Experience

H&R Block appreciates the opportunity to provide our insights on improving the taxpayer experience. We anticipate the 2013 tax season having many challenges related to the uncertainty of expired or expiring tax incentives and technological changes. Eleventh hour changes to the tax code add to the complexities of tax return preparation and further hinder compliance.

At the end of 2011, a number of tax extenders, as well as the AMT patch, expired. Additionally, at the end of 2012, the Bush tax cuts will expire. The uncertainty of these tax incentives' renewal inhibits taxpayers' ability to perform effective tax planning and make financial decisions based on these incentives.

H&R Block anticipates a legislative landscape which will push the possible extension of these incentives to December 2012 or even as late as 2013. Taxpayers, tax return preparers, and the IRS all will suffer as a result of delayed legislation. This was the case in tax season 2011 when late legislative activity for the same tax extenders and AMT patch delayed the start of tax season for many taxpayers. The IRS stated on numerous occasions in 2010 they needed at least six weeks to implement programming changes. Without that necessary lead-time, the IRS was unable to make the necessary changes to tax forms and provide guidance to taxpayers by the start of the tax season.

As we look to tax season 2013, questions cloud the landscape. Will taxpayers who rely on their tax refunds have to wait longer to receive them? Will tax preparers be forced to amend the returns of early filers to implement retroactive changes? The likely legislative uncertainty will cause early-season filers to be met with instability, regardless of who prepares their tax return.

Legislative uncertainty and last-minute changes may also have a significant impact on new technology implementation as the IRS will have to update their systems to reflect changes. As witnessed in the transition to modernized e-file and CADE 2, changes in technology present challenges for the tax preparation industry and taxpayers. H&R

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Block is concerned the final transition to these new technologies may be impeded by last-minute updates to the IRS' systems.

H&R Block believes the taxpayer experience will be improved through the implementation of the registered tax return preparer program. Through proper enforcement, this program should raise professionalism and ensure tax return preparers meet competency standards. While this program is still in its early stages, we are optimistic it will help increase compliance in the 2013 tax season and beyond.

However, it is important to note compliance may be hindered and the taxpayer experience may suffer if the uncertainty surrounding the AMT patch, expired tax incentives, and the Bush tax cuts is not resolved in sufficient time to allow those in the tax preparation industry, the IRS, and taxpayers to respond accordingly. If this uncertainty is not resolved, H&R Block anticipates tax season 2013 to be rife with confusion for taxpayers and burdensome to those in the industry.

H&R Block strongly urges Congress to make resolving the uncertainty around the AMT patch, expired tax incentives, and the Bush tax cuts a priority. Given the uncertainty surrounding legislative and technology changes, we recommend the IRS maintain suitable contingency plans for tax season 2013.

Thank you for your consideration.

Statement for the record of
Mr. David J. Kautter
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Washington, District of Columbia

Committee on Finance
United States Senate

Hearing on
Tax Filing Season: Improving the Taxpayer Experience
April 26, 2012

Chairman Baucus, Ranking Member Hatch and Members of the Committee, thank you for the opportunity to submit written comments on the need to improve the taxpayer experience during tax filing season.

I have been a tax professional for over 35 years. For most of that time, I advised clients on tax matters as a partner with a Big Four accounting firm. I also served as tax counsel to former Senate Finance Committee member John Danforth (R – MO), and I have remained closely involved in the tax policy process over the entire course of my career.

I am writing to you today to encourage and support the need to improve the taxpayer experience during tax filing season. Ever expanding income tax reporting requirements coupled with ever changing federal tax laws are making the tax compliance process an increasing burden for all taxpayers, especially small businesses.

Recently, Kogod Tax Center and Bloomberg BNA jointly conducted a survey[1] of professional tax return preparers that provided valuable insights about the increasing pressures facing tax return preparers and their clients.

In our survey, we asked tax professionals to answer the following nine questions:

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[1] BNA Insights: *"Complexity, Expanding Filings, and the Economy Big Concerns for Return Preparers,"* March 30, 2012.

- What types of Federal/State and local income tax returns to you prepare at your firm or tax department?
- In comparison to last year, how much time do you anticipate spending in 2012 on tax return preparation?
- If you are spending moderately or significantly more time in 2012, what is the cause?
- What types of concerns are most frequent from your clients or Chief Financial Officer?
- Which form(s) are the most difficult to complete?
- In your experience, what type of information is most difficult to accurately collect from your client or organization?
- Compared to last year, will your tax return preparation fees increase, decrease, or stay about the same?
- Compared to last year, what changes are expected to increase your efficiency this filing season?
- Compared to last year, what changes are expected to decrease your efficiency this filing season?

What emerged from the survey was a picture of a compliance system under significant stress as a result of three primary factors: (1) the steadily increasing complexity of the tax law, (2) increasing requirements at both the federal and state level to provide more information as part of the compliance process, and (3) significant economic pressures.

Currently, taxpayers and tax return preparers feel increasingly burdened by constantly expanding recordkeeping and reporting requirements. In 2012, 54 percent of tax return preparers said they expect to spend moderately more of significantly more time on tax return preparation. One of the main reasons for the increase is the IRS is requiring more information on federal tax forms. Specifically, the basis of assets and foreign accounts (Forms 8949 and 8939) are two key areas preparers cited as complex areas increasing preparation time. In addition to new forms, the IRS keeps adding more schedules and questions to existing forms such as Schedule C, Profit or Loss From Business, and Schedule E, Supplemental Income and Loss. In 2012 alone, the IRS revised over 100 forms for which taxpayers must now gather new information and for which tax return preparers must now ensure that the newly required

information is accurate before filing[2]. This means more taxpayer time expended to gather the required information and more time for tax return preparers to complete returns, and both of these mean more expense for taxpayers of all types, especially small businesses.

Taxpayers, as well as preparers, are becoming increasingly frustrated with the expanded amount of time they have to spend gathering and maintaining tax records. The complexity of the forms and the lack of any meaningful level of knowledge by most citizens of a constantly changing and increasingly undecipherable federal tax code is leading to frustration and diverting the focus of business owners from their business to tax compliance. This is an especially significant problem for small businesses and entrepreneurs. Preparers, on the other hand, are frustrated with the quality of information they are receiving from their clients and the effort it takes to gather complete and accurate information to prepare a return. While it is hard to decipher whether the taxpayer is intentionally or unintentionally withholding pertinent information, tax return preparers need to be diligent in their return preparation and that is taking an ever increasing amount of time and effort.

From the survey, it was discovered that Form 1065, U.S. Return of Partnership Income is the most difficult to complete. In response to the question "Which forms are the most difficult to complete" nearly 60 percent of respondents fingered Form 1065, whereas only about 20 percent pointed to Form 1040, U.S. Individual Income Tax Return, about 27 percent to Form 1120, U.S. Corporation Income Tax Return, and only 5 percent cited Form 1120S, U.S. Income Tax Return for an S Corporation. In 2008, IRS Statistics of Income data shows approximately 10 percent of all returns filed are attributable to partnerships and constitute about 14.30 percent of all business receipts[3]. Complex law combined with complex partnership agreements seems to be the main problem. According to a number of respondents, the greatest difficulty is attributable to "complex partnership allocations governed by §704(c) of the Internal Revenue Code." The simple fact of the matter is that most business owners think about the implications of a transaction for the business as a whole, not the tax implications specifically. Simplifying the tax law in the area of partnership taxation would go a long way toward alleviating the adverse experience of taxpayers when it comes to meeting their compliance obligations when

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[2] www.irs.gov

[3] "All returns" is defined as Partnerships is defined as general, limited and LLC.

conducting business as a partnership. For example, when there are complicated rules for transactions such as determining the basis of contributed property and determining built-in gains or losses, energy and resources that could be used to focus on growing a business are now being spent on figuring out and then complying with the tax law.

In addition to the complexity at the federal level, tax law continues to change within the states. As states try to close budgetary gaps, new tax laws are introduced at the state level that increases complexity to an already overburdened system. Often those new laws, parallel the complicated federal rules, but just as often they establish different and complicated rules that vary state by state. Congress needs to take into account the entire tax compliance burden of taxpayers when considering changes to the federal tax law, not just the effect on taxpayers of the federal changes. The overall compliance burden on taxpayers is increasing at an accelerating rate.

A difficult economic environment in addition to changes in the underlying tax law, increased complexity and expansion in reporting requirements increase taxpayers' frustrations with the current tax system. As long as the taxpayer continues to feel overwhelmed by the tax system, taxpayers who prepare their own returns and tax preparers who prepare returns for others will have a hard time fulfilling their obligations in a reasonable amount of time. . This never ending cycle of complexity will continue to get worse as uncertainty continues to loom around the tax community. To reduce stress on the system, taxpayers need to feel confident and find trust in the income tax system once again. A simplified, stable federal tax code would go a long way toward achieving that goal.

I have attached a complete copy of the article and survey results mentioned above in this testimony.

Background on the Kogod Tax Center

The Kogod Tax Center is a tax research institute located at American University's Kogod School of Business. The Center promotes balanced, nonpartisan research on tax law, the challenges of tax compliance and planning, and the implications of tax reform.

Our efforts focus principally on tax issues affecting small businesses, entrepreneurs, and middle-income taxpayers. We develop and analyze potential solutions to selected tax-related problems faced by these three sectors of the economy promote public dialogue to inform taxpayers, policymakers, academics, the press, and tax practitioners about critical tax issues.

We appreciate your taking our concerns on behalf of small businesses into account. Please do not hesitate to contact me if you have any questions.

Bloomberg BNA

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Tax Practice

With the filing season well under way, professional tax return preparers are feeling pressure from a number of different sources, according to a survey conducted by American University's Kogod Tax Center. The center's managing director, David Kautter, examines the results.

Complexity, Expanded Filings, and the Economy Big Concerns for Return Preparers

BY DAVID J. KAUTTER

A recent survey of professional tax return preparers conducted by the Kogod Tax Center at American University between Feb. 17 and March 14 focused on how the current filing season is progressing.

What emerged was a picture of a compliance system under significant stress as a result of three primary factors:

- the steadily increasing complexity of the tax law, both federal and state;
- increasing requirements at both the federal and state level to provide more information as part of the compliance process; and
- significant economic pressures.

Practitioners report that clients feel increasingly burdened by expanding recordkeeping and reporting requirements and that businesses are keenly focused trying to better control both internal and external tax compliance costs.

Here are the major findings of the survey.

David Kautter is managing director of the Kogod Tax Center at the Kogod School of Business at American University in Washington, D.C., and executive in residence in the school's Department of Accounting and Taxation. He joined the Tax Center after more than 30 years at Ernst & Young LLP, most recently as director of national tax.

The Kogod Tax Center promotes independent research and expands knowledge with respect to tax policy, tax planning, and tax compliance for small and midsize businesses, entrepreneurs, and middle-income taxpayers.

Time Spent on Return Preparation Expected to Increase

Almost 54 percent of the tax return preparers surveyed said they expected to spend moderately more or significantly more time on tax return preparation in 2012 and another 43 percent said they expect to spend about the same as in 2011. The primary reasons for the increase are a mix of business and technical issues with three issues virtually tied for the top spot:

- increased information required on federal and state tax forms,
- more clients, and
- fewer staff.

All three factors were within 2 percentage points of each other.

The Internal Revenue Service has expanded the information required on the tax return in two key areas, the basis of assets and foreign accounts (Forms 8949, Sales and Other Dispositions of Capital Assets, and 8938, Statement of Specified Foreign Financial Assets). These were the two reporting areas most frequently cited by preparers as requiring an increase in time.

In addition to new forms, preparers noted that IRS keeps adding more schedules and questions to existing forms, for example on Schedules C, Profit or Loss From Business, and E, Supplemental Income and Loss. This means more taxpayer time to gather the required infor-

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mation and more time for preparers to complete returns.

It is not just federal returns that are expected to take more time this year either—state returns are expected to take more time as well but for a different reason. Practitioners cited constantly changing state tax laws as the primary culprit with respect to state returns.

The other two factors cited for an increase in time represent a continuation of the trend of fewer and fewer taxpayers feeling comfortable preparing their own returns and preparers' efforts to control their costs in an uncertain economic environment.

Preparation Fees Expected to Increase

Consistent with spending more time on tax return preparation, nearly every respondent to the survey said fees for 2012 will either stay about the same or increase slightly. Just under 56 percent of respondents said that they expected fees this year to increase slightly and 44 percent said they expected fees to stay about the same. No respondent said fees would increase significantly.

Time to Gather Info, Compliance Costs Biggest Areas of Concern for Most Taxpayers

One theme that came through clearly in the survey was increasing frustration on the part of both preparers and their clients with the expanding amount of time they have to spend gathering and maintaining tax records.

Clients feel it is diverting them from focusing on their business. Preparers, on the other hand, are frustrated with the quality of information they are receiving from their clients and the effort it takes to gather complete and accurate information to prepare a return.

Fee complaints seem to reflect clients' lack of perceived value with respect to complying with the ever increasing reporting requirements of both federal and state governments.

More than one-half of respondents (56 percent) said that the biggest sources of concern for their clients are:

- the time and complexity required to compile data for return preparation; and
- the cost of compliance, including professional fees.

While fee complaints are not uncommon in all types of professional services, here they seem to reflect clients' lack of perceived value with respect to complying with the ever increasing reporting requirements of both federal and state governments. The desire to control internal compliance costs may be a factor contributing to the quality of information return preparers believe they are receiving.

Partnership Returns Most Difficult to Prepare

By a wide margin, the tax form cited as the most difficult to complete this year is Form 1065, U.S. Return of Partnership Income. Nearly 60 percent of respondents fingered Form 1065, whereas only about 20 percent pointed to Form 1040, U.S. Individual Income Tax Return, about 27 percent to Form 1120, U.S. Corporation Income Tax Return, and only 5 percent cited Form 1120S, U.S. Income Tax Return for an S Corporation.

Complex law combined with complex partnership agreements seems to be the main problem. According to a number of respondents, the greatest difficulty is attributable to "complex partnership allocations governed by [Internal Revenue Code] Section 704(c)." One respondent said the "partnership rules are getting more complex by the day," and another said "partnership returns are not only tricky but risky."

With so many businesses operating in unincorporated form today, preparing partnership returns seems to be viewed as not only an area of significant complexity but an area where there is significant practice management risk.

Basis Information Most Difficult to Obtain

By an overwhelming margin, respondents cited one piece of information as the most difficult to obtain from their clients. Nearly 70 percent said "basis of assets." A distant second was expense receipts.

Factors Hindering Efficiency

More than 40 percent of respondents cited new IRS or state reporting requirements as the biggest factor expected to decrease their efficiency this filing season. In the words of one respondent, "Efficiency will take a hit because of new reporting complexities. Clients don't want to pay for the additional work that goes into the tax return."

Second on the list was staff turnover (36 percent) and third was changes in the underlying tax law (25 percent).

Factors Enhancing Efficiency

In the area of encouraging news, tax return preparers cited three factors as enhancing their efficiency in 2012.

Nearly 50 percent of respondents cited increasingly efficient tax preparation software as the top reason their efficiency would increase this year. Additional experienced staff was second cited by nearly 30 percent of the respondents and improved internal processes such as the networking of computers, greater use of scanning technology, and implementation of better input and review processes were cited by 23 percent of the respondents.

The importance of retaining experienced staff clearly comes through in the survey with staff turnover ranking as the second most significant reason for a decrease in efficiency and staff retention as the second most significant reason for an increase in efficiency.

A System Under Stress

Overall, the survey indicates a system under significant stress. While preparers are finding ways to in-

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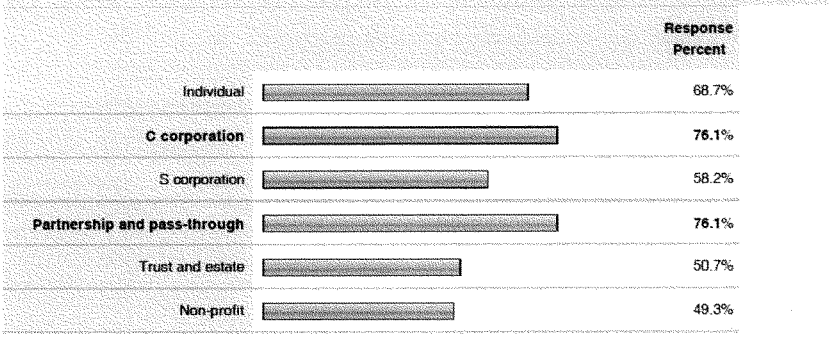
crease their productivity, there is clearly a feeling among preparers that they are swimming against the tide.

Despite the absence of significant new tax legislation at the federal level affecting this year's returns, that has been more than offset by tax law changes by the states as they try to close budget gaps.

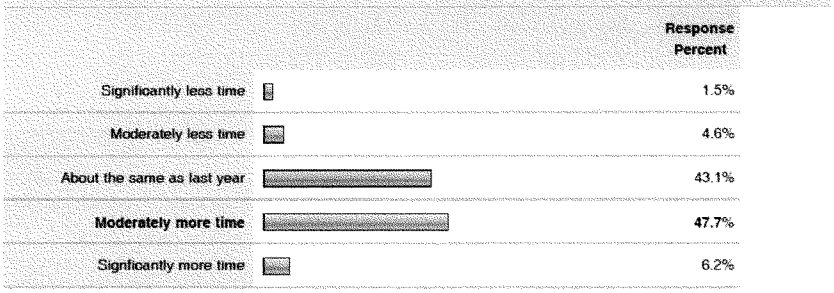
Expanded requests for information in the form of new tax forms, schedules, and questions by both federal and state governments is clearly increasing stress on an already overburdened system.

Ever expanding reporting requirements, changes in the underlying tax law, increasing complexity, and a difficult economic environment are making most preparers feel that this filing season is the most challenging ever.

1. What types of Federal/State and local income tax returns do you prepare at your firm or tax department?



2. In comparison to last year, how much time do you anticipate spending in 2012 on tax return preparation?



3. If you are spending moderately or significantly more time in 2012, what is the cause?

	Response Percent
Fewer staff	**37.2%**
More clients	34.9%
Information reporting	34.9%
Partnership allocations	14.0%
Basis reporting	20.9%
State and local issues (specify below)	23.3%
Clients expect more work for same fee	27.9%

4. What types of concerns are most frequent from your clients or CFO?

	Response Percent
Data-gathering (time and complexity)	54.7%
Fees	**56.3%**
Level of disclosures required on return	40.6%
Penalties	14.1%
Alternative Minimum Tax	14.1%

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5. Which form(s) are the most difficult to complete? Tell us why in the comment section.

	Response Percent
1040	19.6%
1120	26.8%
1120S	5.4%
1065	**58.9%**

6. In your experience, what type of information is most difficult to accurately collect from your client or organization (e.g., client is unresponsive, client provides incorrect data, etc.)?

	Response Percent
Basis of assets	**68.5%**
Expense receipts	25.9%
Charitable contributions (including appraisals)	14.8%
Information about claimed dependents	1.9%
Cash income	13.0%

7. Compared to last year, your fees for 2012 will:

	Response Percent
Stay about the same	44.4%
Increase slightly	**55.6%**
Increase significantly	0.0%
Decrease	1.6%

8. Compared to last year, what changes are expected to increase your efficiency this filing season?

	Response Percent
Added staff	28.6%
New technology (please specify)	**46.9%**
New procedures (please specify)	22.4%
Outsourcing of some functions	20.4%

9. Compared to last year, what changes are expected to decrease your efficiency this filing season?

	Response Percent
Client turnover	11.3%
Reduced staff	35.8%
Technology changes (please specify)	17.0%
New IRS or State regulations (please specify)	**41.5%**
New Federal or State law (please specify)	24.5%

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Improving the Taxpayer Experience

Comments on the 2012 Tax Return Filing Season for the Senate Committee on Finance

By Jackie Lynn Coleman, Executive Director, National Community Tax Coalition

May 9, 2012

Chairman Baucus, Ranking Member Hatch and Members of the Senate Committee on Finance: Thank you for the opportunity to share our thoughts on improving the taxpayer experience, in conjunction with your April 26 hearing on these subjects.

The National Community Tax Coalition (NCTC) is the nation's largest, most comprehensive network of community-based providers offering free tax preparation and financial services to low- and moderate-income working families through Volunteer Income Tax Assistance (VITA). In the 2011 filing season, our member organizations operated more than 6,200 Community VITA sites that leveraged the help if more than 53,000 trained and certified volunteers throughout the country. These efforts helped households meet their tax obligations by filing about 1.5 million federal returns, obtaining more than $2 billion in tax refunds.

In our comments we'd like to briefly address three main points:

- Taxpayer services are most effective when the Internal Revenue Service is as accessible as possible to taxpayers.
- An overcomplicated tax code will continue to drive taxpayers to seek third-party assistance with preparing and filing returns.
- VITA provides free, high-quality taxpayer services that relieve complication for taxpayers by offering them an affordable alternative to often-costly commercial options. But is under increasing strain to meet demand under current levels of support.

Taxpayer services are most effective when the IRS is as accessible as possible to taxpayers.

As filing began in mid-January, some taxpayers seeking basic information about free tax preparation and other tax issues via IRS hotlines reported delays of up to 50 minutes to have their calls answered. Others could not find the information they needed on the IRS web pages designed to answer their questions. These problems, coupled with increasingly limited accessibility to in-person IRS help at Taxpayer Assistance Centers, particularly in rural areas, are straining the often tenuous relationship many low-income taxpayers have with the IRS.

While we appreciate efforts taken during the filing season to alleviate some of the barriers faced by taxpayers, the IRS must continue to pursue simpler and more accessible options for low-income taxpayers to communicate with the agency and obtain answers and assistance. Such options include further improvements to the VITA hotline, as well as upgrading the "IRS2Go" mobile-device application with VITA location functionality to provide low- and moderate-income taxpayers with another avenue for finding free tax-filing assistance.

An overcomplicated tax code will continue to drive taxpayers to seek third-party assistance with preparing and filing returns.

A basic fact of the tax code is that its complexity drives many taxpayers to seek advice from the IRS as well as tax preparers. In light of this need for reliance upon tax preparers, it is necessary to ensure that taxpayers receive the best advice for their individual situations without overburdening their wallets. In the particular case of low-income taxpayers, access to free or low-cost tax services is essential to guarantee these households' much-needed tax refunds go as far as possible. Until such a time that the tax code is reformed to a point that a decreasing number of taxpayers need to seek-out these services, the IRS should continue to promote avenues to free and low-cost assistance, including VITA.

VITA provides free, high-quality taxpayer services that relieve complication for taxpayers by offering them an affordable alternative to often-costly commercial options. But is under increasing strain to meet demand under current levels of support.

The most effective means for ensuring full refunds and high-quality preparation of tax returns for low- and moderate-income families is through VITA. Unfortunately, stagnant federal support for the VITA grant program and decreasing state and local funding support are stifling VITA's ability to meet taxpayer demand for these services. Thus, many potential VITA clients are being driven to higher-cost paid preparers or are forced to pursue self-preparation options that might remain very confusing to them. The result is that much-needed refunds are chiseled-away by preparer fees and potentially valuable credits are not claimed by self-filers unaware of tax benefits due to them.

We strongly recommend Congress recognize the full taxpayer demand for high-quality VITA programs by increasing support for the VITA grant program. We certainly appreciate that such funding at the federal level has remained steady at $12 million the past couple of years, despite the current fiscal climate. However, pressure to expand our field's reach and scope has grown. Further, evidence from a recent survey conducted by NCTC highlights the increasing strain VITA programs feel, being asked to do more with less. Of 12 VITA programs that reported receiving state funding, eight have seen that support decrease while only one realized an increase. In several of the decreasing states, their funding resources have been zeroed-out entirely. This is a serious challenge for our ability to reach low- and moderate-income taxpayers fully and effectively.

The VITA field's ability to serve taxpayers is inherently tied to the stability and capacity of a well-functioning IRS. Therefore, we additionally urge Congress to avoid further budget cuts in the IRS, and instead invest more wisely in the agency and its taxpayer-services programs that help low-income families fully comply with their tax obligations. A strong IRS, enhanced by well-funded volunteer programs, supports the collection of a strong revenue stream, which is more necessary than ever to sustain a strong economy – which, in turn, is truly essential to the improvement of taxpayers' experience.

Statement of Colleen M. Kelley

National President

National Treasury Employees Union

On

"Internal Revenue Service Budget for FY 2013 and the 2012 Tax Filing Season"

Submitted to

Senate Committee on Finance

April 26, 2012

1750 H Street, N.W. • Washington, D.C. 20006 • (202) 572-5500

Chairman Baucus, Ranking Member Hatch and distinguished members of the Committee, I would like to thank you for allowing me to provide comments on the Administration's FY 2013 budget request for the Internal Revenue Service (IRS) and the 2012 tax filing season. 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 2013 BUDGET REQUEST

Mr. Chairman, NTEU strongly supports the Administration's FY 2013 budget request for the IRS. We believe that the President's request will allow the IRS to continue helping taxpayers meet their tax obligations while also improving enforcement of the tax law.

We are particularly pleased the Administration's budget request would provide critical increases for Service enforcement and taxpayer service activities that have been reduced in recent years, and would allow the IRS to rebuild its workforce which is down by almost 25,000 since 1995.

I would also note that in previous years, NTEU has supported the budget recommendations proposed by the IRS Oversight Board which have generally called for additional resources above that requested by the Administration. For FY 2013, the Oversight Board has recommended $13.764 billion in funding for the IRS. While we have not seen the specific details of the Board's proposal, we would be inclined to support providing additional funding for the IRS above the Administration's request and look forward to reviewing the Board's recommendation.

IMPACT OF UNDER FUNDING THE IRS

Mr. Chairman, as you know, despite the critical role that the IRS plays in helping taxpayers meet their tax obligations and generating revenue to fund the federal government, the IRS' ability to continue doing so has been severely challenged due to the lack of adequate funding in FY '11 and FY '12.

For FY '11, the full year CR provided IRS with $12.121 billion in funding, roughly its FY '10 level of $12.146 billion, less a 0.2% rescission, which strained IRS' capacity to carry out its important enforcement and taxpayer service missions and led to a general freeze on hiring.

In FY '12, funding for the IRS was again reduced by almost $330 million below its FY '10 level. In addition to hampering IRS' ability to collect revenue and assist taxpayers in a timely manner, the FY '12 funding reductions resulted in the loss of more than 3,800 FTE's below the FY '11 enacted level at a time when the workload is dramatically increasing and staffing levels are more than 20% below what they were 15 years ago. In 1995, the IRS had a staff of 114,064 to administer the tax law and process 205 million returns. Today, they have just 90,711, yet must administer a much more complicated tax code and process approximately 236 million, much more complicated, tax returns.

The dangers associated with underfunding the IRS cannot be overstated and have been highlighted in recent reports by the IRS Oversight Board, IRS Advisory Council, and most

recently, by the National Taxpayer Advocate. In her most recent Annual Report to Congress, the National Taxpayer Advocate identified inadequate funding for the IRS as the most serious problem facing taxpayers. The report noted that a lack of sufficient resources, coupled with a rising workload and increasingly complex tax code, was negatively impacting IRS' ability to carry out its taxpayer service mission and assist efforts to reduce the federal deficit.

In particular, Olson noted that IRS' capacity to respond to taxpayer inquiries has been severely diminished, to the extent that now the IRS is unable to answer three out of every ten calls it receives, and nearly half of all taxpayers who write to the IRS must wait more than 6 1/2 weeks for a reply. In addition, recent funding cuts resulted in a drop in the telephone level of service from 74 to 70 percent between FY '10 to FY '11. Because of expected higher call demand and new legislation requiring more training for telephone assistors, the Administration's FY '13 target level of service is 63 percent.

In addition to delays in correspondence and reduced telephone levels of service, NTEU has also received reports from our members about abnormally long wait times this filing season for taxpayers seeking assistance at many of the walk-in Taxpayer Assistance Centers (TACs) around the country due to insufficient staffing. According to the IRS, 107 out of the 398 TACs located around the country are currently being staffed by just one or two employees, while overall staffing at many TACs is half of what it was just 8 years ago. The lack of sufficient staffing has greatly increased wait times at the TACs and has hampered the ability of TAC employees to provide taxpayers with the personal one-on-one assistance that they need. Inadequate staffing and availability of service at TACs has long been a problem at the IRS and has previously been highlighted by the National Taxpayer Advocate as a serious problem disproportionately impacting the most vulnerable populations who use TACs most often, including low income taxpayers, those with language barriers, the elderly and the less educated.

In addition to the adverse impact on taxpayer services, the Taxpayer Advocate's Report also noted that the lack of adequate resources was also undermining IRS' ability to effectively implement its enforcement and compliance initiatives, hampering its ability to maximize revenue collection and close the tax gap. Because of the IRS' unique role in generating revenue that funds the federal government, Olson urged Congress to view providing sufficient resources for the IRS as an investment rather than an expense.

We are pleased the President's budget proposal acknowledges the importance of providing IRS with the necessary resources to generate critical revenue for the federal government and devotes a significant portion of the increase from FY '12 to restoring lost revenue resulting from reductions in funding over the past two years.

TAXPAYER SERVICES

NTEU strongly believes that helping taxpayers understand their tax reporting and payment obligations is the foundation of taxpayer compliance. Through a variety of channels, the IRS is able to provide year-round assistance to millions of taxpayers, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, the IRS.gov web site and Taxpayer Assistance Centers (TACs). These efforts have enabled the

IRS to continue raising the standard of service to America's taxpayers and assisted in efforts to improve voluntary compliance even during this challenging budget environment.

The IRS' comprehensive approach to taxpayer service played a critical role in allowing it to deliver a successful 2011 filing season, despite the challenges presented by reduced funding and enactment of tax legislation in late December 2010. During this time, IRS employees processed more than144.7 million individual returns and issued 109 million refunds, totaling $345 billion; answered more than 42 million automated calls and 34.2 million assistor calls; responded accurately to 93.4 percent of tax law questions and 96 percent of account questions; and helped millions of taxpayers at the 398 Taxpayer Assistance Centers located around the country.

But, without the additional funding proposed in the Administration's budget request, NTEU believes taxpayers will continue experiencing a degradation of services including difficulty seeking telephone assistance, delays in responses to letters, including those seeking to resolve issues with taxes due, delayed responses to small business owners or individual taxpayers looking to set up payment plans, and difficulties for those seeking answers on tax deductions and credits due under the tax codes. As noted previously, IRS' ability to respond to taxpayer inquiries has already been diminished due to the FY '12 funding cuts which are resulting in a very challenging filing season.

NTEU strongly believes providing quality services to taxpayers is an important part of any overall strategy to improve compliance, and that the President's request for additional funding for taxpayer services will help prevent further degradation of services and enable the IRS to deliver a successful filing season next year.

ENFORCEMENT

Mr. Chairman, NTEU believes that in the current budgetary environment, it is critical that the IRS has the resources it needs to maximize taxpayer compliance, reduce the tax gap and generate critical revenue for the federal government.

IRS' ability to generate critical revenue necessary to reduce the federal deficit is clear. In FY '11, on a budget of $12.1 billion, the IRS collected $2.42 trillion, 92 percent of federal government receipts. This means that, for every $1 that Congress appropriated for the IRS, the IRS collected about $200 in return.

However, reductions in enforcement funding in FY '11 and FY '12 have undermined IRS' ability to maximize taxpayer compliance and bring in much needed federal revenue. In FY '11, the IRS generated $55 billion in enforcement revenue, down from $57.6 billion in FY '10. The reduction in revenue can be partly attributed to a reduction in the total number of revenue officers (ROs) and revenue agents (RAs). Despite the critical role they play in maximizing taxpayer compliance and generating revenue, the total number of ROs and RAs were reduced by almost 450 between FY '10 and FY '11, and are down almost 20 percent since 1995.

The need for sufficient enforcement staffing is more important than ever. In January the IRS released a new set of tax gap estimates for tax year 2006. The tax gap is defined as the amount of

tax owes by taxpayers that is not paid on time and is the most comprehensive and up to date data that IRS has on noncompliance. According to the IRS, the amount of tax not timely paid is $450 billion, translating to a noncompliance rate of almost 17 percent.

While the tax gap can never be completely eliminated, even an incremental reduction in the amount of unpaid taxes would provide critical resources for the federal government.

That is why NTEU was happy to see the Administration's budget request would provide a $402 million increase in funding for IRS tax enforcement above the FY 2012 level, including additional resources made available through a program integrity cap adjustment.

The increased funding will be invested in Service enforcement programs designed to increase compliance by addressing offshore tax evasion, reduce the underreporting tax gap, and restore revenue lost from FY '12 reductions to examination audit and collection programs. According to the IRS, these investments are expected to generate $1.48 billion in additional annual enforcement revenue, resulting in a return on investment (ROI) of more than 4 to 1, once new hires reach full potential in FY 2015. This estimate does not account for the deterrent effect of IRS enforcement programs, estimated to be at least three times larger than the direct revenue impact.

At a time when Congress is debating painful choices of program cuts and tax increases to address the federal budget deficit, we believe it makes sense to invest in one of the most effective deficit reduction tools: collecting revenue that is owed, but hasn't yet been paid.

NTEU urges support for the Administration's request for an additional $691 million in enforcement funding for FY '13 through a program integrity cap adjustment for high revenue generating enforcement activities. This $691 million in funding, coupled with additional investments through 2022, will support a variety of compliance activities, including new initiatives that deepen and broaden IRS' focus on international tax compliance of high net worth individuals and entities. These investments are expected to generate an additional $44 billion in additional tax revenue over ten years.

In recent years, both Democratic and Republican Administrations have requested and Congress has approved, integrity cap adjustments for IRS enforcement activities. President Bush's FY 2006 budget proposal included a program integrity cap adjustment for IRS enforcement of $446 million. Congress approved that amount and in 2007 the IRS stated in Congressional testimony, "much of the enforcement success in FY 2006 was the direct result of this increased funding provided by the program integrity cap adjustment." Congress also approved an $890 million cap adjustment in FY 2010.

The Budget Control Act of 2011 specifically allows for other program integrity cap adjustments for Social Security disability claim reviews and health care fraud and abuse programs. The Senate version of the Budget Control Act also included an IRS enforcement program integrity cap adjustment, but it was not included in the final legislation. Clearly, Congress recognized the wisdom of small spending increases when they will be more than offset by large returns on investment. NTEU strongly supports the President's request for additional enforcement funding

for FY '13 above the current level, including additional funding made available via a program integrity cap allocation adjustment.

CONCLUSION

Mr. Chairman, thank you for the opportunity to provide NTEU's views on the Administration's FY 2013 budget request for the IRS and the 2012 tax filing season. We believe that by restoring critical funding for demonstrably effective enforcement and taxpayer service programs, the Administration's request will allow the IRS to continue providing America's taxpayers with quality service while maximizing revenue collection that is critical to reducing the federal deficit.

Texas Society of Certified Public Accountants

April 12, 2012

U.S. Senate Committee on Finance
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Washington, DC 20510-6200

The Texas Society of Certified Public Accountants respectfully submits this letter as a written statement into the hearing record on:

"Tax Filing Season: Improving the Taxpayer Experience"
Thursday, April 26, 2012, 10:00 AM

On behalf of the 29,000 members of the Texas Society of Certified Public Accountants (TSCPA), we are writing to encourage your support for full funding of the Internal Revenue Service to help improve fiscal responsibility and fairness to taxpayers.

Supporting the full budget for the IRS is a matter of fiscal responsibility. While we understand the interest in cutting expenses to help balance the federal budget, we believe cuts to the IRS budget and the failure to adequately fund the IRS for a number of years has had, and will continue to have, the opposite effect. The result will be decreased revenue and failure to adequately service the taxpaying public. The IRS serves as the nation's tax collector. That service has historically been performed in a cost-effective manner as evidenced by the fact that the IRS collected about $2.42 trillion in 2011 with a budget of $12.1 billion.[1] The proposed IRS budget for fiscal 2013 (which includes an increase of $944.5 million over the previous funding authorized) includes $403 million in new enforcement initiatives, which are projected to raise nearly $1.5 billion in additional revenues for a 4.3-to-1 return on investment.[2]

We have experienced a significant "tax gap" estimated to be $385 billion in 2006.[3] If the tax gap could be closed to a meaningful extent, revenues would increase dramatically, without the need for an increase in tax rates, elimination of deductions or credits, or cuts in important government programs. For example, if the 2006 gap figure referenced above had been closed, it would have paid for the recent $100 billion payroll tax cut extension almost four times. That gap cannot be closed if we don't provide the IRS with the financial resources to do so. Indeed, the current level of underfunding will exacerbate the tax gap.

[1] IR-2012-6, National Taxpayer Advocate Delivers Annual Report to Congress; Focuses on IRS Funding and Taxpayer Rights (January 11, 2012), Internet.
[2] FS-2012-10, IRS FY 2013 Budget Proposal Summary (February 2012), Internet.
[3] FS-2012-6, IRS Releases 2006 Tax Gap Estimates (January 2012), Internet.

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An additional loss in revenue is likely to result from the reduction in the IRS' ability to provide taxpayer services. Less than half of the IRS budget is for investigations, examinations, collections, and regulatory activities.[4] Since our system is one of self-assessment, equally important is the support the IRS renders to all taxpayers (and their representatives). In this context, the IRS develops forms and instructions, and responds to taxpayer inquiries. The vast majority of Americans are honest and willing to pay taxes that they correctly owe. However, due to the complex and constant changes of the tax law, the average taxpayer, and even those of us who are professionals, frequently need IRS guidance. The necessarily complex system generates much interaction between the IRS and taxpayers.

Unfortunately, taxpayers (and our TSCPA members) have seen this service decline in recent years, making it ever more time consuming, difficult and costly to file accurate returns and to resolve even those issues that should not generate conflict between the IRS and the taxpayer.[5] To quote Colleen Kelley, National Treasury Employees Union president, "IRS employees know taxpayers need assistance and want to help, but long hold times result in dropped calls when taxpayers give up in frustration."[6] She also added, "As the IRS workload continues to rise and the tax code becomes increasingly complex, staffing levels at the agency are 20 percent below what they were 15 years ago." Between 2004 and 2011, the portion of unanswered taxpayer telephone inquiries rose from 13 percent to 30 percent,[7] hardly a level of service that Congress should want in applying its tax laws. Nina Olson, National Taxpayer Advocate has said, "The overriding challenge facing the IRS is that its workload has grown significantly in recent years, while its funding is being cut. This is causing the IRS to resort to shortcuts that undermine fundamental taxpayer rights and harm taxpayers—and at the same time reduces the IRS ability to deliver on its core mission of raising revenue."[8]

We're confident that our members endure this difficulty and get the right answer. But doing so under these circumstances raises the cost to our clients, and we expect many individuals who self-prepare merely give up out of frustration. Cutting the IRS budget will greatly intensify this issue and reduce the effectiveness of our self-assessment system. Taxpayers and practitioners expect competent and responsive IRS personnel. Long waits and dropped calls for telephone information, antiquated technology, delays in processing claims, and overworked personnel frustrate taxpayers (and professionals) and undermine respect for the tax law. These factors also inevitably cause greater work to stressed IRS employees and are counterproductive to efficient tax collection. However, we understand that no increase is allocated in the Administration 2013 budget for taxpayer service, an omission that we regard as a significant problem.

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[4] Tax Analysts, "Obama Budget Proposes Almost $1 Billion More for IRS" (February 14, 2012), Internet.
[5] FOXBusiness, "The IRS Budget: What it Means for Taxpayers" (March 1, 2012), Internet.
[6] Ibid, Tax Analysts.
[7] National Taxpayer Advocate's 2011 Annual Report to Congress Executive Summary: Preface & Highlights (December 31, 2011), 2, from FY 2004 to FY 2011, the percentage of calls the IRS answered from taxpayers seeking to speak with a telephone assistor dropped from 87 percent to 70 percent, Internet.
[8] Ibid, IR-2012-6.

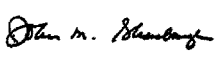
In addition to the loss in revenue, failure to properly fund the IRS introduces a fairness issue. To quote John F. Kennedy, "To the extent some people are dishonest or careless in their dealing with the government, the majority is forced to carry a heavier tax burden."[9] An inability to properly enforce the law because of a lack of budget aggravates this problem and generates a general lack of respect for the ability of the IRS to discover someone who decides to "game the system" and a general perception of lack of fairness in the system. In her 2011 report to Congress, National Taxpayer Advocate Nina Olson said that the average household was assessed a "surtax" of about $2,680[10] to enable the federal government to raise the same level of revenue it would have collected if all taxpayers had reported their income and paid their taxes in full. In fairness to our tax-compliant clients, we believe the IRS must have the resources to assure the highest level of compliance by all taxpayers.

We believe Nina Olson had it right when she stated in her annual report to Congress that the result of the lack of funding meant the IRS cannot adequately meet the needs of taxpayers and cannot adequately detect and address noncompliance and, as a result, cannot maximize revenue collection.[11]

We thank you for considering the views of the Texas Society of CPAs. For the sake of fiscal responsibility and fairness to all taxpayers, we urge you to support the IRS budget at the level submitted by Treasury, plus an additional amount to properly fund taxpayer service. Without adequate funding, both taxpayers and the tax system will continue to suffer.

Sincerely,

Donna Wesling, CPA
Chairman



John M. Sharbaugh
Executive Director/CEO

/pmw

[9] Transcript of speech, "President Kennedy Appeals to the Congress for a Tax Cut" (April 20, 1961), Internet.
[10] Ibid, NTA 2011 Annual Report to Congress, Most Serious Problems, 11, Internet.
[11] Ibid, 3, Internet.